ISABELLA BANK CORP
Form DEF 14A
April 08, 2011

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

**SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.    )

Filed by the Registrant þ
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Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
þ Definitive Proxy Statement
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**ISABELLA BANK CORPORATION**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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**ISABELLA BANK CORPORATION**
**401 N. Main St.**
**Mt. Pleasant, Michigan 48858**

**NOTICE OF THE ANNUAL MEETING OF SHAREHOLDERS**
**To Be Held May 3, 2011**

Notice is hereby given that the Annual Meeting of Shareholders of Isabella Bank Corporation will be held on Tuesday, May 3, 2011 at 5:00 p.m. Eastern Standard Time, at the Comfort Inn, 2424 S. Mission Street, Mt. Pleasant, Michigan. The meeting is for the purpose of considering and acting upon the following items of business:

1. The election of five directors.

2. To hold an advisory, non-binding vote on executive compensation of named executive officers.

3. To hold an advisory, non-binding vote on how frequently advisory votes on the executive compensation of named executive officers should be held.

4. To transact such other business as may properly come before the meeting, or any adjournment or adjournments thereof.

The Board of Directors has fixed April 1, 2011 as the record date for determination of shareholders entitled to notice of, and to vote at, the meeting or any adjournments thereof.

Your vote is important. Even if you plan to attend the meeting, please date and sign the enclosed proxy form, indicate your choice with respect to the matters to be voted upon, and return it promptly in the enclosed envelope. Note that if stock is held in more than one name, all parties should sign the proxy form.

By order of the Board of Directors

Debra Campbell, Secretary

Dated: April 8, 2011

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**ISABELLA BANK CORPORATION**
**401 N. Main St**
**Mt. Pleasant, Michigan 48858**

**PROXY STATEMENT**

**General Information**

This Proxy Statement is furnished in connection with the solicitation of proxies by the Board of Directors of Isabella Bank Corporation (the Corporation) a Michigan financial holding company, to be voted at the Annual Meeting of Shareholders of the Corporation to be held on Tuesday, May 3, 2011 at 5:00 p.m. at the Comfort Inn, 2424 S. Mission Street, Mt. Pleasant, Michigan, or at any adjournment or adjournments thereof, for the purposes set forth in the accompanying Notice of Annual Meeting of Shareholders and in this Proxy Statement.

This Proxy Statement has been mailed on April 8, 2011 to all holders of record of common stock as of the record date. If a shareholder s shares are held in the name of a broker, bank or other nominee, then that party should give the shareholder instructions for voting the shareholder s shares.

**Voting at the Meeting**

The Board of Directors of the Corporation has fixed the close of business on April 1, 2011 as the record date for the determination of shareholders entitled to notice of, and to vote at, the Annual Meeting of Shareholders and any adjournment thereof. The Corporation has only one class of common stock and no preferred stock. As of April 1, 2011, there were 7,546,866 shares of common stock of the Corporation outstanding. Each outstanding share entitles the holder thereof to one vote on each separate matter presented for vote at the meeting. Shareholders may vote on matters that are properly presented at the meeting by either attending the meeting and casting a vote or by signing and returning the enclosed proxy. If the enclosed proxy is executed and returned, it may be revoked at any time before it is exercised at the meeting. All shareholders are encouraged to date and sign the enclosed proxy, indicate their choice with respect to the matters to be voted upon, and return it to the Corporation.

The Corporation will hold the Annual Meeting of Shareholders if holders of a majority of the Corporation s shares of common stock entitled to vote are represented in person or by proxy at the meeting. If a shareholder signs and returns the proxy, those shares will be counted to determine whether the Corporation has a quorum, even if the shareholder abstains or fails to vote on any of the proposals listed on the proxy.

A shareholder s broker may not vote on the election of directors, the advisory vote to approve the named executive officers compensation or the advisory vote on the frequency of the vote on named executive officers compensation if the shareholder does not furnish instructions for such proposals. A shareholder should use the voting instruction card provided by the institution that holds his or her shares to instruct the broker to vote the shares or else the shareholder s shares will be considered broker non-votes.

Broker non-votes are shares held by brokers or nominees as to which voting instructions have not been received from the beneficial owners or the persons entitled to vote those shares and the broker or nominee does not have discretionary voting power under rules applicable to broker-dealers. Under these rules, proposals one, two and three are not items on which brokerage firms may vote in their discretion on behalf of their clients if such clients have not furnished voting instructions.

At this year s annual meeting, shareholders will elect five directors to serve for a term of three years. In voting on the election of directors, a shareholder may vote in favor of the nominees, vote against or withhold votes as to all nominees, or vote against or withhold votes as to specific nominees. Directors are elected by a plurality of the votes cast at the annual meeting. This means that the nominees receiving the greatest number of votes will be elected. Shares not voted, including broker non-votes, have no effect on the election of directors.

In voting on the advisory, nonbinding proposal to approve the executive compensation described in this proxy statement, a shareholder may vote in favor of the advisory proposal, vote against the advisory proposal or abstain from voting. A majority of the shares represented at the annual meeting and entitled to vote on this advisory proposal must be voted in favor of the proposal for it to pass. While this vote is required by law, it will neither be binding on the Board of Directors, nor will it create or imply any change in the fiduciary duties of, or impose any additional fiduciary duty on the Board of Directors. In counting votes on the advisory, nonbinding proposal to approve executive compensation matters, abstentions will have the same effect as a vote against the proposal and broker non-votes will have no effect on the outcome of the vote.

In voting on the advisory, nonbinding proposal on how frequently a shareholder vote on executive compensation matters should be held, a shareholder may vote in favor of holding such a vote once every year, once every two years or once every three years, or may abstain from voting. Generally, approval of any proposal presented to the Corporation s shareholders requires the affirmative vote of a majority of the shares represented at the meeting and entitled to vote on the proposal. However, because this vote is advisory and nonbinding, if none of the vote frequency options receives the affirmative vote of a majority of the shares represented at the meeting and entitled to vote on the proposal, the vote frequency option receiving the greatest number of votes will be considered the frequency option recommended by the Corporation s shareholders. Even though this vote will not be binding on the Board of Directors, and it will not create or imply any change in the fiduciary duties of, or impose any additional fiduciary duty on, the Board of Directors, the Board of Directors will take into account the outcome of this vote in making a determination on the frequency that advisory votes on the Corporation s executive compensation will be included in the Corporation s proxy statements. In counting votes on the advisory, nonbinding proposal on how frequently the shareholder vote on the Corporation s executive compensation should be held, abstentions and broker non-votes will have no effect on the outcome of the vote.

## Proposal 1-Election of Directors

The Board of Directors currently consists of thirteen (13) members and is divided into three classes, with the directors in each class being elected for a term of three years. On December 31, 2010, in accordance with the Corporation s bylaws, William J. Strickler and Theodore W. Kortes retired as members of the Corporation s Board of Directors and the number of directors was reduced to thirteen (13). At the 2011 Annual Meeting of Shareholders five directors, Dennis P. Angner, Jeffrey J. Barnes, G. Charles Hubscher, David J. Maness, and W. Joseph Manifold, whose terms expire at the annual meeting, have been nominated for election through 2014 for the reasons described below.

Except as otherwise specified in the proxy, proxies will be voted for election of the five nominees. If a nominee becomes unable or unwilling to serve, proxies will be voted for such other person, if any, as shall be designated by the Board of Directors. However, the Corporation s management now knows of no reason to anticipate that this will occur. The five nominees for election as directors who receive the greatest number of votes cast will be elected directors. Each of the nominees has agreed to serve as a director if elected.

Nominees for election and current directors are listed below. Also shown for each nominee and each current director is his or her principal occupation for the last five or more years, age and length of service as a director of the Corporation.

**The Board of Directors unanimously recommends that shareholders vote FOR the election of each of the five director nominees nominated by the Board of Directors.**

### Director s Qualifications

The members of the Corporation s Board of Directors (the Board) are all well qualified to serve on the Board and represent our shareholders best interest. As described below, under the caption Nominating and Corporate Governance Committee the Board and Nominating and Corporate Governance Committee (the Nominating Committee ) select nominees to the Board to establish a Board that is comprised of members who:

Have extensive business leadership

Bring a diverse perspective and experience

Are independent and collegial

Have high ethical standards and have demonstrated sound business judgment

Are willing and able to commit the significant time and effort to effectively fulfill their responsibilities

Are active in and knowledgeable of their respective communities

Each director nominee along with the other directors brings these qualifications to the Board. They provide a diverse complement of specific business skills, experience, and knowledge including extensive financial and accounting experience, knowledge of banking, small business operating experience, and specific knowledge of customer market segments, including agriculture, oil and gas, health care, food and beverage, manufacturing, and retail.

The following describes the key qualifications each director brings to the Board, in addition to the general qualifications described above and the information included in the biographical summaries provided below.

| **Director** | **Professional Standing in Chosen Field** | **Expertise in Financial or Related Field** | **Audit Committee Financial Expert** | **Civic and Community Involvement** | **Leadership and Team Building Skills** | **Diversity by Race, Gender, or Cultural** | **Geo-graphical Diversity** | **Finance** | **Tech-nology** | **Market-ing** | **Govern-ance** | **Entre-preneurial Skills** | **Human Resources** | **Bank Business Segment Represent-ation** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| David J. Maness | X | | | X | X | | | | X | | | X | | X |
| Dennis P. Angner | X | X | | X | X | | | X | X | | X | | | |
| Jeffrey J. Barnes | X | | | X | X | | X | | | | | X | | X |
| Richard J. Barz | X | X | | X | X | | | X | | X | | | X | |
| Sandra L. Caul | X | | | X | X | X | | | | | | | X | X |
| James C. Fabiano | X | | | X | X | | | | | X | | X | X | X |
| G. Charles Hubscher | X | X | | X | X | | | | | | | X | | X |
| Thomas L. Kleinhardt | X | | | X | X | | X | | | X | | X | | X |
| Joseph LaFramboise | X | | | X | X | | X | | | X | | | | |
| W. Joseph Manifold | X | X | X | X | X | | | X | X | | | | | |
| W. Michael McGuire | X | X | X | X | X | X | | X | X | | X | | | |
| Dianne C. Morey | X | | | X | X | X | | | | | | X | X | X |
| Dale D. Weburg | X | | | X | X | | X | | | | | X | | X |

The following table identifies the individual members of our Board serving on each of these standing committees:

| **Director** | **Audit** | **Nominating and Corporate Governance** | **Compensation and Human Resource** |
|---|---|---|---|
| David J. Maness | $X_o$ | $X_o$ | $X_{c,o}$ |
| Dennis P. Angner | | | |
| Jeffrey J. Barnes | X | | X |
| Richard J. Barz | | | |
| Sandra L. Caul | | X | X |
| James C. Fabiano | | X | X |
| G. Charles Hubscher | X | | X |
| Thomas L. Kleinhardt | | | X |

| | | | |
|---|---|---|---|
| Joseph LaFramboise | X | | X |
| W. Joseph Manifold | Xc | X | X |
| W. Michael McGuire | X | X | X |
| Dianne C. Morey | | | X |
| Dale D. Weburg | | Xc | X |

C Chairperson

O Ex-Officio

**Director Nominees for Terms Ending in 2014**

*Dennis P. Angner* (age 55) has been a director of the Corporation and Isabella Bank (the Bank) since 2000. Mr. Angner has been principally employed by the Corporation since 1984 and has served as President of the Corporation since December 30, 2001 and CFO since January 1, 2010. Mr. Angner served as Chief Executive Officer of the Corporation from December 30, 2001 through December 31, 2009. He is the past Chair of the Michigan Bankers Association and is currently serving as vice chairman of its taxation committee, is a member of the American Bankers Association Government Relations Council, and has served on the Central Michigan American Red Cross board for over 20 years.

*Dr. Jeffrey J. Barnes* (age 48) has been a director of the Bank since September 2007 and was appointed to the Corporation s Board of Directors effective January 1, 2010. Dr. Barnes is a physician and co-owner of Central Eye Consultants. He is a former member of the Central Michigan Community Hospital Board of Directors.

*G. Charles Hubscher* (age 57) has been a director of the Bank since May 2004 and was appointed to the Corporation s Board of Directors effective January 1, 2010. Mr. Hubscher is the President of Hubscher and Son, Inc., a sand and gravel producer. He is a director of the National Stone and Gravel Association, the Michigan Aggregates Association, serves on the Board of Trustees for the Mt. Pleasant Area Community Foundation, and is a member of the Zoning Board of Appeals for Deerfield Township.

*David J. Maness* (age 57) has been a director of the Bank since 2003 and of the Corporation since 2004. Mr. Maness was elected chairman of the board for the Corporation and the Bank in 2010. He is President of Maness Petroleum, a geological and geophysical consulting services company. Mr. Maness is currently serving as a director for the Michigan Oil & Gas Association, and he previously served on the Mt. Pleasant Public Schools Board of Education.

*W. Joseph Manifold* (age 59) has been a director of the Corporation since 2003 and of the Bank since January 1, 2010. Mr. Manifold is a Certified Public Accountant and CFO of Federal Broach Holdings LLC, a holding company which operates several manufacturing companies. Previously, he was a senior manager with Ernst & Young Certified Public Accounting firm working principally on external bank audits and was CFO of the Delfield Company. Prior to joining the Board, Mr. Manifold also served on the Isabella Community Credit Union Board and was Chairman of the Mt. Pleasant Public Schools Board of Education.

