

REPUBLIC BANCORP INC /KY/
Form 10-K
March 07, 2012

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

FORM 10-K

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

For the fiscal year ended December 31, 2011

Commission File Number: 0-24649

REPUBLIC BANCORP, INC.
(Exact name of registrant as specified in its charter)

Kentucky 61-0862051
(State or other jurisdiction of (I.R.S. Employer Identification No.)
incorporation or organization)

601 West Market Street, Louisville, Kentucky 40202
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (502) 584-3600

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

Title of each class	Name of each exchange on which registered
Class A Common Stock	NASDAQ Global Select Market

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

None
(Title of Class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

1

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold as of June 30, 2011 (the last business day of the registrant’s most recently completed second fiscal quarter) was approximately \$198,535,338 (for purposes of this calculation, the market value of the Class B Common Stock was based on the market value of the Class A Common Stock into which it is convertible).

The number of shares outstanding of the registrant’s Class A Common Stock and Class B Common Stock, as of February 10, 2012 was 18,655,966 and 2,298,803, respectively.

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes:

Portions of the Registrant’s Proxy Statement for the Annual Meeting of Shareholders to be held April 19, 2012 are incorporated by reference into Part III of this Form 10-K.

TABLE OF CONTENTS

PART I

<u>Item 1. Business.</u>	5
<u>Item 1A. Risk Factors.</u>	31
<u>Item 1B. Unresolved Staff Comments.</u>	45
<u>Item 2. Properties.</u>	45
<u>Item 3. Legal Proceedings.</u>	47
<u>Item 4. Mine Safety Disclosures.</u>	49

PART II

<u>Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.</u>	50
<u>Item 6. Selected Financial Data.</u>	53
<u>Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.</u>	55
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk.</u>	110
<u>Item 8. Financial Statements and Supplementary Data.</u>	110
<u>Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.</u>	186
<u>Item 9A. Controls and Procedures.</u>	186
<u>Item 9B. Other Information.</u>	186

PART III

<u>Item 10. Directors, Executive Officers and Corporate Governance.</u>	187
<u>Item 11. Executive Compensation.</u>	187
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.</u>	187
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence.</u>	187
<u>Item 14. Principal Accounting Fees and Services.</u>	187

PART IV

<u>Item 15. Exhibits, Financial Statement Schedules, Signatures</u>	188
<u>Index to Exhibits</u>	190

Cautionary Statement Regarding Forward-Looking Statements

This Annual Report on Form 10-K contains statements relating to future results of Republic Bancorp, Inc. that are considered “forward-looking” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The forward-looking statements are principally, but not exclusively, contained in Part I Item 1 “Business,” Part I Item 1A “Risk Factors” and Part II Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

As used in this filing, the terms “Republic,” the “Company,” “we,” “our” and “us” refer to Republic Bancorp, Inc., and, where the context requires, Republic Bancorp, Inc. and its subsidiaries; and the term the “Bank” refers to the Company’s subsidiary banks: Republic Bank & Trust Company and Republic Bank.

Republic and its subsidiaries operate in a heavily regulated industry. These regulatory requirements can and do affect the Company’s results of operations and financial condition. For an update on regulatory matters affecting the Company and its subsidiaries, see Footnote 22 “Regulatory Matters” in Part II Item 8 “Financial Statements and Supplementary Data.”

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by the forward-looking statements. Actual results may differ materially from those expressed or implied as a result of certain risks and uncertainties, including, but not limited to, changes in political and economic conditions, interest rate fluctuations, competitive product and pricing pressures, equity and fixed income market fluctuations, personal and corporate customers’ bankruptcies, inflation, recession, acquisitions and integrations of acquired businesses, technological changes, changes in law and regulations or the interpretation and enforcement thereof, changes in fiscal, monetary, regulatory and tax policies, monetary fluctuations, success in gaining regulatory approvals when required, as well as other risks and uncertainties reported from time to time in the Company’s filings with the Securities and Exchange Commission (“SEC”) including under Part 1 Item 1A “Risk Factors.”

Broadly speaking, forward-looking statements include:

- projections of revenue, expenses, income, losses, earnings per share, capital expenditures, dividends, capital structure or other financial items;
- descriptions of plans or objectives for future operations, products or services;
- forecasts of future economic performance; and
- descriptions of assumptions underlying or relating to any of the foregoing.

The Company may make forward-looking statements discussing management’s expectations about various matters, including:

- loan delinquencies, future credit losses, non-performing loans and non-performing assets;
- further developments in the Bank’s ongoing review of and efforts to resolve possible problem credit relationships, which could result in, among other things, additional provision for loans losses;
- deteriorating credit quality, including changes in the interest rate environment and reducing interest margins;
- the overall adequacy of the allowance for loans losses;
- future short-term and long-term interest rates and the respective impact on net interest margin, net interest spread, net income, liquidity and capital;
- the future regulatory viability of the Tax Refund Solutions (“TRS”) segment;
- the future operating performance of TRS, including the impact of the cessation of Refund Anticipation Loans (“RALs”);
- future RAL volume;
- future Electronic Refund Check/Electronic Refund Deposit (“ERC/ERD” or “AR/ARD”) volume for TRS;

future revenues associated with ERCs/ERDs at TRS;
future credit losses associated with RALs;
anticipated future funding sources for TRS;
potential impairment of investment securities;
the future value of mortgage servicing rights;
the impact of new accounting pronouncements;

legal and regulatory matters including results and consequences of regulatory guidance, litigation, administrative proceedings, rule-making, interpretations, actions and examinations;

the extent to which regulations written and implemented by the newly created Federal Bureau of Consumer Financial Protection, and other federal, state and local governmental regulation of consumer lending and related financial products and services may limit or prohibit the operation of the Company's business;
financial services reform and other current, pending or future legislation or regulation that could have a negative effect on the Company's revenue and businesses, including the Dodd-Frank Act and legislation and regulation relating to overdraft fees (and changes to the Bank's overdraft practices as a result thereof), debit card interchange fees, credit cards, and other bank services;

future capital expenditures;

the strength of the U.S. economy in general and the strength of the local economies in which the Company conducts operations;

the Bank's ability to maintain current deposit and loan levels at current interest rates and
The Company's ability to successfully implement future growth plans.

