

BANK OF MONTREAL /CAN/
Form 424B5
October 02, 2015

Filed Pursuant to Rule 424(b)(5)
Registration No. 333-196387

Product Supplement to the Prospectus dated June 27, 2014
and the Prospectus Supplement dated June 27, 2014

Senior Medium-Term Notes, Series C
Non-Principal Protected Notes Linked to One or More Equity Indices

Bank of Montreal may offer and sell non-principal-protected notes linked to the performance of one or more equity indices. We refer to the index or indices that are applicable to your notes as the “Underlying Asset.” The payment at maturity on your notes will be based on the performance of the Underlying Asset during the term of your notes. The notes are intended for investors who anticipate that the level of the Underlying Asset will increase (or, in the case of bearish notes, decrease) from its Initial Level to the Final Level on the applicable valuation date or dates. Investors must be willing to forego interest payments on the notes and be willing to accept a return that may be negative, in which case you will receive at maturity less, and possibly significantly less, than your principal.

This product supplement describes terms that will apply generally to the notes, and supplements the terms described in the accompanying prospectus supplement and prospectus. A separate term sheet or pricing supplement, as the case may be, will describe the terms that apply specifically to the notes, including any changes to the terms specified below. We refer to these term sheets and pricing supplements generally as “pricing supplements.” If the terms described in the applicable pricing supplement are inconsistent with those described in this product supplement or in the accompanying prospectus supplement or prospectus, the terms described in the applicable pricing supplement will control.

Unless otherwise specified in the applicable pricing supplement, we will not make periodic payments of interest on the notes.

At maturity, you will receive a payment in excess of the principal amount of your notes if the level of the Underlying Asset increases (or, in the case of bearish notes, decreases). However, if the level of the Underlying Asset decreases (or, in the case of bearish notes, increases), then, depending upon the specific terms of your notes, you may receive an amount that is less than the principal amount of your notes. Your notes may or may not include a “Buffer,” in which case you will lose a portion of your principal amount if the level of the Underlying Asset is less than (or in the case of bearish notes, greater than) a specified level.

The notes will not be listed on any securities exchange.

Because we have provided only a brief summary of the terms of your notes above, you should read the detailed description of the terms of the notes found in “Summary Information” and “General Terms of the Notes.”

Your investment in the notes involves certain risks. We encourage you to read the “Additional Risk Factors Relating to the Notes” section beginning on page PS-5 of this product supplement and in the “Risk Factors” sections beginning on page S-1 of the accompanying prospectus supplement and on page 7 of the accompanying prospectus, so that you may better understand those risks.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the notes or passed upon the accuracy of this product supplement or the accompanying prospectus and prospectus

supplement. Any representation to the contrary is a criminal offense.

The notes will be our unsecured obligations and will not be savings accounts or deposits that are insured by the United States Federal Deposit Insurance Corporation, the Bank Insurance Fund, the Canada Deposit Insurance Corporation or any other governmental agency or instrumentality or other entity.

BMO CAPITAL MARKETS CORP.

Product Supplement dated October 1, 2015

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SUMMARY INFORMATION

We refer to the notes we are offering by this product supplement as the “notes.” Each of the notes, including your notes, has the terms described below and under “General Terms of the Notes.” In addition, references to the “accompanying prospectus” mean the accompanying prospectus, dated June 27, 2014, as supplemented by the accompanying prospectus supplement, dated June 27, 2014 relating to our Series C Senior Medium-Term Notes.

Underlying Asset: Your notes will be linked to one or more equity indices specified in the applicable pricing supplement. Your notes may be linked to a “Basket” of two or more indices. We refer to each index included in a Basket as a “Basket Component.”

Interest Rate: Unless otherwise specified in the applicable pricing supplement, we will not make periodic payments of interest on the notes.

Denominations: Unless otherwise specified in the applicable pricing supplement, the notes will be issued in denominations of \$1,000 and integral multiples of \$1,000.

Payment at Maturity Greater than Principal: If the Final Level (as defined below) of the Underlying Asset exceeds (or in the case of bearish notes, is less than) the Initial Level (as defined below) then, depending upon the terms of your notes, and unless otherwise set forth in the applicable pricing supplement, the payment at maturity will be determined as follows:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Percentage Change} \times \text{Upside Leverage Factor})$$

Your notes may be “Digital Return Notes.” For Digital Return Notes, unless otherwise set forth in the applicable pricing supplement, the payment at maturity will be determined as follows:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Digital Return})$$

Your notes may be “Booster Notes.” For Booster Notes, unless otherwise set forth in the applicable pricing supplement, your payment at maturity will be determined as follows:

If the Percentage Change is greater than the Booster Percentage (as defined below), then the payment at maturity will equal:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Percentage Change})$$

If the Percentage Change is greater than or equal to 0% but less than or equal to the Booster Percentage, then the payment at maturity will equal:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Booster Percentage})$$

For each of the above notes, the payment at maturity may be subject to a Maximum Redemption Amount (as defined below). For Digital Return Notes, the payment at maturity will be limited to the return represented by the Digital Return.

Payment at Maturity If the Final Level is less than (or in the case of bearish notes, greater
Less than or Equal to than) or equal to the Initial Level, then, unless otherwise described in
Principal: the applicable pricing supplement, the payment at maturity will equal:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Percentage Change} \times \text{Downside Leverage Factor})$$

However, if the relevant pricing supplement specifies that a “Buffer” is applicable to your notes, then:

If the Final Level is greater than or equal to (or in the case of bearish notes, less than or equal to) the Buffer Level (as defined below), then the payment at maturity will equal the principal amount of your notes.

If the Final Level is less than (or in the case of bearish notes, greater than) the Buffer Level, then the payment at maturity will equal:

$$\text{Principal Amount} + [\text{Principal Amount} \times (\text{Percentage Change} + \text{Buffer Percentage}) \times \text{Downside Leverage Factor}]$$

In this case, if the Final Level is less than (or in the case of bearish notes, greater than) the Initial Level (or, if applicable, Buffer Level), then, at maturity, you will receive less than the principal amount of your notes.

Percentage Change: Percentage Change will be calculated as follows (and expressed as a percentage):

$$\frac{\text{Final Level} - \text{Initial Level}}{\text{Initial Level}}$$

However, if your notes are bearish notes, the Percentage Change will be calculated as follows (and expressed as a percentage):

$$\frac{\text{Initial Level} - \text{Final Level}}{\text{Initial Level}}$$

Maximum Redemption Amount: The Maximum Redemption Amount, if applicable, will be specified in the relevant pricing supplement. If a Maximum Redemption Amount applies to your notes, then the payment at maturity will be limited to a percentage that will be set forth in the pricing supplement.

Cap: The Cap, if applicable, will be specified in the relevant pricing supplement. If a Cap applies to your notes, the positive Percentage Change in the level of the Underlying Asset will be limited to the Cap.

Upside Leverage Factor: As specified in the relevant pricing supplement, if applicable. The Upside Leverage Factor may be less than, equal to or greater than 100%. If the Upside Leverage Factor is less than 100%, you will participate in less than the full upside performance (or in the case of bearish notes, downside performance) of the Underlying Asset. If the Upside Leverage Factor is greater than 100%, you will participate on a leveraged basis in the upside performance (or in the case of bearish notes, downside performance) of the Underlying Asset (subject to any applicable Maximum Redemption Amount).

Downside Leverage Factor: As specified in the relevant pricing supplement, if applicable. The Downside Leverage Factor may be less than, equal to or greater than 100%. If the Downside Leverage Factor is less than 100%, you will participate in less than the full downside performance (or in the case of bearish notes, upside performance) of the Underlying Asset. If the Downside Leverage Factor is greater than 100%, you will participate on a leveraged basis in the downside performance (or in the case of bearish notes, upside performance) of the Underlying Asset, and you may lose a greater portion of the principal amount of your investment.

Digital Return: A percentage that will be specified in the applicable pricing supplement. If a Digital Return applies to your notes, the return on your

investment will be limited to the return represented by the Digital Return.

Booster Percentage: A specified percentage increase (or in the case of bearish notes, decrease) in the level of the Underlying Asset. The Booster Percentage, if any, will be set forth in the relevant pricing supplement.

Buffer Level: A specified level of the Underlying Asset that is less than (or in the case of bearish notes, greater than) the Initial Level. The Buffer Level, if any, will be expressed as a percentage of the Initial Level and will be set forth in the relevant pricing supplement.

Buffer Percentage: A specified percentage that will be set forth in the relevant pricing supplement, if applicable. For example, if the Buffer Level is 90% of the Initial Level, the Buffer Percentage will be 10%.

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Barrier:	If so specified in the applicable pricing supplement, the notes will be subject to a Barrier. In such a case, holders of the notes will be subject to possible loss of all or a portion of the principal amount of the notes if the level of the Underlying Asset falls beneath (or in the case of bearish notes, exceeds) a specified Barrier Level during a specified observation period. See “General Terms of the Notes—Payment at Maturity—Payment at Maturity Less than or Equal to Principal—Notes with a Barrier Level.”
Initial Level:	As specified in the relevant pricing supplement. Unless otherwise specified in the applicable pricing supplement, the Initial Level for a note linked to a single index will be the closing level of that index on the applicable pricing date. In the case of a note linked to a Basket, the Initial Level will be set forth in the applicable pricing supplement.
Final Level:	The closing level of the Underlying Asset on the valuation date (if there is one valuation date applicable to the notes) or the arithmetic average of the closing levels of the Underlying Asset on each of the valuation dates (if there is more than one valuation date applicable to the notes), or any other dates specified in the relevant pricing supplement. In the case of a note linked to a Basket, the Final Level of the Basket will be the level of the Basket on the valuation date, or the arithmetic average of the level of the Basket on each of the valuation dates, as applicable, determined as described in more detail in the section entitled “General Terms of the Notes—Notes Linked to a Basket” in this product supplement.
Valuation Date(s):	Unless otherwise specified in the relevant pricing supplement, the valuation date, or if there is more than one valuation date, the final valuation date, will be the third trading day prior to the maturity date, subject to postponement as described below.
Additional Terms:	The applicable pricing supplement for your notes may set forth terms that are additional to, or different from, the terms described in this product supplement.
Maturity Date:	As specified in the applicable pricing supplement, subject to any prior automatic redemption, if applicable. If the valuation date or the final valuation date, as applicable, is postponed as described below, the maturity date will be postponed by the same number of trading day(s).
Automatic Redemption:	We may issue notes that are subject to automatic redemption. If your notes are subject to automatic redemption, the pricing supplement will set forth the terms upon which the notes will be redeemed.
Clearance and Settlement:	DTC
Listing:	The notes will not be listed on any securities exchange.
Calculation Agent:	Unless otherwise set forth in the applicable pricing supplement, BMO Capital Markets Corp. will serve as calculation agent for the notes. The calculation agent will make all required determinations as to the amounts payable on the notes.

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ADDITIONAL RISK FACTORS RELATING TO THE NOTES

An investment in the notes involves risks. This section describes significant risks relating to the terms of the notes. Before investing in the notes, you should read the following information about these risks, together with the other information contained in or incorporated by reference in the applicable pricing supplement, this product supplement and the accompanying prospectus supplement and prospectus.

General Risks Relating to the Notes

Your investment in the notes may result in a loss. The notes do not guarantee any return of principal unless otherwise specified in the relevant pricing supplement. The amount payable on the notes at maturity will depend primarily on the Percentage Change in the level of the Underlying Asset from the Initial Level to the Final Level and may be less, and possibly significantly less, than the principal amount. For notes without a buffer, if the Final Level is less than (or, in the case of bearish notes, greater than) the Initial Level, the return on your notes will be less than the principal amount. For notes with a buffer, if the Final Level is less than (or, in the case of bearish notes, greater than) the Buffer Level, the return on your notes will be less than the principal amount. In the case of notes with a Downside Leverage Factor greater than 100%, your notes will participate in the downside performance (or, in the case of bearish notes, upside performance) of the Underlying Asset on a leveraged basis. Depending on the Downside Leverage Factor and the other terms of your notes, you may lose all or a substantial portion of the amount that you invested to purchase the notes.

The notes do not pay interest and your return may be lower than the return on a conventional debt security of comparable maturity. Unless otherwise specified in the applicable pricing supplement, there will be no periodic interest payments on the notes as there would be on a conventional fixed-rate or floating-rate debt security having the same maturity. The yield that you will receive on your notes, which could be negative, may be less than the yield you could earn if you purchased a standard senior debt security of Bank of Montreal with the same maturity date. Your investment may not reflect the full opportunity cost to you when you take into account factors that affect the time value of money.

The appreciation potential of the notes may be limited. If your notes are subject to a Maximum Redemption Amount, a Cap, or a Digital Return, they will provide less opportunity to participate in the appreciation (or, in the case of bearish notes, depreciation) of the Underlying Asset than an investment in a security linked to the Underlying Asset providing full participation in the appreciation (or, in the case of bearish notes, depreciation), because the payment at maturity will not exceed the Maximum Redemption Amount or the principal amount plus the Digital Return, as applicable, and the positive Percentage Change in the level of the Underlying Asset will be limited to the Cap, if applicable. Accordingly, your return on the notes may be less than your return would be if you made an investment in a security directly linked to the positive (or, in the case of bearish notes, negative) performance of the Underlying Asset.

Owning the notes is not the same as owning the Underlying Asset or its components or a security directly linked to the performance of the Underlying Asset or its components. The return on your notes will not reflect the return you would realize if you actually owned the Underlying Asset or its components or a security directly linked to the performance of the Underlying Asset or its underlying components and held that investment for a similar period. For example, if the Underlying Asset includes an equity index that is not a total return index, your return on the notes will not reflect the return you would realize if you actually owned the equity securities included in that equity index and received the dividends paid on those equity securities. Your notes may trade quite differently from the Underlying Asset. Changes in the level of the Underlying Asset may not result in comparable changes in the market value of your notes. Even if the level of the Underlying Asset increases (or, in the case of bearish notes, decreases) from the Initial Level during the term of the notes, the market value of the notes prior to maturity may not increase to the same

extent. It is also possible for the market value of the notes prior to maturity to decrease while the level of the Underlying Asset increases (or, in the case of bearish notes, decreases).

The notes may not have an active trading market. Your notes will not be listed on any securities exchange, and there may be little or no secondary market for your notes. Even if a secondary market for your notes develops, it may not provide significant liquidity. We expect that transaction costs in any secondary market would be high. As a result, the difference between bid and ask prices for your notes in any secondary market could be substantial. If you sell your notes before maturity, you may have to do so at a substantial discount from the issue price, and as a result, you may suffer substantial losses.

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The market value of your notes may be influenced by many unpredictable factors. The following factors, many of which are beyond our control, may influence the market value of your notes:

• the level of the Underlying Asset, including, in the case of notes that have a buffer, whether the level of the Underlying Asset trades or closes at a level below (or in the case of bearish notes, above) the Buffer Level;

• if your notes are subject to a Maximum Redemption Amount, a Cap, or a Digital Return, your potential return on the notes will be limited;

- the volatility of the level of the Underlying Asset;
- the dividend rate on the applicable component stocks;

• economic, financial, political, military, regulatory, legal and other events that affect the applicable securities markets generally and the U.S. markets in particular, and which may affect the level of the Underlying Asset;

• if the Underlying Asset includes one or more indices that have returns that are denominated in currencies other than the U.S. dollar or prices in one or more non-U.S. markets (a “non-U.S. Underlying Asset”), changes in, and the volatility of, the exchange rates between the U.S. dollar and the relevant non-U.S. currency or currencies could have a negative impact on the payments due on your notes and their market value;

- interest rates in the market; and
- the time remaining to maturity of the notes.

These factors may influence the market value of your notes if you sell your notes before maturity. Our creditworthiness, as represented by our credit ratings or as otherwise perceived in the market will also affect the market value of your notes. If you sell your notes prior to maturity, you may receive less than the principal amount of your notes.

Payments on the notes are subject to our credit risk, and changes in our credit ratings are expected to affect the market value of the notes. The notes are our senior unsecured debt securities. As a result, your receipt of interest payments (if applicable) and the amount due on the maturity date are each dependent upon our ability to repay our obligations at that time. This will be the case even if the level of the Underlying Asset increases (or, in the case of bearish notes, decreases) after the pricing date. No assurance can be given as to what our financial condition will be at any time during the term of the notes.

If your notes are linked to a Basket, changes in the level of one or more Basket Components may be offset by changes in the level of one or more other Basket Components. Your notes may be linked to a Basket. In such a case, a change in the levels of one or more Basket Components may not correlate with changes in the levels of one or more other Basket Components. The level of one or more Basket Components may increase, while the level of one or more other Basket Components may not increase as much, or may even decrease. The opposite changes may occur in the case of bearish notes. Therefore, in determining the level of the Basket as of any time, increases (or, in the case of bearish notes, decreases) in the level of one Basket Component may be moderated, or wholly offset, by lesser increases or decreases (or, in the case of bearish notes, lesser decreases and increases) in the level of one or more other Basket Components. If the weightings of the applicable Basket Components are not equal, changes in the level of the Basket Components which are more heavily weighted could have a disproportionately adverse impact upon your notes.

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The amount to be paid at maturity will not be affected by all developments relating to the Underlying Asset. Changes in the level of the Underlying Asset during the term of the notes before or between the relevant valuation date or valuation dates will not be reflected in the calculation of the payment at maturity. The calculation agent will calculate this amount by comparing only the Final Level to the Initial Level (or the Buffer Level, as applicable). No other levels of the Underlying Asset will be taken into account. As a result, you may receive less than the principal amount of your notes, even if the level of the Underlying Asset has increased (or, in the case of bear notes, decreased) at certain times during the term of the notes before decreasing to a level below (or, in the case of bearish notes, increasing to a level above) the Initial Level (or Buffer Level, as applicable) and, if applicable, below (or, in the case of bearish notes, above) the Barrier Level as of the relevant dates.

We will not hold any asset comprising the Underlying Asset for your benefit. The indenture and the terms governing your notes do not contain any restriction on our ability or the ability of any of our affiliates to sell, pledge or otherwise convey all or any portion of the securities that may comprise the Underlying Asset that we or they may acquire. Neither we nor our affiliates will pledge or otherwise hold any assets for your benefit, including any securities included in an Underlying Asset. Consequently, in the event of our bankruptcy, insolvency or liquidation, any of those assets that we own will be subject to the claims of our creditors generally and will not be available for your benefit specifically.

You must rely on your own evaluation of the merits of an investment linked to the Underlying Asset. In the ordinary course of their business, our affiliates may have expressed views on expected movements in any Underlying Asset or its components, and may do so in the future. These views or reports may be communicated to our clients and clients of our affiliates. However, these views are subject to change from time to time. Moreover, other professionals who transact business in markets relating to any Underlying Asset or its components may at any time have significantly different views from those of our affiliates. For these reasons, you are encouraged to derive information concerning the applicable Underlying Asset or its components from multiple sources, and you should not rely solely on views expressed by our affiliates.

The Initial Level may be determined after the pricing date of the notes. If so specified in the relevant pricing supplement, the Initial Level will be determined based on the arithmetic average of the closing levels of the Underlying Asset on certain specified dates. One or more of these days may occur on or following the pricing date or the issue date of the notes; as a result, the Initial Level may not be determined, and you may therefore not know such value, until after the issue date. If there are any increases (or in the case of bearish notes, decreases) in the closing levels of the Underlying Asset on any relevant dates used to determine the Initial Level that occur after the pricing date, and such increases (or decreases) result in the Initial Level being higher (or in the case of bearish notes, lower) than the closing level on the pricing date, this may establish higher levels (or in the case of bearish notes, lower levels) that the Underlying Asset must achieve for you to attain a positive return on your investment or to avoid a loss of principal at maturity.

Our trading and other transactions relating to the Underlying Asset or its components, futures, options or other derivative products may adversely affect the market value of the notes. As described below under “Use of Proceeds and Hedging,” we or one or more affiliates may hedge our obligations under the notes by purchasing or selling shares of the companies included in the Underlying Asset, futures or options relating to the Underlying Asset, or other derivative instruments with returns linked or related to changes in the performance of the Underlying Asset. We or our affiliates may adjust these hedges by, among other things, purchasing or selling those assets at any time. Although they are not expected to do so, any of these hedging activities may adversely affect the level of the Underlying Asset, and, therefore, the market value of the notes, and the amounts payable at maturity. It is possible that we or one or more of our affiliates could receive substantial returns from these hedging activities, even though the market value of the notes decreases.

We or one or more of our affiliates may also engage in trading relating to the Underlying Asset on a regular basis as part of our general broker-dealer and other businesses, for proprietary accounts, for other accounts under management or to facilitate transactions for our customers, including block trades. Any of these activities could adversely affect the level of the Underlying Asset and, therefore, the market value of the notes. We or one or more of our affiliates may also issue or underwrite other securities or financial or derivative instruments with returns linked or related to changes in the performance of the Underlying Asset. By introducing competing products into the marketplace in this manner, we or one or more of our affiliates could adversely affect the market value of the notes.

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Our business activities and the business activities of our affiliates may create conflicts of interest. As noted above, we and our affiliates expect to engage in trading activities related to the Underlying Asset or its components that are not for the account of holders of the notes or on their behalf. These trading activities may present a conflict between the holders' interests in the notes and the interests we and our affiliates will have in their proprietary accounts, in facilitating transactions, including options and other derivatives transactions, for their customers and in accounts under their management. These trading activities, if they influence the level of the Underlying Asset or its components, could be adverse to the interests of the holders of the notes. We and one or more of our affiliates may, at present or in the future, engage in business with the issuers of the equity securities included in an Underlying Asset or the component stocks of any index that is included in an Underlying Asset, including making loans to or providing advisory services to those companies. These services could include investment banking and merger and acquisition advisory services. These activities may present a conflict between our or one or more of our affiliates' obligations and your interests as a holder of the notes. Moreover, we and our affiliates may have published, and in the future expect to publish, research reports with respect to the Underlying Asset or its components. This research is modified from time to time without notice and may express opinions or provide recommendations that are inconsistent with purchasing or holding the notes. Any of these activities by us or one or more of our affiliates may affect the level of the Underlying Asset or its components and, therefore, the market value of the notes.

The calculation agent can postpone the determination of the Final Level if a market disruption event occurs. The determination of the Final Level may be postponed if the calculation agent determines that a market disruption event has occurred or is continuing on any valuation date with respect to the Underlying Asset. If such a postponement occurs, the calculation agent will use the closing level of the Underlying Asset on the first subsequent business day on which no market disruption event occurs or is continuing. In no event, however, will any valuation date be postponed by more than ten trading days. As a result, if a market disruption event occurs or is continuing on a valuation date, the maturity date for the notes could also be postponed, although not by more than ten trading days.

If the determination of the level of the Underlying Asset for any valuation date is postponed to the last possible day, but a market disruption event occurs or is continuing on that day, that day will nevertheless be the date on which the level of the Underlying Asset will be determined by the calculation agent. In such an event, the calculation agent will make a good faith estimate in its sole discretion of the level that would have prevailed in the absence of the market disruption event. See "General Terms of the Notes—Market Disruption Events."

As calculation agent, BMO Capital Markets Corp. will have the authority to make determinations that could affect the value of your notes and your payment at maturity. As calculation agent for your notes, BMO Capital Markets Corp. will have discretion in making various determinations that affect your notes, including determining the Final Level, determining whether any market disruption events have occurred, and determining whether any index included in an Underlying Asset has been materially changed. The exercise of this discretion by BMO Capital Markets Corp. could adversely affect the value of your notes and may present BMO Capital Markets Corp., which is our wholly owned subsidiary, with a conflict of interest.

The historical performance of the Underlying Asset or its components should not be taken as an indication of their future performance. The level of the Underlying Asset will determine the amount to be paid on the notes at maturity. The historical performance of the Underlying Asset or its components does not necessarily give an indication of their future performance. As a result, it is impossible to predict whether the level of the Underlying Asset will rise or fall during the term of the notes. The level of the Underlying Asset and its components will be influenced by complex and interrelated political, economic, financial and other factors.

Significant aspects of the tax treatment of the notes are uncertain. The tax treatment of the notes is uncertain. We do not plan to request a ruling from the Internal Revenue Service or from any Canadian authorities regarding the tax treatment of the notes, and the Internal Revenue Service or a court may not agree with the tax treatment described in

this product supplement.

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The Internal Revenue Service has issued a notice indicating that it and the Treasury Department are actively considering whether, among other issues, a holder should be required to accrue interest over the term of an instrument such as the notes even though that holder will not receive any payments with respect to the notes until maturity and whether all or part of the gain a holder may recognize upon sale or maturity of an instrument such as the notes could be treated as ordinary income. The outcome of this process is uncertain and could apply on a retroactive basis.

Please read carefully the sections entitled “Supplemental Tax Considerations” in this product supplement, the section “United States Federal Income Taxation” in the accompanying prospectus and the section entitled “Certain Income Tax Consequences” in the accompanying prospectus supplement. You should consult your tax advisor about your own tax situation.

Insurance companies and employee benefit plans should carefully review the legal issues of an investment in the notes. Any insurance company or fiduciary of a pension plan or other employee benefit plan that is subject to the prohibited transaction rules of the Employee Retirement Income Security Act of 1974, as amended, which we call “ERISA,” or the Internal Revenue Code of 1986, as amended (the “Code”), including an IRA or Keogh plan (or a governmental plan to which similar prohibitions apply), and that is considering purchasing the notes with the assets of the insurance company or the assets of such plan, should consult with its counsel regarding whether the purchase or holding of the notes could become a “prohibited transaction” under ERISA, the Code or any substantially similar prohibition in light of the representations a purchaser or holder in any of the above categories is deemed to make by purchasing and holding the notes. These issues are discussed in more detail in the section “Employee Retirement Income Security Act” below.

Risks Relating to the Applicable Underlying Asset

You will not have any shareholder rights and will have no right to receive any shares of the Underlying Asset at maturity. Investing in your notes will not make you a holder of any of the constituent stocks of the Underlying Asset. Neither you nor any other holder or owner of the notes will have any voting rights, any right to receive dividends or other distributions or any other rights with respect to any of these securities.

Changes that affect an index included in the Underlying Asset could affect the market value of the notes and the amount you will receive at maturity. The policies of a sponsor of any index that may be included in the Underlying Asset (the “Index Sponsor”) concerning the calculation of that index, additions, deletions or substitutions of the components of that index and the manner in which changes affecting those components, such as stock dividends, reorganizations or mergers, may be reflected in the index and, therefore, could affect the amount payable on the notes at maturity, and the market value of the notes prior to maturity. The amount payable on the notes and their market value could also be affected if the Index Sponsor changes these policies, for example, by changing the manner in which it calculates the index, or if the Index Sponsor discontinues or suspends calculation or publication of the index, in which case it may become difficult to determine the market value of the notes. If events such as these occur, or if the level of the index is not available on the valuation date or dates because of a market disruption event or for any other reason and no successor index is selected, the calculation agent may determine the level of the index—and thus the amount payable at maturity—in a manner it considers appropriate, in its sole discretion.

We have no affiliation with any Index Sponsor and will not be responsible for any actions taken by an Index Sponsor. Unless otherwise specified in the relevant pricing supplement, no Index Sponsor is an affiliate of ours or will be involved in any offerings of the notes in any way. Consequently, we have no control over the actions of any Index Sponsor, including any actions of the type that would require the calculation agent to adjust the payment to you at maturity. No Index Sponsor has any obligation of any sort with respect to the notes. Thus, no Index Sponsor has any obligation to take your interests into consideration for any reason, including in taking any actions that might affect the value of the notes. None of our proceeds from any issuance of the notes will be delivered to any Index Sponsor,

except to the extent that we are required to pay an Index Sponsor licensing fees with respect to an index included in the Underlying Asset.

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An investment in the notes may be subject to risks associated with non-U.S. securities markets. The Underlying Asset may include one or more equity securities that have been issued by non-U.S. companies. An investment in securities linked to the value of non-U.S. equity securities involves particular risks. Non-U.S. securities markets may be more volatile than U.S. securities markets, and market developments may affect non-U.S. securities markets differently from the U.S. securities markets. Direct or indirect government intervention to stabilize these non-U.S. securities markets, as well as cross shareholdings among non-U.S. companies, may affect trading prices and volumes in those markets. Also, there is generally less publicly available information in the U.S. about non-U.S. companies than about those U.S. companies that are subject to the reporting requirements of the SEC, and non-U.S. companies are subject to accounting, disclosure, auditing and financial reporting standards and requirements that differ from those applicable to U.S. reporting companies.

Securities prices in non-U.S. countries are subject to political, economic, financial and social factors that may be unique to the particular country. These factors, which could negatively affect the non-U.S. securities markets, include the possibility of recent or future changes in the economic and fiscal policies of non-U.S. governments, the possible imposition of, or changes in, currency exchange laws or other non-U.S. laws or restrictions applicable to non-U.S. companies or investments in non-U.S. equity securities, the possibility of fluctuations in the rate of exchange between currencies, the possibility of outbreaks of hostility and political instability and the possibility of natural disaster or adverse public health developments in the region. Moreover, the economies of certain foreign countries may differ favorably or unfavorably from the U.S. economy in important respects, such as growth of gross national product, rate of inflation, trade surpluses or deficits, capital reinvestment, resources and self-sufficiency.

The return on the notes may be exposed to fluctuations in exchange rates that might affect the level of the Underlying Asset and the payment at maturity. Because the securities included in the Underlying Asset may be traded in currencies other than U.S. dollars, and the notes are denominated in U.S. dollars, the amount payable on the notes at maturity may be exposed to fluctuations in the exchange rate between the U.S. dollar and each of the currencies in which those securities are denominated. These changes in exchange rates may reflect changes in various non-U.S. economies that in turn may affect the payment on the notes at maturity. An investor's net exposure will depend on the extent to which the currencies in which the relevant securities are denominated either strengthen or weaken against the U.S. dollar and the relative weight of each security. If, taking into account such weighting, the U.S. dollar strengthens (or, in the case of bearish notes, weakens) against the currencies in which the relevant securities are denominated, the value of those securities may be adversely affected and the level of the Underlying Asset may be adversely affected as well. In turn, the payment at maturity may be adversely affected.

We do not control any company included in an Underlying Asset and are not responsible for any disclosure made by any other company. Neither we nor any of our affiliates have the ability to control the actions of any of the companies included in an Underlying Asset, nor do we assume any responsibility for the adequacy or accuracy of any publicly available information about any of these companies, unless (and only to the extent that) our securities or the securities of our affiliates are represented by that Underlying Asset. You should make your own investigation into the companies represented by the applicable Underlying Asset.

Other Risk Factors Relating to the Applicable Underlying Asset

The relevant pricing supplement may set forth additional risk factors as to the Underlying Asset that you should review prior to purchasing the notes.

GENERAL TERMS OF THE NOTES

This product supplement and the accompanying prospectus dated June 27, 2014 relating to the notes, should be read together. Because the notes are part of a series of our senior debt securities called Senior Medium-Term Notes, Series C, this product supplement and the accompanying prospectus should also be read together with the accompanying prospectus supplement, dated June 27, 2014. Terms used but not defined in this product supplement have the meanings given them in the accompanying prospectus or accompanying prospectus supplement, unless the context requires otherwise.

The notes will be issued in book-entry form through The Depository Trust Company. Owners of beneficial interests in the notes should read the section entitled “Description of the Notes We May Offer—Legal Ownership” in the accompanying prospectus supplement and “Description of the Debt Securities We May Offer—Legal Ownership and Book-Entry Issuance” in the accompanying prospectus.

The notes are part of a series of senior debt securities entitled “Senior Medium-Term Notes, Series C” that we may issue from time to time under the senior indenture, dated January 25, 2010, between Bank of Montreal and Wells Fargo Bank, National Association, as trustee. Terms that apply generally to our medium term notes are described in “Description of the Notes We May Offer” in the accompanying prospectus supplement. The terms described in this document supplement those described in the accompanying prospectus and the accompanying prospectus supplement, and, if the terms described here are inconsistent with those described in those documents, the terms described in this product supplement are controlling.

Unless otherwise set forth in the applicable pricing supplement, we will not pay periodic interest payments on the notes. If any payment date, including the maturity date, falls on a day that is not a business day, we will pay the required payment on the first subsequent business day, and no additional interest will accrue on the notes as a result.

Payment at Maturity

Percentage Change. At maturity, subject to our credit risk as issuer of the notes, you will receive a cash payment that is based on the performance of the Underlying Asset. The payment at maturity will depend upon the Percentage Change of the Underlying Asset. Unless otherwise set forth in the applicable pricing supplement, the Percentage Change will be calculated as follows (and expressed as a percentage):

$$\frac{\text{Final Level} - \text{Initial Level}}{\text{Initial Level}}$$

However, if your notes are bearish notes, the Percentage Change will be calculated as follows (and expressed as a percentage):

$$\frac{\text{Initial Level} - \text{Final Level}}{\text{Initial Level}}$$

Initial Level. The relevant pricing supplement will set forth the Initial Level of the Underlying Asset. Unless otherwise specified in the relevant pricing supplement, the Initial Level of an index will be its closing level on the pricing date. The Initial Level may also be the average of the closing levels of the applicable index on two or more days before and/or after the pricing date. In the case of a note linked to a Basket, the Initial Level will be a level specified in the applicable pricing supplement.

Final Level. Unless otherwise specified in the relevant pricing supplement, the level of an index on any valuation date will be its closing level on that date. Your notes may provide for the Final Level to be based upon the arithmetic average of the closing level of the applicable index on two or more valuation dates. In the case of a note linked to a Basket, the Final Level of the Basket will be the closing level of the Basket on the valuation date, or the arithmetic average of the level of the Basket on each of the valuation dates, as applicable, determined as described in more detail in the section entitled “—Notes Linked to a Basket” in this product supplement.

Payment at Maturity in Excess of Principal

General. If the Final Level is greater than (or in the case of bearish notes, less than) the Initial Level, then, at maturity, you will receive an amount equal to:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Percentage Change} \times \text{Upside Leverage Factor})$$

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The Upside Leverage Factor represents the extent to which your notes will participate in the upside performance (or in the case of bearish notes, downside performance) of the Underlying Asset. The Upside Leverage Factor may be less than, equal to, or greater than 100%. If the Upside Leverage Factor is less than 100%, your notes will participate in less than the full upside performance (or in the case of bearish notes, downside performance) of the Underlying Asset. If the Upside Leverage Factor is greater than 100%, your notes will participate in the upside performance (or in the case of bearish notes, downside performance) on a leveraged basis. The Upside Leverage Factor will be specified in the relevant pricing supplement, if applicable.

Digital Return Notes. Your notes may be “Digital Return Notes.” For Digital Return Notes, unless otherwise set forth in the applicable pricing supplement, if the Final Level is greater than (or in the case of bearish notes, less than) the Initial Level, the payment at maturity will be determined as follows:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Digital Return})$$

If your notes are Digital Return Notes, the positive return on your notes will be limited to the Digital Return that will be specified in the applicable pricing supplement.

Booster Notes. Your notes may be “Booster Notes.” For Booster Notes, unless otherwise set forth in the applicable pricing supplement, if the Final Level is greater than (or in the case of bearish notes, less than) the Initial Level, the payment at maturity will be determined as follows:

If the Percentage Change is greater than the Booster Percentage, then the payment at maturity will equal:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Percentage Change})$$

If the Percentage Change is greater than or equal to 0% but less than or equal to the Booster Percentage, then the payment at maturity will equal:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Booster Percentage})$$

Payment at Maturity Less than or Equal to Principal

Notes Without a Buffer. If the Final Level is less than (or in the case of bearish notes, greater than) or equal to the Initial Level, then, unless otherwise described in the applicable pricing supplement, the payment at maturity will equal:

$$\text{Principal Amount} + (\text{Principal Amount} \times \text{Percentage Change} \times \text{Downside Leverage Factor})$$

In this case, if the Final Level is less than (or in the case of bearish notes, greater than) the Initial Level, then, at maturity, you will receive less than the principal amount of your notes.

