PINNACLE FINANCIAL PARTNERS INC
Form 10-K
March 02, 2012

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

FORM 10-K

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

For the fiscal year ended December 31, 2011

OR

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

For the transition period from ________ to ________

Commission File Number: 000-31225

(Exact name of registrant as specified in charter)

Tennessee	62-1812853
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)

150 Third Avenue South, Suite 900, Nashville, Tennessee	37201
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (615) 744-3700

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

Title of Each Class	Name of Exchange on which Registered
Common Stock, par value $1.00	Nasdaq Global Select Market

Securities registered to Section 12(g) of the Act:
None

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

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

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 x No o

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

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 "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer o	Accelerated Filer x	Non-accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

Indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o   No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity as of the last business day of the registrant's most recently completed second fiscal quarter: $531,158,696 as of June 30, 2011.

APPLICABLE ONLY TO CORPORATE REGISTRANTS

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date: 34,607,034 shares of common stock as of February 24, 2012.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders, scheduled to be held April 17, 2012, are incorporated by reference into Part III of this Form 10-K.

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FORWARD-LOOKING STATEMENTS

Certain of the statements in this report may constitute forward-looking statements 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 words "expect," "anticipate," "goal," "objective," "intend," "plan," "believe," "should," "seek," "estimate" and similar express intended to identify such forward-looking statements, but other statements not based on historical information may also be considered forward-looking. All forward-looking statements are subject to risks, uncertainties and other factors that may cause the actual results, performance or achievements of Pinnacle Financial to differ materially from any results expressed or implied by such forward-looking statements. Such risks include, without limitation, (i) deterioration in the financial condition of borrowers resulting in significant increases in loan losses and provisions for those losses; (ii) continuation of the historically low, short-term interest rate environment; (iii) the inability of Pinnacle Financial to grow its loan portfolio in the Nashville-Davidson-Murfreesboro-Franklin MSA ("the Nashville MSA") and the Knoxville MSA; (iv) changes in loan underwriting, credit review or loss reserve policies associated with economic conditions, examination conclusions, or regulatory developments; (v) effectiveness of Pinnacle Financial's asset management activities in improving, resolving or liquidating lower-quality assets; (vi) increased competition with other financial institutions; (vii) greater than anticipated adverse conditions in the national or local economies including the Nashville MSA and the Knoxville MSA, particularly in commercial and residential real estate markets; (viii) rapid fluctuations or unanticipated changes in interest rates; (ix) the results of regulatory examinations; (x) the development of any new market other than Nashville or Knoxville; (xi) a merger or acquisition; (xii) any matter that would cause Pinnacle Financial to conclude that there was impairment of any asset, including intangible assets; (xiii) the ability to attract additional financial advisors or to attract customers from other financial institutions and conversely, the inability to realize the economic benefits of newly hired financial advisors; (xiv) the impact of governmental restrictions on and discretionary regulatory authority over entities participating in the Capital Purchase Program (the "CPP") of the U.S. Department of the Treasury (the "U.S. Treasury"); (xv) further deterioration in the valuation of other real estate owned and increased expenses associated therewith; (xvi) inability to comply with regulatory capital requirements or to secure any required regulatory approvals for capital actions, including redemption of the remaining preferred shares sold to the U.S. Treasury that are outstanding; and, (xvii) changes in state and federal legislation, regulations or policies applicable to banks and other financial service providers, including regulatory or legislative developments arising out of current unsettled conditions in the economy, including implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). A more detailed description of these and other risks is contained in "Item 1A. Risk Factors" below. Many of such factors are beyond Pinnacle Financial's ability to control or predict, and readers are cautioned not to put undue reliance on such forward-looking statements. Pinnacle Financial disclaims any obligation to update or revise any forward-looking statements contained in this release, whether as a result of new information, future events or otherwise.

PART I

Unless this Form 10-K indicates otherwise or the context otherwise requires, the terms "we," "our," "us," "the firm," "Pinnacle Financial Partners," "Pinnacle" or "Pinnacle Financial" as used herein refer to Pinnacle Financial Partners, Inc., and its subsidiaries, including Pinnacle National Bank, which we sometimes refer to as "Pinnacle National," "our bank subsidiary" or "our bank" and its other subsidiaries. References herein to the fiscal years 2007, 2008, 2009, 2010 and 2011 mean our fiscal years ended December 31, 2007, 2008, 2009, 2010 and 2011, respectively.

ITEM 1. BUSINESS

OVERVIEW

Pinnacle Financial Partners is the second-largest bank holding company headquartered in Tennessee, with $4.9 billion in assets as of December 31, 2011. Incorporated on February 28, 2000, the holding company is the parent company of

Pinnacle National and owns 100% of the capital stock of Pinnacle National. The firm started operations on October 27, 2000, with one office in Nashville, Tennessee, and has since grown to 32 offices, including 29 in eight Middle Tennessee counties. The firm also has three offices in Knoxville, Tennessee, the state's third-largest banking market.

The firm operates as a community bank primarily in the urban markets of Nashville and Knoxville, Tennessee. As an urban community bank, Pinnacle Financial provides the personalized service most often associated with small community banks, while seeking to offer the sophisticated products and services, such as investments and treasury management, more typically offered by large regional and national banks. This approach has enabled Pinnacle Financial to attract clients from the regional and national banks in the Nashville and Knoxville MSAs. As a result, Pinnacle has grown to the fourth largest market share in the Nashville MSA and to the seventh largest market share in the Knoxville MSA.

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Competitive Conditions

The Nashville MSA banking market is very competitive, with 63 financial institutions with over $37.9 billion in deposits in the market as of June 30, 2011, up from approximately $37.2 billion at June 30, 2010 according to FDIC data. As of June 30, 2011, approximately 63.8% of this deposit base was controlled by seven large, multi-state banks headquartered outside of Nashville, consisting of the following: Bank of America (headquartered in Charlotte, North Carolina), Regions Financial (headquartered in Birmingham, Alabama), SunTrust (headquartered in Atlanta, Georgia), First Horizon (headquartered in Memphis, Tennessee), Wells Fargo (headquartered in San Francisco, CA), Fifth Third (headquartered in Cinncinnati, OH), and US Bank National Association (headquartered in Minneapolis, MN). According to FDIC deposit information, the collective market share of deposits in the Nashville MSA of Regions Financial (including the acquired Union Planters National Bank and AmSouth Bank), Bank of America, US Bank National Association (including the acquired First Union) and SunTrust (including the acquired National Bank of Commerce) declined from approximately 68.9% to 63.8% between June 30, 2001 and June 30, 2011. Pinnacle, on the other hand, after only eleven years of operations, now holds the No. 4 market share position in the Nashville MSA at June 30, 2011 with 9.0% of the market, immediately behind the top three out-of-state banks.

The Knoxville MSA banking market is also very competitive, with 44 financial institutions with over $13.7 billion in deposits in the market as of June 30, 2011. According to FDIC data, bank and thrift deposits in the Knoxville MSA grew from approximately $12.6 billion at June 30, 2010 to more than $13.7 billion at June 30, 2011. As of June 30, 2011, approximately 61.6% of this deposit base was controlled by four large, multi-state banks headquartered outside of Knoxville, consisting of the following: First Horizon, SunTrust, Regions Financial, and BB&T (headquartered in Winston-Salem, North Carolina). According to FDIC deposit information, the collective market share of deposits in the Knoxville MSA of First Horizon, Regions Financial, BB&T (including the acquired BankFirst) and SunTrust declined from 65.7% to 61.6% between June 30, 2001 and June 30, 2011. At June 30, 2007, shortly after Pinnacle Financial first opened a location in Knoxville, the collective market share of deposits in the Knoxville MSA for the same four competitors was 63.4%. A significant portion of the decline in market share for the top four competitors has occurred since Pinnacle Financial established a presence in the Knoxville MSA.

Consequently, while large, multi-state institutions are well established in both of our market areas, the general trends indicate that a majority of the community banks in our market areas have been able to increase their aggregate deposit market share in recent years at the expense of the larger, multi-state banks.

We believe that the most important criteria to our bank’s targeted clients when selecting a bank is their desire to receive exceptional and personal customer service while being able to enjoy convenient access to a broad array of sophisticated financial products. Additionally, when presented with a choice, we believe that many of our bank’s targeted clients would prefer to deal with a locally-owned institution headquartered in Tennessee, like Pinnacle National, as opposed to a large, multi-state bank, where many important decisions regarding a client’s financial affairs are made elsewhere.

Employees

As of February 15, 2012, we employed 742.5 full-time equivalent associates. We believe these associates are Pinnacle’s most important asset. We consider our relationship with our associates to be excellent. This is supported by the fact that for the ninth consecutive year, Pinnacle was named by the Nashville Business Journal as the “Best Place to Work in Nashville” among Middle Tennessee’s large companies with more than 100 employees. The selection is based on an anonymously conducted survey of associates.

PRODUCTS AND SERVICES

Lending Services

We offer a full range of lending products, including commercial, real estate and consumer loans to individuals and small-to medium-sized businesses and professional entities. We compete for these loans with competitors who are also well established in the Nashville and Knoxville MSAs.

Pinnacle National's loan approval policies provide for various levels of officer lending authority. When the total amount of loans to a single borrower exceeds an individual officer's lending authority, officers with higher lending authority determine whether to approve any new loan requests or renewals of existing loans. Loans to insiders require approval of the board, and, beginning in February 2010, extensions of credit to certain adversely classified loans require approval of a loan committee of the board.

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Pinnacle National's lending activities are subject to a variety of lending limits imposed by federal law. Differing limits apply based on the type of loan or the nature of the borrower, including the borrower's relationship to Pinnacle National. In general, however, at December 31, 2011, we were able to loan any one borrower a maximum amount equal to approximately $79.3 million plus an additional $132.1 million, or a total of approximately $211.4 million, for loans that meet certain additional federal collateral guidelines. These legal limits will increase or decrease as our bank subsidiary's capital increases or decreases as a result of its earnings or losses, the injection of additional capital, payments of dividends, or for other reasons. In addition to these regulatory limits, Pinnacle National currently imposes upon itself an internal lending limit of $15 million for relationships seeking current credit approval, which is significantly less than the prescribed legal lending limit. Prior to October 2009, our internal lending limit was $22 million. At that time, we maintained relationships which had aggregate exposure of greater than $15 million. These relationships have been grand-fathered under the previous guidelines and are not subject to our $15 million limitation. We currently have 21 relationships greater than our current in-house limit of $15 million with no relationship in excess of $25 million. Our loan policy requires that the executive committee of the board of directors determine whether to approve any increases in exposure for any relationships that exceed this internal limit.

The principal economic risk associated with each category of loans that Pinnacle National expects to make is the creditworthiness of the borrower. General economic factors affecting a commercial or consumer borrower's ability to repay include interest, inflation and unemployment rates, as well as other factors affecting a borrower's assets, clients, suppliers and employees. Many of Pinnacle National's commercial loans are made to small- to medium-sized businesses that are sometimes less able to withstand competitive, economic and financial pressures than larger borrowers. During periods of economic weakness, like those currently being experienced, these businesses may be more adversely affected than other enterprises and may cause increased levels of nonaccrual or other problem loans, loan charge-offs and higher provision for loan losses.

Primarily as a result of our acquisitions of Calvary Bancorp in Murfreesboro, TN in 2006 and Mid-America Bancshares in Nashville, TN in 2007, our portfolio includes residential construction and land acquisition and development loans. The prolonged and continuing weakness in the economy in our market areas has negatively impacted this industry, and many of our borrowers, significantly.

Pinnacle National's commercial clients borrow for a variety of purposes. The terms of these loans (which include equipment loans and working capital loans) will vary by purpose and by type of any underlying collateral. Commercial loans may be unsecured or secured by accounts receivable or by other business assets. Pinnacle National also makes a variety of commercial real estate loans, including both investment properties and business loans secured by real estate. We are seeking to decrease our exposure to the residential construction and land acquisition and development components of our portfolio and since December 31, 2008 we have reduced the amount of these loans from $645.4 million to $274.2 million, a decrease of $371.2 million.

Pinnacle National also makes a variety of loans to individuals for personal, family, investment and household purposes, including secured and unsecured installment and term loans, residential first mortgage loans, home equity loans and home equity lines of credit. In 2012, Pinnacle National also began offering auto dealer finance services to expand our product offering to automobile dealers and their customers. We also began offering Pinnacle-branded consumer credit cards to select clients of our firm. Prior to 2012, we issued credit cards to our customers on behalf of a third party.

Deposit Services

Pinnacle National seeks to establish a broad base of core deposits, including savings, checking, interest-bearing checking, money market and certificate of deposit accounts. To attract deposits, Pinnacle National has employed a marketing plan in its overall service area primarily based on relationship banking and features a broad product line and competitive rates and services. The primary sources of deposits are residents and businesses located in the Nashville and Knoxville MSAs. Pinnacle National traditionally has obtained these deposits primarily through personal solicitation by its officers and directors, although its use of media advertising has increased in 2011 because of its advertising and banking sponsorship with the Tennessee Titans NFL football team. In 2009, we began to reduce our reliance on non-core deposits including brokered certificates of deposits and public funds. At December 31, 2011, we had no brokered deposits.

Pinnacle National also offers its targeted commercial clients a comprehensive array of treasury management services as well as remote deposit services, which allow electronic deposits to be made from the client's place of business.

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Investment, Trust and Insurance Services

Pinnacle National contracts with Raymond James Financial Services, Inc. (RJFS), a registered broker-dealer and investment adviser, to offer and sell various securities and other financial products to the public from Pinnacle National's locations through Pinnacle National employees that are also RJFS employees. RJFS is a subsidiary of Raymond James Financial, Inc.

Pinnacle National offers, through RJFS, non-FDIC insured investment products in order to assist Pinnacle National's clients in achieving their financial objectives consistent with their risk tolerances. Pinnacle National's suite of investment products include:

Mutual Funds;	Fixed Annuities;
Variable Annuities;	Stocks;
Money Market Instruments;	Financial Planning;
U.S. Treasury Securities;	Asset Management Accounts; and
Bonds;	Listed Options.

All of the financial products listed above are offered by RJFS from Pinnacle National's main office and its other offices. Additionally, we believe that the brokerage and investment advisory program offered by RJFS complements Pinnacle National's general banking business, and further supports its business philosophy and strategy of delivering to our clients those products and services that meet their financial needs. Pursuant to its contract with us, RJFS is primarily responsible for the compliance monitoring of dual employees of RJFS and Pinnacle National. Additionally, Pinnacle National has developed its own compliance-monitoring program in an effort to further ensure that Pinnacle National personnel deliver these products in a manner consistent with the various regulations governing such activities.

Pinnacle National receives a percentage of commission credits and fees generated by the program. Pinnacle National remains responsible for various expenses associated with the program, including promotional expenses, furnishings and equipment expenses and general personnel costs.

Pinnacle National also maintains a trust department which provides fiduciary and investment management services for individual and commercial clients. Account types include personal trust, endowments, foundations, individual retirement accounts, pensions and custody. Pinnacle Advisory Services, Inc., a registered investment advisor, provides investment advisory services to its clients. Additionally, Miller Loughry Beach Insurance Services, Inc., an insurance agency subsidiary of Pinnacle National, provides insurance products, particularly in the property and casualty area, to its clients.

Other Banking Services

Given client demand for increased convenience in accessing banking and investment services, Pinnacle National also offers a broad array of convenience-centered products and services, including 24 hour telephone and Internet banking, debit cards, direct deposit and cash management services for small- to medium-sized businesses. Additionally, Pinnacle National is associated with a nationwide network of automated teller machines of other financial institutions that our clients are able to use throughout Tennessee and other regions. In many cases, Pinnacle National, in contrast to many of its regional competitors, reimburses its clients for any fees that may be charged to the client for utilizing the nationwide ATM network, providing greater convenience as compared to these competitors. Pinnacle National does not charge an annual or monthly fee for use of this ATM network.

OTHER INFORMATION

Investment Securities

In addition to loans, Pinnacle National has investments primarily in obligations of the United States government, obligations guaranteed as to principal and interest by the United States government and other securities. No investment in any of those instruments exceeds any applicable limitation imposed by law or regulation. The executive committee of the board of directors reviews the investment portfolio on an ongoing basis in order to ensure that the investments conform to Pinnacle National's asset liability management policy as set by the board of directors.

Asset and Liability Management

Our Asset Liability Management Committee (ALCO), composed of senior managers of Pinnacle National, manages Pinnacle National's assets and liabilities and strives to provide a stable, optimized net interest income and margin, adequate liquidity and ultimately a suitable after-tax return on assets and return on equity. ALCO conducts these management functions within the framework of written policies that Pinnacle National's board of directors has adopted. ALCO works to maintain an acceptable position between rate sensitive assets and rate sensitive liabilities. The executive committee of the board of directors oversees the ALCO function on an ongoing basis.

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Available Information

We file reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. We are an electronic filer, and the SEC maintains an Internet site at www.sec.gov that contains the reports, proxy and information statements, and other information we have filed electronically. Our website address is www.pnfp.com. Please note that our website address is provided as an inactive textual reference only. We make available free of charge through our website, the annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. The information provided on our website is not part of this report, and is therefore not incorporated by reference unless such information is otherwise specifically referenced elsewhere in this report.

We have also posted our Corporate Governance Guidelines, our Luxury Expenditure Policy, our Corporate Code of Conduct for directors, officers and employees, and the charters of our Audit Committee, Human Resources and Compensation Committee, and Nominating and Corporate Governance Committee of our board of directors on the Corporate Governance section of our website at www.pnfp.com. Our corporate governance materials are available free of charge upon request to our Corporate Secretary, Pinnacle Financial Partners, Inc., 150 Third Avenue South, Suite 900, Nashville, Tennessee 37201.

SUPERVISION AND REGULATION

Both Pinnacle Financial and Pinnacle National are subject to extensive state and federal banking laws and regulations that impose restrictions on and provide for general regulatory oversight of Pinnacle Financial's and Pinnacle National's operations. These laws and regulations are generally intended to protect depositors and borrowers, not stockholders.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

In July 2010, the Dodd-Frank Act was signed into law, incorporating numerous financial institution regulatory reforms. Many of these reforms were implemented over the course of 2011 through regulations adopted by various federal banking and securities regulatory agencies, while others are expected to be implemented during 2012. The following discussion describes the material elements of the regulatory framework that currently apply. The Dodd-Frank Act implements far-reaching reforms of major elements of the financial landscape, particularly for larger financial institutions. Many of its most far-reaching provisions do not directly impact community-based institutions like Pinnacle National. For instance, provisions that regulate derivative transactions and limit derivatives trading activity of federally-insured institutions, enhance supervision of "systemically significant" institutions, impose new regulatory authority over hedge funds, limit proprietary trading by banks, and phase-out the eligibility of trust preferred securities for Tier 1 capital are among the provisions that do not directly impact Pinnacle Financial either because of exemptions for institutions below a certain asset size or because of the nature of Pinnacle Financial's operations. Other provisions that have either been adopted or are expected to be adopted have impacted and will continue to impact Pinnacle National and Pinnacle Financial include:

- Changing the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminating the ceiling and increasing the size of the floor of the Deposit Insurance Fund, and offsetting the impact of the increase in the minimum floor on institutions with less than $10 billion in assets.

