

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

FORM 10-Q

/ X / Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2009

OR

/ / Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 000-31207

BANK MUTUAL CORPORATION

(Exact name of registrant as specified in its charter)

Wisconsin

(State or other jurisdiction of
incorporation or organization)

39-2004336

(IRS Employer Identification No.)

**4949 West Brown Deer Road
Milwaukee, Wisconsin 53223
(414) 354-1500**

(Address, including Zip Code, and telephone number,
including area code, of registrant's principal executive offices)

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

Yes No

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

Yes No

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

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

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

Yes No

The number of shares outstanding of the issuer's common stock, \$0.01 par value per share, was 46,577,454 shares, at August 10, 2009.

BANK MUTUAL CORPORATION
FORM 10-Q QUARTERLY REPORT

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PART I

Item 1. Financial Statements

Bank Mutual Corporation and Subsidiaries Unaudited Condensed Consolidated Statements of Financial Condition

| | June 30 2009 | December 31 2008 |
|---|-------------------------------|---------------------|
| Assets | <i>(Dollars in thousands)</i> | |
| Cash and due from banks | \$23,092 | \$41,017 |
| Interest-earning deposits | 126,489 | 71,876 |
| Cash and cash equivalents | 149,581 | 112,893 |
| Securities available-for-sale, at fair value: | | |
| Investment securities | 379,028 | 419,138 |
| Mortgage-related securities | 987,016 | 850,867 |
| Loans held-for-sale | 32,080 | 19,030 |
| Loans receivable, net | 1,625,250 | 1,829,053 |
| Goodwill | 52,570 | 52,570 |
| Other intangible assets | 1,607 | 1,809 |
| Mortgage servicing rights, net | 6,361 | 3,703 |
| Other assets | 213,919 | 200,626 |
| Total assets | \$3,447,412 | \$3,489,689 |
| Liabilities and shareholders' equity | | |
| Liabilities: | | |
| Deposit liabilities | \$2,070,708 | \$2,128,277 |
| Borrowings | 907,480 | 907,971 |
| Advance payments by borrowers for taxes and insurance | 21,345 | 1,929 |
| Other liabilities | 45,129 | 48,977 |
| Total liabilities | 3,044,662 | 3,087,154 |
| Shareholders' equity: | | |
| Preferred stock – \$.01 par value: | | |
| Authorized – 20,000,000 shares in 2009 and 2008 | | |
| Issued and outstanding – none in 2009 and 2008 | – | – |
| Common stock – \$.01 par value: | | |
| Authorized – 200,000,000 shares in 2009 and 2008 | | |
| Issued – 78,783,849 shares in 2009 and 2008 | | |
| Outstanding – 46,567,471 shares in 2009 and 47,686,759 in 2008 | 788 | 788 |
| Additional paid-in capital | 499,586 | 498,501 |
| Retained earnings | 276,352 | 273,826 |
| Unearned ESOP shares | (797) | (1,247) |
| Accumulated other comprehensive loss | (10,777) | (16,404) |
| Treasury stock – 32,216,378 shares in 2009 and 31,097,090 in 2008 | (365,326) | (355,853) |
| Total shareholders' equity | 399,826 | 399,611 |
| Non-controlling interest in real estate partnership | 2,924 | 2,924 |
| Total shareholders' equity including non-controlling interest | 402,750 | 402,535 |
| Total liabilities and shareholders' equity | \$3,447,412 | \$3,489,689 |

Refer to Notes to Unaudited Condensed Consolidated Financial Statements

Bank Mutual Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Income

| | Three Months Ended June 30 | |
|--|--|----------|
| | 2009 | 2008 |
| | <i>(Dollars in thousands, except per share data)</i> | |
| Interest income: | | |
| Loans | \$24,541 | \$28,356 |
| Investment securities | 4,551 | 3,621 |
| Mortgage-related securities | 10,052 | 11,393 |
| Interest-earning deposits | 22 | 706 |
| Total interest income | 39,166 | 44,076 |
| Interest expense: | | |
| Deposit liabilities | 11,520 | 16,149 |
| Borrowings | 9,778 | 9,827 |
| Advance payments by borrowers for taxes and insurance | 3 | 4 |
| Total interest expense | 21,301 | 25,980 |
| Net interest income | 17,865 | 18,096 |
| Provision for loan losses | 472 | 67 |
| Net interest income after provision for loan losses | 17,393 | 18,029 |
| Non-interest income: | | |
| Service charges on deposits | 1,610 | 1,657 |
| Brokerage and insurance commissions | 856 | 852 |
| Loan related fees and servicing revenue, net | 16 | 333 |
| Gain (loss) on investments, net | 610 | (1,119) |
| Gain on loan sales activities, net | 2,930 | 540 |
| Other non-interest income | 1,530 | 1,794 |
| Total non-interest income | 7,552 | 4,057 |
| Non-interest expenses: | | |
| Compensation, payroll taxes, and other employee benefits | 10,398 | 9,559 |
| Occupancy and equipment | 2,898 | 2,917 |
| FDIC insurance premiums and special assessment | 2,364 | 61 |
| Amortization of other intangible assets | 101 | 166 |
| Other non-interest expense | 2,815 | 3,023 |
| Total non-interest expenses | 18,576 | 15,726 |
| Income before income tax expense | 6,369 | 6,360 |
| Income tax expense | 2,553 | 2,081 |
| Net income before non-controlling interest | 3,816 | 4,279 |
| Net (income) loss attributable to non-controlling interest | 1 | - |
| Net income | \$3,817 | \$4,279 |
| Per share data: | | |
| Earnings per share – basic | \$0.08 | \$0.09 |
| Earnings per share – diluted | \$0.08 | \$0.09 |
| Cash dividends per share paid | \$0.09 | \$0.09 |

Refer to Notes to Unaudited Condensed Consolidated Financial Statements

Bank Mutual Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Income

| | Six Months Ended June 30 | |
|--|--|----------|
| | 2009 | 2008 |
| | <i>(Dollars in thousands, except per share data)</i> | |
| Interest income: | | |
| Loans | \$50,771 | \$58,467 |
| Investment securities | 9,758 | 5,651 |
| Mortgage-related securities | 20,550 | 24,043 |
| Interest-earning deposits | 73 | 1,182 |
| Total interest income | 81,152 | 89,343 |
| Interest expense: | | |
| Deposit liabilities | 24,634 | 34,548 |
| Borrowings | 19,456 | 19,665 |
| Advance payments by borrowers for taxes and insurance | 4 | 6 |
| Total interest expense | 44,094 | 54,219 |
| Net interest income | 37,058 | 35,124 |
| Provision for loan losses | 3,633 | 223 |
| Net interest income after provision for loan losses | 33,425 | 34,901 |
| Non-interest income: | | |
| Service charges on deposits | 3,056 | 3,175 |
| Brokerage and insurance commissions | 1,518 | 1,507 |
| Loan related fees and servicing revenue, net | (316) | 269 |
| Gain on investments, net | 2,672 | 351 |
| Gain on loan sales activities, net | 6,762 | 1,350 |
| Other non-interest income | 3,145 | 3,697 |
| Total non-interest income | 16,837 | 10,349 |
| Non-interest expenses: | | |
| Compensation, payroll taxes, and other employee benefits | 20,364 | 18,877 |
| Occupancy and equipment | 6,082 | 5,854 |
| FDIC insurance premiums and special assessment | 2,726 | 123 |
| Amortization of other intangible assets | 202 | 331 |
| Other non-interest expense | 5,661 | 6,142 |
| Total non-interest expenses | 35,035 | 31,327 |
| Income before income tax expense | 15,227 | 13,923 |
| Income tax expense | 4,222 | 4,582 |
| Net income before non-controlling interest | 11,005 | 9,341 |
| Net (income) loss attributable to non-controlling interest | - | - |
| Net income | \$11,005 | \$9,341 |
| Per share data: | | |
| Earnings per share – basic | \$0.24 | \$0.20 |
| Earnings per share – diluted | \$0.23 | \$0.19 |
| Cash dividends per share paid | \$0.18 | \$0.18 |

Refer to Notes to Unaudited Condensed Consolidated Financial Statements

Bank Mutual Corporations and Subsidiaries
Unaudited Condensed Consolidated Statements of Shareholders' Equity

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Unearned ESOP Shares | Accumulated Other Comprehensive Income (Loss) | Treasury Stock | Non-Controlling Interest in Real Estate Partnership | Total |
|---|--|----------------------------------|----------------------|----------------------------|--|-------------------|--|-----------|
| | <i>(Dollars in thousands, except per share data)</i> | | | | | | | |
| Balance at January 1, 2009 | \$788 | \$498,501 | \$273,826 | \$(1,247) | \$(16,404) | \$(355,853) | \$2,924 | \$402,535 |
| Comprehensive income: | | | | | | | | |
| Net income | - | - | 11,005 | - | - | - | - | 11,005 |
| Net income attributable to non-controlling interest | - | - | - | - | - | - | - | - |
| Other comprehensive income: | | | | | | | | |
| Change in net unrealized gain on securities available-for-sale, net of deferred income taxes of \$3,195 | - | - | - | - | 7,228 | - | - | 7,228 |
| Reclassification adjustment for gain on securities included in income, net of income taxes of \$(1,071) | - | - | - | - | (1,601) | - | - | (1,601) |
| Total comprehensive income | - | - | - | - | - | - | - | 16,632 |
| Purchase of treasury stock | - | - | - | - | - | (10,564) | - | (10,564) |
| Committed ESOP shares | - | 1,075 | - | 450 | - | - | - | 1,525 |
| Exercise of stock options | - | (805) | - | - | - | 1,091 | - | 286 |
| Share based payments | - | 815 | - | - | - | - | - | 815 |
| Cash dividends (\$0.18 per share) | - | - | (8,479) | - | - | - | - | (8,479) |
| Balance at June 30, 2009 | \$788 | \$499,586 | \$276,352 | \$(797) | \$(10,777) | \$(365,326) | \$2,924 | \$402,750 |
| Balance at January 1, 2008 | \$788 | \$498,408 | \$273,330 | \$(2,166) | \$(6,069) | \$(334,256) | \$2,910 | \$432,945 |
| Comprehensive income: | | | | | | | | |
| Net income | - | - | 9,341 | - | - | - | - | 9,341 |
| Net loss attributable to non-controlling interest | - | - | - | - | - | - | - | - |
| Other comprehensive income: | | | | | | | | |
| Change in net unrealized gain on securities available-for-sale, net of deferred income taxes of \$(555) | - | - | - | - | (829) | - | - | (829) |
| Reclassification adjustment for gain on securities included in income, net of income taxes of \$(141) | - | - | - | - | (210) | - | - | (210) |
| Total comprehensive income | - | - | - | - | - | - | - | 8,302 |
| Capital contribution to real estate partnership | - | - | - | - | - | - | 14 | 14 |
| Purchase of treasury stock | - | - | - | - | - | (22,611) | - | (22,611) |
| Issuance of management recognition plan shares | - | (157) | - | - | - | 157 | - | - |
| Committed ESOP shares | - | 1,346 | - | 450 | - | - | - | 1,796 |
| Exercise of stock options | - | (3,394) | - | - | - | 5,732 | - | 2,338 |
| Share based payments | - | 1,166 | - | - | - | (252) | - | 914 |
| Cash dividends (\$0.18 per share) | - | - | (8,752) | - | - | - | - | (8,752) |
| Balance at June 30, 2008 | \$788 | \$497,369 | \$273,919 | \$(1,716) | \$(7,108) | \$(351,230) | \$2,924 | \$414,946 |

Refer to Notes to Unaudited Condensed Consolidated Financial Statements

Bank Mutual Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows

| | Six Months Ended June 30 | |
|---|-------------------------------|---------------|
| | 2009 | 2008 |
| | <i>(Dollars in thousands)</i> | |
| Operating activities: | | |
| Net income | \$11,005 | \$9,341 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Net provision for loan losses | 3,633 | 223 |
| Provision for depreciation | 1,244 | 1,247 |
| Amortization of intangibles | 202 | 331 |
| Amortization of mortgage servicing rights | 1,947 | 907 |
| Decrease in valuation allowance on MSR's | (453) | - |
| Stock-based compensation expense | 2,340 | 2,696 |
| Net amortization on securities | 245 | (832) |
| Loans originated for sale | (428,135) | (96,408) |
| Proceeds from loan sales | 417,695 | 98,703 |
| Gain on loan sales activities | (6,762) | (1,350) |
| Gain on sale of available-for-sale securities | (3,503) | (2,488) |
| Other-than-temporary impairment of available-for-sale securities | 831 | 2,137 |
| Accrued FDIC special assessment | 1,550 | - |
| Increase (decrease) in other liabilities | (7,522) | 13,689 |
| Increase in other assets | (10,280) | (3,308) |
| Decrease (increase) in accrued interest receivable | 1,696 | (1,733) |
| Net cash (used in) provided by operating activities | <u>(14,267)</u> | <u>23,155</u> |
| Investing activities: | | |
| Proceeds from maturities of investment securities | 156,177 | - |
| Purchases of investment securities | (125,389) | (251,173) |
| Purchases of mortgage-related securities | (457,340) | (117,967) |
| Principal repayments on mortgage-related securities | 162,733 | 110,756 |
| Proceeds from sale of investment securities | 177,958 | 210,846 |
| Net decrease in loans receivable | 192,869 | 146,978 |
| Proceeds from sale of foreclosed properties | 2,167 | 868 |
| Net purchases of premises and equipment | (819) | (1,697) |
| Net cash provided by investing activities | <u>108,356</u> | <u>98,611</u> |

Bank Mutual Corporation and Subsidiaries
Unaudited Condensed Consolidated Statements of Cash Flows (Continued)

| | Six Months Ended June 30 | |
|---|-------------------------------|-----------|
| | 2009 | 2008 |
| | <i>(Dollars in thousands)</i> | |
| Financing activities: | | |
| Net (decrease) increase in deposit liabilities | \$(57,569) | \$52,241 |
| Repayments of long-term borrowings | (491) | (1,503) |
| Net increase in advance payments by borrowers for taxes and insurance | 19,416 | 18,307 |
| Proceeds from exercise of stock options | 249 | 2,110 |
| Excess tax benefit from exercise of stock options | 37 | 228 |
| Cash dividends | (8,479) | (8,752) |
| Capital contribution to real estate partnership | - | 14 |
| Purchase of treasury stock | (10,564) | (22,611) |
| Net cash provided by (used in) financing activities | (57,401) | 40,034 |
| Increase in cash and cash equivalents | 36,688 | 161,800 |
| Cash and cash equivalents at beginning of period | 112,893 | 38,949 |
| Cash and cash equivalents at end of period | \$149,581 | \$200,749 |
| Supplemental information: | | |
| Interest paid on deposit liabilities and borrowings | \$44,179 | \$65,405 |
| Income taxes paid | 8,572 | 5,919 |
| Loans transferred to foreclosed properties and repossessed assets | 7,301 | 1,506 |

Refer to Notes to Unaudited Condensed Consolidated Financial Statements

Bank Mutual Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2009

(Dollars in Thousands, Except Per Share Amounts)

1. Basis of Presentation

The Unaudited Condensed Consolidated Financial Statements include the accounts of Bank Mutual Corporation (the “Company”), its wholly-owned subsidiary Bank Mutual (the “Bank”), and the Bank’s subsidiaries.

The accompanying Unaudited Condensed Consolidated Financial Statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) for interim financial information, Rule 10-01 of Regulation S-X, and the instructions to Form 10-Q. The financial statements do not include all of the information and footnotes required by GAAP for complete financial information. However, in the opinion of management, all adjustments (consisting of normal recurring entries) necessary for a fair presentation of operations, cash flows, and financial position have been included in the accompanying financial statements. This report should be read in conjunction with the Company’s 2008 Annual Report on Form 10-K. Operating results for the three and six months ended June 30, 2009, are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

In 2007 the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (“SFAS 159”), which allows eligible assets and liabilities to be measured at fair value without having to apply complex hedge accounting provisions. SFAS 159 was effective for the Company as of January 1, 2008. As of that date, the Company elected not to apply SFAS 159 to any of its financial assets or financial liabilities. Effective January 1, 2009, the Company elected to measure at fair value the fixed-rate, 15- and 30-year, one- to four-family mortgage loans originated after that date that the Company intends to sell in the secondary market (i.e., loans held-for-sale). The Company believes this change more appropriately matches the accounting treatment of loans held-for-sale with the accounting treatment of the financial instruments the Company uses to hedge its exposure to market risk in such loans. Prior to 2009, loans held-for-sale were carried at the “lower of cost or market.” Additional disclosures related to this accounting change are provided in Note 3, “Fair Value of Financial Instruments,” below.