The Downside Leverage Factor represents the extent to which your notes will participate in the downside performance (or in the case of bearish notes, upside performance) of the Underlying Asset. The Downside Leverage Factor may be less than, equal to, or greater than 100%. If the Downside Leverage Factor is less than 100%, your notes will participate in less than the full downside performance (or in the case of bearish notes, upside performance) of the Underlying Asset. If the Downside Leverage Factor is greater than 100%, your notes will participate in the downside performance (or in the case of bearish notes, upside performance) on a leveraged basis. The Downside Leverage Factor will be specified in the relevant pricing supplement, if applicable. Depending on the Downside Leverage Factor, you may lose all or a substantial portion of the amount that you invested to purchase the notes; however, in no

event will you lose more than your initial investment.

Notes with a Buffer. If the relevant pricing supplement specifies that a “Buffer” is applicable to your notes, then, if the Final Level less than or equal to (or in the case of bearish notes, greater than or equal to) the Initial Level, but is greater than or equal to (or in the case of bearish notes, less than or equal to) the Buffer Level, then the payment at maturity will equal the principal amount of your notes.

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However, if the Final Level is less than (or in the case of bearish notes, greater than) the Buffer Level, then the payment at maturity will equal:

$$\text{Principal Amount} + [\text{Principal Amount} \times (\text{Percentage Change} + \text{Buffer Percentage}) \times \text{Downside Leverage Factor}]$$

The applicable Buffer Level and Buffer Percentage will be set forth in the applicable pricing supplement.

Notes with a Barrier Level. We may issue notes that have a specified “Barrier Level.” For these notes, we will pay an amount at maturity that is less than the principal amount of the notes only if (a) the Final Level is less than (or in the case of bearish notes, greater than) the applicable Initial Level (or, if applicable, Buffer Level), as set forth above, and (b) a “Barrier Event” occurs. A “Barrier Event” will be deemed to occur if the level of the Underlying Asset (as set forth in the applicable pricing supplement) is less than (or in the case of bearish notes, greater than) a Barrier Level during an observation period that will be specified in the applicable pricing supplement. The provisions relating to the Barrier Level, together with any risk factors, will be set forth in the applicable pricing supplement.

Notes Linked to a Basket

If your notes are linked to a Basket, each Basket Component will be assigned a “Weighting Percentage” that will be set forth in the applicable pricing supplement. The sum of the Weighting Percentages of the Basket Components will equal 100%. The Basket Components may or may not have equal Weighting Percentages.

The “Initial Basket Component Level” of each Basket Component will be set forth in the applicable pricing supplement. Unless otherwise set forth in the applicable pricing supplement, the level of any Basket Component on any trading day, including any valuation date, will be its official closing level.

The Initial Level will be set forth in the applicable pricing supplement. Unless otherwise set forth in the applicable pricing supplement, the “Final Level” will equal the Initial Level multiplied by the Percentage Change. The Percentage Change for notes linked to a Basket will equal the sum of the “Weighted Percentage Change” for each Basket Component. The “Weighted Percentage Change” will be equal to the product of (a) the applicable Weighting Percentage and (b) the percentage change in the value of the Basket Component from its Initial Basket Component Level set on the pricing date to its value on the valuation date. If there is more than one valuation date for your notes, the final value of each Basket Component will be equal to the arithmetic average of the closing values of that Basket Component on each of the valuation dates.

When we refer to the level of a Basket during the term of the notes, we are referring to the level that would be determined if the Percentage Change was calculated as of that day.

Valuation Date

Unless otherwise specified in the relevant pricing supplement, the valuation date (if there is only one valuation date applicable to the notes) or the final valuation date (if there is more than one valuation date applicable to the notes) will be the third trading day before the maturity date specified in the relevant pricing supplement. If the calculation agent determines that a market disruption event occurs or is continuing on any valuation date applicable to the notes, the Final Level will be determined according to the calculation in “—Market Disruption Events” below.

Maturity Date

Unless otherwise specified in the relevant pricing supplement, the maturity date will be the third scheduled business day following the valuation date or the final valuation date, as applicable, unless that date is not a business day, in

which case the maturity date will be the next following business day. The maturity date will be postponed by the same number of trading days as the valuation date or the final valuation date, as applicable, if a market disruption event occurs or is continuing as described above. However, no interest will accrue past the maturity date specified in the relevant pricing supplement.

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Certain Definitions

Business Day. Unless otherwise set forth in the applicable pricing supplement, “business day” means a day of the week other than Saturday or Sunday that is neither a legal holiday nor a day on which banking institutions are authorized or obligated by law or executive order to close in New York City, Toronto or Montreal.

Trading Day. Unless otherwise set forth in the applicable pricing supplement, as to any index, “trading day” is any day, as determined by the calculation agent, on which trading is generally conducted on the primary market on which the securities included in the applicable index are listed for trading.

Automatic Call

If so specified in the applicable pricing supplement, your notes will be subject to automatic redemption. The terms relating to any such redemption will be set forth in the applicable pricing supplement.

Unavailability of the Level of the Underlying Asset on a Valuation Date

If the Index Sponsor discontinues publication of an index comprising part of the Underlying Asset and the Index Sponsor or another entity publishes a successor or substitute index that the calculation agent determines, in its sole discretion, to be comparable to the discontinued index (such successor or substitute index being referred to in this section as a “successor index”), then any subsequent index closing level will be determined by reference to the published level of that successor index at the regular weekday close of trading on the applicable valuation date.

Upon any selection by the calculation agent of a successor index, the calculation agent will provide written notice to the trustee of the selection, and the trustee will furnish written notice thereof, to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

If a successor index is selected by the calculation agent, that successor index will be used as a substitute for the Underlying Asset for all purposes, including for purposes of determining whether a market disruption event exists with respect to that index.

If any Index Sponsor discontinues publication of an index comprising a part of the Underlying Asset prior to, and that discontinuance is continuing on, any valuation date and the calculation agent determines, in its sole discretion, that no successor index is available at that time, then the calculation agent will determine the level of the Underlying Asset for the relevant date in accordance with the formula for and method of calculating the index last in effect prior to the discontinuance, without rebalancing or substitution, using the closing level (or, if trading in the relevant underlying securities or components of the index have been materially suspended or materially limited, its good faith estimate of the closing level that would have prevailed but for that suspension or limitation) at the close of the principal trading session of the relevant exchange on that date of each security or component most recently comprising the index. Notwithstanding these alternative arrangements, discontinuance of the publication of an index comprising a part of the Underlying Asset may adversely affect the value of your notes.

If at any time the method of calculating a closing level for an index comprising a part of the Underlying Asset or a successor index is changed in a material respect, or if the index is in any other way modified so that the index does not, in the opinion of the calculation agent, fairly represent the level of the index had those changes or modifications not been made, then, from and after that time, the calculation agent will, at the close of business in New York City on the applicable valuation date, make such calculations and adjustments as, in the good faith judgment of the calculation agent, may be necessary in order to arrive at a level of an index comparable to that index as if those changes or modifications had not been made. Accordingly, if the method of calculating the index is modified so that the value of

that index is a fraction of what it would have been if it had not been modified (e.g., due to a split in the index), then the calculation agent will adjust the index in order to arrive at a value of that index as if it had not been modified (e.g., as if such split had not occurred).

Notwithstanding these alternative arrangements, discontinuance of the publication of an index comprising part of the Underlying Asset may adversely affect the value of your notes.

Adjustments Relating to Notes Linked to a Basket

If the calculation agent substitutes a successor index, or otherwise affects or modifies a Basket Component, then the calculation agent will make those calculations and adjustments as, in judgment of the calculation agent, may be necessary in order to arrive at a basket comparable to the original Basket (including without limitation changing the percentage weights of the Basket Components), as if those changes or modifications had not been made, and will calculate the payment at maturity with reference to that basket or the successor basket (as described below), as adjusted.

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In this event, the calculation agent will provide written notice to the trustee of these calculations and adjustments, and the trustee will furnish written notice thereof to each noteholder, or in the case of global notes, the depositary, as holder of the global notes.

In the event of the adjustment described above, the newly composed basket is referred to in this section as the “successor basket” and will be used as a substitute for the original Basket for all purposes.

If the calculation agent determines that the available successor basket or basket components as described above do not fairly represent the value of the original Basket or Basket Components, as the case may be, then the calculation agent will determine the level of the applicable Basket Components or the Basket level for any valuation date as described under “—Unavailability of the Level of the Underlying Asset on a Valuation Date.”

Notwithstanding these alternative arrangements, discontinuance of trading on the applicable exchanges or markets in any Basket Component may adversely affect the market value of the notes.

Market Disruption Events

If the Final Level will be determined on a single valuation date and a market disruption event occurs or is continuing on that date, the Final Level will equal the closing level of the Underlying Asset on the first trading day following the valuation date on which the calculation agent determines that a market disruption event is not continuing. If a market disruption event occurs or is continuing on each trading day to and including the tenth trading day following the valuation date, the Final Level will be determined (or, if not determinable, estimated by the calculation agent in a manner which is considered commercially reasonable under the circumstances) by the calculation agent on that tenth trading day, regardless of the occurrence or continuation of a market disruption event on that day. In such an event, the calculation agent will make a good faith estimate in its sole discretion of the Final Level that would have prevailed in the absence of the market disruption event.

If the Final Level will be determined over more than one valuation date and a market disruption event occurs or is continuing on any scheduled valuation date other than the final valuation date, the level of the Underlying Asset for that valuation date will equal the closing level of the Underlying Asset on the next scheduled valuation date. For example, if a market disruption event occurs or is continuing on the first and second scheduled valuation dates, but not on the third scheduled valuation date, then the closing level of the Underlying Asset on the third scheduled valuation date will also be deemed to be the closing level of the Underlying Asset on the first and second scheduled valuation dates. If no further scheduled valuation dates occur after a valuation date on which a market disruption event occurs or is continuing or if a market disruption event occurs or is continuing on the final valuation date, then the closing level of the Underlying Asset for that valuation date will be determined (or, if not determinable, estimated by the calculation agent in a manner which is considered to be commercially reasonable under the circumstances) by the calculation agent on that final valuation date, regardless of the occurrence or continuation of a market disruption event on that day. In such an event, the calculation agent will make a good faith estimate in its sole discretion of the closing level of the Underlying Asset that would have prevailed in the absence of the market disruption event.

A market disruption event means any event, circumstance or cause which we determine, and the calculation agent confirms, has or will have a material adverse effect on our ability to perform our obligations under the notes or to hedge our position in respect of obligations to make payment of amounts owing thereunder and more specifically includes the following events to the extent that they have such effect with respect to any index that forms a part of the Underlying Asset:

- a suspension, absence or limitation of trading in index components constituting 20% or more, by weight, of that index;

- a suspension, absence or limitation of trading in futures or options contracts relating to that index on their respective markets;

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- any event that disrupts or impairs, as determined by the calculation agent, the ability of market participants to (i) effect transactions in, or obtain market values for, index components constituting 20% or more, by weight, of that index, or (ii) effect transactions in, or obtain market values for, futures or options contracts relating to that index on their respective markets;
- the closure on any day of the primary market for futures or options contracts relating to that index or index components constituting 20% or more, by weight, of that index on a scheduled trading day prior to the scheduled weekday closing time of that market (without regard to after hours or any other trading outside of the regular trading session hours) unless such earlier closing time is announced by the primary market at least one hour prior to the earlier of (i) the actual closing time for the regular trading session on such primary market on such scheduled trading day for such primary market and (ii) the submission deadline for orders to be entered into the relevant exchange system for execution at the close of trading on such scheduled trading day for such primary market;
- any scheduled trading day on which (i) the primary markets for index components constituting 20% or more, by weight, of that index or (ii) the exchanges or quotation systems, if any, on which futures or options contracts on that index are traded, fails to open for trading during its regular trading session; or
- any other event, if the calculation agent determines that the event interferes with our ability or the ability of any of our affiliates to unwind all or a portion of a hedge with respect to the notes that we or our affiliates have effected or may effect as described below under “Use of Proceeds and Hedging” in this product supplement.

Events of Default

Unless otherwise specified in the applicable pricing supplement, in case an event of default with respect to the notes shall have occurred and be continuing, the amount declared due and payable on the notes upon any acceleration of the notes will be determined by the calculation agent and will be an amount of cash equal to the amount payable as described under the caption “—Payment at Maturity,” calculated as if the date of acceleration were the valuation date or the final valuation date, as applicable, together with accrued and unpaid interest (if applicable to your notes) through the date of acceleration.

If the maturity of the notes is accelerated because of an event of default, we will, or will cause the calculation agent to, provide written notice to the trustee at its New York office, on which notice the trustee may conclusively rely, and to the depository, of the amount due with respect to the notes as promptly as possible and in no event later than two business days after the date of acceleration.

Role of Calculation Agent

The calculation agent will make all determinations regarding the level of the Underlying Asset, business days, market disruption events, the default amount, and the amount payable on your notes. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent. You will not be entitled to any compensation from us for any loss suffered as a result of any of the above determinations or confirmations by the calculation agent.

Please note that our affiliate, BMO Capital Markets Corp., is expected to serve as the calculation agent for the notes. We may change the calculation agent for your notes at any time after the date of this product supplement without notice and BMO Capital Markets Corp. may resign as calculation agent at any time upon 60 days written notice to us.

Listing

Your notes will not be listed on any securities exchange.

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USE OF PROCEEDS AND HEDGING

We will use the net proceeds we receive from the sale of the notes for the purposes we describe in the accompanying prospectus and the accompanying prospectus supplement under “Use of Proceeds.” We or our affiliates may also use those proceeds in transactions intended to hedge our obligations under the notes as described below.

We or our affiliates expect to enter into hedging transactions involving, among other transactions, purchases or sales of the securities included in the Underlying Asset, or listed or over-the-counter options, futures and other instruments linked to the Underlying Asset or its components. In addition, from time to time after we issue the notes, we or our affiliates expect to enter into additional hedging transactions and to unwind those we have entered into in connection with the notes. Consequently, with regard to your notes, from time to time we or our affiliates expect to acquire or dispose of securities included in the Underlying Asset or positions in listed or over-the-counter options, futures or other instruments linked to the Underlying Asset or its components.

We or our affiliates may acquire a long position in securities similar to the notes from time to time and may, in our or their sole discretion, hold or resell those securities.

In the future, we or our affiliates expect to close out hedge positions relating to the notes and possibly relating to other securities or instruments with returns linked to the Underlying Asset or its components. We expect these steps to involve sales of instruments linked to the Underlying Asset or its components on or shortly before the applicable valuation dates. These steps may also involve transactions of the type contemplated above. Notwithstanding the above, we are permitted to and may choose to hedge in any manner not stated above; similarly, we may elect not to enter into any such transactions. Investors will not have knowledge about our hedging positions.

We have no obligation to engage in any manner of hedging activity and will do so solely at our discretion and for our own account. No holder of any notes will have any rights or interest in our hedging activity or any positions we or any counterparty may take in connection with our hedging activity.

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SUPPLEMENTAL TAX CONSIDERATIONS

The following is a general description of certain tax considerations relating to the notes. It does not purport to be a complete analysis of all tax considerations relating to the notes. Prospective purchasers of the notes should consult their tax advisors as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of Canada and the U.S. of acquiring, holding and disposing of the notes and receiving payments of interest, principal and/or other amounts under the notes. This summary is based upon the law as in effect on the date of this product supplement and is subject to any change in law that may take effect after such date.

Supplemental Canadian Tax Considerations

In the opinion of Torys LLP, our Canadian federal income tax counsel, the following summary describes the principal Canadian federal income tax considerations generally applicable to a purchaser who acquires from us as the beneficial owner the notes offered by this document, and who, at all relevant times, for purposes of the application of the Income Tax Act (Canada) and the Income Tax Regulations (collectively, the “Tax Act”), (1) is not, and is not deemed to be, resident in Canada; (2) deals at arm’s length with us and with any transferee resident (or deemed to be resident) in Canada to whom the purchaser disposes of notes, (3) is not affiliated with us, (4) does not receive any payment of interest on a note in respect of a debt or other obligation to pay an amount to a person with whom we do not deal at arm’s length, (5) does not use or hold notes in a business carried on in Canada and (6) is not a “specified shareholder” of ours as defined in the Tax Act for this purpose or a non-resident person not dealing at arm’s length with such “specified shareholder” (a “Holder”). Special rules, which are not discussed in this summary, may apply to a non-Canadian holder that is an insurer that carries on an insurance business in Canada and elsewhere.

This section supersedes and replaces in its entirety the section of the prospectus entitled “Canadian Taxation.”

This summary is based on the current provisions of the Tax Act and on counsel’s understanding of the current administrative policies and assessing practices of the Canada Revenue Agency published in writing prior to the date hereof. This summary takes into account all specific proposals to amend the Tax Act publicly announced by or on behalf of the Minister of Finance (Canada) prior to the date of this document (the “Proposed Amendments”) and assumes that all Proposed Amendments will be enacted in the form proposed. However, no assurances can be given that the Proposed Amendments will be enacted as proposed, or at all. This summary does not otherwise take into account or anticipate any changes in law or administrative policy or assessing practice whether by legislative, administrative or judicial action nor does it take into account tax legislation or considerations of any province, territory or foreign jurisdiction, which may differ from those discussed herein.

Canadian federal income tax considerations applicable to the notes may be described more particularly when such notes are offered (and then only to the extent material) in a pricing supplement related thereto if they are not addressed by the comments following and, in that event, the following will be superseded thereby to the extent indicated in that pricing supplement. These Canadian federal income tax considerations may also be supplemented, amended and/or replaced in a pricing supplement.

This summary is of a general nature only and is not, and is not intended to be, legal or tax advice to any particular holder. This summary is not exhaustive of all Canadian federal income tax considerations. Accordingly, prospective purchasers of the notes should consult their own tax advisors having regard to their own particular circumstances.

Interest paid or credited or deemed to be paid or credited by us on a note (including amounts on account of, or in lieu of, or in satisfaction of interest) to a Holder will not be subject to Canadian non-resident withholding tax, unless any portion of such interest (other than on a “prescribed obligation,” as defined in the Tax Act for this purpose) is contingent or dependent on the use of or production from property in Canada or is computed by reference to revenue, profit, cash

flow, commodity price or any other similar criterion or by reference to dividends paid or payable to shareholders of any class or series of shares of the capital stock of a corporation. The administrative policy of the Canada Revenue Agency is that interest paid on a debt obligation is not subject to withholding tax unless, in general, it is reasonable to consider that there is a material connection between the index or formula to which any amount payable under the debt obligation is calculated and the profits of the issuer. With respect to any interest on a note, or any portion of the principal amount of a note in excess of the issue price, such interest or principal, as the case may be, paid or credited to a Holder should not be subject to Canadian non-resident withholding tax, unless otherwise specified in the applicable pricing supplement.

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In the event that a note, interest on which is not exempt from Canadian non-resident withholding tax (other than a note which is an “excluded obligation,” as defined in the Tax Act for this purpose) is redeemed, cancelled, repurchased or purchased by us or any other person resident or deemed to be resident in Canada from a Holder or is otherwise assigned or transferred by a Holder to a person resident or deemed to be resident in Canada for an amount which exceeds, generally, the issue price thereof, or in certain cases, the price for which such note was assigned or transferred to the Holder by a person resident or deemed resident in Canada, the excess may be deemed to be interest and may, together with any interest that has accrued on the note to that time, be subject to Canadian non-resident withholding tax.

Generally, there are no other taxes on income (including taxable capital gains) payable by a Holder on interest, discount, or premium in respect of a note or on the proceeds received by a Holder on the disposition of a note (including redemption, cancellation, purchase or repurchase).

Supplemental U.S. Federal Income Tax Considerations

The following is a general description of certain U.S. tax considerations relating to the notes. It does not purport to be a complete analysis of all tax considerations relating to the notes. Prospective purchasers of the notes should consult their tax advisors as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of Canada and the U.S. of acquiring, holding and disposing of the notes and receiving payments under the notes. This summary is based upon the law as in effect on the date of this product supplement and is subject to any change in law that may take effect after such date.

The following disclosure—including the opinion of Morrison & Foerster LLP—has been prepared without regard to any particular note that you may purchase in the future and, therefore, is provided solely as a matter of general information. You should not rely upon the following disclosure (including the opinion of Morrison & Foerster LLP), or the disclosure under “United States Federal Income Taxation” in the prospectus or “Certain Income Tax Consequences—United States Federal Income Taxation” in the prospectus supplement, with regard to an investment in any particular note because this disclosure (including the opinion of Morrison & Foerster LLP) does not take into account the terms of any particular note or the tax consequences of investing in or holding any particular note unless the pricing supplement applicable to your notes expressly indicates that you may rely on the following disclosure and expressly states that you may rely on the opinion of Morrison & Foerster LLP. Any note that you purchase may have terms that would result in a tax treatment that is significantly different from the treatment described below. Consequently, any tax disclosure relevant to any note you may purchase will be set forth only in the pricing supplement relating to your note, and, unless the pricing supplement indicates otherwise, you should not rely on the tax disclosure below or in the prospectus supplement or prospectus in deciding whether to invest in any note. In addition, this tax disclosure assumes the following for all notes issued off of this product supplement: (i) no periodic payments of interest will be made on the notes; and (ii) there is a significant possibility of a significant loss of principal on an investment in the notes. Moreover, in all cases, you should consult with your own tax advisor concerning the consequences of investing in and holding any particular note you propose to purchase.

The following section supplements the discussion of U.S. federal income taxation in the accompanying prospectus and prospectus supplement with respect to United States holders (as defined in the accompanying prospectus). It applies only to those holders who are not excluded from the discussion of U.S. federal income taxation in the accompanying prospectus.

You should consult your tax advisor concerning the U.S. federal income tax and other tax consequences of your investment in the notes in your particular circumstances, including the application of state, local or other tax laws and the possible effects of changes in federal or other tax laws.

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NO STATUTORY, JUDICIAL OR ADMINISTRATIVE AUTHORITY DIRECTLY DISCUSSES HOW THE NOTES SHOULD BE TREATED FOR U.S. FEDERAL INCOME TAX PURPOSES. AS A RESULT, THE U.S. FEDERAL INCOME TAX CONSEQUENCES OF AN INVESTMENT IN THE NOTES ARE UNCERTAIN. BECAUSE OF THE UNCERTAINTY, YOU SHOULD CONSULT YOUR TAX ADVISOR IN DETERMINING THE U.S. FEDERAL INCOME TAX AND OTHER TAX CONSEQUENCES OF YOUR INVESTMENT IN THE NOTES, INCLUDING THE APPLICATION OF STATE, LOCAL OR OTHER TAX LAWS AND THE POSSIBLE EFFECTS OF CHANGES IN FEDERAL OR OTHER TAX LAWS.

We will not attempt to ascertain whether the issuer of any of the component stocks included in the Underlying Asset would be treated as a “passive foreign investment company” within the meaning of Section 1297 of the Code or a “U.S. real property holding corporation” within the meaning of Section 897 of the Code. If the issuer of one or more of such stocks were so treated, certain adverse U.S. federal income tax consequences could possibly apply. You should refer to any available information filed with the SEC by the issuers of the component stocks included in the Underlying Asset and consult your tax advisor regarding the possible consequences to you in this regard.

In the opinion of our counsel, Morrison & Foerster LLP, it would generally be reasonable to treat a note with terms described in this product supplement as a pre-paid cash-settled derivative contract in respect of the Underlying Asset or Basket for U.S. federal income tax purposes, and the terms of the notes require a holder and us (in the absence of a change in law or an administrative or judicial ruling to the contrary) to treat the notes for all tax purposes in accordance with such characterization. If the notes are so treated, subject to the discussion below concerning the potential application of the “constructive ownership” rules under Section 1260 of the Code, a United States holder should generally recognize capital gain or loss upon the sale or maturity of the notes in an amount equal to the difference between the amount a United States holder receives at such time and the United States holder’s tax basis in the notes. In general, a United States holder’s tax basis in the notes will be equal to the price the holder paid for the notes. Capital gain recognized by an individual United States holder is generally taxed at preferential rates where the property is held for more than one year and is generally taxed at ordinary income rates where the property is held for one year or less. The deductibility of capital losses is subject to limitations. The holding period for notes of a United States holder who acquires the notes upon issuance will generally begin on the date after the issue date (i.e., the settlement date) of the notes. If the notes are held by the same United States holder until maturity, that holder’s holding period will generally include the maturity date. It is possible that the Internal Revenue Service could assert that a United States holder’s holding period in respect of the notes should end on the date on which the amount the holder is entitled to receive upon the maturity of the notes is determined, even though the holder will not receive any amounts from us in respect of the notes prior to the maturity of the notes. In such case, a United States holder may be treated as having a holding period in respect of the notes that is one year or less even if the holder receives cash upon maturity of the notes at a time that is more than one year after the beginning of its holding period.

Potential Application of Section 1260 of the Code

If the Underlying Asset includes the type of financial asset described under Section 1260 of the Code (including, among others, any equity interest in pass-thru entities such as ETFs, regulated investment companies, real estate investment trusts, partnerships, and passive foreign investment companies, each a “Section 1260 Financial Asset”), while the matter is not entirely clear, unless otherwise specified in the applicable pricing supplement, there exists a substantial risk that an investment in a note is, in whole or in part, a “constructive ownership transaction” to which Section 1260 of the Code applies. If Section 1260 of the Code applies, all or a portion of any long-term capital gain recognized by a United States holder in respect of a note will be recharacterized as ordinary income (the “Excess Gain”). In addition, an interest charge will also apply to any deemed underpayment of tax in respect of any Excess Gain to the extent such gain would have resulted in gross income inclusion for the United States holder in taxable years prior to the taxable year of the sale, exchange, or settlement (assuming such income accrued at a constant rate equal to the applicable federal rate as of the date of sale, exchange, or settlement).

If an investment in a note is treated as a constructive ownership transaction, it is not clear to what extent any long-term capital gain of a United States holder in respect of the note will be recharacterized as ordinary income. It is possible, for example, that the amount of the Excess Gain (if any) that would be recharacterized as ordinary income in respect of the note will equal the excess of (i) any long-term capital gain recognized by the United States holder in respect of the note and attributable to Section 1260 Financial Assets, over (ii) the “net underlying long-term capital gain” (as defined in Section 1260 of the Code) such United States holder would have had if such United States holder had acquired an amount of the corresponding Section 1260 Financial Assets at fair market value on the original issue date for an amount equal to the portion of the issue price of the note attributable to the corresponding Section 1260 Financial Assets and sold such amount of Section 1260 Financial Assets upon the date of sale, exchange, or settlement of the note at fair market value (and appropriately taking into account any leveraged upside exposure). Alternatively, the Internal Revenue Service may contend that the Excess Gain should not be limited to amounts attributable to a Section 1260 Financial Asset, but should instead apply to all of the Underlying Assets. To the extent any gain is treated as long-term capital gain after application of the recharacterization rules of Section 1260 of the Code, such gain would be subject to U.S. federal income tax at the rates that would have been applicable to the net underlying long-term capital gain. United States holders should consult their tax advisors regarding the potential application of Section 1260 of the Code to an investment in the note.

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Under Section 1260 of the Code, there is a presumption that the net underlying long-term capital gain is zero (with the result that the recharacterization and interest charge described above would apply to all of the gain from the notes that otherwise would have been long-term capital gain), unless the contrary is demonstrated by clear and convincing evidence. Holders will be responsible for obtaining information necessary to determine the net underlying long-term capital gain with respect to the corresponding Section 1260 Financial Assets, as we do not intend to supply holders with such information. Holders should consult with their tax advisor regarding the application of the constructive ownership transaction to their notes and the calculations necessary to comply with Section 1260 of the Code.

Alternative Treatments

Alternative tax treatments of the notes are also possible and the Internal Revenue Service might assert that a treatment other than that described above is more appropriate. For example, it would be possible to treat the notes, and the Internal Revenue Service might assert that the notes should be treated, as a single debt instrument. If the notes have a term that exceeds one year, such a debt instrument would be subject to the special tax rules governing contingent payment debt instruments. If the notes are so treated, a United States holder would generally be required to accrue interest currently over the term of the notes even though that holder will not receive any payments from us prior to maturity. In addition, any gain a United States holder might recognize upon the sale or maturity of the notes would be ordinary income and any loss recognized by a holder at such time would be ordinary loss to the extent of interest that same holder included in income in the current or previous taxable years in respect of the notes, and thereafter, would be capital loss. If the notes are treated as a single debt instrument that has a term of no more than one year, the notes would be treated as a single contingent short-term debt instrument, which would also result in tax consequences that are different from those described above.

If the Underlying Asset is, or a Basket includes, an index that periodically rebalances, it is possible that the notes could be treated as a series of pre-paid derivative contracts, each of which matures on the next rebalancing date. If the notes were properly characterized in such a manner, a United States holder would be treated as disposing of the notes on each rebalancing date in return for new pre-paid derivative contracts that mature on the next rebalancing date, and a holder would accordingly likely recognize capital gain or loss on each rebalancing date equal to the difference between the holder's basis in the notes (which would be adjusted to take into account any prior recognition of gain or loss) and the fair market value of the notes on such date.

Because of the absence of authority regarding the appropriate tax characterization of the notes, it is also possible that the Internal Revenue Service could seek to characterize the notes in a manner that results in tax consequences that are different from those described above. For example, the Internal Revenue Service could possibly assert that any gain or loss that a holder may recognize upon the sale or maturity of the notes should be treated as ordinary gain or loss.

The Internal Revenue Service has released a notice that may affect the taxation of holders of the notes. According to the notice, the Internal Revenue Service and the Treasury Department are actively considering whether the holder of an instrument such as the notes should be required to accrue ordinary income on a current basis, and they sought taxpayer comments on the subject. It is not possible to determine what guidance they will ultimately issue, if any. It is possible, however, that under such guidance, holders of the notes will ultimately be required to accrue income currently and this could be applied on a retroactive basis. The Internal Revenue Service and the Treasury Department are also considering other relevant issues, including whether additional gain or loss from such instruments should be treated as ordinary or capital and whether the special "constructive ownership rules" of Section 1260 of the Code might be applied to such instruments. Holders are urged to consult their tax advisors concerning the significance, and the potential impact, of the above considerations. Unless stated otherwise in the relevant pricing supplement, we intend to treat the notes for U.S. federal income tax purposes in accordance with the treatment described in this product supplement unless and until such time as the Treasury Department and Internal Revenue Service determine that some other treatment is more appropriate.

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Backup Withholding and Information Reporting

Please see the discussion under “United States Federal Income Taxation—Backup Withholding and Information Reporting” in the accompanying prospectus for a description of the applicability of the backup withholding and information reporting rules to payments made on your notes.

Non-United States Holders

The following discussion applies to non-United States holders of the notes. A non-United States holder is a beneficial owner of a note that, for U.S. federal income tax purposes, is a non-resident alien individual, a foreign corporation, or a foreign estate or trust.

Except as discussed below, a non-United States holder will generally not be subject to U.S. federal income or withholding tax for amounts paid in respect of the notes, provided that (i) the holder complies with any applicable certification requirements, (ii) the payment is not effectively connected with the conduct by the holder of a U.S. trade or business, and (iii) if the holder is a non-resident alien individual, such holder is not present in the U.S. for 183 days or more during the taxable year of the sale or maturity of the notes. In the case of (ii) above, the holder generally would be subject to U.S. federal income tax with respect to any income or gain in the same manner as if the holder were a United States holder and, in the case of a holder that is a corporation, the holder may also be subject to a branch profits tax equal to 30% (or such lower rate provided by an applicable U.S. income tax treaty) of a portion of its earnings and profits for the taxable year that are effectively connected with its conduct of a trade or business in the U.S., subject to certain adjustments. Payments made to a non-United States holder may be subject to information reporting and to backup withholding unless the holder complies with applicable certification and identification requirements as to its foreign status.

As discussed above, alternative characterizations of the notes for U.S. federal income tax purposes are possible. Should an alternative characterization, by reason of change or clarification of the law, by regulation or otherwise, cause payments as to the notes to become subject to withholding tax, we will withhold tax at the applicable statutory rate. The Internal Revenue Service has also indicated that it is considering whether income in respect of instruments such as the notes should be subject to withholding tax. Prospective investors should consult their own tax advisors in this regard.

A “dividend equivalent” payment is treated as a dividend from sources within the U.S. and such payments generally would be subject to a 30% U.S. withholding tax if paid to a non-United States holder. Under Treasury Department regulations, payments (including deemed payments) that are contingent upon or determined by reference to actual or estimated U.S. source dividends with respect to certain equity-linked instruments, whether explicitly stated or implicitly taken into account in computing one or more of the terms of such instruments, may be treated as dividend equivalents. However, withholding on “dividend equivalent” payments, if any, will not apply to notes issued before January 1, 2016. If any payments are treated as dividend equivalents subject to withholding, we (or the applicable paying agent) would be entitled to withhold taxes without being required to pay any additional amounts with respect to amounts so withheld.

Foreign Account Tax Compliance Act

The Foreign Account Tax Compliance Act imposes a 30% U.S. withholding tax on certain U.S. source payments, including interest (and OID), dividends, other fixed or determinable annual or periodical gain, profits, and income, and on the gross proceeds from a disposition of property of a type which can produce U.S. source interest or dividends (“Withholdable Payments”), if paid to a foreign financial institution (including amounts paid to a foreign financial institution on behalf of a holder), unless such institution enters into an agreement with the Treasury Department to collect and provide to the Treasury Department substantial information regarding U.S. account holders, including certain account holders that are foreign entities with U.S. owners, with such institution. The legislation also generally imposes a withholding tax of 30% on Withholdable Payments made to a non-financial foreign entity unless such entity provides the withholding agent with a certification that it does not have any substantial U.S. owners or a certification identifying the direct and indirect substantial U.S. owners of the entity.

The U.S. Treasury Department and the IRS have announced that withholding on payments of gross proceeds from a sale or redemption of the notes will only apply to payments made after December 31, 2018. If we (or an applicable withholding agent) determine withholding is appropriate with respect to the notes, we (or such agent) will withhold tax at the applicable statutory rate, and we will not pay any additional amounts in respect of such withholding. Account holders subject to information reporting requirements pursuant to the Foreign Account Tax Compliance Act may include holders of the notes. Foreign financial institutions and non-financial foreign entities located in jurisdictions that have an intergovernmental agreement with the United States governing the Foreign Account Tax Compliance Act may be subject to different rules. Holders are urged to consult with their own tax advisors regarding the possible implications of this legislation on their investment in the notes.

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EMPLOYEE RETIREMENT INCOME SECURITY ACT

A fiduciary of a pension, profit-sharing or other employee benefit plan subject to the U.S. Employee Retirement Income Security Act of 1974, as amended (“ERISA”) (each, a “Plan”), should consider the fiduciary standards of ERISA in the context of the Plan’s particular circumstances before authorizing an investment in the notes. Among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan, and whether the investment would involve a prohibited transaction under ERISA or the Code.

Section 406 of ERISA and Section 4975 of the Code prohibit Plans, as well as individual retirement accounts, Keogh plans any other plans that are subject to Section 4975 of the Code (also “Plans”), from engaging in certain transactions involving “plan assets” with persons who are “parties in interest” under ERISA or “disqualified persons” under the Code with respect to the Plan. A violation of these prohibited transaction rules may result in excise tax or other liabilities under ERISA or the Code for those persons, unless exemptive relief is available under an applicable statutory, regulatory or administrative exemption. Employee benefit plans that are governmental plans (as defined in Section 3(32) of ERISA), certain church plans (as defined in Section 3(33) of ERISA) and non-U.S. plans (as described in Section 4(b)(4) of ERISA) (“Non-ERISA Arrangements”) are not subject to the requirements of Section 406 of ERISA or Section 4975 of the Code but may be subject to similar provisions under applicable federal, state, local, non-U.S., or other laws (“Similar Laws”).