**Current Directors with Terms Ending in 2012**

*Richard J. Barz* (age 62) has been a director of the Bank since 2000 and of the Corporation since 2002. Mr. Barz has been employed by the Corporation since 1972 and has been Chief Executive Officer of the Corporation since January 1, 2010 and President and CEO of the Bank since December 2001. Prior to his appointment as President and CEO, he served as Executive Vice President of the Bank. Mr. Barz has been very active in community organizations and events. He is the past chairman of the Central Michigan Community Hospital Board of Directors, is the current chairman of the Middle Michigan Development Corporation Board of Directors, and serves on several boards and committees for Central Michigan University and various volunteer organizations throughout mid-Michigan.

*Sandra L. Caul* (age 67) has been a director of the Bank since 1994 and of the Corporation since 2005. Ms. Caul is Vice Chairperson of the Central Michigan Community Hospital Board of Directors, Chairperson of the Mid Michigan Community College Advisory Board and board member for Central Michigan Community Mental Health Facilities. She also sits on the board of the Central Michigan American Red Cross. Ms. Caul retired in January 2005 as a state representative of the Michigan State House of Representatives. Ms. Caul is a registered nurse.

*W. Michael McGuire* (age 61) has been a director of the Corporation since 2007 and of the Bank since January 1, 2010. He is a director of the Farwell Division of the Bank. Mr. McGuire is currently an attorney and the Director of the Office of the Corporate Secretary and Assistant Secretary of The Dow Chemical Company, a manufacturer of chemicals, plastics and agricultural products, headquartered in Midland, Michigan.

*Dianne C. Morey* (age 64) has been a director of the Bank since December 2000 and was appointed to the Corporation s Board of Directors effective January 1, 2010. Mrs. Morey is an owner of Bandit Industries, Inc., a forestry equipment manufacturer. She serves as a Trustee for the Mt. Pleasant Area Community Foundation.

**Current Directors with Terms Ending in 2013**

*James C. Fabiano* (age 67) has been a director of the Bank since 1979 and of the Corporation since 1988. He served as the Corporations chair from 2004 to 2010. Mr. Fabiano is Chairman and CEO of Fabiano Brothers, Inc., a wholesale beverage distributor operating in several counties throughout Michigan. Mr. Fabiano is a past recipient of the Mt. Pleasant Area Chamber of Commerce Citizen of the Year award. He is also a past Chairman of the Central Michigan University Board of Trustees.

*Thomas L. Kleinhardt* (age 56) has been a director of the Bank since October 1998 and was appointed to the Corporation s Board of Directors effective January 1, 2010. Mr. Kleinhardt is President of McGuire Chevrolet, is active in the Clare Kiwanis Club, and coaches girls Junior Varsity Basketball team at Clare High School.

*Joseph LaFramboise* (age 61) has been a director of the Bank since September 2007, and was appointed to the Corporation s Board of Directors effective January 1, 2010. He is a retired Sales and Marketing Executive of Ford Motor Company. Mr. LaFramboise is Ambassador of Eagle Village in Evart, Michigan.

*Dale D. Weburg* (age 67) has served as a director of the Breckenridge Division of the Bank since 1987 and of the Bank and Corporation since 2000. Mr. Weburg is President of Weburg Farms, a cash crop farm operation. Mr. Weburg also serves as a trustee of the Board of Directors of Gratiot Health System.

Each of the directors has been engaged in their stated professions for more than five years.

**Other Named Executive Officers**

*Timothy M. Miller* (age 60), President of the Breckenridge Division of the Bank and a member of its Board of Directors, has been an employee of the Corporation since 1985. Steven D. Pung (age 61), Chief Operations Officer of the Bank and a member of the Board of Directors of Financial Group Information Services (a wholly owned subsidiary of the Corporation) has been employed by the Corporation since 1978. David J. Reetz (age 50), Senior Vice President and Chief Lending Officer of the Bank, has been employed by the Corporation since 1987.

All officers of the Corporation serve at the pleasure of the Corporation s Board of Directors.

## Proposal 2-Advisory Vote On Executive Compensation

The compensation of the Corporation s principal executive officer, principal financial officer, and three other most highly compensated executive officers (named executive officers) is described below under the headings Compensation Discussion and Analysis and Executive Officers . Shareholders are urged to read these sections of this proxy statement, which discusses the Corporation s compensation policies and procedures with respect to its named executive officers.

In accordance with recently adopted changes to Section 14A of the Securities Exchange Act of 1934 (the Exchange Act), shareholders will be asked at the annual meeting to provide their support with respect to the compensation of the Corporation s named executive officers by voting on the following advisory, non-binding resolution:

**RESOLVED, that the shareholders of Isabella Bank Corporation approve, on an advisory basis, the compensation paid to the Corporation s named executive officers, as disclosed pursuant to the compensation disclosure rules of the Securities and Exchange Commission, SEC including the Compensation Discussion and Analysis, compensation tables and narrative discussion, for purposes of Section 14A (a) of the Securities Exchange Act of 1934.**

This advisory vote, commonly referred to as a say-on-pay advisory vote, is non-binding on the Board of Directors. Although non-binding, the Board of Directors and the Compensation and Human Resource Committee value constructive dialogue on executive compensation and other important governance topics with the Corporation s shareholders and encourage all shareholders to vote their shares on this matter. The Board of Directors and the

Compensation and Human Resource Committee will review the voting results and take them into consideration when making future decisions regarding executive compensation programs. The Board believes shareholders should consider the following in determining whether to approve this proposal:

The Corporation is not required to provide any severance or termination pay or benefits to any named executive officer;

Each member of the Compensation and Human Resource Committee is independent under the applicable standards of the NASDAQ Marketplace Rules;

The Compensation and Human Resource Committee continually monitors the Corporation s performance and adjusts compensation practices accordingly; and

The Compensation and Human Resource Committee with the assistance of an independent compensation consulting firm regularly assesses the Corporation s individual and total compensation programs against peer companies, the general marketplace and other industry data points.

**Unless otherwise instructed, validly executed proxies will be voted FOR this resolution.**

**The Board of Directors unanimously recommends that shareholders vote FOR the nonbinding advisory resolution approving the executive compensation of the Corporation s named executive officers.**

**Proposal 3-Frequency of Advisory Votes On Executive Compensation**

In accordance with recently adopted changes to Section 14A of the Exchange Act, the Corporation is providing a shareholder advisory vote to approve the compensation of our named executive officers (the say-on-pay advisory vote in Proposal 2 above) this year and will do so at least once every three years thereafter. Pursuant to recently adopted changes to Section 14A of the Exchange Act, at the 2011Annual Meeting, the Corporation is also asking shareholders to vote on whether future say-on-pay advisory votes on executive compensation should occur every year, every two years or every three years.

After careful consideration, the Board of Directors recommends that future shareholder say-on-pay advisory votes on executive compensation be conducted every three years. Although the Board of Directors recommends a say-on-pay vote every three years, shareholders will be able to specify one of four choices for this proposal on the proxy card: one year, two years, three years or abstain. Shareholders are not voting to approve or disapprove the Board of Directors recommendation.

Although this advisory vote regarding the frequency of say-on-pay votes is non-binding on the Board of Directors, the Board of Directors and the Compensation and Human Resource Committee will review the voting results and take them into consideration when deciding how often to conduct future say-on-pay shareholder advisory votes.

**Unless otherwise instructed, validly executed proxies will be voted FOR the Three Year frequency option.**

**The Board of Directors unanimously recommends that shareholders vote FOR the Three Year frequency option.**

## Corporate Governance

### Director Independence

The Corporation has adopted the director independence standards as defined under Rule 5605(a)(2) of the NASDAQ Marketplace Rules. The Board has determined that James C. Fabiano, Dale D. Weburg, David J. Maness, W. Joseph Manifold, Sandra L. Caul, W. Michael McGuire, Thomas L. Kleinhardt, Joseph LaFramboise, Jeffrey J. Barnes, Dianne C. Morey, and G. Charles Hubscher are independent directors. Dennis P. Angner is not independent as he is employed as President and Chief Financial Officer of the Corporation. Richard J. Barz is not independent as he is employed as Chief Executive Officer of the Corporation.

**Board Leadership Structure and Risk Oversight**

The Corporation s Governance policy provides that only directors who are deemed to be independent as set forth by NASDAQ and SEC rules are eligible to hold the office of Chairman of the Board. Additionally, the chairpersons of Board established committees must also be independent directors. It is the Board s belief that having a separate Chairman and Chief Executive Officer best serves the interest of the shareholders. The Board of Directors elects its chairperson at the first Board meeting following the annual meeting. Independent members of the Board of Directors meet without insider directors at least twice per year.

Management is responsible for the Corporation s day to day risk management and the Board s role is to engage in informed oversight. The Board utilizes committees to oversee risks associated with compensation, financial, and governance. Financial Group Information Services, the Corporation s information processing subsidiary is responsible for overseeing risks associated with information technology. The Isabella Bank Board of Directors is responsible for overseeing credit, investment, interest rate, and trust risks. The chairpersons of the respective boards or committees report on their activities on a regular basis.

The Audit Committee is responsible for the integrity of the consolidated financial statements of the Corporation; the independent auditors qualifications and independence; the performance of the Corporation s, and its subsidiaries internal audit function and independent auditors; the Corporation s system of internal controls; the Corporation s financial reporting and system of disclosure controls; and the compliance by the Corporation with legal and regulatory requirements and with the Corporation s Code of Business Conduct and Ethics.

**Committees of the Board of Directors and Meeting Attendance**

The Board met 14 times during 2010. All incumbent directors attended 75% or more of the meetings held in 2010. The Board has an Audit Committee, a Nominating and Corporate Governance Committee, and a Compensation and Human Resource Committee.

***Audit Committee***

The Audit Committee is composed of independent directors who meet the requirements for independence as defined in Rule 5605(a)(2) of the NASDAQ Marketplace Rules. Information regarding the functions performed by the Committee, its membership, and the number of meetings held during the year, is set forth in the Report of the Audit Committee included elsewhere in this annual proxy statement. The Audit Committee is governed by a written charter approved by the Board. The Audit Committee Charter is available on the Bank s website, www.isabellabank.com, under the Investor Relations tab.

In accordance with the provisions of the Sarbanes Oxley Act of 2002, directors Manifold and McGuire meet the requirements of Audit Committee Financial Expert and have been so designated by the Board. The Committee also consists of directors Barnes, Hubscher, LaFramboise, and Maness.

***Nominating and Corporate Governance Committee***

The Corporation has a standing Nominating and Corporate Governance Committee consisting of independent directors who meet the requirements for independence as defined in Rule 5605(a)(2) of NASDAQ Marketplace Rules. The Committee consists of directors Caul, Fabiano, Maness, Manifold, McGuire, and Weburg. The Nominating and Corporate Governance Committee held one meeting in 2010, with all directors attended the meeting. The Board has approved a Nominating and Corporate Governance Committee Charter which is available on the Bank s website www.isabellabank.com under the Investor Relations tab.

The Nominating and Corporate Governance Committee is responsible for evaluating and recommending individuals for nomination to the Board for approval. The Committee in evaluating nominees, including incumbent directors and any nominees put forth by shareholders, considers business experience, skills, character, judgment, leadership experience, and their knowledge of the geographical markets, business segments or other criteria the Committee deems relevant and appropriate based on the current composition of the Board. The Committee considers diversity in identifying members with respect to geographical markets served by the Corporation and the business experience of the nominee.

The Nominating and Corporate Governance Committee will consider as potential nominees, persons recommended by shareholders. Recommendations should be submitted in writing to the Secretary of the Corporation, 401 N. Main St., Mt. Pleasant, Michigan 48858 and include the shareholder s name, address and number of shares of the Corporation owned by the shareholder. The recommendation should also include the name, age, address and qualifications of the recommended candidate for nomination. Recommendations for the 2012 Annual Meeting of Shareholders should be delivered no later than December 9, 2011. The Nominating and Corporate Governance Committee does not evaluate potential nominees for director differently based on whether they are recommended to the Nominating and Corporate Governance Committee by a shareholder or otherwise.

***Compensation and Human Resource Committee***

The Compensation and Human Resource Committee of the Corporation is responsible for reviewing and recommending to the Corporation s Board the compensation of the Chief Executive Officer and other executive officers of the Corporation, benefit plans and the overall percentage increase in salaries. The committee consists of independent directors, who meet the requirements for independence as defined in Rule 5605(a) (2) of the NASDAQ Marketplace Rules. The Committee consists of directors Maness, Barnes, Caul, Fabiano, Hubscher, Kleinhardt, LaFramboise, Manifold, McGuire, Morey, and Weburg. The Committee held one meeting during 2010 with all directors attending the meeting. This Committee is governed by a written charter approved by the Board that is available on the Bank s website www.isabellabank.com under the Investor Relations tab.

***Communications with the Board***

Shareholders may communicate with the Corporation s Board of Directors by sending written communications to the Corporation s Secretary, Isabella Bank Corporation, 401 N. Main St., Mt. Pleasant, Michigan 48858. Communications will be forwarded to the Board of Directors or the appropriate committee, as soon as practicable.

***Code of Ethics***

The Corporation has adopted a Code of Business Conduct and Ethics that is applicable to the Corporation s Chief Executive Officer and the Chief Financial Officer. The Corporation s Code of Business Conduct and Ethics is available on the Bank s website www.isabellabank.com under the Investor Relations tab.

**Report of the Audit Committee**

The Audit Committee oversees the Corporation s financial reporting process on behalf of the Board. The 2010 Committee consisted of directors Barnes, Hubscher, LaFramboise, Maness, Manifold and McGuire.

The Audit Committee is responsible for pre-approving all auditing services and permitted non-audit services for the Corporation by its independent auditors or any other auditing or accounting firm if those fees are reasonably expected to exceed 5.0% of the current year agreed upon fee for independent audit services, except as noted below. The Audit Committee has established general guidelines for the permissible scope and nature of any permitted non-audit services in connection with its annual review of the audit plan and reviews the guidelines with the Board of Directors.