Forward-looking statements discuss matters that are not historical facts. As forward-looking statements discuss future events or conditions, the statements often include words such as "anticipate," "believe," "estimate," "expect," "intend," "plan," "project," "target," "can," "could," "may," "should," "will," "would," or similar expressions. Do not rely on forward-looking statements. Forward-looking statements detail management's expectations regarding the future and are not guarantees. Forward-looking statements are assumptions based on information known to management only as of the date the statements are made and management may not update them to reflect changes that occur subsequent to the date the statements are made. See additional discussion under the sections titled Part I Item 1 "Business," Part I Item 1A "Risk Factors" and Part II Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

PART I

Item 1 Business.

Republic Bancorp, Inc. ("Republic" or the "Company") is a bank holding company headquartered in Louisville, Kentucky. Republic is the parent company of Republic Bank & Trust Company ("RB&T") and Republic Bank (collectively referred together with RB&T as the "Bank"), Republic Funding Company and Republic Invest Co. Republic Invest Co. includes its subsidiary, Republic Capital LLC. The consolidated financial statements also include the wholly-owned subsidiaries of RB&T: Republic Financial Services, LLC, TRS RAL Funding, LLC and Republic Insurance Agency, LLC. Republic Bancorp Capital Trust ("RBCT") is a Delaware statutory business trust that is a wholly-owned, unconsolidated finance subsidiary of Republic Bancorp, Inc. Incorporated in 1974, Republic became a bank holding company when RB&T became authorized to conduct commercial banking business in Kentucky in 1981.

The principal business of Republic is directing, planning and coordinating the business activities of the Bank. The financial condition and results of operations of Republic are primarily dependent upon the results of operations of the Bank. At December 31, 2011, Republic had total assets of \$3.4 billion, total deposits of \$1.7 billion and total stockholders' equity of \$452 million. Based on total assets as of December 31, 2011, Republic ranked as the second largest Kentucky-based bank holding company. The executive offices of Republic are located at 601 West Market Street, Louisville, Kentucky 40202, telephone number (502) 584-3600. The Company's website address is www.republicbank.com.

Website Access to Reports

The Company makes its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, available free of charge through its website, www.republicbank.com, as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC.

General Business Overview

As of December 31, 2011, the Company was divided into three distinct segments: Traditional Banking, Mortgage Banking and Tax Refund Solutions. Net income, total assets and net interest margin by segment for the years ended December 31, 2011, 2010 and 2009 are presented below:

(dollars in thousands)	Year Ended December 31, 2011			
	Traditional Banking	Mortgage Banking	Tax Refund Solutions	Total Company
Net income	\$ 26,463	\$ 344	\$ 67,342	\$ 94,149
Total assets	3,099,426	10,880	309,685	3,419,991
Net interest margin	3.55 %	NM	NM	5.09 %

(dollars in thousands)	Year Ended December 31, 2010			
	Traditional Banking	Mortgage Banking	Tax Refund Solutions	Total Company
Net income	\$ 17,895	\$ 2,618	\$ 44,240	\$ 64,753
Total assets	3,026,628	23,359	572,716	3,622,703
Net interest margin	3.57 %	NM	NM	4.65 %

(dollars in thousands)	Year Ended December 31, 2009			
	Traditional Banking	Mortgage Banking	Tax Refund Solutions	Total Company
Net income	\$ 15,362	\$ 6,790	\$ 19,979	\$ 42,131
Total assets	2,976,663	14,176	927,929	3,918,768
Net interest margin	3.79 %	NM	NM	5.04 %

NM – Not Meaningful

For expanded segment financial data see Footnote 21 “Segment Information” of Part II Item 8 “Financial Statements and Supplementary Data.”

(I) Traditional Banking segment

As of December 31, 2011, Republic had 42 full-service banking centers with 34 located in Kentucky, four located in metropolitan Tampa, Florida, three located in southern Indiana and one located in metropolitan Cincinnati, Ohio. RB&T’s primary market areas are located in metropolitan Louisville, Kentucky, central Kentucky, northern Kentucky and southern Indiana. Louisville, the largest city in Kentucky, is the location of Republic’s headquarters, as well as 20 banking centers. RB&T’s central Kentucky market includes 11 banking centers in the following Kentucky cities: Elizabethtown (1); Frankfort (1); Georgetown (1); Lexington, the second largest city in Kentucky (5); Owensboro (2); and Shelbyville (1). RB&T’s northern Kentucky market includes banking centers in Covington, Florence and Independence. RB&T also has banking centers located in Floyds Knobs, Jeffersonville and New Albany, Indiana.

Republic Bank has locations in Hudson, Palm Harbor, Port Richey and Temple Terrace, Florida, as well as Blue Ash (Cincinnati), Ohio.

Effective January 27, 2012, RB&T assumed substantially all of the deposits and certain other liabilities and acquired certain assets of Tennessee Commerce Bank (“TCB”), headquartered in Franklin, Tennessee from the FDIC, as receiver for TCB. This acquisition represents a single banking center located in the Nashville MSA and represents RB&T’s initial entrance into the Tennessee market.

Market for Services

Management believes that the Bank’s principal markets are the residential real estate market and small-to-medium sized businesses within its primary market. Businesses are solicited through the personal efforts of the officers and directors of both Republic and the Bank throughout the Bank’s banking center network. Management believes that a locally-based bank is perceived by the local small-to-medium sized business community as possessing a clearer understanding of local banking needs, thus providing the Bank with advantages over its non-locally based competition. Management also believes that it is able to make prudent lending decisions more quickly than its competitors without compromising asset quality or profitability.