The acquisition of notes by a Plan or any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) with respect to which we or certain of our affiliates is or becomes a party in interest or disqualified person may result in a prohibited transaction under ERISA or Section 4975 of the Code, unless the notes are acquired pursuant to an applicable exemption. The U.S. Department of Labor has issued five prohibited transaction class exemptions, or “PTCEs”, that may provide exemptive relief if required for direct or indirect prohibited transactions that may arise from the purchase or holding of notes. These exemptions are PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers), PTCE 90-1 (for certain transactions involving insurance company pooled separate accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 95-60 (for transactions involving certain insurance company general accounts), and PTCE 96-23 (for transactions managed by in-house asset managers). In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code provide an exemption for the purchase and sale of securities offered hereby, provided that neither the issuer of notes offered hereby nor any of its affiliates have or exercise any discretionary authority or control or render any investment advice with respect to the assets of any Plan involved in the transaction, and provided further that the Plan pays no more and receives no less than “adequate consideration” in connection with the transaction (the “Service Provider Exemption”). Any Plan fiduciary relying on the Service Provider Exemption and purchasing the notes on behalf of a Plan must initially make a determination that (x) the Plan is paying no more than, and is receiving no less than, “adequate consideration” in connection with the transaction and (y) neither we nor any of our affiliates directly or indirectly exercises any discretionary authority or control or renders investment advice with respect to the assets of the Plan which such fiduciary is using to purchase, both of which are necessary preconditions to reliance on the Service Provider Exemption. If we or any of our affiliates provides fiduciary investment management services with respect to a Plan’s acquisition of the notes, the Service Provider Exemption may not be available, and in that case, other exemptive relief would be required as precondition for purchasing the notes. Any Plan fiduciary considering reliance on the Service Provider Exemption is encouraged to consult with counsel regarding the availability of the exemption. There can be no assurance that any of the foregoing exemptions will be available with respect to any particular transaction involving the notes, or that, if an exemption is available, it will cover all aspects of any particular transaction.

Because we or our affiliates may be considered to be a party in interest with respect to many Plans, the notes may not be purchased, held or disposed of by any Plan, unless such purchase, holding or disposition is eligible for exemptive

relief, including relief available under PTCE 96-23, 95-60, 91-38, 90-1, or 84-14 or the Service Provider Exemption, or such purchase, holding or disposition is not otherwise prohibited. Except as otherwise set forth in any applicable pricing supplement, by its purchase of any notes, each purchaser (whether in the case of the initial purchase or in the case of a subsequent transferee) will be deemed to have represented and agreed by its purchase and holding of the notes offered hereby that either (i) it is not and for so long as it holds a note, it will not be a Plan, a Plan Asset Entity, or a Non-ERISA Arrangement, or (ii) its purchase and holding of the notes will not constitute or result in a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or, in the case of such a Non-ERISA Arrangement, under any Similar Laws.

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In addition, any purchaser that is a Plan or a Plan Asset Entity or that is acquiring the notes on behalf of a Plan or a Plan Asset Entity, including any fiduciary purchasing on behalf of a Plan or Plan Asset entity, will be deemed to have represented, in its corporate and its fiduciary capacity, by its purchase and holding of the notes that (a) neither we nor any of our respective affiliates or agents are a “fiduciary” (under Section 3(21) of ERISA, or under any final or proposed regulations thereunder, or with respect to a non-ERISA Arrangement under any Similar Laws with respect to the acquisition, holding or disposition of the notes, or as a result of any exercise by us or our affiliates or agents of any rights in connection with the notes, (b) no advice provided by us or any of our affiliates or agents has formed a primary basis for any investment decision by or on behalf of such purchaser in connection with the notes and the transactions contemplated with respect to the notes, and (c) such purchaser recognizes and agrees that any communication from us or any of our affiliates or agents to the purchaser with respect to the notes is not intended by us or any of our affiliates or agents to be impartial investment advice and is rendered in our or our affiliates’ or agents’ capacity as a seller of such notes and not a fiduciary to such purchaser.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is important that fiduciaries or other persons considering purchasing notes on behalf of or with the assets of any Plan, a Plan Asset Entity or Non-ERISA Arrangement consult with their counsel regarding the availability of exemptive relief under any of the PTCEs listed above, the Service Provider Exemption or the potential consequences of any purchase or holding under Similar Laws, as applicable. Purchasers of notes have exclusive responsibility for ensuring that their purchase and holding of notes do not violate the fiduciary or prohibited transaction rules of ERISA or the Code or any similar provisions of Similar Laws. The sale of any notes to a Plan, Plan Asset Entity or Non-ERISA Arrangement is in no respect a representation by us or any of our affiliates or representatives that such an investment meets all relevant legal requirements with respect to investments by any such Plans, Plan Asset Entities or Non-ERISA Arrangements generally or any particular Plan, Plan Asset Entity or Non-ERISA Arrangement or that such investment is appropriate for such Plans, Plan Asset Entities or Non-ERISA Arrangements generally or any particular Plan, Plan Asset Entity or Non-ERISA Arrangement.

SUPPLEMENTAL PLAN OF DISTRIBUTION

With respect to each note to be issued, we will agree to sell to BMO Capital Markets Corp., and BMO Capital Markets Corp. will agree to purchase from us, the principal amount of the note specified, at the price specified in the applicable pricing supplement, less the indicated underwriting commission. BMO Capital Markets Corp. may also resell the notes to other brokers or dealers in connection with any offering. BMO Capital Markets Corp. or another of our affiliates may repurchase and resell outstanding notes in market-making transactions, with resales being made at prices related to prevailing market prices at the time of resale or at negotiated prices. For more information about the plan of distribution, the distribution agreement and possible market-making activities see “Supplemental Plan of Distribution” in the accompanying prospectus supplement.

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fer Act, and the Federal Deposit Insurance Act. Violation of these laws could result in the imposition of significant damages and fines upon the Bank and its directors and officers.

Branching Authority. Michigan banks have the authority under Michigan law to establish branches anywhere in the State of Michigan, subject to receipt of all required regulatory approvals. Banks may establish interstate branch networks through acquisitions of other banks. The establishment of de novo interstate branches or the acquisition of individual branches of a bank in another state (rather than the acquisition of an out-of-state bank in its entirety) is allowed only if specifically authorized by state law.

Michigan permits both U.S. and non-U.S. banks to establish branch offices in Michigan. The Michigan Banking Code permits, in appropriate circumstances and with the approval of OFIR, (1) acquisition of Michigan banks by FDIC-insured banks, savings banks or savings and loan associations located in other states, (2) sale by a Michigan bank of branches to an FDIC-insured bank, savings bank or savings and loan association located in a state in which a Michigan bank could purchase branches of the purchasing entity, (3) consolidation of Michigan banks and FDIC-insured banks, savings banks or savings and loan associations located in other states having laws permitting such consolidation, (4) establishment of branches in Michigan by FDIC-insured banks located in other states, the District of Columbia or U.S. territories or protectorates having laws permitting a Michigan bank to establish a branch in such jurisdiction, and (5) establishment by foreign banks of branches located in Michigan. A Michigan bank holding company may acquire a non-Michigan bank and a non-Michigan bank holding company may acquire a Michigan bank.

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ITEM 1A: Risk Factors.
Risks related to the our Business

Other than the last three quarters of 2010, our results of operations have not been profitable in recent periods and we may incur additional losses during 2011.

We were profitable in the second, third and fourth quarters of 2010, but we had posted a high net consolidated loss in each of the preceding six consecutive quarters, and a total consolidated net loss during that time period of \$123.5 million. Net income for the second quarter of 2010 was largely due to a \$2.7 million gain on the sale of securities. Net income for the fourth quarter was impacted by a \$574,000 gain on the sale of a bank owned property. The last three quarters of 2010 were positively affected by reductions in the allowance for loan losses. Total nonperforming assets as of December 31, 2010 remained high and related costs were elevated as well. There is no assurance that our results of operations will stay profitable in the short term or at all. We have recorded provisions for loan losses of \$22.5 million and \$74.3 million for the years ended December 31, 2010 and 2009. Costs associated with the administration and disposition of nonperforming assets were \$15.4 million and \$11.4 million for the years ended December 31, 2010 and 2009. In light of the current economic environment, significant additional provisions for loan losses and nonperforming asset costs may yet be necessary. As a result, we may incur significant additional credit costs in 2011 or beyond, which could adversely impact our financial condition, results of operations, and the value of our common stock.

Our past operating results may not be indicative of its future operating results.

Our strategic direction and focus has turned from growth to improving our internal operations, including complying with the Bank's Consent Order, working out of our problem loans and assets and returning to profitable operations. We will not be able to achieve the historical rate of growth we experienced prior to the 2008 economic downturn, may not even be able to grow our business at all and may be forced to continue to shrink assets to maintain regulatory capital ratios. Various factors, many of which are discussed in more detail in the risk factors below, that may impede or prohibit our ability to grow include the impact of elevated levels of nonperforming assets, the inability to maintain or access additional capital and liquidity sources, economic conditions, regulatory and legislative considerations and competition. If we experience a significant decrease in our size, the our results of operations and financial condition could be adversely affected due to the percentage of our operating costs being fixed expenses.

Our elevated level of nonperforming assets and other problem loans could continue to have an adverse effect on our results of operations and financial condition.

Our nonperforming assets were approximately \$133.4 million (which includes non-accrual loans, foreclosed properties and other accruing loans past due 90 days or more at December 31, 2010). These elevated levels could continue to negatively impact operating results through higher loan losses, lost interest and higher costs to administer problem assets. Until these elevated levels of problem assets are reduced, we could continue to record operating losses that further materially deteriorate the our financial condition and reduce capital levels, further exposing us to additional risk factors discussed below.

National, state and local economic conditions could have a material adverse effect on our results of operations and financial condition.

The results of operations for financial institutions, including our Bank, may be materially and adversely affected by changes in prevailing national, state and local economic conditions. Our profitability is heavily influenced by the

quality of our loan portfolio and the stability of our deposits. Unlike larger national or other regional banks that are more geographically diversified, we provide banking and financial services to customers primarily in Ottawa, Kent and Allegan Counties of Western Michigan. The local economic conditions in these areas have a significant impact on the demand for our products and services, as well as the ability of the our customers to repay loans, the value of the collateral securing loans and the stability of the our deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities, financial, or credit markets or other factors could impact national as well as these local economic conditions and, in turn, have a material adverse effect on our results of operations and financial condition.

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Our credit losses could increase and our allowance for loan losses may not be adequate to cover actual loan losses.

The risk of nonpayment of loans is inherent in all lending activities and nonpayment of loans may have a material adverse effect on our earnings and overall financial condition, as well as the value of our common stock. We make various assumptions and judgments about the collectability of our loan portfolio and provide an allowance for potential losses based on a number of factors. If our assumptions are wrong, our allowance for loan losses may not be sufficient to cover our losses, which could have an adverse affect on our operating results, and may cause us to increase the allowance in the future. The actual amount of future provisions for loan losses cannot now be determined and may exceed the amounts of past provisions. Federal banking regulators, as an integral part of their supervisory function, periodically review our allowance for loan losses. These regulatory agencies may require us to increase our provision for loan losses or to recognize further loan charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses could have a negative effect on our regulatory capital ratios, net income, financial condition and results of operations.

Macatawa Bank Corporation has only limited cash and cash equivalents available at the holding company level. If its cash and cash equivalents are exhausted and it is unable to access additional funds through capital raising efforts or other funding sources, it could be unable to meet its financial obligations as they came due rendering the Company insolvent.

At December 31, 2010, Macatawa Bank Corporation held at the holding company level cash and cash equivalents of \$579,000 compared to \$1,143,000 at December 31, 2009. As of the date of this report, Macatawa Bank Corporation anticipates that its cash and cash equivalents could be exhausted, unless it is able to access additional funds through capital raising efforts or other funding sources. If Macatawa Bank Corporation's cash and cash equivalents are exhausted, it would be unable to meet its financial obligations as they came due rendering Macatawa Bank Corporation insolvent. If Macatawa Bank Corporation were to become insolvent, it could be subject to voluntary or involuntary bankruptcy or similar insolvency proceedings and its business, financial condition and results of operations would be materially and adversely affected.

If the condition of the Bank's loan portfolio worsens, its ability to borrow funds from the Federal Home Loan Bank and Federal Reserve Bank could be adversely affected, which could materially adversely affect the Bank's liquidity position.

As part of its liquidity management, the Bank borrows funds from the Federal Home Loan Bank and has the ability to borrow from the Federal Reserve Bank. The borrowed funds are collateralized by certain investment securities and qualifying residential and commercial real estate loans. The Bank is permitted to borrow an amount of funds up to a certain percentage of the total investment securities and loans pledged as collateral. The Federal Home Loan Bank and Federal Reserve Bank will not accept as collateral any loan that is rated as a 5 or worse on our internal loan grading system. If the quality of the Bank's loan portfolio worsens, the Bank could have fewer loans eligible to be pledged as collateral for borrowed funds, reducing the total amount of available funds that the Bank is permitted to borrow. A reduction in the total amount of the available funds that the Bank is permitted to borrow from the Federal Home Loan Bank and Federal Reserve Bank could materially adversely affect the Bank's liquidity position.

The Bank cannot accept, renew or roll over brokered deposits without a waiver from the FDIC, which could materially adversely affect the Bank's liquidity position.

Because the Bank is subject to a Consent Order, the Bank cannot be categorized as "well-capitalized," regardless of actual capital levels. As of the date of this report, the Bank was categorized as "adequately capitalized." As a result,

the Bank cannot accept, renew or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC. It is not likely that the Bank will be granted a waiver of this prohibition. At December 31, 2010, the Bank's brokered deposits totaled \$48.2 million and represented 4% of deposits. If the Bank is not able to replace the funding required for maturing brokered deposits, the Bank's liquidity position could be materially adversely affected.

We are subject to liquidity risk in our operations, which could adversely affect our ability to fund various obligations.

Liquidity risk is the possibility of being unable to meet obligations as they come due, pay deposits when withdrawn, and fund loan and investment opportunities as they arise because of an inability to liquidate assets or obtain adequate funding on a timely basis, at a reasonable cost and within acceptable risk tolerances. Liquidity is required to fund various obligations, including credit obligations to borrowers, mortgage originations, withdrawals by depositors, repayment of debt, operating expenses and capital expenditures. Liquidity of the Bank is derived primarily from retail deposit growth and retention, principal and interest payments on loans and investment securities, net cash provided from operation and access to other funding sources. Liquidity is essential to our business. We must maintain sufficient funds to respond to the needs of depositors and borrowers. An inability to raise funds through deposits, borrowings, the sale or pledging as collateral of loans and other assets could have a material adverse effect on our liquidity. An inability to retain the current level of deposits, including the loss of one or more of the Bank's larger deposit relationships, could have a material adverse effect on the Bank's liquidity. Our access to funding sources

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in amounts adequate to finance activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of the business activity due to a market down turn or regulatory action that limits or eliminates access to alternate funding sources, including brokered deposits discussed above. Our ability to borrow could also be impaired by factors that are nonspecific to the Company, such as severe disruption of the financial markets or negative expectations about the prospects for the financial services industry as a whole, as evidenced by recent turmoil in the domestic and worldwide credit markets.

We are not in compliance with the Consent Order. This could result in enforcement action against us.

The Bank is subject to a Consent Order with the FDIC and OFIR. The Bank is required to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11%. The Bank was not in compliance with these capital ratios at December 31, 2010. We are evaluating alternatives to reach and maintain the capital levels required by the Consent Order. Achievement of these capital levels could be impacted, positively or negatively, as a result of certain uncertainties, including, but not limited to, earnings levels, changing economic conditions, asset quality and property values. A failure to raise additional capital to satisfy the capital levels required by the Consent Order could materially adversely affect our ability to maintain our current level of assets and to further expand our operations through organic growth. In addition, the Bank could become subject to an enforcement action, which could result in removal of directors, officers, employees and institution affiliated parties, and the imposition of civil money penalties and even ultimately closure of the Bank.

Failure to comply with the Written Agreement could result in enforcement proceedings.

Macatawa Bank Corporation is subject to a Written Agreement with the FRB. The failure to comply with the terms of the Written Agreement could result in proceedings to enforce the Written Agreement. Such proceedings could result in removal of directors, officers, employees and institution affiliated parties, and the imposition of civil money penalties.

A pending SEC investigation may subject us to significant costs and could divert management attention.

We have been fully cooperating with the SEC, which is conducting a non-public fact-finding investigation into the circumstances surrounding the Company's restatement of earnings for the quarter ended June 30, 2008 and our decision to revise its previously announced financial results for the quarter ending June 30, 2009. The SEC has not provided us with notice asserting that any violations of the securities laws have occurred, but there can be no assurance as to the outcome of its investigation. We have already incurred, and expect to continue to incur, significant legal expenses arising from the investigation. If the SEC were to institute legal action, we could face fines and penalties in an amount that could be material and we could be required to take remedial actions determined by the SEC or a court.

Our construction and development lending has exposed us to significant risks and has resulted in a disproportionate amount of the increase in our provision for loan losses in recent periods.

Construction and development loans consist of loans to commercial customers for the construction of their business facilities. They also include construction loans to builders and developers for the construction of one- to four-family residences and the development of one- to four-family lots, residential subdivisions, condominium developments and other commercial developments. This portfolio has been particularly adversely affected by job losses, declines in real estate value, declines in home sale volumes, and declines in new home building. Declining real estate values have resulted in sharp increases in losses, particularly in the land development and construction loan portfolios to residential developers. This type of lending is generally considered to have more complex credit risks than traditional

single-family residential lending because the principal is concentrated in a limited number of loans with repayment dependent on the successful completion and sales of the related real estate project. Consequently, these loans are often more sensitive to adverse conditions in the real estate market or the general economy than other real estate loans. These loans are generally less predictable and more difficult to evaluate and monitor and collateral may be difficult to dispose of in a market decline. Additionally, we may experience significant construction loan losses if independent appraisers or project engineers inaccurately estimate the cost and value of construction loan projects. The Company curtailed this type of lending in 2008. During 2009 and 2010, we also made a significant effort to reduce our exposure to residential land development and other construction and development loans.

Construction and development loans have contributed disproportionately to the increase in our provisions for loan losses in recent periods. As of December 31, 2010, we had approximately \$95.7 million in loans to residential developers, or approximately 7.8% of our loan portfolio. Approximately \$28.9 million, or 49.8%, of our net charge-offs during 2009 and approximately \$9.2 million, or 31.0%, of our net charge-offs during 2010 were attributable to construction and development loans. Further deterioration in our construction and development loan portfolio could result in additional increases in the provision for loan losses and an increase in charge-offs, all of which could have a material adverse effect on our financial condition and results of operations.

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We have significant exposure to risks associated with commercial and residential real estate.

A substantial portion of our loan portfolio consists of commercial and residential real estate-related loans, including real estate development, construction and residential and commercial mortgage loans. As of December 31, 2010, we had approximately \$669.2 million of commercial real estate loans outstanding, which represented approximately 55% of our loan portfolio. As of that same date, we had approximately \$135.2 million in residential real estate loans outstanding, or approximately 11% of our loan portfolio. Consequently, real estate-related credit risks are a significant concern for us. The adverse consequences from real estate-related credit risks tend to be cyclical and are often driven by national economic developments that are not controllable or entirely foreseeable by us or our borrowers. General difficulties in our real estate markets have recently contributed to significant increases in our nonperforming loans, charge-offs, and decreases in our income.

Commercial loans may expose us to greater financial and credit risk than other loans.

Our commercial loan portfolio, including commercial mortgages, was approximately \$933.9 million at December 31, 2010, comprising approximately 77% of our total loan portfolio. Commercial loans generally carry larger loan balances and can involve a greater degree of financial and credit risk than other loans. Any significant failure to pay on time by our customers would hurt our earnings. The increased financial and credit risk associated with these types of loans are a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans. In addition, when underwriting a commercial or industrial loan, we may take a security interest in commercial real estate, and, in some instances upon a default by the borrower, we may foreclose on and take title to the property, which may lead to potential financial risks for us under applicable environmental laws. If hazardous substances were discovered on any of these properties, we may be liable to governmental agencies or third parties for the costs of remediation of the hazard, as well as for personal injury and property damage. Many environmental laws can impose liability regardless of whether we knew of, or were responsible for, the contamination.

Our loan portfolio has and will continue to be affected by the on-going correction in residential real estate prices and reduced levels of home sales.

Loans to residential developers involved in the development or sale of 1-4 family residential properties were approximately \$95.7 million and \$153.3 million at December 31, 2010 and 2009. There continues to be a general slowdown in the housing market in our market area, reflecting declining prices and excess inventories of houses to be sold. As a result, home builders have shown signs of financial deterioration. We expect the home builder market to continue to be volatile and anticipate continued pressure on the home builder segment. As we continue our on-going portfolio monitoring, we will make credit and reserve decisions based on the current conditions of the borrower or project combined with our expectations for the future. If the deterioration in the housing market continues, we could experience higher charge-offs and delinquencies in this portfolio.

We may face increasing pressure from historical purchasers of our residential mortgage loans to repurchase those loans or reimburse purchasers for losses related to those loans.

We generally sell the fixed rate long-term residential mortgage loans we originate on the secondary market and retain adjustable rate mortgage loans for our portfolios. In response to the financial crisis, we believe that purchasers of residential mortgage loans, such as government sponsored entities, are increasing their efforts to seek to require sellers of residential mortgage loans to either repurchase loans previously sold or reimburse purchasers for losses related to

loans previously sold when losses are incurred on a loan previously sold due to actual or alleged failure to strictly conform to the purchaser's purchase criteria. As a result, while we have not yet been required to repurchase such loans, we may face increasing pressure from historical purchasers of our residential mortgage loans to repurchase those loans or reimburse purchasers for losses related to those loans and we may face increasing expenses to defend against such claims. If we are required in the future to repurchase loans previously sold, reimburse purchasers for losses related to loans previously sold, or if we incur increasing expenses to defend against such claims, our financial condition and results of operations would be negatively affected, and would lower our capital ratios as a result of increasing assets and lowering income through expenses and any loss incurred.

Changes in interest rates may negatively affect our earnings and the value of our assets.

Our earnings and cash flows depend substantially upon our net interest income. Net interest income is the difference between interest income earned on interest-earnings assets, such as loans and investment securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Interest rates are sensitive to many factors that are beyond our control, including general economic conditions, competition and policies of various governmental and regulatory agencies and, in particular, the policies of the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, could

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influence not only the interest we receive on loans and investment securities and the amount of interest they pay on deposits and borrowings, but such changes could also affect: (i) our ability to originate loans and obtain deposits; (ii) the fair value of our financial assets and liabilities, including our securities portfolio; and (iii) the average duration of our interest-earning assets. This also includes the risk that interest-earning assets may be more responsive to changes in interest rates than interest-bearing liabilities, or vice versa (repricing risk), the risk that the individual interest rates or rates indices underlying various interest-earning assets and interest-bearing liabilities may not change in the same degree over a given time period (basis risk), and the risk of changing interest rate relationships across the spectrum of interest-earning asset and interest-bearing liability maturities (yield curve risk), including a prolonged flat or inverted yield curve environment. Any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on our financial condition and results of operations.

The Dodd-Frank Act may adversely impact our results of operations, financial condition or liquidity.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), was signed into law by President Obama. The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States, establishes the new federal Bureau of Consumer Financial Protection (the "BCFP"), and will require the BCFP and other federal agencies to implement many new and significant rules and regulations. At this time, it is difficult to predict the extent to which the Dodd-Frank Act or the resulting rules and regulations will impact the Company's and the Bank's business. Compliance with these new laws and regulations will likely result in additional costs, which could be significant, and could adversely impact our results of operations, financial condition or liquidity.

We are subject to significant government regulation, and any regulatory changes may adversely affect us.

The banking industry is heavily regulated under both federal and state law. These regulations are primarily intended to protect customers, not our creditors or shareholders. We are subject to extensive regulation by the Federal Reserve, the FDIC and OFIR, in addition to other regulatory and self-regulatory organizations. Regulations affecting banks and financial services companies undergo continuous change, and we cannot predict the ultimate effect of such changes, which could have a material adverse effect on our profitability or financial condition.

We could be adversely affected by the soundness of other financial institutions, including defaults by larger financial institutions.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of credit, trading, clearing, counterparty or other relationships between financial institutions. We have exposure to multiple counterparties, and we routinely execute transactions with counterparties in the financial industry. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by the Bank or by other institutions. This is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which we interact on a daily basis, and therefore could adversely affect us.

The Bank may be required to pay additional insurance premiums to the FDIC, which could negatively impact earnings.

Recent insured institution failures, as well as deterioration in banking and economic conditions, have significantly increased FDIC loss provisions, resulting in a decline in the designated reserve ratio to historical lows. The reserve ratio may continue to decline in the future. In addition, the limit on FDIC coverage has been increased to \$250,000. These developments have caused the premiums assessed to the Bank by the FDIC to increase. Further, depending

upon any future losses that the FDIC insurance fund may suffer, there can be no assurance that there will not be additional premium increases in order to replenish the fund. The FDIC may need to set a higher base rate schedule or impose special assessments due to future financial institution failures and updated failure and loss projections. Potentially higher FDIC assessment rates could have an adverse impact on our results of operations.

The proposed offering of our common stock may increase the risk of an "ownership change" for purposes of Section 382 of the Internal Revenue Code, which may materially impair our ability to use our deferred tax assets.

On February 2, 2011, we filed a Form S-1 Registration Statement to register shares of our common stock that we intend to offer to our shareholders in a shareholder rights offering and to other investors in a public offering. For more information, see above under the heading "Strategies for Complying with the Consent Order - Capital Raising."

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At December 31, 2010, our net deferred tax asset was \$25.6 million (before valuation allowance). Our ability to use our deferred tax assets to offset future taxable income will be limited if we experience an "ownership change" as defined in Section 382 of the Internal Revenue Code. In general, an ownership change will occur if there is a cumulative increase in our ownership by "5-percent shareholders" (as defined in the Code) that exceeds 50 percentage points over a rolling three-year period. A corporation that experiences an ownership change will generally be subject to an annual limitation on the use of its pre-ownership change deferred tax assets equal to the equity value of the corporation immediately before the ownership change, multiplied by the long-term tax-exempt rate, which is currently 4.47% for ownership changes occurring in February 2011.

The offering could cause us to experience an "ownership change" as defined for U.S. federal income tax purposes. Even if the offering does not cause us to experience an "ownership change," the issuance of our shares of common stock in the offering materially increases the risk that we could experience an "ownership change" in the future. As a result, issuances or sales of common stock or other securities in the future, or certain other direct or indirect changes in ownership, could result in an "ownership change" under Section 382 of the Code.

In the event an "ownership change" were to occur, we could realize a permanent loss of a significant portion of our U.S. federal deferred tax assets (related to net operating loss carryforwards) and lose certain built-in losses that have not been recognized for tax purposes. The amount of the permanent loss would depend on the size of the annual limitation (which is in part a function of our market capitalization at the time of an "ownership change") and the remaining carry forward period (U.S. federal net operating losses generally may be carried forward for a period of 20 years).

Due to the losses incurred in recent years and in the first quarter of 2010, we continue to maintain a full valuation allowance on our entire deferred tax asset. If an "ownership change" had occurred on December 31, 2010, there would have been no direct financial impact because the asset is fully reserved, however, the ownership change would have affected the amount of valuation allowance we may be able to reverse in the future.

We rely heavily on our management and other key personnel, and the loss of any of them may adversely affect our operations.

We are and will continue to be dependent upon the services of our management team and other key personnel. Losing the services of one or more key members of our management team could adversely affect our operations.

Our controls and procedures may fail or be circumvented.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met.

If we fail to identify and remediate control deficiencies, it is possible that a material misstatement of interim or annual financial statements will not be prevented or detected on a timely basis. In addition, any failure or circumvention of our other controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

We may be a defendant in a variety of litigation and other actions, which may have a material adverse effect on our financial condition and results of operations.

We may be involved from time to time in a variety of litigation arising out of our business. Our insurance may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation or cause us to incur unexpected expenses, which could be material in amount. Should the ultimate expenses, judgments or settlements in any litigation exceed our insurance coverage, they could have a material adverse effect on our financial condition and results of operations. In addition, we may not be able to obtain appropriate types or levels of insurance in the future, nor may it be able to obtain adequate replacement policies with acceptable terms, if at all.

Our future success is dependent on our ability to compete effectively in the highly competitive banking industry.

We face substantial competition in all phases of our operations from a variety of different competitors. Our future growth and success will depend on our ability to compete effectively in this highly competitive environment. We compete for deposits, loans and other financial services with numerous Michigan-based and out-of-state banks, thrifts, credit unions and other financial institutions as well as other entities which provide financial services. Some of the financial institutions and financial services organizations with which we compete are not subject to the same degree of regulation as we are. Most of our competitors have been in business for many years, have established customer bases, are larger, and have substantially higher

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lending limits than we do. The financial services industry is also likely to become more competitive as further technological advances enable more companies to provide financial services.

Evaluation of investment securities for other-than-temporary impairment involves subjective determinations and could materially impact our results of operations and financial condition.

The evaluation of impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition or future recovery prospects, the effects of changes in interest rates or credit spreads and the expected recovery period. Estimating future cash flows involves incorporating information received from third-party sources and making internal assumptions and judgments regarding the future performance of the underlying collateral and assessing the probability that an adverse change in future cash flows has occurred. The determination of the amount of other-than-temporary impairments is based upon our periodic evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments are revised as conditions change and new information becomes available. Our management considers a wide range of factors about the security issuer and uses reasonable judgment in evaluating the cause of the decline in the estimated fair value of the security and in assessing the prospects for recovery. Inherent in management's evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Impairments to the carrying value of our investment securities may need to be taken in the future, which could have a material adverse effect on our results of operations and financial condition.

We depend upon the accuracy and completeness of information about customers.

In deciding whether to extend credit to customers, we may rely on information provided to it by its customers, including financial statements and other financial information. We may also rely on representations of customers as to the accuracy and completeness of that information and, with respect to financial statements, on reports of independent auditors. Our financial condition and results of operations could be negatively impacted to the extent that we extend credit in reliance on financial statements or other information provided by customers that is false or misleading.

We continually encounter technological change, and we may have fewer resources than our competitors to continue to invest in technological improvements.

The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to reduce costs. Our future success will depend, in part, on our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. There can be no assurance that we will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to our customers.

Risks associated with the Company's stock

Our ability to pay dividends is limited and we may be unable to pay future dividends.

We have suspended payment of dividends on our preferred and common stock in order to preserve capital and we do not expect to resume payment of dividends in the near term. Our ability to pay dividends is limited by regulatory restrictions and the need to maintain sufficient regulatory capital. The ability of the Bank to pay dividends to Macatawa Bank Corporation is limited by its obligation to maintain sufficient capital and by other general restrictions on dividends that are applicable to us. Under Michigan law, the Bank is restricted from paying dividends to the Company until its deficit retained earnings has been restored. The Bank had a retained deficit of approximately \$39.8 million at December 31, 2010.

Additional information on restrictions on payments of dividends by us may be found in Item 1 of this report under the headings "Regulatory Developments" and "Supervision and Regulation," in Item 7 of this report under the heading "Capital Resources" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition" and in Item 8 of this report in Notes 1 and 18 to the Consolidated Financial Statements, and is here incorporated by reference.

The market price of our common stock can be volatile, which may make it more difficult to resell our common stock at a desired time and price.

Stock price volatility may make it more difficult for a shareholder to resell our common stock when a shareholder wants to and at prices a shareholder finds attractive or at all. Our stock price can fluctuate significantly in response to a variety of factors, regardless of operating results. These factors include, among other things:

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Variations in our anticipated or actual operating results or the results of our competitors;
Changes in investors' or analysts' perceptions of the risks and conditions of our business;
The size of the public float of our common stock;
Regulatory developments;
Interest rate changes or credit loss trends;
Trading volume in our common stock;
Market conditions; and
General economic conditions.

We may issue additional shares of our common stock in the future, which could dilute a shareholder's ownership of common stock.

Our articles of incorporation authorize our Board of Directors, without shareholder approval, to, among other things, issue additional shares of common or preferred stock. The issuance of any additional shares of common or preferred stock could be dilutive to a shareholder's ownership of Company common stock. To the extent that we issue options or warrants to purchase common stock in the future and the options or warrants are exercised, our shareholders may experience further dilution. Holders of shares of our common stock have no preemptive rights that entitle holders to purchase their pro rata share of any offering of shares of any class or series and, therefore, shareholders may not be permitted to invest in future issuances of our common or preferred stock.

Because of our capital requirements, we may find it necessary to sell common stock to raise capital under circumstances and at prices which result in extreme dilution.

Although publicly traded, our common stock has substantially less liquidity than the average liquidity of stocks listed on the NASDAQ Global Select Market.

Although our common stock is listed for trading on the NASDAQ Global Select Market, our common stock has substantially less liquidity than the average liquidity for companies listed on the NASDAQ Global Select Market. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This marketplace depends on the individual decisions of investors and general economic and market conditions over which we have no control. This limited market may affect a shareholder's ability to sell shares on short notice, and the sale of a large number of shares at one time could temporarily depress the market price of our common stock. For these reasons, our common stock should not be viewed as a short-term investment.

Our common stock is not insured by any governmental entity.

Our common stock is not a deposit account or other obligation of any bank and is not insured by the FDIC or any other governmental entity. Investment in our common stock is subject to risk, including possible loss.

We may issue debt and equity securities that are senior to our common stock as to distributions and in liquidation, which could negatively affect the value of our common stock.

We have in the past and may in the future increase its capital by entering into debt or debt-like financing or issuing debt or equity securities, which could include issuances of senior notes, subordinated notes, preferred stock or common stock. In the event of the Company's liquidation, its lenders and holders of its debt securities would receive a distribution of the Company's available assets before distributions to the holders of Company common stock. The Company's decision to incur debt and issue securities in future offerings will depend on market conditions and other factors beyond its control. The Company cannot predict or estimate the amount, timing or nature of its future offerings

and debt financings. Future offerings could reduce the value of shares of Company common stock and dilute a shareholder's interest in the Company.

Exercise of our outstanding Warrants to purchase common stock or conversion of our outstanding preferred stock could substantially dilute a shareholder's ownership of common stock.

We have issued Warrants to purchase a total of 1,478,811 shares of our common stock at an exercise price of \$9.00 per share.

We have outstanding 31,290 shares of Class A Preferred Stock, which are convertible into approximately 3,496,032 shares of our common stock at a conversion price of \$8.95 per share. We have outstanding 2,350 shares of Class B Preferred Stock, which are convertible into approximately 391,675 shares of our common stock at a conversion price of \$6.00 per share.

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Additional information about the Warrants and the preferred stock may be found in Item 8 of this report in the Notes to the Consolidated Financial Statements and is here incorporated by reference.

The exercise or conversion, in whole or in part, of these securities into shares of our common stock could substantially dilute a shareholder's ownership of common stock.

Our articles of incorporation and bylaws and Michigan laws contain certain provisions that could make a takeover more difficult.

Our articles of incorporation and bylaws, and the laws of Michigan, include provisions which are designed to provide our Board of Directors with time to consider whether a hostile takeover offer is in our best interest and the best interests of our shareholders. These provisions could discourage potential acquisition proposals and could delay or prevent a change in control. The provisions also could diminish the opportunities for a holder of our common stock to participate in tender offers, including tender offers at a price above the then-current price for our common stock. These provisions could also prevent transactions in which our shareholders might otherwise receive a premium for their shares over then current market prices, and may limit the ability of our shareholders to approve transactions that they may deem to be in their best interests.

The Michigan Business Corporation Act contains provisions intended to protect shareholders and prohibit or discourage certain types of hostile takeover activities. In addition to these provisions and the provisions of our articles of incorporation and by-laws, Federal law requires the Federal Reserve Board's approval prior to acquisition of "control" of a bank holding company. All of these provisions may have the effect of delaying or preventing a change in control at the company level without action by our shareholders, and therefore, could adversely affect the price of our common stock.

If an entity holds as little as a 5% interest in our outstanding securities, that entity could, under certain circumstances, be subject to regulation as a "bank holding company."

Any entity, including a "group" composed of natural persons, owning or controlling with the power to vote 25% or more of our outstanding securities, or 5% or more if the holder otherwise exercises a "controlling influence" over us, may be subject to regulation as a "bank holding company" in accordance with the Bank Holding Company Act of 1956, as amended (the "BHC Act"). In addition, (i) any bank holding company or foreign bank with a U.S. presence may be required to obtain the approval of the Federal Reserve Board under the BHC Act to acquire or retain 5% or more of our outstanding securities and (ii) any person not otherwise defined as a company by the BHC Act and its implementing regulations may be required to obtain the approval of the Federal Reserve Board under the Change in Bank Control Act of 1978, as amended, to acquire or retain 10% or more of our outstanding securities. Becoming a bank holding company imposes statutory and regulatory restrictions and obligations, such as providing managerial and financial strength for its bank subsidiaries. Regulation as a bank holding company could require the holder to divest all or a portion of the holder's investment in our securities or those nonbanking investments that may be deemed impermissible or incompatible with bank holding company status, such as a material investment in a company unrelated to banking.