Management has the primary responsibility for the consolidated financial statements and the reporting process including the systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed the audited consolidated financial statements in the Annual Report with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the consolidated financial statements. The Audit Committee also reviewed with management and the independent auditors, management s assertion on the design and effectiveness of the Corporation s internal control over financial reporting as of December 31, 2010.

The Audit Committee reviewed with the Corporation s independent auditors, who are responsible for expressing an opinion on the conformity of those audited consolidated financial statements with accounting principles generally accepted in the United States of America, their judgments as to the quality, not just the acceptability, of the Corporation s accounting principles and such other matters as are required to be discussed with the Audit Committee by the standards of the Public Company Accounting Oversight Board (United States), including those described in AU Section 380 Communication with Audit Committees , as may be modified or supplemented. In addition, the Audit Committee has received the written disclosures and the letter from the independent accountants required by PCAOB Rule 3526, Communication with Audit Committees Concerning Independence, as may be modified or supplemented, and has discussed with the independent accountant the independent accountants independence.

The Audit Committee discussed with the Corporation s internal and independent auditors the overall scope and plans for their respective audits. The Audit Committee meets with the internal and external independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Corporation s internal controls and the overall quality of the Corporation s financial reporting process. The Audit Committee held six meetings during 2010, and all committee members attended 75% or more of the meetings.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors (and the Board has approved) that the audited consolidated financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2010 for filing with the Securities and Exchange Commission. The Audit Committee has appointed Rehmann Robson as the independent auditors for the 2011 audit.

Respectfully submitted,

W. Joseph Manifold, Audit Committee Chairperson
Jeffrey J. Barnes
G. Charles Hubscher
Joseph LaFramboise
David J. Maness
W. Michael McGuire

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## Compensation Discussion and Analysis

The Compensation and Human Resource Committee (the Committee ) is responsible for the compensation and benefits for the Chief Executive Officer, President, and executive officers of the Corporation. The Committee evaluates and approves the executive officer and senior management compensation plans, policies and programs of the Corporation and its affiliates. The Chief Executive Officer, Richard J. Barz, conducts annual performance reviews for Named Executive Officers, excluding himself. Mr. Barz recommends an appropriate salary to the Committee based on the performance review and the officer s years of service along with competitive market data.

### Compensation Objectives

The Committee considers asset growth with the safety and soundness objectives and earnings per share to be the primary ratios in measuring financial performance. The Corporation s philosophy is to maximize long-term return to shareholders consistent with safe and sound banking practices, while maintaining the commitment to superior customer and community service. The Corporation believes that the performance of executive officers in managing the business should be the basis for determining overall compensation. Consideration is also given to overall economic conditions and current competitive forces in the market place. The objectives of the Committee are to effectively balance salaries and potential compensation to an officer s individual management responsibilities and encourage them to realize their potential for future contributions to the Corporation. The objectives are designed to attract and retain high performing executive officers who will lead the Corporation while attaining the Corporation s earnings and performance goals.

### What the Compensation Programs are Designed to Reward

The Corporation s compensation programs are designed to reward dedicated and conscientious employment with the Corporation, loyalty in terms of continued employment, attainment of job related goals and overall profitability of the Corporation. In measuring an executive officer s contributions to the Corporation, the Committee considers numerous factors including, among other things, the Corporation s growth in terms of asset size and increase in earnings per share. In rewarding loyalty and long-term service, the Corporation provides attractive retirement benefits.

### Review of Risks Associated with Compensation Plans

Based on an analysis conducted by management and reviewed by the Committee, management does not believe that the Corporation s compensation programs for employees are reasonably likely to have a material short or long term adverse effect on the Corporation s Results of Operation.

### Use of Consultants

In 2010, the Committee directly engaged the services of Blanchard Chase, an outside compensation consulting firm, to assist with a total compensation review for the top two executive officers of the Corporation (CEO and President). Blanchard Chase is an independent consulting firm and does not perform any additional services for the Corporation or senior management. In addition, Blanchard Chase does not have any other personal or business relationships with any Board member or any officer of the Corporation. The Committee is continuing to work with Blanchard Chase on proxy support in 2011. During 2009, the Committee did not employ any services of outside compensation or benefit consultants to assist it in compensation-related initiatives.

### Elements of Compensation

The Corporation s executive compensation program has consisted primarily of base salary and benefits, annual cash bonus incentives, director fees for insider directors, and participation in the Corporation s retirement plans.

**Why Each of the Elements of Compensation is Chosen**

*Base Salary and Benefits* are set to provide competitive levels of compensation to attract and retain officers with strong motivated leadership. Each officer s performance, current compensation, and responsibilities within the Corporation are considered by the Committee when establishing base salaries. The Corporation also believes it is best to pay sufficient base salary because it believes an over-reliance on equity incentive compensation could potentially skew incentives toward short-term maximization of shareholder value as opposed to building long-term shareholder value. Base salary encourages management to operate the Corporation in a safe and sound manner even when incentive goals may prove unattainable.

*Annual Performance Incentives* are used to reward executive officers for the Corporation s overall financial performance. This element of the Corporation s compensation programs is included in the overall compensation in order to reward employees above and beyond their base salaries when the Corporation s performance and profitability exceed established annual targets. The inclusion of a modest incentive compensation encourages management to be more creative, diligent and exhaustive in managing the Corporation to achieve specific financial goals without incurring inordinate risks.

Performance incentives paid under the Executive Incentive Plan in 2010 were determined by reference to seven performance measures that related to services performed in 2009. The maximum award that may be granted under the Executive Incentive Plan to each eligible employee equals 10% of the employee s base salary (the Maximum Award ). The payment of 35% of the Maximum Award was conditioned on the eligible employee accomplishing personal performance goals that were established by such employee s supervisor as part of the employee s annual performance review. Each of the employees who were eligible to participate in the Executive Incentive Plan in 2009 accomplished his or her personal performance goals and was accordingly paid 35% of the 2009 Maximum Award. The payment of the remaining 65% of the Maximum Award was conditioned on the achievement of Corporation-wide targets in the following six categories: (1) earnings per share (weighted 40%); (2) net operating expenses to average assets (weighted 15%); (3) Fully Taxable Equivalent FTE net interest margin, excluding loan fees (weighted 15%); (4) in-market deposit growth (weighted 10%); (5) loan growth (weighted 10%); and (6) exceeding peer group return on average assets (weighted 10%). The following chart provides the 2009 target for each of the foregoing targets that were used to determine bonus awards that were paid in 2010, as well as the performance obtained for each target.

**Executive Incentive Plan**

| | 2009 Targets | | | | 2009 |
|---|---|---|---|---|---|
| **Target** | **25.00%** | **50.00%** | **75.00%** | **100.00%** | **Performance** |
| Earning per share | $ 0.90 | $ 0.93 | $ 0.96 | $ 0.99 | $ 1.04 |
| Net operating expenses to average assets | 1.66% | 1.65% | 1.64% | 1.63% | 1.71% |
| FTE Net Interest Margin | 3.71% | 3.73% | 3.75% | 3.77% | 3.86% |
| In market deposit growth | 4.50% | 5.00% | 5.50% | 6.00% | 1.87% |
| Loan growth | 5.50% | 6.00% | 6.50% | 7.00% | 8.28% |
| Exceeding peer group return on average assets | −0.26% | −0.25% | −0.25% | −0.24% | 0.91% |

*Retirement Plans.* The Corporation s retirement plans are designed to assist executives in providing themselves with a financially secure retirement. The retirement plans include: a frozen defined benefit pension plan; a 401(k) plan; and a non-leveraged employee stock ownership plan (ESOP), which is frozen to new participants; and a retirement bonus plan.

**How the Corporation Chose Amounts for Each Element**

The Committee s approach to determining the annual base salary of executive officers is to offer competitive salaries in comparison with other comparable financial institutions. The Committee utilizes both an independent compensation consultant, Blanchard Chase and a survey prepared by the Michigan Bankers Association of similar sized Michigan based institutions. The independent compensation consultant established a benchmark peer group of 20 mid-west financial institutions in non urban areas whose average assets size, number of branch locations, return on average assets and nonperforming assets that were comparable to Isabella Bank Corporation. The Michigan Bankers Association 2010 compensation survey was based on the compensation information provided by these organizations for 2009. Specific factors used to decide where an executive officer s salary should be within the established range include the historical financial performance, financial performance outlook, years of service, and job performance.

The annual performance incentive is based on the achievement of goals set for each individual. An analysis is conducted by the Chief Executive Officer. The Chief Executive Officer makes a recommendation to the Committee for the appropriate amount for each individual executive officer. The Committee reviews, modifies if necessary, and approves the recommendations of the Chief Executive Officer. The Committee reviews the performance of the Chief Executive Officer. The Committee uses the following factors as quantitative measures of corporate performance in determining annual cash bonus amounts to be paid:

Peer group financial performance compensation

1 and 5 year shareholder returns

Earnings per share and earnings per share growth

Budgeted as compared to actual annual operating performance

Community and industry involvement

Results of audit and regulatory exams

Other strategic goals as established by the board of directors

While no particular weight is given to any specific factor, the Committee gives at least equal weight to the subjective analyses as described above.

Total compensation in 2010 was based on the Committee targeting its Chief Executive Officer s and President & Chief Financial Officer s compensation to approximate the median of the range provided by the independent compensation consultant. Compensation for other named executive officers was based on the ranges provide by the Michigan Bankers Association surveys.

*Retirement plans.* The Corporation has a 401(k) plan in which substantially all employees are eligible to participate. Employees may contribute up to 50% of their compensation subject to certain limits based on federal tax laws. As a result of the curtailment of the defined benefit plan noted below, the Corporation increased the contributions to the 401(k) plan effective January 1, 2007. The Corporation makes a annual 3.0% safe harbor contribution for all eligible employees and matching contributions equal to 50% of the first 4.0% of an employee s compensation contributed to the Plan during the year. Employees are 100% vested in the safe harbor contributions and are 0% vested through their first two years of employment and are 100% vested after 6 years through a laddered vesting schedule of service for matching contributions.

The Corporation maintains a non-leveraged employee stock ownership plan (ESOP) which covers substantially all of its employees. The plan was frozen effective December 31, 2006 to new participants. Contributions to the plan are discretionary and approved by the Board of Directors.

The retirement bonus plan is a nonqualified plan of deferred compensation benefits for eligible employees effective January 1, 2007. An initial amount has been credited for each eligible employee as of January 1, 2007. Subsequent amounts will be credited on each allocation date thereafter as defined in the plan. The amount of the initial allocation and the annual allocation are determined pursuant to the payment schedule adopted at the sole and exclusive discretion of the Board of Directors, as set forth in the plan.

In December 2006, the Board of Directors voted to curtail the defined benefit plan effective March 1, 2007. The effect of the curtailment was recognized in the first quarter of 2007 and the current participants accrued benefits were frozen as of March 1, 2007. Participation in the plan was limited to eligible employees as of December 31, 2006.

*Other Benefits and Perquisites.* Executive officers are eligible for all of the benefits made available to full-time employees of the Corporation (such as the 401(k) plan, employee stock purchase plan, health insurance, group term life insurance and disability insurance) on the same basis as other full-time employees and are subject to the same sick leave and other employee policies. The Corporation also provides its executive officers with certain additional benefits and perquisites, which it believes are appropriate in order to attract and retain the proper quality of talent for these positions and to recognize that similar executive benefits and perquisites are commonly offered by comparable financial institutions.

A description and the cost to the Corporation of these perquisites are included in footnote two in the Summary Compensation Table appearing on page 14.

The Corporation believes that benefits and perquisites provided to its executive officers in 2010 represented a reasonable percentage of each executive s total compensation package and was not inconsistent, in the aggregate, with perquisites provided to executive officers of comparable competing financial institutions.

The Corporation maintains a plan for qualified officers to provide death benefits to each participant. Insurance policies, designed primarily to fund death benefits, have been purchased on the life of each participant with the Corporation as the sole owner and beneficiary of the policies.

**How Elements Fit into Overall Compensation Objectives**

The elements of the Corporation s compensation are structured to reward past and current performance, continued service and motivate its leaders to excel in the future. The Corporation s salary compensation has generally been used to retain and attract motivated leadership. The Corporation intends to continually ensure salaries are sufficient to attract and retain exceptional officers. The Corporation s cash bonus incentive rewards current performance based upon personal and corporate goals and targets. The Corporation offers the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors Plan ) to motivate its eligible officers to enhance value for shareholders by aligning the interests of management with those of its shareholders.

As part of its goal of attracting and retaining quality team members, the Corporation has developed competitive employee benefit plans. Management feels that the combination of all of the plans listed above makes the Corporation s total compensation packages attractive.

**Compensation and Human Resource Committee Report**

The following Report of the Compensation and Human Resource Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other Corporation filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Corporation specifically incorporates this Report by reference therein.

The Compensation and Human Resource Committee, which includes all of the independent directors of the Board, has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of SEC Regulation S-K with management, and based on such review and discussion, the Compensation and Human Resource Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Proxy Statement and the Annual Report on Form 10-K.

Submitted by the Compensation and Human Resource Committee of Isabella Bank Corporation s Board of Directors:

David J. Maness, Chairperson
Jeffrey J. Barnes
Sandra L. Caul
James C. Fabiano
G. Charles Hubscher
Thomas L. Kleinhardt
Joseph LaFramboise
W. Joseph Manifold
W. Michael McGuire

Dianne C, Morey
Dale D. Weburg

**Executive Officers**

Executive Officers of the Corporation are compensated in accordance with their employment with the applicable entity. The following table shows information on compensation earned from the Corporation or its subsidiaries for each of the last three fiscal years ended December 31, 2010, for the Chief Executive Officer, the Chief Financial Officer, and the Corporation s three other most highly compensated executive officers.