Making permanent the $250,000 limit for federal deposit insurance, increasing the cash limit of Securities Investor Protection Corporation protection to $250,000 and providing unlimited federal deposit insurance until December 31, 2012 for non-interest-bearing demand transaction accounts at all insured depository institutions.

Repealing the federal prohibition on payment of interest on demand deposits, thereby permitting depositing institutions to pay interest on business transaction and other accounts.

Centralizing responsibility for consumer financial protection by creating a new agency, the Consumer Financial Protection Bureau, responsible for implementing federal consumer protection laws, although banks below $10 billion in assets will continue to be examined and supervised for compliance with these laws by their federal bank regulator.

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Restricting the preemption of state law by federal law and disallowing national bank subsidiaries from availing themselves of such preemption.

Limiting the debit interchange fees that certain financial institutions are permitted to charge.

Imposing new requirements for mortgage lending, including new minimum underwriting standards, prohibitions on certain yield-spread compensation to mortgage originators, special consumer protections for mortgage loans that do not meet certain provision qualifications, prohibitions and limitations on certain mortgage terms and various new mandated disclosures to mortgage borrowers.

Applying the same leverage and risk based capital requirements that apply to insured depository institutions to holding companies, although Pinnacle Financial's currently outstanding trust preferred securities (but not new issuances) will continue to qualify as Tier 1 capital.

Permitting national and state banks to establish de novo interstate branches at any location where a bank based in that state could establish a branch, and requiring that bank holding companies and banks be well-capitalized and well managed in order to acquire banks located outside their home state.

Imposing new limits on affiliated transactions and causing derivative transactions to be subject to lending limits.

Implementing certain corporate governance revisions that apply to all public companies.

As described above, many aspects of the Dodd-Frank Act are not yet effective and remain subject to rulemaking and will take effect over several years, and their impact on Pinnacle Financial or the financial industry is difficult to predict before such regulations are adopted.

Pinnacle Financial

We are a bank holding company under the federal Bank Holding Company Act of 1956. As a result, we are subject to the supervision, examination, and reporting requirements of the Bank Holding Company Act and the regulations of the Federal Reserve.

Acquisition of Banks. The Bank Holding Company Act requires every bank holding company to obtain the Federal Reserve's prior approval before:

Acquiring direct or indirect ownership or control of any voting shares of any bank if, after the acquisition, the bank holding company will directly or indirectly own or control more than 5% of the bank's voting shares;

Acquiring all or substantially all of the assets of any bank; or

Merging or consolidating with any other bank holding company.

Additionally, the Bank Holding Company Act provides that the Federal Reserve may not approve any of these transactions if it would substantially lessen competition or otherwise function as a restraint of trade, or result in or tend to create a monopoly, unless the anticompetitive effects of the proposed transaction are clearly outweighed by the public interest in meeting the convenience and needs of the communities to be served. The Federal Reserve is also required to consider the financial and managerial resources and future prospects of the bank holding companies and banks concerned; the effectiveness of the company in combatting money laundering; the convenience and needs of the communities to be served; and the extent to which the proposal would result in greater or more concentrated risk to the United States banking or financial system.

Under the Bank Holding Company Act, as amended by the Dodd-Frank Act, if well-capitalized and well managed, a bank holding company located in Tennessee may purchase a bank located outside of Tennessee. Conversely, a well-capitalized and well managed bank holding company located outside of Tennessee may purchase a bank located inside Tennessee. In each case, however, state law restrictions may be placed on the acquisition of a bank that has only been in existence for a limited amount of time or will result in specified concentrations of deposits. For example, Tennessee law currently prohibits a bank holding company from acquiring control of a Tennessee-based financial institution until the target financial institution has been in operation for three years.

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Change in Bank Control. Subject to various exceptions, the Bank Holding Company Act and the Federal Change in Bank Control Act, together with related regulations, require Federal Reserve approval prior to any person or company acquiring “control” of a bank holding company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Control is rebuttably presumed to exist if a person or company acquires 10% or more, but less than 25%, of any class of voting securities and either:

The bank holding company has registered securities under Section 12 of the Securities Exchange Act of 1934; or

No other person owns a greater percentage of that class of voting securities immediately after the transaction.

Our common stock is registered under Section 12 of the Securities Exchange Act of 1934. The regulations provide a procedure for challenge of the rebuttable control presumption.

Permitted Activities. The Gramm-Leach-Bliley Act of 1999 amended the Bank Holding Company Act and expanded the activities in which bank holding companies and affiliates of banks are permitted to engage. The Gramm-Leach-Bliley Act eliminated many federal and state law barriers to affiliations among banks and securities firms, insurance companies, and other financial service providers. Generally, if we qualify and elect to become a financial holding company, which is described below, we may engage in activities that are:

Financial in nature;

Incidental to a financial activity (as determined by the Federal Reserve in consultation with the Secretary of the U.S. Treasury); or

Complementary to a financial activity and do not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally (as determined by the Federal Reserve).

The Gramm-Leach-Bliley Act expressly lists the following activities as financial in nature:

Lending, trust and other banking activities;

Insuring, guaranteeing, or indemnifying against loss or harm, or providing and issuing annuities, and acting as principal, agent, or broker for these purposes, in any state;

Providing financial, investment, or advisory services;

Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly;

Underwriting, dealing in or making a market in securities;

Activities that the Federal Reserve has determined to be so closely related to banking or managing or controlling banks as to be a proper incident to banking or managing or controlling banks;

Activities permitted outside of the United States that the Federal Reserve has determined to be usual in connection with banking or other financial operations abroad;

Merchant banking through securities or insurance affiliates; and

Insurance company portfolio investments.

The Gramm-Leach-Bliley Act also authorizes the Federal Reserve, in consultation with the Secretary of the U.S. Treasury, to determine activities in addition to those listed above that are financial in nature or incidental to such financial activity. In determining whether a particular activity is financial in nature or incidental or complementary to a financial activity, the Federal Reserve must consider (1) the purpose of the Bank Holding Company Act and the Gramm-Leach-Bliley Act, (2) changes or reasonably expected changes in the marketplace in which financial holding companies compete and in the technology for delivering financial services, and (3) whether the activity is necessary or appropriate to allow financial holding companies to effectively compete with other financial service providers and to efficiently deliver information and services. We have not elected to become a financial holding company as of the date of this report.

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Under the Bank Holding Company Act, a bank holding company, which has not qualified or elected to become a financial holding company, is generally prohibited from engaging in or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in nonbanking activities unless, prior to the enactment of the Gramm-Leach-Bliley Act, the Federal Reserve found those activities to be so closely related to banking as to be a proper incident to the business of banking. Activities that the Federal Reserve has found to be so closely related to banking as to be a proper incident to the business of banking include:

- Factoring accounts receivable;
- Acquiring or servicing loans;
- Leasing personal property;
- Conducting discount securities brokerage activities;
- Performing selected data processing services;
- Acting as agent or broker in selling credit life insurance and other types of insurance in connection with credit transactions; and
- Underwriting certain insurance risks of the holding company and its subsidiaries.

Despite prior approval, the Federal Reserve may order a bank holding company or its subsidiaries to terminate any of these activities or to terminate its ownership or control of any subsidiary when it has reasonable cause to believe that the bank holding company's continued ownership, activity or control constitutes a serious risk to the financial safety, soundness, or stability of any of its bank subsidiaries.

Support of Subsidiary Institutions. Under the Dodd-Frank Act, and previously under Federal Reserve policy, we are required to act as a source of financial strength for our bank subsidiary, Pinnacle National, and to commit resources to support Pinnacle National. This support can be required at times when it would not be in the best interest of our stockholders or creditors to provide it. In the unlikely event of our bankruptcy, any commitment by us to a federal bank regulatory agency to maintain the capital of Pinnacle National would be assumed by the bankruptcy trustee and entitled to a priority of payment.

Participation in the Capital Purchase Program of the Troubled Asset Relief Program. On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (EESA) became law. On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (ARRA), more commonly known as the economic stimulus or economic recovery package. ARRA, which amends EESA, includes a wide variety of programs intended to stimulate the economy and provide for extensive infrastructure, energy, health, and education needs. Under the Troubled Asset Relief Program (TARP) authorized by EESA, the U.S. Treasury established a capital purchase program (CPP) providing for the purchase of senior preferred shares of qualifying U.S. controlled banks, savings associations and certain bank and savings and loan holding companies. On December 12, 2008, Pinnacle Financial sold 95,000 shares of Series A preferred stock and warrants to acquire 534,910 shares of common stock to the U.S. Treasury pursuant to the CPP for aggregate consideration of $95 million. Under ARRA, Pinnacle Financial is permitted to redeem the preferred shares it sold to the U.S. Treasury without penalty and without the need to raise new capital, subject to the U.S. Treasury's consultation with Pinnacle Financial's and Pinnacle National's appropriate regulatory agency. On June 16, 2009, Pinnacle Financial completed the sale of 8,855,000 shares of its common stock in a public offering, resulting in net proceeds to Pinnacle Financial of approximately $109.0 million. As a result, and pursuant to the terms of the warrants issued to the U.S. Treasury in connection with Pinnacle Financial's participation in the CPP, the number of shares issuable upon exercise of the warrants issued to the U.S. Treasury in connection with the CPP was reduced by 50%, or 267,455 shares.

During the fourth quarter of 2011, Pinnacle Financial repurchased 25% of the preferred shares originally issued to the U.S. Treasury under the CPP in a transaction totaling approximately $23.9 million. Following the partial redemption of preferred shares, 71,250 shares of Series A Preferred stock remain issued and outstanding and held by the U.S. Treasury.

In connection with Pinnacle Financial's participation in the CPP, Pinnacle Financial agreed to not pay dividends on its common stock for three years following consummation of the U.S. Treasury's investment and to certain limitations on executive compensation. For as long as the U.S. Treasury owns any debt or equity securities of Pinnacle Financial issued in connection with the CPP, Pinnacle Financial will be required to take all necessary action to ensure that its benefit plans with respect to its senior executive officers comply in all respects with Section 111(b) of EESA, as amended by ARRA, and the regulations issued and in effect thereunder as of the closing date of the sale of the preferred shares to the U.S. Treasury, as modified by the U.S. Treasury's interim final rule related to compensation and corporate governance issued on June 15, 2009 (the IFR). This means that, among other things, while the U.S. Treasury owns debt or equity securities issued by Pinnacle Financial in connection with the CPP, Pinnacle Financial must:

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Ensure that the incentive compensation programs for its senior executive officers do not encourage unnecessary and excessive risks that threaten the value of Pinnacle Financial;

Implement a required clawback of any bonus or incentive compensation paid to Pinnacle Financial's senior executive officers and next twenty most highly compensated employees based on materially inaccurate financial statements or any other materially inaccurate performance metric and such employees may not receive any gross up or reimbursement of taxes owed on any compensation;

Not make any bonus, incentive or retention payment to any of Pinnacle Financial's five most highly compensated employees, except as permitted under the IFR;

Not make any "golden parachute payment" (as defined in the IFR) to any of Pinnacle Financial's senior executive officers or five next most highly compensated employees; and

Not deduct for tax purposes executive compensation in excess of $500,000 in any one fiscal year for each of Pinnacle Financial's senior executive officers.

Pinnacle National

We own one bank - Pinnacle National. Pinnacle National is a national bank chartered under the federal National Bank Act. As a result, it is subject to the supervision, examination and reporting requirements of the National Bank Act and the regulations of the Office of the Comptroller of the Currency (the OCC). The OCC has the authority to approve or disapprove mergers, the establishment of branches and similar corporate actions. The OCC regularly examines national banks like Pinnacle National and in connection with its examinations may identify matters necessary to improve a bank's operation in accordance with principles of safety and soundness. Any matters identified in such examinations are required to be appropriately addressed by the bank. Pinnacle National is also subject to numerous state and federal statutes and regulations that will affect its business, activities and operations.

Branching. While the OCC has authority to approve branch applications, national banks are required by the National Bank Act to adhere to branching laws applicable to state chartered banks in the states in which they are located. With prior regulatory approval, Tennessee law permits banks based in the state to either establish new or acquire existing branch offices throughout Tennessee. As a result of the Dodd-Frank Act, Pinnacle National and any other national or state-chartered bank generally may branch across state lines to the same extent as banks chartered in the state of the branch.

FDIC Insurance. The FDIC has adopted a risk-based assessment system for insured depository institutions that takes into account the risks attributable to different categories and concentrations of assets and liabilities. Under the Dodd-Frank Act, the FDIC has adopted regulations that base deposit insurance assessments on total assets less capital rather than deposit liabilities and include off-balance sheet liabilities of institutions and their affiliates in risk-based assessments.

The Dodd-Frank Act increased the basic limit on federal deposit insurance coverage to $250,000 per depositor. In addition, non-interest bearing deposit transaction accounts have unlimited FDIC insurance coverage until December 31, 2012. The Dodd-Frank Act also repealed the prohibition on paying interest on demand transaction accounts, but did not extend unlimited insurance protection for these accounts.

The FDIC may terminate its insurance of deposits if it finds that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

Capital Adequacy

Both Pinnacle Financial and Pinnacle National are required to comply with the capital adequacy standards established by the Federal Reserve, in our case, and the OCC, in the case of Pinnacle National. The Federal Reserve has established a risk-based and a leverage measure of capital adequacy for bank holding companies. Pinnacle National is also subject to risk-based and leverage capital requirements adopted by the OCC, which are substantially similar to those adopted by the Federal Reserve for bank holding companies. In addition, the OCC may require national banks to maintain capital at levels higher than those required by general regulatory requirements.

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The risk-based capital standards are designed to make regulatory capital requirements more sensitive to differences in risk profiles among banks and bank holding companies, to account for off-balance-sheet exposure, and to minimize disincentives for holding liquid assets. Assets and off-balance-sheet items, such as letters of credit and unfunded loan commitments, are assigned to broad risk categories, each with appropriate risk weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and off-balance-sheet items.

Under Federal Reserve guidelines, the minimum ratio of total capital to risk-weighted assets is 8%. Total capital consists of two components, Tier 1 capital and Tier 2 capital. Tier 1 capital generally consists of common stock, minority interests in the equity accounts of consolidated subsidiaries, noncumulative perpetual preferred stock, and a limited amount of cumulative perpetual preferred stock, less goodwill and other specified intangible assets. The preferred stock that Pinnacle Financial sold to the U.S. Treasury in connection with the CPP and the trust preferred securities previously issued by Pinnacle Financial each qualifies as Tier 1 capital, and as described below will continue to qualify as Tier 1 capital under the Dodd-Frank Act. Under Federal Reserve guidelines, Tier 1 capital must equal at least 4% of risk-weighted assets. Tier 2 capital generally consists of subordinated debt, other preferred stock, and a limited amount of loan loss reserves. The total amount of Tier 2 capital is limited to 100% of Tier 1 capital. For a holding company to be considered "well-capitalized," it must maintain a total risk-based capital ratio of at least 10%, a Tier 1 risk-based capital ratio of at least 6% and not be subject to a written agreement, order or directive to maintain a specific capital level.

In addition, the Federal Reserve has established minimum leverage ratio guidelines for bank holding companies. These guidelines provide that a minimum ratio of Tier 1 capital to average assets, less goodwill and other specified intangible assets, of at least 4% should be maintained for most bank holding companies. The guidelines also provide that bank holding companies experiencing high internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels. Furthermore, the Federal Reserve has indicated that it will consider a bank holding company's Tier 1 capital leverage ratio, after deducting all intangibles, and other indicators of capital strength in evaluating proposals for expansion or new activities.

In late 2010, the Basel Committee on Banking Supervision issued Basel III, a new capital framework for banks and bank holding companies. Basel III will impose a stricter definition of capital, with more focus on common equity for those banks to which it is applicable. At this time, we do not know whether Basel III, as implemented in the United States will be applicable to us and Pinnacle National.

The Federal Reserve has recently adopted regulations applicable to bank holding companies with assets over $50 billion that require such holding companies to develop and submit to the Federal Reserve annually capital plans demonstrating the company's ability to meet, under various stressed economic conditions and over a nine-quarter planning horizon, the above-described minimum leverage capital, Tier 1 risk based capital and total risk based capital requirements, as well as a minimum Tier 1 common capital Ratio (Tier 1 risk based capital less preferred stock and trust preferred securities) of at least 5%.

The OCC has adopted regulations requiring national banks to meet minimum ratios for leverage capital to assets and total capital to risk-based assets. The minimum leverage capital ratio is generally 4% and the minimum total risk based capital ratio is 8%. The OCC can require individual banks to maintain higher minimum ratios, and in the first quarter of 2010, the OCC established a minimum leverage capital ratio for Pinnacle National of 8% and a minimum total capital to net based assets ratio of 12%. In the fourth quarter of 2011, the OCC lifted this individual minimum capital requirement on Pinnacle National although it remains as an internal policy.

Failure to meet statutorily mandated capital guidelines or more restrictive ratios separately established for a financial institution could subject a bank or bank holding company to a variety of enforcement remedies, including issuance of a capital directive, the termination of deposit insurance by the FDIC, a prohibition on accepting or renewing brokered deposits, limitations on the rates of interest that the institution may pay on its deposits and other restrictions on its business. As described above, significant additional restrictions can be imposed on FDIC-insured depository institutions that fail to meet applicable capital requirements.

Additionally, the Federal Deposit Insurance Corporation Improvement Act of 1991 establishes a system of prompt corrective action to resolve the problems of undercapitalized financial institutions. Under this system, the federal banking regulators have established five capital categories (well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized) into one of which all institutions are placed. Federal banking regulators are required to take various mandatory supervisory actions and are authorized to take other discretionary actions with respect to institutions in the three undercapitalized categories. The severity of the action depends upon the capital category in which the institution is placed. Generally, subject to a narrow exception, the banking regulator must appoint a receiver or conservator for an institution that is critically undercapitalized. The federal banking agencies have specified by regulation the relevant capital level for each category.

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Under OCC regulations, a national bank is "well capitalized" if it has a leverage capital ratio of 5% or better, a Tier 1 risk-based capital ratio of 6% or better, a total risk based capital ratio of 10% or better, and is not subject to a regulatory agreement, order or directive to maintain a specific level for any capital measure. A national bank is considered "adequately capitalized" if it has a leverage ratio of at least 4%, a Tier 1 risk-based capital ratio of at least 4%, a total risk-based capital ratio of at least 8% and does not meet the definition of a well-capitalized bank. Lower levels of capital result in a bank being considered undercapitalized, significantly undercapitalized and critically undercapitalized.