ITEM 1B: Unresolved Staff Comments.
None.

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We own or lease facilities located in Ottawa County, Allegan County and Kent County, Michigan. Our administrative offices are located at 10753 Macatawa Drive, Holland, Michigan 49424. Our administrative offices are approximately 49,000 square feet and contain our administration, human resources, trust, loan underwriting and processing, and deposit operations. We believe our facilities are well-maintained and adequately insured. Our facilities as of February 24, 2011, were as follows:

<u>Location of Facility</u>	<u>Use</u>
10753 Macatawa Drive, Holland	Main Branch, Administrative, and Loan Processing Offices
815 E. Main Street, Zeeland	Branch Office
125 Ottawa Avenue N.W., Grand Rapid	Trust and Mortgage Offices (Leased facility)
126 Ottawa Avenue N.W., Grand Rapids	Branch Office (Leased facility)
141 E. 8th Street, Holland	Branch Office
489 Butternut Dr., Holland	Branch Office
701 Maple Avenue, Holland	Branch Office
699 E. 16th Street, Holland	Branch Office
41 N. State Street, Zeeland	Branch Office
2020 Baldwin Street, Jenison	Branch Office
6299 Lake Michigan Dr., Allendale	Branch Office
132 South Washington, Douglas	Branch Office
4758 - 136th Street, Hamilton*	Branch Office
3526 Chicago Drive, Hudsonville	Branch Office
20 E. Lakewood Blvd., Holland	Branch Office
3191 - 44th Street, S.W., Grandville	Branch Office
2261 Byron Center Avenue S.W., Byron Center	Branch Office
5271 Clyde Park Avenue, S.W., Wyoming	Branch Office and Loan Center
4590 Cascade Road, Grand Rapids	Branch Office
3177 Knapp Street, N.E., Grand Rapids	Branch Office and Loan Center
15135 Whittaker Way, Grand Haven	Branch Office and Loan Center
12415 Riley Street, Holland	Branch Office
2750 Walker N.W., Walker	Branch Office
1575 - 68th Street S.E., Grand Rapids	Branch Office
2820 - 10 Mile Road, Rockford	Branch Office
520 Baldwin Street, Jenison	Branch Office
2440 Burton Street, S.E., Grand Rapids	Branch Office
6330 28 th Street, S.E., Grand Rapids	Branch Office

ITEM 3: Legal Proceedings.

As of the date of this report, there are no material pending legal proceedings, other than routine litigation incidental to the business of banking, to which Macatawa Bank Corporation or the Bank are a party or of which any of our properties are the subject.

ITEM 4: [Reserved]

By SEC rule, Item 4 of Form 10-K has been removed and reserved.

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Our common stock is quoted on the Nasdaq Global Select Market under the symbol MCBC. High and low closing prices (as reported on the Nasdaq Global Select Market) of, and the amount of dividends declared on, our common stock for each quarter for the years ended December 31, 2010 and 2009 are set forth in the table below.

	2010			2009		
<u>Quarter</u>	<u>High</u>	<u>Low</u>	<u>Dividends Declared</u>	<u>High</u>	<u>Low</u>	<u>Dividends Declared</u>
First Quarter	\$2.08	\$1.50	\$ ---	\$3.94	\$1.70	\$ ---
Second Quarter	\$2.78	\$1.10	\$ ---	\$3.95	\$2.82	\$ ---
Third Quarter	\$1.83	\$1.12	\$ ---	\$3.07	\$2.18	\$ ---
Fourth Quarter	\$4.13	\$1.46	\$ ---	\$2.70	\$1.56	\$ ---

On February 23, 2011, there were approximately 705 owners of record and, in addition, approximately 6,828 beneficial owners of our common stock.

Information regarding our equity compensation plans may be found in Item 12 of this report and is here incorporated by reference. Information on restrictions on payments of dividends by us may be found in Item 1 of this report under the headings "Regulatory Developments" and "Supervision and Regulation," in Item 7 of this report under the heading "Capital Resources" included in "Management's Discussion and Analysis of Results of Operations and Financial Condition" and in Item 8 of this report in Notes 1 and 18 to the Consolidated Financial Statements, and is here incorporated by reference.

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The following unaudited table sets forth selected historical consolidated financial information as of and for the years ended December 31, 2010, 2009, 2008, 2007, and 2006 derived from our audited consolidated financial statements. You should read this information in conjunction with our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this report.

(Dollars in thousands, except per share data)

As of and For the Year Ended December 31

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Financial Condition					
Total assets	\$ 1,578,261	\$ 1,830,172	\$ 2,149,372	\$ 2,132,973	\$ 2,074,816
Securities	9,203	129,504	186,516	203,415	201,257
Loans	1,217,196	1,510,816	1,774,063	1,750,632	1,711,450
Deposits	1,276,620	1,416,337	1,665,761	1,523,553	1,667,557
Long term debt	42,888	42,888	41,238	41,238	41,238
Other borrowed funds	185,336	278,023	284,790	354,052	192,018
Shareholders' equity	67,842	87,991	149,213	160,625	156,849
Share Information*					
Basic earnings (loss) per common share	\$ (1.01)	\$ (3.81)	\$ (2.33)	\$.54	\$ 1.17
Diluted earnings (loss) per common share	(1.01)	(3.81)	(2.33)	.54	1.14
Book value per common share	1.96	3.10	6.91	9.47	9.19
Tangible book value per common share	1.94	3.07	6.88	7.82	7.73
Dividends per common share	\$ ---	\$ ---	\$.26	\$.51	\$.46
Dividend payout ratio	---	---	(11.16)%	94.44%	40.35%
Average dilutive common shares outstanding	17,686,362	17,449,943	17,044,893	17,305,770	17,381,120
Common shares outstanding at end of period	17,679,621	17,698,108	17,161,515	16,968,398	17,067,350
Operations					
Interest income	\$ 76,003	\$ 95,878	\$ 116,075	\$ 139,372	\$ 133,506
Interest expense	25,436	43,085	57,944	76,456	66,089
Net interest income	50,567	52,793	58,131	62,916	67,417
Provision for loan losses	22,460	74,340	37,435	15,750	7,715
Net interest income (loss) after provision					
for loan losses	28,107	(21,547)	20,696	47,166	59,702
Total noninterest income	18,023	16,697	18,144	16,098	14,177
Total noninterest expense	62,681	67,391	86,067	50,259	44,913
Income (loss) before tax	(16,551)	(72,241)	(47,227)	13,005	28,966
Federal income tax	1,303	(8,600)	(8,373)	3,736	9,135
Net income (loss)	(17,854)	(63,641)	(38,854)	9,269	19,831
Dividend declared on preferred shares	---	2,870	817	---	---
Net income (loss) available to common shares	\$ (17,854)	\$ (66,511)	\$ (39,671)	\$ 9,269	\$ 19,831
Performance Ratios					
Return on average equity	(24.99)%	(50.60)%	(24.06)%	5.63%	13.09%
Return on average assets	(1.08)	(3.16)	(1.82)	.44	1.01
Yield on average interest-earning assets	4.93	5.10	5.86	7.11	7.26
Cost on average interest-bearing liabilities	1.88	2.56	3.23	4.32	4.01

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Average net interest spread	3.05	2.54	2.63	2.79	3.25
Average net interest margin	3.28	2.82	2.94	3.21	3.67
Efficiency ratio	91.39	96.98	112.84	63.61	55.04
Capital Ratios					
Period-end equity to assets	4.30%	4.81%	6.94%	7.53%	7.56%
Average equity to average assets	4.30	6.24	7.58	7.83	7.69
Total risk-based capital ratio	9.65	9.23	11.26	10.68	10.85
(Parent)					
Credit Quality Ratios					
Allowance for loan losses to total loans	3.90%	3.62%	2.16%	1.91%	1.36%
Nonperforming assets to total assets	8.45	7.71	5.21	3.75	1.23
Net charge-offs to average loans	2.18	3.54	1.85	.32	.33

Retroactively adjusted to reflect the effect of all stock splits and dividends.

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ITEM 7: Management's Discussion and Analysis of Results of Operations and Financial Condition.

Management's discussion and analysis of results of operations and financial condition contains forward-looking statements. Please refer to the discussion of forward-looking statements at the beginning of this report.

The following section presents additional information to assess our results of operations and financial condition. This section should be read in conjunction with the consolidated financial statements and the supplemental financial data contained elsewhere in this Annual Report.

OVERVIEW

Macatawa Bank Corporation is a Michigan corporation and a registered holding company. It wholly-owns Macatawa Bank, Macatawa Statutory Trust I and Macatawa Statutory Trust II. Macatawa Bank is a Michigan chartered bank with deposit accounts insured by the FDIC. The Bank operates twenty-six branch offices and a lending and operational service facility, providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan. Macatawa Statutory Trusts I and II are grantor trusts and issued \$20.0 million each of pooled trust preferred securities. These trusts are not consolidated in our Consolidated Financial Statements. For further information regarding consolidation, see the Notes to the Consolidated Financial Statements.

At December 31, 2010, we had total assets of \$1.58 billion, total loans of \$1.22 billion, total deposits of \$1.28 billion and shareholders' equity of \$67.8 million. While we recognized a net loss of \$17.9 million for 2010, it was substantially improved compared to the prior two years, and we experienced three consecutive quarters of net income to end 2010. The weak local and national economic conditions that have persisted over the past few years contributed to the \$38.9 million and \$63.6 million of operating losses we reported during 2008 and 2009 and the \$21.1 million loss in the first quarter of 2010. The losses for each period were largely attributable to loan losses, lost interest on non-performing assets and rising costs of administering problem assets associated with the rapid increase in problem loans and other real estate assets. The results for 2009 also included a non-cash charge of \$18.0 million included in federal income tax expense associated with the establishment of a valuation allowance for deferred tax assets and the results for 2008 included non-cash, after tax impairment charges for goodwill and intangible assets of \$27 million. There will be no further negative affect on our results of operations associated with deferred tax assets or goodwill, as these assets have been written off or reserved for in their entirety.

As a result of our losses, in 2009, our Board of Directors significantly changed our strategic direction to focus on improving our internal operations and working out of our problem loans and assets. The Board of Directors has implemented additional corporate governance practices and disciplined business and banking principles, including more conservative lending principles that comply with regulatory standards. The focus of our management team turned from growth in our business to executing these disciplined business and banking procedures and policies designed to limit future losses, preserve capital and improve operational efficiencies. In addition, the Board of Directors added experienced members during the year to provide further oversight and guidance to the Company. These efforts are reflected in the results for 2010 with lower levels of chargeoffs and provision for loan losses, reductions in operating expenses and reduction in balance sheet totals resulting in improvement in our regulatory capital and liquidity ratios. As of the date of this report, the Bank was categorized as "adequately capitalized" under applicable regulatory guidelines.

During the course of the audit procedures for 2009, our independent registered accounting firm for the year ended December 31, 2009, Crowe Horwath LLP, identified certain deficiencies in our credit administration and allowance for loan loss process that we and they determined constituted a "material weakness" in internal control over financial

reporting at December 31, 2009. Also at December 31, 2009, Crowe Horwath LLP determined that there was substantial doubt about our ability to continue as a going concern. As discussed above and throughout this document, significant improvements in our processes and our financial results and financial condition occurred during the year ended December 31, 2010. We do not have substantial doubt about our ability to continue as a going concern, and our independent public accounting firm for the year ended December 31, 2010, BDO USA LLP, has issued an unqualified report on its audit of our financial statements as of and for the year ended December 31, 2010 in Item 8 of this report, and did not include a paragraph in its report expressing substantial doubt about the Company's ability to continue as a going concern. We have determined that the improved controls instituted in response to the material weakness identified at December 31, 2009 have remediated the deficiencies and have concluded that there are no material weaknesses in internal control over financial reporting at December 31, 2010. BDO USA LLP has also issued an unqualified report on its audit of our internal control over financial reporting as of December 31, 2010 in Item 9A of this report, which states that Macatawa Bank Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010.

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We have also worked closely with our regulators at the FRB, the FDIC and the OFIR to put in place improved controls and procedures. On February 22, 2010, the Bank entered into a Consent Order with the FDIC and OFIR, its primary banking regulators.

Additional information further describing changes in our business, including those in response to our recent losses and to the Consent Order, are described in detail in Item 8 of this report in Note 2 of the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Summary: Net loss available to common shares was \$17.9 million or \$1.01 loss per common share for 2010 compared to net loss of \$66.5 million or \$3.81 loss per common share for 2009.

The results for 2010 included the following: a \$2.7 million gain on the sale of our investment securities portfolio in the second quarter and a \$574,000 gain recognized on the sale of property in the fourth quarter that had been held for future expansion. The results for 2009 included the following: a non-cash charge of \$18.0 million included in federal income tax expense associated with the establishment of a valuation allowance for deferred tax assets, a \$5.5 million charge associated with the settlement of the Trade Partners lawsuit, and a \$960,000 industry-wide special FDIC assessment. These items are discussed more fully below.

The overall improvement in financial results for 2010 compared to 2009 relate primarily to the performance of the loan portfolio. The provision for loan losses was \$22.5 million for 2010 compared to \$74.3 million for 2009. Net chargeoffs of loans were down in 2010 at \$29.7 million compared to \$58.0 million in 2009. Costs associated with nonperforming assets were \$15.4 million for 2010 compared to \$11.4 million for 2009. The increase in 2010 is primarily the result of losses and writedowns of other real estate owned. Lost interest from non-performing assets was approximately \$9.8 million and \$9.1 million for 2010 and 2009. Each of these items is discussed more fully below.

More information regarding the steps designed to limit future losses including complying with the requirements of the Consent Order may be found below in this Item 7 of the report under the headings "Noninterest Expense" and "Loan Portfolio and Asset Quality", and in Item 1 of this report under the heading "Recent Business Developments."

Net Interest Income: Net interest income totaled \$50.6 million during 2010 compared to \$52.8 million during 2009.

The decrease in net interest income during 2010 compared to 2009 was due primarily to a \$349.3 million decrease in average earning assets partially offset by a 46 basis point increase in net interest income as a percentage of average interest-earning assets (i.e. "net interest margin" or "margin"). As is customary in the banking industry, interest income on tax-exempt securities is adjusted in the computation of the yield on tax-exempt securities and net interest margin using a 35% tax rate to report these items on a fully taxable equivalent basis. Average interest earning assets decreased from \$1.88 billion to \$1.54 billion from a focus on reducing credit exposure within certain segments throughout 2010, liquidity improvement and capital preservation.

The net interest margin increased to 3.28% for 2010 from 2.82% for 2009. Reduced reversals of accrued interest on loans moving to nonaccrual status resulted in approximately 4 basis points of the increase. Despite the negative impact of the sale of our securities portfolio in the second quarter of 2010, our net interest margin has continued to improve during 2010; from 3.04% in the fourth quarter of 2009 to 3.38% in the fourth quarter of 2010. The sale of the securities portfolio is discussed further in this Item 7 under the heading "Noninterest Income".

The yield on earning assets decreased 17 basis points to 4.93% for 2010 from 5.10% for 2009. The decline was from a decrease in the yield on our variable rate loan portfolio, an increase in the balance of lower yielding liquid investments and elevated average balances of non-accrual loans. The 400 basis point decline in the prime rate that occurred during 2008 continued to cause a decrease in the yield on our variable rate loan portfolio in 2010 as loans continued to mature and reprice at lower interest rates. We have chosen to hold excess investable funds in these lower yielding short-term investments to improve our balance sheet liquidity during this period of challenging economic conditions.

The primary driver of our improvement in net interest margin for 2010 was a 68 basis point decrease in our cost of funds from 2.56% for 2009 to 1.88% for 2010. Average interest bearing liabilities decreased from \$1.7 billion in 2009 to \$1.3 billion in 2010. Most of this decrease was in our highest costing sources of funds thereby accomplishing a favorable mix change in interest bearing liabilities. The largest decrease was a \$195.9 million decrease in average balances of time deposits, decreasing the cost of funds for those deposits from 3.66% in 2009 to 1.40% in 2010. Also impacting the reduction in cost of funds were reductions in the rates paid on other deposit and borrowing types in 2010 as compared to 2009.

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In 2011, the level of earning assets is expected to continue to decline due to the persistent weak economic conditions in Michigan. The continued decline in the level of earning assets may have a further negative impact on net interest income in 2011, however, we expect the pace of decline in balances to be reduced in 2011. A continued decline in the cost of funds, primarily from the repricing of term funding at lower costs, is expected to partially offset the impact of lower earning asset levels in 2011.

The following table shows an analysis of net interest margin for the years ended December 31, 2010 and 2009.

(Dollars in Thousands)	For the years ended December 31,			For the years ended December 31,		
	2010			2009		
	Average Balance	Interest Earned or Paid	Average Yield or Cost	Average Balance	Interest Earned Or Paid	Average Yield or Cost
Assets:						
Taxable securities	\$ 36,332	\$ 1,049	2.79%	\$ 105,041	\$ 4,201	4.00%
Tax-exempt securities (1)	18,137	775	6.58%	51,165	2,155	6.48%
Loans (2)	1,364,207	73,544	5.34%	1,640,307	88,713	5.35%
Federal Home Loan Bank stock	12,234	230	1.86%	12,275	353	2.84%
Federal funds sold and other short-term investments	104,236	405	0.39%	75,643	456	0.60%
Total interest earning assets (1)	1,535,146	76,003	4.93%	1,884,431	95,878	5.10%
Noninterest earning assets:						
Cash and due from banks	24,307			23,507		
Other	101,456			108,941		
Total assets	\$ 1,660,909			\$ 2,016,879		
Liabilities and Shareholders'						
Equity:						
Deposits:						
Interest bearing demand	\$ 224,843	\$ 689	0.31%	\$ 238,372	\$ 1,367	0.58%
Savings and money market accounts	315,640	1,785	0.57%	391,758	2,717	0.69%
Time deposits	534,429	14,821	1.40%	730,358	26,719	3.66%
Borrowings:						
Other borrowed funds	226,340	6,579	2.87%	275,555	10,629	3.81%
Long-term debt	41,238	1,380	3.30%	41,238	1,577	3.77%
Subordinated debt	1,650	182	11.03%	736	76	10.18%
Federal funds purchased	---	---	---%	51	---	---%
Total interest bearing liabilities	1,344,140	25,436	1.88%	1,678,068	43,085	2.56%
Noninterest bearing liabilities:						
Noninterest bearing demand accounts	238,974			202,978		
Other noninterest bearing liabilities	6,350			10,057		
Shareholders' equity	71,445			125,776		
Total liabilities and Shareholders' equity	\$ 1,660,909			\$ 2,016,879		

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Net interest income	\$ 50,567	\$ 52,793
Net interest spread (1)	3.05%	2.54%
Net interest margin (1)	3.28%	2.82%
Ratio of average interest earning assets to average interest bearing liabilities	114.21%	112.30%

- (1) Yields are presented on a tax equivalent basis using a 35% tax rate.
- (2) Loan fees of \$1.6 million and \$1.9 million 2010 and 2009 are included in interest income. Includes nonaccrual loans of approximately \$90.8 million and \$98.1 million for 2010 and 2009.

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The following table presents the dollar amount of changes in net interest income due to changes in volume and rate.

(Dollars in thousands)	For The Year Ended December 31 2010 vs 2009		
	Increase (Decrease) Due to		
	Volume	Rate	Total
Interest income			
Taxable securities	\$ (2,212)	\$ (940)	\$ (3,152)
Tax-exempt securities	(1,444)	64	(1,380)
Loans	(14,885)	(284)	(15,169)
FHLB stock	(1)	(122)	(123)
Fed funds sold and other short-term investments	139	(190)	(51)
Total interest income	\$ (18,403)	\$ (1,472)	\$ (19,875)
Interest expense			
Interest bearing demand	\$ (74)	\$ (604)	\$ (678)
Savings and money market accounts	(478)	(454)	(932)
Time deposits	(6,256)	(5,642)	(11,898)
Other borrowed funds	(1,702)	(2,348)	(4,050)
Long-term debt	---	(197)	(197)
Subordinated debt	94	12	106
Fed funds purchased	---	---	---
Total interest expense	(8,416)	(9,233)	(17,649)
Net interest income	\$ (9,987)	\$ 7,761	\$ (2,226)

Provision for Loan Losses: The provision for loan losses for 2010 was \$22.5 million compared to \$74.3 million for 2009. The reduction in provision for 2010 was partially related to decreases in net charge-offs during the past eighteen months but also due to a slowing in the decline of real estate values in 2010 on properties securing our loans compared to the previous two years. The provision for loan losses was higher in 2009 as we responded to rapid declines in real estate values due to weakness in the economy. Our response required higher levels of charge-offs which also led to a higher provision for loan losses. Net charge-offs were \$29.7 million in 2010 and \$58.0 million in 2009. The higher level of charge-offs have been mostly associated with significant declines in the value of collateral securing collateral dependent real estate loans primarily for residential land development. We are starting to see signs of stabilization of values in these portfolio segments.

In response to these elevated loan losses and the need to comply with the requirements of the Consent Order, the Board of Directors has increased the governance over the lending function and, working directly with the management team, has taken steps to reduce our exposure within certain credit concentrations, establish more conservative lending principles that comply with regulatory standards and implement new lending and compliance procedures and policies and new problem loan identification and resolution plans. More information regarding these steps may be found in this Item 7 of the report under the heading "Loan Portfolio and Asset Quality."

The ultimate amount of the loan loss provision in all periods is a byproduct of establishing our allowance for loan losses at levels believed to be adequate under our methodology for determining the adequacy of the allowance. More information about our allowance for loan losses and our methodology for establishing its level may be found in this Item 7 of the report under the heading "Allowance for Loan Losses" below and in Item 8 of this report in Note 4 of the Consolidated Financial Statements.

Noninterest Income: Noninterest income totaled \$18.0 million in 2010 compared to \$16.7 million in 2009. Noninterest income for 2010 included \$2.7 million in gains on the sale of our investment securities portfolio and a \$574,000 gain on the sale of a property we were holding for future expansion.

Revenue from deposit services decreased \$524,000 to \$4.3 million in 2010 compared to \$4.8 million in 2009. The decline in 2010 was related primarily to decreases in non-sufficient fund fees, consistent with a decline across the entire banking industry.

Net gains on mortgage loans included gains on the sale of real estate mortgage loans to the secondary market. We sell the majority of the fixed-rate mortgage loans we originate. We do not retain the servicing rights for the loans we sell.

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A summary of net gains on mortgage loans and related volume was as follows:

(Dollars in thousands)	For The Year Ended December 31	
	2010	2009
Net gains on sales of loans	\$ 1,462	\$ 2,388
Real estate mortgage loans originated for sale	\$ 93,746	\$ 160,151
Real estate mortgage loans sold	93,338	164,321
Net gain on the sale of real estate mortgage loans as a percent of real estate mortgage loans sold ("Loan sales margin")	1.57%	1.45%

Gains on sales of loans decreased \$926,000 in 2010 to \$1.5 million compared to \$2.4 million in 2009. The low level of mortgage interest rates reached in the first quarter of 2009 and sustained throughout 2010 led to a higher level of refinancing in both periods. This favorable rate environment for mortgage refinancing and our focus on shrinking our loan portfolio and preserving capital, are the primary reasons for the increase in loans originated for sale and the resulting level of gains on sales of loans for 2009 and 2010. The 2009 volume was also positively impacted by a governmental program providing tax credits for first time home buyers. This program ended in early 2010.

We recently added a new consumer loan manager, which we anticipate will positively impact our volume of mortgage and consumer loan activity. Along with this, as mortgage rates remain low at the end of 2010, we anticipate continued elevated levels of mortgage banking income in the first part of 2011.

Trust service revenue declined \$728,000, or 19.1%, to \$3.1 million in 2010 from \$3.8 million in 2009. A challenging market for account growth and retention and general declines in customer stock portfolio values associated with the significant decline in the stock market during 2008 were the primary reasons for the decrease in trust income in each period. Our financial performance and the existence of the Consent Order may also be impacting how we are perceived in the marketplace, resulting in challenges to retain trust customers and maintain current levels of trust revenue.

ATM and debit card processing income increased \$580,000 in 2010 to \$3.8 million compared to \$3.2 million in 2009. The increase reflected a continued increase in usage from current customers and overall growth in the number of debit and ATM card customers. Promotional efforts to increase volume in these low cost transaction alternatives continued to be successful.

During the second quarter of 2010, the sale of our securities portfolio resulted in a gain of \$2.7 million. We completed the disposition of nearly all of the municipal, corporate and U.S. agency securities in our available-for-sale investment portfolio through sales in the open market. These securities were comprised of approximately \$46.9 million in municipal securities with an average yield of 4.15% and an average life of 3.5 years, \$5.2 million in corporate securities with an average yield of 2.94% and an average life of 2.6 years, and \$50.2 million in U.S. agency securities with an average yield of 3.84% and an average life of 1.1 years. The sales were executed as part of our overall strategy to increase our regulatory capital ratios. The majority of the proceeds have been initially invested in liquid money market balances with money center banks. We intend to ultimately reinvest the proceeds in higher yielding investment securities when market conditions improve.

Other income was \$2.7 million in 2010 compared to \$2.5 million in 2009. The amount for 2010 included a gain on the sale of a property that was held for future branch expansion. This property was sold in the fourth quarter of 2010 for a gain \$574,000. Offsetting this was a decrease in earnings from bank owned life insurance ("BOLI") which totaled \$620,000 in 2010 compared to \$1.3 million in 2009. A death benefit was realized in 2009 causing higher BOLI

income.

Noninterest Expense: Noninterest expense totaled \$62.7 million for 2010 compared to \$67.4 million for 2009.

Noninterest expense for 2009 included a \$5.5 million charge associated with the settlement of the Trade Partners lawsuit. The Trade Partners settlement is further discussed in Item 8 of this report in the Notes to the Consolidated Financial Statements in Note 17.

Costs associated with nonperforming assets continues to remain elevated, increasing \$4.0 million in 2010 to \$15.4 million compared to \$11.4 million in 2009. These costs included legal costs, repossessed and foreclosed property administration expense and losses on repossessed and foreclosed properties. Repossessed and foreclosed property administration expense included survey and appraisal, property maintenance and management and other disposition and carrying costs. Losses on

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repossessed and foreclosed properties included both net losses on the sale of properties and unrealized losses from value declines for outstanding properties.

Costs associated with nonperforming assets are itemized in the following table (in thousands):

	<u>2010</u>	<u>2009</u>
Legal and professional	\$ 2,609	\$ 1,317
Repossessed and foreclosed property administration	4,360	5,693
Losses on repossessed and foreclosed properties	8,446	4,385
	<hr/>	<hr/>
Total	\$ 15,415	\$ 11,395
	<hr/>	<hr/>

In response to the elevated problem asset levels, the related costs to administer these assets and the need to comply with the requirements of the Consent Order, the Board of Directors and management have taken tangible steps to reduce problem asset levels. These steps are discussed further in this Item 7 under the heading "Loan Portfolio and Asset Quality" below and in Item 8 of this report in Note 2 of the Consolidated Financial Statements. Because of these additional steps and as problems loans move through the collection process, these costs associated with nonperforming assets have remained elevated during 2010 and are expected to continue to be elevated in 2011.

FDIC assessments increased to \$4.7 million in 2010 compared to \$4.5 million in 2009. The FDIC assessments were high as a result of increased assessment rates implemented by the FDIC in late 2008, including additional risk-based assessments applicable to the Bank. The increase for 2009 included an industry-wide special assessment of \$960,000. We expect our FDIC assessments for 2011 to remain high as a result of these increased assessment rates. Further discussion regarding the determination of FDIC assessments for the Bank may be found in Item 1 of this report under the heading "Supervision and Regulation."

Total noninterest expense was \$62.7 million in 2010, compared to \$67.4 million in 2009. When excluding the Trade Partners litigation settlement charge in 2009 and the nonperforming asset costs and FDIC assessments for each year, other non-interest expense items were approximately \$42.6 million in 2010 compared to \$46.0 million in 2009. The steady decline in these other expense areas reflected our active management of controllable costs to offset the increases in nonperforming asset costs.

Salaries and benefit expense decreased \$2.5 million, or 10%, to \$21.9 million from \$24.3 million in 2009 due to our continued focus on operational efficiencies and continued curtailment of bonuses and wage increases in response to economic conditions. We have continued to scale down our operations with the shrinkage in size of the Bank and focus on a disciplined approach to our business. Staff reductions in the loan origination function are discussed more fully below under the heading "Loan Portfolio and Asset Quality." Salaries and benefit expense are expected to remain stable in 2011 as a result of the initiatives taken in the past two years to right size our Bank. Merit increases have again been suspended for 2011.

Occupancy expense declined \$287,000 in 2010 following a decrease of \$59,000 in 2009. Furniture and equipment expense was down \$472,000 in 2010 after a decrease of \$53,000 in 2009. Marketing and data processing expenses both declined slightly in 2010 and 2009. Other expense was down \$1.5 million in both 2010 and 2009. The declines in 2010 and 2009 within these expense areas were the direct result of initiatives to reduce controllable costs, including the curtailment of certain growth activities as a result of the difficult economic conditions that have impacted our results. In addition to eliminating or outsourcing certain backroom functions, these initiatives included restructuring third party contracts, acceleration of electronic delivery for certain customers and trimming controllable costs.

Legal and professional fees increased \$510,000 from \$1,277,000 in 2009 to \$1,787,000 in 2010. The increase was a result of additional professional time and effort with respect to regulatory filings and matters surrounding the Consent Order.

Insurance costs for bond and directors and officers ("D&O") insurance increased significantly from \$541,000 in 2009 to \$2,214,000 in 2010. Our costs increased as a result of increasing our coverage levels from 2009 and a higher rate per dollar of coverage charged due to the perceived increased risk by the insurance carrier of our coming under the Consent Order in 2010.

We expect efficiency, excluding FDIC assessments and the costs necessary to manage non-performing assets, to continue to improve in 2011 as a result of our continued expense reduction initiatives.

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Federal Income Tax Expense (Benefit): We recorded federal income tax expense of \$1.3 million in 2010 and federal income tax benefit of \$8.6 million in 2009. We recorded income tax expense of \$1.3 million for 2010 primarily related to a reclassification from other comprehensive income for gains recognized in earnings associated with the sale of our investment securities. A \$26.6 million tax benefit in 2009, primarily associated with the \$72.2 million loss before income taxes, a portion of which was able to be carried back due to a tax law change, was offset by the need to establish an \$18.0 million valuation allowance on the net deferred tax assets. A valuation allowance has been maintained on our deferred tax assets each reporting period since then. The realization of deferred tax assets (net of a recorded valuation allowance) is largely dependent upon future taxable income, future reversals of existing taxable temporary differences and the ability to carry-back losses to available tax years. In assessing the need for a valuation allowance, we consider all positive and negative evidence, including taxable income in carry-back years, scheduled reversals of deferred tax liabilities, expected future taxable income and tax planning strategies. At December 31, 2010, our tax valuation allowance totaled \$25.6 million. The valuation allowance may be reversed to income in future periods to the extent that the related deferred tax assets are realized or the valuation allowance is no longer required. The realization of our deferred tax assets is largely dependent upon our ability to generate future taxable income. We returned to profitability in each of the last three quarters of 2010 and if we continue to generate consistent profitability, the need to maintain the valuation allowance will diminish. We perform an analysis each quarter as to the need to maintain the valuation allowance.

During the fourth quarter of 2009, a tax law change extended the carry-back of 2009 and 2008 net operating losses to five years from the previous two year carry-back period. As a result we recorded an \$11.4 million favorable tax benefit that reduced our net operating loss for 2009. This carry-back extension was only available to financial institutions, such as Macatawa, that did not receive capital under the U.S. Treasury's Troubled Asset Relief Program (TARP). This change allowed us to carry-back and recover the full tax benefit of our 2009 net operating loss. We received \$18.1 million in income tax refunds during 2010 as a result of this tax law change.

FINANCIAL CONDITION

Summary: Total assets were \$1.58 billion at December 31, 2010, a decrease of \$251.9 million from \$1.83 billion at December 31, 2009.

The decrease in total assets was largely from a decline of \$293.6 million in our loan portfolio due to efforts to reduce concentration in certain loan types and improve on-balance-sheet liquidity. Part of the decline in the loan portfolio was from \$29.7 million of net loan charge-offs primarily associated with valuation declines on collateral dependent real estate loans.

The reduction in assets since December 31, 2009 allowed us to reduce wholesale funding, including out-of-market deposits from brokers by \$158.4 million, and higher costing deposits. Total deposits were \$1.28 billion at December 31, 2010, down \$139.7 million, from \$1.42 billion at December 31, 2009. In addition to the decline in brokered deposits, local jumbo time deposits were down \$5.7 million.

Total shareholders' equity decreased by \$20.1 million primarily from the net loss recorded in the first quarter of 2010. Each subsequent quarter resulted in positive earnings and increases in shareholders' equity. As a result of our losses in 2008 and 2009 and the resulting decline in our shareholders' equity, the Bank's regulatory capital ratios fell below levels required to be categorized as "well capitalized" in 2009. As of the date of this report, the Bank was categorized as "adequately capitalized" under applicable regulatory guidelines. In addition, because the Bank is subject to the Consent Order, the Bank cannot be categorized as "well-capitalized," regardless of actual capital levels. As a result, the Bank cannot accept, renew or rollover any brokered deposit unless it has applied for and been granted a waiver of

this prohibition by the FDIC.

We intend to return the Bank to "well-capitalized" status and comply with the terms of the Consent Order through improved earnings, continued balance sheet management and capital raising efforts expected to be completed in 2011.

Cash and Cash Equivalents: Our cash and cash equivalents, which include federal funds sold and short-term investments, were \$236.1 million at December 31, 2010 compared to \$78.7 million at December 31, 2009. The \$157.4 million increase was primarily the result of proceeds obtained from the sale of investment securities as described more fully in this Item 7 under the heading "Noninterest Income" as well as shrinkage in our loan portfolio. We expect to maintain higher than normal balances of short term investments until conditions improve and more attractive investment opportunities emerge.

Securities: Securities decreased \$120.3 million to \$9.2 million at December 31, 2010 from \$129.5 million at December 31, 2009. The balance at December 30, 2010 primarily consisted of U.S. Treasury securities held for collateral purposes. As discussed above, the decrease was primarily associated with the sale of \$102.3 million of securities available for sale. As

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conditions improve, we expect to reinvest excess liquidity and selectively rebuild our investment portfolio to diversify our asset concentrations.

Loan Portfolio and Asset Quality: In response to the losses we have incurred and the need to comply with the requirements of the Consent Order, our Board of Directors has increased governance over the lending function and has taken tangible steps to reduce our loan portfolio, including our exposure within certain credit concentrations. More discussion regarding these steps may be found in Item 8 of this report in Note 2 of the Consolidated Financial Statements. In order to comply with the requirements of the Consent Order, we expect to continue to shrink our loan portfolio in 2011, but at a slower pace than experienced in 2010.

Our total loan portfolio decreased \$293.6 million to \$1.22 billion at December 31, 2010 from \$1.51 billion at December 31, 2009. During 2010, our commercial and industrial loans decreased \$111.9 million, commercial real estate loans declined \$126.8 million and consumer loans decreased \$54.9 million.

Our consumer residential mortgage loan portfolio, which also includes residential construction loans made to individual homeowners, comprised approximately 11% of portfolio loans at the end of 2010 and 2009, respectively. However, a large portion of the origination volume of these types of loans is sold on the secondary market with servicing released.

While we have seen a \$27.8 million decline in our consumer residential mortgage portfolio, the volume of activity in this segment remained relatively strong during 2010. Much of the decline in the residential mortgage portfolio was from customers refinancing and our subsequent sale of these loans in the secondary market. Our focus on shrinking our loan portfolio and preserving capital were the primary reasons for the reduction in these loans in 2010. Mortgage loans originated for sale were \$93.8 million in 2010 compared to \$160.2 million in 2009 and \$81.0 million in 2008. Mortgage interest rates declined in the first half of 2009, as the government responded to weak economic conditions through efforts to stimulate the residential home market. Accordingly, we experienced a significant increase in refinancing activity. As refinancing activity slowed and underwriting in the secondary markets became more stringent, volumes generally declined over the remainder of 2009 and 2010. Rates remained low during 2010 and we saw an increase in volumes in the latter part of 2010. We have not yet been required to repurchase any loans sold, however, due to market conditions many banks are being required to repurchase loans due to actual or alleged failure to strictly conform to the purchaser's purchase criteria.