**Summary Compensation Table**

| Name and principal position | Year | Salary ($)(1) | Bonus ($) | Change in pension Value and Non-Qualified Deferred Compensation Earnings ($)(2) | All Other Compensation ($)(3) | Total ($) |
|---|---|---|---|---|---|---|
| Richard J. Barz | 2010 | $ 357,600 | $ 24,706 | $ 116,364 | $ 34,856 | $ 533,526 |
| CEO Isabella Bank Corporation | 2009 | 354,250 | 9,625 | 90,184 | 30,568 | 484,627 |
| President and CEO Isabella Bank | 2008 | 333,275 | 9,100 | 110,559 | 22,697 | 475,631 |
| Dennis P. Angner | 2010 | $ 352,600 | $ 24,706 | $ 103,340 | $ 27,922 | $ 508,568 |
| President and CFO | 2009 | 359,425 | 9,800 | 79,623 | 25,252 | 474,100 |
| Isabella Bank Corporation | 2008 | 336,095 | 9,450 | 83,957 | 18,453 | 447,955 |
| Timothy M. Miller | 2010 | $ 161,220 | $ 12,370 | $ 9,000 | $ 32,798 | $ 215,388 |
| President of the Breckenridge | 2009 | 174,600 | 7,319 | 6,000 | 17,323 | 205,242 |
| Division of Isabella Bank | 2008 | 166,860 | 3,200 | 11,000 | 14,127 | 195,187 |
| Steven D. Pung | 2010 | $ 143,632 | $ 10,572 | $ 62,288 | $ 32,886 | $ 249,378 |
| Sr. Vice President and COO | 2009 | 127,100 | 6,003 | 48,518 | 18,468 | 200,089 |
| Isabella Bank | 2008 | 118,225 | 3,785 | 65,111 | 13,169 | 200,290 |
| David J. Reetz(4) | 2010 | $ 123,910 | $ 9,165 | $ 36,429 | $ 13,694 | $ 183,198 |
| Sr. Vice President and CLO | | | | | | |
| Isabella Bank | | | | | | |

(1) Includes compensation voluntarily deferred under the Corporation s 401(k) plan. Directors fees are also included, for calendar years 2010, 2009 and 2008 respectively as follows: Richard J. Barz $52,600, $59,250, and $58,275; Dennis P. Angner $52,600, $59,425, and $56,095; Timothy M. Miller $11,300, $26,900, and $24,160; and Steven D. Pung $900, $900, and $1,125.

(2) Represents the aggregate change in the actuarial present value of the noted executive s accumulated benefit under the Isabella Bank Corporation Pension Plan and the Isabella Bank Corporation Retirement Bonus Plan.

(3) For all noted executives all other compensation includes 401(k) matching contributions. For Richard J. Barz, Steven D. Pung, and David J. Reetz this also includes club dues and auto allowance. For Dennis P. Angner and Timothy M. Miller, this also includes auto allowance.

(4) Not a named executive officer prior to 2010.

**2010 Pension Benefits**

The following table indicates the present value of accumulated benefits as of December 31, 2010 for each named executive in the summary compensation table.

| Name | Plan name | Number of Years of Vesting Service as of 01/01/11 (#) | Present Value of Accumulated Benefit ($) | Payments During Last Fiscal Year |
|---|---|---|---|---|
| Richard J. Barz | Isabella Bank Corporation Pension Plan | 39 | $ 762,000 | $ |
| | Isabella Bank Corporation Retirement Bonus Plan | 39 | 270,931 | |
| Dennis P. Angner | Isabella Bank Corporation Pension Plan | 27 | 382,000 | |
| | Isabella Bank Corporation Retirement Bonus Plan | 27 | 275,533 | |
| Timothy M. Miller | Isabella Bank Corporation Pension Plan | 10 | 79,000 | |
| Steven D. Pung | Isabella Bank Corporation Pension Plan | 32 | 384,000 | |
| | Isabella Bank Corporation Retirement Bonus Plan | 32 | 145,630 | |
| David J. Reetz | Isabella Bank Corporation Pension Plan | 24 | 119,000 | |
| | Isabella Bank Corporation Retirement Bonus Plan | 24 | 90,378 | |

*Defined benefit pension plan.* The Corporation sponsors the Isabella Bank Corporation Pension Plan, a frozen defined benefit pension plan. In December 2006, the Board of Directors voted to curtail the defined benefit plan effective March 1, 2007. The curtailment froze the current participant s accrued benefits as of March 1, 2007 and limited participation in the plan to eligible employees as of December 31, 2006. Due to the curtailment of the plan, the number of years of credited service was frozen. As such, the years of credited service for the plan may differ from the participant s actual years of service with the Corporation.

Annual contributions are made to the plan as required by accepted actuarial principles, applicable federal tax laws, and expenses of operating and maintaining the plan. The amount of contributions on behalf of any one participant cannot be separately or individually computed.

Pension plan benefits are based on years of service and the employees five highest consecutive years of compensation out of the last ten years of service, effective through December 31, 2006.

A participant may earn a benefit for up to 35 years of accredited service. Earned benefits are 100 percent vested after five years of service. Benefit payments normally start when a participant reaches age 65. A participant with more than five years of service may elect to take early retirement benefits anytime after reaching age 55. Benefits payable under early retirement are reduced actuarially for each month prior to age 65 in which benefits begin.

Dennis P. Angner, Richard J. Barz, Timothy M. Miller, and Steven D. Pung are eligible for early retirement under the Isabella Bank Corporation Pension Plan. Under the provisions of the Plan, participants are eligible for early retirement after reaching the age of 55 with at least 5 years of service. The early retirement benefit amount is the accrued benefit payable at normal retirement date reduced by 5/9% for each of the first 60 months and 5/18% for each of the next 60 months that the benefit commencement date precedes the normal retirement date.

*Retirement bonus plan.* The Corporation sponsors the Isabella Bank Corporation Retirement Bonus Plan. The Retirement Bonus Plan is a nonqualified plan of deferred compensation benefits for eligible employees effective January 1, 2007. This plan is intended to provide eligible employees with additional retirement benefits. To be eligible, the employee needed to be employed by the Corporation on January 1, 2007, and be a participant in the Corporation s frozen Executive Supplemental Income Agreement. Participants must also be an officer of the Corporation with at least 10 years of service as of December 31, 2006. The Corporation has sole and exclusive discretion to add new participants to the plan by authorizing such participation pursuant to action of the Corporation s Board of Directors.

An initial amount has been credited for each eligible employee as of January 1, 2007. Subsequent amounts shall be credited on each allocation date thereafter as defined in the Plan. The amount of the initial allocation and the annual allocation shall be determined pursuant to the payment schedule adopted by the sole and exclusive discretion of the Board, as set forth in the Plan.

Dennis P. Angner, Richard J. Barz, Timothy M. Miller, and Steven D. Pung are eligible for early retirement under the Isabella Bank Corporation Retirement Bonus Plan. Under the provisions of the plan, participants are eligible for early retirement upon attaining 55 years of age. There is no difference between the calculation of benefits payable upon early retirement and normal retirement.

**2010 Nonqualified Deferred Compensation**

| Name | Executive Contributions in Last FY ($) | Aggregate Earnings in Last FY ($) | Aggregate Balance at Last FYE ($) |
|---|---|---|---|
| Richard J. Barz | $ 30,650 | $ 3,501 | $ 97,379 |
| Dennis P. Angner | 44,400 | 4,836 | 134,713 |
| Timothy M. Miller | 3,500 | 839 | 21,990 |
| Steven D. Pung | 900 | 181 | 4,799 |
| David J. Reetz | N/A | N/A | N/A |

The directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees into the Directors Plan and may defer up to 100% of their earned fees based on their annual election. These amounts are reflected in the 2010 nonqualified deferred compensation table above. Under the Directors Plan, these deferred fees are converted on a quarterly basis into shares of the Corporation s common stock based on the fair market value of shares of the Corporation s common stock at that time. Shares credited to a participant s account are eligible for stock and cash dividends as payable.

Distribution from the Directors Plan occurs when the participant retires from the Board, attains age 70 or upon the occurrence of certain other events. Distributions must take the form of shares of the Corporation s common stock. Any Corporation common stock issued under the Directors Plan will be considered restricted stock under the Securities Act of 1933, as amended.

**Potential Payments Upon Termination or Change in Control**

The estimated payments payable to each named executive officer upon severance from employment, retirement, termination upon death or disability or termination following a change in control of the Corporation are described below. For all termination scenarios, the amounts assume such termination took place as of December 31, 2010.

**Any Severance of Employment**

Regardless of the manner in which a named executive officer s employment terminates, he or she is entitled to receive amounts earned during his or her term of employment. Such amounts include:

Amounts accrued and vested through the Defined Benefit Pension Plan.

Amounts accrued and vested through the Retirement Bonus Plan.

Amounts deferred in the Directors Plan.

Unused vacation pay.

**Retirement**

In the event of the retirement of an executive officer, the officer would receive the benefits identified above.

As of December 31, 2010, the named executive officers listed had no unused vacation days.

**Death or Disability**

In the event of death or disability of an executive officer, in addition to the benefits listed above, the executive officer will also receive payments under the Corporation s life insurance plan or benefits under the Corporation s disability plan as appropriate.

In addition to potential payments upon termination available to all employees, the estates for the executive officers listed below would receive the following payments upon death:

| Name | While an Active Employee | Subsequent to Retirement |
|---|---|---|
| Richard J. Barz | $ 610,000 | $ 305,000 |
| Dennis P. Angner | 600,000 | 300,000 |
| Timothy M. Miller | 299,800 | 149,900 |
| Steven D. Pung | 285,400 | 142,700 |
| David J. Reetz | 247,800 | 123,900 |

**Change in Control**

The Corporation currently does not have a change in control agreement with any of the executive officers; provided, however, pursuant to the Retirement Bonus Plan each participant would become 100% vested in their benefit under the plan if, following a change in control, they voluntarily terminate employment or are terminated without just cause.

**Director Compensation**

The following table summarizes the Compensation of each non-employee director who served on the Board of Directors during 2010.

| Name | Fees Earned or Paid in Cash ($) | Total ($) |
|---|---|---|
| Jeffrey J. Barnes | 21,000 | 21,000 |
| Sandra L. Caul | 35,800 | 35,800 |
| James Fabiano | 40,915 | 40,915 |
| G. Charles Hubscher | 25,950 | 25,950 |
| Thomas L. Kleinhardt | 29,450 | 29,450 |
| Ted W. Kortes | 31,100 | 31,100 |
| Joseph LaFramboise | 27,900 | 27,900 |
| David J. Maness | 52,300 | 52,300 |
| W. Joseph Manifold | 29,146 | 29,146 |
| W. Michael McGuire | 31,800 | 31,800 |
| Dianne C. Morey | 18,850 | 18,850 |

| | | |
|---|---|---|
| William J. Strickler | 39,085 | 39,085 |
| Dale D. Weburg | 36,400 | 36,400 |

The Corporation paid a $14,000 retainer plus $1,350 per board meeting to external directors and a $6,000 retainer plus $1,350 per board meeting to inside directors during 2010. Members of the audit committee were paid $350 per audit committee meeting attended.

Pursuant to the Directors Plan the directors of the Corporation and its subsidiaries are required to defer at least 25% of their earned board fees. Under the Directors Plan, deferred directors fees are converted on a quarterly basis into shares of the Corporation s common stock, based on the fair market value of a share of the Corporation s common stock at that time. Shares of stock credited to a participant s account are eligible for cash and stock dividends as payable. Directors of the Corporation deferred $419,696 under the Directors Plan in 2010.

Upon a participant s attainment of age 70, retirement from the Board, or the occurrence of certain other events, the participant is eligible to receive a lump-sum, in-kind distribution of all of the stock that is then credited to his or her account. The plan does not allow for cash settlement. Stock issued under the Directors Plan is restricted stock under the Securities Act of 1933, as amended.

The Corporation established a Trust effective as of January 1, 2008 to fund the Directors Plan. The Trust is an irrevocable grantor trust to which the Corporation may contribute assets for the limited purpose of funding a nonqualified deferred compensation plan. Although the Corporation may not reach the assets of the Trust for any purpose other than meeting its obligations under the Directors Plan, the assets of the Trust remain subject to the claims of the Corporation s creditors. The Corporation may contribute cash or common stock to the Trust from time to time for the sole purpose of funding the Directors Plan. The Trust will use any cash that the Corporation may contribute to purchase shares of the Corporation s common stock on the open market through the Corporation s brokerage services department.

The Corporation transferred $492,958 to the Trust in 2010, which held 32,686 shares of the Corporation s common stock for settlement as of December 31, 2010. As of December 31, 2010, there were 191,977 shares of stock credited to participants accounts, which credits are unfunded as of such date to the extent that they are in excess of the stock and cash that has been credited to the Trust. All amounts are unsecured claims against the Corporation s general assets. The net cost of this benefit to the Corporation was $165,353 in 2010.