In 2007 FASB issued SFAS 160, “Non-Controlling Interests in Consolidated Financial Statements—An Amendment of ARB No. 51.” SFAS 160 established new accounting and reporting standards for non-controlling interests in subsidiaries and for the deconsolidation of certain subsidiaries. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The Company applied the provisions of SFAS 160 effective January 1, 2009. SFAS 160 did not have a material impact on the Company’s financial condition, results of operations, or liquidity, although it affects how these matters are presented in the financial statements.

In April 2009, FASB issued three FASB Staff Positions (“FSPs”): FSP FAS 115-2, “Recognition and Presentation of Other-Than-Temporary Impairments;” FSP FAS 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly;” and FSP FAS 107-1, “Interim Disclosures about Fair Value of Financial Instruments.” All of these FSPs are effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ended after March 15, 2009. The Company adopted all three of these FSPs during the second quarter of 2009. These FSPs did not have a material impact on the Company’s financial condition, results of operations, or liquidity, although it affects how certain matters are presented in the financial statements. Most notably, the Company has expanded its

Bank Mutual Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2009

(Dollars in Thousands, Except Per Share Amounts)

1. Basis of Presentation (continued)

quarterly disclosures related to the fair value of financial instruments in Note 3, "Fair Value of Financial Instruments," as required by FSP FAS 107-1.

As of June 30, 2009, the Company adopted FASB SFAS No. 165, "Subsequent Events" ("SFAS 165"). SFAS 165 established general standards and requirements for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date; that is, whether that date represents the date the financial statements were issued or were available to be issued. The Company evaluated subsequent events through the financial statement issuance date of August 10, 2009.

In June 2009 FASB issued SFAS 166, "Accounting for Transfers of Financial Assets—An amendment of FASB Statement No. 140." The provisions of SFAS 166 must be applied as of the beginning of the first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. The provisions of SFAS 166 must be applied to transfers occurring on or after the effective date. Earlier application is prohibited. Management does not expect the adoption of SFAS 166 will have a material impact on the Company's financial condition, results of operations, or liquidity.

In June 2009 FASB issued SFAS 167, "Amendments to FASB Interpretation No. 46(R)." SFAS 167 is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. Management does not expect the adoption of SFAS 167 will have a material impact on the Company's financial condition, results of operations, or liquidity.

The Company describes all of its critical and/or significant accounting policies, judgments, and estimates in Part II, Item 7, of its 2008 Annual Report on Form 10-K, as well as Note 1 of the Company's Audited Consolidated Financial Statements contained in the same Form 10-K.

Particular attention should be paid to the Company's allowance for losses on loans, which requires significant management judgments and/or estimates because of the inherent uncertainties surrounding this area and/or the subjective nature of the area. Information regarding the impact loss allowances have had on the Company's financial condition and results of operations for the three and six month periods ended June 30, 2009 and 2008, can be found in Part I, Item 2, of this Form 10-Q, under the headings entitled "Results of Operations—Provision for Loan Losses" and "Financial Condition—Asset Quality." In addition, refer to Note 5, "Loans Receivable," below.

Significant judgments and/or estimates are also made in accounting for the Company's mortgage servicing rights ("MSRs"), goodwill, and other-than-temporary impairment ("OTTI") of its securities available-for-sale. In the judgment of management there has been no change in the status of the Company's goodwill during the six month period ended June 30, 2009. Information regarding the impact MSRs and OTTI have had on the Company's financial condition and results of operations for the six month periods ended June 30, 2009 and 2008, can be found in Note 6, "Other Intangible Assets and Mortgage Servicing Rights," and Note 2, "Securities Available-for-Sale," below.

Bank Mutual Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2009

(Dollars in Thousands, Except Per Share Amounts)

1. Basis of Presentation (continued)

Management also makes judgments and estimates related to its assessment of the Company's tax assets and liabilities. Information relating to the impact tax assets and liabilities have had on the Company's financial condition and results of operations for the six month periods ended June 30, 2009 and 2008, can be found in Part I, Item 2, of this Form 10-Q, under the heading entitled "Results of Operations—Income Taxes."

2. Securities Available-for-Sale

The amortized cost and fair value of investment securities available-for-sale are as follows:

| | June 30, 2009 | | | Estimated Fair Value |
|--|-------------------|------------------------------|-------------------------------|----------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Investment securities: | | | | |
| U.S. government and federal obligations | \$341,920 | \$418 | \$(2,478) | \$339,860 |
| Mutual funds | 38,801 | 445 | (78) | 39,168 |
| Total investment securities | 380,721 | 863 | (2,556) | 379,028 |
| Mortgage-related securities: | | | | |
| Federal Home Loan Mortgage Corporation | 460,681 | 5,280 | (2,121) | 463,840 |
| Federal National Mortgage Association | 373,369 | 5,031 | (1,068) | 377,332 |
| Private-label CMOs | 138,456 | – | (17,782) | 120,674 |
| Government National Mortgage Association | 24,764 | 406 | – | 25,170 |
| Total mortgage-related securities | 997,270 | 10,717 | (20,971) | 987,016 |
| Total securities available-for-sale | \$1,377,991 | \$11,580 | \$(23,527) | \$1,366,044 |
| December 31, 2008 | | | | |
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Investment securities: | | | | |
| U.S. government and federal obligations | \$372,446 | \$7,089 | – | \$379,535 |
| Mutual funds | 39,632 | 36 | \$(65) | 39,603 |
| Total investment securities | 412,078 | 7,125 | (65) | 419,138 |
| Mortgage-related securities: | | | | |
| Federal Home Loan Mortgage Corporation | 281,652 | 1,367 | (782) | 282,237 |
| Federal National Mortgage Association | 411,528 | 2,534 | (698) | 413,364 |
| Private-label CMOs | 157,760 | – | (29,147) | 128,559 |
| Government National Mortgage Association | 26,739 | 208 | (240) | 26,707 |
| Total mortgage-related securities | 877,625 | 4,109 | (30,867) | 850,867 |
| Total securities available-for-sale | \$1,289,703 | \$11,234 | \$(30,932) | \$1,270,005 |

Bank Mutual Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2009

(Dollars in Thousands, Except Per Share Amounts)

2. Securities Available-for-Sale (continued)

The Company has determined that the unrealized losses reported for its investment and mortgage-related securities as of June 30, 2009 and 2008, were temporary. The Company believes it is probable that it will receive all future contractual cash flows related to these securities. The Company does not intend to sell these securities and it is unlikely that it will be required to sell the securities before the recovery of their amortized cost.

As of June 30, 2009, the following schedule identifies securities by time in which the securities had a gross unrealized loss.

| | Less Than 12 Months in an Unrealized Loss Position | | | Greater Than 12 Months in an Unrealized Loss Position | | | Gross Unrealized Loss Amount | Total Estimated Fair Value |
|---|---|----------------------------|----------------------------|--|----------------------------|----------------------------|---------------------------------------|-------------------------------------|
| | Unrealized Loss Amount | Number of Securities | Estimated Fair Value | Unrealized Loss Amount | Number of Securities | Estimated Fair Value | | |
| Investment securities: | | | | | | | | |
| U.S. government and federal obligations | \$(1,355) | 7 | \$79,065 | \$(1,123) | 5 | \$95,777 | \$(2,478) | \$174,842 |
| Mutual funds | — | — | — | (78) | 1 | 630 | (78) | 630 |
| Total investment securities | (1,355) | 7 | 79,065 | (1,201) | 6 | 96,407 | (2,556) | 175,472 |
| Mortgage-related securities: | | | | | | | | |
| Federal Home Loan Mortgage Corporation | (1,985) | 11 | 142,853 | (136) | 7 | 13,761 | (2,121) | 156,614 |
| Federal National Mortgage Association | (949) | 13 | 86,317 | (119) | 4 | 10,523 | (1,068) | 96,840 |
| Private-label CMOs | (4,496) | 5 | 12,309 | (13,286) | 24 | 108,365 | (17,782) | 120,674 |
| Total mortgage-related securities | (7,430) | 29 | 241,479 | (13,541) | 35 | 132,649 | (20,971) | 374,128 |
| Total | \$(8,785) | 36 | \$320,544 | \$(14,742) | 41 | \$229,056 | \$(23,527) | \$549,600 |

As of December 31, 2008, the following schedule identifies securities by time in which the securities had a gross unrealized loss.

| | Less Than 12 Months in an Unrealized Loss Position | | | Greater Than 12 Months in an Unrealized Loss Position | | | Gross Unrealized Loss Amount | Total Estimated Fair Value |
|--|---|----------------------------|----------------------------|--|----------------------------|----------------------------|---------------------------------------|-------------------------------------|
| | Unrealized Loss Amount | Number of Securities | Estimated Fair Value | Unrealized Loss Amount | Number of Securities | Estimated Fair Value | | |
| Investment securities: | | | | | | | | |
| Mutual funds | \$ (65) | 1 | \$ 643 | \$ — | — | \$ — | \$ (65) | \$ 643 |
| Mortgage-related securities: | | | | | | | | |
| Federal Home Loan Mortgage Corporation | — | — | — | (782) | 38 | 94,959 | (782) | 94,959 |
| Federal National Mortgage Association | (192) | 8 | 12,537 | (506) | 40 | 96,429 | (698) | 108,966 |
| Government National Mortgage Association | (4) | 1 | 218 | (236) | 6 | 14,825 | (240) | 15,043 |
| Private label CMOs | (6,078) | 11 | 56,594 | (23,069) | 18 | 71,963 | (29,147) | 128,557 |
| Total mortgage-related securities | (6,274) | 20 | 69,349 | (24,593) | 102 | 278,176 | (30,867) | 347,525 |
| Total | \$(6,339) | 21 | \$69,992 | \$(24,593) | 102 | \$278,176 | \$(30,932) | \$348,168 |

During the first quarter of 2009 the Company recorded an additional impairment of \$831 on one of its mutual fund investments. This impairment was included as a component of net gain on investments in the income statement for the six months ended June 30, 2009. During the second quarter of 2008 the Company recorded an additional impairment of \$2,137 on this same mutual fund. This impairment was

Bank Mutual Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

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2. Securities Available-for-Sale (continued)

included as a component of net gain on investments in the income statement for the three and six month periods ended June 30, 2008.

Results of operations for the three month periods ended June 30, 2009 and 2008, included gross realized gains on the sale of securities available-for-sale of \$610 and \$1,018, respectively. Results of operations for the six month periods ended as of the same dates included gross realized gains on the sale of such securities of \$3,503 and \$2,488, respectively. None of these periods included gross realized losses on the sale of securities available-for-sale.

The amortized cost and fair values of securities by contractual maturity at June 30, 2009, are shown below. Actual maturities may differ from contractual maturities because issuers have the right to call or prepay obligations with or without call or prepayment penalties.

| | Amortized Cost | Fair Value |
|--|--------------------|--------------------|
| Due in one year or less | — | — |
| Due after one year through five years | \$106,007 | \$105,239 |
| Due after five years through ten years | 19,382 | 18,862 |
| Due after ten years | 216,531 | 215,759 |
| Mutual funds | 38,801 | 39,168 |
| Mortgage-related securities | 997,270 | 987,016 |
| Total securities available-for-sale | <u>\$1,377,991</u> | <u>\$1,366,044</u> |

Investment securities with a fair value of approximately \$262,286 and \$206,642 at June 30, 2009 and December 31, 2008, were pledged to secure deposits, borrowings, and for other purposes as permitted or required by law.

3. Fair Value of Financial Instruments

Disclosure of fair value information about certain financial instruments, whether or not recognized in the consolidated financial statements, for which it is practicable to estimate the value, is summarized below. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques.

Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instrument.

Certain financial instruments and all nonfinancial instruments are excluded from this disclosure. Accordingly, the aggregate fair value of amounts presented does not represent the underlying value of the Company and is not particularly relevant to predicting the Company's future earnings or cash flows.

The following methods and assumptions are used by the Company in estimating its fair value disclosures of financial instruments:

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(Dollars in Thousands, Except Per Share Amounts)

3. Fair Value of Financial Instruments (continued)

Cash and Cash Equivalents The carrying amounts reported in the statements of financial condition for cash and cash equivalents approximate those assets' fair values.

Securities Available-for-Sale Fair values for these securities are based on quoted market prices or such prices of comparable instruments. These securities are recorded on the statement of financial condition at fair value; thus the carrying value equals fair value.

Loans Held-for-Sale The fair value of loans held-for-sale is based on the current market price for securities collateralized by similar loans. Loans held-for-sale are recorded on statement of financial condition at fair value; thus the carrying value equals fair value.

Loans Receivable Loans receivable are segregated by type such as one- to four-family, multi-family, and commercial real estate mortgage loans, consumer loans, and commercial business loans. The fair value of each type is calculated by discounting scheduled cash flows through the expected maturity of the loans using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan type.

The estimated maturity is based on the Company's historical experience with prepayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions.

Mortgage Servicing Rights The Company has calculated the fair market value of mortgage servicing rights for those loans that are sold with servicing rights retained. For valuation purposes, loans are stratified by product type and, within product type, by interest rates. The fair value of mortgage servicing rights is based upon the present value of estimated future cash flows using current market assumptions for prepayments, servicing cost and other factors.

Federal Home Loan Bank Stock FHLB of Chicago stock is carried at cost, which is its redeemable (fair) value, since the market for this stock is restricted.

Accrued Interest Receivable and Payable The carrying values of accrued interest receivable and payable approximate their fair value.

Deposit Liabilities and Advance Payments by Borrowers for Taxes and Insurance Fair value for demand deposits equal book value. Fair values for other deposits are estimated using a discounted cash flow calculation that applies current market borrowing interest rates to a schedule of aggregated expected monthly maturities on deposits. The advance payments by borrowers for taxes and insurance are equal to their carrying amounts at the reporting date.

Borrowings The fair value of long-term borrowings is estimated using discounted cash flow calculations with the discount rates equal to interest rates currently being offered for borrowings with similar terms and maturities. The carrying value on short-term borrowings approximates fair value.

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3. Fair Value of Financial Instruments (continued)

The carrying values and fair values of the Company's financial instruments are presented in the following table as of the indicated dates.

| | June 30 2009 | | December 31 2008 | |
|--------------------------------|-------------------|---------------|---------------------|---------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Cash and cash equivalents | \$149,581 | \$149,581 | \$112,893 | \$112,893 |
| Securities available-for-sale | 1,366,044 | 1,366,044 | 1,270,005 | 1,270,005 |
| Loans receivable, net | 1,625,250 | 1,611,259 | 1,829,053 | 1,781,536 |
| Loans held-for-sale | 32,080 | 32,080 | 19,030 | 19,455 |
| Mortgage servicing rights, net | 6,361 | 7,668 | 3,703 | 4,696 |
| Federal Home Loan Bank stock | 46,092 | 46,092 | 46,092 | 46,092 |
| Accrued interest receivable | 14,837 | 14,837 | 16,533 | 16,533 |
| Deposit liabilities | 2,070,708 | 2,014,111 | 2,130,348 | 2,123,284 |
| Advance payments by borrowers | 21,345 | 21,345 | 1,929 | 1,929 |
| Borrowings | 907,480 | 1,010,426 | 907,971 | 1,060,896 |
| Accrued interest payable | 5,293 | 5,293 | 3,312 | 3,312 |

Excluded from the above table are off-balance-sheet items (refer to Note 14) as the fair value of these items is not significant.