Our portfolio of other consumer loans includes loans secured by personal property and home equity fixed term and line of credit loans. These types of loans decreased to \$148.1 million at December 31, 2010 from \$175.2 million at December 31, 2009 and comprised approximately 12% of our portfolio loans at the end of 2010 and 2009.

The decline in the commercial loan portfolio during 2009 and 2010 reflected the continuing weak economic conditions in West Michigan and efforts to reduce our exposure within certain credit concentrations. We focused our efforts throughout 2009 and 2010 on reducing our exposure to residential land development loans which were the source of most of our loan losses since 2008, thereby diversifying our commercial loan portfolio and improving asset quality. We have made good progress with this and we expect continued shrinkage in 2011 in our real estate portfolios.

Total commercial loans, consisting of commercial and industrial loans and commercial real estate loans, were \$933.9 million at December 31, 2010 and \$1.17 billion at December 31, 2009. This portfolio remains our largest loan segment and accounted for approximately 77% of the total loan portfolio at both December 31, 2010 and 2009. Our commercial loan portfolio is made up of loans to small and mid-sized business.

Our commercial and industrial loan portfolio decreased by \$111.9 million to \$264.7 million at December 31, 2010 and represented 28% of our commercial portfolio. The decrease was primarily from a general decline in business activity resulting from the soft economy. The commercial real estate loan portfolio declined by \$126.8 million, primarily in construction and land development loans, due to charge-offs and substantial effort to reduce exposure in these segments.

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A further breakdown of the composition of the commercial loan portfolio is shown in the table below (in thousands):

	December 31, 2010	December 31, 2009
Residential developed	\$ 46,835	\$ 85,745
Unsecured to residential developers	7,631	13,032
Vacant and unimproved	71,528	82,859
Commercial development	8,952	14,932
Residential improved	96,784	115,270
Commercial improved	355,899	403,826
Manufacturing and industrial	81,560	80,344
	<hr/>	<hr/>
Total commercial real estate loans	669,189	796,008
Commercial and industrial	264,679	376,567
	<hr/>	<hr/>
Total commercial loans	\$ 933,868	\$ 1,172,575

Of the decline in commercial real estate, \$57.6 million was from loans to residential developers, the portfolio that has caused the majority of stress within our loan portfolio. Loans to residential developers involved in the development or sale of 1-4 family residential properties were approximately \$95.7 million and \$153.3 million at December 31, 2010 and 2009.

As we entered 2010, we were focused on efforts to continue to reduce the commercial loan portfolio in order to improve our asset quality, reduce concentrations in certain loan types, maintain or improve our capital ratios and comply with the Bank's Consent Order. Initiatives intended to achieve these results are described in more detail in Item 8 of this report in Note 2 of the Consolidated Financial Statements and included the following:

- Downsized the loan origination team, including termination of loan officers whose loan portfolios included a majority of our non-performing assets.
- Curtailed the origination of residential land development loans, the portfolio primarily responsible for loan losses in 2008 and 2009.
- Established goals for the reduction of credit concentrations in the broader commercial real estate portfolio and implemented reporting requirements for accountability.
- Established individual lender scorecards which are monitored on an ongoing basis. Lenders are apprised monthly of these targets/scorecards and held accountable.

In response to the elevated levels of nonperforming assets and loans classified substandard or worse, and the need to comply with the requirements of the Consent Order, our Board of Directors took the following steps to stabilize and reduce our problem asset levels.

Realigned departments in the lending function in late 2009. The Special Asset Group responsible for the disposition of problem assets and the Credit Administration department responsible for loan policy and credit monitoring are led by recently appointed senior officers who now report directly to the Audit Committee. The Risk Management department also reports directly to the Audit Committee.

The Risk Management department is now administratively responsible for the Loan Review function and has expanded this team with senior loan review specialists to support its goal of completing an independent review of the entire commercial loan portfolio by March 31, 2011.

Certain loan officers whose loan portfolios included a majority of the our non-performing assets were terminated.

In addition, the Special Assets Group has set specific objectives and targets for the reduction in nonperforming asset levels. To accomplish these reductions, the Special Assets Group has been pursuing various strategies. These strategies include the use of troubled debt restructures for viable businesses, attachment of additional collateral where possible, active communication and workout plans with loan customers under stress and accelerated disposition strategies for certain loan types and foreclosed assets.

We made significant progress during 2010 in these efforts as demonstrated by the decrease in nonperforming loan and delinquency levels as well as the substantial decrease in net chargeoffs incurred during 2010.

When reasonable doubt exists concerning collectability of interest or principal of one of our loans, that loan is considered impaired and placed in nonaccrual status. Any interest previously accrued but not collected is reversed and charged against current earnings. Nonperforming assets are comprised of nonperforming loans, foreclosed assets and repossessed assets.

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Nonperforming loans include loans on non-accrual status and loans delinquent more than 90 days but still accruing. Foreclosed and repossessed assets include assets acquired in settlement of loans.

Nonperforming loans as of December 31, 2010 totaled \$75.4 million or 6.19% of total portfolio loans compared to \$103.9 million or 6.88% of total portfolio loans at December 31, 2009. Nonperforming loans at the end of 2010 and 2009 were primarily on nonaccrual and were considered to be either well collateralized or adequately reserved.

Nonperforming loans for the development or sale of 1-4 family residential properties were approximately \$22.1 million or 29% of total non-performing loans at December 31, 2010 compared to \$50.0 million or 49% of total non-performing loans at December 31, 2009. The remaining balance of non-performing loans at December 31, 2010 consisted of \$38.1 million of commercial real estate loans secured by non-residential real estate, \$12.2 million of commercial and industrial loans, and \$3.0 million of consumer and residential mortgage loans.

Foreclosed assets totaled \$58.0 million at December 31, 2010 compared to \$37.2 million at December 31, 2009. The increase was the result of the migration of non-performing loans secured by real estate into foreclosed assets through the foreclosure process. Of the \$58.0 million, there were 152 commercial real estate properties totaling \$49.8 million. The remaining balance was comprised of 55 residential real estate properties totaling \$8.2 million.

All properties acquired through or in lieu of foreclosure are initially transferred at their fair value less costs to sell and then evaluated for impairment after transfer using a lower of cost or market approach. Proceeds from sales of foreclosed properties were \$16.0 million, \$7.5 million and \$3.6 million for 2010, 2009 and 2008. The higher level of success in 2010 in disposing of foreclosed properties can be attributed to the concentrated efforts of the Special Assets Group, the specific goal setting of this group and the application of additional resources during 2010 to accomplish these specific goals.

Total nonperforming assets amounted to \$133.4 million or 8.45% of total assets at December 31, 2010 compared to \$141.2 million or 7.71% as of December 31, 2009.

The following table shows the composition and amount of our nonperforming assets.

(Dollars in thousands)

	<u>As of December 31</u>	
	<u>2010</u>	<u>2009</u>
Nonaccrual loans	\$ 74,761	\$ 95,725
Loans 90 days or more delinquent and still accruing	600	8,160
Total nonperforming loans (NPLs)	75,361	103,885
Foreclosed assets	57,984	37,184
Repossessed assets	50	124
Total nonperforming assets (NPAs)	133,395	141,193
Accruing restructured loans (ARLs) (1)	25,395	18,000
Total NPAs and ARLs	\$ 158,790	\$ 159,193
NPLs to total loans	6.19%	6.88%
NPAs to total assets	8.45%	7.71%

- (1) Comprised of approximately \$12.1 million and \$7.9 million of commercial loans and \$13.3 million and \$10.1 million of consumer mortgage loans as of December 31, 2010 and 2009, respectively. Interest is being accrued on these loans under their restructured terms as they are less than 90 days past due.

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Loans rated a 6 or worse per our internal risk rating system are considered substandard, doubtful or loss. Additional information regarding our internal rating system is included in Item 8 in the Notes to the Consolidated Financial Statements in Note 4 and in this Item 7 under the heading "Allowance for Loan Losses" below. Loans classified as substandard or worse were as follows at year-end (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Not classified as impaired	\$ 65,533	\$ 68,287
Classified as impaired	78,434	89,356
	<hr/>	<hr/>
Total loans classified substandard or worse	\$ 143,967	\$ 157,643
	<hr/>	<hr/>
Loans classified substandard or worse as a percent of total loans	11.83%	10.43%

At December 31, 2010, approximately \$74.8 million of the \$144.0 million of loans classified as substandard or worse were on nonaccrual status while the remaining \$69.2 million of these loans were on accrual status. Additional information regarding the Company's impaired loans may be found in Item 8 of this report under the Notes to the Consolidated Financial Statements in Note 4.

The levels of nonperforming assets and loans classified as substandard or worse remained elevated throughout 2009 and 2010 as the persistently weak economic conditions continued to impact many of our commercial loan customers. Our residential developer customers continued to be the segment impacted most severely.

The local economy remains weak as evidenced by elevated unemployment levels, though we are encouraged by recent signs of improvement in our market areas. Our levels of delinquencies and nonperforming loans decreased in the fourth quarter of 2010. As our nonperforming loans work through the collection process, we may see increases in the balance of our foreclosed assets, however, we also expect sales velocity to increase in 2011.

Allowance for Loan Losses: Determining the appropriate level of the allowance for loan losses is highly subjective. As loan losses escalated over 2008 and 2009 and then began to slow in 2010, we have had to continually re-evaluate and refine our approach to determining the allowance for loan losses. Timely identification of risk rating changes within the commercial loan portfolio is key to our process of establishing an appropriate allowance balance. The internal risk rating system is discussed below. To accomplish effective risk rating, additional efforts took place in the latter half of 2009 and throughout 2010.

In early 2010, our Loan Review function began reporting functionally to the Audit Committee. The Risk Management department is now responsible administratively for the Loan Review function and expanded this team to include a Senior Loan Review Manager and additional resources. Under our new framework, all commercial loan risk ratings are to be independently evaluated by our internal loan review function upon origination or renewal. In addition, the majority of our commercial loans are to be independently reviewed by our internal loan review function at least annually to monitor the accuracy and completeness of the watch list and all risk ratings. Also, throughout 2010, we completed our analysis of the adequacy of the allowance for loan losses on a monthly basis versus the quarterly approach previously used. These actions were intended to further strengthen our process for establishing, in a timely fashion, the amount of the allowance for loan losses that management believes to be appropriate in light of changes in the condition of our loan portfolio.

Our allowance for loan losses at December 31, 2010 was \$47.4 million compared to \$54.6 million at December 31, 2009. While the allowance for loan losses declined from December 31, 2009 to December 31, 2010, the coverage ratios have increased. Our allowance for loan losses to total portfolio loans increased from 3.62% at December 31, 2009 to 3.90% at December 31, 2010. Our allowance for loan losses as a percentage of nonperforming loans increased

from 52.58% at December 31, 2009 to 62.93% at December 31, 2010. Generally, the primary factors supporting the decline in the balance of the allowance for loan losses during 2010 was an overall decrease in the size of the total loan portfolio and a decrease in the amount of nonperforming loans.

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The following is a summary of our portfolio loan balances and changes in the allowance for loan losses and related ratios.

(Dollars in thousands)

	December 31	
	<u>2010</u>	<u>2009</u>
Portfolio Loans:		
Average daily balance of loans for the year	\$ 1,360,548	\$ 1,637,143
Amount of loans outstanding at end of period	1,217,196	1,510,816
Allowance for loan losses:		
Balance at beginning of year	\$ 54,623	\$ 38,262
Addition to allowance charged to operations	22,460	74,340
Loans charged-off:		
Real estate - construction	(9,768)	(29,237)
Real estate - mortgage	(11,499)	(17,952)
Commercial and industrial	(7,400)	(10,632)
	<u>(28,667)</u>	<u>(57,821)</u>
Total Commercial	(28,667)	(57,821)
Residential mortgage	(1,364)	(613)
Consumer	(1,806)	(1,508)
	<u>(31,837)</u>	<u>(59,942)</u>
Recoveries:		
Real estate - construction	613	142
Real estate - mortgage	663	157
Commercial and industrial	694	1,608
	<u>1,970</u>	<u>1,907</u>
Total Commercial	1,970	1,907
Residential mortgage	115	13
Consumer	95	43
	<u>2,180</u>	<u>1,963</u>
Net charge-offs	(29,657)	(57,979)
Balance at end of year	<u>\$ 47,426</u>	<u>\$ 54,623</u>
Ratios:		
Net charge-offs to average loans outstanding	2.18%	3.54%
Allowance for loan losses to loans outstanding at year end	3.90%	3.62%
Allowance for loan losses to nonperforming loans at year-end	62.93%	52.58%

Net charge-offs totaled \$29.7 million or 2.18% of average loans for 2010 compared to \$58.0 million or 3.54% of average loans for 2009. The majority of the net charge-offs in each year were largely associated with impaired real estate loans, which migrated to loss as persistent deterioration in the economy and resulting significant declines in the value of collateral securing these loans occurred throughout these years. The majority of the charge-offs in each year related to loans associated with residential land development. For these loans, cash flow to service the debt is primarily expected from sales of lots and properties that secure the loans. The pace of these sales declined markedly throughout 2009 and 2008. The reduction in charge-offs in 2010 over 2009 reflected improvements in the asset quality and financial condition of our borrowers as well as the effects of our efforts to improve identification of problem loans earlier and proactive measures taken to work with customers to right-size their loans, refinance them elsewhere or restructure their borrowings to fit their cash flow situations.

Our allowance for loan losses was maintained at a level considered appropriate based upon our monthly assessment of the probable estimated losses inherent in the loan portfolio. Our methodology for measuring the appropriate level of allowance and related provision for loan losses relies on several key elements, which include specific allowances for loans considered impaired, formula allowance for commercial loans based upon applying our loan rating system, and general allocations based on historical trends for homogeneous loan groups with similar risk characteristics.

Specific allowances are established on individually impaired credits where we believe it is probable that a loss may be incurred. Specific allowances are determined based on discounting estimated cash flows over the life of the loan or based on the fair value of collateral supporting the loan. For commercial real estate, generally appraisals are used to estimate the fair value and determine the appropriate specific allowance. Estimated selling costs are also considered in the estimate. When it becomes apparent that liquidation of the collateral is the only source of repayment, the collateral shortfall is charged off rather than carried as a specific allowance.

The formula allowance allocated to commercial loans that are not considered to be impaired is calculated by applying historical loss factors to outstanding loans based on the internal risk rating of such loans. We use a loan rating method based upon an eight point system. Loans rated a 4 or better are considered of acceptable risk. Loans rated a 5 exhibit above normal risk to the Company and warrant a greater level of attention by management. These loans are subject to on-going review and assessment

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by our Administrative Loan Committee. Loans rated a 6 or worse are considered substandard, doubtful or loss, exhibit a greater relative risk of loss to the Company based upon the rating and warrant an active workout plan administered by our Special Asset Group, as discussed above.

Loans are assigned a loss allocation factor for each loan class based principally on the loss history for each risk rating within each loan category. Commercial real estate loans are stratified and grouped by the type of real estate securing such loans for determining the loan classification category. For 2009 and the first three quarters of 2010 the loss history was based upon the latest 12 month period, as this was considered most representative within the then current economic cycle. However, given the significant improvement in our chargeoff history over the 12 month periods in late 2010, we determined that an 18 month historical period was more appropriate for the fourth quarter 2010 as heavy chargeoff months would have rolled off the 12 month period, and would have resulted in a substantially smaller overall allowance balance. Until overall levels of nonperforming loans decline over a sustained period, we believe such a reduction in the allowance balance would be premature. The historical loss allocation factor used is adjusted for consideration of significant qualitative factors that affect the collectability of the portfolio as of the analysis date. The worse the risk rating assigned to a loan category, the greater the loss allocation factor that is applied.

The qualitative factors assessed and used to adjust historical loss experience reflect our best assessment of the impact economic trends, delinquency and other problem loan trends, trends in valuations supporting underlying collateral, changes in loan portfolio concentrations and changes in internal credit administration practices have on probable losses inherent in our loan portfolio. Qualitative adjustments are inherently subjective and there can be no assurance that these adjustments have properly identified probable losses in our loan portfolio. More information regarding the subjectivity involved in determining the estimate of the allowance for loan losses may be found in this Item 7 of the report under the heading "Critical Accounting Policies and Estimates."

Groups of homogeneous loans, such as residential real estate, open- and closed-end consumer loans, etc., receive general allowance allocations based on a review of loss trends by specific loan segments. These loss allocations are then adjusted based upon past due status, and consideration for general economic and business conditions, collateral values, seasoning of the portfolios and most recent loss experience for similar pools of loans.

The following table shows the allocation of the allowance for loan losses by portfolio type at the dates indicated.

(Dollars in thousands)	As of December 31			
	<u>2010</u>		<u>2009</u>	
	<u>Allowance Amount</u>	<u>% of Each Category to Total Loans</u>	<u>Allowance Amount</u>	<u>% of Each Category to Total Loans</u>
Commercial and commercial real estate	\$ 42,011	77%	\$ 51,856	77%
Residential mortgage	2,155	11%	1,263	11%
Consumer	3,260	12%	1,504	12%
Total	\$ 47,426	100%	\$ 54,623	100%

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The components of the allowance for loan losses were as follows:

(Dollars in thousands)	As of December 31			
	<u>2010</u>		<u>2009</u>	
	<u>Balance of Loans</u>	<u>Allowance Amount</u>	<u>Balance of Loans</u>	<u>Allowance Amount</u>
Commercial and commercial real estate:				
Impaired with allowance recorded	\$ 29,915	\$ 6,910	\$ 48,298	\$ 11,354
Impaired with no allowance recorded	\$ 48,519	\$ 0	\$ 43,073	\$ 0
Loss allocation factor on non-impaired loans	855,434	35,101	1,081,204	40,502
	<u>933,868</u>	<u>42,011</u>	<u>1,172,575</u>	<u>51,856</u>
Residential mortgage and consumer:				
Reserves on residential mortgage troubled debt restructurings	13,752	458	10,536	282
Loss allocation factor	269,576	4,957	327,705	2,485
	<u>283,328</u>	<u>5,415</u>	<u>338,241</u>	<u>2,767</u>
Total	\$ 1,217,196	\$ 47,426	\$ 1,510,816	\$ 54,623

All of the impaired commercial loans at December 31, 2010 were classified as substandard or worse per our internal risk rating system. The \$13.8 million of residential mortgage troubled debt restructurings were associated with programs approved by the U.S. government during 2009 to minimize the number of consumer foreclosures. These loans involved the restructuring of terms on consumer mortgages to allow customers to mitigate foreclosure by meeting a lower loan payment requirement based upon their current cash flow. We have been active at utilizing these programs and working with our customers to reduce the risk of foreclosure. Additional information regarding impaired loans at December 31, 2010 and 2009 may be found in Item 8 of this report in the Notes to the Consolidated Financial Statements in Note 4.

The decrease in the level of the allowance for 2010 was due to decreases in net charge-offs from commercial loans, shrinkage in the overall loan portfolio during 2010 and a reduction in the level of impaired loans and related specific reserves. The decrease of \$9.8 million in reserves on commercial loans was due to a reduction of \$4.4 million in specific reserves and a \$5.4 million decrease in the loss allocation factor allowance on non-impaired loans. The decrease in the loss experience incurred during this period and a general improvement in the credit quality and the overall risk ratings of commercial loans is the primary reason for this decrease.

The general allowance for residential real estate and consumer loans was \$5.0 million at December 31, 2010 compared to \$2.5 million at December 31, 2009. The increase was largely related to increases in the historical and subjective qualitative allocations for loss experience with home equity loans which amounted to \$125.9 million of the total \$269.6 million of loans in this category. Many of these loans have sizeable first mortgages financed elsewhere. When these loans default and the underlying collateral values have decreased, our ultimate collectability becomes stressed. As a result, in 2010 we substantially increased the judgmental qualitative allocations for these loan types. Of the \$47.4 million allowance at December 31, 2010, 15.5% related to specific allocations on impaired loans, 74.0% related to the formula allowance on commercial loans and 10.5% related to general allocations for homogeneous loans.

The above allocations are not intended to imply limitations on usage of the allowance. The entire allowance is available for any loan losses without regard to loan type.

More information regarding steps to address the elevated levels of substandard, impaired and nonperforming loans, which have largely resulted in the need to increase the allowance for loan losses, may be found in this Item 7 of the report under the heading "Loan Portfolio and Asset Quality" above and in Item 8 of this report in the Notes to the Consolidated Financial Statements in Note 4.

Although we believe our allowance for loan losses has captured the losses that are probable in our portfolio as of December 31, 2010, there can be no assurance that all losses have been identified or that the allowance is sufficient. The additional efforts by management to accelerate the identification and disposition of problem assets discussed above, and the impact of the lasting economic slowdown may result in additional losses in 2011.

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Premises and Equipment: Premises and equipment totaled \$57.0 million at December 31, 2010, representing a decrease of \$4.0 million from \$61.0 million at December 31, 2009. The decline was largely from depreciation of current facilities in excess of capital additions during 2010. Also impacting the decrease was the sale of one of our properties. This property was purchased in prior years for future branch expansion but since we have slowed our overall asset growth amidst the weak economic conditions in West Michigan, we have suspended our branch expansion initiatives. We sold this property for \$2.2 million in the fourth quarter of 2010, recognizing a gain of \$574,000. When economic conditions and financial performance improve, we will assess the prospects for future branch expansion.

Deposits: Total deposits decreased \$139.7 million to \$1.28 billion at December 31, 2010, as compared to \$1.42 billion at December 31, 2009.

Because of the decline in assets during 2010, we decreased some of our higher costing deposits. The decline in deposits was primarily from a \$158.4 million decrease in out-of-market deposits generated from brokers and an \$5.7 million decrease in local jumbo time deposits. These reductions were partially offset by increases in other deposit type balances, particularly a \$52.1 million increase in institutional money market accounts. A maturity table of deposits issued through brokers may be found in Item 8 of this report in the Notes to the Consolidated Financial Statements in Note 8.

The overall declines in deposit categories noted above were partially offset by growth in balances of personal and business checking and savings accounts. These increases are particularly noteworthy considering the lack of economic expansion in Western Michigan and the intense competition for core deposit growth in our markets. We believe our growth in balances of personal and business checking and savings accounts was primarily attributable to our focus on quality customer service, the desire of customers to deal with a local bank, the convenience of our maturing branch network and the breadth and depth of our expanding and sophisticated product line.

Noninterest bearing demand accounts comprised 20% of total deposits at December 31, 2010 compared to 16% of total deposits at December 31, 2009. Part of the reason for the increase in noninterest bearing demand accounts was associated with temporary insurance programs provided for these account types by the U.S Government. Because of the generally low rates paid on interest bearing account alternatives, many of our business customers chose to keep their balances in these more liquid and insured account types. Interest bearing demand, including money market and savings accounts, comprised 45% of total deposits at December 31, 2010 compared to 41% at the end of 2009. Time accounts as a percentage of total deposits were 35% at December 31, 2010 compared to 43% at the end of 2009.

Additional information about the restrictions on the Bank's deposit gathering activities may be found in Item 8 of this report in the Notes to the Consolidated Financial Statements in Note 1 and is here incorporated by reference.

Borrowed Funds: Borrowed funds consist of advances from the Federal Home Loan Bank, securities sold under agreements to repurchase ("repo borrowings"), long-term debt associated with the issuance of trust preferred securities, subordinated debt, and federal funds purchased provided by our correspondent banks.

Borrowed funds totaled \$228.2 million at December 31, 2010, including \$185.3 million of Federal Home Loan Bank advances, \$41.2 million in long-term debt associated with trust preferred securities and, as discussed below, \$1.7 million in subordinated debt. Borrowed funds totaled \$320.9 million at December 31, 2009 including \$238.0 million of Federal Home Loan Bank advances, \$40.0 million in repo borrowings, \$41.2 million in long-term debt associated with trust preferred securities and \$1.7 million in subordinated debt.

We have exercised our right to defer interest payments on our trust preferred securities for 20 consecutive quarters or until such earlier time as is determined by further action of the Board of Directors. During the deferral period, we may not declare or pay any dividends on our common stock or preferred stock or make any payment on any outstanding debt obligations that rank equally with or junior to the trust preferred securities. Through December 31, 2010, we have deferred interest payments for five quarters. We continue to accrue interest during the deferral period.

Borrowed funds decreased during 2010 as we were able to payoff maturing borrowings with excess liquidity derived from shrinkage in assets on our balance sheet.

In connection with capital raising activities, as more fully discussed below, we issued 11% subordinated notes in the amount of \$1,650,000 during the second and third quarters of 2009. The notes are not convertible into common or preferred stock and will mature on August 31, 2017.

Table of Contents**CAPITAL RESOURCES*****Holding Company:***

Total shareholders' equity was \$67.8 million at December 31, 2010 compared to \$88.0 million at December 31, 2009. The decrease of \$20.2 million was primarily due to the \$17.9 million net loss we incurred in 2010, particularly the \$21.1 million net loss in the first quarter of 2010.

Cash dividends of \$2.9 million were declared on preferred shares during 2009. Following this, we suspended payment of cash dividends on our common and preferred stock for the remainder of 2009 and all of 2010 in an effort to preserve capital. As disclosed in Note 2 of the Consolidated Financial Statements, the Bank is subject to the Consent Order that, among other items, prohibits the Bank from declaring or paying any cash dividend without the prior written consent of its regulators. As the payment of future cash dividends by Macatawa Bank Corporation is largely dependent upon dividends received from the Bank out of its earnings, we do not expect to pay cash dividends in the near term. We expect to reassess our ability to resume the payment of dividends on our preferred and common stock if and when the Consent Order has been lifted, current levels of cash, earnings and capital are at acceptable levels and the prospects are positive for sustained economic growth and improved performance.

Additional information on restrictions on payments of dividends by us may be found in Item 1 of this report under the headings "Regulatory Developments" and "Supervision and Regulation," and in Item 8 of this report in Notes 1 and 18 to the Consolidated Financial Statements, and is here incorporated by reference.

We earlier increased our capital through the sale of \$31.3 million of Series A Preferred Stock in the fourth quarter of 2008. During second and third quarters of 2009, we increased our capital by \$5.9 million through the issuance of Series B Preferred Stock, common stock and the subordinated debt discussed above. We had no preferred or common stock issuances during 2010. For more information regarding the private offerings, see Item 8 of this report under the Notes to the Consolidated Financial Statements in Note 19.

The following table shows the Company's various consolidated capital ratios for 2010 and 2009.

As of and for the year ended December 31,	<u>2010</u>	<u>2009</u>
Average equity to average assets	4.1%	6.2%
Total risk-based capital	9.7%	9.2%
Tier 1 risk-based capital	6.9%	7.1%
Tier 1 capital to average assets	5.8%	6.0%

Capital ratios have been positively impacted by the decline in our total assets. The extent of our operating losses, however, outpaced the decline in asset levels, thereby causing an overall decline in some of our consolidated capital ratios for 2010. Approximately \$28.4 million of the \$40.0 million of trust preferred securities outstanding at December 31, 2010 qualified as Tier 1 capital. The remaining \$11.6 million qualified as Tier II capital, a component of total risk-based capital.

We have suspended payments of cash dividends on our preferred stock until further action by the Board of Directors. During the period that we do not declare and pay cash dividends on our preferred stock, we may not declare and pay cash dividends on our common stock.

Macatawa Bank:

The Bank is required to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11% under the Consent Order. We are evaluating alternatives to reach and maintain the capital levels required by the Consent Order. We have not been able to meet the timeline prescribed by the Consent

Order for reaching the required capital levels, however, our regulators have been apprised of our strategies and our capital plan and have allowed us to take additional time to execute our strategies.

We have been working toward executing our capital plan. More information regarding our plan can be found in Item 8 in Note 2 of the Consolidated Financial Statements. In early 2011, we filed a registration statement with the Securities and Exchange Commission to sell up to \$30 million of our common stock to existing shareholders in a rights offering. Despite these efforts, there can be no assurance that full compliance with the capital requirements will be achieved. See the risk factor entitled "We are not in compliance with the Consent Order. This could result in enforcement action against us."

At December 31, 2010, two of the three regulatory capital ratios for the Bank, including the tier one risk-based capital ratio and the tier one leverage capital ratio, were maintained at levels in excess of those ordinarily required to be categorized as "well

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capitalized" under applicable regulatory capital guidelines, but the Bank did not have capital at levels required by its Consent Order. At December 31, 2010, the Bank's total risk-based capital ratio of 9.68 percent was below the 10.0 percent minimum ordinarily required to be categorized as "well capitalized" and below the 11.0 percent minimum required by the Consent Order, but this ratio has improved since March 31, 2010 when it was 8.14 percent. Because the Bank is subject to the Consent Order, it cannot be categorized as "well capitalized" regardless of actual capital levels. The Bank needed \$17.2 million of additional qualifying capital to comply with the Consent Order at December 31, 2010, compared to \$43.2 million at March 31, 2010. The Bank was categorized as "adequately capitalized" at December 31, 2010.

Capital sources include, but are not limited to, additional private and public common stock offerings, preferred stock offerings and subordinated debt.

LIQUIDITY

Liquidity of Macatawa Bank: The liquidity of a financial institution reflects its ability to manage a variety of sources and uses of funds. Our Consolidated Statements of Cash Flows categorize these sources and uses into operating, investing and financing activities. We primarily focus on developing access to a variety of borrowing sources to supplement our deposit gathering activities and provide funds for growing our investment and loan portfolios. Our sources of liquidity include our borrowing capacity of \$62.6 million with the Federal Reserve Bank of Chicago's discount window, the Federal Home Loan Bank, federal funds purchased lines and other secured borrowing sources with our correspondent banks, loan payments by our borrowers, maturity and sales of our securities available for sale, growth of our deposits and deposit equivalents, federal funds sold, and the various capital resources discussed above.

Liquidity management involves the ability to meet the cash flow requirements of our customers. Our customers may be either borrowers with credit needs or depositors wanting to withdraw funds. Our liquidity management involves periodic monitoring of our assets considered to be liquid and illiquid, and our funding sources considered to be core and non-core and short-term (less than 12 months) and long-term. We have established parameters that monitor, among other items, our level of liquid assets to short-term liabilities, our level of non-core funding reliance and our level of available borrowing capacity. We have also developed a contingency funding plan to stress test our liquidity requirements arising from certain events that may trigger liquidity shortages, such as rapid loan growth in excess of normal growth levels or the loss of deposits and other funding sources under extreme circumstances.

Prior to 2008, our balance sheet size was led by loan growth. During that time, the Bank utilized brokered deposits and other wholesale funding sources to augment its local deposits within its liquidity and interest rate risk tolerances. Limits have always been placed on brokered deposit and wholesale funding exposure and monitored monthly by the ALCO Committee. We maintained a diversified wholesale funding structure and actively manage our maturing wholesale sources to reduce the risk to liquidity shortages.

In response to the volatile conditions in the national markets since 2008, we have actively pursued initiatives to further strengthen our liquidity position. The Bank has made significant progress to intentionally reduce its reliance on non-core funding sources, including brokered deposits, and is focused on achieving a non-core funding dependency ratio of below its peer group average. During 2010, we reduced our deposits generated through brokers by \$158.4 million. We also reduced other borrowed funds by \$92.7 million in this same time period, thereby shrinking non-core funding by a total of \$251.1 million during 2010. In addition, we sold our investment security portfolio in the second quarter of 2010 and reinvested the proceeds into short term investments. These activities resulted in an increase in our liquid investments of \$160.8 million. The Bank held \$173.7 million of liquid money market investments at December 31, 2010. Further declines in the loan portfolio and total assets and corresponding reductions in wholesale funding sources are planned for 2011. A maturity table of deposits issued through brokers may be found in Item 8 of this report in the Notes to the Consolidated Financial Statements in Note 9.

In addition to strategies focused on improving the liquidity of the balance sheet, the Bank's borrowing capacity from correspondent banks was approximately \$138.9 million as of December 31, 2010.

Additional information about the restrictions on the Bank's deposit gathering activities may be found in Item 1 of this report under the heading "Regulatory Developments - Deposits and Other Funding Activities," and is here incorporated by reference.

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In the normal course of business, we enter into certain contractual obligations including obligations which are considered in our overall liquidity management. The table below summarizes our significant contractual obligations at December 31, 2010.

(Dollars in thousands)	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long term debt	\$ ---	\$ ---	\$ ---	\$ 41,238
Subordinated debt	---	---	---	1,650
Time deposit maturities	317,282	99,511	31,446	---
Other borrowed funds	45,000	95,000	30,000	15,336
Total	\$ 362,282	\$ 194,511	\$ 61,446	\$ 58,224

In addition to normal loan funding, we also maintain liquidity to meet customer financing needs through unused lines of credit, unfunded loan commitments and standby letters of credit. The level and fluctuation of these commitments is also considered in our overall liquidity management. At December 31, 2010, we had a total of \$242.4 million in unused lines of credit, \$50.4 million in unfunded loan commitments and \$4.9 million in standby letters of credit.

Liquidity of Holding Company: The primary sources of liquidity for Macatawa Bank Corporation are dividends from the Bank, existing cash resources and the various capital resources discussed above. Banking regulations and the laws of the state of Michigan in which our Bank is chartered limit the amount of dividends the Bank may declare and pay to Macatawa Bank Corporation in any calendar year. Under the state law limitations, the Bank is restricted from paying dividends to Macatawa Bank Corporation until its deficit retained earnings has been restored. Throughout 2010, Macatawa Bank Corporation has not received dividends from the Bank and the Company has suspended payment of dividends on its common stock.

The Company has suspended payments of cash dividends on its preferred stock until further action by the Board of Directors. During the period that the Company does not declare and pay cash dividends on its preferred stock, it may not declare and pay cash dividends on its common stock.

The Company has exercised its right to defer interest payments on its trust preferred securities for 20 consecutive quarters or until such earlier time as is determined by further action of the Board of Directors. During the deferral period, the Company may not declare or pay any dividends on its common stock or preferred stock or make any payment on any outstanding debt obligations that rank equally with or junior to the trust preferred securities.

Additional information on restrictions on payments of dividends by us may be found in Item 1 of this report under the headings "Regulatory Developments" and "Supervision and Regulation," in this Item 7 under the heading "Capital Resources," and in Item 8 of this report in Notes 1 and 18 to the Consolidated Financial Statements, and is here incorporated by reference.

The Company's cash balance at December 31, 2010 was \$579,000. Based upon projected cash flows for 2011, the anticipated capital raise discussed above or other sources of liquidity will be necessary in order to maintain appropriate cash balances at the Company.

For information on the liquidity risks we face, see the risk factors in Item 1A of this report entitled "We are subject to liquidity risk in our operations, which could adversely affect our ability to fund various obligations," "The Bank cannot accept, renew or roll over brokered deposits without a waiver from the FDIC, which could materially adversely affect the Bank's liquidity position," and "If the condition of the Bank's loan portfolio worsens, its ability to borrow

funds from the Federal Home Loan Bank could be adversely affected, which could materially adversely affect the Bank's and the Company's liquidity position."

CRITICAL ACCOUNTING POLICIES AND ESTIMATES:

To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and future results could differ. The allowance for loan losses, other real estate owned valuation, loss contingencies and income taxes are deemed critical due to the required level of management judgment and the use of estimates, making them particularly subject to change.

Our methodology for determining the allowance for loan losses and the related provision for loan losses is described above in the "Allowance for Loan Losses" discussion. This area of accounting requires significant judgment due to the number of factors which can influence the collectability of a loan. Unanticipated changes in these factors could significantly change the level of the allowance for loan losses and the related provision for loan losses. Although, based upon our internal analysis, and in our judgment, we believe that we have provided an adequate allowance for loan losses, there can be no assurance that our analysis

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has properly identified all of the probable losses in our loan portfolio. As a result, we could record future provisions for loan losses that may be significantly different than the levels that we recorded in 2010.

Assets acquired through or instead of foreclosure, primarily other real estate owned, are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. New real estate appraisals are generally obtained at the time of foreclosure and are used to establish fair value. If fair value declines, a valuation allowance is recorded through expense. Estimating the initial and ongoing fair value of these properties involves a number of factors and judgments including holding time, costs to complete, holding costs, discount rate, absorption and other factors.