The following table displays the number of equity shares credited pursuant to the terms of the Directors Plan as of December 31, 2010:

| **Name** | **# of Shares of Stock Credited** |
|---|---|
| Dennis P Angner | 7,787 |
| Jeffrey J. Barnes | 31,280 |
| Richard J. Barz | 5,629 |
| Sandra L. Caul | 287,411 |
| James Fabiano | 756,559 |
| G. Charles Hubscher | 71,357 |
| Thomas L. Kleinhardt | 165,741 |
| Ted W. Kortes | 15,636 |
| Joseph LaFramboise | 36,348 |
| David J. Maness | 166,134 |
| W. Joseph Manifold | 108,959 |
| W. Michael McGuire | 84,660 |
| Dianne C. Morey | 103,849 |
| William J. Strickler | 368,446 |
| Dale D. Weburg | 200,490 |

**Compensation and Human Resource Committee Interlocks and Insider Participation**

The Compensation and Human Resource Committee of the Corporation is responsible for reviewing and recommending to the Corporation s Board the compensation of the Chief Executive Officer and other executive officers of the Corporation, benefit plans and the overall percentage increase in salaries. The committee consists of directors Maness, Barnes, Caul, Fabiano, Hubscher, Kleinhardt, LaFramboise, Manifold, McGuire, Morey, and Weburg.

**Indebtedness of and Transactions with Management**

Certain directors and officers of the Corporation and members of their families were loan customers of Isabella Bank, or have been directors or officers of corporations, or partners of partnerships which have had transactions with the Bank. In management s opinion, all such transactions were made in the ordinary course of business and were substantially on the same terms, including collateral and interest rates, as those prevailing at the same time for comparable transactions with customers not related to the Bank. These transactions do not involve more than normal risk of collectability or present other unfavorable features. Total loans to these customers were approximately $4,347,000 as of December 31, 2010. The Corporation addresses transactions with related parties in its *Code of Business Conduct and Ethics* policy. Conflicts of interest are prohibited as a matter of Corporation policy, except under guidelines approved by the Board of Directors or committees of the Board.

**Security Ownership of Certain Beneficial Owners and Management**

As of April 1, 2011 the Corporation does not have any person who is known to the Corporation to be the beneficial owner of more than 5% of the common stock of the Corporation.

The following table sets forth certain information as of April 1, 2011 as to the common stock of the Corporation owned beneficially by each director and director nominee, by each named executive officer, and by all directors, director nominees and executive officers of the Corporation as a group. The shares to be credited under the Directors Plan are not included in the table below.

| | Amount and Nature of Beneficial Ownership | | | |
|---|---|---|---|---|
| **Name of Owner** | **Sole Voting and Investment Powers** | **Shared Voting or Investment Powers** | **Total Beneficial Ownership** | **Percentage of Common Stock Outstanding** |
| Dennis P. Angner* | 18,100 | | 18,100 | 0.24% |
| Jeffrey J. Barnes | | 5,669 | 5,669 | 0.08% |
| Richard J. Barz* | 20,325 | | 20,325 | 0.27% |
| Sandra L. Caul | | 10,609 | 10,609 | 0.14% |
| James C. Fabiano | 264,871 | 6,579 | 271,450 | 3.60% |
| G. Charles Hubscher | 28,031 | 3,548 | 31,579 | 0.42% |
| Thomas L. Kleinhardt | | 31,179 | 31,179 | 0.41% |
| Joseph LaFramboise | | 910 | 910 | 0.01% |
| David J. Maness | 466 | 1,135 | 1,601 | 0.02% |
| W. Joseph Manifold | 2,089 | | 2,089 | 0.03% |
| W. Michael McGuire | 56,531 | | 56,531 | 0.75% |
| Dianne C. Morey | | 40,283 | 40,283 | 0.53% |
| Dale D. Weburg | 27,842 | 31,683 | 59,525 | 0.79% |
| Timothy M. Miller | 215 | 3,330 | 3,545 | 0.05% |
| Steven D. Pung | 9,422 | 8,236 | 17,658 | 0.23% |
| David J. Reetz | 8,468 | 175 | 8,643 | 0.11% |
| All Directors, nominees and Executive Officers as a Group (16 persons) | 436,360 | 143,336 | 579,696 | 7.68% |

* Trustees of the ESOP who vote ESOP stock.

**Independent Registered Public Accounting Firm**

The Audit Committee has appointed Rehmann Robson as the independent auditors of the Corporation for the year ending December 31, 2011.

A representative of Rehmann Robson is expected to be present at the Annual Meeting of Shareholders to respond to appropriate questions from shareholders and to make any comments Rehmann believes is appropriate.

**Fees for Professional Services Provided by Rehmann Robson P.C.**

The following table shows the aggregate fees billed by Rehmann Robson for the audit and other services provided to the Corporation for 2010 and 2009.

| | 2010 | 2009 |
|---|---|---|
| Audit fees | $ 252,163 | $ 291,497 |
| Audit related fees | 39,089 | 40,135 |
| Tax fees | 24,730 | 39,784 |
| Other professional services fees | | |
| Total | $ 315,982 | $ 371,416 |

The audit fees were for performing the integrated audit of the Corporation s consolidated annual financial statements and the audit of internal control over financial reporting related to the Federal Deposit Insurance Corporation Improvement Act, review of interim quarterly financial statements included in the Corporation s Forms 10-Q, and services that are normally provided by Rehmann Robson in connection with statutory and regulatory filings or engagements. The decline in audit fees from 2009 to 2010 is primarily related to the Corporations continued improvement in financial reporting and SOX 404 processes.

The audit related fees are typically for various discussions related to the adoption and interpretation of new accounting pronouncements. Also included are fees for auditing of the Corporation s employee benefit plans.

The tax fees were for the preparation of the Corporation s and its subsidiaries state and federal tax returns and for consultation with the Corporation on various tax matters. During 2009 tax fees also included consulting related to the then new State of Michigan Business Tax (MBT).

The Audit Committee has considered whether the services provided by Rehmann Robson, P.C. other than the audit fees, are compatible with maintaining Rehmann Robson, P.C. s independence and believes that the other services provided are compatible.

**Pre-Approval Policies and Procedures**

All audit and non-audit services over $5,000 to be performed by Rehmann Robson must be approved in advance by the Audit Committee if those fees are reasonably expected to exceed 5.0% of the current year agreed upon fee for independent audit services. As permitted by the SEC s rules, the Audit Committee has authorized its Chairperson to pre-approve audit, audit-related, tax and non-audit services, provided that such approved service is reported to the full

Audit Committee at its next meeting.

As early as practicable in each calendar year, the independent auditor provides to the Audit Committee a schedule of the audit and other services that the independent auditor expects to provide or may provide during the next twelve months. The schedule will be specific as to the nature of the proposed services, the proposed fees, timing, and other details that the Audit Committee may request. The Audit Committee will by resolution authorize or decline the proposed services. Upon approval, this schedule will serve as the budget for fees by specific activity or service for the next twelve months.

A schedule of additional services proposed to be provided by the independent auditor, or proposed revisions to services already approved, along with associated proposed fees, may be presented to the Audit Committee for their consideration and approval at any time. The schedule will be specific as to the nature of the proposed service, the proposed fee, and other details that the Audit Committee may request. The Audit Committee will by resolution authorize or decline authorization for each proposed new service.

Applicable SEC rules and regulations permit waiver of the pre-approval requirements for services other than audit, review or attest services if certain conditions are met. Out of the services characterized above as audit-related, tax and professional services, none were billed pursuant to these provisions in 2010 and 2009 without pre-approval as required under the Corporation s policies.

## Shareholder Proposals

Any proposals which shareholders of the Corporation intend to present at the next annual meeting of the Corporation must be received before December 9, 2011 to be considered for inclusion in the Corporation s proxy statement and proxy for that meeting. Proposals should be made in accordance with Securities and Exchange Commission Rule 14a-8.

## Directors Attendance at the Annual Meeting of Shareholders

The Corporation s directors are encouraged to attend the annual meeting of shareholders. At the 2010 annual meeting, all directors were in attendance.

## Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Corporation s directors and certain officers and persons who own more than ten percent of the Corporation s common stock, to file with the SEC initial reports of ownership and reports of changes in ownership of the Corporation s common stock. These officers, directors, and greater than ten percent shareholders are required by SEC regulation to furnish the Corporation with copies of these reports.

To the Corporation s knowledge, based solely on review of the copies of such reports furnished to the Corporation, during the year ended December 31, 2010 all Section 16(a) filing requirements were satisfied, with respect to the applicable officers, directors, and greater than 10 percent beneficial owners.

## Other Matters

The cost of soliciting proxies will be borne by the Corporation. In addition to solicitation by mail, officers and other employees of the Corporation may solicit proxies by telephone or in person, without compensation other than their regular compensation.

## As to Other Business Which May Come Before the Meeting

Management of the Corporation does not intend to bring any other business before the meeting for action. However, if any other business should be presented for action, it is the intention of the persons named in the enclosed form of proxy to vote in accordance with their judgment on such business.

By order of the Board of Directors

Debra Campbell, Secretary

**Isabella Bank Corporation**

**Financial Information Index**

## SUMMARY OF SELECTED FINANCIAL DATA

| | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|
| | (Dollars in thousands except per share data) | | | | |
| INCOME STATEMENT DATA | | | | | |
| Total interest income | $ 57,217 | $ 58,105 | $ 61,385 | $ 53,972 | $ 44,709 |
| Net interest income | 40,013 | 38,266 | 35,779 | 28,013 | 24,977 |
| Provision for loan losses | 4,857 | 6,093 | 9,500 | 1,211 | 682 |
| Net income | 9,045 | 7,800 | 4,101 | 7,930 | 7,001 |
| BALANCE SHEET DATA | | | | | |
| End of year assets | $ 1,225,810 | $ 1,143,944 | $ 1,139,263 | $ 957,282 | $ 910,127 |
| Daily average assets | 1,182,930 | 1,127,634 | 1,113,102 | 925,631 | 800,174 |
| Daily average deposits | 840,392 | 786,714 | 817,041 | 727,762 | 639,046 |
| Daily average loans/net | 712,272 | 712,965 | 708,434 | 596,739 | 515,539 |
| Daily average equity | 139,855 | 139,810 | 143,626 | 119,246 | 91,964 |
| PER SHARE DATA(1) | | | | | |
| Earnings per share | | | | | |
| Basic | $ 1.20 | $ 1.04 | $ 0.55 | $ 1.14 | $ 1.12 |
| Diluted | 1.17 | 1.01 | 0.53 | 1.11 | 1.09 |
| Cash dividends | 0.72 | 0.70 | 0.65 | 0.62 | 0.58 |
| Book value (at year end) | 19.23 | 18.69 | 17.89 | 17.58 | 16.61 |
| FINANCIAL RATIOS | | | | | |
| Shareholders equity to assets (at year end) | 11.84% | 12.31% | 11.80% | 12.86% | 12.72% |
| Return on average equity | 6.47 | 5.58 | 2.86 | 6.65 | 7.61 |
| Return on average tangible equity | 9.55 | 8.53 | 4.41 | 8.54 | 8.31 |
| Cash dividend payout to net income | 59.93 | 67.40 | 118.82 | 54.27 | 53.92 |
| Return on average assets | 0.76 | 0.69 | 0.37 | 0.86 | 0.87 |

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | 4th | 3rd | 2nd | 1st | 4th | 3rd | 2nd | 1st |
| Quarterly Operating Results: | | | | | | | | |
| Total interest income | $ 14,540 | $ 14,306 | $ 14,272 | $ 14,099 | $ 14,411 | $ 14,516 | $ 14,505 | $ 14,673 |
| Interest expense | 4,217 | 4,296 | 4,291 | 4,400 | 4,657 | 4,928 | 5,026 | 5,228 |
| Net interest income | 10,323 | 10,010 | 9,981 | 9,699 | 9,754 | 9,588 | 9,479 | 9,445 |
| Provision for loan losses | 1,626 | 968 | 1,056 | 1,207 | 1,544 | 1,542 | 1,535 | 1,472 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Noninterest income | 2,629 | 2,634 | 1,870 | 2,167 | 2,102 | 2,566 | 3,131 | 2,357 |
| Noninterest expenses | 8,558 | 8,620 | 8,275 | 8,354 | 8,176 | 7,995 | 8,468 | 9,044 |
| Net income | 2,318 | 2,553 | 2,151 | 2,023 | 2,073 | 2,197 | 2,201 | 1,329 |
| Per Share of Common Stock: | | | | | | | | |
| Earnings per share | | | | | | | | |
| Basic | $ 0.30 | $ 0.34 | $ 0.29 | $ 0.27 | $ 0.28 | $ 0.29 | $ 0.29 | $ 0.18 |
| Diluted | 0.30 | 0.33 | 0.28 | 0.26 | 0.27 | 0.28 | 0.29 | 0.17 |
| Cash dividends | 0.18 | 0.18 | 0.18 | 0.18 | 0.32 | 0.13 | 0.13 | 0.12 |
| Book value (at quarter end) | 19.23 | 19.59 | 19.39 | 18.89 | 18.69 | 18.97 | 18.06 | 18.01 |

(1) Retroactively restated for the 10% stock dividend, paid on February 29, 2008.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
Isabella Bank Corporation
Mount Pleasant, Michigan

We have audited the accompanying consolidated balance sheets of ***Isabella Bank Corporation*** as of December 31, 2010 and 2009, and the related consolidated statements of changes in shareholders equity, income, comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2010. We also have audited ***Isabella Bank Corporation s*** internal control over financial reporting as of December 31, 2010, based on criteria established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). ***Isabella Bank Corporation s*** management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the effectiveness of ***Isabella Bank Corporation*** **s** internal control over financial reporting, based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material misstatement exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. We believe that our audits provide a reasonable basis for our opinion.

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

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2008, the Corporation adopted ASC Topic 715, *Compensation Retirement Benefits*.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ***Isabella Bank Corporation*** as of December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion ***Isabella Bank Corporation*** maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in the *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

Rehmann Robson, P.C.