The Company adopted SFAS 157, "Fair Value Measurements," on January 1, 2008. Adoption of SFAS 157 had no material effect on the Company's financial statements. As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in pricing its financial assets and liabilities, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements and endeavors to utilize the best available information. Accordingly, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company is able to classify fair value balances based on the observability of those inputs. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1), the next highest priority to prices based on models, methodologies, and/or management judgments that rely on direct or indirect observable inputs (Level 2), and the lowest priority to prices derived from models, methodologies, and/or management judgments that rely on significant unobservable inputs (Level 3).

The following table sets forth by level within the fair value hierarchy (i.e., Level 1, 2, or 3) the Company's financial assets that were accounted for at fair value on a recurring basis as of June 30, 2009. The Company's financial liabilities accounted for at fair value were a negligible amount as of June 30, 2009. As required by SFAS 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

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(Dollars in Thousands, Except Per Share Amounts)

3. Fair Value of Financial Instruments (continued)

| | Fair Value Hierarchy | | | Total |
|--------------------------------|----------------------|-----------|---------|-----------|
| | Level 1 | Level 2 | Level 3 | |
| Securities available-for-sale: | | | | |
| Investment securities | \$39,168 | \$339,860 | – | \$379,028 |
| Mortgage-related securities | – | 987,016 | – | 987,016 |
| Loans held-for-sale | – | 32,080 | – | 32,080 |

For purposes of the impairment testing of mortgage servicing rights, the underlying mortgage loans are stratified into pools by product type and, within product type, by interest rates. Pools with an amortized cost basis greater than fair value are carried at fair value in the Company's financial statements (refer to Note 1 for additional discussion). Although not included in the above table, the Company considers the fair value of mortgage servicing rights to be Level 3 in the fair value hierarchy. Pools determined to be impaired at June 30, 2009, had an amortized cost basis of \$2,992 and a fair value of \$2,623 as of that date. Accordingly, the Company established a valuation allowance of \$369 as of June 30, 2009, compared to \$822 as of December 31, 2008. Refer to Note 6 for additional disclosures related to mortgage servicing rights.

As described in Note 1, "Basis of Presentation," the Company elected to measure at fair value its loans held-for-sale that were originated after January 1, 2009. Loans held-for-sale were \$32,080 at June 30, 2009, and consisted of loans originated after January 1, 2009. Included in loans held-for-sale as of June 30, 2009, was an unrealized gain of \$117. This unrealized gain was included as a component of net gain on loan sale activities for the three and six months ended June 30, 2009.

4. Derivative Financial Instruments

The Company sells substantially all of its long-term, fixed-rate, one- to four-family loan originations in the secondary market. The Company uses derivative instruments to manage interest rate risk associated with these activities. Specifically, the Company enters into interest rate lock commitments ("IRLCs") with borrowers, which are considered to be derivative instruments. The Company manages its exposure to interest rate risk in IRLCs (as well as interest rate risk in its loans held-for-sale) by entering into forward commitments to sell loans to the Federal National Mortgage Association ("Fannie Mae"). Such forward commitments are also considered to be derivative instruments. These derivatives are not designated as accounting hedges under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." As such, changes in the fair value of the derivative instruments are recognized currently through earnings.

As of June 30, 2009 and 2008, net unrealized gains of \$417 and \$63, respectively, were recognized in net gain on loan sales activities on the derivative instruments specified in the previous paragraph. These amounts were exclusive of net unrealized gains (losses) of \$117 and \$(41) on loans held-for-sale as of those dates, respectively, that were also included in net gain on loan sales activities.

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4. Derivative Financial Instruments (continued)

The following table summarizes the Company's derivative assets and liabilities as of the dates indicated.

| | June 30, 2009 | | December 31, 2008 | |
|--------------------------------|--------------------|--------------|--------------------|--------------|
| | Notional Amount | Fair Value | Notional Amount | Fair Value |
| Interest rate lock commitments | \$25,858 | \$258 | \$74,298 | \$1,025 |
| Forward commitments | 46,913 | 159 | 69,587 | (628) |
| Net unrealized gain | | <u>\$417</u> | | <u>\$397</u> |

Other assets include unrealized gains on IRLCs of \$258 and \$1,025 as of June 30, 2009, and December 31, 2008, respectively. Unrealized gains of \$159 on forward commitments are included in other assets at June 30, 2009. Unrealized losses of \$628 on forward commitments are included in other liabilities as of December 31, 2008.

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5. Loans Receivable

Loans receivable consist of the following:

| | June 30 2009 | December 31 2008 |
|-------------------------------------|-----------------|---------------------|
| Permanent mortgage loans: | | |
| One- to four-family | \$736,563 | \$881,288 |
| Multi-family | 184,381 | 190,497 |
| Commercial real estate | 269,387 | 275,802 |
| Total permanent mortgages | 1,190,331 | 1,347,587 |
| Construction and development loans: | | |
| One- to four-family | 7,886 | 17,349 |
| Multi-family | 71,371 | 71,208 |
| Commercial real estate | 62,113 | 70,612 |
| Total construction and development | 141,370 | 159,169 |
| Total real estate mortgage loans | 1,331,701 | 1,506,756 |
| Consumer loans: | | |
| Fixed-term home equity | 140,871 | 173,104 |
| Home equity lines of credit | 84,753 | 86,962 |
| Student | 20,498 | 21,469 |
| Home improvement | 30,634 | 36,023 |
| Automobile | 7,543 | 11,775 |
| Other consumer | 9,104 | 8,740 |
| Total consumer loans | 293,403 | 338,073 |
| Commercial business loans | 51,372 | 49,623 |
| Total loans receivable | 1,676,476 | 1,894,452 |
| Undisbursed loan proceeds | (38,172) | (54,187) |
| Allowance for loan losses | (13,392) | (12,208) |
| Unearned loan fees and discounts | 338 | 996 |
| Total loans receivable, net | \$1,625,250 | \$1,829,053 |

The Company's mortgage loans and home equity loans are primarily secured by properties that are located in the Company's local lending areas in Wisconsin, Minnesota, Michigan, and Illinois.

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6. Other Intangible Assets and Mortgage Servicing Rights

Other intangible assets consist of deposit base intangibles. As of June 30, 2009, and December 31, 2008, deposit base intangibles were net of accumulated amortization of \$12,893 and \$12,691, respectively.

The following table presents the activity in the Company's MSR's for the periods indicated.

| | Six Months Ended June 30 | |
|---------------------------------|--------------------------|----------------|
| | 2009 | 2008 |
| MSRs at beginning of the period | \$4,525 | \$4,708 |
| Additions | 4,152 | 1,084 |
| Amortization | (1,947) | (907) |
| MSRs at end of period | 6,730 | 4,885 |
| Valuation allowance | (369) | - |
| MSRs at end of the period, net | <u>\$6,361</u> | <u>\$4,885</u> |

The projections of amortization expense shown below for MSR's are based on existing asset balances and the existing interest rate environment as of June 30, 2009. Future amortization expense may be significantly different depending upon changes in the mortgage servicing portfolio, mortgage interest rates, and market conditions. The following table shows the current period and estimated future amortization expense for MSR's and deposit base intangibles:

| | Mortgage Servicing Rights | Deposit Base Intangibles | Total |
|---|---------------------------------|--------------------------------|----------------|
| Six months ended June 30, 2009 (actual) | \$1,947 | \$202 | \$2,149 |
| Estimate for six months ended December 31, 2009 | \$584 | \$202 | \$786 |
| Estimate for year ended December 31: | | | |
| 2010 | 1,160 | 405 | 1,565 |
| 2011 | 1,036 | 405 | 1,441 |
| 2012 | 874 | 199 | 1,073 |
| 2013 | 769 | 140 | 909 |
| 2014 | 684 | 140 | 824 |
| Thereafter | 1,254 | 116 | 1,370 |
| Total | <u>\$6,361</u> | <u>\$1,607</u> | <u>\$7,968</u> |

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7. Other Assets

Other assets are summarized as follows:

| | June 30 2009 | December 31 2008 |
|--|-----------------|---------------------|
| Accrued interest: | | |
| Mortgage-related securities | \$5,864 | \$6,669 |
| Investment securities | 1,257 | 1,734 |
| Loans receivable | 7,716 | 8,130 |
| Total accrued interest | 14,837 | 16,533 |
| Foreclosed properties and repossessed assets | 9,885 | 4,768 |
| Premises and equipment, net | 51,740 | 52,209 |
| Federal Home Loan Bank stock, at cost | 46,092 | 46,092 |
| Bank-owned life insurance | 52,241 | 51,261 |
| Prepaid and other | 39,124 | 29,763 |
| Total other assets | \$213,919 | \$200,626 |

8. Deposit Liabilities

Deposit liabilities are summarized as follows:

| | June 30 2009 | December 31 2008 |
|-----------------------------------|-----------------|---------------------|
| Checking accounts: | | |
| Non-interest-bearing | \$89,012 | \$89,106 |
| Interest-bearing | 184,024 | 180,269 |
| Total checking accounts | 273,036 | 269,375 |
| Money market accounts | 323,853 | 340,631 |
| Savings accounts | 204,665 | 185,003 |
| Certificates of deposit: | | |
| Due within one year | 965,076 | 958,863 |
| After one but within two years | 159,898 | 243,104 |
| After two but within three years | 22,735 | 25,746 |
| After three but within four years | 81,011 | 13,723 |
| After four but within five years | 40,434 | 91,832 |
| After five years | - | - |
| Total certificates of deposits | 1,269,154 | 1,333,268 |
| Total deposit liabilities | \$2,070,708 | \$2,128,277 |

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9. Borrowings

Borrowings consist of the following:

| | June 30, 2009 | | December 31, 2008 | |
|--|---------------|-----------------------|-------------------|-----------------------|
| | Balance | Weighted-Average Rate | Balance | Weighted-Average Rate |
| Federal Home Loan Bank advances maturing in: | | | | |
| 2012 | \$100,000 | 4.52% | \$100,000 | 4.52% |
| 2013 | 271 | 4.17 | 278 | 4.17 |
| Thereafter | 807,209 | 4.23 | 807,693 | 4.23 |
| Total borrowings | \$907,480 | | \$907,971 | |

Substantially all of the Company's advances from the Federal Home Loan Bank ("FHLB") of Chicago are subject to prepayment penalties if voluntarily repaid prior to their stated maturity. At June 30, 2009, \$856,000 of the Company's FHLB of Chicago advances were redeemable on a quarterly basis at the option of the FHLB of Chicago.

The Company is required to maintain certain unencumbered mortgage loans and certain mortgage-related securities as collateral against its outstanding advances from the FHLB of Chicago. Total advances from the FHLB of Chicago are limited to the lesser of: (1) 35% of the Bank's total assets; (2) twenty times the capital stock of the FHLB of Chicago that is owned by the Bank; or (3) the total of 60% of the book value of certain multi-family mortgage loans, 75% of the book value of one- to four-family mortgage loans, and 95% of certain mortgage-related securities. Advances are also collateralized by any capital stock of the FHLB of Chicago that is owned by the Bank, which amounted to \$46,092 at June 30, 2009.

10. Shareholders' Equity

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory actions and possible additional discretionary actions by regulators, that, if undertaken, could have a direct material effect on the Bank's and the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by federal regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total capital and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to adjusted assets (as all of these terms are defined in the applicable regulations). Management believes, as of June 30, 2009, that the Bank met or exceeded all capital adequacy requirements to which it is subject.

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10. Shareholders' Equity (continued)

The following table presents the Bank's actual and required regulatory capital amounts and ratios as of June 30, 2009:

| | Actual | | Required For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|--|-----------|--------|--|-------|---|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Total capital (to risk-weighted assets) | \$353,028 | 21.07% | \$134,032 | 8.00% | \$167,540 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 339,636 | 20.27 | 67,016 | 4.00 | 100,524 | 6.00 |
| Tier 1 capital (to adjusted total assets) | 339,636 | 9.99 | 135,937 | 4.00 | 169,922 | 5.00 |

The Company is not aware of any conditions or events which would change the Bank's status from "well capitalized."

11. Earnings Per Share

The computation of basic and diluted earnings per share is presented in the following table:

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|---|----------------------------|------------|--------------------------|------------|
| | 2009 | 2008 | 2009 | 2008 |
| Basic earnings per share: | | | | |
| Net income | \$3,817 | \$4,279 | \$11,005 | \$9,341 |
| Weighted average shares outstanding | 46,229,841 | 47,148,758 | 46,462,061 | 47,361,457 |
| Allocated ESOP shares for period | 81,813 | 81,812 | 163,626 | 163,625 |
| Vested MRP shares for period | 15,360 | 42,807 | 58,179 | 101,331 |
| Basic shares outstanding | 46,327,014 | 47,273,377 | 46,683,866 | 47,626,413 |
| Basic earnings per share | \$0.08 | \$0.09 | \$0.24 | \$0.20 |
| Diluted Earnings Per Share: | | | | |
| Net income | \$3,817 | \$4,279 | \$11,005 | \$9,341 |
| Weighted average shares used in basic earnings per share | 46,327,014 | 47,273,377 | 46,683,866 | 47,626,413 |
| Dilutive effect of: | | | | |
| Stock option shares | 665,012 | 874,044 | 663,383 | 958,268 |
| Unvested MRP shares | – | 2,944 | – | 4,586 |
| Diluted shares outstanding | 46,992,026 | 48,150,365 | 47,347,249 | 48,589,267 |
| Diluted earnings per share | \$0.08 | \$0.09 | \$0.23 | \$0.19 |

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11. Earnings Per Share (continued)

The Company had stock options for 2,065,600 shares outstanding as of June 30, 2009, and for 82,000 shares as of June 30, 2008, that were not included in the computation of diluted earnings per share because they were anti-dilutive. These shares had weighted average exercise prices of \$10.75 and \$11.81 per share as of those dates, respectively.

12. Employee Benefit Plans

The Company has a discretionary, defined contribution savings plan (the "Savings Plan"). The Savings Plan is qualified under Sections 401 and 401(k) of the Internal Revenue Code and provides employees meeting certain minimum age and service requirements the ability to make contributions to the Savings Plan on a pretax basis. The Company then matches a percentage of the employee's contributions. Matching contributions made by the Company were \$41 and \$36 during the three months ended June 30, 2009 and 2008, respectively, and \$91 and \$79 during the six months ended June 30, 2009 and 2008, respectively.

The Company also has a defined benefit pension plan (the "Qualified Plan") covering employees meeting certain minimum age and service requirements and a non-qualified supplemental pension plan (the "Supplemental Plan") for certain qualifying employees. The supplemental pension plan is funded through a "rabbi trust" arrangement. The benefits are generally based on years of service and the employee's average annual compensation for five consecutive calendar years in the last ten calendar years that produces the highest average. The Company's funding policy for the qualified plan is to contribute annually the amount necessary to satisfy the requirements of the Employee Retirement Income Security Act of 1974.

The following tables set forth the plans' net periodic benefit cost:

| | Qualified Plan | | Qualified Plan | |
|------------------------------------|----------------------|-------|--------------------|-------|
| | For the Three Months | | For the Six Months | |
| | Ended June 30 | | Ended June 30 | |
| | 2009 | 2008 | 2009 | 2008 |
| Service cost | \$441 | \$435 | \$882 | \$871 |
| Interest cost | 456 | 414 | 911 | 828 |
| Expected return on plan assets | (430) | (488) | (860) | (976) |
| Amortization of prior service cost | 139 | 5 | 279 | 11 |
| Net periodic benefit cost | \$606 | \$366 | \$1,212 | \$734 |
| | Supplemental Plan | | Supplemental Plan | |
| | For the Three Months | | For the Six Months | |
| | Ended June 30 | | Ended June 30 | |
| | 2009 | 2008 | 2009 | 2008 |
| Service cost | \$49 | \$46 | \$98 | \$92 |
| Interest cost | 107 | 105 | 215 | 210 |
| Net periodic benefit cost | \$156 | \$151 | \$313 | \$302 |

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12. Employee Benefit Plans (continued)

The amount of the 2009 contribution was determined based on a number of factors, including the results of the Actuarial Valuation Report as of January 1, 2009. The contribution to the Qualified Plan in 2009 will be \$5,000 and no contribution is necessary to the Supplemental Plan.