Loss contingencies are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. This, too, is an accounting area that involves significant judgment. Although, based upon our judgment, internal analysis, and consultations with legal counsel we believe that we have properly accounted for loss contingencies, future changes in the status of such contingencies could result in a significant change in the level of contingent liabilities and a related impact to operating earnings.

Our accounting for income taxes involves the valuation of deferred tax assets and liabilities primarily associated with differences in the timing of the recognition of revenues and expenses for financial reporting and tax purposes. At December 31, 2010, we had gross deferred tax assets of \$28.4 million, gross deferred tax liabilities of \$2.8 million and a valuation allowance of \$25.6 million for the entire amount of net deferred tax assets. Accounting standards require that companies assess whether a valuation allowance should be established against their deferred tax assets based on the consideration of all available evidence using a "more likely than not" standard. Based upon a number of factors, including our net operating loss in recent years and the challenging environment currently confronting banks that could negatively impact future operating results, we concluded that we needed to continue to maintain a valuation allowance during 2010 for our net deferred tax assets. Changes in tax laws, changes in tax rates, changes in ownership and our future level of earnings can impact the ultimate realization of our net deferred tax asset as well as the valuation allowance that we established.

ITEM 7A: Quantitative and Qualitative Disclosures About Market Risk.
Not Applicable.

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ITEM 8: Financial Statements and Supplementary Data.
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Macatawa Bank Corporation
Holland, Michigan

We have audited the accompanying consolidated balance sheet of Macatawa Bank Corporation as of December 31, 2010 and the related consolidated statements of income, changes in shareholder's equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Macatawa Bank Corporation at December 31, 2010, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Macatawa Bank Corporation's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 24, 2011 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

February 24, 2011

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited the accompanying consolidated balance sheet of Macatawa Bank Corporation ("the Company") as of December 31, 2009, and the related consolidated statements of operations, shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2009, and the results of its operations and its cash flows for the year ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company incurred significant net losses in 2009, primarily from higher provisions for loan losses and expenses associated with the administration and disposition of non-performing assets at its wholly owned bank subsidiary (Macatawa Bank or "the Bank"). These losses have caused the Bank's regulatory capital to fall from well capitalized to adequately capitalized, which in turn limits its ability to use certain funding sources, such as brokered deposits. As discussed in Notes 1 and 2, the Bank is under a regulatory Consent Order that requires among other items, higher levels of regulatory capital. At December 31, 2009 the Bank was below the stated regulatory capital levels and is not expected to be in compliance with the regulatory capital requirements of the Consent Order within the timeframe established under the Consent Order. Failure to reduce the level of non-performing assets, higher costs to administer and dispose of those assets and comply with the Consent Order, limitations on funding sources, and failure to comply with higher regulatory capital requirements may result in additional enforcement actions. These events raise substantial doubt about the Company's ability to continue as a going concern. Management's plans are discussed further in Note 2. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Crowe Horwath LLP

Crowe Horwath LLP

Grand Rapids, Michigan
March 30, 2010

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MACATAWA BANK CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2010 and 2009
(Dollars in thousands, except per share data)

	<u>2010</u>	<u>2009</u>
ASSETS		
Cash and due from banks	\$ 21,274	\$ 24,687
Federal funds sold and other short-term investments	214,853	54,062
	<hr/>	<hr/>
Cash and cash equivalents	236,127	78,749
Securities available for sale, at fair value	9,120	129,090
Securities held to maturity (fair value 2010 - \$83, 2009 - \$421)	83	414
Federal Home Loan Bank (FHLB) stock	11,932	12,275
Loans held for sale, at fair value	2,537	649
Total loans	1,217,196	1,510,816
Allowance for loan losses	(47,426)	(54,623)
	<hr/>	<hr/>
	1,169,770	1,456,193
Premises and equipment - net	56,988	61,015
Accrued interest receivable	3,845	6,460
Bank-owned life insurance	25,014	24,395
Other real estate owned	57,984	37,183
Other assets	4,861	23,749
	<hr/>	<hr/>
Total assets	\$ 1,578,261	\$ 1,830,172
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	\$ 255,897	\$ 221,470
Interest-bearing	1,020,723	1,194,867
	<hr/>	<hr/>
Total	1,276,620	1,416,337
Other borrowed funds	185,336	278,023
Long-term debt	41,238	41,238
Subordinated debt	1,650	1,650
Accrued expenses and other liabilities	5,575	4,933
	<hr/>	<hr/>
Total liabilities	1,510,419	1,742,181
Commitments and contingent liabilities	---	---
Shareholders' equity		
Preferred stock, no par value, 500,000 shares authorized;		
Series A Noncumulative Convertible Perpetual Preferred Stock, liquidation value of \$1,000 per share, 31,290 shares issued and outstanding	30,604	30,604
Series B Noncumulative Convertible Perpetual Preferred Stock, liquidation value of \$1,000 per share, 2,600 shares issued and outstanding	2,560	2,560
Common stock, no par value, 40,000,000 shares authorized; 17,679,621 and 17,698,108 shares issued and outstanding at December 31, 2010 and 2009, respectively	167,321	167,183
Retained deficit	(132,654)	(114,800)
Accumulated other comprehensive income	11	2,444
	<hr/>	<hr/>
Total shareholders' equity	67,842	87,991

Total liabilities and shareholders' equity	\$ 1,578,261	\$ 1,830,172
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See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2010 and 2009
(Dollars in thousands, except per share data)

	<u>2010</u>	<u>2009</u>
Interest income		
Loans, including fees	\$ 73,544	\$ 88,713
Securities		
Taxable	1,049	4,201
Tax-exempt	775	2,155
FHLB stock	230	353
Federal funds sold and other short-term investments	405	456
Total interest income	76,003	95,878
Interest expense		
Deposits	17,295	30,803
Other borrowings	6,579	10,629
Subordinated and long-term debt	1,562	1,653
Total interest expense	25,436	43,085
Net interest income	50,567	52,793
Provision for loan losses	22,460	74,340
Net interest income (loss) after provision for loan losses	28,107	(21,547)
Noninterest income		
Service charges and fees	4,252	4,776
Net gains on mortgage loans	1,462	2,388
Trust fees	3,079	3,806
ATM and debit card fees	3,789	3,209
Gain on sales of securities	2,715	---
Other	2,726	2,518
Total noninterest income	18,023	16,697
Noninterest expense		
Salaries and benefits	21,886	24,349
Occupancy of premises	4,056	4,343
Furniture and equipment	3,554	4,026
Legal and professional	1,787	1,277
Marketing and promotion	835	907
Data processing	1,260	1,844
FDIC assessment	4,706	4,495
ATM and debit card processing	1,134	1,326
Bond and D&O insurance	2,214	541
Losses on repossessed and foreclosed properties	8,475	4,568
Administration and disposition of problem assets	6,940	6,827
Trade Partners litigation settlement	---	5,533
Other	5,834	7,355
Total noninterest expenses	62,681	67,391
Income (loss) before income tax	(16,551)	(72,241)
Income tax expense (benefit)	1,303	(8,600)

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Net income (loss)	(17,854)	(63,641)
Dividends declared on preferred shares	---	2,870
Net income (loss) available to common shares	\$ (17,854)	\$ (66,511)
Basic earnings (loss) per common share	\$ (1.01)	\$ (3.81)
Diluted earnings (loss) per common share	\$ (1.01)	\$ (3.81)
Cash dividends per common share	\$ ---	\$ ---

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
 CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
 Years ended December 31, 2010 and 2009
 (Dollars in thousands, except per share data)

	Preferred Stock <u>Series A</u>	Preferred Stock <u>Series B</u>	Common <u>Stock</u>	Retained Earnings <u>(Deficit)</u>	Accumulated Other Comprehensive <u>Income (Loss)</u>	Total Shareholders' <u>Equity</u>
Balance, January 1, 2009	\$ 30,637	\$ ---	\$ 164,327	\$ (48,289)	\$ 2,538	\$ 149,213
Net loss				(63,641)		(63,641)
Other comprehensive income (loss):						
Net change in unrealized gain (loss) on securities available for sale					(94)	(94)
Comprehensive loss						(63,735)
Issued 2,600 shares of preferred stock		2,600				2,600
Preferred stock issuance costs	(33)	(40)				(73)
Stock compensation expense			519			519
Tax effect of vested stock awards			(119)			(119)
Issued 538,386 shares of common stock			1,650			1,650
Common stock warrants issued			806			806
Cash dividends declared on preferred shares				(2,870)		(2,870)
Balance, December 31, 2009	30,604	2,560	167,183	(114,800)	2,444	87,991
Net loss				(17,854)		(17,854)
Other comprehensive income (loss):						
Net change in unrealized gain (loss) on securities available for sale					(668)	(668)
Less reclassification adjustment for gains recognized in earnings, net of tax					(1,765)	(1,765)
Other comprehensive loss						(2,433)
Comprehensive loss						(20,287)
Stock compensation expense			138			138
Balance, December 31, 2010	\$ 30,604	\$ 2,560	\$ 167,321	\$ (132,654)	\$ 11	\$ 67,842

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended December 31, 2010 and 2009
(Dollars in thousands)

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities		
Net income (loss)	\$ (17,854)	\$ (63,641)
Adjustments to reconcile net income (loss) to net cash from operating activities		
Depreciation and amortization	2,956	3,693
Stock compensation expense	138	519
Stock warrant expense	---	806
Provision for loan losses	22,460	74,340
Deferred tax asset valuation allowance	---	18,020
Origination of loans for sale	(93,764)	(160,151)
Proceeds from sales of loans originated for sale	93,338	164,321
Net gains on mortgage loans	(1,462)	(2,388)
Gain on sales of securities	(2,715)	---
Gain on sale of bank property	(574)	---
Write-down of other real estate	8,277	4,348
Net (gain) loss on sale of other real estate	167	(110)
Decrease (increase) in accrued interest and other assets	22,543	(11,278)
Earnings in bank-owned life insurance	(619)	(991)
Increase (decrease) in accrued expenses and other liabilities	642	(2,499)
	<hr/>	<hr/>
Net cash from operating activities	33,533	24,989
Cash flows from investing activities		
Loan originations and payments, net	218,715	175,817
Purchases of securities available for sale	(18,985)	(17,346)
Proceeds from:		
Maturities and calls of securities available for sale	32,625	72,607
Maturities and calls of securities held to maturity	277	1,369
Sales of securities available for sale	105,553	---
Principal paydowns on securities	88	93
Redemption of FHLB stock	343	---
Sales of other real estate	16,003	7,546
Sale of bank property	2,250	---
Return of bank-owned life insurance investment benefit	---	241
Additions to premises and equipment	(620)	(800)
	<hr/>	<hr/>
Net cash from investing activities	356,249	239,527
Cash flows from financing activities		
Net increase (decrease) in deposits	(139,717)	(249,424)
Proceeds from other borrowed funds	120,000	85,000
Repayments of other borrowed funds	(212,687)	(91,767)
Proceeds from issuance of subordinated debt	---	1,650
Cash dividends paid on preferred shares	---	(3,687)
Net proceeds from issuance of preferred stock	---	2,527
Proceeds from issuance of common stock	---	1,650
	<hr/>	<hr/>
Net cash from financing activities	(232,404)	(254,051)
	<hr/>	<hr/>
Net change in cash and cash equivalents	157,378	10,465
Beginning cash and cash equivalents	78,749	68,284

Ending cash and cash equivalents	\$ 236,127	\$ 78,749
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See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
 CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)
 Years Ended December 31, 2010 and 2009
 (Dollars in thousands)

	<u>2010</u>	<u>2009</u>
Supplemental cash flow information:		
Interest paid	\$ 24,963	\$ 45,523
Income taxes paid (refunded)	(18,118)	(9,272)
Supplemental noncash disclosures:		
Transfers from loans to other real estate	45,248	29,451
Transfer from fixed assets to other real estate	1,676	---

See accompanying notes to consolidated financial statements.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Macatawa Bank Corporation ("Macatawa" or the "Company") and its wholly-owned subsidiary, Macatawa Bank (the "Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Macatawa Bank is a Michigan chartered bank with depository accounts insured by the Federal Deposit Insurance Corporation. The Bank operates 26 full service branch offices providing a full range of commercial and consumer banking and trust services in Kent County, Ottawa County, and northern Allegan County, Michigan.

The Company owns all of the common securities of Macatawa Statutory Trust I and Macatawa Statutory Trust II. These are grantor trusts that issued trust preferred securities and are discussed in a separate note. Under generally accepted accounting principles, these trusts are not consolidated into the financial statements of the Company.

Regulatory Developments:

Consent Order with Macatawa Bank and its Regulators

On February 22, 2010, Macatawa Bank Corporation's wholly-owned subsidiary, Macatawa Bank, entered into a Consent Order with the Federal Deposit Insurance Corporation ("FDIC") and the Michigan Office of Financial and Insurance Regulation ("OFIR"), the primary banking regulators of the Bank. The Bank agreed to the terms of the negotiated Consent Order without admitting or denying any charges of unsafe or unsound banking practices. The Consent Order imposes no fines or penalties on the Bank. The Consent Order will remain in effect and enforceable until it is modified, terminated, suspended, or set aside by the FDIC and the OFIR. The Consent Order, among other requirements, includes the following:

The Consent Order requires the Bank, within 90 days, to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11%. The Bank has not yet met these capital requirements. See further discussion below and in Note 2.

The Consent Order requires the Bank to charge off all assets or portions of assets classified "Loss" in the most recent FDIC Report of Examination ("ROE") that have not been previously collected or charged off. This was accomplished subsequent to the examination in October, 2009.

The Consent Order prohibits the Bank from extending additional credit to, or for the benefit of, any borrower who is already obligated to the Bank on any loan that has been charged off by the Bank, so long as the amount charged off remains uncollected. In addition, the Consent Order prohibits the Bank from extending any additional credit to a borrower who has an uncollected loan that has been classified "Substandard" or "Doubtful", unless the Bank's Board of Directors has determined that extending additional credit to the borrower is in the best interest of the Bank. The Bank has adhered with this requirement.

The Consent Order requires the Board of Directors of the Bank upon the issuance of the order and before each quarterly Report of Condition and Income to review the adequacy of the Bank's Allowance for Loan and Lease Losses ("ALLL") and make adjustments needed to provide for an adequate ALLL. The Board has adhered with this requirement.

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While the Consent Order is in effect, the Bank may not declare or pay any cash dividend without the prior written consent of the FDIC and the OFIR. The Bank did not pay dividends to the Company during 2009 or 2010. In previous periods, dividends from the Bank to the Company were primarily utilized by the Company to pay dividends on its common and preferred stock and interest on its trust preferred securities. The Company has suspended payment of dividends on common and preferred stock and has deferred interest payments on trust preferred securities.

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MACATAWA BANK CORPORATION
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Consent Order also requires the Bank and its Board of Directors to adopt and implement a variety of policies, plans, procedures and practices intended to aid in the safe and sound conduct of the Bank's business. Throughout 2010, the Bank has addressed or taken steps to address the requirements of the Consent Order.

Requirements of the Consent Order already addressed, or where steps have been taken to address, include implementing new lending and compliance policies and new problem loan identification and resolution plans, strengthening Audit Committee oversight, creating a Compliance Committee of the Board, and developing a comprehensive, board-approved action plan for Macatawa Bank to address and monitor each requirement of the Consent Order.

The Company is implementing a capital plan with various alternatives to reach and maintain the capital levels required by the Consent Order in a timely fashion. While the Company was not able to meet the timeline prescribed by the Consent Order for reaching the required capital levels, tangible progress has been made, including the filing of a registration statement in February 2011 for the issuance of common stock. Achievement of the required capital levels could be impacted, positively or negatively, as a result of certain uncertainties, including, but not limited to, earnings levels, changing economic conditions, asset quality and property values.

Written Agreement with Macatawa and its Regulator

The Company has formally entered into a Written Agreement with the Federal Reserve Bank of Chicago ("FRB"). The Written Agreement became effective on July 29, 2010, when it was executed and published by the FRB, and was assigned an effective date of July 23, 2010. Among other things, the Written Agreement provides that: (i) the Company must take appropriate steps to fully utilize its financial and managerial resources to serve as a source of strength to Macatawa Bank; (ii) the Company may not declare or pay any dividends without prior FRB approval; (iii) the Company may not take dividends or any other payment representing a reduction in capital from Macatawa Bank without prior FRB approval; (iv) the Company may not make any distributions of interest, principal or other sums on subordinated debentures or trust preferred securities without prior FRB approval; (v) the Company may not incur, increase or guarantee any debt without prior FRB approval; (vi) the Company may not purchase or redeem any shares of its stock without prior FRB approval; (vii) the Company must submit a written capital plan to the FRB within 60 days of the Written Agreement; and (viii) the Company may not appoint any new director or senior executive officer, or change the responsibilities of any senior executive officer so that the officer would assume a different senior executive officer position, without prior regulatory approval. The Company requested and received approval from the FRB to make its third and fourth quarter interest payments on its \$1.65 million in outstanding subordinated debt. Each quarter the Company requests approval from the FRB to make the next quarter's interest payment on its subordinated debt and is continuing to accrue the interest amounts due. The Company submitted a written capital plan to the FRB for approval in November 2010, but that plan has not yet been approved.

Deposit Gathering Activities

During 2009 the Bank's regulatory capital ratios fell below levels required to be categorized as "well capitalized" under applicable regulatory guidelines. In addition, because the Bank is subject to the Consent Order, the Bank cannot

be categorized as "well-capitalized," regardless of actual capital levels. As a result, the Bank is subject to the following restrictions regarding its deposit gathering activities:

Effective January 1, 2010, the interest rate paid for deposits by institutions that are categorized as less than "well capitalized" is limited to 75 basis points above the national rate for similar products unless the institution can support to the FDIC that prevailing rates in its market area exceed the national average. During the first quarter of 2010, the Company received notification from the FDIC that the prevailing rates in our market area exceeded the national average. Accordingly, the interest rates paid for deposits by the Bank are limited to 75 basis points above the average rate for similar products within our market area. Although this may impact our ability to compete for more rate sensitive deposits, we expect to continue to reduce our need to utilize rate sensitive deposits.

The Bank cannot accept, renew or rollover any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC. The Bank has not accepted or renewed brokered deposits since November of 2008. A maturity table of deposits issued through brokers is included in Note 9. The Bank expects it will be able to fund maturing brokered deposits under its current liquidity contingency program.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, fair value of intangible assets, valuation of deferred tax assets, the status of contingencies, fair value of other real estate owned and fair values of financial instruments are particularly subject to change.

Concentration of Credit Risk: Loans are granted to, and deposits are obtained from, customers primarily in the western Michigan area as described above. Substantially all loans are secured by specific items of collateral, including residential real estate, commercial real estate, commercial assets and consumer assets. Commercial real estate loans are the largest concentration, comprising 55% of total loans. Commercial and industrial loans total 22%, while residential real estate and consumer loans make up the remaining 23%. Other financial instruments, which potentially subject the Company to concentrations of credit risk, include deposit accounts in other financial institutions.

Cash Flow Reporting: Cash and cash equivalents include cash on hand, demand deposits with other financial institutions and short-term securities (securities with maturities equal to or less than 90 days and federal funds sold). Cash flows are reported net for customer loan and deposit transactions, interest-bearing time deposits with other financial institutions and short-term borrowings with maturities of 90 days or less.

Securities: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities available for sale consist of those securities which might be sold prior to maturity due to changes in interest rates, prepayment risks, yield and availability of alternative investments, liquidity needs or other factors. Securities classified as available for sale are reported at their fair value and the related unrealized holding gain or loss is reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level yield method without anticipating prepayments. Gains and losses on sales are based on the amortized cost of the security sold.

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under ASC Topic 320, *Investments - Debt and Equity Instruments*.

In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time. Management has determined that no OTTI charges were necessary during 2010, 2009 and 2008.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment. Because this stock is viewed as a long term investment, impairment is based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Loans Held for Sale: Mortgage loans originated and intended for sale in the secondary market are carried at fair value, as determined by outstanding commitments from investors. As of December 31, 2010 and 2009 these loans had a net unrealized gain of \$40,163 and \$10,170 which are reflected in their carrying value. Changes in fair value of loans held for sale are included in net gains on mortgage loans. Loans are sold servicing released; therefore no mortgage servicing right assets are established.

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MACATAWA BANK CORPORATION
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs and an allowance for loan losses.

Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income over the respective term of the loan using the level-yield method without anticipating prepayments.

Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the loan is well-secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received for loans placed on nonaccrual is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and recoveries, and decreased by charge-offs of loans. Management estimates the allowance for loan losses balance believed to be adequate based on known and inherent risks in the portfolio, past loan loss experience, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current qualitative environmental factors. The Company maintains a loss migration analysis that tracks loan losses and recoveries based on loan class as well as the loan risk grade assignment for commercial loans. At December 31, 2010, an 18 month annualized historical loss experience was used for commercial loans and a 12 month historical loss experience period was applied to residential mortgage and consumer loan portfolios. These historical loss percentages are adjusted (both upwards and downwards) for certain qualitative environmental factors, including economic trends, credit quality trends, valuation trends, concentration risk, quality of loan review, changes in personnel, external factors and other considerations.

A loan is impaired when, based on current information and events, it is believed to be probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified and for which the borrower is experiencing financial difficulties, are considered troubled

debt restructurings and classified as impaired.

Commercial and commercial real estate loans with relationship balances exceeding \$500,000 and an internal risk grading of 6 or worse are evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing interest rate or at the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment and, accordingly, they are not separately identified for impairment disclosures. Troubled debt restructurings are also considered impaired with impairment generally measured at the present value of estimated future cash flows using the loan's effective rate at inception or using the fair value of collateral, less estimated costs to sell, if repayment is expected solely from the collateral.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Foreclosed Assets: Assets acquired through or instead of loan foreclosure, primarily other real estate owned, are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed unless they add value to the property.

Premises and Equipment: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 15 years. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur and major improvements are capitalized.

Bank-Owned Life Insurance (BOLI): The Bank has purchased life insurance policies on certain officers. Bank-owned life insurance is recorded at its currently realizable cash surrender value. Changes in cash surrender value are recorded in other income.

Goodwill and Acquired Intangible Assets: Goodwill resulting from business combinations represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. The Company had no goodwill at December 31, 2010 and 2009.

Acquired intangible assets consist of core deposit and customer relationship intangible assets arising from acquisitions. They are initially measured at fair value and then are amortized on an accelerated method over their estimated useful lives, which range from ten to sixteen years.

Long-term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Mortgage Banking Derivatives: Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as derivatives not qualifying for hedge accounting. Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. At times, the Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into, in order to hedge the change in interest rates resulting from its commitments to fund the loans. During 2010, the Company did not use forward commitments, but instead entered into best efforts agreements. Changes in the fair values of these interest rate lock and forward commitment derivatives are included in net gains on mortgage loans. The net fair value of mortgage banking derivatives was approximately (\$126,674) and (\$9,000) at December 31, 2010 and 2009.

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MACATAWA BANK CORPORATION
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes: Income tax expense is the sum of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax consequences of temporary differences between the carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

The Company recognizes a tax position as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Earnings Per Common Share: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. All outstanding unvested restricted stock awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock options and the conversion of the Company's convertible preferred stock.

Comprehensive Income (Loss): Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale.

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

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank of \$2,386,000 at December 31, 2010 was required to meet regulatory reserve and clearing requirements.

Stock Splits and Dividends: Stock dividends in excess of 20% are reported by transferring the par value of the stock issued from retained earnings to common stock. Stock dividends for 20% or less are reported by transferring the fair value, as of the ex-dividend date, of the stock issued from retained earnings to common stock and additional paid-in capital. Fractional share amounts are paid in cash with a reduction in retained earnings. All share and per share amounts are retroactively adjusted for stock splits and dividends.

Dividend Restriction: Banking regulations and the Consent Order require maintaining certain capital levels and impose limitations on dividends paid by the Bank to the Company and by the Company to shareholders. This is discussed further in this Note 1 under "Regulatory Developments" above and elsewhere in the Notes to the Consolidated Financial Statements.

Fair Values of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed separately. Fair value estimates involve uncertainties and

matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on-and off-balance sheet financial instruments do not include the value of anticipated future business or the values of assets and liabilities not considered financial instruments.

Segment Reporting: The Company, through the branch network of the Bank, provides a broad range of financial services to individuals and companies in western Michigan. These services include demand, time and savings deposits; lending; ATM and debit card processing; cash management; and trust and brokerage services. While the Company's management team monitors the revenue streams of the various Company products and services, operations are managed and financial performance is evaluated on a Company-wide basis. Accordingly, all of the Company's banking operations are considered by management to be aggregated in one reportable operating segment - commercial banking.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation.

Adoption of New Accounting Standards:

In July 2010, FASB issued ASU No. 2010-20, *Receivables (Topic 310): Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. The ASU amends FASB Accounting Standards Codification™ Topic 310, *Receivables*, to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate, by portfolio segment or class of financing receivable, certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010 and have been added to Note 4. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010.

In December 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") ASU 2009-16, *Accounting for Transfers of Financial Assets*. This standard amends the guidance on accounting for transfers of financial assets, including securitization transactions, where entities have continued exposure to risks related to transferred financial assets. This standard also expands the disclosure requirements for such transactions. It is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The adoption of this standard on January 1, 2010 had no impact on our results of operations or financial position.

Newly Issued Not Yet Effective Standards:

The FASB has issued ASU 2010-29, *Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations*. This ASU reflects the decision reached in EITF Issue No. 10-G. The amendments in this ASU affect any public entity as defined by Topic 805, *Business Combinations*, that enters into business combinations that are material on an individual or aggregate basis. The amendments in this ASU specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted.

In January 2010, the FASB issued ASU 2010-06, *Improving Disclosure about Fair Value Measurements*. This standard requires new disclosures on the amount and reason for transfers in and out of Level 1 and Level 2 recurring fair value measurements. The standard also requires disclosure of activities (i.e., on a gross basis), including purchases, sales, issuances, and settlements, in the reconciliation of Level 3 fair value recurring measurements. The

standard clarifies existing disclosure requirements on levels of disaggregation and disclosures about inputs and valuation techniques. The new disclosures regarding Level 1 and Level 2 fair value measurements and clarification of existing disclosures are effective for periods beginning after December 15, 2009. The disclosures about the reconciliation of information in Level 3 recurring fair value measurements are required for periods beginning after December 15, 2010. Adoption of the applicable portions of this standard on January 1, 2010 did not have a significant impact on our quarterly disclosures. For those additional disclosures required for fiscal years beginning after December 15, 2010, we anticipate first including those disclosures in our Form 10-Q for the quarter ending March 31, 2011.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The FASB has issued ASU No. 2010-28, *Intangibles - Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts*. This ASU reflects the decision reached in EITF Issue No. 10-A. The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. Early adoption is not permitted.

NOTE 2 - PLANS TO ADDRESS RECENT LOSSES

The Company recorded net losses to common shareholders of \$66.5 million in 2009 and \$39.7 million in 2008. These results were largely due to losses from the loan portfolio. During 2009 and 2008 the Company recorded provisions for loan losses of \$74.3 million and \$37.4 million, respectively. Total nonperforming assets amounted to \$141.2 million at December 31, 2009 compared to \$112.1 million as of December 31, 2008. The levels of nonperforming assets remained elevated throughout 2009 as the persistently weak economic conditions continued to impact many of the Company's commercial loan customers. The Company's residential developer customers continued to be the segment impacted most severely. The local economy remains weak as evidenced by elevated unemployment levels.

Other items impacting the 2009 and 2008 results included an \$18.0 million charge in 2009 to establish a valuation allowance on the entire balance of the Company's deferred tax assets and a \$27.6 million charge in 2008 to record goodwill impairment, after which no goodwill remained on the Company's balance sheet.

As a result of losses during 2009 and 2008 and the level of non-performing assets, the Board of Directors of the Company has significantly changed the strategic direction and focus of the Bank to improve its internal operations and to work out of its problem loans and assets. During the fourth quarter of 2009, the Board of Directors elected a new Chairman of the Board. The Company has since worked closely with its regulators at the FRB and the Bank's regulators at the FDIC and OFIR to put in place improved controls and procedures. The Board has implemented additional corporate governance practices and disciplined business and banking principles, including additional Board oversight, specific plans to reduce substandard assets and credit concentrations, more conservative lending principles that comply with regulatory standards, and appointed experienced and disciplined lending and compliance personnel. The focus of our management team turned from growth in our business to executing these disciplined business and banking procedures and policies designed to limit future losses, preserve capital and improve operational efficiencies.

Meaningful progress was made in 2010 with the Company ending the year with three consecutive profitable quarters. Net loss for the year was \$17.9 million compared to \$66.5 million in 2009. This improvement was driven by decreases in net loan charge-offs and provision for loan losses. For 2010, net charge-offs were \$29.7 million, down from \$58.0 million in 2009. The resulting provision for loan losses was down to \$22.5 million in 2010 compared to \$74.3 million

in 2009.

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MACATAWA BANK CORPORATION
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NOTE 2 - PLANS TO ADDRESS RECENT LOSSES (Continued)

In addition, the following table further highlights asset quality results achieved in 2010:

(in millions)	Quarter Ended December 31, <u>2010</u>	Quarter Ended September 30, <u>2010</u>	Quarter Ended June 30, <u>2010</u>	Quarter Ended March 31, <u>2010</u>	Quarter Ended December 31, <u>2009</u>
Commercial loans	\$ 933.9	\$ 973.6	\$ 1,047.4	\$ 1,112.6	\$ 1,210.4
Nonperforming loans	75.4	84.4	95.1	102.5	103.9
Other real estate owned and repo assets	58.0	54.1	48.8	45.9	37.3
Total nonperforming assets	133.4	138.6	143.8	148.4	141.2
Net chargeoffs	5.2	4.6	6.3	13.6	15.0
Total delinquencies	55.7	81.1	94.2	124.8	118.6

As discussed in Note 1, On February 22, 2010 Macatawa Bank entered into a Consent Order with the FDIC and OFIR. The Consent Order covers various aspects of the Bank's financial condition and performance; loan administration; and capital planning as outlined in Note 1. The Bank has already addressed or taken steps to address the requirements of the Consent Order and manages its comprehensive plan to address all of the requirements of the Consent Order. We believe we have complied with all the provisions of the Consent Order, except with respect to the capital requirements.

The Consent Order required the Bank, within 90 days, to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11%. At December 31, 2010, the Bank's Tier 1 Leverage Ratio was 7.1% and the Total Risk Based Ratio was 9.7%, which would qualify the Bank as "adequately capitalized" under the regulatory capital standards absent the Consent Order. The Bank would need a capital injection of approximately \$13.9 million as of December 31, 2010 in order to comply with the Tier 1 Ratio requirement and would need a capital injection of approximately \$17.2 million in order to comply with the Total Risk Based Ratio requirement of the Consent Order.

The Company has developed a capital plan including evaluation of alternatives to reach and maintain the capital levels required by the Consent Order. Achievement of these capital levels could be impacted, positively or negatively, by certain uncertainties, including, but not limited to, earnings levels, changing economic conditions, asset quality, property values and the receptiveness of capital markets to new capital offerings of Macatawa.

Strategies to increase the Bank's regulatory capital ratios in order to comply with the capital requirements of the Consent Order include reducing operating costs, shrinking assets of the Bank without weakening its liquidity position, preserving capital through suspension of dividends, and raising additional capital. Following is more information regarding these strategies:

Earnings improvements. Steps to reduce expenses have already resulted in the removal of approximately \$9 million from the Bank's annualized operating costs. The reduction in wholesale funding has improved the Bank's net interest margin in 2010, improving its capacity to generate net interest income and enhancing franchise value. The Company was profitable in the last three quarters of 2010.

Suspension of dividends: The Bank did not pay dividends to the Company during 2009 and 2010. In previous periods, dividends from the Bank to the Company were primarily utilized by the Company to pay dividends on its common and preferred stock and

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interest on its trust preferred securities. To preserve Bank regulatory capital, the Company has suspended payment of dividends on common and preferred stock and has deferred interest payments on trust preferred securities. The Company has the option to defer these interest payments for up to 20 consecutive quarters.

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MACATAWA BANK CORPORATION
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NOTE 2 - PLANS TO ADDRESS RECENT LOSSES (Continued)

Asset Reduction. Total assets were reduced by \$319.2 million to \$1.83 billion at December 31, 2009, from \$2.15 billion at December 31, 2008. In 2010, total assets declined an additional \$251.9 million to \$1.58 billion. The decrease in total assets was largely from a reduction of \$263.2 million in 2009 and \$293.6 million in 2010 in the Company's loan portfolio from efforts to reduce concentration in certain loan types. A \$57.0 million decline in investment securities in 2009 and \$120.3 million in 2010 also contributed to the decline in total assets. We implemented a concentration reduction plan to measure and monitor concentrations of credit on an ongoing basis. Execution of that plan included curtailing the origination of residential land development loans, the portfolio primarily responsible for loan losses since 2008. Increased emphasis has been placed on obtaining updated property valuations and "right- sizing" of loan balances either through pay downs or by obtaining additional collateral in order to protect the Bank. Further asset reductions in these areas are expected in 2011 as we continue to execute this plan. The reductions in assets in 2010 were achieved while improving the Company's liquidity. Liquid assets to short term liabilities improved from 9.10% at December 31, 2009 to 20.50% at December 31, 2010.

Capital Raising. The Company earlier increased its capital through the sale of \$31.3 million of Series A Preferred Stock in the fourth quarter of 2008. During second and third quarters of 2009, the Company increased its capital by \$5.9 million through the issuance of Series B Preferred Stock, common stock and the subordinated debt. See Note 19 for more information regarding these capital raises.

The Company also remains active at exploring alternatives to raise new capital. During the fourth quarter of 2009, the Company engaged an independent consulting firm to assess the risk in the Company's loan portfolio, an important step in supporting its capital planning efforts. In February 2011, the Company filed a registration statement with the Securities and Exchange Commission to issue shares of common stock in a rights offering and a public offering in order to raise equity capital.

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MACATAWA BANK CORPORATION
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NOTE 3 - SECURITIES

The amortized cost and fair value of securities at year-end were as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2010				
Available for Sale				
U.S. Treasury and federal agency securities	\$ 8,103	\$ 6	\$ ---	\$ 8,109
Other equity securities	1,000	11	---	1,011
	<u>\$ 9,103</u>	<u>\$ 17</u>	<u>\$ ---</u>	<u>\$ 9,120</u>
Held to Maturity				
State and municipal bonds	\$ 83	\$ ---	\$ ---	\$ 83
	<u>\$ 83</u>	<u>\$ ---</u>	<u>\$ ---</u>	<u>\$ 83</u>
December 31, 2009				
Available for Sale				
U.S. Treasury and federal agency securities	\$ 69,372	\$ 1,738	\$ ---	\$ 71,110
State and municipal bonds	49,711	2,055	(32)	51,734
Corporate bonds	5,247	8	(10)	5,245
Other equity securities	1,000	1	---	1,001
	<u>\$ 125,330</u>	<u>\$ 3,802</u>	<u>\$ (42)</u>	<u>\$ 129,090</u>
Held to Maturity				
State and municipal bonds	\$ 414	\$ 7	\$ ---	\$ 421
	<u>\$ 414</u>	<u>\$ 7</u>	<u>\$ ---</u>	<u>\$ 421</u>

The Company had no securities with unrealized losses at year-end 2010. Securities with unrealized losses at year-end 2009, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows (dollars in thousands):

	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
December 31, 2009						
U.S. Treasury and federal agency securities	\$ ---	\$ ---	\$ 880	\$ (32)	\$ 880	\$ (32)
State and municipal bonds	4,193	(10)	---	---	4,193	(10)
Other equity securities	---	---	---	---	---	---
	<u>\$ 4,193</u>	<u>\$ (10)</u>	<u>\$ 880</u>	<u>\$ (32)</u>	<u>\$ 5,073</u>	<u>\$ (42)</u>

Management evaluates securities for other-than-temporary impairment ("OTTI") at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. Management determined that no OTTI charges were necessary during 2010 and 2009.