Saginaw, Michigan
March 8, 2011

## CONSOLIDATED BALANCE SHEETS

| | December 31 | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in thousands) | |
| **ASSETS** | | |
| Cash and cash equivalents | | |
| Cash and demand deposits due from banks | $ 16,978 | $ 17,342 |
| Interest bearing balances due from banks | 1,131 | 7,140 |
| **Total cash and cash equivalents** | **18,109** | **24,482** |
| Certificates of deposit held in other financial institutions | 15,808 | 5,380 |
| Trading securities | 5,837 | 13,563 |
| Available-for-sale investment securities (amortized cost of $329,435 in 2010 and $258,585 in 2009) | 330,724 | 259,066 |
| Mortgage loans available-for-sale | 1,182 | 2,281 |
| Loans | | |
| Agricultural | 71,446 | 64,845 |
| Commercial | 348,852 | 340,274 |
| Installment | 30,977 | 32,359 |
| Residential real estate mortgage | 284,029 | 285,838 |
| **Total loans** | **735,304** | **723,316** |
| Less allowance for loan losses | 12,373 | 12,979 |
| **Net loans** | **722,931** | **710,337** |
| Premises and equipment | 24,627 | 23,917 |
| Corporate owned life insurance | 17,466 | 16,782 |
| Accrued interest receivable | 5,456 | 5,832 |
| Equity securities without readily determinable fair values | 17,564 | 17,921 |
| Goodwill and other intangible assets | 47,091 | 47,429 |
| Other assets | 19,015 | 16,954 |
| **Total Assets** | **$ 1,225,810** | **$ 1,143,944** |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Deposits | | |
| Noninterest bearing | $ 104,902 | $ 96,875 |
| NOW accounts | 142,259 | 128,111 |
| Certificates of deposit under $100 and other savings | 425,981 | 389,644 |
| Certificates of deposit over $100 | 204,197 | 188,022 |
| **Total deposits** | **877,339** | **802,652** |

| | | |
|---|---|---|
| Borrowed funds ($10,423 in 2010 and $17,804 in 2009 at fair value) | 194,917 | 193,101 |
| Accrued interest and other liabilities | 8,393 | 7,388 |
| **Total liabilities** | **1,080,649** | **1,003,141** |
| Shareholders equity | | |
| Common stock no par value 15,000,000 shares authorized; issued and outstanding 7,550,074 (including 32,686 shares to be issued) in 2010 and 7,535,193 (including 30,626 shares to be issued) in 2009 | 133,592 | 133,443 |
| Shares to be issued for deferred compensation obligations | 4,682 | 4,507 |
| Retained earnings | 8,596 | 4,972 |
| Accumulated other comprehensive loss | (1,709) | (2,119) |
| **Total shareholders equity** | **145,161** | **140,803** |
| **Total liabilities and shareholders equity** | **$ 1,225,810** | **$ 1,143,944** |

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY**

| | Common Stock Shares Outstanding | Common Stock | Shares to be Issued for Deferred Compensation Obligations | Retained Earnings | Accumulated Other Comprehensive Loss | Totals |
|---|---|---|---|---|---|---|
| | (Dollars in thousands except per share data) | | | | | |
| Balance, January 1, 2008 | 6,364,120 | $ 112,547 | $ 3,772 | $ 7,027 | $ (266) | $ 123,080 |
| Cumulative effect to apply ASC Topic 715, net of tax | | | | (1,571) | | (1,571) |
| Comprehensive loss | | | | 4,101 | (5,303) | (1,202) |
| Common stock dividends (10)% | 687,599 | 30,256 | | (30,256) | | |
| Regulatory capital transfer | | (28,000) | | 28,000 | | |
| Bank acquisition | 514,809 | 22,652 | | | | 22,652 |
| Issuance of common stock | 73,660 | 2,476 | | | | 2,476 |
| Common stock issued for deferred compensation obligations | 27,004 | 360 | (360) | | | |
| Share-based payment awards under equity compensation plan | | | 603 | | | 603 |
| Common stock purchased for deferred compensation obligations | | (249) | | | | (249) |
| Common stock repurchased pursuant to publicly announced repurchase plan | (148,336) | (6,440) | | | | (6,440) |
| Cash dividends ($0.65 per share) | | | | (4,873) | | (4,873) |
| Balance, December 31, 2008 | 7,518,856 | 133,602 | 4,015 | 2,428 | (5,569) | 134,476 |
| Comprehensive income | | | | 7,800 | 3,450 | 11,250 |
| Issuance of common stock | 126,059 | 2,664 | | | | 2,664 |
| Common stock issued for deferred compensation obligations | 12,890 | 331 | (185) | | | 146 |
| Share-based payment awards under equity compensation plan | | | 677 | | | 677 |
| Common stock purchased for deferred compensation obligations | | (767) | | | | (767) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Common stock repurchased pursuant to publicly announced repurchase plan | (122,612) | (2,387) | | | | (2,387) |
| Cash dividends ($0.70 per share) | | | | (5,256) | | (5,256) |
| Balance, December 31, 2009 | 7,535,193 | 133,443 | 4,507 | 4,972 | (2,119) | 140,803 |
| Comprehensive income | | | | 9,045 | 410 | 9,455 |
| Issuance of common stock | 124,953 | 2,683 | | | | 2,683 |
| Common stock issued for deferred compensation obligations | 28,898 | 537 | (475) | | | 62 |
| Share-based payment awards under equity compensation plan | | | 650 | | | 650 |
| Common stock purchased for deferred compensation obligations | | (514) | | | | (514) |
| Common stock repurchased pursuant to publicly announced repurchase plan | (138,970) | (2,557) | | | | (2,557) |
| Cash dividends ($0.72 per share) | | | | (5,421) | | (5,421) |
| Balance, December 31, 2010 | 7,550,074 | $ 133,592 | $ 4,682 | $ 8,596 | $ (1,709) | $ 145,161 |

The accompanying notes are an integral part of these consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF INCOME

| | Year Ended December 31 | | |
|---|---|---|---|
| | **2010** | **2009** | **2008** |
| | (Dollars in thousands except per share data) | | |
| **Interest income** | | | |
| Loans, including fees | $ 46,794 | $ 47,706 | $ 49,674 |
| Investment securities | | | |
| Taxable | 5,271 | 4,712 | 5,433 |
| Nontaxable | 4,367 | 4,623 | 4,642 |
| Trading account securities | 306 | 687 | 1,093 |
| Federal funds sold and other | 479 | 377 | 543 |
| **Total interest income** | **57,217** | **58,105** | **61,385** |
| **Interest expense** | | | |
| Deposits | 11,530 | 13,588 | 19,873 |
| Borrowings | 5,674 | 6,251 | 5,733 |
| **Total interest expense** | **17,204** | **19,839** | **25,606** |
| **Net interest income** | **40,013** | **38,266** | **35,779** |
| Provision for loan losses | 4,857 | 6,093 | 9,500 |
| **Net interest income after provision for loan losses** | **35,156** | **32,173** | **26,279** |
| **Noninterest income** | | | |
| Service charges and fees | 6,480 | 6,913 | 6,370 |
| Gain on sale of mortgage loans | 610 | 886 | 249 |
| Net (loss) gain on trading securities | (94) | 80 | 245 |
| Net gain (loss) on borrowings measured at fair value | 227 | 289 | (641) |
| Gain on sale of available-for-sale investment securities | 348 | 648 | 24 |
| Other | 1,729 | 1,340 | 1,555 |
| **Total noninterest income** | **9,300** | **10,156** | **7,802** |
| **Noninterest expenses** | | | |
| Compensation and benefits | 18,552 | 18,258 | 16,992 |
| Occupancy | 2,351 | 2,170 | 2,035 |
| Furniture and equipment | 4,344 | 4,146 | 3,849 |
| FDIC insurance premiums | 1,254 | 1,730 | 313 |
| Other | 7,306 | 7,379 | 7,515 |
| **Total noninterest expenses** | **33,807** | **33,683** | **30,704** |
| **Income before federal income tax expense (benefit)** | **10,649** | **8,646** | **3,377** |
| Federal income tax expense (benefit) | 1,604 | 846 | (724) |
| **Net income** | **$ 9,045** | **$ 7,800** | **$ 4,101** |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Earnings per share** | | | | | | |
| Basic | **$** | **1.20** | **$** | **1.04** | **$** | **0.55** |
| Diluted | **$** | **1.17** | **$** | **1.01** | **$** | **0.53** |
| **Cash dividends per basic share** | **$** | **0.72** | **$** | **0.70** | **$** | **0.65** |

The accompanying notes are an integral part of these consolidated financial statements.

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| | (Dollars in thousands) | | |
| **Net income** | **$ 9,045** | **$ 7,800** | **$ 4,101** |
| Unrealized holding gains (losses) on available-for-sale securities: | | | |
| Unrealized gains (losses) arising during the year | 1,156 | 3,415 | (3,104) |
| Reclassification adjustment for net realized gains included in net income | (348) | (648) | (24) |
| Net unrealized gains (losses) | 808 | 2,767 | (3,128) |
| Tax effect | (351) | 436 | (643) |
| Unrealized gains (losses), net of tax | 457 | 3,203 | (3,771) |
| (Increase) reduction of unrecognized pension costs | (72) | 374 | (2,320) |
| Tax effect | 25 | (127) | 788 |
| Net unrealized (loss) gain on defined benefit pension plan | (47) | 247 | (1,532) |
| **Other comprehensive income (loss), net of tax** | **410** | **3,450** | **(5,303)** |
| **Comprehensive income (loss)** | **$ 9,455** | **$ 11,250** | **$ (1,202)** |

The accompanying notes are an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2010 | 2009 | 2008 |
| | (Dollars in thousands) (Unaudited) | | |
| **Operating activities** | | | |
| Net income | $ 9,045 | $ 7,800 | $ 4,101 |
| Reconciliation of net income to net cash provided by operations: | | | |
| Provision for loan losses | 4,857 | 6,093 | 9,500 |
| Impairment of foreclosed assets | 180 | 157 | 231 |
| Depreciation | 2,522 | 2,349 | 2,171 |
| Amortization and impairment of originated mortgage servicing rights | 543 | 683 | 346 |
| Amortization of acquisition intangibles | 338 | 375 | 415 |
| Net amortization of available-for-sale investment securities | 1,153 | 741 | 356 |
| Realized gain on sale of available-for-sale investment securities | (348) | (648) | (24) |
| Net unrealized losses (gains) on trading securities | 94 | (80) | (245) |
| Net gain on sale of mortgage loans | (610) | (886) | (249) |
| Net unrealized (gains) losses on borrowings measured at fair value | (227) | (289) | 641 |
| Increase in cash value of corporate owned life insurance | (642) | (641) | (616) |
| Realized gain on redemption of corporate owned life insurance | (21) | | |
| Share-based payment awards under equity compensation plan | 650 | 677 | 603 |
| Deferred income tax expense (benefit) | 179 | (641) | (1,812) |
| Origination of loans held for sale | (72,106) | (153,388) | (33,353) |
| Proceeds from loan sales | 73,815 | 152,891 | 34,918 |
| Net changes in operating assets and liabilities which provided (used) cash: | | | |
| Trading securities | 7,632 | 8,292 | 8,513 |
| Accrued interest receivable | 376 | 490 | 226 |
| Other assets | (1,914) | (6,331) | (3,565) |
| Accrued interest and other liabilities | 1,005 | 581 | (1,496) |
| **Net cash provided by operating activities** | **26,521** | **18,225** | **20,661** |
| **Investing activities** | | | |
| Net change in certificates of deposit held in other financial institutions | (10,428) | (4,805) | 882 |
| Activity in available-for-sale securities | | | |
| Maturities, calls, and sales | 85,273 | 130,580 | 66,387 |
| Purchases | (156,928) | (140,517) | (96,168) |
| Loan principal (originations) collections, net | (21,319) | 4,437 | (42,700) |
| Proceeds from sales of foreclosed assets | 2,778 | 4,145 | 2,310 |
| Purchases of premises and equipment | (3,232) | (3,035) | (2,990) |
| Bank acquisition, net of cash acquired | | | (9,465) |
| Cash contributed to title company joint venture formation | | | (4,542) |
| Purchases of corporate owned life insurance | (175) | | (1,560) |
| Proceeds from the redemption of corporate owned life insurance | 154 | 11 | |
| **Net cash used in investing activities** | **(103,877)** | **(9,184)** | **(87,846)** |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Financing activities** | | | | | | |
| Acceptances and withdrawals of deposits, net | | 74,687 | | 27,022 | | (47,892) |
| Advances (repayments) of borrowed funds | | 2,043 | | (28,960) | | 123,016 |
| Cash dividends paid on common stock | | (5,421) | | (5,256) | | (4,873) |
| Proceeds from issuance of common stock | | 2,208 | | 2,479 | | 2,476 |
| Common stock repurchased | | (2,020) | | (2,056) | | (6,440) |
| Common stock purchased for deferred compensation obligations | | (514) | | (767) | | (249) |
| **Net cash provided by (used in) financing activities** | | **70,983** | | **(7,538)** | | **66,038** |
| **(Decrease) increase in cash and cash equivalents** | | **(6,373)** | | **1,503** | | **(1,147)** |
| Cash and cash equivalents at beginning of year | | 24,482 | | 22,979 | | 24,126 |
| **Cash and cash equivalents at end of year** | **$** | **18,109** | **$** | **24,482** | **$** | **22,979** |
| Supplemental cash flows information: | | | | | | |
| Interest paid | $ | 17,344 | $ | 20,030 | $ | 25,556 |
| Federal income taxes paid | | 1,261 | | 2,237 | | 1,155 |
| Supplemental noncash information: | | | | | | |
| Transfers of loans to foreclosed assets | $ | 3,868 | $ | 2,536 | $ | 3,398 |
| Common stock issued for deferred compenstion obligations | | 475 | | 185 | | 360 |
| Common stock repurchased from an associated grantor trust (Rabbi Trust) | | (537) | | (331) | | (360) |

The accompanying notes are an integral part of these consolidated financial statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(Dollars in thousands except per share amounts)**

## NOTE 1 Nature of Operations and Summary of Significant Accounting Policies

***Basis of Presentation and Consolidation:***

The consolidated financial statements include the accounts of Isabella Bank Corporation (the Corporation ), a financial services holding company, and its wholly owned subsidiaries, Isabella Bank (the Bank ), Financial Group Information Services, and IB&T Employee Leasing, LLC. All intercompany balances and accounts have been eliminated in consolidation.