Lending Activities

The Bank principally markets its lending products and services through the following delivery channels:

Mortgage Lending – A major component of the Bank’s lending activities consists of the origination of single family first lien residential real estate loans collateralized by owner occupied property, predominately located in the Bank’s primary market areas. Additionally, the Bank offers home equity loans and home equity lines of credit. These loans are originated through the Bank’s retail banking center network.

The Bank generally retains adjustable rate mortgage (“ARM”) single family first lien residential real estate loans with fixed terms up to ten years. All mortgage loans retained on balance sheet are included as a component of the Company’s “Traditional Banking” segment and are discussed below and elsewhere in this filing.

Single family first lien residential real estate loans with fixed rate terms of 15, 20 and 30 years are generally sold into the secondary market and their accompanying mortgage servicing rights (“MSRs”), which may be either sold or retained, are included as a component of the Company’s “Mortgage Banking” segment and are discussed below and elsewhere in this filing. Home equity loans or home equity lines of credit are actively marketed in conjunction with single family first lien residential real estate loans and are not sold into the secondary market. In order to take advantage of the steep yield curve during 2011, 2010 and 2009, the Bank elected to retain approximately \$45 million, \$65 million and \$100 million of 15 year fixed rate single family first lien residential real estate loans, funding these loans with excess cash in 2011 and 2010 and long-term Federal Home Loan Bank (“FHLB”) advances in 2009. In addition, during 2011, the Bank retained approximately \$14 million of 30 year fixed rate single family first lien residential real estate loans.

As a result of the historically low interest rate environment the last three years, the Bank has been challenged to grow its residential real estate portfolio, as consumer demand shifted to 15 and 30 year fixed rate loan products that the Bank has historically sold into the secondary market. As previously discussed, the Bank did elect during 2011 to originate and retain \$59 million of longer-term fixed rate loans that it has typically sold into the secondary market. In addition to this strategy, the Bank also created a fixed rate Home Equity Amortizing Loan (“HEAL”) product during the second half of 2010 in an effort to grow its residential real estate portfolio. The HEAL product is a first mortgage or a junior lien mortgage product with amortization periods of 20 years or less. Features of the HEAL include \$199 fixed closing costs; no requirement for the client to escrow insurance and property taxes; and as with the Bank’s traditional ARM products, no requirement for private mortgage insurance. The overall features of the HEAL have made it an attractive alternative to long-term fixed rate secondary market products. As of December 31, 2011, the Bank had \$58 million of HEALs outstanding.

The Bank offers ARMs with rate adjustments tied to various indices with specified minimum and maximum interest rate adjustments. The interest rates on a majority of these loans are adjusted after their fixed rate terms on an annual basis, with most having limitations on upward adjustments over the life of the loan. These loans typically feature amortization periods of up to 30 years and have fixed rate features for one, three, five, seven or ten years. While there is no requirement for a client to refinance his or her loan at the end of the fixed rate period, the client has historically done so the substantial majority of the time as most clients are interest rate risk-averse on their first mortgage loans. Because the substantial majority of these loans refinance at the end of their fixed rate periods, the interest rate risk that the Bank incurs as a result of these products is similar to balloon products.

The Bank generally charges a higher interest rate for its ARM products if the property is not owner occupied. It has been the Bank’s experience that the proportions of fixed rate and ARM originations depend in large part on the interest rate environment. As interest rates decline, there is generally a reduced demand for ARMs and an increased demand for fixed rate secondary market loans. Alternatively, as interest rates rise, there is generally an increased demand for

ARMs, as consumer demand shifts away from fixed rate secondary market loans.

7

Prior to the fourth quarter of 2009, in the Bank's primary markets of Kentucky and southern Indiana, ARM loans collateralized by single family first lien residential real estate were generally originated in amounts up to 90% of appraised value; however, the Bank commonly included home equity lines of credit in conjunction with its first liens, often increasing the loan to value of the entire relationship to 100%. During the fourth quarter of 2009, the Bank reduced the maximum combined first and second lien position loan-to-value ratio for new ARM originations in all markets to 80%. The Bank requires mortgagee's title insurance to protect the Bank against defects in its liens on the properties that collateralize the loans. The Bank, in most cases, requires title, fire, and extended casualty insurance to be obtained by the borrower and when required by applicable regulations, flood insurance. The Bank maintains an errors and omissions insurance policy to protect the Bank against loss in the event a borrower fails to maintain proper fire and other hazard insurance policies.

See the sections titled "Allowance for Loan Losses and Provision for Loan Losses" and "Credit Quality" within Part II Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for detail regarding the Bank's allowance methodology related to its home equity loan portfolio.

Although the contractual loan payment periods for single family first lien residential real estate ARM loans are generally for a 15 to 30 year period, such loans often remain outstanding for only their fixed rate periods, which is significantly shorter than the contractual terms. The Bank generally charges a penalty for prepayment of ARM loans if they are refinanced prior to the completion of their fixed rate period.

The Bank does on occasion purchase single family first lien residential real estate loans in low to moderate income areas in order to meet its obligations under the Community Reinvestment Act ("CRA"). The Bank generally applies secondary market underwriting criteria to these purchased loans and generally reserves the right to reject particular loans from a loan package being purchased that do not meet its underwriting criteria. In connection with loan purchases, the Bank receives various representations and warranties from the sellers of the loans regarding the quality and characteristics of the loans.

Commercial Lending – The Bank's commercial real estate and multi-family ("commercial real estate") loans are typically secured by improved property such as office buildings, medical facilities, retail centers, warehouses, apartment buildings, condominiums, hotels and other types of commercial real estate.