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MACATAWA BANK CORPORATION
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NOTE 3 - SECURITIES (Continued)

Contractual maturities of debt securities at December 31, 2010 were as follows (dollars in thousands):

	<u>Held-to-Maturity Securities</u>		<u>Available-for-Sale Securities</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 83	\$ 83	\$ 8,008	\$ 8,010
Due from one to five years	---	---	---	---
Due from five to ten years	---	---	19	21
Due after ten years	---	---	76	78
	\$ 83	\$ 83	\$ 8,103	\$ 8,109

Proceeds from the sale of available for sale securities were \$105.6 million and \$21.7 million, resulting in gross gains of \$2.7 million for the year ended December 31, 2010. There were no sales of securities in 2009.

At December 31, 2010 and 2009, securities with a carrying value of approximately \$2,250,000 and \$8,695,000, respectively, were pledged as security for public deposits, letters of credit and for other purposes required or permitted by law. At December 31, 2010 there were no securities pledged as collateral for securities sold under agreements to repurchase. At December 31, 2009, securities with a carrying value of approximately \$44,108,000 were pledged as collateral for securities sold under agreements to repurchase and securities with a carrying value of approximately \$20,125,000 were pledged as collateral for a Federal funds borrowing facility.

NOTE 4 - LOANS

Year-end portfolio loans were as follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Commercial and industrial	\$ 264,679	\$ 376,567
Commercial real estate:		
Residential developed	46,835	85,745
Unsecured to residential developers	7,631	13,032
Vacant and unimproved	71,528	82,859
Commercial development	8,952	14,932
Residential improved	96,784	115,270
Commercial improved	355,899	403,826
Manufacturing and industrial	81,560	80,344
Total commercial real estate	669,189	796,008
Consumer		
Residential mortgage	135,227	163,074
Unsecured	2,867	4,445
Home equity	125,866	145,539
Other secured	19,368	25,183
Total consumer	283,328	338,241

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Total loans	1,217,196	1,510,816
Allowance for loan losses	(47,426)	(54,623)
	<u>\$ 1,169,770</u>	<u>\$ 1,456,193</u>

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NOTE 4 - LOANS (Continued)

Activity in the allowance for loan losses was as follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Beginning balance	\$ 54,623	\$ 38,262
Provision for loan losses	22,460	74,340
Loans charged-off	(31,837)	(59,942)
Recoveries	2,180	1,963
	<u> </u>	<u> </u>
Ending balance	\$ 47,426	\$ 54,623

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2010 (dollars in thousands):

	<u>Commercial and Industrial</u>	<u>Commercial Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
Allowance for loan losses:					
Ending allowance attributable to loans:					
Individually reviewed for impairment	\$ 1,576	\$ 5,334	\$ 458	\$ ---	\$ 7,368
Collectively evaluated for impairment	5,436	29,639	4,957	26	40,058
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total ending allowance balance	\$ 7,012	\$ 34,973	\$ 5,415	\$ 26	\$ 47,426
Loans:					
Individually reviewed for impairment	\$ 7,757	\$ 70,677	\$ 13,752	\$ ---	\$ 92,186
Collectively evaluated for impairment	256,922	598,512	269,576	---	1,125,010
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total ending loans balance	\$ 264,679	\$ 669,189	\$ 283,328	\$ ---	\$ 1,217,196

Impaired loans were as follows at year-end (dollars in thousands)

	<u>2010</u>	<u>2009</u>
Impaired commercial loans with no allocated allowance for loan losses	\$ 48,519	\$ 43,073
Impaired loans with allocated allowance for loan losses:		
Impaired commercial loans	29,915	48,298
Consumer mortgage loans modified under a troubled debt restructuring	13,752	10,536
	<u> </u>	<u> </u>
Total impaired loans	\$ 92,186	\$ 101,907
	<u> </u>	<u> </u>
Amount of the allowance for loan losses allocated	\$ 7,368	\$ 11,636

20102009

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Average of impaired loans during the period	\$	102,209	\$	100,930
Interest income recognized during impairment		1,631		2,495
Cash-basis interest income recognized		2,432		2,319

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 December 31, 2010 and 2009

NOTE 4 - LOANS (Continued)

The following table presents loans individually evaluated for impairment by class of loans as of December 31, 2010 (dollars in thousands):

	Unpaid Principal <u>Balance</u>	Recorded <u>Investment</u>	Allowance <u>Allocated</u>
With no related allowance recorded:			
Commercial and industrial	\$ 5,394	\$ 4,286	\$ ---
Commercial real estate:			
Residential developed	28,289	8,205	---
Unsecured to residential developers	315	315	---
Vacant and unimproved	6,219	5,693	---
Commercial development	3,176	1,055	---
Residential improved	4,396	4,378	---
Commercial improved	24,566	22,749	---
Manufacturing and industrial	2,239	1,838	---
	<u>69,200</u>	<u>44,233</u>	
Consumer:			
Residential mortgage	---	---	---
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	<u>---</u>	<u>---</u>	<u>---</u>
	<u>\$ 74,594</u>	<u>\$ 48,519</u>	<u>\$ ---</u>
With an allowance recorded:			
Commercial and industrial	\$ 3,517	\$ 3,470	\$ 1,576
Commercial real estate:			
Residential developed	6,373	6,373	2,402
Unsecured to residential developers	2,364	609	84
Vacant and unimproved	266	266	44
Commercial development	199	199	15
Residential improved	4,806	4,662	1,381
Commercial improved	6,710	6,172	1,096
Manufacturing and industrial	8,163	8,164	312
	<u>28,881</u>	<u>26,445</u>	<u>5,334</u>
Consumer:			
Residential mortgage	13,752	13,752	458
Unsecured	---	---	---
Home equity	---	---	---
Other secured	---	---	---
	<u>13,752</u>	<u>13,752</u>	<u>458</u>

Total	\$ 46,150	\$ 43,667	\$ 7,368
-------	-----------	-----------	----------

The Company has allocated \$1,361,000 and \$854,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2010 and 2009. These loans involved the restructuring of terms on consumer mortgages to allow customers to mitigate foreclosure by meeting a lower loan payment requirement based upon their current cash flow. The Company has been active at utilizing these programs and working with its customers to reduce the risk of foreclosure.

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MACATAWA BANK CORPORATION
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NOTE 4 - LOANS (Continued)

The following table presents the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2010:

	<u>Nonaccrual</u>	<u>Over 90 days Accruing</u>
Commercial and industrial	\$ 11,583	\$ ---
Commercial real estate:		
Residential developed	10,848	---
Unsecured to residential developers	925	390
Vacant and unimproved	7,517	---
Commercial development	1,652	---
Residential improved	9,858	---
Commercial improved	27,816	---
Manufacturing and industrial	1,570	197
	<u>60,186</u>	<u>587</u>
Consumer:		
Residential mortgage	1,830	---
Unsecured	25	---
Home equity	1,127	13
Other secured	10	---
	<u>2,992</u>	<u>13</u>
Total	<u>\$ 74,761</u>	<u>\$ 600</u>

Nonaccrual loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

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MACATAWA BANK CORPORATION
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NOTE 4 - LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans as of December 31, 2010 by class of loans (dollars in thousands):

	30-90 Days	Greater Than 90 Days	Total Past Due	Loans Not Past Due	Total
Commercial and industrial	\$ 825	\$ 5,389	\$ 6,214	\$ 258,465	\$ 264,679
Commercial real estate:					
Residential developed	438	4,568	5,006	41,829	46,835
Unsecured to residential developers	---	999	999	6,632	7,631
Vacant and unimproved	670	4,367	5,037	66,491	71,528
Commercial development	---	1,144	1,144	7,808	8,952
Residential improved	1,929	6,353	8,282	88,502	96,784
Commercial improved	901	21,440	22,341	333,558	355,899
Manufacturing and industrial	1,084	613	1,697	79,863	81,560
	<u>5,022</u>	<u>39,484</u>	<u>44,506</u>	<u>624,683</u>	<u>669,189</u>
Consumer:					
Residential mortgage	1,293	1,489	2,782	132,445	135,227
Unsecured	45	---	45	2,822	2,867
Home equity	1,207	927	2,134	123,732	125,866
Other secured	57	10	67	19,301	19,368
	<u>2,602</u>	<u>2,426</u>	<u>5,028</u>	<u>278,300</u>	<u>283,328</u>
Total	<u>\$ 8,449</u>	<u>\$ 47,299</u>	<u>\$ 55,748</u>	<u>\$ 1,161,448</u>	<u>\$ 1,217,196</u>

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 4 - LOANS (Continued)

Credit Quality Indicators: The Company categorizes loans into risk categories based on relevant information about the ability of the borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information and current economic trends, among other factors. The Company analyzes commercial loans individually and classifies these relationships by credit risk grading. The Company uses an eight point grading system, with grades 5 through 8 being considered classified, or watch, credits. All commercial loans are assigned a grade at origination, at each renewal or any amendment. When a credit is first downgraded to a watch credit (either through renewal, amendment, lender identification or the loan review process), an Administrative Loan Review ("ALR") is generated by credit and the lender. All watch credits have an ALR completed monthly which analyzes the collateral position and cash flow of the borrower and its guarantors. The lender is required to complete both a short term and long term plan to rehabilitate or exit the credit and to give monthly comments on the progress to these plans. Management meets quarterly with lenders to discuss each of these credits in detail and to help formulate solutions where progress has stalled. When necessary, the loan officer proposes changes to the assigned loan grade as part of the ALR. Additionally, Loan Review reviews all loan grades upon origination, renewal or amendment and again as loans are selected through the loan review process. The credit will stay on the ALR until either its grade has improved to a 4 or the credit relationship is at a zero balance. The Company uses the following definitions for the risk grades:

1. Excellent - Borrowings supported by extremely strong financial condition or secured by the Bank's own deposits. Minimal risk to the Bank and the probability of serious rapid financial deterioration is extremely small.
2. Above Average - Borrowings supported by sound financial statements that indicate the ability to repay or borrowings secured (and margined properly) with marketable securities. Nominal risk to the Bank and probability of serious financial deterioration is highly unlikely. The overall quality of these credits is very high.
3. Good Quality - Average borrowings supported by satisfactory asset quality and liquidity, good debt capacity coverage, and good management in all critical positions. Loans are secured by acceptable collateral with adequate margins. There is a slight risk of deterioration if adverse market conditions prevail.
4. Acceptable Risk - This is an acceptable risk to the Bank, which may be slightly below average quality. The borrower has limited financial strength with considerable leverage. There is some probability of deterioration if adverse market conditions prevail. These credits should be monitored closely by the Relationship Manager.
5. Marginally Acceptable - Loans are of marginal quality with above normal risk to the Bank. The borrower shows acceptable asset quality but very little liquidity with high leverage. There is inconsistent earning performance without the ability to sustain adverse market conditions. The primary source of repayment is questionable, but the secondary source of repayment still remains an option. Very close attention by the Relationship Manager and management is needed.

6. Substandard - Loans are inadequately protected by the net worth and paying capacity of the borrower or the collateral pledged. The primary and secondary sources of repayment are questionable. Heavy debt condition may be evident and volume and earnings deterioration may be underway. It is possible that the Bank will sustain some loss if the deficiencies are not immediately addressed and corrected.

7. Doubtful - Borrowings supported by weak or no financial statements, as well as the ability to repay the entire loan, are questionable. Loans in this category are normally characterized less than adequate collateral, insolvent, or extremely weak financial condition. A loan classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses makes collection or liquidation in full highly questionable. The possibility of loss is extremely high, however, activity may be underway to minimize the loss or maximize the recovery.

8. Loss - Loan are considered uncollectible and of little or no value as a bank asset.

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NOTE 4 - LOANS (Continued)

As of December 31, 2010, the risk grade category of loans by class of loans is as follows (dollars in thousands):

	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>	<u>8</u>
Commercial and industrial	\$ 442	\$ 1,583	\$ 51,558	\$ 148,880	\$ 41,467	\$ 9,165	\$ 11,584	\$ ---
Commercial real estate:								
Residential developed	---	---	240	6,682	14,705	14,360	10,848	---
Unsecured to residential developers	---	---	4,784	907	500	515	925	---
Vacant and unimproved	---	794	5,450	38,808	14,978	3,982	7,516	---
Commercial development	---	---	---	4,240	2,765	295	1,652	---
Residential improved	---	---	3,321	49,905	18,715	14,985	9,858	---
Commercial improved	---	---	71,622	191,772	41,490	23,199	27,816	---
Manufacturing and industrial	---	246	14,299	37,487	22,261	5,697	1,570	---
	<u>\$ 442</u>	<u>\$ 2,623</u>	<u>\$ 151,274</u>	<u>\$ 478,681</u>	<u>\$ 156,881</u>	<u>\$ 72,198</u>	<u>\$ 71,769</u>	<u>\$ ---</u>

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For consumer loan classes, the Company also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in consumer loans based on payment activity as of December 31, 2010 (dollars in thousands):

	Residential <u>Mortgage</u>	Consumer <u>Unsecured</u>	Home <u>Equity</u>	Consumer <u>Other</u>
Performing	\$ 133,738	\$ 2,867	\$ 124,939	\$ 19,358
Nonperforming	1,489	---	927	10
Total	<u>\$ 135,227</u>	<u>\$ 2,867</u>	<u>\$ 125,866</u>	<u>\$ 19,368</u>

Loans rated a 6 or worse per the Company's internal risk rating system are considered substandard, doubtful or loss. Loans classified as substandard or worse were as follows at year-end (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Not classified as impaired	65,533	68,287
Classified as impaired	78,434	89,356
Total loans classified substandard or worse	<u>\$ 143,967</u>	<u>\$ 157,643</u>

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MACATAWA BANK CORPORATION
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 December 31, 2010 and 2009

NOTE 4 - LOANS (Continued)

At December 31, 2010, approximately \$74.8 million of the \$144.0 million of loans classified as substandard or worse were on nonaccrual status, while the remaining \$69.2 million of these loans were on accrual status.

At December 31, 2009, approximately \$89.4 million of the \$157.6 million of loans classified as substandard or worse were on nonaccrual status, while the remaining \$68.2 million of these loans were on accrual status.

NOTE 5 - OTHER REAL ESTATE OWNED

Year-end other real estate owned was as follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Beginning balance	\$ 41,987	\$ 21,135
Additions, transfers from loans	45,248	29,451
Proceeds from sales of other real estate owned	(16,003)	(7,546)
Valuation allowance reversal upon sale	(2,677)	(1,163)
Gain (loss) on sale of other real estate owned	(167)	110
	<u>68,388</u>	<u>41,987</u>
Less: valuation allowance	(10,404)	(4,804)
Ending balance	<u>\$ 57,984</u>	<u>\$ 37,183</u>

Activity in the valuation allowance was as follows:

	<u>2010</u>	<u>2009</u>
Beginning balance	\$ 4,804	\$ 1,619
Additions charged to expense	8,277	4,348
Reversals upon disposition	(2,677)	(1,163)
Ending balance	<u>\$ 10,404</u>	<u>\$ 4,804</u>

Proceeds from the sale of other real estate owned totaled \$16.0 million in 2010 and \$7.5 million in 2009 resulting in net loss of \$167,000 in 2010 and net gain of \$110,000 in 2009.

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NOTE 6 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The three levels of inputs that may be used to measure fair value include:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Securities: The fair values of investment securities are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

Loans Held for Sale: The fair value of loans held for sale is based upon binding quotes from 3rd party investors (Level 2 inputs).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Other Real Estate Owned: Nonrecurring adjustments to certain commercial and residential real estate properties classified as other real estate owned (OREO) are measured at the lower of carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

Assets measured at fair value on a recurring basis are summarized below (in thousands):

Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
------------	---	---	--

December 31, 2010

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US Treasury and federal agency securities	\$ 8,109	\$ ---	\$ 8,109	\$ ---
State and municipal bonds	---	---	---	---
Corporate bonds	---	---	---	---
Other equity securities	1,011	---	1,011	---
Loans held for sale	2,537	---	2,537	---
<u>December 31, 2009</u>				
US federal agency securities	\$ 71,110	\$ ---	\$ 71,110	\$ ---
State and municipal bonds	51,734	---	51,734	---
Corporate bonds	5,245	---	5,245	---
Other equity securities	1,001	---	1,001	---
Loans held for sale	649	---	649	---

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 6 - FAIR VALUE (Continued)

Assets measured at fair value on a non-recurring basis are summarized below (in thousands):

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2010				
Impaired loans	\$ 37,173	\$ ---	\$ ---	\$ 37,173
Other real estate owned	32,262	---	---	32,262
December 31, 2009				
Impaired loans	\$ 69,141	\$ ---	\$ ---	\$ 69,141
Other real estate owned	36,660	---	---	36,660

The following represent impairment charges recognized during the period:

Impaired loans which are measured for impairment using the fair value of the collateral had a carrying amount of \$37.2 million net of a valuation allowance of \$5.6 million at December 31, 2010, resulting in an additional provision for loan losses of approximately \$409,000 for the year. Impaired loans which are measured for impairment using the fair value of the collateral had a carrying amount of \$69.1 million net of a valuation allowance of \$10.8 million at December 31, 2009, resulting in an additional provision for loan losses of approximately \$32.2 million for the year.

Other real estate owned measured using the fair value of collateral, had a carrying amount of \$32.3 million net of a valuation allowance of \$10.4 million at December 31, 2010 resulting in write-downs of approximately \$8.3 million for the year ending December 31, 2010. Other real estate owned measured using the fair value of collateral, had a carrying amount of \$36.7 million net of a valuation allowance of \$4.8 million at December 31, 2009 resulting in write-downs of approximately \$4.3 million for the year ending December 31, 2009.

Carrying amount and estimated fair value of financial instruments, not previously presented, were as follows at year-end (dollars in thousands).

	<u>2010</u>		<u>2009</u>	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	\$ 236,127	\$ 236,127	\$ 78,749	\$ 78,749
Securities held to maturity	83	83	414	421
FHLB stock	11,932	NA	12,275	NA
Loans, net	1,169,770	1,169,497	1,456,193	1,449,526
Accrued interest receivable	3,845	3,845	6,460	6,460
Financial liabilities				
Deposits	(1,276,620)	(1,280,238)	(1,416,337)	(1,423,929)
Other borrowed funds	(185,336)	(187,104)	(278,023)	(281,433)
Long-term debt	(41,238)	(34,506)	(41,238)	(34,313)
Subordinated debt	(1,650)	(1,650)	(1,650)	(1,650)
Accrued interest payable	(2,401)	(2,401)	(1,928)	(1,928)

Off-balance sheet credit-related items

Loan commitments

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MACATAWA BANK CORPORATION
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NOTE 6 - FAIR VALUE (Continued)

The methods and assumptions used to estimate fair value are described as follows.

Carrying amount is the estimated fair value for cash and cash equivalents, short-term borrowings, accrued interest receivable and payable, demand deposits, and variable rate loans or deposits that reprice frequently and fully. Security fair values are determined by matrix pricing, which is a mathematical technique widely used in the industry to value debt securities as discussed above. For fixed rate loans or deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk (including consideration of widening credit spreads). Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance-sheet credit-related items is not significant.

NOTE 7 - PREMISES AND EQUIPMENT - NET

Year-end premises and equipment were as follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Land	\$ 18,236	\$ 18,236
Building	42,368	44,063
Leasehold improvements	826	1,215
Furniture and equipment	21,309	20,960
Construction in progress	199	302
	<u>82,938</u>	<u>84,776</u>
Less accumulated depreciation	(25,950)	(23,761)
	<u>\$ 56,988</u>	<u>\$ 61,015</u>

Depreciation expense was \$2,971,000 and \$3,267,000 for 2010 and 2009.

During the fourth quarter of 2010, the Bank sold a property it held for future branch expansion in downtown Grand Rapids for \$2.2 million, recognizing a gain of \$574,000.

The Bank leases certain office and branch premises and equipment under operating lease agreements. Total rental expense for all operating leases aggregated to \$339,000 and \$345,000 for 2010 and 2009. Future minimum rental expense under noncancelable operating leases as of December 31, 2010 is as follows (dollars in thousands):

2011	\$ 278
2012	55
2013	33
Thereafter	26
	<u>\$ 392</u>

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NOTE 8 - DEPOSITS

Deposits at year-end were as follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Noninterest bearing demand	\$ 255,897	\$ 221,470
Interest bearing demand	216,827	268,011
Savings and money market accounts	355,657	308,928
Certificates of deposit	448,239	617,928
	<u>\$ 1,276,620</u>	<u>\$ 1,416,337</u>

The following table depicts the maturity distribution of certificates of deposit at December 31, 2010 (dollars in thousands):

2011	\$ 317,282
2012	88,511
2013	11,000
2014	752
2015	30,694
After	---
	<u>\$ 448,239</u>

Approximately \$192,657,000 and \$356,380,000 in certificates of deposit were in denominations of \$100,000 or more at December 31, 2010 and 2009, respectively. Brokered deposits totaled approximately \$48,172,000 and \$206,525,000 at December 31, 2010 and 2009, respectively. Since the Bank was not categorized as "well capitalized" at December 31, 2010 and 2009, regulatory waiver is required to accept, renew or rollover brokered deposits. The Bank has not issued brokered deposits since November of 2008. At December 31, 2010 and 2009, brokered deposits had interest rates ranging from 3.75% to 4.55% and 3.50% to 4.55%, respectively. At December 31, 2010, maturities of brokered deposits were as follows (in thousands):

Due in one year or less	\$ 48,172
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Additional information about the restrictions on the Bank's deposit gathering activities may be found in Note 1 under the heading "Regulatory Developments."

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MACATAWA BANK CORPORATION
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NOTE 9 - OTHER BORROWED FUNDS

Other borrowed funds include advances from the Federal Home Loan Bank, securities sold under agreements to repurchase and borrowings from the Federal Reserve Bank.

Federal Home Loan Bank Advances

At year-end, advances from the Federal Home Loan Bank were as follows (dollars in thousands):

<u>Principal Terms</u>	<u>Advance Amount</u>	<u>Range of Maturities</u>	<u>Weighted Average Interest Rate</u>
December 31, 2010			
Single maturity fixed rate advances	\$170,000	March 2011 to November 2015	1.95%
Amortizable mortgage advances	15,336	March 2018 to July 2018	3.77%
	\$185,336		

<u>Principal Terms</u>	<u>Advance Amount</u>	<u>Range of Maturities</u>	<u>Weighted Average Interest Rate</u>
December 31, 2009			
Single maturity fixed rate advances	\$195,000	January 2010 to December 2012	2.79%
Putable advances	26,000	March 2010 to December 2010	5.79%
Amortizable mortgage advances	17,023	March 2018 to July 2018	3.77%
	\$238,023		

Each advance is subject to a prepayment penalty if paid prior to its maturity date. Fixed rate advances are payable at maturity. Amortizable mortgage advances are fixed rate advances with scheduled repayments based upon amortization to maturity. Putable advances are fixed rate advances that can be changed to a variable rate at the option of the FHLB. If the FHLB exercises that option, these advances may be repaid without penalty. These advances were collateralized by residential and commercial real estate loans totaling \$420,479,000 and \$607,371,000 under a specific loan collateral arrangement at December 31, 2010 and 2009.

Scheduled repayments of FHLB advances as of December 31, 2010 were as follows (in thousands):

2011	\$ 46,733
2012	66,781
2013	31,831
2014	21,884
2015	11,938
Thereafter	6,169
	\$ 185,336

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MACATAWA BANK CORPORATION
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NOTE 9 - OTHER BORROWED FUNDS (Continued)Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase ("repo borrowings") are financing arrangements secured by U.S. federal agency securities. These borrowings were collateralized by securities with a carrying amount of approximately \$44,108,000 at December 31, 2009. At maturity, the securities underlying the arrangements are returned to the Company. The Company had no repo borrowings at December 31, 2010.

At December 31, 2009, repo borrowings were as follows (dollars in thousands):

<u>Principal Terms</u>	<u>Amount</u>	<u>Range of Maturities</u>	<u>Weighted Average Interest Rate</u>
December 31, 2009			
Fixed rate borrowings	\$40,000	March 2010 to November 2010	4.62%

Federal Reserve Bank borrowings

The Company has a financing arrangement with the Federal Reserve Bank. There were no borrowings outstanding at December 31, 2010 and 2009, and the Company had approximately \$46 million in unused borrowing capacity based on commercial and mortgage loans pledged to the Federal Reserve Bank totaling \$62.6 million at December 31, 2010.

NOTE 10 - LONG-TERM DEBT

The Company has issued \$40.0 million of pooled trust preferred securities ("Preferred Securities") through its wholly-owned subsidiary grantor trusts. Macatawa Statutory Trust I issued \$619,000 of common securities to the Company and \$20.0 million of Preferred Securities on July 15, 2003 at a floating interest rate of three-month LIBOR plus 3.05%. Macatawa Statutory Trust II issued \$619,000 of common securities and \$20.0 million of Preferred Securities on March 18, 2004 at a floating interest rate of three-month LIBOR plus 2.75%.

The Company issued subordinated debentures ("Debentures") to each trust in exchange for ownership of all of the common securities of each trust and the \$41,238,000 in proceeds of the offerings, which Debentures represent the sole asset of each trust. The Preferred Securities represent an interest in the Company's Debentures, which have terms that are similar to the Preferred Securities. The Company is not considered the primary beneficiary of each trust (variable interest entity), therefore each trust is not consolidated in the Company's financial statements, but rather the Debentures are shown as a liability.

As provided in each trust's indenture, the Preferred Securities accrue and pay distributions quarterly at a specified rate and are subject to mandatory redemption upon the maturity of the Debentures, 30 years from the date of issuance, or upon earlier redemption. The Company has the right to redeem the Debentures in whole or in part beginning five years from the date of issuance at a redemption price specified in each trust's indenture. The Debentures are also redeemable in whole or in part from time to time, upon the occurrence of specific events defined within the trust indenture.

The Company has the option to defer interest payments on the Debentures from time to time for up to twenty consecutive quarterly payments, although interest continues to accrue on the outstanding balance. On December 4, 2009, the Board of Directors of the Company resolved that the Company will exercise its right to defer interest payments on the Debentures for each trust for twenty consecutive quarterly periods or until such earlier time as is determined by further action of the Board of Directors. The Company is not in default with respect to each trust's indenture and the deferral of interest does not constitute an event of default under the indentures. Upon expiration of the deferral, all accrued and unpaid interest is due and payable. During the deferral period, the Company may not declare or pay any dividends on the Company's common stock or preferred stock or make any payment on any outstanding debt obligations that rank equally with or junior to the Debentures. There was approximately \$1.7 million of accrued and unpaid interest that was included in accrued expenses and other liabilities at December 31, 2010.

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NOTE 10 - LONG-TERM DEBT (Continued)

At December 31, 2010 and 2009, the Debentures totaling \$41,238,000 are reported in liabilities as long-term debt, and the common securities of \$1,238,000 and unamortized debt issuance costs are included in other assets. The Preferred Securities may be included in Tier I capital (with certain limitations applicable) under current regulatory guidelines and interpretations. At December 31, 2010, approximately \$22.4 million of Preferred Securities issued qualified as Tier 1 capital for regulatory capital purposes. At December 31, 2009, approximately \$28.4 million of Preferred Securities issued qualified as Tier 1 capital for regulatory capital purposes.

NOTE 11 - RELATED PARTY TRANSACTIONS

Loans to principal officers, directors, and their affiliates were as follows (dollars in thousands).

	<u>2010</u>	<u>2009</u>
Beginning balance	\$ 7,092	\$ 21,898
New loans and renewals	2,470	8,492
Repayments and renewals	(3,043)	(18,917)
Effect of changes in related parties	(5,651)	(4,381)
Ending balance	<u>\$ 868</u>	<u>\$ 7,092</u>

Deposits from principal officers, directors, and their affiliates at December 31, 2010 and 2009 were \$145.7 million and \$91.4 million, respectively. The majority of the deposit balances for each year are associated with institutional accounts of affiliated organizations of one of the Company's directors.

NOTE 12 - STOCK-BASED COMPENSATION

The Company has stock-based compensation plans for its employees (the Employees' Plans) and directors (the Directors' Plans). The Employees' Plans permit the grant of stock options or the issuance of restricted stock for up to 1,917,210 shares of common stock. The Directors' Plans permit the grant of stock options or the issuance of restricted stock for up to 473,278 shares of common stock. There were 560,284 shares under the Employees' Plans and 165,375 shares under the Directors' Plans available for future issuance as of December 31, 2010. The Company issues new shares under its stock-based compensation plans from its authorized but unissued shares.

Stock Options

Option awards are granted with an exercise price equal to the market price at the date of grant. Option awards have vesting periods ranging from one to three years and have ten year contractual terms.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not

transferable. The Company expects that all options granted will vest and become exercisable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

There were no options granted during 2010 and 2009.

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NOTE 12 - STOCK-BASED COMPENSATION (Continued)

A summary of option activity in the plans is as follows (dollars in thousands, except per option data):

<u>Options</u>	<u>Number Outstanding</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted- Average Remaining Contractual Life in Years</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at January 1, 2010	924,937	14.68		
Forfeited	(187,517)	13.43		
Expired	(14,856)	5.63		
	<u>722,564</u>	<u>15.02</u>	<u>3.92</u>	<u>\$ ---</u>
Outstanding at December 31, 2010	722,564	15.02	3.92	\$ ---
	<u>651,564</u>	<u>15.72</u>	<u>3.57</u>	<u>\$ ---</u>
Exercisable at December 31, 2010	651,564	15.72	3.57	\$ ---

Information related to stock options during each year follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Intrinsic value of options exercised	\$ ---	\$ ---
Cash received from option exercises	---	---
Tax benefit realized from option exercises	---	---

Compensation cost for stock options was \$36,000 (with no tax benefit) representing less than \$0.01 per share for 2010 and \$181,000 (with no tax benefit), representing \$0.01 per share for 2009.

As of December 31, 2010, there was no unrecognized compensation cost related to nonvested stock options granted under the Company's stock-based compensation plans.

Stock Awards

Stock awards have vesting periods of up to four years. A summary of changes in the Company's nonvested stock awards for the year follows:

<u>Nonvested Stock Awards</u>	<u>Shares</u>	<u>Weighted-Average Grant-Date Fair Value</u>
Outstanding at January 1, 2010	96,811	\$ 4.47
Vested	(41,199)	3.51
Forfeited	(18,487)	5.08
	<u>37,125</u>	<u>\$ 5.23</u>
Outstanding at December 31, 2010	37,125	\$ 5.23

Compensation cost for stock awarded in 2010 and 2009 was \$102,000 and \$338,000, respectively.

As of December 31, 2010, there was \$69,000 of total unrecognized compensation cost related to nonvested shares granted under the Company's stock-based compensation plans. The cost is expected to be recognized over a weighted-average period of .55 years. The total fair value of shares vested was \$145,000 and \$523,000 during 2010 and 2009, respectively.

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NOTE 13 - EMPLOYEE BENEFITS

The Company sponsors a 401(k) plan which covers substantially all employees. Employees may elect to contribute to the plan up to the maximum percentage of compensation and dollar amount subject to statutory limitations. During 2009, the Company made matching contributions equal to 100% of the first 3% of employee contributions and 50% of employee contributions in excess of 3%, up to 6%. The Company's contributions in 2009 were approximately \$719,000. Effective January 1, 2010, the Company temporarily suspended the matching contribution.

The Company sponsors an Employee Stock Purchase Plan which covers substantially all employees. Employees are allowed to direct the Company to withhold payroll dollars and purchase Company stock at market price on a payroll by payroll basis. The Company has reserved 210,000 shares of common stock to be issued under the plan. The plan allows for shares to be issued directly from the Company or purchased on the open market.

NOTE 14 - EARNINGS PER COMMON SHARE

A reconciliation of the numerators and denominators of basic and diluted earnings per common share are as follows (dollars in thousands except per share data):

	<u>2010</u>	<u>2009</u>
Net income (loss)	\$ (17,854)	\$ (63,641)
Dividends declared on preferred shares	---	2,870
	<u> </u>	<u> </u>
Net income (loss) available to common shares	\$ (17,854)	\$ (66,511)
	<u> </u>	<u> </u>
Weighted average shares outstanding, including participating stock awards - Basic	17,686,362	17,449,943
Dilutive potential common shares:		
Stock options	---	---
Conversion of preferred stock	---	---
Stock warrants	---	---
	<u> </u>	<u> </u>
Weighted average shares outstanding - Diluted	17,686,362	17,449,943
	<u> </u>	<u> </u>
Basic earnings (loss) per common share	\$ (1.01)	\$ (3.81)
Diluted earnings (loss) per common share (1)	(1.01)	(3.81)

(1) For any period in which a loss is recorded, the assumed exercise of stock options would have an anti-dilutive impact on loss per share and thus are ignored in the diluted per share calculation.

Stock options for 722,564 and 924,937 shares of common stock were not considered in computing diluted earnings per common share for 2010 and 2009, respectively, because they were antidilutive. Potential common shares associated with the convertible preferred stock were excluded from dilutive potential common shares for 2010 and 2009 as they were antidilutive. Potential common shares associated with stock warrants issued in 2009 were excluded from dilutive potential common shares for 2010 and 2009 as they were antidilutive.

NOTE 15 - FEDERAL INCOME TAXES

Income tax expense (benefit) was as follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Current	\$ (7)	\$ (19,139)
Deferred (benefit) expense	1,310	(7,481)
Change in valuation allowance	---	18,020
	<u> </u>	<u> </u>
	\$ 1,303	\$ (8,600)
	<u> </u>	<u> </u>

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NOTE 15 - FEDERAL INCOME TAXES (Continued)

The difference between the financial statement tax expense (benefit) and amount computed by applying the statutory federal tax rate to pretax income was reconciled as follows (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Statutory rate	35%	35%
Statutory rate applied to income (loss) before taxes	\$ (5,793)	\$ (25,284)
Add (deduct)		
Change in valuation allowance	7,629	18,020
Tax-exempt interest income	(246)	(669)
Bank-owned life insurance	(217)	(440)
Other, net	(70)	(227)
	<u>\$ 1,303</u>	<u>\$ (8,600)</u>

The realization of deferred tax assets (net of a recorded valuation allowance) is largely dependent upon future taxable income, future reversals of existing taxable temporary differences and the ability to carryback losses to available tax years. In assessing the need for a valuation allowance, we consider all positive and negative evidence, including taxable income in carry-back years, scheduled reversals of deferred tax liabilities, expected future taxable income and tax planning strategies.

At December 31, 2009, the need for a valuation allowance was based primarily on the Company's net operating loss for 2009 and 2008, and the challenging environment currently confronting banks that could impact future operating results. As a result, an \$18.0 million valuation allowance on deferred tax assets was charged to federal income tax expense in 2009. As a result of losses incurred in 2010, the Company increased the valuation allowance to \$25.6 million at December 31, 2010. The valuation allowance may be reversed to income in future periods to the extent that the related deferred tax assets are realized or the valuation allowance is no longer required. If the Company returns to consistent, sustained profitability, the need for the valuation allowance would diminish.

The net deferred tax asset recorded included the following amounts of deferred tax assets and liabilities (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Deferred tax asset		
Allowance for loan losses	\$ 16,599	\$ 19,118
Nonaccrual loan interest	548	250
Valuation allowance on other real estate owned	3,641	1,681
Net operating loss carryforward	6,656	---
Other	975	1,431
	<u>28,419</u>	<u>22,480</u>
Gross deferred tax assets	28,419	22,480
Valuation allowance	(25,649)	(18,020)
	<u>2,770</u>	<u>4,460</u>
Total net deferred tax assets	2,770	4,460
Deferred tax liabilities		

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Depreciation	(1,984)	(2,202)
Purchase accounting adjustments	(113)	(207)
Unrealized gain on securities available for sale	(6)	(1,316)
Prepaid expenses	(347)	(348)
Other	(320)	(387)
	<hr/>	
Gross deferred tax liabilities	(2,770)	(4,460)
	<hr/>	
Net deferred tax asset	\$ ---	\$ ---
	<hr/>	

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NOTE 15 - FEDERAL INCOME TAXES (Continued)

At December 31, 2010, we had federal net operating loss carryforwards of \$6.7 million that expire in 2030.

There were no unrecognized tax benefits at December 31, 2010 or 2009 and the Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months. The Company is no longer subject to examination by the Internal Revenue Service for years before 2007.