***Nature of Operations:***

Isabella Bank Corporation is a financial services holding company offering a wide array of financial products and services in several mid-Michigan counties. Its banking subsidiary, Isabella Bank, offers banking services through 25 locations, 24 hour banking services locally and nationally through shared automatic teller machines, 24 hour online banking, and direct deposits to businesses, institutions, and individuals. Lending services offered include commercial loans, agricultural loans, residential real estate loans, consumer loans, student loans, and credit cards. Deposit services include interest and noninterest bearing checking accounts, savings accounts, money market accounts, and certificates of deposit. Other related financial products include trust and investment services, safe deposit box rentals, and credit life insurance. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all of the Corporation s principal markets. The Corporation s results of operations can be significantly affected by changes in interest rates or changes in the local economic environment.

Financial Group Information Services provides information technology services to Isabella Bank Corporation and its subsidiaries.

IB&T Employee Leasing provides payroll services, benefit administration, and other human resource services to Isabella Bank Corporation and its subsidiaries.

***Use of Estimates:***

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting year. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the fair value of certain available-for-sale investment securities, the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, valuation of goodwill and other intangible assets, and determinations of assumptions in accounting for the defined benefit pension plan. In connection with the determination of the allowance for loan losses and the carrying value of foreclosed real estate, management obtains independent appraisals for significant properties.

***Fair Value Measurements:***

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, such as the reporting entity s own data. The Corporation may choose to measure eligible items at fair value at specified election dates. Unrealized gains and losses on items for which the fair value measurement option has been elected are reported in earnings at each subsequent reporting date. The fair value option (i) may be applied instrument by instrument, with certain exceptions, allowing the Corporation to record identical financial assets and liabilities at fair value or by another

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

measurement basis permitted under generally accepted accounting principles, (ii) is irrevocable (unless a new election date occurs) and (iii) is applied only to entire instruments and not to portions of instruments.

For assets and liabilities recorded at fair value, it is the Corporation s policy to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements for those financial instruments for which there is an active market. In cases where the market for a financial asset or liability is not active, the Corporation includes appropriate risk adjustments that market participants would make for nonperformance and liquidity risks when developing fair value measurements. Fair value measurements for assets and liabilities for which limited or no observable market data exists are accordingly based primarily upon estimates, are often calculated based on the economic and competitive environment, the characteristics of the asset or liability and other factors. Therefore, the results cannot be determined with precision and may not be realized in an actual sale or immediate settlement of the asset or liability. Additionally, there may be inherent weaknesses in any calculation technique, and changes in the underlying assumptions used, including discount rates and estimates of future cash flows, could significantly affect the results of current or future values.

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Investment securities available-for-sale, trading securities, and certain liabilities are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record other assets at fair value on a nonrecurring basis, such as mortgage loans available-for-sale, impaired loans, foreclosed assets, originated mortgage servicing rights, goodwill, and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

***Fair Value Hierarchy***

Under fair value measurement and disclosure authoritative guidance, the Corporation groups assets and liabilities measured at fair value into three levels, based on the markets in which the assets and liabilities are traded, and the reliability of the assumptions used to determine fair value, based on the prioritization of inputs in the valuation techniques. These levels are:

*Level 1:* Valuation is based upon quoted prices for identical instruments traded in active markets.

*Level 2:* Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model based valuation techniques for which all significant assumptions are observable in the market.

*Level 3:* Valuation is generated from model based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability.

The asset s or liability s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs.

For a further discussion of fair value considerations, refer to Notes 19 to the consolidated financial statements.

***Significant Group Concentrations of Credit Risk:***

Most of the Corporation s activities conducted are with customers located within the central Michigan area. A significant amount of its outstanding loans are secured by commercial and residential real estate. Other than these types of loans, there is no significant concentration to any other industry or any one customer.

***Cash and Cash Equivalents:***

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, federal funds sold, and other deposit accounts. Generally, federal funds sold are for a one day

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

period. The Corporation maintains deposit accounts in various financial institutions which generally exceed federally insured limits or are not insured. Management does not believe the Company is exposed to any significant interest, credit or other financial risk as a result of these deposits.

***Certificates of Deposit Held in Other Financial Institutions:***

Certificates of deposits held in other financial institutions consist of interest bearing certificates of deposit that mature within 3 years and are carried at cost.

***Trading Securities:***

The Corporation engages in trading activities of its own accounts. Securities that are held principally for resale in the near term are recorded in the trading assets account at fair value with changes in fair value recorded in noninterest income. Interest income is included in net interest income.

***Available-For-Sale Investment Securities:***

All purchases of investment securities are generally classified as available-for-sale. However, classification of investment securities as either held to maturity or trading may be elected by management of the Corporation. Securities classified as available-for-sale are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, excluded from earnings and reported in other comprehensive income. Auction rate money market preferred securities and preferred stocks are considered equity securities for federal income tax purposes, as such, no estimated federal income tax impact is expected or recorded. Auction rate money market preferred securities and preferred stock are recorded at fair value, with unrealized gains and losses, considered not other-than-temporary, excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Realized gains and losses on the sale of available-for-sale investment securities are determined using the specific identification method.

Investment securities are reviewed quarterly for possible other-than-temporary impairment (OTTI). In determining whether an other-than-temporary impairment exists for debt securities, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Corporation must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security s amortized cost basis and its fair value, and such amount is included in noninterest income. For debt securities that do not meet the above criteria, and the Corporation does not expect to recover the security s amortized cost basis, the security is considered other-than-temporarily impaired. For these debt securities, the Corporation separates the total impairment into the credit risk loss component and the amount of the loss related to market and other risk factors. In order to determine the amount of the credit loss for a debt security, the Corporation calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total other-than-temporary impairment related to the credit risk is recognized in earnings and is included in noninterest income. The amount of the total other-than-temporary impairment related to other risk factors is recognized as a component of other comprehensive income. For debt securities that have recognized an other-than-temporary impairment through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Available-for-sale equity securities are reviewed for other-than-temporary impairment at each reporting date. This evaluation considers a number of factors including, but not limited to, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, and management s ability and intent to hold the securities until fair value recovers. If it is determined that management does not have the ability and intent to hold the securities until recovery or that there are conditions that indicate that a security may

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

not recover in value then the difference between the fair value and the cost of the security is recognized in earnings and is included in noninterest income. No such losses were recognized in 2010, 2009, or 2008.

***Loans:***

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal balance adjusted for any charge-offs, the allowance for loans losses, and any deferred fees or costs on originated loans. Interest income on loans is accrued over the term of the loan based on the principal amount outstanding. Loan origination fees and certain direct loan origination costs are capitalized and recognized as a component of interest income over the term of the loan using the constant yield method.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days or more past due unless the credit is well-secured and in the process of collection. Credit card loans and other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

For loans that are placed on non-accrual status or charged off, all interest accrued in the current calendar year, but not collected, is reversed against interest income while interest accrued in prior calendar years, but not collected is charged against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income continues to be accrued over the term of the loan based on the principal amount outstanding.

***Allowance for Loan Losses:***

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of the loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are deemed to be impaired. For such loans that are also analyzed for specific allowance allocations, an allowance is established when the discounted cash flows or collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non classified loans and is based on historical loss experience. An unallocated component is maintained to cover uncertainties that management believes affect its estimate of probable losses based on qualitative factors. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Loans may be classified as impaired if they meet one or more of the following criteria:

1. There has been a chargeoff of its principal balance;

2. The loan has been classified as a troubled debt restructuring; or

3. The loan is in nonaccrual status.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Impairment is measured on a loan by loan basis for commercial and commercial real estate loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral, less cost to sell, if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer loans for impairment allocations and related disclosures.

***Loans Held for Sale:***

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value as determined by aggregating outstanding commitments from investors or current investor yield requirements. Net unrealized losses, if any, are recognized through a valuation allowance of which the provision is accounted for in other noninterest expenses in the consolidated statements of income.

Mortgage loans held for sale are sold with the mortgage servicing rights retained by the Corporation. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated mortgage servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold.

***Transfers of Financial Assets:***

Transfers of financial assets, including sold mortgage loans and mortgage loans held for sale, as described above, and participation loans are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is determined to be surrendered when 1) the assets have been legally isolated from the Corporation, 2) the transferee obtains the right (free of conditions that constrain it from taking advantage of the right) to pledge or exchange the transferred assets and 3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 5, the Corporation has no substantive continuing involvement related to these loans. Servicing fee earned on such loans was $760, $724, and $627 for 2010, 2009, and 2008, respectively, and is included in other noninterest income.

***Servicing:***

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. The Corporation has no purchased servicing rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type, and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranche. If the Corporation later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the valuation allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Servicing fee income is recorded for fees earned for servicing loans for others. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned.

***Loans Acquired Through Transfer:***

Authoritative accounting guidance related to acquired loans requires that a valuation allowance for loans acquired in a transfer, including in a business combination, reflect only losses incurred after acquisition, and should not be recorded at acquisition. This standard applies to any loan acquired in a transfer that shows evidence of credit quality deterioration since it was originated.

***Foreclosed Assets:***

Assets acquired through, or in lieu, of loan foreclosure are held for sale and are initially recorded at the lower of the Corporation s carrying amount or fair value less estimated selling costs at the date of transfer, establishing a new cost basis. Any write downs based on the asset s fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, property held for sale is carried at the lower of the new cost basis or fair value less costs to sell. Impairment losses on property to be held and used are measured at the amount by which the carrying amount of property exceeds its fair value. Costs relating to holding these assets are expensed as incurred. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of the Corporation s carrying amount or fair value less costs to sell. Foreclosed assets of $2,067 and $1,157 are included in Other Assets on the accompanying consolidated balance sheets.

***Premises and Equipment:***

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management annually reviews these assets to determine whether carrying values have been impaired.

***Fdic Insurance Premium:***

In 2009, the Corporation was required to prepay quarterly FDIC risk-based assessments for the fourth quarter of 2009 and each of the quarters in the years ending December 31, 2010, 2011 and 2012. The assessments for 2010 through 2012, which had a carrying balance of $3,586 and $4,737 as of December 31, 2010 and 2009, respectively, have been recorded as a prepaid asset in the accompanying consolidated balance sheets in Other Assets, and will be expensed on a ratable basis quarterly through December 31, 2012.

***Equity Securities Without Readily Determinable Fair Values:***

Included in equity securities without readily determinable fair values are restricted securities, which are carried at cost, and investments in nonconsolidated entities accounted for under the equity method of accounting.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Equity securities without readily determinable fair values consist of the following as of December 31:

| | 2010 | 2009 |
|---|---|---|
| Federal Home Loan Bank Stock | $ 7,596 | $ 7,960 |
| Investment in Corporate Settlement Solutions | 6,793 | 6,782 |
| Federal Reserve Bank Stock | 1,879 | 1,879 |
| Investment in Valley Financial Corporation | 1,000 | 1,000 |
| Other | 296 | 300 |
| Total | $ 17,564 | $ 17,921 |

***Stock Compensation Plans:***

At December 31, 2010, the Isabella Bank Corporation and Related Companies Deferred Compensation Plan for Directors (the Directors Plan ) had 224,663 shares to be issued to participants, for which an associated grantor trust (Rabbi Trust) held 32,686 shares. The Corporation had 216,905 shares to be issued in 2009, with 30,626 shares held in the Rabbi Trust. Compensation costs relating to share based payment transactions are recognized in the consolidated financial statements and the cost is measured based on the fair value of the equity or liability instruments issued. The Corporation has no other share based compensation plans.

***Corporate Owned Life Insurance:***

The Corporation has purchased life insurance policies on key members of management. In the event of death of one of these individuals, the Corporation would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be realized on the balance sheet dates. Increases in cash surrender value in excess of single premiums paid are reported as Other Noninterest Income.

ASC Topic 715 was amended to require that the Corporation recognize a liability for any post retirement benefits provided by the Corporation, beginning January 1, 2008. As a result of the adoption of the new authoritative guidance, the Corporation recognized a liability of $1,571 as of January 1, 2008. As of December 31, 2010 and 2009, the present value of the post retirement benefits promised by the Corporation to the covered employees was estimated to be $2,573 and $2,505, respectively, and is included in Accrued Interest and Other Liabilities on the consolidated balance sheets. The periodic policy maintenance costs were $68 and $45 for 2010 and 2009, respectively.

***Acquisition Intangibles and Goodwill:***

The Corporation previously acquired branch facilities and related deposits in business combinations accounted for as a purchase. The acquisitions included amounts related to the valuation of customer deposit relationships (core deposit intangibles). Core deposit intangibles arising from acquisitions are included in Other Assets and are being amortized over their estimated lives. Goodwill, which is included in Other Assets, represents the excess of purchase price over identifiable assets, is not amortized but is evaluated for impairment at least annually, or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of the reporting unit below the carrying value.