National banks are required to be 'well capitalized" in order to take advantage of expedited procedures on certain applications, such as branches and mergers, and to accept and renew brokered deposits without further regulatory approval.

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

An institution that is categorized as undercapitalized, significantly undercapitalized, or critically undercapitalized is required to submit an acceptable capital restoration plan to its appropriate federal banking agency. In addition, a bank holding company must guarantee that a subsidiary depository institution meets its capital restoration plan, subject to various limitations. The controlling holding company's obligation to fund a capital restoration plan is limited to the lesser of 5% of an undercapitalized subsidiary's assets or the amount required to meet regulatory capital requirements. An undercapitalized institution is also generally prohibited from increasing its average total assets, making acquisitions, establishing any branches or engaging in any new line of business, except under an accepted capital restoration plan or with FDIC approval. The regulations also establish procedures for downgrading an institution into a lower capital category based on supervisory factors other than capital. As of December 31, 2011, Pinnacle National would be considered "well-capitalized" by the OCC.

The Dodd-Frank Act contains a number of provisions dealing with capital adequacy of insured depository institutions and their holding companies, and for the most part will result in insured depository institutions and their holding companies being subject to more stringent capital requirements. Under the so-called Collins Amendment to the Dodd-Frank Act, federal regulators have established minimum leverage and risk-based capital requirements for, among other entities, banks and bank holding companies on a consolidated basis. These minimum requirements require that a bank holding company maintain a Tier 1 leverage ratio of not less than 4% and a total risk-based capital ratio of not less than 8%. The Collins Amendment also excludes trust preferred securities issued after May 19, 2010 from being included in Tier 1 capital unless the issuing company is a bank holding company with less than $500 million in total assets. Trust preferred securities issued prior to that date will continue to count as Tier 1 capital for bank holding companies with less than $15 billion in total assets, and such securities will be phased out of Tier 1 capital treatment for bank holding companies with over $15 billion in total assets over a three-year period beginning in 2013. The Collins Amendment did not exclude preferred stock issued to the U.S. Treasury through the CPP from Tier 1 capital treatment. Accordingly, Pinnacle Financial's trust preferred securities and preferred stock issued to the U.S. Treasury through the CPP will continue to qualify as Tier 1 capital.

At December 31, 2011, Pinnacle National's Tier 1 risk-based capital ratio was 12.5%, its total risk-based capital ratio was 14.0% and its leverage ratio was 10.3%, compared to 11.8%, 13.4 % and 9.2% at December 31, 2010, respectively. More information concerning our, and Pinnacle National's, regulatory ratios at December 31, 2011 is included in Note 20 to the "Notes to Consolidated Financial Statements" included elsewhere in this Annual Report on Form 10-K.

Payment of Dividends

We are a legal entity separate and distinct from Pinnacle National. Since inception, Pinnacle Financial has not paid dividends to its common stockholders. Over time, the principal source of our cash flow, including cash flow to pay dividends to our holders of trust preferred securities, holders of the Series A preferred stock we issued to the U.S. Treasury in connection with the CPP and any potential dividends we may ultimately pay to common stock stockholders, will be dividends that Pinnacle National pays to us as its sole stockholder. Under Tennessee law, we are not permitted to pay dividends if, after giving effect to such payment, we would not be able to pay our debts as they become due in the usual course of business or our total assets would be less than the sum of our total liabilities plus any amounts needed to satisfy any preferential rights if we were dissolving. In addition, in deciding whether or not to declare a dividend of any particular size, our board of directors must consider our and Pinnacle National's current and prospective capital, liquidity, and other needs.

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In addition to the limitations on our ability to pay dividends under Tennessee law, our ability to pay dividends on our common stock has also been limited by our participation in the CPP and by certain statutory or regulatory limitations. Prior to December 12, 2011, the consent of the U.S. Treasury was required before we could declare or pay any dividend or make any distribution on our common stock. After December 12, 2011, we are no longer prohibited from paying dividends on our common stock without the consent of the U.S. Treasury; however, to pay common dividends, we must be current in the payment of quarterly dividends on the Series A preferred stock. Additionally, we have informally committed to the Federal Reserve Bank of Atlanta, that we will not pay dividends on our preferred stock, including our Series A preferred stock, trust preferred securities or common stock without the prior consent of the Federal Reserve Bank of Atlanta. Generally, the Federal Reserve indicates that holding companies that are experiencing financial difficulties generally should eliminate, reduce or defer dividends on Tier 1 capital instruments, including trust preferred, preferred stock or common stock, if the holding company needs to conserve capital for safe and sound operation and to serve as a source of strength to its subsidiaries.

Statutory and regulatory limitations also apply to Pinnacle National's payment of dividends to us. Pinnacle National is required by federal law to obtain the prior approval of the OCC for payments of dividends if the total of all dividends declared by its board of directors in any year will exceed (1) the total of Pinnacle National's net profits for that year, plus (2) Pinnacle National's retained net profits of the preceding two years, less any required transfers to surplus. As of January 1, 2012, Pinnacle National could pay dividends to us of $20.8 million. However, we have informally committed to the Federal Reserve Bank of Atlanta that we will not pay any dividends to Pinnacle Financial from Pinnacle National without their prior consent. During 2011, Pinnacle National did not pay dividends to Pinnacle Financial. Generally, federal regulatory policy encourages holding company debt to be serviced by subsidiary bank dividends or additional equity rather than debt issuances. Until such time as it receives dividends from Pinnacle National, Pinnacle Financial anticipates servicing its preferred stock dividend and subordinated indebtedness requirements from its available cash balances which amounted to approximately $36.5 million at December 31, 2011.

The payment of dividends by Pinnacle National and us may also be affected by other factors, such as the requirement to maintain adequate capital above statutorily mandated guidelines, or more restrictive requirements imposed on Pinnacle National or us by our regulators. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. See "Capital Adequacy" above.

Restrictions on Transactions with Affiliates

Both Pinnacle Financial and Pinnacle National are subject to the provisions of Section 23A of the Federal Reserve Act. Section 23A places limits on the amount of:

A bank's loans or extensions of credit, including purchases of assets subject to an agreement to repurchase, to affiliates;

A bank's investment in affiliates;

Assets a bank may purchase from affiliates, except for real and personal property exempted by the Federal Reserve;

The amount of loans or extensions of credit to third parties collateralized by the securities or obligations of affiliates;

Transactions involving the borrowing or lending of securities and any derivative transaction that results in credit exposure to an affiliate; and

A bank's guarantee, acceptance or letter of credit issued on behalf of an affiliate.

The total amount of the above transactions is limited in amount, as to any one affiliate, to 10% of a bank's capital and surplus and, as to all affiliates combined, to 20% of a bank's capital and surplus. In addition to the limitation on the amount of these transactions, each of the above transactions must also meet specified collateral requirements. Pinnacle National must also comply with other provisions designed to avoid the taking of low-quality assets.

Pinnacle Financial and Pinnacle National are also subject to the provisions of Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in the above transactions with affiliates unless the transactions are on terms substantially the same, or at least as favorable to the institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies.

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Pinnacle National is also subject to restrictions on extensions of credit to its executive officers, directors, principal stockholders and their related interests. These extensions of credit (1) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (2) must not involve more than the normal risk of repayment or present other unfavorable features.

Community Reinvestment

The Community Reinvestment Act (CRA) requires that, in connection with examinations of financial institutions within their respective jurisdictions, the Federal Reserve, the OCC or the FDIC shall evaluate the record of each financial institution in meeting the credit needs of its local community, including low- and moderate-income neighborhoods. These facts are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. Failure to adequately meet these criteria could impose additional requirements and limitations on Pinnacle National. Additionally, banks are required to publicly disclose the terms of various Community Reinvestment Act-related agreements. Pinnacle National received a “satisfactory” CRA rating from the OCC on its most recent regulatory examination.

Privacy

Under the Gramm-Leach-Bliley Act, financial institutions are required to disclose their policies for collecting and protecting confidential information. Customers generally may prevent financial institutions from sharing personal financial information with nonaffiliated third parties except for third parties that market the institutions’ own products and services. Additionally, financial institutions generally may not disclose consumer account numbers to any nonaffiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to consumers. Pinnacle National has established a privacy policy to ensure compliance with federal requirements.

Other Consumer Laws and Regulations

Interest and other charges collected or contracted for by Pinnacle National are subject to state usury laws and federal laws concerning interest rates. For example, under the Soldiers’ and Sailors’ Civil Relief Act of 1940, a lender is generally prohibited from charging an annual interest rate in excess of 6% on any obligations for which the borrower is a person on active duty with the United States military. Pinnacle National’s loan operations are also subject to federal laws applicable to credit transactions, such as the:

Federal Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;

Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;

Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;

Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies;

Bank Secrecy Act, governing how banks and other firms report certain currency transactions and maintain appropriate safeguards against “money laundering” activities;

Soldiers’ and Sailors’ Civil Relief Act of 1940, governing the repayment terms of, and property rights underlying, secured obligations of persons in active military service; and

Rules and regulations of the various federal agencies charged with the responsibility of implementing the federal laws.

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Pinnacle National's deposit operations are subject to the:

Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records; and

Electronic Funds Transfer Act and Regulation E issued by the Federal Reserve to implement that act, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities (including with respect to the permissibility of overdraft charges) arising from the use of automated teller machines and other electronic banking services.

Anti-Terrorism Legislation

On October 26, 2001, the President of the United States signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT) Act of 2001. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and foreign customers.

In addition, the USA PATRIOT Act authorizes the Secretary of the U.S. Treasury to adopt rules increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institution complying with these rules will not be deemed to have violated the privacy provisions of the Gramm-Leach-Bliley Act, as discussed above. Pinnacle National currently has policies and procedures in place designed to comply with the USA PATRIOT Act.

Recent and Proposed Legislation and Regulatory Action

New regulations and statutes are regularly proposed that contain wide-ranging proposals for altering the structures, regulations and competitive relationships of the nation's financial institutions. In 2010, the U.S. Congress passed the Dodd-Frank Act, which includes significant consumer protection provisions related to, among other things, residential mortgage loans that have increased, and are likely to further increase, our regulatory compliance costs. We expect that the Dodd-Frank Act will continue to have a negative impact on our earnings through fee reductions, higher costs and new restrictions. The ultimate impact of the Dodd-Frank Act on our businesses and results of operations will depend on regulatory interpretation and rulemaking, as well as the success of any of our actions to mitigate the negative earnings impact of certain provisions. We cannot predict whether or in what form any proposed regulation or statute will be adopted or the extent to which our business may be affected by any new regulation or statute. With the enactments of EESA, AARA and the Dodd-Frank Act and the significant amount of regulations that have been issued in 2010 and 2011 and that are to come from the passage of that legislation, the nature and extent of the future legislative and regulatory changes affecting financial institutions and the resulting impact on those institutions is very unpredictable at this time. The Dodd-Frank Act, in particular, requires that a significant number of new regulations be adopted by various financial regulatory agencies over 2011 and 2012.

Effect of Governmental Monetary Policies

Our earnings are affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The Federal Reserve's monetary policies have had, and are likely to continue to have, an important impact on the operating results of commercial banks through the Federal Reserve's statutory power to implement national monetary policy in order, among other things, to curb inflation or combat a recession. The Federal Reserve, through its monetary and fiscal policies, affects the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which member banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

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ITEM 1A. RISK FACTORS

Investing in our common stock involves various risks which are particular to our company, our industry and our market area. If any of the following risks were to occur, we may not be able to conduct our business as currently planned and our financial condition or operating results could be negatively impacted. These matters could cause the trading price of our common stock to decline in future periods.

Negative developments in the U.S. and local economy and in local real estate markets have adversely impacted our results and may continue to adversely impact our results in the future.

Economic conditions in the markets in which we operate deteriorated significantly between early 2008 and the middle of 2010. As a result, we incurred significant losses in 2009 and the first half of 2010 and have continued to experience reduced earnings since that period as compared to our historical level of performance. These challenges resulted primarily from provisions for loan losses and other real estate expense related to declining collateral values in our real estate loan portfolio and increased costs associated with our portfolio of other real estate owned. Although economic conditions began to stabilize in our markets in the second half of 2010 and throughout 2011 and we began to refocus our efforts on growing our earning assets, we believe that we will continue to experience a somewhat, albeit less, challenging economic environment in 2012. Accordingly, we expect that our results of operations will continue to be negatively impacted by economic conditions, including reduced loan demand, in 2012. There can be no assurance that the economic conditions that have adversely affected the financial services industry, and the capital, credit and real estate markets, generally, or us in particular, will improve materially, or at all, in the near future, or thereafter, in which case we could continue to experience reduced earnings or again experience significant losses and write-downs of assets, and could face capital and liquidity constraints or other business challenges.

Our loan portfolio includes a meaningful amount of real estate construction and development loans, which have a greater credit risk than residential mortgage loans.

Although we have made meaningful progress over the last two years in reducing our concentration of real estate construction and development loans, the percentage of these loans in Pinnacle National’s portfolio was approximately 8.3% of total loans at December 31, 2011. These loans make up approximately 27.1% of our non-performing loans at December 31, 2011. This type of lending is generally considered to have relatively high credit risks because the principal is concentrated in a limited number of loans with repayment dependent on the successful completion and operation of the related real estate project. The credit quality of many of these loans has deteriorated as a result of the current adverse conditions in the real estate market. The continued depression in residential real estate market prices and demand could result in further price reductions in home and land values adversely affecting the value of collateral securing the construction and development loans that we hold. These adverse economic and real estate market conditions may lead to further increases in non-performing loans and other real estate owned, increased losses and expenses from the management and disposition of non-performing assets, increases in provision for loan losses, and increases in operating expenses as a result of the allocation of management time and resources to the collection and work out of loans, all of which would negatively impact our financial condition and results of operations.

We have a concentration of credit exposure to borrowers in certain industries, and we also target small to medium-sized businesses.

At December 31, 2011, we had significant credit exposures to borrowers in certain businesses, including commercial and residential building lessors, new home builders, and land subdividers. These industries continue to experience adversity as a result of the continued sluggish economic conditions, and, as a result, an increased level of borrowers in these industries have been unable to perform their obligations under their existing loan agreements with us, or have suffered loan downgrades which has negatively impacted our results of operations. If the economic environment in our markets does not improve significantly in 2012 or beyond, these industry concentrations could result in higher than normal deterioration in credit quality, past dues, loan charge offs and collateral value declines, which could cause our earnings to be negatively impacted. Furthermore, any of our large credit exposures that deteriorate unexpectedly could cause us to have to make significant additional loan loss provisions, negatively impacting our earnings.

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A substantial focus of our marketing and business strategy is to serve small to medium-sized businesses in the Nashville and Knoxville MSAs. As a result, a relatively high percentage of our loan portfolio consists of commercial loans primarily to small to medium-sized businesses. At December 31, 2011, our commercial and industrial loans accounted for almost 34.8% of our total loans up from 31.5% at December 31, 2010. Additionally, approximately, 17.7% of our loans at December 31, 2011 are owner-occupied commercial real estate loans, which are loans to businesses secured by the businesses' real estate. We expect to seek to expand the amount and percentage of such loans in our portfolio in 2012. During periods of economic weakness like those we are currently experiencing, small to medium-sized businesses may be impacted more severely and more quickly than larger businesses. Consequently, the ability of such businesses to repay their loans may deteriorate, and in some cases this deterioration may occur quickly, which would adversely impact our results of operations and financial condition.

We are geographically concentrated in the Nashville, Tennessee and Knoxville, Tennessee MSAs, and changes in local economic conditions impact our profitability.

We currently operate primarily in the Nashville, Tennessee and Knoxville, Tennessee MSAs, and most of our loan, deposit and other customers live or have operations in these areas. Accordingly, our success significantly depends upon the growth in population, income levels, deposits and housing starts in these markets, along with the continued attraction of business ventures to the areas, and our profitability is impacted by the changes in general economic conditions in these markets. Economic conditions in the Nashville and Knoxville MSAs remained sluggish during 2011, negatively affecting our operations, particularly the real estate construction and development segment of our loan portfolio. We cannot assure you that economic conditions, including loan demand, in our markets will improve during 2012 or thereafter, and in that case, we may not be able to grow our loan portfolio in line with our expectations, the ability of our customers to repay their loans to us may be negatively impacted and our financial condition and results of operations could be negatively impacted.

Compared to regional or national financial institutions, we are less able to spread the risks of unfavorable local economic conditions across a large number of diversified economies. Moreover, we cannot give any assurance that we will benefit from any market growth or return of more favorable economic conditions in our primary market areas if they do occur.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings will decrease.

If loan customers with significant loan balances fail to repay their loans, our earnings and capital levels will suffer. We make various assumptions and judgments about the probable losses in our loan portfolio, including the creditworthiness of our borrowers and the value of any collateral securing the loans. We maintain an allowance for loan losses to cover our estimate of the probable losses in our loan portfolio. In determining the size of this allowance, we utilize estimates based on analyses of volume and types of loans, internal loan classifications, trends in classifications, volume and trends in delinquencies, nonaccruals and charge-offs, loss experience of various loan categories, national and local economic conditions, industry and peer bank loan quality indications, and other pertinent factors and information. If our assumptions are inaccurate, our current allowance may not be sufficient to cover potential loan losses, and additional provisions may be necessary which would decrease our earnings.

In addition, federal and state regulators periodically review our loan portfolio and may require us to increase our allowance for loan losses or recognize loan charge-offs. Their conclusions about the quality of a particular borrower or our entire loan portfolio may be different than ours. Any increase in our allowance for loan losses or loan charge offs as required by these regulatory agencies could have a negative effect on our operating results. Moreover, additions to the allowance may be necessary based on changes in economic and real estate market conditions, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our management's control. These additions may require increased provision expense which would negatively impact our results of operations.

We have increased levels of other real estate owned, primarily as a result of foreclosures, and we anticipate higher levels of foreclosed real estate expense.

As we have acted to resolve non-performing real estate loans, we have increased the level of foreclosed properties, primarily those acquired from builders and from residential land developers. Foreclosed real estate expense consists of three types of charges: maintenance costs, valuation adjustments to appraisal values and gains or losses on disposition. As levels of other real estate owned increase and also as local real estate values decline, these charges will increase, negatively impacting our results of operations.

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The effectiveness of our asset management activities are critical to our ability to improve, resolve or liquidate nonperforming loans and other real estate owned and thereby reduce loan losses and other real estate expense.