NOTE 16 - COMMITMENTS AND OFF-BALANCE-SHEET RISK

Some financial instruments are used to meet customer financing needs and to reduce exposure to interest rate changes. These financial instruments include commitments to extend credit and standby letters of credit. These involve, to varying degrees, credit and interest rate risk in excess of the amount reported in the financial statements.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the commitment, and generally have fixed expiration dates. Standby letters of credit are conditional commitments to guarantee a customer's performance to a third party. Exposure to credit loss if the other party does not perform is represented by the contractual amount for commitments to extend credit and standby letters of credit. Collateral or other security is normally not obtained for these financial instruments prior to their use, and many of the commitments are expected to expire without being used.

A summary of the contractual amounts of financial instruments with off-balance-sheet risk was as follows at year-end (dollars in thousands):

	<u>2010</u>	<u>2009</u>
Commitments to make loans	\$ 50,377	\$ 30,706
Letters of credit	4,873	9,857
Unused lines of credit	242,448	306,517

The notional amount of commitments to fund mortgage loans to be sold into the secondary market was approximately \$12.1 million at December 31, 2010. The notional amount of commitments to fund mortgage loans to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans was approximately \$12.8 million at December 31, 2009.

At year-end 2010, approximately 16% of the Bank's commitments to make loans were at fixed rates, offered at current market rates. The remainder of the commitments to make loans was at variable rates tied to prime and generally expire within 30 days. The majority of the unused lines of credit were at variable rates tied to prime.

NOTE 17 - CONTINGENCIES

The Company and its subsidiaries periodically become defendants in certain claims and legal actions arising in the ordinary course of business.

As previously disclosed, the Company and Macatawa Bank entered into a Settlement and Release and Stock and Warrant Issuance Agreement and amendments (as amended, the "Settlement Agreement") in connection with the legal

proceedings related to Trade Partners, Inc. The settlement with respect to approximately 91% of the number of plaintiffs and the aggregate amount of their claims was completed and became effective on June 17, 2009. On July 27, 2009, the Company completed a second settlement with additional plaintiffs representing approximately 8.7% of the total number of original plaintiffs.

Including both the June 17 and July 27 settlements, the Company paid a total of \$5.91 million for the cash portion of the settlement and issued warrants to purchase a total of 1,478,811 shares of common stock at an exercise price of \$9.00 per share.

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NOTE 17 - CONTINGENCIES (Continued)

The Company's insurers contributed \$950,000 to the \$5.91 million cash portion of the settlement. Both the June 17 and July 27 settlements were expensed in the quarter ended June 30, 2009 and reduced the Company's net income by \$5.5 million.

The fair value of the warrants was \$806,000 and recorded in Common Stock based upon \$0.54 per warrant as determined using a Black-Scholes model. The assumptions used in the determination of fair value included a risk-free interest rate of 2.22%, an expected life of four years, expected stock price volatility of 56.00% and expected dividend yield of 1.00%.

Following the June 17 and July 27 settlements, all plaintiffs have either settled with the Company or have been dismissed.

The Settlement Agreement did not contain any admission of liability or wrongdoing by the Company or Macatawa Bank. The offer to settle was made in an attempt to avoid exposure to future litigation and to avoid the cost of litigation.

As of the date hereof, except as disclosed above, there were no material pending legal proceedings, other than routine litigation incidental to the business of banking to which we or any of our subsidiaries are a party of or which any of our properties are the subject.

NOTE 18 - SHAREHOLDERS' EQUITY

Regulatory Capital

The Company and the Bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about components, risk weightings, and other factors, and the regulators can lower classifications in certain cases. Failure to meet various capital requirements would result in regulatory action that could have a direct material effect on the financial statements.

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If the Bank is only adequately capitalized, regulatory approval is required to accept brokered deposits; and if the Bank is undercapitalized, capital distributions are limited, as is asset growth and expansion, and plans for capital restoration are required.

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NOTE 18 - SHAREHOLDERS' EQUITY (Continued)

Actual capital levels (dollars in thousands) and minimum required levels were as follows at year-end:

	<u>Actual</u>		<u>Minimum Required For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Regulations</u>		<u>Minimum Required Under Consent Order</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
December 31, 2010								
Total capital (to risk weighted assets)								
Consolidated	\$ 125,483	9.7%	\$ 104,013	8.0%	N/A	N/A	N/A	N/A
Bank	125,797	9.7	103,970	8.0	\$ 129,963	10.0%	\$ 142,960	11.0%
Tier 1 capital (to risk weighted assets)								
Consolidated	89,585	6.9	52,007	4.0	N/A	N/A	N/A	N/A
Bank	109,160	8.4	51,985	4.0	77,978	6.0	N/A	N/A
Tier 1 capital (to average assets)								
Consolidated	89,585	5.8	61,605	4.0	N/A	N/A	N/A	N/A
Bank	109,160	7.1	61,520	4.0	76,901	5.0	123,041	8.0
December 31, 2009								
Total capital (to risk weighted assets)								
Consolidated	\$ 147,162	9.2%	\$ 127,496	8.0%	N/A	N/A		
Bank	144,301	9.1	127,357	8.0	\$ 159,196	10.0%		
Tier 1 capital (to risk weighted assets)								
Consolidated	113,549	7.1	63,748	4.0	N/A	N/A		
Bank	123,972	7.8	63,678	4.0	95,517	6.0		
Tier 1 capital (to average assets)								
Consolidated	113,549	6.0	75,559	4.0	N/A	N/A		
Bank	123,972	6.6	75,448	4.0	94,311	5.0		

Approximately \$22.4 million and \$28.4 of trust preferred securities outstanding at December 31, 2010 and 2009, respectively, qualified as Tier 1 capital for regulatory capital purposes.

The Bank was categorized as "adequately capitalized" at December 31, 2010 and 2009. There are no conditions or events since December 31, 2010 that management believes have changed its category. The Bank's total regulatory capital was \$4.2 million below the level required to be categorized as "well capitalized" at December 31, 2010. However, because the Bank is subject to the Consent Order, the Bank cannot be categorized as "well capitalized" regardless of actual capital levels.

As part of the Consent Order, the Bank was required, within 90 days from the date of the Consent order, to have and maintain a Tier 1 Leverage Capital Ratio of at least 8% and a Total Risk Based Capital Ratio of at least 11%. The Bank would need a capital injection of approximately \$13.9 million as of December 31, 2010 in order to comply with the Tier 1 Ratio requirement and would need a capital injection of approximately \$17.2 million in order to comply

with the Total Risk Based Ratio requirement of the Consent Order. The ability of the Bank to achieve these requirements is largely dependent on the success of capital raising initiatives in process by the Company as discussed previously. The Consent Order also prohibits the Bank from declaring or paying any cash dividend without the prior written consent of its regulators. The payment of future cash dividends by the Company is largely dependent upon dividends received from the Bank out of its earnings. Under Michigan law, the Bank is also restricted from paying dividends to the Company until its deficit retained earnings has been restored. The Bank had a retained deficit of approximately \$39.8 million at December 31, 2010.

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 18 - SHAREHOLDERS' EQUITY (Continued)

Additional information about the Consent Order may be found in Note 1 under the heading "Regulatory Developments."

Issuance of Capital

A summary of the capital instruments issued to accredited investors during recent years is as follows:

Convertible Preferred Stock

In 2008, the Company completed a private offering of 31,290 shares of 12.0% Series A Non-cumulative Convertible Perpetual Preferred Stock (Series A Preferred Stock) with a liquidation preference of \$1,000 per share, resulting in an aggregate liquidation preference of \$31.3 million. Proceeds of \$30.6 million from issuance were net of \$686,000 of costs.

Each share of the Series A Preferred Stock is non-voting and may be convertible at any time, at the option of the holder, into 111.73 shares of common stock of the Company, which represents an approximate initial conversion price of \$8.95 per share of common stock. On or after the third anniversary of the issue date, at the option of the Company, the Series A Preferred Stock will be subject to mandatory conversion into common stock at the prevailing conversion rate, if the closing price of the Company's common stock exceeds 130% of the then applicable conversion price for 20 trading days during any 30 consecutive trading day period and the Company has paid full dividends on the Series A Preferred Stock for four consecutive quarters. The conversion rate and conversion price will be subject to adjustments in certain circumstances.

In 2009, the Company issued 2,600 shares of 9.0% Series B Non-cumulative Convertible Perpetual Preferred Stock (Series B Preferred Stock) with a liquidation preference of \$1,000 per share, resulting in an aggregate liquidation preference of \$2.6 million. Proceeds of \$2.6 million from issuance were net of \$40,000 of costs.

Each share of the Series B Preferred Stock is non-voting and may be convertible at any time, at the option of the holder, into 166.67 shares of common stock of the Company, which represents an approximate initial conversion price of \$6.00 per share of common stock. On or after the third anniversary of the issue date, at the option of the Company, the Series B Preferred Stock will be subject to mandatory conversion into common stock at the prevailing conversion rate, if the closing price of the Company's common stock exceeds 120% of the then applicable conversion price for 20 trading days during any 30 consecutive trading day period and the Company has paid full dividends on the Series B Preferred Stock for four consecutive quarters. The conversion rate and conversion price will be subject to adjustments in certain circumstances. The Series B Preferred Stock is subordinate to the Series A Preferred Stock. If all of the outstanding shares of the Series A and Series B Preferred Stock were converted into common stock, the shares of Series A and Series B Preferred Stock would convert into a total of approximately 3.9 million shares of common stock at December 31, 2010.

On December 4, 2009, the Board of Directors of the Company resolved that it will not declare or pay any cash dividends on the Series A or Series B Preferred Stock until further action by the Board of Directors. During the period

that the Company does not declare and pay cash dividends on its Series A or Series B Preferred Stock, it may not declare or pay any cash dividends on the Company's common stock.

Both the Series A and Series B Preferred Stock qualified as Tier I capital for the Company.

Common Stock

In 2009, the Company issued 538,386 shares of common stock to accredited investors as part of the private offering. The shares were issued at an average price of \$3.06 per share resulting in total proceeds of \$1.7 million.

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2010 and 2009

NOTE 18 - SHAREHOLDERS' EQUITY (Continued)*Subordinated Notes*

In 2009, the Company received proceeds of \$1,650,000 from the issuance of unsecured subordinated debt. The subordinated debt was in the form of 11% subordinated notes due 2017 and redeemable three years after issued. The subordinated notes are not convertible into common stock or preferred stock.

NOTE 19 - CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY)

Following are condensed parent company only financial statements (dollars in thousands):

CONDENSED BALANCE SHEETS

	<u>2010</u>	<u>2009</u>
ASSETS		
Cash and cash equivalents	\$ 579	\$ 1,143
Investment in Bank subsidiary	109,812	126,800
Investment in other subsidiaries	1,591	1,563
Other assets	537	1,762
	<hr/>	<hr/>
Total assets	\$ 112,519	\$ 131,268
	<hr/>	<hr/>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Subordinated debt	\$ 1,650	\$ 1,650
Long-term debt	41,238	41,238
Other liabilities	1,789	389
	<hr/>	<hr/>
Total liabilities	44,677	43,277
Total shareholders' equity	67,842	87,991
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 112,519	\$ 131,268
	<hr/>	<hr/>

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MACATAWA BANK CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010 and 2009

NOTE 19 - CONDENSED FINANCIAL STATEMENTS (PARENT COMPANY ONLY) (Continued)

CONDENSED STATEMENTS OF INCOME

	<u>2010</u>	<u>2009</u>
Income		
Dividends from subsidiaries	\$ ---	\$ 49
Other	---	6
	<u>---</u>	<u>55</u>
Expense		
Interest expense	1,562	1,653
Other expense	761	876
	<u>2,323</u>	<u>2,529</u>
Income (loss) before income tax and equity in undistributed earnings (loss) of subsidiaries	(2,323)	(2,474)
Equity in undistributed earnings (loss) of subsidiaries	(15,531)	(61,955)
	<u>(17,854)</u>	<u>(64,429)</u>
Income (loss) before income tax	(17,854)	(64,429)
Income tax benefit	---	(788)
	<u>(17,854)</u>	<u>(63,641)</u>
Net income (loss)	(17,854)	(63,641)
Dividends declared on preferred shares	---	2,870
	<u>(17,854)</u>	<u>(66,511)</u>
Net income (loss) available to common stock	\$ (17,854)	\$ (66,511)

CONDENSED STATEMENTS OF CASH FLOWS

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities		
Net income (loss)	\$ (17,854)	\$ (63,641)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Equity in undistributed (earnings) loss of subsidiaries	16,402	61,955
(Increase) decrease in other assets	359	(581)
Increase (decrease) in other liabilities	1,400	(53)
	<u>307</u>	<u>(2,320)</u>
Net cash from operating activities	307	(2,320)
Cash flows from investing activities		
Investment in subsidiaries	(871)	(9,000)
	<u>(871)</u>	<u>(9,000)</u>
Net cash from investing activities	(871)	(9,000)
Cash flows from financing activities		
Proceeds from exercises of stock options	---	---
Proceeds from issuance of subordinated debt	---	1,650
Proceeds from issuance of common stock	---	1,650
Fractional shares purchased	---	---

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Cash dividends paid	---	(3,687)
Net proceeds from issuance of preferred stock	---	2,527
Repurchase of stock	---	---
	<u> </u>	<u> </u>
Net cash from financing activities	---	2,140
	<u> </u>	<u> </u>
Net change in cash and cash equivalents	(564)	(9,180)
Cash and cash equivalents at beginning of year	1,143	10,323
	<u> </u>	<u> </u>
Cash and cash equivalents at end of year	\$ 579	\$ 1,143
	<u> </u>	<u> </u>
Supplemental noncash disclosures:		
Preferred stock dividends accrued, paid in subsequent quarter	\$ ---	\$ ---

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MACATAWA BANK CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 20 - QUARTERLY FINANCIAL DATA (Unaudited)

(Dollars in thousands except per share data)

	<u>Interest Income</u>	<u>Net Interest Income</u>	<u>Provision for Loan Losses</u>	<u>Net Income/ (Loss) (1)</u>	<u>Earnings (Loss) Per Common Share</u>	
					<u>Basic</u>	<u>Fully Diluted</u>
2010						
First quarter	\$ 20,938	\$ 13,028	\$ 19,710	\$ (21,140)	\$ (1.19)	\$ (1.19)
Second quarter	19,537	12,818	1,800	1,748	.10	.10
Third quarter	18,444	12,437	550	703	.04	.04
Fourth quarter	17,084	12,284	400	835	.05	.05
2009						
First quarter	\$ 25,124	\$ 12,796	\$ 10,530	\$ (4,142)	\$ (.30)	\$ (.30)
Second quarter	24,531	13,398	20,630	(30,406)	(1.82)	(1.82)
Third quarter	23,534	13,194	21,580	(19,883)	(1.18)	(1.18)
Fourth quarter	22,690	13,406	21,600	(9,209)	(.52)	(.52)

(1) Net income for the second quarter of 2010 includes a \$2.7 million gain on sale of investment securities.

Net income for the fourth quarter of 2010 includes a \$574,000 gain on the sale of a property owned by the Bank.

Net loss for the fourth quarter of 2009 includes an \$11.4 million favorable tax benefit resulting from a tax law change extending the carry-back of net operating losses to five years from the previous two-year carry-back period.

Net loss for the second quarter of 2009 includes a non-cash charge of \$14.9 million to establish a valuation allowance on deferred tax assets and a one-time charge of \$5.5 million associated with the settlement of the substantial majority of the Trade Partners litigation disclosed in previous announcements.

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ITEM 9: Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.
None.

ITEM 9A: Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures.

Under the supervision of and with the participation of our management, including our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (Exchange Act), as of December 31, 2010. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as the Company's are designed to do, and management necessarily was required to apply its judgment in evaluating whether the benefits of the controls and procedures that the Company adopts outweigh their costs. Our management, including our CEO and CFO, after evaluating the effectiveness of the Company's disclosure controls and procedures, have concluded that, as of December 31, 2010, the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within time periods specified in the Commission's rules and forms.

(b) Changes in Internal Controls.

The Company's management is committed to continuing efforts to improve the design and operation of the Company's disclosure controls, and internal control over financial reporting, including taking all steps believed necessary to remediate the material weakness discussed below under "Management's Report on Internal Control over Financial Reporting." During the year ended December 31, 2010, we have made the following changes in our internal control over financial reporting that will materially affect or are reasonably likely to materially affect our internal control over financial reporting:

Timely identification of grade changes within the commercial loan portfolio is key to our process of establishing an appropriate allowance balance. To accomplish effective risk rating, additional efforts took place in the latter half of 2009. Our Special Assets Group reviewed all credits risk rated a 5 or worse under our risk rating system. Accelerated downgrading of credits took place as a result of this review. Although we were comfortable with risk rating results as of December 31, 2009, additional measures were being taken in 2010 to further enhance the risk rating system.

The Loan Review function traditionally reported administratively through Credit Administration and functionally to the Board Loan Committee. Loan Review now reports functionally to the Audit Committee. The Risk Management department is now responsible administratively for the Loan Review function and has expanded the department to include a Senior Loan Review Manager and additional resources. Under our new framework, all commercial loan risk ratings are required to be independently evaluated by our internal loan review function upon origination or renewal. In addition, commercial loans are required to be independently reviewed by our internal loan review function at least annually to monitor the accuracy and completeness of the watch list and all risk ratings.

During 2010 the Loan Review department has completed its quarterly independent reviews of the risk rating for each loan selected for review, and issued its report to the Audit Committee. The Loan Review department remains focused on completing its independent review of all commercial loan risk ratings.

At least quarterly, Loan Review issues a report to the Audit Committee which outlines the loans that were evaluated during that period. The report indicates the files reviewed and outlines any grade changes that were recommended or any credits that could not be graded due to missing information. The Loan Review department has implemented a monthly reporting process to the Audit Committee and management regarding the status of loans that could not be graded and the resulting grade change once documentation is obtained. The Loan Review report also summarizes any credit file or documentation exceptions found.

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It is the intent of the Loan Review department to finalize internal loan review reports in a timely manner. The second, third and fourth quarter loan review reports were completed, and reviewed and considered by management involved in the analysis of the allowance for loan losses as of June 30, 2010, September 30, 2010 and December 31, 2010. As part of the new monthly analysis of the adequacy of the allowance for loan losses, management involved in the allowance for loan losses analysis further communicated with other departments involved in managing credit quality, including Loan Review, to determine if there were any further trends regarding credit quality that should be included in its assessment of qualitative factors utilized in the allowance for loan loss analysis. These considerations were considered in the qualitative factor adjustments used in the allowance for loan losses analysis as of December 31, 2010 and believed to be appropriate. These additional controls are completed on at least a quarterly basis and considered in the qualitative factor adjustments used in the allowance for loan losses analysis.

The loss emergence period of one year used as of December 31, 2010 was consistent with the updated period used as of December 31, 2009 and considered appropriate.

Qualitative factor adjustments used in the allowance for loan losses analysis were updated as of December 31, 2010 to be consistent with trends in the loan portfolio and were considered appropriate. These factors are updated on at least a quarterly basis to be consistent with trends in the loan portfolio incorporating input from senior management in accounting, loan review, lending, risk management and our market data committee.

(c) Management's Report on Internal Control over Financial Reporting.

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control system was designed by, or under the supervision of, our CEO and CFO and effected by our Board of Directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements and related notes for external purposes in accordance with generally accepted accounting principles in the United States of America.

An internal control system, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable, not absolute, assurance that the control system's objectives have been met. The inherent limitations include the realities that judgments in decision-making can be deficient and breakdowns can occur because of simple errors or mistakes.

During the course of the audit procedures for 2009, our independent registered public accounting firm for the year ended December 31, 2009, Crowe Horwath LLP, identified certain deficiencies in the Company's credit administration practices and allowance for loan losses process. Crowe Horwath LLP concluded that these control deficiencies constituted a "material weakness" in internal control over financial reporting at December 31, 2009. Our CEO and CFO also concluded that the control deficiencies constituted a material weakness in internal control over financial reporting at December 31, 2009. We concluded that solely as a result of the material weakness in internal control over financial reporting, we did not maintain effective internal control over financial reporting as of December 31, 2009 based on those criteria. We have since addressed the control deficiencies that constituted a material weakness in internal control over financial reporting as of December 31, 2009 as described above under "Changes in Internal Controls."

Company management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on our assessment, we concluded that we maintained effective internal control over financial reporting as of December 31, 2010 based on those criteria.

BDO USA LLP, an independent registered certified public accounting firm that audited the consolidated financial

statements included herein, has issued an attestation report on our internal control over financial reporting as of December 31, 2010, as stated in their report below.

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(d) Report of Independent Registered Public Accounting Firm.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Macatawa Bank Corporation
Holland, Michigan

We have audited Macatawa Bank Corporation's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Macatawa Bank Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Macatawa Bank Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Macatawa Bank Corporation as of December 31, 2010, and the related

consolidated statements of income, changes in shareholders' equity, and cash flows for the year then ended, and our report dated February 24, 2011 expressed an unqualified opinion thereon.

/s/ BDO USA, LLP

February 24, 2011
Certified Public Accountants

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ITEM 9B: Other Information.
None.

PART III**ITEM 10: Directors, Executive Officers and Corporate Governance.**

The information under the headings "The Board of Directors - General, - Qualifications and Biographical Information, - Board Committees - Audit Committee," "Executive Officers," "Section 16(a) Beneficial Ownership Reporting Compliance," "Corporate Governance - Code of Ethics" and "Shareholder Proposals" in our definitive Proxy Statement relating to our May 10, 2011 Annual Meeting of Shareholders is here incorporated by reference.

ITEM 11: Executive Compensation.

Information under the headings "Executive Compensation," "Compensation Committee Report" and "Compensation Committee Interlocks and Insider Participation" in our definitive Proxy Statement relating to our May 10, 2011 Annual Meeting of Shareholders is here incorporated by reference.

ITEM 12: Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information under the heading "Ownership of Macatawa Stock" in our definitive Proxy Statement relating to our May 10, 2011 Annual Meeting of Shareholders is here incorporated by reference.

The following table sets forth certain information regarding the Company's equity compensation plans as of December 31, 2010. The following information has been adjusted to reflect the effect of all stock dividends and stock splits.

	Equity Compensation Plan Information		
	(a)	(b)	(c)
<u>Plan Category</u>	<u>Number of securities to be issued upon exercise of outstanding options, warrants and rights</u>	<u>Weighted-average Exercise price of outstanding options, warrants and rights</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u>
Equity compensation plans approved by security holders	722,564	\$15.02	725,659
Equity compensation plans not approved by security holders	0	N/A	0
Total	722,564	\$15.02	725,659

The Company has no equity compensation plans not approved by shareholders.

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ITEM 13: Certain Relationships and Related Transactions, and Director Independence.

Information under the headings "Transactions with Related Persons" and "The Board of Directors - Board Committees" in our definitive Proxy Statement relating to our May 10, 2011 Annual Meeting of Shareholders is here incorporated by reference.

ITEM 14: Principal Accountant Fees and Services.

Information under the headings "Independent Auditors - Fees and - Audit Committee Approval Policies" in our definitive Proxy Statement relating to our May 10, 2011 Annual Meeting of Shareholders is here incorporated by reference.

PART IV

ITEM 15: Exhibits and Financial Statement Schedules.

(a) 1. The following documents are filed as part of Item 8 of this report:

Reports of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of December 31, 2010 and 2009
Consolidated Statements of Income for the years ended December 31, 2010 and 2009
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2010 and 2009
Consolidated Statements of Cash Flows for the years ended December 31, 2010 and 2009
Notes to Consolidated Financial Statements

(a) 2. Financial statement schedules are omitted because they are not required or because the information is set forth in the consolidated financial statements or related notes.

(a) 3. The following exhibits are filed as part of this report:

Exhibit Number and Description

3.1	Restated Articles of Incorporation. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 3.1. Here incorporated by reference.
3.2	Bylaws. Previously filed with the Commission on November 24, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 3.1. Here incorporated by reference.
3.3	Certificate of Designation of Series A Noncumulative Convertible Perpetual Preferred Stock. Previously filed with the Commission on November 5, 2008 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
3.4	Certificate of Designation of Series B Noncumulative Convertible Perpetual Preferred Stock. Previously filed with the Commission on July 2, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
4.1	Restated Articles of Incorporation. Exhibit 3.1 is here incorporated by reference.
4.2	Bylaws. Exhibit 3.2 is here incorporated by reference.
4.3	

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Certificate of Designation of Series A Noncumulative Convertible Perpetual Preferred Stock. Exhibit 3.3 is here incorporated by reference.

4.4

Certificate of Designation of Series B Noncumulative Convertible Perpetual Preferred Stock. Exhibit 3.4 is here incorporated by reference.

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- 4.5 First Amended Settlement and Release and Warrant Issuance Agreement dated January 30, 2009. Previously filed with the Commission on January 30, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.1. Here incorporated by reference.
- 4.6 Second Amendment to Settlement and Release and Warrant Issuance Agreement dated April 30, 2009. Previously filed with the Commission on May 8, 2009 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10. Here incorporated by reference.
- 4.7 Warrant Agreement between the Company and Registrar and Transfer Company dated June 16, 2009. Previously filed with the Commission on June 19, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
- 4.8 Warrant Agreement Addendum. Previously filed with the Commission on July 31, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
- 4.9 Form of Warrant Certificate (first series). Previously filed with the Commission on June 19, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.2. Here incorporated by reference.
- 4.10 Form of Warrant Certificate (second series). Previously filed with the Commission on July 31, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.2. Here incorporated by reference.
- 4.11 Long-Term Debt. The registrant has outstanding long-term debt which at the time of this report does not exceed 10% of the registrant's total consolidated assets. The registrant agrees to furnish copies of the agreements defining the rights of holders of such long-term debt to the SEC upon request.
- 10.1* Macatawa Bank Corporation Stock Compensation Plan. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 10.1. Here incorporated by reference.
- 10.2* Macatawa Bank Corporation 1998 Directors' Stock Option Plan. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 10.2. Here incorporated by reference.
- 10.3* Macatawa Bank Corporation 2006 Stock Compensation Plan. Previously filed with the Commission on March 9, 2006 in Macatawa Bank Corporation's Proxy Statement dated March 6, 2006, Appendix A. Here incorporated by reference.
- 10.4* Macatawa Bank Corporation 2006 Directors' Stock Compensation Plan. Previously filed with the Commission on March 9, 2006 in Macatawa Bank Corporation's Proxy Statement dated March 6, 2006, Appendix B. Here incorporated by reference.
- 10.5* Amended and Restated Employment Agreement between Benj. A Smith III and Macatawa Bank Corporation dated May 9, 2007. Previously filed with the Commission on May 10, 2007 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.1. Here incorporated by reference.
- 10.6* Noncompetition Agreement dated October 11, 2006, by and between Macatawa Bank Corporation and Benj. A. Smith, III. Previously filed with the Commission on October 12, 2006 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.2. Here incorporated by reference.
- 10.7 Form of Indemnity Agreement between Macatawa Bank Corporation and certain of its directors. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 10.7. Here incorporated by reference.
- 10.8* Form of Stock Option Agreement.
- 10.9* Form of Stock Option Agreement for non-qualified stock options. Previously filed with the Commission on August 8, 2006 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.3. Here incorporated by reference.

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- 10.10* Form of Stock Option Agreement for incentive stock options. Previously filed with the Commission on August 8, 2006 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.4. Here incorporated by reference.
- 10.11* Form of Stock Option Agreement under the Directors' Stock Compensation Plan. Previously filed with the Commission on August 8, 2006 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.5. Here incorporated by reference.
- 10.12* Form of Restricted Stock Agreement. Previously filed with the Commission on March 16, 2007 in Macatawa Bank Corporation's Annual Report on Form 10-K, Exhibit 10.15. Here incorporated by reference.
- 10.13 Board Representation Agreement dated November 5, 2008, between Macatawa Bank Corporation and White Bay Capital, LLC. Previously filed with the Commission on November 5, 2008 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.2. Here incorporated by reference.
- 10.14 Form of Subscription and Purchase Agreement between Macatawa Bank Corporation and purchasers of Series A Noncumulative Convertible Perpetual Preferred Stock. Previously filed with the Commission on November 5, 2008 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.1. Here incorporated by reference.
- 10.15 First Amended Settlement and Release and Warrant Issuance Agreement dated January 30, 2009. Exhibit 4.5 is here incorporated by reference.
- 10.16 Second Amendment to Settlement and Release and Warrant Issuance Agreement dated April 30, 2009. Exhibit 4.6 is here incorporated by reference.
- 10.17 Warrant Agreement between the Company and Registrar and Transfer Company dated June 16, 2009. Exhibit 4.7 is here incorporated by reference.
- 10.18 Warrant Agreement Addendum. Exhibit 4.8 is here incorporated by reference.
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- 10.20 Form of 11% Subordinated Note Due 2017. Previously filed with the Commission on July 2, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.2. Here incorporated by reference.
- 10.21 Form of Subscription and Purchase Agreement between Macatawa Bank Corporation and purchasers of Series B Noncumulative Convertible Perpetual Preferred Stock. Previously filed with the Commission on July 2, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.1. Here incorporated by reference.
- 10.22 Form of Subscription and Purchase Agreement for 11% Subordinated Notes Due 2017. Previously filed with the Commission on July 2, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.2. Here incorporated by reference.
- 10.23 Form of Subscription and Purchase Agreement for Common Stock. Previously filed with the Commission on July 2, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.3. Here incorporated by reference.
- 10.24 Consent Order dated February 22, 2010. Previously filed with the Commission on February 24, 2010 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.1. Here incorporated by reference.
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- 21 Subsidiaries of the Registrant. One or more subsidiaries were omitted from this exhibit in accordance with Item 601(b)(21)(ii) of Regulation S-K.

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23.1	Consent of BDO USA LLP, independent registered public accounting firm.
23.2	Consent of Crowe Horwath LLP, independent registered public accounting firm.
24	Powers of Attorney.
31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. § 1350.

* Management contract or compensatory plan.

The Registrant will furnish a copy of any exhibits listed on the Exhibit Index to any shareholder of the Registrant without charge upon written request to Chief Financial Officer, Macatawa Bank Corporation, 10753 Macatawa Drive, Holland, Michigan 49424.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, dated February 24, 2011.

MACATAWA BANK CORPORATION

/s/ Ronald L. Haan

Ronald L. Haan
Chief Executive Officer
(Principal Executive Officer)

/s/ Jon W. Swets

Jon W. Swets
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature

*s/ Richard L. Postma February 24, 2011

Richard L. Postma, Chairman of the Board

/s/ Ronald L. Haan February 24, 2011

Ronald L. Haan, Chief Executive Officer

/s/ Jon W. Swets February 24, 2011

Jon W. Swets, Senior Vice President and Chief Financial Officer

*s/ Mark J. Bugge February 24, 2011

Mark J. Bugge, Director

*s/ Arend D. Lubbers February 24, 2011

Arend D. Lubbers, Director

*s/ Thomas J. Wesholski February 24, 2011

Thomas J. Wesholski, Director

*s/ Douglas B. Padnos February 24, 2011

Douglas B. Padnos, Director

*s/ Wayne J. Elhart February 24, 2011

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Wayne J. Elhart, Director

**/s/ Charles A. Geenen*

February 24, 2011

Charles A. Geenen, Director

**/s/ Birgit M. Klohs*

February 24, 2011

Birgit M. Klohs, Director

**/s/ Robert L. Herr*

February 24, 2011

Robert L. Herr, Director

**/s/ Thomas P. Rosenbach*

February 24, 2011

Thomas P. Rosenbach, Director

*By: */s/ Jon W. Swets*

Jon W. Swets
Attorney-in-Fact

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Exhibit Number and Description

- 3.1 Restated Articles of Incorporation. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 3.1. Here incorporated by reference.
- 3.2 Bylaws. Previously filed with the Commission on November 24, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 3.1. Here incorporated by reference.
- 3.3 Certificate of Designation of Series A Noncumulative Convertible Perpetual Preferred Stock. Previously filed with the Commission on November 5, 2008 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
- 3.4 Certificate of Designation of Series B Noncumulative Convertible Perpetual Preferred Stock. Previously filed with the Commission on July 2, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
- 4.1 Restated Articles of Incorporation. Exhibit 3.1 is here incorporated by reference.
- 4.2 Bylaws. Exhibit 3.2 is here incorporated by reference.
- 4.3 Certificate of Designation of Series A Noncumulative Convertible Perpetual Preferred Stock. Exhibit 3.3 is here incorporated by reference.
- 4.4 Certificate of Designation of Series B Noncumulative Convertible Perpetual Preferred Stock. Exhibit 3.4 is here incorporated by reference.
- 4.5 First Amended Settlement and Release and Warrant Issuance Agreement dated January 30, 2009. Previously filed with the Commission on January 30, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.1. Here incorporated by reference.
- 4.6 Second Amendment to Settlement and Release and Warrant Issuance Agreement dated April 30, 2009. Previously filed with the Commission on May 8, 2009 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10. Here incorporated by reference.
- 4.7 Warrant Agreement between the Company and Registrar and Transfer Company dated June 16, 2009. Previously filed with the Commission on June 19, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
- 4.8 Warrant Agreement Addendum. Previously filed with the Commission on July 31, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.1. Here incorporated by reference.
- 4.9 Form of Warrant Certificate (first series). Previously filed with the Commission on June 19, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.2. Here incorporated by reference.
- 4.10 Form of Warrant Certificate (second series). Previously filed with the Commission on July 31, 2009 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 4.2. Here incorporated by reference.
- 4.11 Long-Term Debt. The registrant has outstanding long-term debt which at the time of this report does not exceed 10% of the registrant's total consolidated assets. The registrant agrees to furnish copies of the agreements defining the rights of holders of such long-term debt to the SEC upon request.
- 10.1* Macatawa Bank Corporation Stock Compensation Plan. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 10.1. Here incorporated by reference.

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- 10.2* Macatawa Bank Corporation 1998 Directors' Stock Option Plan. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 10.2. Here incorporated by reference.
- 10.3* Macatawa Bank Corporation 2006 Stock Compensation Plan. Previously filed with the Commission on March 9, 2006 in Macatawa Bank Corporation's Proxy Statement dated March 6, 2006, Appendix A. Here incorporated by reference.
- 10.4* Macatawa Bank Corporation 2006 Directors' Stock Compensation Plan. Previously filed with the Commission on March 9, 2006 in Macatawa Bank Corporation's Proxy Statement dated March 6, 2006, Appendix B. Here incorporated by reference.
- 10.5* Amended and Restated Employment Agreement between Benj. A Smith III and Macatawa Bank Corporation dated May 9, 2007. Previously filed with the Commission on May 10, 2007 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.1. Here incorporated by reference.
- 10.6* Noncompetition Agreement dated October 11, 2006, by and between Macatawa Bank Corporation and Benj. A. Smith, III. Previously filed with the Commission on October 12, 2006 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.2. Here incorporated by reference.
- 10.7 Form of Indemnity Agreement between Macatawa Bank Corporation and certain of its directors. Previously filed with the Commission on March 30, 2010 in Macatawa Bank Corporation's Annual Report on Form 10-K for the year ended December 31, 2009, Exhibit 10.7. Here incorporated by reference.
- 10.8* Form of Stock Option Agreement.
- 10.9* Form of Stock Option Agreement for non-qualified stock options. Previously filed with the Commission on August 8, 2006 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.3. Here incorporated by reference.
- 10.10* Form of Stock Option Agreement for incentive stock options. Previously filed with the Commission on August 8, 2006 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.4. Here incorporated by reference.
- 10.11* Form of Stock Option Agreement under the Directors' Stock Compensation Plan. Previously filed with the Commission on August 8, 2006 in Macatawa Bank Corporation's Quarterly Report on Form 10-Q, Exhibit 10.5. Here incorporated by reference.
- 10.12* Form of Restricted Stock Agreement. Previously filed with the Commission on March 16, 2007 in Macatawa Bank Corporation's Annual Report on Form 10-K, Exhibit 10.15. Here incorporated by reference.
- 10.13 Board Representation Agreement dated November 5, 2008, between Macatawa Bank Corporation and White Bay Capital, LLC. Previously filed with the Commission on November 5, 2008 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.2. Here incorporated by reference.
- 10.14 Form of Subscription and Purchase Agreement between Macatawa Bank Corporation and purchasers of Series A Noncumulative Convertible Perpetual Preferred Stock. Previously filed with the Commission on November 5, 2008 in Macatawa Bank Corporation's Current Report on Form 8-K, Exhibit 10.1. Here incorporated by reference.
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