In the Bank's primary market area of Kentucky and southern Indiana, commercial real estate loans are generally made in amounts up to 85% of the lesser of the appraised value or purchase price of the property. In its Florida market, the Bank will typically only originate commercial real estate loans up to 80% of the lesser of the appraised value or the purchase price of the property. Commercial real estate loans generally have fixed or variable interest rates indexed to prime interest rates and have terms of three, five, seven or ten years with amortizing terms up to 20 years. Although the contractual loan payment period for these types of loans is generally a 20 year period, such loans often remain outstanding for only their fixed rate periods, which is significantly shorter than their contractual terms. The Bank generally charges a penalty for prepayment of commercial real estate loans if the loans are refinanced prior to the completion of their fixed rate period.

Loans secured by commercial real estate generally are larger and involve greater risks than single family first lien residential real estate loans. Because payments on loans secured by commercial real estate properties often are dependent on successful operation or management of the properties or businesses operated from the properties, repayment of such loans may be impacted to a greater extent by adverse conditions in the national and local economies. The Bank seeks to minimize these risks in a variety of ways, including limiting the size of commercial real estate loans and generally restricting such loans to its primary market area. In determining whether to originate commercial real estate loans, the Bank also considers such factors as the financial condition of the borrower and guarantor and the debt service coverage of the property when applicable.

A broad range of short-to-medium-term collateralized commercial loans are made available to businesses for working capital, business expansion (including acquisitions of real estate and improvements), and the purchase of equipment or machinery. The Bank also offers a variety of commercial loans, including term loans, lines of credit and equipment and receivables financing. Equipment loans are typically originated on a fixed-term basis ranging from one to five years.

As mentioned above, the availability of funds for the repayment of commercial loans may be substantially dependent on the success of the business itself. Further, the collateral underlying the loans, which may depreciate over time, usually cannot be appraised with as much precision as residential real estate and may fluctuate in value over the term of the loan.

In June 2011, the Bank commenced business in its newly established warehouse lending division. Through this division, the Bank provides short-term, revolving credit facilities to mortgage bankers across the nation. These credit facilities are secured by single family first lien residential real estate loans. The credit facility enables the mortgage banking customers to close single family first lien residential real estate loans in their own name and temporarily fund their inventory of these closed loans until the loans are sold to investors approved by the Bank. These individual loans are expected to remain on the warehouse line for an average of 15 to 30 days. Interest income and loan fees are accrued for each individual loan during the time the loan remains on the warehouse line and collected when the loan is sold to the secondary market investor. The Bank receives the sale proceeds of each loan directly from the investor and applies the funds to payoff the warehouse advance and related accrued interest and fees. The remaining proceeds are credited to the mortgage banking customer.

Construction Lending – The Bank originates residential construction real estate loans to finance the construction of single family dwellings. The Bank’s construction loans to individuals typically range in size from \$100,000 to \$300,000. Construction loans also are made to contractors to build single family dwellings under contract. Construction loans are generally offered on the same basis as other single family first lien residential real estate loans, except that a larger percentage down payment is typically required.

The Bank finances the construction of individual owner occupied houses on the basis of written underwriting and construction loan management guidelines. Construction loans are structured either to be converted to permanent loans with the Bank at the end of the construction phase or to be paid off at closing. Construction loans on residential properties in the Bank’s markets are generally made in amounts up to 80% of anticipated cost of construction. Construction loans to developers and builders generally have terms of nine to 12 months. Loan proceeds on builders’ projects are disbursed in increments as construction progresses and as property inspections warrant.

The Bank also may make residential land development loans to real estate developers for the acquisition, development and construction of residential subdivisions. Such loans may involve additional risks because the funds are advanced to fund the project while under construction, and the project is of uncertain value prior to completion. Moreover, because it is relatively difficult to evaluate completion value accurately, the total amount of funds required to complete a development may be subject to change. Repayments of these loans depend to a large degree on results of operations, management of properties and conditions in the real estate market or the economy.

Consumer Lending – Traditional consumer loans made by the Bank include home improvement and home equity loans, as well as other secured and unsecured personal loans in addition to credit cards. With the exception of home equity loans, which are actively marketed in conjunction with single family first lien residential real estate loans, other traditional consumer loan products, while available, are not and have not been actively promoted in the Bank’s markets.

Loan Origination and Processing – Loan originations are derived primarily from direct solicitation by the Bank’s loan officers, present bank customers, builders, realtors and walk-in customers. Mortgage loan applications are underwritten and closed based on the Bank’s standards, which are generally consistent with the Federal Home Loan Mortgage Corporation (“Freddie Mac” or “FHLMC”) underwriting guidelines. Consumer and commercial real estate loan originations emanate from many of the same sources.

The loan underwriting procedures followed by the Bank are designed to assess the borrower’s ability to make principal and interest payments and to support the value of any assets or property serving as collateral for the loan. Generally, as part of the process, a bank loan officer meets with the applicant to obtain the appropriate employment and financial information, as well as any other required application information. Upon receipt of the borrower’s completed loan application, the Bank obtains reports with respect to the borrower’s credit record and independent appraisals of any collateral for the loan are ordered. The application information supplied by the borrower is independently verified.

Once a loan application has been completed and all information has been obtained and verified, the loan request is submitted for a final review process. As part of the loan approval process, all uncollateralized loans of more than \$150,000 and all collateralized loans of more than \$1.5 million require approval by the Bank's Loan Committee. Loans to one borrower are subject to limits depending on the Bank's internal risk ratings and applicable legal lending limitations.

The Bank's commercial and commercial real estate loans undergo centralized underwriting on the basis of the borrower's ability to make repayment from the cash flow of their business. As a general practice, in addition to personal guarantees, the Bank takes a security interest in real estate, equipment, or other general business assets. Collateralized working capital loans are primarily secured by short-term assets, whereas long-term loans are primarily secured by long-term assets.