Over the last several years, we have undertaken various initiatives to enhance our credit review, loan administration and special asset management and administration procedures, and believe that these enhancements have begun to reduce the levels of our problem and potential problem assets. However, continued improvement is dependent to a degree on the market conditions and other factors beyond our control and if we are unable to successfully manage our problem and potential problem assets in a timely matter, we could experience materially increased loan losses and other real estate expense.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have an adverse effect on our financial condition and results of operations.

Our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify these systems as circumstances warrant, the security of our computer systems, software and networks may be vulnerable to breaches, unauthorized access, misuse, computer viruses or other malicious code and other events that could have a security impact. We outsource many of our major systems, such as data processing, loan servicing and deposit processing systems. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to process new and renewal loans, gather deposits and provide customer service, compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

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

Environmental liability associated with commercial lending could result in losses.

In the course of business, Pinnacle National may acquire, through foreclosure, properties securing loans it has originated or purchased which are in default. Particularly in commercial real estate lending, there is a risk that hazardous substances could be discovered on these properties. In this event, we, or Pinnacle National, might be required to remove these substances from the affected properties at our sole cost and expense. The cost of this removal could substantially exceed the value of affected properties. We may not have adequate remedies against the prior owner or other responsible parties and could find it difficult or impossible to sell the affected properties. These events could have a material adverse effect on our business, results of operations and financial condition.

National or state legislation or regulation may increase our expenses and reduce earnings.

Federal bank regulators are increasing regulatory scrutiny, and additional restrictions (including those originating from the Dodd-Frank Act) on financial institutions have been proposed or adopted by regulators and by Congress. Changes in tax law, federal legislation, regulation or policies, such as bankruptcy laws, deposit insurance, consumer protection laws, and capital requirements, among others, can result in significant increases in our expenses and/or charge-offs, which may adversely affect our earnings. Changes in state or federal tax laws or regulations can have a similar impact. Many state and municipal governments, including the State of Tennessee, are under financial stress due to the economy. As a result, these governments could seek to increase their tax revenues through increased tax levies which could have a meaningful impact on our results of operations. Furthermore, financial institution regulatory agencies are expected to continue to be very aggressive in responding to concerns and trends identified in examinations, including the continued issuance of additional formal or informal enforcement or supervisory actions. These actions, whether formal or informal, could result in our agreeing to limitations or to take actions that limit our operational flexibility, restrict our growth or increase our capital or liquidity levels. Failure to comply with any formal or informal regulatory restrictions, including informal supervisory actions, could lead to further regulatory enforcement actions. Negative developments in the financial services industry and the impact of recently enacted or new legislation in response to those developments could negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance. In addition, industry, legislative or regulatory developments may cause us to materially change our existing strategic direction, capital strategies, compensation or operating plans.

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Implementation of the various provisions of the Dodd-Frank Act may increase our operating costs or otherwise have a material effect on our business, financial condition or results of operations.

On July 21, 2010, President Obama signed the Dodd-Frank Act. This landmark legislation includes, among other things, (i) the creation of a Financial Services Oversight Counsel to identify emerging systemic risks and improve interagency cooperation; (ii) the elimination of the Office of Thrift Supervision and the transfer of oversight of federally chartered thrift institutions and their holding companies to the Office of the Comptroller of the Currency and the Federal Reserve; (iii) the creation of a Consumer Financial Protection Agency authorized to promulgate and enforce consumer protection regulations relating to financial products that would affect banks and non-bank finance companies; (iv) the establishment of new capital and prudential standards for banks and bank holding companies; (v) the termination of investments by the U.S. Treasury under TARP; (vi) enhanced regulation of financial markets, including the derivatives, securitization and mortgage origination markets; (vii) the elimination of certain proprietary trading and private equity investment activities by banks; (viii) the elimination of barriers to de novo interstate branching by banks; (ix) a permanent increase of the previously implemented temporary increase of FDIC deposit insurance to $250,000; (x) the authorization of interest-bearing transaction accounts; and (xi) changes in how the FDIC deposit insurance assessments will be calculated and an increase in the minimum designated reserve ratio for the Deposit Insurance Fund.

Certain provisions of the legislation are not immediately effective or are subject to required studies and implementing regulations. Further, community banks with less than $10 billion in assets (like us) are exempt from certain provisions of the legislation. Although certain regulations implementing portions of the Dodd-Frank Act have been promulgated, we are still unable to predict how this significant new legislation may be interpreted and enforced or how implementing regulations and supervisory policies may affect us. There can be no assurance that these or future reforms will not significantly increase our compliance or operating costs or otherwise have a significant impact on our business, financial condition and results of operations.

We may not be able to continue to expand into the Knoxville MSA in the time frame and at the levels that we currently expect.

In order to continue our expansion into the Knoxville MSA, we will be required to hire additional associates and expand our branch network. We cannot assure you that we will be able to hire the number of experienced associates that we need to successfully execute our strategy in the Knoxville MSA, nor can we assure you that the associates we hire will be able to successfully execute our growth strategy in that market. Additionally, we are required to seek OCC approval prior to the construction of any new branch facility, which cannot be assured. Because we seek to hire experienced associates, the compensation cost associated with these individuals may be higher than that of other financial institutions of similar size in the market. If we are unable to grow our loan portfolio at planned rates or slow our growth in the Knoxville MSA, the increased compensation expense of these experienced associates may negatively impact our results of operations. Because there will be a period of time before we are able to fully deploy our resources in the Knoxville MSA, our start up costs, including the cost of our associates and our branch expansion, will negatively impact our results of operations.

If we are unable to redeem the remaining outstanding shares of our Series A preferred stock prior to December 12, 2013, the dividend rate payable by us on those shares increases to 9% per annum.

The dividend rate on our Series A preferred stock is currently 5% per annum and will remain 5% per annum until the five year anniversary of the issuance date of those shares. Thereafter, the dividend rate increases to 9% per annum. While we believe that we will be able to redeem the remaining outstanding shares of Series A preferred stock prior to the dividend rate increasing, we must receive the approval of the Federal Reserve Bank of Atlanta in order to do so. While we believe that we will be able to redeem the remaining outstanding shares of Series A preferred stock with minimal or no dilution to our common shareholders, the Federal Reserve Bank of Atlanta may require us to increase our common equity capital in connection with granting its required approval. If we are required to sell additional shares of common stock to raise additional equity capital in connection with the redemption of shares of our Series A preferred stock that remain outstanding, we may have to sell these shares of common stock at prices below the then current market price of those shares, diluting the ownership interest of our then common shareholders.

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Our ability to maintain required capital levels and adequate sources of funding and liquidity could be impacted by changes in the capital markets and deteriorating economic and market conditions.

We, and Pinnacle National, are required to maintain certain capital levels established by banking regulations or specified by bank regulators, including those capital maintenance standards imposed on us as a result of the Dodd-Frank Act, and we are required to serve as a source of strength to Pinnacle National. We must also maintain adequate funding sources in the normal course of business to support our operations and fund outstanding liabilities. Our ability to maintain capital levels, sources of funding and liquidity could be impacted by changes in the capital markets in which we operate and deteriorating economic and market conditions. We have informally agreed to obtain prior approval of the Federal Reserve Bank of Atlanta before incurring new debt, repurchasing stock, paying interest on subordinated debt or paying dividends on our common or preferred stock. This repayment and any failure to obtain such approval, could adversely affect our access to the capital markets or ability to obtain funding. Pinnacle National will be required to obtain regulatory approval in order to pay dividends to us unless the amount of such dividends does not exceed its retained net profits for that year plus the preceding two years. Failure by our bank subsidiary to meet applicable capital guidelines or to satisfy certain other regulatory requirements could subject our bank subsidiary to a variety of enforcement remedies available to the federal regulatory authorities.

Certain of our deposits and other funding sources may be volatile and impact our liquidity.

In addition to the traditional core deposits, such as demand deposit accounts, interest checking, money market savings and certificates of deposits, we utilize several noncore funding sources, such as brokered certificates of deposit, Federal Home Loan Bank (FHLB) of Cincinnati advances, federal funds purchased and other sources. We utilize these noncore funding sources to fund the ongoing operations and growth of Pinnacle National. The availability of these noncore funding sources is subject to broad economic conditions and to investor assessment of our financial strength and, as such, the cost of funds may fluctuate significantly and/or be restricted, thus impacting our net interest income, our immediate liquidity and/or our access to additional liquidity. We have somewhat similar risks to the extent core deposits exceed the amount of deposit insurance coverage available.

We impose certain internal limits as to the absolute level of noncore funding we will incur at any point in time. Should we exceed those limitations, we may need to modify our growth plans, liquidate certain assets, participate loans to correspondents or execute other actions to allow for us to return to an acceptable level of noncore funding within a reasonable amount of time.

If the federal funds rate remains at current extremely low levels, our net interest margin, and consequently our net earnings, may be negatively impacted.

Because of significant competitive pressures in our market and the negative impact of these pressures on our deposit and loan pricing, coupled with the fact that a significant portion of our loan portfolio has variable rate pricing that moves in concert with changes to the Federal Reserve Board of Governors' federal funds rate (which is at an extremely low rate as a result of current economic conditions), our net interest margin may be negatively impacted. Additionally, the amount of non-accrual loans and other real estate owned has been and may continue to be elevated. We also expect loan pricing to remain competitive in 2012 and believe that economic factors affecting broader markets will likely result in reduced yields for our investment securities portfolio as prepayments continue to escalate. As a result, our net interest margin, and consequently our profitability, may continue to be negatively impacted in 2012 and beyond.

Fluctuations in interest rates could reduce our profitability.

The absolute level of interest rates as well as changes in interest rates may affect our level of interest income, the primary component of our gross revenue, as well as the level of our interest expense. Interest rate fluctuations are caused by many factors which, for the most part, are not under our control. For example, national monetary policy plays a significant role in the determination of interest rates. Additionally, competitor pricing and the resulting negotiations that occur with our customers also impact the rates we collect on loans and the rates we pay on deposits.

As interest rates change, we expect that we will periodically experience “gaps” in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities (usually deposits and borrowings) will be more sensitive to changes in market interest rates than our interest-earning assets (usually loans and investment securities), or vice versa. In either event, if market interest rates should move contrary to our position, this “gap” may work against us, and our earnings may be negatively affected. Changes in the level of interest rates also may negatively affect our ability to originate loans, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately affect our earnings. A decline in the market value of our assets may limit our ability to borrow additional funds. As a result, we could be required to sell some of our loans and investments under adverse market conditions, upon terms that are not favorable to us, in order to maintain our liquidity. If those sales are made at prices lower than the amortized costs of the investments, we will incur losses.

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A decline in our stock price or expected future cash flows, or a material adverse change in our results of operations or prospects, could result in impairment of our goodwill.

A significant and sustained decline in our stock price and market capitalization below book value, a significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates or other factors could result in impairment of our goodwill. At December 31, 2011, our goodwill and other identifiable intangible assets totaled approximately $251.9 million. If we were to conclude that a write-down of our goodwill is necessary, then the appropriate charge would likely cause a material loss. Any significant loss would further adversely impact the capacity of Pinnacle National to pay dividends to us without seeking prior regulatory approval, which could adversely affect our ability to pay required interest payments and preferred stock dividends.

We have a significant deferred tax asset and cannot assure you that it will be fully realized.

We had net deferred tax assets of $15.8 million as of December 31, 2011. There is no valuation allowance against our federal net deferred tax assets as of December 31, 2011 because we believe that it is more likely than not that all of these assets will be realized. In evaluating the need for a valuation allowance, we considered the reversal of deferred tax liabilities, tax planning strategies and estimated future taxable income based on management prepared forecasts. This process required significant judgment by management about matters that are by nature uncertain. If future events differ significantly from our current forecasts, we may need to establish a valuation allowance, which could have a material adverse effect on our results of operations and financial condition.

Competition with other banking institutions could adversely affect our profitability.

A number of banking institutions in the Nashville and Knoxville MSAs have higher lending limits, more banking offices, and a larger market share of loans or deposits. In addition, our asset management division competes with numerous brokerage firms and mutual fund companies which are also much larger. In some respects, this may place these competitors in a competitive advantage. This competition may limit or reduce our profitability, reduce our growth and adversely affect our results of operations and financial condition.

Inability to retain senior management and key employees or to attract new experienced financial services professionals could impair our relationship with our customers, reduce growth and adversely affect our business.

We have assembled a senior management team which has substantial background and experience in banking and financial services in the Nashville market. We have also been able to attract experienced financial services professionals who have been able to attract customers from other financial institutions. Inability to retain these key personnel could negatively impact our growth and future growth because of their skills, customer relationships and/or the potential difficulty of promptly replacing them.

The limitations on bonuses, retention awards, severance payments and incentive compensation contained in ARRA may adversely affect our ability to retain our highest performing employees.

For so long as any equity securities that we issued to the U.S. Treasury under the CPP remain outstanding, ARRA severely restricts bonuses, retention awards, severance payments and other incentive compensation payable to our most highly compensated employees including our senior executive officers. It is possible that we may be unable to create a compensation structure that permits us to retain such officers or other key employees or recruit additional employees, especially if we are competing against institutions that are not subject to the same restrictions. Regulatory approval may be required in order to add or replace certain executive officers. Our key employees are not subject to post-termination non-competition or non-solicitation agreements. Failure to retain our key employees could materially adversely affect our business and results of operations.

We are subject to certain litigation, and our expenses related to this litigation may adversely affect our results.

We are from time to time subject to certain litigation in the ordinary course of our business. These claims and legal actions, including supervisory actions by our regulators, could involve large monetary claims and significant defense costs. The outcome of these cases is uncertain. However, during the current credit crisis, we have seen both the number of cases and our expenses related to those cases increase. Substantial legal liability or significant regulatory action against us could have material adverse financial effects or cause significant reputational harm to us, which in turn could seriously harm our business prospects.

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We may issue additional common stock or other equity securities in the future which could dilute the ownership interest of existing stockholders.

In order to maintain our or Pinnacle National's capital at desired or regulatory-required levels or to replace existing capital such as our preferred stock, we may issue additional shares of common stock, or securities convertible into, exchangeable for or representing rights to acquire shares of common stock. We may sell these shares at prices below the current market price of shares, and the sale of these shares may significantly dilute stockholder ownership. We could also issue additional shares in connection with acquisitions of other financial institutions, which would also dilute stockholder ownership.

Even though our common stock is currently traded on the Nasdaq Stock Market's Global Select Market, it has less liquidity than many other stocks quoted on a national securities exchange.

The trading volume in our common stock on the Nasdaq Global Select Market has been relatively low when compared with larger companies listed on the Nasdaq Global Select Market or other stock exchanges. Although we have experienced increased liquidity in our stock, we cannot say with any certainty that a more active and liquid trading market for our common stock will continue to develop. Because of this, it may be more difficult for stockholders to sell a substantial number of shares for the same price at which stockholders could sell a smaller number of shares.

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

The market price of our common stock has fluctuated significantly, and may fluctuate in the future. These fluctuations may be unrelated to our performance. General market or industry price declines or overall market volatility in the future could adversely
affect the price of our common stock, and the current market price may not be indicative of future market prices.

If a change in control is delayed or prevented, the market price of our common stock could be negatively affected.

Provisions in our corporate documents, as well as certain federal and state regulations, may make it difficult and expensive to pursue a tender offer, change in control or takeover attempt that our board of directors opposes. As a result, our stockholders may not have an opportunity to participate in such a transaction, and the trading price of our stock may not rise to the level of other institutions that are more vulnerable to hostile takeovers. Anti-takeover provisions contained in our charter also will make it more difficult for an outside stockholder to remove our current board of directors or management.

Holders of Pinnacle Financial's bank indebtedness and junior subordinated debentures have rights that are senior to those of Pinnacle Financial's stockholders.

Pinnacle Financial has supported its continued growth through the issuance of trust preferred securities from special purpose trusts and accompanying junior subordinated debentures. At December 31, 2011, Pinnacle Financial had outstanding trust preferred securities and accompanying junior subordinated debentures totaling $82.5 million. Payments of the principal and interest on the trust preferred securities of these trusts are conditionally guaranteed by Pinnacle Financial. Further, the accompanying junior subordinated debentures Pinnacle Financial issued to the trusts are senior to Pinnacle Financial's shares of common stock and preferred stock. As a result, Pinnacle Financial must make payments on the junior subordinated debentures before any dividends can be paid on its preferred stock, or common stock and, in the event of Pinnacle Financial’s bankruptcy, dissolution or liquidation, the holders of the junior subordinated debentures must be satisfied before any distributions can be made on Pinnacle Financial’s common stock and preferred stock. Pinnacle Financial has the right to defer distributions on its junior subordinated debentures (and the related trust preferred securities) for up to five years, during which time no dividends may be paid on its common stock or preferred stock. If our financial condition deteriorates or if we do not receive required regulatory approvals, we may be required to cease paying dividends on our preferred stock and to defer distributions on our junior subordinated debentures.

Our business is dependent on technology, and an inability to invest in technological improvements may adversely affect our results of operations and financial condition.

The financial services 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. We have made significant investments in data processing, management information systems and internet banking accessibility. Our future success will depend in part upon our ability to create additional efficiencies in our operations through the use of technology. Many of our competitors have substantially greater resources to invest in technological improvements. We cannot make assurances that our technological improvements will increase our operational efficiency or that we will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

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We are subject to various statutes and regulations that may impose additional costs or limit our ability to take certain actions.

We operate in a highly regulated industry and are subject to examination, supervision, and comprehensive regulation by various regulatory agencies. Our compliance with these regulations is costly and restricts certain of our activities, including payment of dividends, mergers and acquisitions, investments, loans and interest rates charged on loans, interest rates paid on deposits and locations of offices. We are also subject to capital requirements established by our regulators, which require us to maintain specified levels of capital. Recent bank and thrift closures have depleted the Deposit Insurance Fund, and we were assessed a special assessment in the second quarter of 2009 and were required to prepay our risk based assessment for the fourth quarter of 2009 and for all of 2010, 2011 and 2012 in the fourth quarter of 2009. It is possible that our assessments may increase in the future. Any future assessment increases could negatively impact our results of operations. Significant changes in laws and regulations applicable to the banking industry have been recently adopted and others are being considered in Congress. We cannot predict the effects of these changes on our business and profitability. Because government regulation greatly affects the business and financial results of commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company's executive offices are located at 150 Third Avenue South, Suite 900, Nashville, Tennessee. The Company operates 32 banking locations throughout our market areas, of which for 9 locations the Company leases the land, the building or both. The Company has locations in the Tennessee municipalities of Nashville, Knoxville, Murfreesboro, Dickson, Ashland City, Mt. Juliet, Lebanon, Franklin, Brentwood, Hendersonville, Goodlettsville, Smyrna and Shelbyville.

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ITEM 3. LEGAL PROCEEDINGS

Various legal proceedings to which Pinnacle Financial or a subsidiary of Pinnacle Financial is party arise from time to time in the normal course of business. Except as described below, as of the date hereof, there are no material pending legal proceedings to which Pinnacle Financial or any of its subsidiaries is a party or of which any of its or its subsidiaries' properties are subject.