13. Stock-Based Benefit Plans

In 2001 the Company's shareholders approved the 2001 Stock Incentive Plan (the "2001 Plan"), which provided for stock option awards of up to 4,150,122 shares. Options granted under the 2001 Plan vested over five years and have expiration terms of ten years. The 2001 Plan also provided for restricted stock ("MRP") awards of up to 1,226,977 shares. All options and MRPs awarded under the 2001 Plan are fully vested and no further awards may be granted under the plan.

In 2004 the Company's shareholders approved the 2004 Stock Incentive Plan (the "2004 Plan"), which provided for stock option awards of up to 4,106,362 shares. Options granted under the 2004 Plan vest over five years and have terms of ten years. The 2004 Plan also provided for MRP awards of up to 1,642,521 shares. MRP shares awarded under the 2004 Plan vest over five years. As of June 30, 2009, options for 1,592,362 shares and 654,721 MRP shares remain eligible for award under the 2004 Plan.

The Company has no stock compensation plans that have not been approved by shareholders.

MRP grants are amortized to compensation expense as the Company's employees and directors become vested in the granted shares. The amount amortized to expense was \$666 and \$761 for the six month periods ended June 30, 2009 and 2008, respectively. Outstanding non-vested MRP grants had a fair value of \$264 and an unamortized cost of \$306 at June 30, 2009. The cost of these shares is expected to be recognized over a weighted-average period of 2.0 years.

During the three months ended June 30, 2009 and 2008, the Company recorded stock option compensation expenses of \$58 and \$82, and for the six months ended June 30, 2009 and 2008, the Company recorded stock option compensation expense of \$150 and \$153, respectively. As of June 30, 2009, there was \$131 in total unrecognized stock option compensation expense related to non-vested options. This cost is expected to be recognized over a weighted-average period of 2.0 years.

Bank Mutual Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2009

(Dollars in Thousands, Except Per Share Amounts)

13. Stock-Based Benefit Plans (continued)

The following schedule reflects activity in the Company's stock options during the six month periods ended June 30, 2009 and 2008.

| | Six Months Ended June 30 | | | |
|------------------------------------|--------------------------|--|------------------|--|
| | 2009 | | 2008 | |
| | Stock Options | Weighted Average Exercise Price | Stock Options | Weighted Average Exercise Price |
| Outstanding at beginning of period | 3,445,967 | \$7.8763 | 4,090,628 | \$7.3650 |
| Granted | – | – | 32,000 | 11.1600 |
| Exercised | (92,660) | 3.2056 | (472,038) | 4.4710 |
| Forfeited | (68,200) | 10.6730 | (58,800) | 10.6730 |
| Outstanding at end of period | <u>3,285,107</u> | <u>\$7.9500</u> | <u>3,591,790</u> | <u>\$7.7310</u> |

The following table provides additional information regarding the Company's outstanding options as of June 30, 2009.

| | Remaining Contractual Life | Non-Vested Options | | Vested Options | |
|---|----------------------------------|--------------------|--------------------|------------------|--------------------|
| | | Stock Options | Intrinsic Value | Stock Options | Intrinsic Value |
| Exercise price: | | | | | |
| \$3.2056 | 1.8 years | – | – | 1,219,507 | \$6,725 |
| \$10.6730 | 4.8 years | – | – | 1,933,600 | – |
| \$12.2340 | 7.0 years | 30,000 | – | 20,000 | – |
| \$11.1600 | 8.8 years | 25,600 | – | 6,400 | – |
| \$12.0250 | 9.1 years | 50,000 | – | – | – |
| Total | | <u>105,600</u> | <u>–</u> | <u>3,179,507</u> | <u>\$6,725</u> |
| Weighted average remaining contractual life | | <u>8.4 years</u> | | <u>3.7 years</u> | |
| Weighted average exercise price | | <u>\$11.8747</u> | | <u>\$7.8197</u> | |

The intrinsic value of options exercised during the six month periods ended June 30, 2009 and 2008, was \$541 and \$3,264, respectively. The weighted average grant date fair value of non-vested options at June 30, 2009, was \$2.06 per share. There were no grants or forfeitures of non-vested options during the six months ended June 30, 2009; however, options for 411,600 shares became vested during this period.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of granted options. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. However, the Company's stock options have characteristics significantly different from traded options and changes in the subjective input assumptions can materially affect the fair value estimate. Option valuation models such as Black-Scholes require the input of highly subjective assumptions including the expected stock price volatility, which is computed using five-years of actual price activity in the Company's stock. The Company uses historical data of employee behavior as a basis to estimate the expected life of the options, as well as forfeitures due to employee terminations. The Company also uses its actual dividend yield at the time of the grant, as well as actual U.S. Treasury yields in effect at the time of the grant to estimate the risk-free rate. There were no options granted during the six

Bank Mutual Corporation and Subsidiaries

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2009

(Dollars in Thousands, Except Per Share Amounts)

13. Stock-Based Benefit Plans (continued)

month period ended June 30, 2009. The following assumptions were used to value 32,000 options granted during the six month period ended June 30, 2008: risk free interest rate of 3.18%, dividend yield of 3.00%, expected stock volatility of 16.8%, and expected term to exercise of five years.

14. Financial Instruments with Off-Balance Sheet Risk

Off-balance sheet financial instruments or obligations whose contract amounts represent credit and/or interest rate risk at June 30, 2009, and December 31, 2008, are as follows:

| | June 30 2009 | December 31 2008 |
|-----------------------------------|-----------------|---------------------|
| Unused consumer lines of credit | \$152,363 | \$153,568 |
| Unused commercial lines of credit | 19,941 | 21,760 |
| Commitments to extend credit: | | |
| Fixed rate | 18,948 | 22,690 |
| Adjustable rate | 15,226 | 20,585 |
| Undisbursed commercial loans | 1,318 | 994 |

Forward commitments to sell mortgage loans of \$46,913 at June 30, 2009, represent commitments obtained by the Company from Fannie Mae to purchase mortgages from the Company. Forward commitments to sell loans expose the Company to interest rate risk if market rates of interest decrease during the commitment period. Forward commitments to sell loans are made to mitigate interest rate risk on the Company's loans held-for-sale as well as its IRLCs. There were \$69,587 of forward commitments at December 31, 2008.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement

This report contains various forward-looking statements concerning the Company's prospects that are based on the current expectations and beliefs of management. Forward-looking statements may contain words such as "anticipate," "believe," "estimate," "expect," "objective," "projection" and similar expressions or use of verbs in the future tense, are intended to identify forward-looking statements, and any discussions of periods after the date for which this report is filed, are also forward-looking statements. The statements contained herein and such future statements involve or may involve certain assumptions, risks and uncertainties, many of which are beyond the Company's control, that could cause its actual results and performance to differ materially from what is expected. In addition to the assumptions and other factors referenced specifically in connection with such statements, the following factors could impact the business and financial prospects of the Company: general economic conditions, including the significant instability of credit, lending, and financial markets; declines in the real estate market, which could affect both collateral values and loan activity; negative developments affecting particular borrowers, which could adversely impact loan repayments and collection; negative developments affecting particular investment and mortgage-related securities, which could adversely impact the fair value and/or cash flows from such securities; legislative and regulatory initiatives, including action taken, or that may be taken, in response to the current financial market crisis and/or which could negatively affect the rights of creditors; monetary and fiscal policies of the federal government; increased competition and/or disintermediation within the financial services industry; the effects of further regulation and consolidation within the financial services industry; changes in tax rates, deductions, and/or policies; changes in deposit flows; changes in the cost of funds; fluctuations in general market rates of interest and/or yields or rates on competing loans, investments, and sources of funds; demand for loan or deposit products; demand for other financial services; changes in accounting policies or guidelines; natural disasters, acts of terrorism, or developments in the war on terrorism; the factors discussed in "Outlook," below; and other factors discussed in the Company's filings with the Securities and Exchange Commission, particularly under Part I, Item 1A, "Risk Factors," of the Company's 2008 Annual Report on Form 10-K.

Results of Operations

Overview The Company's net income was \$3.8 million or \$0.08 per diluted share in the second quarter of 2009 compared to \$4.3 million or \$0.09 per diluted share during the same period in 2008. Net income for the six month period ended June 30, 2009, was \$11.0 million or \$0.23 per diluted share compared to \$9.3 million or \$0.19 per diluted share in the same period last year. The Company's net income for these periods represented a return on average assets ("ROA") of 0.44% and 0.48%, respectively, and a return on average equity ("ROE") of 3.78% and 4.13%, respectively. For the six month periods, net income represented an ROA of 0.63% and 0.53% in 2009 and 2008, respectively, and an ROE of 5.46% and 4.43% in the same periods, respectively.

Net income during the three months ended June 30, 2009, was negatively impacted by a \$1.6 million non-recurring special assessment from the Federal Deposit Insurance Corporation ("FDIC") and a \$752,000 increase in regular FDIC deposit insurance premiums compared to the same quarter in 2008. Also contributing to the decline in net income during the second quarter of 2009 compared to the same period in 2008 were the following developments:

- a \$548,000 or 3.5% increase in all other non-interest expenses (excluding regular FDIC insurance premiums and the special assessment described above);
- a \$472,000 or 22.7% increase in income tax expense due principally to a change in Wisconsin tax law;
- a \$405,000 or over 600% increase in provision for loan losses;
- a \$317,000 or approximately 95% decrease in loan related fees and service charges;
- a \$264,000 or 14.7% decline in other non-interest income; and

- a \$231,000 or 1.3% decrease in net interest income.

The unfavorable developments itemized above were partially offset by a \$2.4 million or approximately 440% increase in gain on loan sales activities and a \$1.7 million improvement in gain (loss) on investments in the second quarter of 2009 compared to the same quarter of 2008.

Net income during the six months period ended June 30, 2009, benefited from the following developments compared to the same period in 2008:

- a \$5.4 million or approximately 400% increase in gain on loan sales activities;
- a \$2.3 million or approximately 660% increase in net gain on investments;
- a \$1.9 million or 5.5% increase in net interest income; and
- a \$1.8 million one-time tax benefit recorded against income tax expense as a result of a change in Wisconsin tax law.

These favorable developments were offset in part by the following unfavorable developments:

- a \$3.4 million increase in provision for loan loss;
- a \$1.6 million non-recurring special assessment from the FDIC;
- a \$1.4 million or 31.4% increase in income tax expense;
- a \$1.1 million increase in regular FDIC insurance premiums;
- a \$1.1 million or 3.5% increase in all other non-interest expenses (excluding regular FDIC insurance premiums and the special assessment);
- a \$585,000 decrease in loan related fees and service charges; and
- a \$552,000 or 14.9% decrease in other non-interest income.

The following paragraphs describe these changes in greater detail, along with other matters affecting the Company's results of operations during the three and six month periods ended June 30, 2009 and 2008.

Net Interest Income Net interest income decreased by \$231,000 or 1.3% during the three months ended June 30, 2009, compared to the same period in 2008. This decline was principally the result of a \$49.9 million or 1.5% decrease in average earning assets that was only partially offset by a nine basis point improvement in the interest rate spread. For the six months ended June 30, 2009, net interest income increased by \$1.9 million or 5.5% relative to the same six months in 2008. This improvement was primarily attributable to a declining interest rate environment in which the Company was able to lower its cost of interest-bearing liabilities more quickly than the decline in yield on its earning assets. This resulted in a 25 basis points improvement in the interest rate spread between the six month periods. The impact of this development was partially offset by a \$43.6 million or 1.3% decrease in average earning assets in the first six months of 2009 relative to the same period in 2008. Also affecting the comparison of net interest income between the 2009 and 2008 periods was a modest decline in the ratio of average earning assets to average interest-bearing liabilities. The decline in this ratio was principally the result of the Company's stock repurchases, which were funded by cash flows from increases in interest-bearing liabilities, decreases in earning assets, or a combination of the two.

The Company's interest rate spread was 1.92% during the second quarter of 2009 compared to 2.07% in the first quarter of 2009. In recent periods the Company has experienced increased levels of liquidity due to reduced loan demand and increased repayment activity in its loan and securities portfolios. These developments were attributable to a general deterioration in economic conditions, as well as a historically low interest rate environment that has resulted in increased refinancing of adjustable-rate residential and home equity loans into fixed-rate residential loans, which the Company typically sells in the secondary market. In an effort to reduce its exposure to the negative effects of higher interest rates in the future, the Company has reinvested cash flows from these sources in variable-rate or medium-term securities. Such

investments typically have lower yields than longer-term, fixed-rate loans and securities. As a result of these developments, the Company expects that its interest rate spread may decline modestly in the near term, although there can be no assurances. The Company has also managed its liquidity position in recent periods by reducing the rates it offers on its certificates of deposits and certain other deposit accounts, which has resulted in a \$57.6 million or 2.7% decrease in deposit liabilities during the six months ended June 30, 2009.

The following table presents certain details regarding the Company's average balance sheet and net interest income for the periods indicated. The tables present the average yield on interest-earning assets and the average cost of interest-bearing liabilities. The yields and costs are derived by dividing income or expense by the average balance of interest-earning assets or interest-bearing liabilities, respectively, for the periods shown. The average balances are derived from daily balances over the periods indicated. Interest income includes fees, which are considered adjustments to yields. Net interest spread is the difference between the yield on interest-earning assets and the rate paid on interest-bearing liabilities. Net interest margin is derived by dividing net interest income by average interest-earning assets. No tax equivalent adjustments were made since the Company does not have any tax exempt investments.

Three Months Ended June 30

| | 2009 | | | 2008 | | |
|---|--------------------|--------------------------|------------------------|--------------------|--------------------------|------------------------|
| | Average Balance | Interest Earned/ Paid | Average Yield/ Rate | Average Balance | Interest Earned/ Paid | Average Yield/ Rate |
| <i>(Dollars in thousands)</i> | | | | | | |
| Assets: | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans receivable (1) | \$1,732,909 | \$24,541 | 5.66% | \$1,880,378 | \$28,356 | 6.03% |
| Mortgage-related securities | 996,655 | 10,052 | 4.03 | 971,140 | 11,393 | 4.69 |
| Investment securities (2) | 379,771 | 4,551 | 4.79 | 319,700 | 3,621 | 4.53 |
| Interest-earning deposits | 149,670 | 22 | 0.06 | 33,257 | 168 | 2.02 |
| Federal funds sold | — | — | | 104,396 | 538 | 2.06 |
| Total interest-earning assets | <u>3,259,005</u> | <u>39,166</u> | <u>4.81</u> | <u>3,308,871</u> | <u>44,076</u> | <u>5.33</u> |
| Non-interest-earning assets | 231,546 | | | 244,629 | | |
| Total average assets | <u>\$3,490,551</u> | | | <u>\$3,553,500</u> | | |
| Liabilities and equity: | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Regular savings accounts | \$202,739 | 37 | 0.07 | \$193,410 | 152 | 0.31 |
| Money market accounts | 331,313 | 635 | 0.77 | 329,948 | 2,106 | 2.55 |
| Interest-bearing demand accounts | 187,160 | 28 | 0.06 | 171,923 | 99 | 0.23 |
| Certificates of deposit | 1,300,010 | 10,820 | 3.33 | 1,343,841 | 13,792 | 4.11 |
| Total deposit liabilities | <u>2,021,222</u> | <u>11,520</u> | <u>2.28</u> | <u>2,039,122</u> | <u>16,149</u> | <u>3.17</u> |
| Advance payments by borrowers for taxes and insurance | 17,089 | 3 | 0.07 | 16,582 | 4 | 0.10 |
| Borrowings | 907,569 | 9,778 | 4.31 | 911,044 | 9,827 | 4.31 |
| Total interest-bearing liabilities | <u>2,945,880</u> | <u>21,301</u> | <u>2.89</u> | <u>2,966,748</u> | <u>25,980</u> | <u>3.50</u> |
| Non-interest-bearing liabilities: | | | | | | |
| Non-interest-bearing demand accounts | 92,310 | | | 91,701 | | |
| Other non-interest-bearing liabilities | 48,957 | | | 80,471 | | |
| Total liabilities | <u>3,087,147</u> | | | <u>3,138,920</u> | | |
| Shareholders' equity | 403,404 | | | 414,580 | | |
| Total average liabilities and equity | <u>\$3,490,551</u> | | | <u>\$3,553,500</u> | | |
| Net interest income and net interest rate spread | | <u>\$17,864</u> | <u>1.92%</u> | | <u>\$18,096</u> | <u>1.83%</u> |
| Net interest margin | | | <u>2.19%</u> | | | <u>2.19%</u> |
| Average interest-earning assets to average interest-bearing liabilities | <u>1.11x</u> | | | <u>1.12x</u> | | |

- (1) For the purposes of these computations, non-accruing loans and loans held-for-sale are included in the average loans outstanding.
- (2) FHLB of Chicago stock and mutual funds are included in investment securities dollars outstanding and yields.