Loan applicants are notified promptly of the decision of the Bank by telephone and a letter. If a commercial loan is approved, a commitment letter is generated that specifies the terms and conditions of the proposed loan including the amount of the loan, interest rate, amortization term, a brief description of the required collateral and required insurance coverage. Interest rates on committed loans are normally locked in at the time of application for a 30 to 45 day period.

Private Banking – The Bank provides financial products and services to high net worth individuals through its Private Banking Department. The Bank’s Private Banking officers have extensive banking experience and are trained to meet the unique financial needs of high net worth individuals.

Treasury Management Services – The Bank provides various deposit products designed for commercial business customers located throughout its market areas. Lockbox processing, remote deposit capture, business online banking, account reconciliation and Automated Clearing House (“ACH”) processing are additional services offered to commercial businesses through the Bank’s Treasury Management Department.

Internet Banking – The Bank expands its market penetration and service delivery by offering customers Internet banking services and products through its website, www.republicbank.com.

Other Banking Services – The Bank also provides trust, title insurance and other financial institution related products and services.

(II) Mortgage Banking segment

Mortgage Banking activities primarily include 15, 20 and 30-year fixed-term single family first lien residential rate real estate loans that are sold into the secondary market, primarily to FHLMC. The Bank typically retains servicing on loans sold into the secondary market. Administration of loans with servicing retained by the Bank includes collecting principal and interest payments, escrowing funds for property taxes and insurance and remitting payments to secondary market investors. A fee is received by the Bank for performing these standard servicing functions.

As part of the sale of loans with servicing retained, the Bank records a MSR. MSRs represent an estimate of the present value of future cash servicing income, net of estimated costs, which the Bank expects to receive on loans sold with servicing retained by the Bank. MSRs are capitalized as separate assets. This transaction is posted to net gain on sale of loans, a component of “Mortgage Banking income” in the income statement. Management considers all relevant factors, in addition to pricing considerations from other servicers, to estimate the fair value of the MSRs to be recorded when the loans are initially sold with servicing retained by the Bank. The carrying value of MSRs is initially amortized in proportion to and over the estimated period of net servicing income and subsequently adjusted quarterly based on the weighted average remaining life of the underlying loans. The amortization is recorded as a reduction to Mortgage Banking income.

The carrying value of the MSRs asset is reviewed monthly for impairment based on the fair value of the MSRs, using groupings of the underlying loans by interest rates. Any impairment of a grouping is reported as a valuation allowance. A primary factor influencing the fair value is the estimated life of the underlying loans serviced. The estimated life of the loans serviced is significantly influenced by market interest rates. During a period of declining interest rates, the fair value of the MSRs is expected to decline due to increased anticipated prepayment speed assumptions within the portfolio. Alternatively, during a period of rising interest rates, the fair value of MSRs is expected to increase, as prepayment speed assumptions on the underlying loans would be anticipated to decline. Management utilizes an independent third party on a monthly basis to assist with the fair value estimate of the MSRs.

Due to the reduction in long-term interest rates during the second half of 2011, the fair value of the MSR portfolio declined as prepayment speed assumptions were adjusted upwards, resulting in an impairment charge of \$203,000 at December 31, 2011.

Due to the significant reduction in long-term interest rates during December of 2008, the fair value of the MSR portfolio declined. As prepayment speed assumptions were adjusted upwards, the Bank incurred an impairment charge of \$1.3 million for the fourth quarter and year ended December 31, 2008. During the first quarter of 2009, prepayment speed assumptions stabilized to levels similar to those assumed in the third quarter of 2008 and the Bank reversed \$1.1 million from the valuation allowance. The Bank reversed an additional \$122,000 during the second quarter of 2009.

There were no impairment charges recorded prior to the fourth quarter of 2008 and no MSR valuation allowance existed at December 31, 2009. During the third quarter of 2010, the Bank recorded an MSR valuation allowance of \$157,000; however, this valuation allowance was reversed in the fourth quarter of 2010 resulting in an end-of-year valuation allowance of \$0.

See additional discussion regarding Mortgage Banking under the sections titled: Part I Item 1A “Risk Factors” and Part II Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Footnote 5 “Mortgage Banking Activities” and Footnote 21 “Segment Information” of Part II Item 8 “Financial Statements and Supplementary Data.”

(III) TRS segment

Republic, through its TRS segment, is one of a limited number of financial institutions which facilitates the payment of federal and state tax refund products through third-party tax preparers located throughout the U.S., as well as tax-preparation software providers. TRS’s three primary tax-related products include: ERCs, ERDs and RALs. Substantially all of the business generated by TRS occurs in the first quarter of the year. TRS traditionally operates at a loss during the second half of the year, during which the segment incurs costs preparing for the upcoming year’s first quarter tax season.

During the years ended December 31, 2011, 2010 and 2009, net income from the TRS segment accounted for approximately 72%, 68% and 47% of the Company’s total net income. Net income associated with RALs represented approximately 35%, 45% and 70% of the TRS segment’s net income for same respective periods. As discussed below, the Company has agreed to cease the RAL portion of the TRS business subsequent to April 30, 2012.

ERCs/ERDs are products whereby a tax refund is issued to the taxpayer after RB&T has received the refund from the federal or state government. There is no credit risk or borrowing cost for RB&T associated with these products, because they are only delivered to the taxpayer upon receipt of the refund directly from the Internal Revenue Service (“IRS”). Fees earned on ERCs/ERDs are reported as non interest income under the line item “Electronic Refund Check fees.”