During the fourth quarter, a customer of Pinnacle National's filed a punative class action lawsuit (styled John Higgins, et al. v. Pinnacle Financial Partners, Inc., d/b/a Pinnacle National Bank) in Davidson County, Tennessee Circuit Court against Pinnacle National and Pinnacle Financial, on his own behalf, as well as on behalf of a purported class of Pinnacle National's customers within the State of Tennessee alleging that Pinnacle National's method of ordering debit card transactions had caused customers of Pinnacle National to incur higher overdraft charges than had a different method been used. In support of his claims, the plaintiff asserts theories of breach of contract, breach of the implied covenant of good faith and fair dealing, unjust enrichment and unconscionability. The plaintiff is seeking, among other remedies, an award of unspecified compensatory, pre-judgment interest, costs and attorneys' fees. On January 17, 2012, Pinnacle Financial and Pinnacle National filed a motion to dismiss the complaint. As of December 31, 2011, the Company cannot reasonably estimate the probability of a potential loss, if any, associated with this litigation and intends to contest this matter vigorously.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Pinnacle Financial's common stock is traded on the Nasdaq Global Select Market under the symbol "PNFP" and has traded on that market since July 3, 2006. The following table shows the high and low closing sales price information for Pinnacle Financial's common stock for each quarter in 2011 and 2010 as reported on the Nasdaq Global Select Market.

	Price Per Share	
	High	Low
2011:		
First quarter	$ 16.60	$ 13.55
Second quarter	16.82	14.15
Third quarter	16.21	10.52
Fourth quarter	16.65	10.28
2010:		
First quarter	$ 16.88	$ 13.10
Second quarter	18.93	11.81
Third quarter	14.33	8.51
Fourth quarter	13.74	9.27

As of February 24, 2012, Pinnacle Financial had approximately 3,579 stockholders of record.

Pinnacle Financial has not paid any cash dividends on our common stock since inception, and it does not anticipate that it will consider paying dividends until Pinnacle National has achieved a level of profitability appropriate to fund such dividends and support asset growth. See ITEM 1. "Business – Supervision and Regulation – Payment of Dividends" and ITEM 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information on dividend restrictions applicable to Pinnacle Financial and Pinnacle National.

Pinnacle Financial repurchased shares of its common stock during the quarter ended December 31, 2011 as follows:

Period	Total Number of Shares Repurchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs
October 1, 2011 to October 31, 2011	-	-	-	-
November 1, 2011 to November 30, 2011	-	-	-	-
December 1, 2011 to December 31, 2011	11,838	$16.41	-	-

Total	11,838	$16.41	-	-

(1) On December 30, 2011, we issued 54,526 shares of our common stock to certain of our executive officers in settlement of salary stock units that had been issued to these individuals throughout 2011. We withheld 11,838 of these shares to satisfy tax withholding requirements related to this issuance.

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ITEM 6. SELECTED FINANCIAL DATA

	2011	2010	2009	2008	2007(1)
	($ in 000s except per share data)				
Statement of Financial Condition Data (as of December 31):					
Total assets	$4,863,951	$4,909,004	$5,128,811	$4,754,075	$3,794,170
Loans, net of unearned income	3,291,351	3,212,440	3,563,382	3,354,907	2,749,641
Allowance for loan losses	73,975	82,575	91,959	36,484	28,470
Total securities	897,292	1,018,637	937,555	849,781	522,685
Goodwill, core deposit and other intangible assets	251,919	254,795	257,793	261,032	260,900
Deposits and securities sold under agreements to repurchase	3,785,931	3,979,352	4,099,064	3,717,544	3,081,390
Advances from FHLB and other borrowings	226,069	121,393	212,655	273,609	141,666
Subordinated debt	97,476	97,476	97,476	97,476	82,476
Stockholders' equity	710,145	677,457	701,020	627,298	466,610
Statement of Operations Data:					
Interest income	$188,347	$203,348	$205,716	$206,082	$150,931
Interest expense	36,882	58,975	74,925	91,867	75,219
Net interest income	151,465	144,373	130,791	114,215	75,712
Provision for loan losses	21,798	53,695	116,758	11,214	4,720
Net interest income after provision for loan losses	129,667	90,678	14,033	103,001	70,992
Noninterest income	37,940	36,315	39,651	34,718	22,521
Noninterest expense	139,107	146,883	118,577	94,478	60,480
Income (loss) before income taxes	28,500	(19,890)	(64,893)	43,241	33,033
Income tax (benefit) expense	(15,238)	4,410	(29,393)	12,367	9,992
Net income (loss)	43,737	(24,300)	(35,500)	30,874	23,041
Preferred dividends and accretion on common stock warrants	6,664	6,142	5,930	309	-
Net income (loss) available to common stockholders	$37,073	$(30,442)	$(41,430)	$30,565	$23,041
Per Share Data:					
Earnings (loss) per share available to common stockholders – basic	$1.11	$(0.93)	$(1.46)	$1.34	$1.43
Weighted average common shares outstanding – basic	33,420,015	32,789,871	28,395,618	22,793,699	16,100,076
Earnings (loss) per common share available to common stockholders – diluted	$1.09	$(0.93)	$(1.46)	$1.27	$1.34
Weighted average common shares outstanding – diluted	34,060,228	32,789,871	28,395,618	24,053,972	17,255,543
Book value per common share	$18.56	$17.22	$18.41	$22.40	$20.96
Common shares outstanding at end of period	34,354,960	33,870,380	33,029,719	23,762,124	22,264,817

Performance Ratios and Other Data:										
Return on average assets	0.77	%	(0.61	%)	(0.82	%)	0.74	%	0.96	%
Return on average stockholders' equity	5.27	%	(4.37	%)	(6.10	%)	6.13	%	8.34	%
Net interest margin (2)	3.55	%	3.25	%	2.93	%	3.17	%	3.55	%
Net interest spread (3)	3.33	%	2.99	%	2.64	%	2.78	%	2.88	%
Noninterest income to average assets	0.78	%	0.72	%	0.79	%	0.84	%	0.94	%
Noninterest expense to average assets	2.88	%	2.93	%	2.34	%	2.30	%	2.53	%
Efficiency ratio (4)	73.45	%	81.29	%	69.57	%	63.43	%	61.57	%
Average loan to average deposit ratio	86.76	%	87.64	%	94.51	%	97.70	%	94.88	%
Average interest-earning assets to average interest-bearing liabilities	125.84	%	120.27	%	117.52	%	115.27	%	119.46	%
Average equity to average total assets ratio	14.6	%	13.90	%	13.55	%	12.15	%	11.56	%
Asset Quality Ratios:										
Allowance for loan losses to nonaccrual loans	154.6	%	102.1	%	73.7	%	335.95	%	144.69	%
Allowance for loan losses to total loans	2.25	%	2.57	%	2.58	%	1.09	%	1.04	%
Nonperforming assets to total assets	1.80	%	2.86	%	3.01	%	0.61	%	0.56	%
Nonperforming assets to total loans and other real estate	2.66	%	4.29	%	4.29	%	0.86	%	0.78	%
Net loan charge-offs to average loans	0.94	%	1.96	%	1.71	%	0.11	%	0.06	%
Capital Ratios (Pinnacle Financial):										
Leverage (5)	11.4	%	10.7	%	10.7	%	10.5	%	11.6	%
Tier 1 risk-based capital	13.8	%	13.8	%	13.1	%	12.1	%	9.5	%
Total risk-based capital	15.3	%	15.4	%	14.8	%	13.5	%	10.4	%

(1) Information for 2007 fiscal year includes the post-merger operations of Mid-America, which Pinnacle Financial merged with on November 30, 2007 and reflects approximately 6.7 million shares of Pinnacle Financial common stock issued in connection with the merger.

(2) Net interest margin is the result of net interest income for the period divided by average interest earning assets.

(3) Net interest spread is the result of the difference between the interest earned on interest earning assets less the interest paid on interest bearing liabilities.

(4) Efficiency ratio is the result of noninterest expense divided by the sum of net interest income and noninterest income.

(5) Leverage ratio is computed by dividing Tier 1 capital by average total assets for the fourth quarter of each year.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial condition at December 31, 2011 and 2010 and our results of operations for each of the years in the three-year period ended December 31, 2011. The purpose of this discussion is to focus on information about our financial condition and results of operations which is not otherwise apparent from the consolidated financial statements. The following discussion and analysis should be read along with our consolidated financial statements and the related notes included elsewhere herein.

Overview

General. During 2011, our focus has been to build our core earnings capacity and to aggressively deal with troubled assets. Our fully diluted net income for the year ended December 31, 2011 was $1.09 per common share available to common stockholders compared to fully diluted net loss per common share available to common stockholders of $0.93 and $1.46 for the years ended December 31, 2010 and 2009, respectively. At December 31, 2011, net loans totaled $3.291 billion, as compared to $3.212 billion at December 31, 2010, while total deposits decreased slightly to $3.654 billion at December 31, 2011 from $3.833 billion at December 31, 2010.

Results of operations. Our net interest income increased to $151.5 million for 2011 compared to $144.4 million for 2010 and $130.8 million for 2009. The net interest margin (the ratio of net interest income to average earning assets) for 2011 was 3.55% compared to 3.25% for 2010 and 2.93% for 2009. Our net interest margin was impacted favorably in all three years by our decreased dependency on wholesale funding and an increased effort to reduce to our cost of funds. Growth within our lower cost money market account balances and a decrease within our time deposits also favorably impacted our net interest margin.

Impacting the provision for loan losses in any accounting period are several matters including the change in outstanding loan balances during the period, the level of charge-offs during the period, the changes in the amount of impaired loans, changes in the risk ratings assigned to our loans, results of regulatory examinations, credit quality comparison to peer banks and the industry at large, and, ultimately, the results of our quarterly assessment of the inherent risks of our loan portfolio including past loan loss experience. The economic downturn and excess supply forced degradation in the local real estate market; that deterioration impacted the amount of charge-offs, impaired loans, risk rating downgrades and assessment of risk inherent in the loan portfolio particularly in 2009 and 2010. Our 2009 provisioning expense was also negatively impacted by a single charge-off of a large, $21.55 million loan to a Georgia bank holding company as a result of the receivership of its bank subsidiary.

Our provision for loan losses was $21.8 million for 2011 compared to $53.7 million in 2010 and $116.8 million in 2009. Our net charge-offs were $30.4 million during 2011 compared to $63.1 million in 2010 and $61.3 million in 2009. During 2011, we decreased our allowance for loan losses as a percentage of loans from 2.57% at December 31, 2010 to 2.25% at December 31, 2011 primarily due to the ongoing resolution of non-performing loans, the reduction of our construction and development portfolio and overall improvements in the asset quality of our loan portfolio during 2011.

Noninterest income for 2011 compared to 2010 increased by $1.6 million, or 4.5%. This growth was primarily attributable to increased production in our fee-based products such as investments, insurance and trust as well as our mortgage origination business. Noninterest income for 2010 compared to 2009 decreased by $3.3 million, or 8.4%, which was primarily attributable to substantially higher gains on the sale of investment securities for the year ended 2009 as compared to 2010.

Noninterest expense for 2011 compared to 2010 decreased by $7.8 million, or 5.3%, primarily due to decreased other real estate owned expenses which decreased by $11.8 million over the 2010 levels. The decrease in other real estate owned expense was partially offset by salaries and employee benefits expense which increased by $9.8 million. The increase in salaries and benefits was primarily attributable to incentive compensation earned in 2011 and the payment of stock-settled salary stock units to our executive officers. The remaining decrease in noninterest expense is attributable to a reduction in various administrative expenses such as FDIC assessments, insurance, and franchise taxes and other expenses. Noninterest expense for 2010 compared to 2009 increased by $28.3 million, or 23.9%, primarily due to increased other real estate owned expenses which increased by $15.0 million over the 2009 levels, and increased salaries and employee benefits expense which increased by $7.9 million. The increase in salary expense between 2009 and 2010 was largely due to new personnel hired to resolve problem assets and increased health insurance costs. The number of full-time equivalent employees decreased from 777 at December 31, 2009 to 769 at December 31, 2010. There were 747 full-time equivalent employees at December 31, 2011.

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Income tax benefit for 2011 was $15.2 million compared to income tax expense of $4.4 million in 2010 and income tax benefit of $29.4 million in 2009. The effective income tax benefit for the year ended December 31, 2011 was approximately 53.5%, compared to an income tax rate of 22.2% for the year ended December 31, 2010. For the years ended December 31, 2011 and 2010, our income tax expense rate was principally impacted by the reversal of the deferred tax valuation allowance in the third quarter of 2011 which had been initially established during the second quarter of 2010. We realized an effective income tax expense rate of 45.3% for the year ended December 31, 2009.

Our efficiency ratio (the ratio of noninterest expense to the sum of net interest income and noninterest income) was 73.5% in 2011 compared to 81.3% in 2010 and 69.6% in 2009. Our efficiency ratio was negatively impacted by other real estate owned expenses and other costs related to the management and collection of troubled loans.

Net income available to common stockholders for 2011 was $37.1 million compared to $30.4 million and $41.4 million in net loss available to common stockholders in 2010 and 2009, respectively. Fully-diluted net income per common share available to common stockholders was $1.09 for 2011 compared to fully-diluted net loss per common share available to common stockholders of $0.93 for 2010 and $1.46 for 2009. Included in net income available to common stockholders for the year ended December 31, 2011 was approximately $4.6 million and $2.1 million, respectively, of charges related to preferred stock dividends and accretion of the preferred stock discount related to our participation in the U.S. Treasury's CPP, as compared to $4.8 million and $1.3 million, respectively, for the year ended December 31, 2010 and $4.8 million and $1.1 million, respectively, for the year ended December 31, 2009. The increased charges associated with the accretion of the preferred stock discount in fiscal 2011 over fiscal 2010 were the result of our redemption of 23,750 shares of Series A preferred stock on December 28, 2011.

Financial Condition.

Our loan balances increased by $78.9 million during 2011 compared to a decrease of $350.9 million in 2010. The increase in our outstanding loan balances was offset in part by the continued resolution of non-performing loans, specifically loans within the construction and development portfolio. We reduced our construction and development portfolio by $57.0 million during 2011 and $194.0 million in 2010. We continue to focus on the timely resolution of nonperforming assets.

Total deposits decreased from $3.833 billion at December 31, 2010 to $3.654 billion at December 31, 2011. Within our deposits, the ratio of core funding to total deposits increased from 81.6% at December 31, 2010 to 83.8% at December 31, 2011. The increase in our core funding percentage contributed significantly to our improved cost of funds during 2011. Additionally, we reduced our brokered deposit balance from $14.2 million at December 31, 2010 to zero at December 31, 2011. This reduction was largely due to the efforts of our sales force. We have hired experienced relationship managers that have significant client portfolios and longstanding reputations within the communities we serve. As such, we believe they will attract additional loans and deposits by new and existing small-and middle-market clients as our economy continues to recover.

Capital and Liquidity. At December 31, 2011 and 2010, our capital ratios, including our bank's capital ratios, exceeded regulatory minimum capital requirements. Additionally, we believe our bank would be considered to be "well-capitalized" pursuant to banking regulations at these dates. Our bank may require additional capital from us over that which can be earned through operations. To support the capital needs of Pinnacle National, at December 31, 2011, we had approximately $36.5 million of cash and cash equivalents at the holding company. Additionally, we would continue to use various capital raising techniques in order to support the capital needs of our bank, if necessary.

During the fourth quarter of 2008, we further increased our capital through our participation in the CPP, issuing 95,000 shares of Series A preferred stock for $95 million. Additionally, we issued warrants to acquire 534,910 shares of our common stock to the U.S. Treasury. The warrants have an exercise price of $26.64 each, are immediately exercisable and expire 10 years from the date of issuance. The common stock warrants were assigned a fair value of $6.7 million, as of December 12, 2008. The resulting $88.3 million was assigned to the Series A preferred stock issued in the CPP and will be accreted up to the redemption amount of $95 million prior to the redemption of the Series A preferred stock. During the fourth quarter of 2011, we repurchased 25% of the shares of Series A preferred stock originally issued to the U.S. Treasury under the CPP in a transaction totaling approximately $23.9 million. This partial redemption was financed from available cash resources of the Company. Following the partial redemption of the 23,750 shares of Series A preferred stock, 71,250 shares of Series A preferred stock remain issued and outstanding and held by the U.S. Treasury.

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Approximately $4.5 million of the discount recorded on the preferred stock has been accreted as a reduction to net income available to common stockholders through December 31, 2011, including the acceleration of the remaining preferred stock discount associated with the shares we redeemed on December 28, 2011. The remaining discount is $2.2 million at December 31, 2011. This discount will be accreted as a reduction to net income available to common stockholders over the next two years at approximately $1.1 million per year unless we receive permission from our regulators to redeem the remaining shares of the Series A preferred stock at which time the remaining balance of the discount associated with such redeemed shares will be reflected as a reduction to net income available to common stockholders.

On June 16, 2009, we issued 8,855,000 shares of our common stock through a public offering resulting in net proceeds to us of approximately $109.0 million further increasing our capital position. As a result, and pursuant to the terms of the warrants issued to the U.S. Treasury in connection with our participation in the CPP, the number of shares issuable upon exercise of the warrants issued to the U.S. Treasury in connection with the CPP was reduced by 50%, or 267,455 shares.

Pinnacle National is a national bank chartered under the Federal National Bank Act. As a result, it is subject to the supervision, examination and reporting requirements of the National Bank Act and the regulations of the OCC. In January 2010, Pinnacle National informally agreed to an OCC requirement that it maintain a minimum Tier 1 capital to average assets ratio of 8% and a minimum total capital to risk-weighted assets ratio of 12%. During the fourth quarter of 2011, the OCC lifted this individual minimum capital requirement although it remains as an internal policy. At December 31, 2011, Pinnacle National had a 13.8% Tier 1 capital to average assets ratio and a 15.3% total capital to risk-weighted assets ratio. Information concerning our and Pinnacle National's regulatory ratios at December 31, 2011 is included in Note 20 to the "Notes to Consolidated Financial Statements" included elsewhere in this Annual Report on Form 10-K.

Critical Accounting Estimates

The accounting principles we follow and our methods of applying these principles conform with U.S. generally accepted accounting principles and with general practices within the banking industry. In connection with the application of those principles, we have made judgments and estimates which, in the case of the determination of our allowance for loan losses, the valuation of other real estate owned, the assessment of the valuation of deferred tax assets and the assessment of impairment of intangibles has been critical to the determination of our financial position and results of operations.