Six Months Ended June 30

| | 2009 | | | 2008 | | |
|---|--------------------|--------------------------|------------------------|--------------------|--------------------------|------------------------|
| | Average Balance | Interest Earned/ Paid | Average Yield/ Rate | Average Balance | Interest Earned/ Paid | Average Yield/ Rate |
| <i>(Dollars in thousands)</i> | | | | | | |
| Assets: | | | | | | |
| Interest-earning assets: | | | | | | |
| Loans receivable (1) | \$1,782,772 | \$50,771 | 5.70% | \$1,931,190 | \$58,467 | 6.05% |
| Mortgage-related securities | 949,668 | 20,550 | 4.33 | 1,015,316 | 24,043 | 4.74 |
| Investment securities (2) | 404,853 | 9,758 | 4.82 | 258,838 | 5,651 | 4.37 |
| Interest-earning deposits | 126,532 | 73 | 0.12 | 21,701 | 248 | 2.29 |
| Federal funds sold | – | – | | 80,425 | 934 | 2.32 |
| Total interest-earning assets | <u>3,263,825</u> | <u>81,152</u> | <u>4.97</u> | <u>3,307,470</u> | <u>89,343</u> | <u>5.40</u> |
| Non-interest-earning assets | 233,039 | | | 227,501 | | |
| Total average assets | <u>\$3,496,864</u> | | | <u>\$3,534,971</u> | | |
| Liabilities and equity: | | | | | | |
| Interest-bearing liabilities: | | | | | | |
| Regular savings accounts | \$195,551 | 74 | 0.08 | \$188,396 | 334 | 0.35 |
| Money market accounts | 333,323 | 1,647 | 0.99 | 313,097 | 4,259 | 2.72 |
| Interest-bearing demand accounts | 182,067 | 114 | 0.13 | 167,541 | 186 | 0.22 |
| Certificates of deposit | 1,325,189 | 22,799 | 3.44 | 1,367,675 | 29,769 | 4.35 |
| Total deposit liabilities | <u>2,036,130</u> | <u>24,634</u> | <u>2.42</u> | <u>2,036,709</u> | <u>34,548</u> | <u>3.39</u> |
| Advance payments by borrowers for taxes and insurance | 12,079 | 4 | 0.07 | 11,823 | 6 | 0.10 |
| Borrowings | 907,693 | 19,456 | 4.29 | 911,441 | 19,665 | 4.32 |
| Total interest-bearing liabilities | <u>2,955,902</u> | <u>44,094</u> | <u>2.98</u> | <u>2,959,973</u> | <u>54,219</u> | <u>3.66</u> |
| Non-interest-bearing liabilities: | | | | | | |
| Non-interest-bearing demand accounts | 88,539 | | | 90,667 | | |
| Other non-interest-bearing liabilities | 49,566 | | | 62,295 | | |
| Total liabilities | <u>3,094,007</u> | | | <u>3,112,935</u> | | |
| Shareholders' equity | 402,857 | | | 422,036 | | |
| Total average liabilities and equity | <u>\$3,496,864</u> | | | <u>\$3,534,971</u> | | |
| Net interest income and net interest rate spread | | <u>\$37,058</u> | <u>1.99%</u> | | <u>\$35,124</u> | <u>1.74%</u> |
| Net interest margin | | | <u>2.77%</u> | | | <u>2.12%</u> |
| Average interest-earning assets to average interest-bearing liabilities | <u>1.10x</u> | | | <u>1.12x</u> | | |

- (1) For the purposes of these computations, non-accruing loans and loans held-for-sale are included in the average loans outstanding.
- (2) FHLB of Chicago stock and mutual funds are included in investment securities dollars outstanding and yields.

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to the change attributable to change in volume (change in volume multiplied by prior rate), the change attributable to change in rate (change in rate multiplied by prior volume), and the net change. The change attributable to the combined impact of volume and rate has been allocated proportionately to the change due to volume and the change due to rate.

| | Three Months Ended | | |
|---|--|-----------|-----------|
| | June 30, 2009, Compared to June 30, 2008 | | |
| | Increase (Decrease) | | |
| | Volume | Rate | Net |
| | <i>(Dollars in thousands)</i> | | |
| Interest-earning assets: | | | |
| Loans receivable | \$(2,136) | \$(1,679) | \$(3,815) |
| Mortgage-related securities | 296 | (1,637) | (1,341) |
| Investment securities | 710 | 220 | 930 |
| Interest-earning deposits | 142 | (288) | (146) |
| Federal funds sold | (262) | (269) | (538) |
| Total interest-earning assets | (1,257) | (3,653) | (4,910) |
| Interest-bearing liabilities: | | | |
| Regular savings accounts | 7 | (122) | (115) |
| Money market accounts | 9 | (1,480) | (1,471) |
| Interest-bearing demand accounts | 8 | (79) | (71) |
| Certificates of deposit | (438) | (2,534) | (2,972) |
| Total deposit liabilities | (414) | (4,215) | (4,629) |
| Advance payments by borrowers for taxes and insurance | — | (1) | (1) |
| Borrowings | (37) | (12) | (49) |
| Total interest-bearing liabilities | (451) | (4,228) | (4,679) |
| Net change in net interest income | \$(806) | \$575 | \$(231) |

| | Six Months Ended | | |
|---|--|-----------|-----------|
| | June 30, 2009, Compared to June 30, 2008 | | |
| | Increase (Decrease) | | |
| | Volume | Rate | Net |
| | <i>(Dollars in thousands)</i> | | |
| Interest-earning assets: | | | |
| Loans receivable | \$(4,428) | \$(3,268) | \$(7,696) |
| Mortgage-related securities | (1,489) | (2,004) | (3,493) |
| Investment securities | 3,468 | 639 | 4,107 |
| Interest-earning deposits | 249 | (424) | (175) |
| Federal funds sold | (467) | (467) | (934) |
| Total interest-earning assets | (2,667) | (5,524) | (8,191) |
| Interest-bearing liabilities: | | | |
| Regular savings accounts | 4 | (264) | (260) |
| Money market accounts | 259 | (2,871) | (2,612) |
| Interest-bearing demand accounts | 15 | (87) | (72) |
| Certificates of deposit | (899) | (6,071) | (6,970) |
| Total deposit liabilities | (621) | (9,293) | (9,914) |
| Advance payments by borrowers for taxes and insurance | - | (2) | (2) |
| Borrowings | (81) | (128) | (209) |
| Total interest-bearing liabilities | (702) | (9,423) | (10,125) |
| Net change in net interest income | \$(1,965) | \$3,899 | \$1,934 |

Provision for Loan Losses The Company provided \$472,000 for loan losses in the second quarter of 2009 compared to \$67,000 in the second quarter of 2008. The provision for loan losses for the six month periods in 2009 and 2008 was \$3.6 million and \$223,000, respectively. During the first quarter of 2009 the Company recorded a \$1.3 million provision for loss against a \$9.1 million loan secured by a completed condominium development project and a \$576,000 loss on an apartment complex for which the Company accepted a deed in lieu of foreclosure during that quarter. The Company also established \$466,000 in specific loss allowances on a number of smaller commercial real estate and commercial business loans during the first quarter and recorded nearly \$600,000 in additional loan loss provision to reflect management's general concerns regarding continued deterioration in economic conditions and declines in real estate values. There were no increases in specific loan loss allowances in the second quarter of 2009. However, as a result of deteriorating economic conditions, the Company has experienced an overall increase in charge-off activity in its portfolio of residential and consumer loans. This development accounts for substantially all of the increase in the provision for loan losses in the second quarter of 2009 compared to the same period in 2008. The \$1.3 million loss on the condominium project described above was in addition to a separate \$1.3 million loss that was recorded against this same loan in the third quarter of 2008. In the judgment of management, continued deterioration in the market for these condominiums, as evidenced by the lack of unit sales in the project, warranted the additional loss provision in 2009. For additional discussion, refer to "Financial Condition—Asset Quality," below.

Non-Interest Income Total non-interest income increased by \$3.5 million or 86.1% in the second quarter of 2009 compared to the same period in 2008. During the six months ended June 30, 2009, the increase was \$6.5 million or 62.7% compared to the same period in 2008. Significant reasons for these increases are discussed in the following paragraphs.

Gains on loan sales were \$2.9 million during the three months ended June 30, 2009, compared to \$540,000 during the same three month period in 2008. For the six months ended June 30, 2009, gains on loan sales were \$6.8 million compared to \$1.4 million during the same six months in 2008. Sales of one- to four-family mortgage loans were \$415.1 million in the first six months of 2009 compared to \$98.4 million in the same

period of 2008. Sales increased substantially in 2009 as a result of a historically low interest rate environment that encouraged borrowers to refinance higher-rate fixed-rate loans into new loans with lower rates. At the same time, the Company's existing adjustable-rate borrowers were incented to convert their loans into fixed-rate loans. As a result of this behavior, the Company's one- to four-family mortgage loan originations were \$457.5 million during the six months ended June 30, 2009, compared to \$126.0 million during the same period in 2008. Most of these originations were fixed-rate mortgages. The Company's policy is to sell substantially all of its fixed-rate, one- to four-family mortgage loan originations in the secondary market. As a result of increases in market interest rates in recent weeks, management expects loan origination and sales activity to decline during the remainder of 2009, which is likely to result in lower gains on sales of loans in the near term.

Loan-related fees and servicing revenue was \$16,000 for the three months ended June 30, 2009, compared to \$333,000 for the same quarter in 2008. For the six month periods, this revenue was a negative \$316,000 in 2009 compared to a positive \$269,000 in 2008. Low interest rate environments typically cause an increase in actual mortgage loan prepayment activity, which generally results in an increase in the amortization of MSR. During the six months ended June 30, 2009 and 2008, MSR amortization expense, which is netted against loan-related fees and servicing revenue, was \$1.9 million and \$907,000, respectively. The negative impact of this increase was partially offset by the positive impact of an increase in the value of the Company's MSR due to a modest increase in mortgage interest rates near the end of the second quarter. Higher interest rates typically result in lower expectations for future loan prepayment activity, which has a positive impact on the value of MSR. As of June 30, 2009, the Company had a valuation allowance of \$369,000 against MSR with a gross book value of \$6.7 million. These amounts compared to a valuation allowance of \$822,000 against a gross book value of \$4.5 million as of December 31, 2008. The net recovery in the valuation allowance of \$453,000 in 2009 was recorded in loan-related fees and servicing revenue. In the prior year, a \$174,000 increase in the valuation allowance in the first quarter of that year was recovered in its entirety in the following quarter when interest rates increased in the second quarter of 2008, similar to 2009.

If market interest rates for one- to four-family loans continue to increase and/or loan prepayment expectations decrease in future periods, the Company could recover all or a portion of its previously established allowance on MSR, as well as record reduced levels of MSR amortization expense. Alternatively, if interest rates decrease and/or prepayment expectations increase, the Company could potentially record additional charges to earnings related to increases in the valuation allowance on its MSR. In addition, amortization expense could remain elevated due to likely increases in loan prepayment activity.

As of June 30, 2009, the Company serviced \$924.4 million in loans for third-party investors compared to \$728.4 million at December 31, 2008. This increase was a result of the substantial increase in one- to four-family loans originated and sold in the secondary market, as previously described.

Gains (losses) on investment activities were \$610,000 during the three month period ended June 30, 2009, compared to \$(1.1) million in the same period in 2008. For the six month periods, gains were \$2.7 million in 2009 compared to \$351,000 in 2008. Results for the six month periods of 2009 and 2008 are net of \$831,000 and \$2.1 million, respectively, in OTTI charges related to one of the Company's mutual fund investments. This mutual fund invests primarily in mortgage-related securities, none of which are secured by sub-prime mortgages, but a portion of which are secured by interest-only mortgages, option-payment mortgages, and other "Alt-A" mortgages. The Company has recorded a total of \$8.7 million in impairment charges on this mutual fund since the fourth quarter of 2007, although no additional impairment was recorded in the second quarter of 2009. The \$2.1 million charge recorded in 2008 occurred in the second quarter of that year. Given the significant uncertainty and illiquidity that exists in the markets for securities secured by these types of loans, the Company may be required to record future impairment charges against this investment, although there can be no assurances. This investment had a remaining book value of \$20.8 million at June 30, 2009 (after impairment charges). Its fair value as of the same date was \$21.0 million.

Excluding the OTTI losses described in the previous paragraph, gains on investment activities were \$610,000 in the second quarter of 2009 compared to \$1.0 million in the same period in 2008. Year-to-date, these gains were \$3.5 million in 2009 and \$2.5 million in 2008. During the six months ended June 30, 2009, the Company sold \$174.5 million in long-term, fixed-rate, mortgage-related securities, the proceeds of which were reinvested primarily in adjustable-rate government agency mortgage-backed securities (“MBSs”) and other medium-term government agency securities. Management considered these actions to be prudent in light of its expectations that interest rates may trend higher in the future. Gains on investment activities in 2008 resulted from the sale of \$392.4 million in mortgage-related securities in that period.

Other non-interest income declined by \$264,000 or 14.7% during the three months ended June 30, 2009, compared to the same period in 2008. For the six month periods the decline was \$552,000 or 14.9% from 2008 to 2009. These declines were primarily attributable to a decrease in earnings from the Company’s investment in bank-owned life insurance (“BOLI”), the yield on which has been adversely impacted by a lower interest rate environment since last year.

Non-Interest Expense Total non-interest expense increased by \$2.8 million or 18.1% in the second quarter of 2009 compared to the same period in 2008. The increase was \$3.7 million or 11.8% for the six month period in 2009 compared to the same period in 2008. A significant portion of the increase in both periods was due to a \$1.6 million non-recurring special assessment from the FDIC. This special assessment was charged to all FDIC-insured financial institutions in the second quarter of 2009, although it will not be paid until September 30, 2009. In the Bank’s case, the assessment was 0.05% of total assets less Tier 1 capital at June 30, 2009. Also contributing to the increase in non-interest expense in both periods was an increase in regular deposit insurance premiums charged by the FDIC. Beginning in 2009, the FDIC increased deposit insurance rates for all financial institutions. As a result of this increase, regular deposit insurance premium expense increased from \$123,000 during the six months ended June 30, 2008, to \$1.2 million in the same period of 2009.

Excluding the FDIC deposit premiums and the special assessment, total expenses for the second quarter of 2009 increased \$548,000 or 3.5% from the same quarter in the prior year; the increase for the six month periods was \$1.1 million or 3.5%. These increases were due to normal annual merit increases in employee compensation, an increase in the number of personnel employed by the Company, and an increase in expenses associated with increased residential loan production, as previously discussed. Also contributing was an increase in expenses related to the number of the Company’s office locations. The Company opened one new office in the third quarter of 2008.

Income Taxes Income tax expense was \$2.6 million during the three months ended June 30, 2009, compared to \$2.1 million in the same quarter of 2008. Income tax expense was \$4.2 million during the six months ended June 30, 2009, compared to \$4.6 million in the same period of 2009. In the first quarter of 2009 the Company recorded a \$1.8 million tax benefit related to the elimination of a valuation allowance the Company established against a deferred tax asset in prior years. The deferred tax asset related to Wisconsin net operating loss carryovers for which management was unable to determine whether it was more likely than not that the tax benefits would be realized in future periods. In the first quarter of 2009 Wisconsin law was amended from a system that taxed each affiliated entity separately to a form of combined reporting. As a result of this change, management determined that the Company’s Wisconsin net operating losses that had not been recognized in prior periods would be realizable, resulting in a one-time tax benefit of \$1.8 million in the first quarter of 2009.