RALs are short-term consumer loans offered to taxpayers that are secured by the customer’s anticipated tax refund, which represents the source of repayment. Prior to 2011, RB&T historically underwrote the RAL application utilizing the Debt Indicator (“DI”) from the IRS in combination with an automated underwriting model utilizing information contained in the taxpayer’s tax return. The DI, which indicates whether an individual taxpayer will have any portion of the refund offset for delinquent tax or other debts, such as unpaid child support or federally funded student loans, has historically been a meaningful underwriting component. In August 2010, the IRS announced that it would no longer provide tax preparers and associated financial institutions with the DI beginning with the first quarter 2011 tax season. In response to loss of access to the DI in 2011, RB&T significantly reduced the maximum RAL amount to \$1,500 for individual customers, raised the RAL offering price to its customers and modified its underwriting and application requirements resulting in fewer RALs approved.

If a consumer’s RAL application is approved, RB&T advances \$1,500 of the taxpayer’s refund. As part of the RAL application process, each taxpayer signs an agreement directing the applicable taxing authority to send the taxpayer’s refund directly to RB&T. The refund received from the IRS or state taxing authority, if applicable, is used by RB&T to pay off the RAL. Any amount due the taxpayer above the amount of the RAL is remitted to the taxpayer once the refund is received by RB&T. The funds advanced by RB&T are generally repaid by the applicable taxing authority within two weeks. The fees earned on RALs are reported as interest income under the line item “Loans, including fees.”

RB&T has agreements with Jackson Hewitt Inc. (“JHI”), a subsidiary of Jackson Hewitt Tax Service Inc. (“JH”), and Liberty Tax Service (“Liberty”) to offer RAL and ERC/ERD products. JH and Liberty provide preparation services of federal, state and local individual income tax returns in the U.S. through a nationwide network of franchised and company-owned tax-preparers offices. Approximately 40% and 34% of RB&T’s 2011 and 2010 TRS gross revenue was derived from JH tax offices with another 20% and 29% from Liberty tax offices for the same respective periods.

Substantially all RALs issued by RB&T each year are made during the first quarter. RALs are generally repaid by the IRS or applicable taxing authority within two weeks of origination. Losses associated with RALs result from the IRS not remitting taxpayer refunds to RB&T associated with a particular tax return. This occurs for a number of reasons, including errors in the tax return and tax return fraud which are identified through IRS audits resulting from revenue protection strategies. In addition, RB&T also incurs losses as a result of tax debts not previously disclosed during its underwriting process.

At March 31st of each year, RB&T has historically reserved for its estimated RAL losses for the year based on current and prior year funding patterns, information received from the IRS on current year payment processing, projections using RB&T's internal RAL underwriting criteria applied against prior years' customer data, and the subjective experience of RB&T management. RALs outstanding 30 days or longer are charged off at the end of each quarter, with subsequent collections recorded as recoveries. Since the RAL season is over by the end of April of each year, essentially all uncollected RALs are charged off by June 30th of each year, except for those RALs management deems certain of collection.

Subsequent to the first quarter, the results of operations for the TRS segment consist primarily of fixed overhead expenses and adjustments to the segment's estimated provision for loan losses, as estimated results became final.

TRS Funding – First Quarter 2012 Tax Season

During the fourth quarter of 2011, in anticipation of first quarter 2012 RAL program, RB&T obtained \$300 million in FHLB advances with a weighted average life of three months with a weighted average interest rate of 0.10%. Management anticipates obtaining between \$200 million and \$300 million of short-term brokered deposits during January 2012 to complete its anticipated funding needs for the first quarter 2012 tax season. Management expects these brokered deposits to have a weighted average maturity of 44 days with a weighted average cost of approximately 0.39%. Management estimates its total weighted average funding cost to be 0.23% for the first quarter 2012 tax season.

TRS Funding – First Quarter 2011 Tax Season

Due to RB&T's reduction to its maximum RAL offering amount and its revised underwriting guidelines in response to the elimination of the DI by the IRS, RB&T's funding needs for the first quarter 2011 tax season were significantly reduced compared to prior years. During the fourth quarter of 2010, RB&T obtained \$562 million in brokered certificates of deposits to be utilized to fund the first quarter 2011 RAL program. These brokered certificates of deposits had a weighted average life of three months with a weighted average interest rate of 0.42%.

Direct IRS Competition for TRS

During 2010, the IRS announced plans to explore the possibility of providing a new tool to give taxpayers a mechanism to use a portion of their tax refund to pay for the services of a professional tax preparer. This product would likely present direct competition for RB&T's ERC products. During June 2011, the IRS announced it was no longer pursuing this initiative in the near-term.

TRS Material Contracts

In December 2011, amended and restated its Marketing and Servicing Agreement (the "Marketing Agreement") with Liberty to, among other things:

- set the term of the Agreement to expire on October 16, 2014;
- name RB&T as the exclusive provider of all RAL and ERC/ERD products for a mutually agreed upon list of locations through the term of the contract;
- remove RB&T's annual option to unilaterally terminate the Agreement;
- amend the designated level of RAL delinquency which, if exceeded, provides RB&T with the right to receive certain monies; and
- provided that either party may at its option terminate the Marketing Agreement upon twenty days' prior written notice if (i) the other party has materially breached any of the terms thereof and has failed to cure such breach within such twenty day time period or (ii) the continued operation of the Financial Product Program or the electronic filing program is no longer commercially feasible or practical, or no longer provides the same opportunity, to the terminating party due to legal, legislative or regulatory determinations, enactments or interpretations or significant external events or occurrences beyond the control of the terminating party; provided, however, that in the case of clause (ii), the parties shall first mutually endeavor in good faith to modify the Financial Product Program in a manner resolving the problems caused by legal, legislative or regulatory or external events or occurrences.

As a result of this amendment, the total number of Liberty tax preparation offices that will offer RB&T's tax products in 2012 is not expected to differ materially from the number of Liberty tax preparation offices that offered the RB&T's products in 2011.