Allowance for Loan Losses (allowance). Our management assesses the adequacy of the allowance prior to the end of each calendar quarter. This assessment includes procedures to estimate the allowance and test the adequacy and appropriateness of the resulting balance. The level of the allowance is based upon management's evaluation of the loan portfolio, past loan loss experience, current asset quality trends, known and inherent risks in the portfolio, adverse situations that may affect the borrowers' ability to repay (including the timing of future payment), the estimated value of any underlying collateral, composition of the loan portfolio, economic conditions, industry and peer bank loan quality indications and other pertinent factors, including regulatory recommendations. The level of allowance maintained is believed by management to be adequate to absorb probable losses inherent in the loan portfolio at the balance sheet date. The allowance is increased by provisions charged to expense and decreased by charge-offs, net of recoveries of amounts previously charged-off. Allocation of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed to be uncollectible.

In assessing the adequacy of the allowance, we also consider the results of our ongoing independent loan review process. We undertake this process both to ascertain those loans in the portfolio with credit risk and to assist in our overall evaluation of the risk characteristics of the entire loan portfolio. Our loan review process includes the judgment of management, independent internal loan reviewers, and reviews that may have been conducted by third-party reviewers including regulatory examiners. We incorporate relevant loan review results in the loan impairment determination.

Our allowance for loan losses is composed of the result of two independent analyses pursuant to the provisions of ASC 450-20, Loss Contingencies and ASC 310-10-35, Receivables. The ASC 450-20 analysis is intended to quantify the inherent risk in our performing loan portfolio. The component of the allowance generated by ASC 310-10-35 is the result of a loan-by-loan analysis of loans that have been specifically identified as impaired or troubled.

The ASC 450-20 component of the allowance for loan losses begins with a process of estimating the probable losses based on our internal system of risk ratings and historical loss data for our risk rated portfolio. Prior to 2010, because of Pinnacle Financial's limited loss history, loss estimates were primarily derived from historical loss data by loan categories for comparable peer institutions. During 2010, we incorporated the results of our own historical migration analysis of all loans that were charged-off during the prior eight quarters. The look-back period in our migration analysis was extended in 2011 to eleven quarters to continue to include the losses incurred by Pinnacle Financial in the second quarter of 2009. In this current economic environment, we believed the extension of our look-back period in our migration analysis was appropriate due to the risks inherent in our loan portfolio. Absent the extension, the early cycle periods in which we experienced significant losses would have been excluded from the determination of the allowance for loan losses. This migration analysis assists in evaluating loan loss allocation rates for the various risk grades assigned to loans in our portfolio. The results of the migration analysis are then compared to other industry factors to determine the loss allocation rates for the risk rated loan portfolios. The loss allocation rates from our migration analysis and the industry loss factors are weighted to determine a weighted average loss allocation rate for these portfolios.

The allowance allocation for non risk-rated portfolios is based on consideration of our actual historical loss rates and industry loss rates for those particular segments. Non risk-rated loans are evaluated as a group by category rather than on a individual loan basis because these loans are smaller and homogeneous. We weight the allocation methodologies for the non risk-rated loan portfolio and determine a weighted average allocation for these portfolios.

The estimated loan loss allocation for all loan segments is then adjusted for management's estimate of probable losses for several environmental factors. The allocation for environmental factors is particularly subjective and does not lend itself to exact mathematical calculation. This amount represents estimated probable inherent credit losses which exist, but have not yet been identified, as of the balance sheet date, and is based upon quarterly trend assessments in delinquent and nonaccrual loans, unanticipated charge-offs, credit concentration changes, prevailing economic conditions, changes in lending personnel experience, changes in lending policies or procedures and other influencing factors. These environmental factors are considered for each of the five loan segments, and the allowance allocation, as determined by the processes noted above for each segment, is increased or decreased based on the incremental assessment of these various environmental factors.

The ASC 450-20 portion of the allowance also includes an unallocated component. We believe that the unallocated amount is warranted for inherent factors that cannot be practically assigned to individual loan categories, such as the imprecision in the overall loss allocation measurement process, the volatility of the local economies in the markets we serve and imprecision in our credit risk ratings process.

The second component of the allowance for loan losses is determined pursuant to ASC 310-10-35. Loans are impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Collection of all amounts due according to the contractual terms means that both the interest and principal payments of a loan will be collected as scheduled in the loan agreement. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. Loan losses are charged off when management believes that the full collectability of the loan is unlikely. A loan may be partially charged-off after a "confirming event" has occurred which serves to validate that full repayment pursuant to the terms of the loan is unlikely.

An impairment allowance is recognized if the fair value of the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net of deferred loan fees or costs and unamortized premium or discount). The impairment is recognized through the provision for loan losses and is a component of the allowance. Loans that are impaired are recorded at the present value of expected future cash flows discounted at the loan's effective interest rate or if the loan is collateral dependent, the fair value of the collateral, less estimated disposal costs. If the loan is collateral dependent, the principal balance of the loan is charged-off in an amount equal to the impairment measurement. The fair value of collateral dependent loans is derived primarily from collateral appraisals performed by independent third-party appraisers. Management believes it follows appropriate accounting and regulatory guidance in determining impairment and accrual status of impaired loans.

Pursuant to the guidance set forth in ASU No. 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring, the above impairment methodology is applied to those loans identified as troubled debt restructurings.

We then test the resulting allowance by comparing the balance in the allowance to historical trends and industry and peer information. Our management then evaluates the result of the procedures performed, including the results of our testing, and decides on the appropriateness of the balance of the allowance in its entirety. The audit committee of our board of directors reviews and approves the assessment prior to the filing of quarterly and annual financial information.

While our policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to operations, are considered adequate by management and are reviewed from time to time by our regulators, they are necessarily approximate and imprecise. There are factors beyond our control, such as conditions in the local and national economy, a local real estate market or particular industry conditions which may negatively impact, materially, our asset quality and the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

Other Real Estate Owned. Other real estate owned (OREO), consists of properties obtained through foreclosure or through deed in lieu of foreclosure in satisfaction of loans, is reported at the lower of cost or fair value based on appraised value, less selling costs estimated as of the date acquired, with any loss recognized as a charge-off through the allowance for loan losses. Additional OREO losses for subsequent downward valuation adjustments are determined on a specific property basis and are included as a component of other noninterest expense along with holding costs. The fair value of other real estate owned is derived primarily from independent appraisers. At December 31, 2011, the average age of our other real estate owned appraisals was 4.53 months. Any net gains or losses on disposal realized at the time of disposal are reflected in noninterest income or noninterest expense, as applicable. Significant judgments and complex estimates are required in estimating the fair value of other real estate owned, and the period of time within which such estimates can be considered current is significantly shortened during periods of market volatility, as experienced during the last three years. As a result, the net proceeds realized from sales transactions could differ significantly from appraisals, comparable sales, and other estimates used to determine the fair value of other real estate owned.

Deferred Tax Asset Valuation. A valuation allowance is recognized for a deferred tax asset if, based on the weight of available evidence, it is more-likely-than-not that some portion or the entire deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. In making such judgments, significant weight is given to evidence that can be objectively verified. Primarily as a result of credit losses, we entered into a three-year cumulative pre-tax loss position as of June 30, 2010. A cumulative loss position is considered significant negative evidence in assessing the realizability of a deferred tax asset which is difficult to overcome and accordingly, we established a valuation allowance against the net deferred tax asset at June 30, 2010. Subsequently, Pinnacle Financial reported several linked-quarters with increasing profitability, demonstrated an improved ability to produce reliable projections, and realized an improvement in overall asset quality and related credit metrics. Due to these factors, other positive trends, and the relatively short period of time in which we forecast we will be able to exit a three-year cumulative tax loss position and utilize our net deferred tax asset, we determined during the quarter ended September 30, 2011 that we had sufficient objective positive evidence to reverse the beginning of the year deferred tax valuation allowance at September 30, 2011. At December 31, 2011, we do not have a deferred tax valuation allowance.

Impairment of Intangible Assets. Long-lived assets, including purchased intangible assets subject to amortization, such as our core deposit intangible asset, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. There are no such assets to be disposed of at December 31, 2011.

Goodwill is evaluated for impairment annually and more frequently if events and circumstances indicate that the asset might be impaired. The annual assessment date is September 30 for Pinnacle Financial. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The goodwill impairment analysis is a two-step test. The first step, used to identify potential impairment, involves comparing each reporting unit's estimated fair value to its carrying value, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying value, the first step is "passed" and no further impairment tests are required. If the carrying value exceeds estimated fair value, there is an indication of potential impairment and a second step is performed to measure the amount of impairment, if any.

We engage an independent third-party valuation firm to assist in performing Step 1 of the goodwill impairment assessment. Step 1 of the goodwill impairment assessment determines the fair value of equity of Pinnacle Financial as a whole since Pinnacle Financial is deemed to have only one reporting unit, and compares the result to the carrying value. Step 1 testing consists of three testing methods to determine the estimated fair value of Pinnacle Financial: the Guideline Publicly Traded Company Method, the Guideline Merged or Acquired Company Method, and the Subject Company Stock Transactions Method as more fully discussed below.

- Guideline Publicly Traded Company Method – This method considers the implied value of Pinnacle Financial by comparing Pinnacle Financial to a select peer group of public companies and their current market capitalizations, adjusted for differences between the companies. This value is then increased by a control premium which is supported by expected cost savings, or synergies, that could be realized by a market participant. To develop the control premium assumptions, management performed a detailed analysis of expenses that would be eliminated by a future acquirer based on a likely management/operational structure that would be established by the acquiring entity. The synergies were identified based on our historical experience realized in previous acquisitions and known redundancies that could be eliminated in a merger scenario. The resulting control premium utilized in Step 1 testing was corroborated by current period acquisitions.

- Guideline Merged/Acquired Company Method –This method considers the amount an acquiring company might be willing to pay to gain control of Pinnacle Financial based on multiples of tangible book value paid by acquirers in recent merger and acquisition transactions.

- Subject Company Stock Transaction Method –This method relies on the closing stock price on the testing date, as well as the five and ten day closing stock price averages surrounding the closing stock price on the testing date, multiplied by the number of shares outstanding to arrive at an estimated fair value for Pinnacle Financial. The control premium, as discussed more fully under the Guideline Publicly Traded Company method, is also applied to the subject company stock transaction method.

The results of the three testing methodologies are then weighted equally to determine our estimate of the fair value of equity. If the fair value of equity determined through Step 1 is less than the carrying value of the assets and liabilities, Step 2 of the goodwill impairment analysis must be performed. Step 2 testing involves calculating an implied fair value of goodwill for which the first step indicated potential impairment. The implied fair value of goodwill is determined in a manner similar to the amount of goodwill calculated in a business combination, by measuring the excess of the estimated fair value, as determined in the first step, over the aggregate estimated fair values of the individual assets, liabilities and identifiable intangibles as if Pinnacle Financial was being acquired in a business combination. If the implied fair value of goodwill exceeds the carrying value of goodwill, there is no impairment. If the carrying value of goodwill exceeds the implied fair value of the goodwill, an impairment charge is recorded for the excess.

While we believe that the assumptions utilized in our testing were appropriate, they may not reflect actual outcomes that could occur. Specific factors that could negatively impact the assumptions used include the following: a change in the control premiums being realized in the market or a meaningful change in the number of mergers and acquisitions occurring; the amount of expense savings that may be realized in an acquisition scenario; significant fluctuations in our asset/liability balances or the composition of our balance sheet; a change in the overall valuation of the stock market, specifically bank stocks; performance of Southeast U.S. Banks; and Pinnacle Financial's performance relative to peers. Changing these assumptions, or any other key assumptions, could have a material impact on the amount of goodwill impairment, if any.

We performed our annual evaluation of goodwill impairment as of September 30, 2011. The September 30, 2011 closing price for our common stock was less than our carrying value per share of our assets and liabilities at September 30, 2011. However, using the September 30, 2011, closing stock price of $10.94 and a control premium estimate calculated in accordance with the methodology discussed above, the fair value of Pinnacle Financial's assets and liabilities exceeded the carrying value of our assets and liabilities by approximately 3% and, as a result, Step 1 of the goodwill impairment test was met, and we determined that further testing for impairment was not required. For each dollar increase in our common stock price and resulting market cap, the excess of fair value over carrying value increases by approximately 5% of total equity. Our closing stock price was $16.15 at December 31, 2011 which exceeded our September 30, 2011 closing price providing further evidence of no impairment of goodwill. Our common stock at September 30, 2011 and December 31, 2011 was trading at levels higher than those that were utilized in our impairment testing as of September 30, 2010. At September 30, 2010, Pinnacle Financial performed a Step 2 assessment which resulted in no impairment. Based on the results of these analyses, we determined that there was no impairment at December 31, 2011. Should our common stock price decline or other impairment indicators become known, additional impairment testing of goodwill may be required. Should it be determined in a future period that the goodwill has become impaired, then a charge to earnings will be recorded in the period such determination is made.

In September 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-8, Intangibles—Goodwill and Other, regarding testing goodwill for impairment. The new guidance provides an entity the option to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If an entity determines that this is the case, it is required to perform the currently prescribed two-step goodwill impairment test to identify potential goodwill impairment and measure the amount of goodwill impairment loss to be recognized for that reporting unit (if any). Based on the qualitative assessment, if an entity determines that the fair value of a reporting unit is more than its carrying amount, the two-step goodwill impairment test is not required. The new guidance will be effective for Pinnacle Financial beginning January 1, 2012. We will not know the impact of the adoption of this pronouncement on our financial position or results of operations as it is not practical to determine its effect until each prospective reporting date and after we have completed the qualitative assessments outlined in this ASU. At this time, we have no reason to believe it will have a significant impact on our financial position or results of operations.

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Results of Operations

The following is a summary of our results of operations for 2011, 2010 and 2009 (in thousands except per share data):

	Years ended December 31, 2011	Years ended December 31, 2010	2011-2010 Percent Increase (Decrease)	Year ended December 31, 2009	2010-2009 Percent Increase (Decrease)
Interest income	$188,346	$203,348	(7.4%)	$ 205,716	(1.2%)
Interest expense	36,882	58,975	(37.5%)	74,925	(21.3%)
Net interest income	151,464	144,373	4.9%	130,791	10.4%
Provision for loan losses	21,798	53,695	(59.4%)	116,758	(54.0%)
Net interest income after provision for loan losses	129,666	90,678	43.0%	14,033	546.2%
Noninterest income	37,940	36,315	4.5%	39,651	(8.4%)
Noninterest expense	139,107	146,883	(5.3%)	118,577	23.9%
Net income (loss) before income taxes	28,499	(19,890)	243.3%	(64,893)	(69.3%)
Income tax expense (benefit)	(15,238)	4,410	445.5%	(29,393)	(115.0%)
Net income (loss)	43,737	(24,300)	280.0%	(35,500)	(31.5%)
Preferred dividends and preferred stock discount accretion	6,665	6,142	8.5%	5,930	3.6%
Net income (loss) available to common stockholders	$37,072	$(30,442)	221.8%	$ (41,430)	(26.5%)
Basic net income (loss) per common share available to common stockholders	$1.11	$(0.93)	219.4%	$ (1.46)	(36.4%)
Diluted net income (loss) per common share available to common stockholders	$1.09	$(0.93)	217.2%	$ (1.46)	(36.4%)

Net Interest Income. Net interest income represents the amount by which interest earned on various earning assets exceeds interest paid on deposits and other interest bearing liabilities and is the most significant component of our earnings. For the year ended December 31, 2011, we recorded net interest income of $151,464,000, which resulted in a net interest margin (net interest income divided by the average balance of interest earning assets) of 3.55%. For the year ended December 31, 2010, we recorded net interest income of $144,373,000, which resulted in a net interest margin of 3.25% for the year. For the year ended December 31, 2009, we recorded net interest income of $130,791,000, which resulted in a net interest margin of 2.93%.

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The following table sets forth the amount of our average balances, interest income or interest expense for each category of interest-earning assets and interest-bearing liabilities and the average interest rate for total interest-earning assets and total interest-bearing liabilities, net interest spread and net interest margin for each of the years in the three-year period ended December 31, 2011 (in thousands):

	2011			2010			2009		
	Average Balances	Interest	Rates/ Yields	Average Balances	Interest	Rates/ Yields	Average Balances	Interest	Rates/ Yields
Interest-earning assets:									
Loans (1)	$3,218,123	$154,749	4.82%	$3,362,024	$162,902	4.85%	$3,525,033	$162,271	4.61%
Securities:									
Taxable	768,063	23,972	3.12%	780,643	30,306	3.88%	754,623	35,057	4.65%
Tax-exempt (2)	193,397	7,394	5.10%	205,029	7,917	5.09%	165,702	6,541	5.21%
Federal funds sold and other	167,932	2,232	1.43%	188,091	2,223	1.27%	93,212	1,847	2.16%
Total interest-earning assets	4,347,515	188,347	4.40%	4,535,787	203,348	4.55%	4,538,570	205,716	4.58%
Nonearning assets:									
Intangible assets	253,443			256,379			259,483		
Other nonearning assets	232,477			221,730			213,681		
	$4,833,435			$5,013,896			$5,011,734		
Interest-bearing liabilities:									
Interest-bearing deposits:									
Interest checking	$583,212	$3,522	0.60%	$520,351	3,491	0.67%	$359,774	1,983	0.55%
Savings and money market	1,597,965	13,773	0.86%	1,368,659	18,310	1.34%	884,173	11,049	1.25%
Certificates of deposit	876,864	13,293	1.52%	1,419,358	28,056	1.98%	2,022,196	50,097	2.48%
Total deposits	3,058,041	30,588	1.00%	3,308,368	49,857	1.51%	3,266,143	63,129	1.93%
Securities sold under agreements to repurchase	161,845	1,110	0.69%	222,179	1,750	0.79%	250,435	1,689	0.67%
Federal Home Loan Bank advances and other borrowings	137,466	2,519	1.83%	143,372	4,044	2.82%	247,992	6,106	2.46%
Subordinated debt	97,476	2,665	2.73%	97,476	3,324	3.41%	97,476	4,001	4.10%
Total interest-bearing liabilities	3,454,828	36,882	1.07%	3,771,395	58,975	1.56%	3,862,046	74,925	1.94%
Noninterest-bearing deposits	650,602	-	-	527,673	-	-	463,683	-	-
Total deposits and interest- bearing	4,105,430	36,882	0.90%	4,299,068	58,975	1.37%	4,325,729	74,925	1.73%

liabilities								
Other liabilities	24,752			17,842			6,968		
Stockholders' equity	703,253			696,986			679,037		
	$4,833,435			$5,013,896			$5,011,734		
Net interest income		$151,465			$144,373			$130,791	
Net interest spread (3)			3.33%			2.99%			2.64%
Net interest margin (4)			3.55%			3.25%			2.93%

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(1) Average balances of nonperforming loans are included in average loan balances.
(2) Yields based on the carrying value of those tax exempt instruments are shown on a fully tax equivalent basis.
(3) Yields realized on interest-bearing assets less the rates paid on interest-bearing liabilities. The net interest spread calculation excludes the impact of demand deposits. Had the impact of demand deposits been included, the net interest spread for the year ended December 31, 2011 would have been 3.50% compared to a net interest spread for the years ended December 31, 2010 and 2009 of 3.18% and 2.85%, respectively.
(4) Net interest margin is the result of net interest income calculated on a tax-equivalent basis divided by average interest earning assets for the period.