Excluding the impact of the tax benefit described in the previous paragraph, the Company’s income tax expense for the first six months of 2009 would have been \$6.0 million. This amount represented an effective tax rate (“ETR”) of 39.5% compared to 32.9% in the same period last year. This increase was caused by the amendment of Wisconsin law described above, which became effective January 1, 2009. Prior to this amendment, the state of Wisconsin imposed a corporate franchise tax on the separate taxable incomes of the members of the Company’s consolidated income tax group, excluding the Bank’s out-of-state investment

subsidiaries. However, beginning January 1, 2009, the Company's consolidated income tax group is subject to combined reporting, which results in state income taxes being imposed on the earnings of the Bank's out-of-state investment subsidiaries. Accordingly, the Company's ETR increased compared to the prior period. Management expects the current period ETR to be representative of the rate in future periods, although there can be no assurances.

Financial Condition

Overview The Company's total assets declined by \$42.3 million or 1.2% during the six months ended June 30, 2009. Total assets at June 30, 2009, were \$3.45 billion compared to \$3.49 billion at December 31, 2008. During the period the Company's loans receivable decreased by \$203.8 million or 11.1%. This development was partially offset by a \$96.0 million or 7.6% aggregate increase in securities available-for-sale and a \$36.7 million or 32.5% increase in cash and cash equivalents. Deposit liabilities decreased \$57.6 million or 2.7% during the six months ended June 30, 2009. The Company's total shareholders' equity increased slightly during the six months ended June 30, 2009, and the ratio of its total shareholders' equity to total assets improved from 11.45% to 11.60%. Non-performing assets increased by \$8.3 million or 21.9% to \$46.1 million during the six months ended June 30, 2009.

The following paragraphs describe these changes in greater detail, along with other changes in the Company's financial condition during the six months ended June 30, 2009 and 2008.

Cash and Cash Equivalents Cash and cash equivalents increased from \$112.9 million at December 31, 2008, to \$149.6 million at June 30, 2009. This increase was purposeful and reflected management's belief that it is prudent to increase Company's liquidity and future flexibility in light of recent developments in financial markets, as well as management's expectations for higher interest rates in the future.

Securities Available-for-Sale The Company's portfolio of securities available-for-sale increased by \$96.0 million or 7.6% during the six months ended June 30, 2009. This increase was primarily caused by the purchase of \$582.7 million in securities consisting principally of adjustable-rate government agency MBSs and other medium-term government agency securities. These purchases were offset in part by \$174.5 million in sales of long-term, fixed-rate MBSs, as previously described, as well as \$156.2 million in securities that were called by their issuers during the period. In addition, the Company's mortgage-related securities portfolio experienced an increase in prepayment activity during the period due to lower interest rates.

The Company classifies all of its securities as available-for-sale. Changes in the fair value of such securities are recorded through accumulated other comprehensive loss (net of deferred income taxes), which is a component of shareholders' equity. During the second quarter of 2009 the fair value adjustment on the Company's available-for-sale securities improved from a net unrealized loss of \$19.7 million at December 31, 2008, to a net unrealized loss of \$11.9 million at June 30, 2009. This improvement was due primarily to an increase in the fair value of the Company's portfolio of private-label collateralized mortgage obligations ("CMOs"). The Company's private-label CMOs were originally purchased from 2004 to early 2006 and are secured by prime residential mortgage loans. The securities were all rated "triple-A" by various credit rating agencies at the time of their original purchase. However, in recent periods, a number of the securities in the portfolio have been downgraded. The following table presents the credit ratings, carrying values, and unrealized losses of the Company's private-label CMO portfolio as of the dates indicated:

| | June 30, 2009 | | December 31, 2008 | |
|--------------------------|-------------------------------|-----------------|-------------------|-----------------|
| | Carrying Value | Unrealized Loss | Carrying Value | Unrealized Loss |
| Credit rating (1): | <i>(Dollars in thousands)</i> | | | |
| AAA/Aaa | \$64,510 | \$6,257 | \$116,021 | \$23,219 |
| AA/Aa | 10,634 | 823 | 12,536 | 5,928 |
| A | 23,754 | 5,807 | – | – |
| BBB/Baa | 16,667 | 3,899 | – | – |
| BB/Ba | 5,109 | 995 | – | – |
| Total private-label CMOs | \$120,674 | \$17,782 | \$128,557 | \$29,147 |

(1) In instances of split-ratings, each security has been classified according to its lowest rating.

Although the unrealized loss on the Company’s private-label CMOs declined substantially during the six months ended June 30, 2009, the market for these securities has remained depressed in response to stress and illiquidity in the financial markets and a general deterioration in economic conditions. Although mindful of these developments, management has determined that it is unlikely the Company will not collect all amounts due according to the contractual terms of these securities. As such, management has determined that none of the Company’s private-label CMOs are other-than-temporarily impaired as of June 30, 2009. However, collection is subject to numerous factors outside of the Company’s control and a future determination of OTTI could result in significant losses being recorded through earnings in future periods. For additional discussion relating to the Company’s securities available-for-sale, refer to “Results of Operations—Non-Interest Income,” above, as well as Note 2, “Securities Available-for-Sale,” of the Company’s Unaudited Condensed Consolidated Financial Statements, above.

Loans Held-for-Sale Loans held-for-sale increased from \$19.0 million at December 31, 2008, to \$32.1 million at June 30, 2009. The Company’s policy is to sell substantially all of its fixed-rate, one- to four-family mortgage loan originations in the secondary market. Originations and sales of such loans have increased in recent months in response to historically low interest rates on mortgage loans, which has resulted in increased demand by customers for such loans. For additional discussion refer to “Results of Operations—Non-Interest Income,” above.

Loans Receivable Loans receivable decreased by \$203.8 million or 11.1% as of June 30, 2009, compared to December 31, 2008. As previously mentioned, the Company’s originations of one- to four-family mortgage loans increased significantly during the six months ended June 30, 2009. Despite this development, the portfolio of one- to four-family loans declined from \$881.3 at December 31, 2008, to \$736.6 million at June 30, 2009. This decline was caused by increased refinancing of adjustable-rate mortgage loans by borrowers (which the Company typically retains in portfolio) into fixed-rate mortgage loans (which the Company generally sells in the secondary market). The Company expects this trend to continue in the near term assuming interest rates remain at their current levels. However, in light of the increases in market interest rates in recent weeks, the pace of decline is likely to be slower than it has been during the first six months of 2009, although there can be no assurances.

The Company’s multi-family and commercial real estate mortgage loan originations were \$26.7 million in the aggregate for the first six months of 2009 compared to \$102.8 million for the same period in 2008. In addition, its commercial business loan originations for the first six months of 2009 were \$19.0 million compared to \$21.7 million in 2008. Although the Company continues to emphasize originations of these types of loans, originations have declined in recent periods due to a general deterioration in economic conditions, as well as the Company’s more conservative underwriting standards. Primarily as a result of lower origination activity, the Company’s aggregate portfolio of multi-family and commercial real estate mortgage loans declined from \$466.3 million at December 31, 2008, to \$453.8 million at June 30, 2009. Furthermore, its portfolio of construction and development loans declined by \$17.8 million or 11.2%. The

Company's portfolio of commercial business loans increased modestly, from \$49.6 million to \$51.4 million during the most recent quarter.

The Company's consumer loan originations, including fixed-term home equity loans and lines of credit, were \$38.4 million for the six months ended June 30, 2009, compared to \$54.2 million for the same period last year. Lower origination activity in 2009 was primarily the result of declining demand due to slower economic growth, as well as smaller increases, or even decreases, in home values, which has had a negative impact on homeowners' equity. This reduced origination activity resulted in a decline in the Company's consumer loan portfolio from \$338.1 million at December 31, 2008, to \$293.4 million at June 30, 2009. Also contributing to this decline was a historically low interest rate environment which encouraged many borrowers to refinance their home equity loans or lines of credit and other consumer loans into first mortgage loans during the period. Many of these borrowers reestablished home equity lines of credit with the Company in accordance with its established lending standards, but had not drawn substantial amounts on these lines as of the end of the second quarter.

The following table sets forth the Company's mortgage, consumer, and commercial loan originations and purchases for the periods indicated:

| | Three Months Ended | | Six Months Ended | |
|--|-------------------------------|-----------|------------------|-----------|
| | June 30 | | June 30 | |
| | 2009 | 2008 | 2009 | 2008 |
| Mortgage loans: | <i>(Dollars in thousands)</i> | | | |
| One- to four-family | \$240,329 | \$59,375 | \$457,514 | \$126,020 |
| Multi-family | 832 | 28,977 | 6,318 | 36,512 |
| Commercial real estate | 6,778 | 45,553 | 20,340 | 66,258 |
| Total mortgage loans | 247,939 | 133,905 | 484,172 | 228,790 |
| Consumer loans | 19,120 | 33,236 | 38,389 | 54,240 |
| Commercial business loans | 10,233 | 10,863 | 18,998 | 21,689 |
| Total loan originations | 277,292 | 178,004 | 541,559 | 304,719 |
| One- to four-family mortgage loans purchased | 1,088 | 6,185 | 2,658 | 11,323 |
| Total loans originated and purchased | \$278,380 | \$184,189 | \$544,217 | \$316,042 |

In light of current economic conditions and recent loan origination activity, management expects growth in all categories of the Company's loan portfolio to be slow or negative in the near term, although there can be no assurances.

Mortgage Servicing Rights The carrying value of the Company's MSR's were \$6.4 million at June 30, 2009, compared to \$3.7 million at December 31, 2008, net of valuation allowances of \$369,000 and \$822,000, respectively. The increase in net carrying value was principally the result of the Company's increased origination and sale of fixed-rate, one- to four-family loans on a servicing retained basis. For additional discussion, refer to "Results of Operations—Non-Interest Income," above. As of June 30, 2009, the Company serviced \$924.4 million in loans for third-party investors compared to \$728.4 million at December 31, 2008.

Other Assets Other assets increased by \$13.3 million or 6.6% during the six months ended June 30, 2009. A portion of this increase is the result of a \$5.1 million increase in foreclosed properties and repossessed assets, from \$4.8 million at December 31, 2008, to \$9.9 million at June 30, 2009. This increase was principally due to the Company's acceptance of deeds in lieu of foreclosure on two larger loans and the transfer of the related collateral to foreclosed properties. For additional details related to other assets, refer to Note 7, "Other Assets," of the Company's Unaudited Condensed Consolidated Financial Statements, above.

Deposit Liabilities Deposit liabilities decreased by \$57.6 million or 2.7% during the six months ended June 30, 2009, to \$2.07 billion compared to \$2.13 billion at December 31, 2008. Within the deposit

portfolio, core deposits (checking, savings, and money market accounts) increased \$6.5 million or 0.8% and certificates of deposit decreased \$64.1 million or 4.8%. As previously described, the Company has reduced the rates it offers on its certificates of deposits and certain other deposit accounts in recent periods in an effort to manage its overall liquidity. As a result of these efforts, the weighted average cost of interest-bearing deposit liabilities declined by 97 basis points during the six months ended June 30, 2009.

Borrowings Borrowings, which consisted of advances from the FHLB of Chicago, declined slightly during the three months ended June 30, 2009. All of the Company's borrowings have a stated final maturity after 2011. However, \$856.0 million in advances contain quarterly redemption options that are subject to potential exercise by the FHLB of Chicago. As of June 30, 2009, substantially all of the Company's FHLB of Chicago advances were subject to significant prepayment penalties if voluntarily repaid prior to their stated maturity.

Advance Payments by Borrowers for Taxes and Insurance Advance payments by borrowers for taxes and insurance (i.e., escrow deposits) were \$21.3 million at June 30, 2009, compared to \$1.9 million at December 31, 2008. Escrow deposits typically increase during the course of the calendar year until real estate tax obligations are paid, generally in December of each year or January of the following year.

Shareholders' Equity The Company's shareholders' equity increased slightly during the six months ended June 30, 2009, and the ratio of its total shareholders' equity to total assets improved from 11.45% to 11.60%. During this period the positive effects of the Company's earnings and a decline in its accumulated other comprehensive loss were substantially offset by dividend payments and stock repurchases, resulting in little change in shareholders' equity. Quarterly cash dividends of \$0.09 per share were paid in each of the first and second quarters of 2009. The dividend payout ratio was 77.0% of net income for the six months ended June 30, 2009. On August 3, 2009, the Company's board of directors declared a \$0.09 per share dividend payable on September 1, 2009, to shareholders of record on August 13, 2009.

During the three and six month periods ended June 30, 2009, the Company repurchased 336,110 and 1,206,800 shares of Company common stock, respectively. The weighted average prices of these repurchases were \$9.18 and \$8.75 per share, respectively. For additional discussion, refer to "Liquidity and Capital Resources—Capital Resources," and Part II, Item 2, "Unregistered Sale of Equity Securities and Use of Proceeds," below.

Asset Quality The following table summarizes non-performing loans and assets as of the dates indicated:

| | At June 30 2009 | At December 31 2008 |
|---|-------------------------------|------------------------|
| | <i>(Dollars in thousands)</i> | |
| Non-accrual mortgage loans: | | |
| One- to four-family | \$9,706 | \$8,185 |
| Multi-family | 9,708 | 13,255 |
| Commercial real estate | 12,809 | 8,420 |
| Construction and development | – | – |
| Total non-accrual mortgage loans | 32,223 | 29,860 |
| Non-accrual consumer loans: | | |
| Secured by real estate | 1,468 | 759 |
| Other consumer loans | 532 | 400 |
| Total non-accrual consumer loans | 2,000 | 1,159 |
| Non-accrual commercial business loans | 1,281 | 1,494 |
| Total non-accrual loans | 35,504 | 32,513 |
| Accruing loans delinquent 90 days or more | 751 | 576 |
| Total non-performing loans | 36,255 | 33,089 |
| Foreclosed properties and repossessed assets | 9,885 | 4,768 |
| Total non-performing assets | \$46,140 | \$37,857 |
| Non-performing loans to loans receivable, net | 2.23% | 1.81% |
| Non-performing assets to total assets | 1.34% | 1.08% |
| Allowance for loan losses to non-performing loans | 36.94% | 36.89% |
| Allowance for loan losses to total loans | 0.82% | 0.67% |
| Net charge-offs (1) | \$2,449 | \$1,013 |
| Net charge-offs to average loans (annualized) | 0.27% | 0.05% |
| Allowance for loan losses | \$13,392 | \$12,208 |

(1) The dollar amounts shown for net charge-offs are for the six and twelve month periods ended June 30, 2009, and December 31, 2008, respectively.

Total non-performing loans increased by \$3.2 million or 9.6% as of June 30, 2009, compared to December 31, 2008. The Company's ratio of non-performing loans to total loans was 2.23% at June 30, 2009, compared to 1.81% at December 31, 2008. Included in non-performing loans as of both dates was a \$9.1 million loan on a completed condominium project mentioned elsewhere in this report. The increase in non-performing loans during the period was due in part to a \$2.0 million commercial real estate loan secured by a multi-tenant office/showroom located in the Twin Cities area of Minnesota and \$3.2 million in smaller commercial real estate loans that became 90 or more days delinquent during the period. Also contributing to the increase were smaller increases in delinquent one- to four-family loans and consumer loans due to deteriorating economic conditions. These developments were offset by the Company's acceptance during the period of deeds in lieu of foreclosure on two larger loans and the transfer of the related collateral to foreclosed real estate. Total foreclosed real estate, which is a component of other assets, was \$9.9 million at June 30, 2009, compared to \$4.8 million at December 31, 2008. Due to current economic conditions, management expects the Company's non-performing loans and assets to continue to increase in the near term, which could have an adverse impact on the Company's results of operations in future periods. In August 2009, a \$4.5 million commercial real estate loan secured by a 20,000 square-foot office building located in the Twin Cities area was placed on non-accrual by the Company. Management does not anticipate a loss on these loans at this time, although there can be no assurances.