In August 2011, RB&T amended and restated its Program Agreement (the “Program Agreement”) with JHI to, among other things:

add Jackson Hewitt Technology Services LLC (“JHTSL”) as a party to the Program Agreement whereby JHTSL agreed to provide certain technology services, including personnel to RB&T, in connection with the services provided for under the Program Agreement;

set the term of the Program Agreement to expire on October 14, 2014;

remove RB&T’s annual option to unilaterally terminate the Program Agreement;

amend the termination provisions of the Program Agreement to provide RB&T an additional termination right due to regulatory direction relative to its tax products; and

amend the provisions of the Program Agreement to modify, in part, the method of designation of Jackson Hewitt tax preparation locations that will offer RB&T’s tax products in 2012, 2013 and 2014 and provide that RB&T shall be the exclusive tax product provider in those locations.

As a result of this amendment, the total number of JH tax preparation offices that will offer RB&T's tax products in 2012 is not expected to differ materially from the number of JH tax preparation offices that offered the RB&T's products in 2011.

Resolution of FDIC-Related Regulatory Matters

On a recurring basis, the FDIC performs a Community Reinvestment Act Performance Evaluation of RB&T. Among other things, the purpose of this evaluation is to assess RB&T's performance and initiatives that are designed to help meet the credit needs of the areas it serves, including low- and moderate-income individuals, neighborhoods and businesses. The evaluation also includes a review of RB&T's community development services and investments in RB&T's assessment areas.

In February 2009, RB&T entered into a Stipulation and Consent Agreement with the FDIC agreeing to the issuance of a Cease and Desist Order (the "2009 Order"), predominately related to required improvements and increased oversight of RB&T's compliance management system. For additional discussion regarding the 2009 Order, see the Company's Form 10-K filed with the Securities and Exchange Commission (the "SEC") on March 6, 2009, including Exhibit 10.62.

The 2009 Order cited insufficient oversight of RB&T's consumer compliance programs, most notably in RB&T's RAL program. The 2009 Order required increased compliance oversight of the RAL program by RB&T's management and board of directors, subject to review and approval by the FDIC. Under the 2009 Order, RB&T increased its training and audits of its Electronic Return Originator ("ERO") partners, who make RB&T's tax products available to taxpayers across the nation. In addition, various components of the 2009 Order required RB&T to meet certain implementation, completion and reporting timelines, including the establishment of a compliance management system to appropriately assess, measure, monitor and control third-party risk and ensure compliance with consumer laws.

In addition to the compliance issues cited in regard to the RAL program, the 2009 Order also required RB&T to correct Home Mortgage Disclosure Act ("HMDA") reporting errors. As a consequence, RB&T made certain corrections to its 2007 and 2006 HMDA reporting. As a result of the errors in its 2007 and 2006 HMDA data and paid a \$22,000 Civil Money Penalty ("CMP") during the first quarter of 2009.

During the fourth quarter of 2009, the FDIC began the process for the 2009 Community Reinvestment Act Performance Evaluation (the "2009 CRA Evaluation"). During the third quarter of 2010, the FDIC notified RB&T of its 2009 CRA Evaluation performance rating. RB&T received "High Satisfactory" ratings on the Investment Test component and the Service Test component evaluated as part of the 2009 CRA Evaluation. Based on alleged Regulation B ("Reg B") violations regarding documentation of spousal obligations on a limited number of loans identified within RB&T's commercial lending area, RB&T received a "Needs to Improve" rating on the Lending Test component, and as a result, a "Needs to Improve" rating on its overall rating. As required by statute, the FDIC referred these alleged Reg B violations to the Department of Justice ("DOJ"). The FDIC subsequently notified RB&T that the DOJ had referred this matter back to the FDIC for administrative handling.

Prior to the FDIC's notification to RB&T of its 2009 CRA Evaluation results, RB&T changed certain procedures and processes to better document its commercial loan origination process as it relates to the intent of both spouses to become obligated to repay certain commercial loans. The FDIC did notify RB&T of certain additional corrective actions to be undertaken in response to the alleged Reg B violations.

FDIC Proceedings Regarding the TRS segment:

In February 2011, RB&T received a Notice of Charges for an Order to Cease and Desist and Notice of Hearing from the FDIC (the "Notice") regarding its RAL program. The Notice contended that RB&T's practice of originating RALs

without the benefit of the Debt Indicator (“DI”) from the Internal Revenue Service (“IRS”) was unsafe and unsound. The Notice did not address RB&T’s ERC and ERD products. The Notice initiated an agency adjudication proceeding, In Republic Bank & Trust Company, to determine whether the FDIC should issue a cease and desist order to restrain RB&T’s RAL program. For additional discussion regarding the Notice, see the Company’s Form 8-K filed with the SEC on February 10, 2011, including Exhibit 10.1.

On May 3, 2011, RB&T received an Amended Notice of Charges for an Order to Cease and Desist and Notice of Hearing from the FDIC (the “Amended Notice”) from the FDIC revising its original Notice referenced in the preceding paragraph. The Amended Notice resulted from conclusions made by the FDIC during a targeted visitation of 250 ERO offices in 36 states, which it conducted on February 15 and 16, 2011. In addition to the allegations contained in the Notice, the Amended Notice alleged violations of the Truth-In-Lending Act, the Equal Credit Opportunity Act, and the Federal Trade Commission Act. The Amended Notice also accused RB&T of, among other things, unsafe or unsound banking practices resulting from its third-party management; unsafe or unsound hindrance, impediment, or interference with a financial institution examination; unsafe or unsound physical security or electronic protection of ERO premises; violations of the Gramm-Leach-Bliley Act and FDIC regulation; and violations of the 2009 Order. Moreover, the Amended Notice included an assessment of a \$2 million CMP. As a result, RB&T recorded a \$2 million liability as of June 30, 2011. For additional discussion regarding the Amended Notice, see the Company’s Form 8-K filed with the SEC on May 5, 2011, including Exhibits 99.1 and 99.2.