***Off Balance Sheet Credit Related Financial Instruments:***

In the ordinary course of business, the Corporation has entered into commitments to extend credit, including commitments under credit card arrangements, home equity lines of credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded only when funded.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Federal Income Taxes:***

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax assets or liability is determined based on the tax effects of the temporary differences between the book and tax bases on the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Valuations allowances are established, where necessary, to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

The Corporation analyzes its filing positions in the jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Corporation has also elected to retain its existing accounting policy with respect to the treatment of interest and penalties attributable to income taxes, and continues to reflect any charges for such, to the extent they arise, as a component of its noninterest expenses

***Marketing Costs:***

Marketing costs are expensed as incurred (see Note 10).

***Computation of Earnings Per Share:***

Basic earnings per share represents income available to common stockholders divided by the weighted average number of common shares issued during the period. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Corporation relate solely to outstanding shares in the Corporation s Directors Plan (see Note 16).

Earnings per common share have been computed based on the following:

| | **2010** | **2009** | **2008** |
|---|---|---|---|
| Average number of common shares outstanding for basic calculation | 7,541,676 | 7,517,276 | 7,492,677 |
| Average potential effect of shares in the Deferred Director fee plan(1) | 187,744 | 181,319 | 184,473 |
| Average number of common shares outstanding used to calculate diluted earnings per common share | 7,729,420 | 7,698,595 | 7,677,150 |
| Net income | $ 9,045 | $ 7,800 | $ 4,101 |
| **Earnings per share** | | | |
| **Basic** | **$ 1.20** | **$ 1.04** | **$ 0.55** |
| **Diluted** | **$ 1.17** | **$ 1.01** | **$ 0.53** |

(1) Exclusive of shares held in the Rabbi Trust

***Reclassifications:***

Certain amounts reported in the 2009 and 2008 consolidated financial statements have been reclassified to conform with the 2010 presentation.

***Recent Accounting Pronouncements:***

FASB ASC Topic 310, Receivables. In April 2010, ASC Topic 310 was amended by Accounting Standards Update (ASU) No. 2010-18, *Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset (a consensus of the FASB Emerging Issues Task* ), to clarify that individual loans accounted for

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

within pools are not to be removed from the pool solely as a result of modifications to the loan (including troubled debt restructurings). The new guidance was effective for interim and annual periods ending on or after July 15, 2010 and did not have a significant impact on the Corporation s consolidated financial statements.

In July 2010, ASC Topic 310 was amended by ASU No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* to provide financial statement users greater transparency about the Corporation s allowance for loan losses and the credit quality of its financing receivables. Existing disclosures are amended that required the Corporation to provide the following disclosure about its loan portfolio on a disaggregated basis: (1) a rollforward schedule of the allowance for loan losses from the beginning of the reporting period to the end of a reporting period on a portfolio segment basis, with the ending balance further disaggregated on the basis of the impairment method, (2) for each disaggregated ending balance in item (1), the related recorded investment in loans, (3) the nonaccrual status of loans by class of loans, and (4) impaired loans by class of loans.

The amendments in this update required the Corporation to provide the following additional disclosures about its loans: (1) credit quality indicators of financing receivables at the end of the reporting period by class of loans, (2) the aging of past due loans at the end of the reporting period by class of loans, (3) the nature and extent of troubled debt restructurings that occurred during the period by class of loans and their effect on the allowance for loan losses, (4) the nature and extent of financing receivables modified within the previous 12 months that defaulted during the period by class of financing receivables and their effect on the allowance for loan losses and (5) significant purchases and sales of loans during the period disaggregated by portfolio segment. The new disclosures as of the end of a reporting period were effective for interim and annual reporting periods ending on or after December 15, 2010, with the exception of the new disclosures related to troubled debt restructurings which are not required to be reported until the second quarter of 2011. The new disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The new guidance has significantly expanded the Corporation s consolidated financial statement disclosures. (See Note 4)

FASB ASC Topic 350, Intangibles Goodwill and Other. In December 2010, ASC Topic 350 was amended by ASU No. 2010-28, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts (a consensus of the FASB Emerging Issues Task Force)* , to address questions related to the testing for goodwill impairments for entities with goodwill with zero or negative carrying amounts. The new guidance is effective for interim and annual periods beginning after December 15, 2010 and is not anticipated to have any impact on the Corporation s consolidated financial statements.

FASB ASC Topic 715, Compensation Retirement Benefits. In January 2010, ASC Topic 715 was amended by ASU No. 2010-06, *Improving Disclosures about Fair Value Measurements* , to change the terminology for major categories of assets to classes of assets to correspond with the amendments to ASC Topic 820 (see below). The new guidance was effective for interim and annual periods ending on or after January 1, 2010 and had no impact on the Corporation s consolidated financial statements.

FASB ASC Topic 805, Business Combinations. In December 2010, ASC Topic 805 was amended by ASU No. 2010-29, *Disclosure of Supplementary Pro Forma Information for Business Combinations (a consensus of the FASB Emerging Issues Task Force* , to address diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The new guidance is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2010 and is not anticipated to impact the Corporation s consolidated financial statements.

FASB ASC Topic 810, Consolidation. New authoritative accounting guidance under ASC Topic 810 amends prior guidance to change how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other factors, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. The new authoritative accounting guidance requires additional disclosures about the reporting entity s involvement with

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

variable interest entities and any significant changes in risk exposure due to that involvement as well as its affect on the entity s financial statements. The new authoritative accounting guidance under ASC Topic 810 was effective January 1, 2010 and had no impact on the Corporation s consolidated financial statements.

FASB ASC Topic 820, Fair Value Measurements and Disclosures. In January 2010, ASC Topic 820 was amended by ASU No. 2010-06, to add new disclosures for: (1) significant transfers in and out of Level 1 and Level 2 fair value measurements and the reasons for the transfers and (2) presenting separately information about purchases, sales, issuances and settlements for Level 3 fair value instruments (as opposed to reporting activity as net).

ASU No. 2010-06 also clarifies existing disclosures by requiring reporting entities to provide fair value measurement disclosures for each class of assets and liabilities and to provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

The new authoritative guidance was effective for interim and annual reporting periods beginning January 1, 2010 except for the disclosures about purchases, sales, issuances and settlements in the rollforward of activity in Level 3 fair value measurements, which will be effective January 1, 2011. The new guidance did not, and is not anticipated to, have a significant impact on the Corporation s consolidated financial statements.

FASB ASC Topic 860, Transfers and Servicing. New authoritative accounting guidance under ASC Topic 860 amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a qualifying special purpose entity and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. The new authoritative accounting guidance under ASC Topic 860 was effective January 1, 2010 and had no significant impact on the Corporation s consolidated financial statements.

**NOTE 2 Trading Securities**

Trading securities, at fair value, consist of the following investments at December 31:

| | **2010** | **2009** |
|---|---|---|
| States and political subdivisions | $ 5,837 | $ 9,962 |
| Mortgage-backed | | 3,601 |
| **Total** | $ 5,837 | $ 13,563 |

Included in the net trading losses of $94 during 2010, were $74 of net trading losses on securities that relate to the Corporation s trading portfolio as of December 31, 2010. Included in net trading gains of $80 during 2009, were $38 of net trading gains on securities that relate to the Corporation s trading portfolio as of December 31, 2009.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 3 Available-for-Sale Investment Securities**

The amortized cost and fair value of available-for-sale investment securities, with gross unrealized gains and losses, are as follows as of December 31:

| | 2010 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Government sponsored enterprises | $ 5,394 | $ 10 | $ | $ 5,404 |
| States and political subdivisions | 167,328 | 3,349 | 960 | 169,717 |
| Auction rate money market preferred | 3,200 | | 335 | 2,865 |
| Preferred stocks | 7,800 | | 864 | 6,936 |
| Mortgage-backed | 101,096 | 1,633 | 514 | 102,215 |
| Collateralized mortgage obligations | 44,617 | 103 | 1,133 | 43,587 |
| **Total** | **$ 329,435** | **$ 5,095** | **$ 3,806** | **$ 330,724** |

| | 2009 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Government sponsored enterprises | $ 19,386 | $ 127 | $ 42 | $ 19,471 |
| States and political subdivisions | 150,688 | 3,632 | 2,590 | 151,730 |
| Auction rate money market preferred | 3,200 | | 227 | 2,973 |
| Preferred stocks | 7,800 | | 746 | 7,054 |
| Mortgage-backed | 67,215 | 638 | 119 | 67,734 |
| Collateralized mortgage obligations | 10,296 | | 192 | 10,104 |
| **Total** | **$ 258,585** | **$ 4,397** | **$ 3,916** | **$ 259,066** |

The Corporation had pledged available-for-sale and trading securities in the following amounts as of December 31:

| | 2010 | 2009 |
|---|---|---|
| Pledged to secure borrowed funds | $ 86,788 | $ 41,612 |
| Pledged to secure repurchase agreements | 86,381 | 74,605 |
| Pledged for public deposits and for other purposes necessary or required by law | 14,626 | 20,054 |
| **Total** | **$ 187,795** | **$ 136,271** |

While borrowed funds increased $1,816 since December 31, 2009, the Corporation increased the level of securities pledged to secure other borrowed funds and repurchase agreements by $51,524 in the same period. The additional pledging has enhanced the Corporation s liquidity position as it allows for an increased availability of borrowed funds.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The amortized cost and fair value of available-for-sale securities by contractual maturity at December 31, 2010 are as follows:

| | Maturing | | | | Securities | |
|---|---|---|---|---|---|---|
| | Due in One Year or Less | After One Year But Within Five Years | After Five Years But Within Ten Years | After Ten Years | With Variable Monthly Payments | Total |
| Government sponsored enterprises | $ | $ 5,000 | $ 394 | $ | $ | $ 5,394 |
| States and political subdivisions | 14,061 | 33,702 | 85,757 | 33,808 | | 167,328 |
| Auction rate money market preferred | | | | | 3,200 | 3,200 |
| Preferred stocks | | | | | 7,800 | 7,800 |
| Mortgage-backed | | | | | 101,096 | 101,096 |
| Collateralized mortgage obligations | | | | | 44,617 | 44,617 |
| **Total amortized cost** | **$ 14,061** | **$ 38,702** | **$ 86,151** | **$ 33,808** | **$ 156,713** | **$ 329,435** |
| **Fair value** | **$ 14,132** | **$ 39,844** | **$ 87,660** | **$ 43,286** | **$ 145,802** | **$ 330,724** |

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, auction rate money market preferreds, preferred stocks, mortgage-backed securities and collateralized mortgage obligations are not reported by a specific maturity group.

A summary of the activity related to the sale of available-for-sale debt securities is as follows during the years ended December 31:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Proceeds from sales of securities | $ 18,303 | $ 32,204 | $ 6,096 |
| Gross realized gains | $ 351 | $ 648 | $ 24 |
| Gross realized losses | (3) | | |
| Net realized gains | $ 348 | $ 648 | $ 24 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Applicable income tax expense | $ | 118 | $ | 220 | $ | 8 |

The cost basis used to determine the realized gains or losses of securities sold was the amortized cost of the individual investment security as of the trade date.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Information pertaining to available-for-sale securities with gross unrealized losses at December 31 aggregated by investment category and length of time that individual securities have been in continuous loss position, follows:

| | December 31, 2010 | | | | |
|---|---|---|---|---|---|
| | Less Than Twelve Months | | Over Twelve Months | | |
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Total Unrealized Losses |
| States and political subdivisions | $ 960 | $ 29,409 | $ | $ | $ 960 |
| Auction rate money market preferred | | | 335 | 2,865 | 335 |
| Preferred stock | | | 864 | 2,936 | 864 |
| Mortgage-backed | 514 | 38,734 | | | 514 |
| Collateralized mortgage obligations | 1,133 | 33,880 | | | 1,133 |
| **Total** | **$ 2,607** | **$ 102,023** | **$ 1,199** | **$ 5,801** | **$ 3,806** |
| **Number of securities in an unrealized loss position:** | | **82** | | **4** | **86** |

| | December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Less Than Twelve Months | | Over Twelve Months | | |
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Total Unrealized Losses |
| Government sponsored enterprises | $ 42 | $ 7,960 | $ | $ | $ 42 |
| States and political subdivisions | 2,536 | 11,459 | 54 | 2,267 | 2,590 |
| Auction rate money market preferred | | | 227 | 2,973 | 227 |
| Preferred stocks | | | 746 | 3,054 | 746 |
| Mortgage-backed | 119 | 25,395 | | | 119 |
| Collateralized mortgage obligations | 192 | 10,104 | | | 192 |
| **Total** | **$ 2,889** | **$ 54,918** | **$ 1,027** | **$ 8,294** | **$ 3,916** |
| **Number of securities in an unrealized loss position:** | | **39** | | **8** | **47** |

The Corporation invested $11,000 in auction rate money market preferred investment security instruments, which are classified as available-for-sale securities and reflected at estimated fair value. Due to credit market uncertainty, the trading for these securities has been limited. As a result of the limited trading of these securities, $7,800 converted to preferred stock with debt like characteristics in 2009.

Due to the limited trading activity of these securities, the fair values were estimated utilizing a discounted cash flow analysis as of December 31, 2010 and December 31, 2009. These analyses considered creditworthiness of the counterparty, the timing of expected future cash flows, and the current volume of trading activity. As of December 31, 2010, the Corporation held an auction rate money market preferred security and preferred stock which declined in fair value as a result of the securities interest rates, they are currently lower than the offering rates of securities with similar characteristics. Despite the limited trading of these securities, management has determined that any declines in the fair value of these securities are the result of changes in interest rates and not risks related to the underlying credit quality of the security. Additionally, none of these securities are deemed to be below investment grade, and management does not intend to sell the securities in an unrealized loss position, and it is more