The banking industry uses two key ratios to measure relative profitability of net interest income - the net interest spread and the net interest margin. The net interest spread measures the difference between the average yield on interest earning assets and the average rate paid on interest bearing liabilities. The interest rate spread eliminates the effect of non-interest-bearing deposits and other non-interest bearing funding sources and gives a direct perspective on the effect of market interest rate movements. The net interest margin is an indication of the profitability of a company's overall balance sheet management activities and is defined as net interest income as a percentage of total average interest earning assets, which includes the positive effect of funding a portion of interest earning assets with customers' non-interest bearing deposits and with stockholders' equity.

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For the twelve month periods ended December 31, 2011 and 2010, our net interest spread was 3.33% and 2.99%, respectively, while the net interest margin was 3.55% and 3.25%, respectively. The net interest spread and net interest margin were 2.64% and 2.93%, respectively, for the twelve month period ended December 31, 2009. The improving net interest margin reflected management's efforts to maximize earnings by focusing on loan and, particularly, deposit pricing. During the year ended December 31, 2011, total funding rates were less than those rates for the years ended December 31, 2010 and 2009 by 47 and 83 basis points, respectively. The net decrease was largely impacted by the continued shift in our deposit mix, as we increased our savings and money market account balances and concurrently reduced balances of both our higher cost time deposits and higher-cost wholesale funding.

Additionally, lower levels of nonperforming loans positively impacted our net interest margin during the twelve months ended December 31, 2011 when compared to the same period in 2010. Average nonperforming loans were $63.9 million for the year ended December 31, 2011, which was less than the $108.4 million for the year ended December 31, 2010. Also, we continue to increase our focus on loan pricing. Loan pricing competition for creditworthy borrowers is becoming more competitive in our markets and limited our ability to increase pricing on new and renewed loans over the last several quarters.

We continue to deploy various asset liability management strategies to manage our risk to interest rate fluctuations. We currently believe that short term rates will remain stable for an extended period of time. We believe our net interest margin should increase during 2012 due to several factors related to pricing adjustments primarily for deposits. We believe margin expansion over the longer term will be challenging due to increased pricing competition for quality loan opportunities and an anticipated flattening of the yield curve.

We believe our net interest income should increase in 2012 compared to 2011 primarily due to an anticipated increased net interest margin and an increased emphasis by our sales force on pursuing quality loans. We anticipate funding these increased loan fundings by focusing on continuing to grow our core deposits, limited wholesale deposit fundings and reducing the size of our investment portfolio in relation to our total assets.

Rate and Volume Analysis. Net interest income increased by $7,091,000 between the years ended December 31, 2010 and 2011 and by $13,582,000 between the years ended December 31, 2009 and 2010. The following is an analysis of the changes in our net interest income comparing the changes attributable to rates and those attributable to volumes (in thousands):

	2011 Compared to 2010 Increase (decrease) due to			2010 Compared to 2009 Increase (decrease) due to		
	Rate	Volume	Net	Rate	Volume	Net
Interest-earning assets:						
Loans	$(1,153)	$(7,012)	$(8,165)	$8,460	$(7,829)	$631
Securities:						
Taxable	(5,925)	(409)	(6,334)	(5,811)	1,060	(4,751)
Tax-exempt	27	(549)	(522)	(199)	1,575	1,376
Federal funds sold	310	(301)	9	(830)	1,206	376
Total interest-earning assets	(6,741)	(8,271)	(15,012)	1,620	(3,988)	(2,368)
Interest-bearing liabilities:						
Interest-bearing deposits:						
Interest checking	(369)	400	31	432	1,076	1,508
Savings and money market	(6,513)	1,975	(4,538)	796	6,465	7,261
Certificates of deposit	(6,538)	(8,224)	(14,762)	(10,111)	(11,930)	(22,041)
Total deposits	(13,420)	(5,849)	(19,269)	(8,883)	(4,389)	(13,272)

Securities sold under agreements to repurchase	(217)	(423)	(640)	301	(240)	61
Federal Home Loan Bank advances and other borrowings	(1,409)	(123)	(1,532)	893	(2,955)	(2,062)
Subordinated debt	(664)	2	(662)	(673)	(4)	(677)
Total interest-bearing liabilities	(15,710)	(6,393)	(22,103)	(8,362)	(7,588)	(15,950)
Net interest income	$8,969	$(1,878)	$7,091	$9,982	$3,600	$13,582

Changes in net interest income are attributed to either changes in average balances (volume change) or changes in average rates (rate change) for earning assets and sources of funds on which interest is received or paid. Volume change is calculated as change in volume times the previous rate while rate change is change in rate times the previous volume. The change attributed to rates and volumes (change in rate times change in volume) is considered above as a change in volume.

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Provision for Loan Losses. The provision for loan losses represents a charge to earnings necessary to establish an allowance for loan losses that, in our management's evaluation, should be adequate to provide coverage for the inherent losses on outstanding loans. The provision for loan losses amounted to approximately $21,798,000, $53,695,000, and $116,758,000 for the years ended December 31, 2011, 2010, and 2009, respectively.

Provision expense for year ended December 31, 2011 has decreased as compared to 2010 and 2009, primarily due to a reduction in both net charge-offs and in the overall amount of the allowance for loan losses. Elevated net-charge offs and increased non-performing assets were the primary reasons for the provisioning expense in 2010 and 2009. Our construction and development loan portfolio contributed to elevated credit costs. This portfolio experienced credit deterioration due to depressed real estate market conditions. For substantially all construction and development loans, our collateral is our primary source of repayment and as the value of the collateral deteriorates, ultimate repayment in full by the borrower becomes increasingly difficult. Our provisioning expense for 2010 as compared to 2009 decreased due to the slowing of non-performing and troubled loan inflows. Also, our 2009 provisioning expense was impacted by a $21.55 million charge-off of a bank holding company loan when the subsidiary bank was placed in receivership by the OCC in the second quarter of 2009 and by an overall increase in the allowance for loan losses as a percentage of loans from 1.08% to 2.58%.

Based upon management's assessment of the loan portfolio, we adjust our allowance for loan losses to an amount deemed appropriate to adequately cover probable losses in the loan portfolio. Our allowance for loan losses as a percentage of loans decreased from 2.57% at December 31, 2010 to 2.25% at December 31, 2011. Based upon our evaluation of the loan portfolio, we believe the allowance for loan losses to be adequate to absorb our estimate of probable losses existing in the loan portfolio at December 31, 2011. While our policies and procedures used to estimate the allowance for loan losses, as well as the resultant provision for loan losses charged to operations, are considered adequate by management, they are necessarily approximate and imprecise. There are factors beyond our control, such as conditions in the local and national economy, local real estate market or a particular industry or borrower which may negatively impact, materially, our asset quality and the adequacy of our allowance for loan losses and, thus, the resulting provision for loan losses.

Noninterest Income. Our noninterest income is composed of several components, some of which vary significantly between quarterly and annual periods. Service charges on deposit accounts and other noninterest income generally reflect our growth and market conditions, while investment services and fees from the origination of mortgage loans and gains on the sale of securities will often reflect market conditions and fluctuate from period to period. The opportunities for recognition of gains on loan sales and net gains on sales of investment securities may also vary widely from quarter to quarter and year to year.

The following is the makeup of our noninterest income for the years ended December 31, 2011, 2010, and 2009 (in thousands):

	Years ended December 31, 2011	Years ended December 31, 2010	2011-2010 Percent Increase (Decrease)	Year ended December 31, 2009	2010-2009 Percent Increase (Decrease)
Noninterest income:					
Service charges on deposit accounts	$9,244	$9,592	(3.63 %)	$ 10,200	(5.96 %)
Investment services	6,246	5,050	23.68 %	4,181	20.78 %
Insurance sales commissions	3,999	3,864	3.49 %	4,026	(4.02 %)
Trust fees	3,000	2,872	4.46 %	2,591	10.85 %
Gains on mortgage loans sold, net	4,155	4,086	1.69 %	4,929	(17.10 %)

Net gain on sale of investment securities	961	2,624	(63.38	%)	6,462	(59.39	%)
Other noninterest income:							
ATM and other consumer fees	6,381	5,373	18.76	%	4,510	19.14	%
Bank-owned life insurance	1,159	913	27.08	%	518	76.06	%
Other noninterest income	2,795	1,941	44.00	%	2,235	(13.15	%)
Total other noninterest income	10,335	8,227	25.62	%	7,263	13.27	%
Total noninterest income	$37,940	$36,315	4.47	%	$ 39,652	(8.42	%)

The decrease in service charges on deposit accounts in 2011 compared to 2010 is primarily related to decreased overdraft protection and insufficient fund charges on individual retail consumer accounts. Overall, depository fees are down due to recent regulatory changes required of banks and changes in client spending behavior patterns.

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Also included in noninterest income are commissions and fees from investment services at our financial advisory unit, Pinnacle Asset Management, a division of Pinnacle National. At December 31, 2011, Pinnacle Asset Management was receiving commissions and fees in connection with approximately $1.06 billion in brokerage assets held with Raymond James Financial Services, Inc. compared to $1.04 billion at December 31, 2010. Insurance commissions were approximately $4.0 million during 2011 compared to $3.9 million during 2010. Additionally, at December 31, 2011, our trust department was receiving fees on approximately $633 million in assets compared to $693 million at December 31, 2010.

Gains on loans sold consists of fees from the origination and sale of mortgage loans. These mortgage fees are for loans originated in both the Middle Tennessee and Knoxville markets that are subsequently sold to third-party investors. All of our mortgage loan sales transfer servicing rights to the buyer. Generally, mortgage origination fees increase in lower interest rate environments and more robust housing markets and decrease in rising interest rate environments and more challenging housing markets. As a result, mortgage origination fees may fluctuate greatly in different rate or housing environments. The fees from the origination and sale of mortgage loans have been netted against the commission expense associated with these originations.

During the year ended December 31, 2011, Pinnacle Financial realized approximately $961,000 in net gains from the sale of $166.4 million of available-for-sale securities. Sales during the year ended 2011 consisted of three primary groups: securities identified as other-than-temporarily-impaired in previous quarters during 2011, which had previously been marked-to-market, mortgage-backed securities in which the pre-payment frequency was expected to accelerate due to the mortgage refinancing expected due to lower rates, and municipal securities that had fallen outside of the parameters of our Asset/Liability policy due to a change in the quality of the security.

Included in other noninterest income are miscellaneous consumer fees, such as ATM revenues and other consumer fees. The fees realized during the year ended December 31, 2011 have increased as compared to the same periods in the prior year due to increased check card usage. Based on the recent changes under the Dodd-Frank Act, we expect income from check card and interchange fees to decline over time. While we are exempt from the cap on debit interchange fees because of our current asset size, we believe that there may be downward pressure on interchange fees as debit networks compete for transaction volume. We believe that this potential reduction in interchange fees will likely happen gradually over an extended period of time.

Additionally, noninterest income from increases in the cash surrender value of bank-owned life insurance was $1,159,000 for the year ended December 31, 2011 compared to $913,000 in the same prior year period. Pinnacle Financial has not had any additional investments in bank-owned life insurance policies during 2011. The assets that support these policies are administered by the life insurance carriers and the income we receive (i.e., increases or decreases in the cash surrender value of the policies) on these policies is dependent upon the returns the insurance carriers are able to earn on the underlying investments that support the policies. Earnings on these policies generally are not taxable.

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Noninterest Expense. Noninterest expense consists of salaries and employee benefits, equipment and occupancy expenses, and other operating expenses. The following is the makeup of our noninterest expense for the years ended December 31, 2011, 2010 and 2009 (in thousands):

	Years ended December 31, 2011	2010	2011-2010 Percent Increase (Decrease)	Year ended December 31, 2009	2010-2009 Percent Increase (Decrease)
Noninterest expense:					
Salaries and employee benefits:					
Salaries	$43,450	$44,994	(3.43 %)	$ 38,478	16.93 %
Commissions	3,992	2,834	40.86 %	2,479	14.32 %
Incentives	9,389	-	100.00 %	45	(100.00 %)
Employee benefits and other	17,594	16,801	4.72 %	15,708	6.96 %
Total salaries and employee benefits	74,425	64,629	15.16 %	56,710	13.96 %
Equipment and occupancy	19,987	21,077	(5.17 %)	18,056	16.73 %
Other real estate expense	17,432	29,210	(40.32 %)	14,257	104.88 %
Marketing and business development	3,303	3,233	2.17 %	2,534	27.58 %
Postage and supplies	2,121	2,538	(16.43 %)	2,929	(13.35 %)
Amortization of intangibles	2,863	2,981	(3.96 %)	3,185	(6.41 %)
Other noninterest expense:					
Deposit related expenses	9,330	12,507	(25.40 %)	11,492	8.83 %
Lending related expenses	1,707	2,175	(21.52 %)	1,074	102.51 %
Investment sales expense	272	316	(13.92 %)	425	(25.65 %)
Trust expenses	376	343	9.62 %	305	12.46 %
Administrative and other expenses	7,291	7,874	(7.4 %)	7,610	3.47 %
Total other noninterest expense	18,976	23,215	(18.26 %)	20,906	11.04 %
Total noninterest expense	$139,107	$146,883	(5.29 %)	$ 118,577	23.87 %

The increase in total salaries and employee benefits expense for the year ended December 31, 2011 as compared to prior years is primarily related to incentive compensation costs. We believe that variable pay incentives are a valuable tool in motivating an employee base that is focused on providing our clients effective financial advice and increasing stockholder value. As a result, and unlike many other financial institutions, all of our salary-based employees have historically participated in our annual cash incentive plan. Under the plan, the targeted level of incentive payments requires us to achieve a certain soundness threshold and a targeted level of pre-tax earnings. To the extent that actual pre-tax earnings are above or below targeted amount, the aggregate incentive payments generally are increased or decreased. Our performance for fiscal 2011 was in line with our targeted performance levels under our annual incentive plan which resulted in increased incentive costs in 2011 as compared to 2010, in which no incentives were accrued because our performance objectives were not met. As a result of our participation in the CPP, our named executive officers do not participate in the annual cash incentive plan.

We also believe that equity incentives provide an excellent vehicle for all associates to become meaningful stockholders of the Company over an extended period of time and create a stockholder centric culture throughout our Company. Thus, early in our history we elected to support and provide a broad-based equity inventive plan for all associates. As a result, included in employee benefits and other expense for the years ended December 31, 2011, 2010, and 2009 were approximately $4.4 million, $3.9 million, and $3.3 respectively, of compensation expenses related to stock options and restricted share awards which have been issued to our associates. Also included in employee benefits and other expenses in 2011 was $777,000 in costs related to the salary stock units issued to our senior executives. In connection with these awards, the executive officers received salary stock units throughout the year which were settled in the Company's common stock on a one-for-one basis at the end of 2011. We believe that upon our ultimate redemption of all of the preferred shares issued pursuant to the CPP that the Human Resources and Compensation Committee will no longer employ salary stock units as a component of our executive officers' compensation, as these executive officers will then be eligible to participate in our annual cash incentive plan after the date of the redemption of the preferred shares.

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Equipment and occupancy expense for the year ended December 31, 2011 was 5.2 % less than in 2010 and 10.7% greater than in 2009. The decrease from 2010 is attributable to the consolidation of our corporate offices in our new central location which was completed in the second quarter of 2010. In the third quarter of 2011, we converted two of our Middle Tennessee offices to drive-thru facilities only and on September 30, 2011, we closed one branch in the Middle Tennessee market. Subsequently, we closed one of the drive-thru facilities as of December 31, 2011. We expect to return to branch expansion in the Knoxville MSA beginning in 2012. The increase between 2010 and 2009 is primarily attributable to the continued market expansion in the Knoxville MSA, and increased presence in the Nashville MSA since the end of 2009.

Other real estate expense was $17.4 million for the year ended December 31, 2011 compared to $29.2 million and $14.3 million for the years ended December 31, 2010 and 2009, respectively. Approximately $12.8 million, $25.7 million, and $11.9 million of the other real estate expense incurred during the twelve months ended December 31, 2011, 2010 and 2009, respectively, were realized losses on dispositions and holding losses due to reduced valuations of OREO properties. The remaining other real estate expense consisted of carrying costs to maintain or improve the properties.

Until we are able to significantly reduce the absolute level of our other real estate portfolio, other real estate expense for the next several quarters will likely remain elevated and fluctuate depending on market conditions as we maintain and market for sale various foreclosed properties. These properties could also be subject to future valuation adjustments as a result of updated appraisal information and further deterioration in real estate values, thus causing additional fluctuations in our quarterly other real estate expense. Additionally, we will continue to incur expenses associated with maintenance costs and property taxes associated with these assets.

Management’s strategy is to aggressively pursue disposition of nonperforming loans and other real estate owned in order to ultimately reduce the expense associated with carrying these nonperforming assets and better position the firm for increased future profitability. Our disposition strategy generally has been to negotiate sales of foreclosed properties on a property-by-property basis. We have also utilized both traditional and online auctions. Our strategy is reviewed on an on-going basis and could change in the future.

Noninterest expense related to the amortization of intangibles relates primarily to the intangibles acquired in the Mid-America and Cavalry mergers. The core deposit intangibles are being amortized over ten years for Mid-America and over seven years for Cavalry, in each case using an accelerated method which anticipates the life of the underlying deposits to which the intangible is attributable. Amortization expense associated with these core deposit intangibles will approximate $700,000 to $1.0 million per year for the next six years with lesser amounts for the remaining amortization period. Additionally, in connection with our acquisition of an insurance brokerage firm in July of 2008, we recorded a customer list intangible of $1,270,000 which is being amortized over 20 years on an accelerated basis. Amortization of the customer list intangible amounted to $109,000 for the year ended December 31, 2011 and $115,000 and $118,000 for the years ended December 31, 2010 and 2009, respectively.

Total other noninterest expenses decreased to $19.0 million or by 18.3% during 2011 when compared to 2010. A substantial portion of the decrease in this expense is attributable to decreased FDIC deposit insurance assessments and decreased lending related expenses related to problem assets, including appraisal, legal and other charges, and other expenses which are incidental variable costs related to deposit gathering and lending. Also included in total other noninterest expenses are expenses related to ATM networks, correspondent bank service charges, check losses, and closing attorney expenses.