Federal District Court Litigation:

On February 28, 2011, RB&T filed a complaint in the United States District Court for the Western District of Kentucky (the “Court”) against the FDIC and various officers of the FDIC in their official capacities, entitled Republic Bank & Trust Company v. Federal Deposit Insurance Corporation, et al (the “Litigation”). The complaint stated that the FDIC’s actions to prohibit RB&T from offering RALs constituted a generally applicable change in law that must be administered through the traditional notice and comment rulemaking required by the Administrative Procedure Act (the “APA”) or otherwise in a fashion permitted by law that is separate and apart from the adjudicatory process initiated by the Notice. The complaint also stated that the FDIC had unlawfully ignored its procedural rules regarding discovery in the proceedings initiated by the Notice by conducting a series of unscheduled “visitations.” The complaint sought declaratory and injunctive relief. On March 31, 2011, the FDIC filed a Motion to Dismiss (the “Motion”) RB&T’s complaint with the Court. RB&T timely filed its brief in opposition to the Motion, and the matter remained pending with the Court up through RB&T’s resolution with the FDIC discussed below.

Resolution of all FDIC-Related Proceedings:

Effective December 8, 2011, RB&T entered into an agreement with the FDIC resolving its differences regarding the TRS operating segment. RB&T’s resolution with the FDIC was in the form of a Stipulation Agreement and a Consent Order (collectively, the “Agreement”). As part of the Agreement, RB&T and the FDIC settled all matters set out in the Amended Notice and the Litigation. More specifically,

the FDIC terminated the 2009 Order against RB&T entered on February 27, 2009;
the \$2 million CMP was reduced to \$900,000;

RB&T was allowed to immediately resume expansionary activities and transactions in the ordinary course, so long as RB&T maintains appropriate regulatory ratings;

RB&T developed an Electronic Return Originator (“ERO”) Oversight Plan (the “ERO Plan”), which the FDIC agreed to and is more fully described below;

RB&T agreed to cease the RAL portion of its tax business by April 30, 2012, after the first quarter 2012 tax season;

the FDIC and RB&T discontinued their administrative proceeding commenced in February 2011; and
RB&T terminated the Litigation.

As disclosed above, the Agreement reduced the previously announced CMP against RB&T from \$2 million to \$900,000. As a result of the reduced CMP, RB&T, which had previously reserved \$2 million for the CMP during the second quarter of 2011, recorded a \$1.1 million credit to pre-tax income during the fourth quarter of 2011.

As disclosed above, RB&T developed an ERO Plan, which was agreed to by the FDIC. The ERO Plan articulates a framework for RB&T to continue to offer non-RAL tax related products and services with specified oversight of the tax preparers with which RB&T does business. The ERO Plan includes requirements for, among other things,

positive affirmations by EROs of individual tax preparer training related to regulatory requirements applicable to bank products;

annual audits covering 10% of active ERO locations and a significant sample of applications for Bank products. The audits will consist of onsite visits, document reviews, mystery shops of tax preparation offices, and tax product customer surveys;

on-site audit confirmation of ERO agreements to adhere to laws, processes, procedures, disclosure requirements and physical and electronic security requirements;

an advertising approval process that requires RB&T to approve all tax preparer advertisements prior to their issuance;

monitoring of ERO offices for income tax return quality;

monitoring of ERO offices for adherence to acceptable tax preparation fee parameters;

- monitoring for federal and state tax preparation requirements, including local and state tax preparer registration, and posting and disclosure requirements relative to Bank products;
- RB&T to provide advance notification, as practicable, to the FDIC of any significant changes in the TRS line of business, including
 - o a change of more than 25% from the prior tax season in the number of EROs with which RB&T is doing business, or
 - o the addition of tax-related products offered by RB&T that it did not previously offer; and
 - RB&T to provide advance notification, as practicable, to the FDIC when RB&T enters into a relationship with a new corporation that has multiple owned or franchised locations, when the relationship alone will represent an increase of more than 10% from the prior tax season in the number of EROs with which RB&T is doing business.

Because the Agreement does not affect RB&T’s ability to offer RALs for the first quarter 2012 tax season, it is not expected to have a material adverse impact on net income for the first quarter of 2012 or for the 2012 calendar year. RB&T’s discontinuance of RALs beyond 2012 is expected to have a material adverse impact on net income in 2013 and beyond, as the RAL product accounted for approximately 35% of the TRS segment’s 2011 net income of \$67.3 million. It is expected that TRS will continue to be a material contributor to the Company’s overall net income in 2013 and beyond. Actual TRS net income for 2012 and beyond will be impacted by a number of factors, including those factors disclosed from time to time in the Company’s filings with the SEC and set forth under Part I Item 1A “Risk Factors.”

For additional discussion regarding TRS, see the following sections:

- o Part I Item 1 “Business”
 - o Part I Item 1A “Risk Factors”
- o Part II Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations:”
 - o “Critical Accounting Policies and Estimates”
 - o “Recent Developments”
 - o “Overview”
 - o “Results of Operations”
 - o “Financial Condition”
 - o Part II Item 8 “Financial Statements and Supplementary Data:”
 - o Footnote 1 “Summary of Significant Accounting Policies”
 - o Footnote 3 “Loans and Allowance for Loan Losses”
 - o Footnote 8 “Deposits”
 - o Footnote 10 “FHLB Advances”
 - o Footnote 18 “Off balance sheet risks, Commitments and Contingent Liabilities”
 - o Footnote 21 “Segment Information”
 - o Footnote 22 “Regulatory Matters”