A summary of the allowance for loan losses is shown below for the periods indicated:

| | Six Months Ended June 30 | Twelve Months Ended December 31 |
|--|-------------------------------|------------------------------------|
| | 2009 | 2008 |
| | <i>(Dollars in thousands)</i> | |
| Balance at the beginning of the period | \$12,208 | \$11,774 |
| Provision for loan losses | 3,633 | 1,447 |
| Charge-offs: | | |
| Mortgage loans | (1,383) | (613) |
| Consumer loans | (214) | (411) |
| Commercial business loans | (871) | (34) |
| Total charge-offs | (2,468) | (1,058) |
| Recoveries: | | |
| Mortgage loans | - | - |
| Consumer loans | 19 | 45 |
| Commercial business loans | - | - |
| Total recoveries | 19 | 45 |
| Net charge-offs | (2,449) | (1,013) |
| Balance at the end of the period | \$13,392 | \$12,208 |
| Net recoveries (charge-offs) to average loans (annualized) | 0.27% | 0.05% |
| Allowance as a percent of total loans | 0.82% | 0.67% |
| Allowance as a percent of non-performing loans | 36.94% | 36.89% |

As of June 30, 2009, the Company's allowance for loan losses was \$13.4 million or 0.82% of loans receivable compared to \$12.2 million or 0.67% at December 31, 2008, and \$11.4 million or 0.59% at June 30, 2008. As a percent of non-performing loans, the Company's allowance for loan losses was 36.9% at both June 30, 2009, and December 31, 2008. The dollar increase in the allowance for loan losses since December 31, 2008, was primarily caused by the additional loss allowances established on the condominium development project and certain other smaller loans, as previously mentioned. Also contributing was an addition to the allowance that reflected management's general concerns related to continued deterioration in economic conditions and declines in real estate values, as previously mentioned. These developments were offset in part by charge-offs related to the Company's acceptance of deeds in lieu of foreclosure on certain loans, as previously described. Also contributing was an increase in loan charge-off activity related to the Company's portfolio of residential and consumer loans due to deterioration in general economic conditions over the past year.

The allowance for loan losses has been determined in accordance with GAAP. Management is responsible for the timely and periodic determination of the amount of the allowance required. Future provisions for loan losses will continue to be based upon management's assessment of the overall loan portfolio and the underlying collateral, trends in non-performing loans, current economic conditions, and other relevant factors. To the best of management's knowledge, all known and inherent losses have been provided for in the allowance for loan losses.

In determining the allowance for loan losses, management considers loans to be collateral dependent when, in its judgment, there is no source of repayment for the loan other than the ultimate sale or disposition of the underlying collateral. Factors management considers in making this determination typically include, but are not limited to, the length of time a borrower has been delinquent with respect to loan payments, the nature and extent of the financial or operating difficulties experienced by the borrower, the performance of the underlying collateral, and the availability of other sources of cash flow or net worth from the borrower and/or guarantor.

When a loan becomes collateral dependent, management measures impairment based on the estimated fair value of the underlying collateral. Such estimates are based on management's judgment or, when considered appropriate, on an updated appraisal or similar evaluation. Updated appraisals are typically obtained on or about the time of foreclosure or repossession of the underlying collateral. However, updated appraisals may also be obtained prior to foreclosure when management considers it to be prudent. Factors management considers in obtaining updated appraisals prior to foreclosure include, but are not limited to, management's familiarity with the nature and/or location of the collateral, the complexity of the collateral, significant changes in the condition of the collateral, substantial changes in the cash flows derived or expected to be derived from the collateral, significant changes or developments in the market for the collateral, the age of the original appraisal or other estimate of value, and the overall materiality of the loan to the Company's financial condition and results of operations.

The Company has policies and procedures in place to manage its exposure to credit risk (including collateral risk) related to its lending operations. As a matter of policy, the Company limits its lending to geographic areas in which it has substantial familiarity and/or a physical presence. Currently, this is limited to certain specific market areas in Wisconsin and contiguous states. In addition, from time-to-time the Company will prohibit or restrict lending in situations in which the underlying business operations and/or collateral exceed management's tolerance for risk. For example, the Company does not currently make loans secured by hotels, motels, resort properties, restaurants, or bars. The Company obtains appraisals or similar estimates of value prior to the origination of mortgage loans or other secured loans. It also manages its exposure to collateral risk by regularly monitoring loan payment status, conducting periodic site visits and inspections, obtaining regular financial updates from large borrowers and/or guarantors, corresponding regularly with large borrowers and/or guarantors, and/or updating appraisals as appropriate, among other things. These procedures are emphasized when a borrower has failed to make scheduled loan payments, has otherwise defaulted on the terms of the loan agreement, or when management has become aware of a significant adverse change in the financial condition of the borrower, guarantor, or underlying collateral.

As a result of applying management judgment in accordance with GAAP, it is possible that there may be periods when the amount of the allowance and/or its percentage to total loans may decrease even though non-performing loans may increase, as is the case in the current period.

The establishment of the amount of the loan loss allowance inherently involves judgments by management as to the adequacy of the allowance, which ultimately may or may not be correct. Higher rates of loan defaults than anticipated would likely result in a need to increase provisions in future years. Also, as multi-family, commercial real estate, construction and development, and commercial business loan portfolios increase, additional provisions would likely be added to the loan loss allowances as they carry a higher risk of loss. The dollar amount of these types of loans tends to be larger than the Company's average single family loan and, therefore, any loss that the Company experiences on these loans could be larger than what it has historically experienced on single family loans.

Refer to "Operating Results—Provision for Loan Losses," above, for additional discussion.

Liquidity and Capital Resources

Liquidity The term "liquidity" refers to the Company's ability to generate cash flow to fund loan originations, loan purchases, deposit withdrawals, and operating expenses. The Company's primary sources of funds are deposit liabilities, scheduled payments, prepayments, and maturities of loans and securities available-for-sale, sales of one- to four-family loans in the secondary market, occasional sales of securities available-for-sale, borrowings from the FHLB of Chicago, and cash flow provided by the Company's operations. Historically, these sources of funds have been adequate to maintain liquidity, with the Company borrowing correspondingly more in periods in which its operations generate less cash. In the

event these sources of liquidity would become inadequate, management believes that the Company could access the wholesale deposit market, although there can be no assurances that wholesale deposits would be available if needed.

Scheduled payments and maturities of loans and securities available-for-sale are relatively predictable sources of funds. However, cash flows from deposit liabilities, calls of investment securities, and prepayments of loans and mortgage-related securities are strongly influenced by interest rates, general and local economic conditions, and competition in the marketplace. For example, during the six months ended June 30, 2009, prepayments in the Company's mortgage-related securities, prepayments in its one- to four-family mortgage loan portfolio, and calls of certain investment securities increased because of the interest rate environment. A different interest rate environment could lead to a significantly different result. These factors reduce the predictability of the timing of these sources of funds.

The Company is committed to maintaining a strong liquidity position; therefore, management monitors the Company's liquidity position on a daily basis. Based upon historical experience and available sources of liquidity, management anticipates that the Company will have sufficient funds to meet current funding commitments. For additional discussion refer to "Financial Condition," above, and "Qualitative and Quantitative Disclosures about Market Risk" in Part I, Item 3, below.

Capital Resources At June 30, 2009, the Bank exceeded each of the applicable regulatory capital requirements (refer to Note 10, "Shareholders' Equity," of the Unaudited Condensed Consolidated Financial Statements, above). In order to be classified as "well-capitalized" by the FDIC, the Bank is required to have Tier 1 (leverage) capital to total adjusted assets of at least 5.0%. To be classified as a "well-capitalized," the Bank must also have total risk-based capital to risk-weighted assets of at least 10.0%. At June 30, 2009, the Bank had a Tier 1 capital ratio of 9.99% and a total risk-based capital ratio of 21.07%.

From time to time, the Company repurchases shares of its common stock, and these repurchases have had the effect of reducing the Company's capital and increasing its dependence on borrowing; further repurchases will continue to have the same effect. The Company regularly reviews its capital position, market conditions, and the cost of funds to determine whether share repurchases are appropriate. On February 2, 2009, the Company announced a plan to repurchase an additional one million shares (the "2009 Plan"). At August 10, 2009, 143,100 shares remained available for repurchase under this plan. For additional discussion, refer to "Financial Condition—Shareholders' Equity," above, and Part II, Item 2, "Unregistered Sale of Equity Securities and Use of Proceeds," below.

The Company paid a cash dividend of \$0.09 per share during each of the first and second quarters of 2009. On August 3, 2009, the Company's board of directors declared a \$0.09 per share dividend payable on September 1, 2009, to shareholders of record on August 13, 2009. The Company anticipates that it will continue to pay quarterly cash dividends on its common stock, although there can be no assurance that payment of such dividends will continue or that they will not be reduced. The payment of dividends in the future is discretionary with the Company's board of directors and will depend on the Company's operating results and financial condition, regulatory limitations, tax considerations, and other factors. Furthermore, banking regulators and lawmakers have become increasingly concerned with the levels of capital adequacy of financial institutions. Even though the Bank exceeds all current regulatory standards and believes that it is well capitalized, the regulators' interpretation and enforcement of existing and new requirements may in the future affect the level of capital required to be maintained by the Bank and/or the percentage of income that may be used for dividends to its parent holding company. The Company's ability to pay dividends at existing levels and/or its ability to repurchase additional shares may be affected by these actions. Refer to Part I, Item 1, "Business—Regulation and Supervision," of the Company's 2008 Annual Report on Form 10-K for additional discussion.

Contractual Obligations, Commitments, Contingent Liabilities, and Off-Balance Sheet Arrangements

Contractual Obligations The following table presents, as of June 30, 2009, significant fixed and determinable contractual obligations to third parties by payment date (excluding interest payments due in the future on deposits and borrowed funds).

| | Payments Due In | | | | Total |
|--|-------------------------------|--------------------|---------------------|-----------------|-----------|
| | One Year Or Less | One to Three Years | Three to Five Years | Over Five Years | |
| | <i>(Dollars in thousands)</i> | | | | |
| Deposits with no stated maturity | \$801,554 | – | – | – | \$801,554 |
| Certificates of deposits | 965,076 | \$182,633 | \$121,445 | – | 1,269,154 |
| Borrowed funds (1) | – | – | 100,271 | \$807,209 | 907,480 |
| Operating leases | 1,046 | 1,575 | 1,256 | 3,246 | 7,123 |
| Purchase obligations | 1,800 | – | – | – | 1,800 |
| Non-qualified retirement plans and deferred compensation plans | 769 | 2,000 | 1,962 | 8,754 | 13,485 |

(1) Includes \$856.0 million in advances that are redeemable on a quarterly basis at the option of the FHLB of Chicago.

The Company's operating lease obligations represent short- and long-term lease and rental payments for facilities, certain software and data processing equipment, and other equipment. Purchase obligations represent obligations under agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. The purchase obligation amounts presented above primarily relate to certain contractual payments for services provided for information technology.

The Company also has obligations under its deferred retirement plan for executives and directors as described in Note 12, "Employee Benefit Plans," to the Unaudited Condensed Consolidated Financial Statements, above.

Commitments to Extend Credit The following table details the amounts and expected maturities of approved commitments as of June 30, 2009.

| | Payments Due In | | | | Total |
|---|-------------------------------|--------------------|---------------------|-----------------|---------|
| | One Year Or Less | One to Three Years | Three to Five Years | Over Five Years | |
| | <i>(Dollars in thousands)</i> | | | | |
| Commercial loans | \$856 | – | – | – | \$856 |
| Residential real estate loans | 33,318 | – | – | – | 33,318 |
| Revolving home equity and credit card lines | 152,363 | – | – | – | 152,363 |
| Standby letters of credit | 50 | – | – | \$10 | 60 |
| Commercial lines of credit | 19,941 | – | – | – | 19,941 |
| Undisbursed commercial loans | 1,318 | – | – | – | 1,318 |

Approved commitments to extend credit, including loan commitments, standby letters of credit, unused lines of credit, and commercial letters of credit do not necessarily represent future cash requirements, since these commitments often expire without being drawn upon.

Off-Balance Sheet Arrangements At June 30, 2009, the Company had forward commitments to sell one- to four-family mortgage loans of \$46,913 to Fannie Mae. As described in Note 4, “Derivative Financial Instruments,” the Company uses forward commitments to sell loans to mitigate interest rate risk on one- to four-family IRLCs and loans held-for-sale.

Contingent Liabilities The Company did not have a material exposure to contingent liabilities as of June 30, 2009.

Outlook

This report contains forward-looking statements, including those in the following paragraphs. Please refer to “Cautionary Statement,” above. In addition, the Company’s management has identified a number of factors which may affect the Company’s financial condition and results of operations in the near term, which are as follows:

- The recent decline in real estate markets and general economic conditions may continue. If that is the case, there are a number of effects that the Company, like other financial institutions, would likely experience.
 - Loan originations could continue to fluctuate from period to period, along with related interest and fee income.
 - Although real estate values in Wisconsin have not been impacted as negatively as certain other regions of the United States, recent declines in the value of real estate could negatively affect mortgage and home equity loan originations, refinancings, and prepayments.
 - A continued decline in real estate values could also affect the value of the collateral securing the Company’s mortgage loans. A decrease in value could, in turn, lead to increased losses on loans in the event of foreclosures, which would affect the provisions for loan losses and profitability.
 - A continued slowdown in the economy may affect borrowers’ ability to repay their loan obligations, which could lead to increased non-performing loans, loan charge-offs, and loan loss provisions and/or reduced income.
 - If customer demand for real estate and other loans continues to decline, the Company’s profits may decrease because alternative investments, primarily investments and mortgage-related securities, generally yield less than the Company’s own originations of real estate loans.
 - The current difficulties in real estate markets may also affect the liquidity and/or value of mortgage-related investments such as MBSs and CMOs.
- The well-publicized liquidity crisis in the world credit markets may continue. If this occurs, there are a number of effects that the Company, like other financial institutions, would likely experience.
 - The fair value of its available-for-sale securities may continue to fluctuate with corresponding impacts on other comprehensive income and/or net income.
 - In the event the Company wishes to sell financial assets, its ability to sell such assets and the prices it could receive for such assets, could adversely affect its liquidity, financial position, and earnings.
 - The rates the Company receives on short-term or variable-rate investments and the rates it pays on short-term or variable-rate borrowings may fluctuate dramatically.
 - Acceptable investment opportunities may be limited given the Company’s desire to actively manage its exposure to credit and/or counter-party risks.
 - The Company’s access to borrowing sources to fund loan originations, investment purchases, and operations may be adversely impacted.

- The current credit market and economic crisis has led to the adoption of significant legislation and regulatory actions in recent months, which are expected to affect financial institutions and holding companies such as Bank Mutual Corporation in a far reaching manner, including in ways which cannot yet be fully determined. Additional legislation may be forthcoming. Changes resulting from this legislation, regulatory actions, and/or other reactions to the crisis could have an adverse impact on the financial condition and/or results of operations of the Company.
- Banking regulators and lawmakers have become increasingly concerned with the levels of capital adequacy of financial institutions. Even though the Bank exceeds all current regulatory standards and believes that it is well capitalized, the regulators' interpretation and enforcement of existing and new requirements may in the future affect the level of capital required to be maintained by the Bank and/or the percentage of income that may be used for dividends to its parent holding company. The Company's ability to pay dividends at existing levels and/or repurchase additional shares may be affected by these actions.
- The FDIC recently substantially increased regular premiums to financial institutions for deposit insurance, and has also recently imposed a substantial special assessment on financial institutions which is stated to be non-recurring. There may be further increases in the FDIC premium rates and there may be additional special assessments in the future, either as a result of changes in law or to respond to losses in the FDIC's insurance fund. Any such increases or special assessments would affect the Company's results of operations in future periods.
- The current economic turmoil has increased the potential for federal or state governments to legislate foreclosure forbearance, forced loan modifications, or "cram downs" of losses to lenders in bankruptcy proceedings. Such efforts could lead to increased loan charge-offs or loan loss provisions and/or reduced income. These efforts could also have an adverse impact on the value of certain mortgage-related securities not guaranteed by the FHLMC, FNMA, and GNMA, such as the private-label CMOs owned by the Company.
- The Company will continue to further emphasize commercial real estate and commercial business loans, both of which can present a higher risk than residential mortgages. However, market conditions and other factors may continue to negatively affect the Company's ability to increase its loan portfolio with these types of loans, and a weak economy could increase the risk that borrowers will not be able to repay these loans.
- Like many Wisconsin financial institutions, the Bank has non-Wisconsin subsidiaries that hold and manage investment assets, the income from which was not subject to Wisconsin tax prior to 2009. The Wisconsin Department of Revenue previously instituted an audit program specifically aimed at the Bank's out-of-state investment subsidiaries. This audit program has not been concluded, is not being actively pursued, and the Department has not asserted a claim against the Bank or its subsidiaries. Depending upon the terms and circumstances, an adverse resolution of these matters could result in additional Wisconsin tax obligations for prior periods, which could have a substantial negative impact on the Bank's earnings in the period of the resolution. Although the Bank believes it has reported income and paid Wisconsin taxes in prior periods in accordance with applicable legal requirements and the Department's long-standing interpretations of them, the Bank's position may not prevail in court or other actions may occur which give rise to liabilities. The Bank may also incur further costs in the future to address and defend these issues.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Gap Analysis

Repricing characteristics of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring a financial institution's interest rate sensitivity "gap." An asset or liability is said to be "interest rate sensitive" within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity "gap" is defined as the difference between the amount of interest-earning assets maturing or repricing within a specific time period and the amount of interest-bearing liabilities maturing or repricing within that same time period.