Our efficiency ratio (ratio of noninterest expense to the sum of net interest income and noninterest income) was 73.5% in fiscal year 2011 compared to 81.3% in fiscal year 2010. The efficiency ratio measures the amount of expense that is incurred to generate a dollar of revenue. Our efficiency ratio was adversely impacted by other real estate owned and other credit related costs, including the increase in associates dedicated to problem loan resolution.

Income Taxes. During the year ended December 31, 2011, Pinnacle Financial recorded income tax benefit of $15.3 million as a result of the reversal of the beginning of year valuation allowance. Our effective income tax benefit rate was 53.5% for the year ended December 31, 2011. Pinnacle Financial's effective income tax benefit rate differs from the Federal income tax statutory rate of 35% primarily due to the reversal of the deferred tax valuation allowance.

Preferred Stock Dividends and Preferred Stock Discount Accretion. Net income (loss) available for common stockholders was reduced (increased) by preferred stock dividends of $4,606,000 in 2011 and $4,816,000 in 2010 and 2009, and the accretion on the preferred stock discount of $2,058,000, $1,326,000, and $1,114,000, for the years ended December 31, 2011, 2010 and 2009, respectively. On December 12, 2008, we received $95.0 million from the sale of preferred stock to the U.S. Treasury as a result of our participation in the CPP. The Series A preferred stock we sold the U.S. Treasury pays cumulative dividends quarterly at a rate of 5 percent per annum for the first five years and 9 percent thereafter. During the fourth quarter of 2011, Pinnacle Financial repurchased 25% of the preferred shares originally issued to the U.S. Treasury under the CPP in a transaction totaling approximately $23.9 million. This partial redemption was the cause of the increase in the accretion on the preferred stock discount in 2011 as compared to 2010 and 2009. Following the partial redemption of preferred shares, 71,250 shares of Series A preferred stock remain issued and outstanding and held by the U.S. Treasury. On June 16, 2009, we issued 8,855,000 shares of common stock through a public offering resulting in net proceeds to us of approximately $109.0 million. As a result, and pursuant to the terms of the warrants issued to the U.S. Treasury in connection with our participation in the CPP, the number of shares issuable upon exercise of the warrants issued to the U.S. Treasury in connection with the CPP was reduced by 50%, or 267,455 shares.

Financial Condition

Our consolidated balance sheet at December 31, 2011 reflects an increase of $78.9 million in outstanding loans to $3.29 billion and a decrease of $178.7 million in total deposits to $3.65 billion. Total assets were $4.86 billion at December 31, 2011 as compared to $4.91 billion at December 31, 2010.

Loans.

Loan Origination Risk Management. We maintain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, concentrations of credit, loan delinquencies and non-performing and potential problem loans. Diversification in the loan portfolio is a means of managing risk associated with fluctuations in economic conditions.

Underwriting standards are designed to promote relationship banking rather than transactional banking. Our management examines current and projected cash flows to determine the expected ability of a borrower to repay its obligations as agreed. Commercial and industrial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial and industrial loans are secured by the assets being financed or other business assets such as accounts receivable, inventory or equipment and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial and industrial loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be adversely affected by conditions in the real estate markets or in the general economy. As detailed in the discussion of real estate loans below, the properties securing our commercial real estate portfolio generally are diverse in terms of type and industry. We believe this diversity helps reduce our exposure to adverse economic events that affect any single industry or type of real estate product.

Management monitors and evaluates commercial real estate loans based on cash flow, collateral, geography and risk grade criteria. We also utilize third-party experts to provide insight and guidance about economic conditions and trends affecting market areas we serve.

Although we have substantially reduced the amount of residential construction and development loans in our portfolio, we continue to pursue sound commercial construction and development projects. With respect to commercial construction and development loans we may originate from time to time, we generally require the borrower to have had an existing relationship with us and have a proven record of success. Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from us until permanent financing is obtained. These loans are closely monitored by on-site inspections and are considered to have higher risks than other real estate loans because their ultimate repayment is sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

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We also originate consumer loans, including consumer real-estate loans, where we typically use a computer-based credit scoring analysis to supplement the underwriting process. To monitor and manage consumer loan risk, policies and procedures are developed and modified, as needed, jointly by line and staff personnel. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, seeks to minimize risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements.

We also maintain an independent loan review department that reviews and validates the credit risk program on a periodic basis. Results of these reviews are presented to management and the audit committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as our policies and procedures.

The composition of loans at December 31 for each of the past five years and the percentage (%) of each segment to total loans are summarized as follows (in thousands):

	2011		2010		2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
mmercial l estate - rtgage	$1,110,962	33.8 %	$1,094,615	34.1 %	$1,118,068	31.4 %	$963,530	28.7 %	$710,546	25.9 %
nsumer l estate - rtgage	695,745	21.1 %	705,487	22.0 %	756,015	21.2 %	675,606	20.1 %	539,768	19.6 %
nstruction l land velopment	274,248	8.3 %	331,261	10.3 %	525,271	14.7 %	658,799	19.6 %	582,959	21.2 %
mmercial l industrial	1,145,735	34.8 %	1,012,091	31.5 %	1,071,444	30.0 %	966,563	28.8 %	794,419	28.9 %
nsumer l other	64,661	2.0 %	68,986	2.1 %	92,584	2.7 %	90,409	2.8 %	121,949	4.4 %
tal loans	$3,291,351	100.0%	$3,212,440	100.0%	$3,563,382	100.0%	$3,354,907	100.0%	$2,749,641	100.0%

The primary change within the composition of our loan portfolio at December 31, 2011 as compared to previous periods is the percentage of construction and land development loans in our portfolio and a 13.2% increase in our commercial and industrial loans. The decrease in the construction and land development loans is due in part to our decision to reduce our exposure to this particular segment. Our continued reduction of these types of loans will likely restrain our loan growth in the future in comparison to historical periods. The commercial real estate – mortgage category includes owner-occupied commercial real estate loans. Owner-occupied commercial real estate is similar in many ways to our commercial and industrial lending in that these loans are generally made to businesses on the basis of the cash flows of the business rather than on the valuation of the real estate. We continue to consider commercial real estate mortgage products to be desirable. At December 31, 2011, approximately 52% of the outstanding principal balance of our commercial real estate loans was secured by owner-occupied properties.

The following table classifies our fixed and variable rate loans at December 31, 2011 according to contractual maturities of (1) one year or less, (2) after one year through five years, and (3) after five years. The table also classifies our variable rate loans pursuant to the contractual repricing dates of the underlying loans (in thousands):

	Amounts at December 31, 2011				
	Fixed	Variable		At December 31,	At December 31,

	Rates	Rates	Totals	2011		2010	
Based on contractual maturity:							
Due within one year	$224,216	$729,153	$953,369	29.0	%	31.6	%
Due in one year to five years	702,950	757,923	1,460,873	44.4	%	47.1	%
Due after five years	298,473	578,636	877,109	26.6	%	21.3	%
Totals	$1,225,639	$2,065,712	$3,291,351	100.0	%	100.0	%
Based on contractual repricing dates:							
Daily floating rate(*)	$-	$1,066,514	$1,066,514	32.4	%	36.6	%
Due within one year	224,216	827,408	1,051,624	32.0	%	30.3	%
Due in one year to five years	702,950	165,552	868,502	26.4	%	30.3	%
Due after five years	298,473	6,238	304,711	9.3	%	2.8	%
Totals	$1,225,639	$2,065,712	$3,291,351	100.0	%	100.0	%

The above information does not consider the impact of scheduled principal payments.
(*)Daily floating rate loans are tied to Pinnacle National's prime lending rate or a national interest rate index with the underlying loan rates changing in relation to changes in these indexes. Included in variable rate loans are $1.250 billion of loans which are currently priced at their contractual floors with a weighted average rate of 4.75%. The weighted average contractual rates on these loans is $3.58%. As a result, interest income on these loans will not adjust until the contractual rate on the underlying loan exceeds the interest rate floor.

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Lending Concentrations. We periodically analyze our commercial loan portfolio to determine if a concentration of credit risk exists to any one or more industries. We use broadly accepted industry classification systems in order to classify borrowers into various industry classifications. We have a credit exposure (loans outstanding plus unfunded commitments) exceeding 25% of Pinnacle National's total risk-based capital to borrowers in the following industries at December 31, 2011 and 2010 (in thousands):

	At December 31, 2011			
	Outstanding Principal Balances	Unfunded Commitments	Total exposure	Total Exposure at December 31, 2010
Lessors of nonresidential buildings	$ 454,952	$ 54,051	$ 509,003	$ 502,268
Lessors of residential buildings	150,903	26,511	177,414	132,668
Land subdividers	104,051	15,055	119,106	144,550

The decrease in our credit exposure to land subdividers is primarily due to our focused reduction of the construction and land development portfolio, in which the majority of these loans were included.

We also acquire certain loans from other banks and sell certain loans to other banks. At December 31, 2011, we had acquired approximately $130.4 million of commercial loans which were originated by other banks and sold approximately $62.2 million of loans to other banks. Substantially all of these loans are to Nashville or Knoxville based businesses and were acquired in order to potentially develop other business opportunities with these firms or to balance our exposure to a particular borrower or industry.

Performing Loans in Past Due Status. The following table is a summary of our accruing loans that were past due between 30 and 90 days and greater than 90 days as of December 31, 2011 and 2010 (in thousands):

Accruing loans past due 30 to 89 days:	December 31, 2011	December 31, 2010
Commercial real estate – mortgage	$ 5,749	$ 1,964
Consumer real estate – mortgage	2,589	3,544
Construction and land development	1,572	2,157
Commercial and industrial	648	1,636
Consumer and other	526	152
Total accruing loans past due 30 to 90 days	$ 11,084	$ 9,453
Accruing loans past due 89 days or more:		
Commercial real estate – mortgage	$ -	$ -
Consumer real estate – mortgage	254	-
Construction and land development	-	38
Commercial and industrial	604	100
Consumer and other	-	-
Total accruing loans past due 90 days or more	$ 858	$ 138
Ratios:		
Accruing loans past due 30 to 90 days as a percentage of total loans	0.34 %	0.29 %
Accruing loans past due 90 days or more as a percentage of total loans	0.03 %	0.01 %

Total accruing loans in past due status as a percentage of total loans	0.36	%	0.30	%

Potential Problem Loans. Potential problem loans, which are not included in nonperforming loans, amounted to approximately $130.4 million, or 3.4% of total loans outstanding at December 31, 2011, compared to $223.1 million, or 7.0% of total loans outstanding at December 31, 2010. Potential problem loans represent those loans with a well-defined weakness and where information about possible credit problems of borrowers has caused management to have serious doubts about the borrower’s ability to comply with present repayment terms. This definition is believed to be substantially consistent with the standards established by the OCC, Pinnacle National’s primary regulator, for loans classified as substandard or worse, but not considered nonperforming loans. Approximately $6.9 million of potential problem loans were past due at least 30 but less than 90 days as of December 31, 2011.

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Non-Performing Assets and Troubled Debt Restructurings. At December 31, 2011, we had $87.6 million in nonperforming assets compared to $140.5 million at December 31, 2010. Included in nonperforming assets were $47.9 million in nonperforming loans and $39.7 million in other real estate owned at December 31, 2011 and $80.9 million in nonperforming loans and $59.6 million in other real estate owned at December 31, 2010. At December 31, 2011 and 2010, there were $23.4 million and $20.3 million, respectively, of troubled debt restructurings that were performing as of the restructured date and remain in a performing status.

We have dedicated experienced credit administration resources to the residential construction and residential development portfolios by assigning senior executives and bankers to these portfolios. These individuals meet frequently to discuss the performance of the portfolio and specific relationships with emphasis on underperforming assets. Their objective is to identify relationships that warrant continued support and remediate those relationships that will tend to cause our portfolio to underperform over the long term. We reappraise real estate-related nonperforming assets to ascertain appropriate valuations, and we continue to systematically review these valuations as new data is received. We seek to maintain current appraisals on nonperforming real estate loans and other real estate owned with a maximum age of nine months.

All nonaccruing loans are reviewed by and, in many cases, reassigned to a special assets officer who was not responsible for originating the loan. If the loan is reassigned, the special assets officer is responsible for developing an action plan designed to minimize our future losses. Typically, these special assets officers review our loan files, interview prior officers assigned to the relationship, meet with borrowers, inspect collateral, reappraise collateral and/or consult with legal counsel. The special assets officer then recommends an action plan to a committee of directors and/or senior associates including lenders and workout specialists, which could include foreclosing on collateral, restructuring the loan, issuing demand letters or other actions.

We discontinue the accrual of interest income when (1) there is a significant deterioration in the financial condition of the borrower and full repayment of principal and interest is not expected or (2) the principal or interest is more than 90 days past due, unless the loan is both well-secured and in the process of collection.

Due to the weakening credit status of a borrower, we may elect to formally restructure certain loans to facilitate a repayment plan that seeks to minimize the potential losses, if any, that we might incur. These loans are considered troubled debt restructurings. If on nonaccruing status as of the date of restructuring, any restructured loan is included in the nonperforming loan balances noted above and is classified as an impaired loan. Loans that have been restructured that were performing in accordance with the loan’s restructured terms as of the restructure date are not included in nonperforming loans. At December 31, 2011 and December 31, 2010, there were $23.4 million and $20.3 million, respectively, of troubled debt restructurings that remain in a performing status.

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The following table is a summary of our nonperforming assets and troubled debt restructurings at December 31, 2011 and 2010 (in thousands):

	At December 31, 2010	Increases (3)	Decreases (4)	At December 31, 2011
Nonperforming assets:				
Nonperforming loans (1):				
Commercial real estate – mortgage	$ 12,542	$ 16,390	$ (18,970)	$ 9,962
Consumer real estate – mortgage	9,035	22,497	(19,045)	12,487
Construction and land development	43,514	15,417	(45,966)	12,965
Commercial and industrial	14,740	25,791	(28,641)	11,890
Consumer and other	1,032	930	(1,411)	551
Total nonperforming loans (2)	80,863	81,025	(114,033)	47,855
Other real estate owned	59,608	33,916	(53,810)	39,714
Total nonperforming assets	140,471	114,941	(167,843)	87,569
Troubled debt restructurings:				
Commercial real estate – mortgage	16,129	3,681	(4,432)	15,378
Consumer real estate – mortgage	561	6,745	(1,433)	5,873
Construction and land development	-	77	-	77
Commercial and industrial	3,778	3,961	(5,895)	1,844
Consumer and other	-	242	-	242
Total troubled debt restructurings:	20,468	14,706	(11,760)	23,414
Total nonperforming assets and troubled debt restructurings	$ 160,939	129,647	(179,603)	$ 110,983
Ratios:				
Nonperforming loans to total loans	2.52 %			1.45 %
Nonperforming assets to total loans plus other real estate owned	4.29 %			2.75 %
Nonperforming loans plus troubled debt restructurings to total loans and other real estate owned	3.10 %			2.23 %
Nonperforming assets, potential problem loans and troubled debt restructurings to Pinnacle National Tier I capital and allowance for loan losses	75.4 %			44.2 %

(1) Nonperforming loans exclude loans that have been restructured and remain on accruing status. These loans are not considered to be nonperforming if they were performing loans immediately prior to their restructuring and are currently performing in accordance with the restructured terms.

(2) Approximately $25.5 million and $33.2 million as of December 31, 2011 and December 31, 2010, respectively, of nonperforming loans included above are currently performing pursuant to their contractual terms. If a loan does not have a substantiated cash repayment plan, that loan is classified as an impaired loan—although the loan continues to perform according to its contractual terms.

(3) Increases in nonperforming loans represent loans where we have discontinued the accrual of interest at some point during the fiscal year ended December 31, 2011. Increases in other real estate owned represent the value of properties that have been foreclosed upon or acquired by deed in lieu of foreclosure during fiscal year 2011. Increases in troubled debt restructurings are those loans where we have granted the borrower a concession

due to the deteriorating financial condition of the borrower during the fiscal year ended December 31, 2011. These concessions can be in the form of a reduced interest rate, extended maturity date or other matters.

(4) Decreases in nonperforming loans are primarily attributable to payments we have collected from borrowers, charge-offs of recorded balances and transfers of balances to other real estate owned during the fiscal year ended December 31, 2011. Decreases in other real estate owned represent either the sale, disposition or valuation adjustment on properties which had previously been foreclosed upon or acquired by deed in lieu of foreclosure. Decreases in troubled debt restructurings are those loans which were previously restructured and the borrower has satisfactorily performed in accordance with the restructured terms.

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At December 31, 2011, we owned $39.7 million in real estate which we had acquired, usually through foreclosure, from borrowers compared to $59.6 million at December 31, 2010; all of this real estate is located within our principal markets. We categorize other real estate owned into four types: new home construction, developed lots, undeveloped land, and other. Included in the “other” category are primarily condos, office buildings and existing homes. The following table shows the amounts of our other real estate owned (in thousands) in such categories:

	December 31, 2011	December 31, 2010
New home construction	$ 2,733	$ 10,370
Developed lots	7,091	14,037
Undeveloped land	22,455	18,675
Other	7,435	16,526
	$ 39,714	$ 59,608

Allowance for Loan Losses (allowance). We maintain the allowance at a level that our management deems appropriate to adequately cover the probable losses inherent in the loan portfolio. As of December 31, 2011 and December 31, 2010, our allowance for loan losses was $74.0 million and $82.6 million, respectively, which our management deemed to be adequate at each of the respective dates. The decrease in the allowance for loan losses in 2011 as compared to 2010 is primarily the result of improving credit metrics within our portfolio. Our allowance for loan loss as a percentage of total loans has decreased from 2.57% at December 31, 2010 to 2.25% at December 31, 2011. The judgments and estimates associated with our allowance determination are described under “Critical Accounting Estimates” above.

The following table sets forth, based on management's best estimate, the allocation of the allowance to types of loans as well as the unallocated portion as of December 31 for each of the past five years and the percentage of loans in each category to total loans (in thousands):

	At December 31,									
	2011		2010		2009		2008		2007	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Commercial real estate - Mortgage	$23,397	33.8 %	$19,252	34.1 %	$22,505	31.4 %	$11,523	28.7 %	$8,068	25.9 %
Consumer real estate - Mortgage	10,302	21.1 %	9,898	22.0 %	10,725	21.2 %	5,149	20.1 %	1,890	19.6 %
Construction and land development	12,040	8.3 %	19,122	10.3 %	23,027	14.7 %	7,899	19.6 %	4,897	21.2 %
Commercial and industrial	20,789	34.8 %	21,426	31.5 %	26,332	30.0 %	9,966	28.8 %	11,660	28.9 %
Consumer and other	1,125	2.0 %	1,874	2.1 %	2,456	2.7 %	1,372	2.8 %	1,400	4.4 %
Unallocated	6,322	NA	11,003							