A gap is considered positive when the amount of interest-earning assets maturing or repricing within a specific time period exceeds the amount of interest-bearing liabilities maturing or repricing within that same time period. A gap is considered negative when the amount of interest-bearing liabilities maturing or repricing within a specific time period exceeds the amount of interest-earning assets maturing or repricing within the same period. During a period of rising interest rates, a financial institution with a negative gap position would be expected, absent the effects of other factors, to experience a greater increase in the costs of its liabilities relative to the yields of its assets and thus a decrease in the institution's net interest income. An institution with a positive gap position would be expected, absent the effect of other factors, to experience the opposite result. Conversely, during a period of falling interest rates, a negative gap would tend to result in an increase in net interest income while a positive gap would tend to reduce net interest income.

The following table presents the amounts of the Company's interest-earning assets and interest-bearing liabilities outstanding at June 30, 2009, which management anticipates will reprice or mature in each of the future time periods shown. The information presented in the following table is based on the following assumptions:

- Investment securities—based upon contractual maturities and if applicable, call dates. \$341.9 million in investment securities with maturities beyond one year have been classified as due within one year based on their call dates. These investments may or may not be called prior to their stated maturities.
- Mortgage-related securities—based upon an independent outside source for determining estimated cash flows or repricing dates (if applicable) using expected prepayment rates.
- Loans receivable—based upon contractual maturities, repricing dates (if applicable), scheduled repayments of principal, and projected prepayments of principal based upon the Company's historical experience or management estimates; the analysis does not include non-accrual loans.
- Deposit liabilities—based upon contractual maturities and historical decay rates.
- Borrowings—based upon stated maturity. However, \$856.0 million of borrowings classified as due beyond one year contain a redemption option which has not been reflected in the analysis. These borrowings could be redeemed at the option of the lender prior to their stated maturity (refer to "Financial Condition—Borrowings" in Part I, Item 2, above).

| | At June 30, 2009 | | | | | |
|--|-------------------------------|------------------------------|--|--|--------------------|------------------|
| | Within Three Months | Three to Twelve Months | More Than One Year To Three Years | More Than Three Years To Five Years | Over Five Years | Total |
| Interest-earning assets: | <i>(Dollars in thousands)</i> | | | | | |
| Loans receivable: | | | | | | |
| Mortgage loans: | | | | | | |
| Permanent: | | | | | | |
| Fixed | \$69,894 | \$99,369 | \$177,345 | \$87,289 | \$94,402 | \$528,299 |
| Adjustable | 83,356 | 283,227 | 237,249 | 65,862 | 268 | 669,962 |
| Construction: | | | | | | |
| Fixed | 3,072 | 9,242 | 19,692 | – | 23,438 | 55,444 |
| Adjustable | 23,471 | 2,099 | 7,571 | 7,380 | – | 40,521 |
| Consumer loans | 97,615 | 71,782 | 79,761 | 26,678 | 16,094 | 291,930 |
| Commercial business loans | 24,364 | 15,367 | 9,427 | 913 | 20 | 50,091 |
| Interest-earning deposits | 126,489 | – | – | – | – | 126,489 |
| Investment securities | 258,466 | 122,255 | – | – | – | 380,721 |
| Mortgage-related securities: | | | | | | |
| Fixed | 78,968 | 98,929 | 110,786 | 120,724 | 86,081 | 495,488 |
| Adjustable | 501,782 | – | – | – | – | 501,782 |
| Other interest-earning assets | 46,092 | – | – | – | – | 46,092 |
| Total interest-earning assets | <u>1,313,569</u> | <u>702,270</u> | <u>641,831</u> | <u>308,846</u> | <u>220,303</u> | <u>3,186,819</u> |
| Non-interest-bearing and interest-bearing liabilities: | | | | | | |
| Non-interest-bearing demand accounts | 1,037 | 3,040 | 7,602 | 6,922 | 70,411 | 89,012 |
| Interest-bearing liabilities: | | | | | | |
| Deposit liabilities: | | | | | | |
| Interest-bearing demand accounts | 2,136 | 6,261 | 15,659 | 14,257 | 145,711 | 184,024 |
| Regular savings accounts | 2,615 | 7,641 | 18,959 | 17,066 | 158,384 | 204,665 |
| Money market accounts | 323,853 | – | – | – | – | 323,853 |
| Certificates of deposit | 307,987 | 678,344 | 161,378 | 121,445 | – | 1,269,154 |
| Advance payments by borrowers for taxes and insurance | – | 21,345 | – | – | – | 21,345 |
| Borrowings | 248 | 770 | 2,198 | 102,626 | 801,638 | 907,480 |
| Total interest-bearing and non-interest-bearing liabilities | <u>637,876</u> | <u>717,401</u> | <u>205,796</u> | <u>262,316</u> | <u>1,176,144</u> | <u>2,999,533</u> |
| Interest rate sensitivity gap | <u>\$675,693</u> | <u>\$(15,131)</u> | <u>\$436,035</u> | <u>\$46,530</u> | <u>\$(955,841)</u> | <u>\$187,286</u> |
| Cumulative interest rate sensitivity gap | <u>\$675,693</u> | <u>\$660,562</u> | <u>\$1,096,597</u> | <u>\$1,143,127</u> | <u>\$187,286</u> | |
| Cumulative interest rate sensitivity gap as a percentage of total assets | <u>19.60%</u> | <u>19.16%</u> | <u>31.81%</u> | <u>33.16%</u> | <u>5.43%</u> | |
| Cumulative interest-earning assets as a percentage of interest bearing liabilities | <u>205.93%</u> | <u>148.74%</u> | <u>170.25%</u> | <u>162.69%</u> | <u>106.24%</u> | |

Based on the above gap analysis, at June 30, 2009, the Company's interest-earning assets maturing or repricing within one year exceeded its interest-bearing liabilities maturing or repricing within the same period by \$660.6 million. This represented a positive cumulative one-year interest rate sensitivity gap of 19.2%, and a ratio of interest-earning assets maturing or repricing within one year to interest-bearing liabilities maturing or repricing within one year of 148.7%. Based on this information, management anticipates that over the course of the next year the Company's net interest income could benefit from an increase in market interest rates. Alternatively, the Company's net interest income could be adversely affected by a decline in market

interest rates. However, it should be noted that the Company's future net interest income is affected by more than just future market interest rates. Net interest income is also affected by absolute and relative levels of earning assets and interest-bearing liabilities, the level of non-performing loans and other investments, and by other factors outlined in Part I, Item 2, "Management Discussion and Analysis of Financial Condition and Results of Operations—Cautionary Statement" and "Outlook," above, as well as Part I, Item 1A, "Risk Factors," of the Company's 2008 Annual Report on Form 10-K.

In addition to not anticipating all of the factors that could impact future net interest income, gap analysis has certain shortcomings. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Certain assets, such as adjustable-rate loans, have features which limit changes in interest rates on a short-term basis and over the life of the loan. If interest rates change, prepayment, and early withdrawal levels would likely deviate significantly from those assumed in calculating the table. Finally, the ability of borrowers to make payments on their adjustable-rate loans may decrease if interest rates increase.

Present Value of Equity

In addition to the gap analysis table, management also uses simulation models to monitor interest rate risk. The models report the present value of equity ("PVE") in different interest rate environments, assuming an instantaneous and permanent interest rate shock to all interest rate-sensitive assets and liabilities. The PVE is the difference between the present value of expected cash flows of interest rate-sensitive assets and liabilities. The changes in market value of assets and liabilities due to changes in interest rates reflect the interest rate sensitivity of those assets and liabilities as their values are derived from the characteristics of the asset or liability (i.e., fixed rate, adjustable rate, caps, and floors) relative to the current interest rate environment. For example, in a rising interest rate environment, the fair market value of a fixed rate asset will decline whereas the fair market value of an adjustable rate asset, depending on its repricing characteristics, may not decline. Increases in the market value of assets will increase the PVE whereas decreases in market value of assets will decrease the PVE. Conversely, increases in the market value of liabilities will decrease the PVE whereas decreases in the market value of liabilities will increase the PVE.

The following table presents the estimated PVE over a range of interest rate change scenarios at June 30, 2009. The present value ratio shown in the table is the PVE as a percent of the present value of total assets in each of the different rate environments. For purposes of this table, management has made assumptions such as prepayment rates and decay rates similar to those used for the gap analysis table.

| Change in Interest Rates (Basis Points) | Present Value of Equity | | | Present Value of Equity as a Percent of Present Value of Assets | |
|---|-------------------------------|------------------|-------------------|---|-------------------|
| | Dollar Amount | Dollar Change | Percent Change | Present Value Ratio | Percent Change |
| | <i>(Dollars in thousands)</i> | | | | |
| +300 | \$439,137 | \$(69,747) | (13.7)% | 12.89% | (8.7)% |
| +200 | 488,069 | (20,815) | (4.1) | 13.99 | (0.9) |
| +100 | 513,086 | 4,202 | (0.8) | 14.43 | 2.2 |
| 0 | 508,884 | – | – | 14.12 | – |
| -100 | 443,902 | (64,982) | (12.8) | 12.27 | (13.1) |

Based on the above analysis, management anticipates that the Company's PVE could benefit from an increase in market interest rates of less than 200 basis points. Alternatively, the Company's PVE could be adversely affected by a decline in market interest rates or by an increase in such rates of 200 basis points or more. The decline in the PVE as a result of an increase in rates of 200 basis points or more is attributable to

the combined effects of the Company's advances from the FHLB of Chicago, which the model assumes would be redeemed higher interest rate levels, and continued declines in the present value of the Company's earning assets due to rising interest rates. It should be noted that the Company's PVE is impacted by more than changes in market interest rates. Future PVE is also affected by management's decisions relating to reinvestment of future cash flows, decisions relating to funding sources, and by other factors outlined in Part I, Item 2, "Management Discussion and Analysis of Financial Condition and Results of Operations—Cautionary Statement" and "Outlook," above, as well as Part I, Item 1A, "Risk Factors," of the Company's 2008 Annual Report on Form 10-K.

As is the case with gap analysis, PVE analysis also has certain shortcomings. PVE modeling requires management to make assumptions about future changes in market interest rates that are unlikely to occur, such as parallel or equal changes in all market rates across all maturity terms. PVE modeling also requires that management make assumptions which may not reflect the manner in which actual yields and costs respond to changes in market interest rates. For example, management makes assumptions regarding the acceleration rate of the prepayment speeds of higher yielding mortgage loans. Prepayments will accelerate in a falling rate environment and the reverse will occur in a rising rate environment. Management also assumes that decay rates on core deposits will accelerate in a rising rate environment and the reverse in a falling rate environment. The model assumes that the Company will take no action in response to the changes in interest rates, when in practice rate changes on certain products, such as savings deposits, may lag behind market changes. In addition, prepayment estimates and other assumptions within the model are subjective in nature, involve uncertainties, and therefore cannot be determined with precision. Accordingly, although the PVE model may provide an estimate of the Company's interest rate risk at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in interest rates on the Company's PVE.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

Internal Control Over Financial Reporting

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

Item 1A. Risk Factors

Refer to "Risk Factors" in Part I, Item 1A, of the Company's 2008 Annual Report on Form 10-K. Refer also "Outlook" in Part I, Item 2, above.

Item 2. Unregistered Sale of Equity Securities and Use of Proceeds

The following table provides the specified information about the repurchases by the Company of its common shares during the second quarter of 2009.

| Month: | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans (1) | Maximum Number of Shares That May Yet be Purchased Under the Plans |
|-----------------|--|------------------------------------|---|--|
| April 2009 | — | — | — | 555,710 |
| May 2009 | 245,400 | \$9.3308 | 245,400 | 310,310 |
| June 2009 | 94,398 | 8.8027 | 90,710 | 219,600 |
| Total purchased | 339,798 | \$9.1841 | 336,110 | |

(1) Shares not repurchased as part of a publicly announced program were existing owned shares used by option holders in payment of the purchase price and/or tax withholding obligations in connection with the exercise of stock options under the Company's stock incentive plans. The "price paid per share" for these purposes was the fair market price on the date of the exercise.

Item 4. Submission of Matters to a Vote of Security Holders

The results of the Company's annual meeting of shareholders on May 4, 2009, were presented in Part II, Item 4, of the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2009. That item is incorporated herein by reference.

Item 6. Exhibits

Refer to Exhibit Index, which follows the signature page hereof.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BANK MUTUAL CORPORATION
(Registrant)

Date: August 10, 2009

/s/Michael T. Crowley, Jr.
Michael T. Crowley, Jr.
Chairman, President, and Chief Executive Officer

Date: August 10, 2009

/s/Michael W. Dosland
Michael W. Dosland
Senior Vice President and
Chief Financial Officer

EXHIBIT INDEX

BANK MUTUAL CORPORATION

Form 10-Q for Quarter Ended June 30, 2009

| <u>Exhibit No.</u> | <u>Description</u> | <u>Filed Herewith</u> |
|--------------------|---|-----------------------|
| 31.1 | Sarbanes-Oxley Act Section 302 Certification signed by the Chairman, President and Chief Executive Officer of Bank Mutual Corporation | X |
| 31.2 | Sarbanes-Oxley Act Section 302 Certification signed by the Senior Vice President and Chief Financial Officer of Bank Mutual Corporation | X |
| 32.1 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Executive Officer of Bank Mutual Corporation | X |
| 32.2 | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 signed by the Chief Financial Officer of Bank Mutual Corporation | X |

CERTIFICATION

I, Michael T. Crowley, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2009, of Bank Mutual Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2009

/s/Michael T. Crowley, Jr.

Michael T. Crowley, Jr.

Chairman, President, and Chief Executive Officer

CERTIFICATION

I, Michael W. Dosland, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the period ended June 30, 2009, of Bank Mutual Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2009

/s/Michael W. Dosland
Michael W. Dosland
Senior Vice President and Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Bank Mutual Corporation (the “Company”) on Form 10-Q for the period ended June 30, 2009, as filed with the Securities and Exchange Commission on or about the date hereof (the “Report”), I, Michael T. Crowley, Jr., Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/Michael T. Crowley, Jr.

Michael T. Crowley, Jr.

Chief Executive Officer

August 10, 2009

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Bank Mutual Corporation and will be retained by Bank Mutual Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Bank Mutual Corporation (the “Company”) on Form 10-Q for the period ended June 30, 2009, as filed with the Securities and Exchange Commission on or about the date hereof (the “Report”), I, Michael W. Dosland, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/Michael W. Dosland

Michael W. Dosland
Chief Financial Officer
August 10, 2009

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Bank Mutual Corporation and will be retained by Bank Mutual Corporation and furnished to the Securities and Exchange Commission or its staff upon request.