

HMN FINANCIAL INC
Form DEF 14A
March 22, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material under Rule 14a-12

HMN FINANCIAL INC.

(Name of registrant as specified in its charter)

(Name of person(s) filing proxy statement, if other than the registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

.. Fee paid previously with preliminary materials.

.. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

1016 Civic Center Drive N.W.
Rochester, Minnesota 55901-6057
(507) 535-1200

March 22, 2013

Dear Stockholder:

You are cordially invited to attend the annual meeting of stockholders to be held at the Rochester Golf and Country Club, located at 3100 W. Country Club Road, Rochester, Minnesota, on Tuesday, April 23, 2013, at 10:00 a.m., local time.

The corporate secretary's notice of annual meeting and the proxy statement that follow describe the matters to come before the meeting. During the meeting, we also will review the activities of the past year and items of general interest about our company.

We hope that you will be able to attend the meeting in person, and we look forward to seeing you. Please vote your proxy through the Internet, by telephone, or mark, date and sign the enclosed proxy card and return it in the accompanying postage-paid reply envelope as quickly as possible, even if you plan to attend the annual meeting. If you later desire to revoke the proxy, you may do so at any time before it is exercised.

Sincerely,

Hugh C. Smith
Chairman of the Board of Directors

VOTING METHODS

The accompanying proxy statement describes important issues affecting HMN Financial, Inc. If you are a stockholder of record, you have the right to vote your shares through the Internet, by telephone or by mail. You also may revoke your proxy any time before the annual meeting. Please help us save time and administrative costs by voting through the Internet or by telephone. Each method is generally available 24 hours a day and will ensure that your vote is confirmed and posted immediately. To vote:

1. **BY INTERNET**

- a. Go to the web site at <http://www.eproxy.com/hmnf>, 24 hours a day, seven days a week, until 11:59 p.m. central time on April 22, 2013.
- b. Please have your proxy card and the last four digits of your social security number or tax identification number and create an electronic ballot.
- c. Follow the simple instructions provided.

2. **BY TELEPHONE**

- a. On a touch-tone telephone, call toll free 1-800-560-1965, 24 hours a day, seven days a week, until 11:59 p.m. central time on April 22, 2013.
- b. Please have your proxy card and the last four digits of your social security number or tax identification number.
- c. Follow the simple instructions provided.

3. **BY MAIL (if you vote by telephone or Internet, please do not mail your proxy card)**

- a. Mark, sign and date your proxy card.
- b. Return it in the enclosed postage paid envelope.

If your shares are held in the name of a bank, broker or other holder of record, you will receive instructions from the holder of record that you must follow in order for your shares to be voted.

Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on April 23, 2013:

The Proxy Statement and Annual Report to Stockholders are available at

<http://www.proxydocs.com/hmnf>

Your vote is important. Thank you for voting.

HMN FINANCIAL, INC.

Notice of Annual Meeting of Stockholders

to be held on

April 23, 2013

Notice is hereby given that the annual meeting of stockholders of HMN Financial, Inc. will be held at the Rochester Golf and Country Club, located at 3100 W. Country Club Road, Rochester, Minnesota, at 10:00 a.m., local time, on April 23, 2013.

A proxy card and a proxy statement for the meeting are enclosed.

The meeting is for the purpose of considering and acting upon:

1. the election of three directors, to serve until the conclusion of the third succeeding annual meeting of stockholders or until their successors have been duly elected and qualified;
2. an advisory (non-binding) vote for the approval of the compensation of executives, as disclosed in this proxy statement;
3. an advisory (non-binding) vote on the frequency of the advisory (non-binding) vote for the approval of the compensation of executives, as disclosed in this proxy statement;
4. the approval to amend our certificate of incorporation, as amended, to increase the number of authorized shares of common stock from 11,000,000 shares, \$0.01 par value per share, to 16,000,000 shares, \$0.01 par value per share; and
5. the ratification of the appointment of KPMG LLP as our independent registered public accounting firm for 2013; and such other matters as may properly come before the meeting, or any adjournments or postponements thereof. As of the date of this notice, the board of directors is not aware of any other business to come before the meeting.

Any action may be taken on the foregoing proposals at the meeting on the date specified above, or on any date or dates to which the meeting may be adjourned or postponed. Stockholders of record at the close of business on February 26, 2013, are the stockholders entitled to receive notice of, and to vote at, the meeting and any adjournments or postponements thereof.

A complete list of stockholders entitled to vote at the meeting will be available for examination by any stockholder, for any purpose germane to the meeting, between 9:00 a.m. and 5:00 p.m. central time, Monday through Friday, at HMN Financial, Inc., 1016 Civic Center Drive N.W., Rochester, Minnesota for a period of ten days prior to the meeting.

Your proxy is important to ensure a quorum at the meeting. Even if you own only a few shares, and whether or not you expect to be present at the meeting, please vote your proxy by telephone or through the Internet, in accordance with the voting instructions set forth on the enclosed proxy card, or mark, date and sign the enclosed proxy card and return it in the accompanying postage-paid reply envelope as quickly as possible. You may revoke your proxy at any time prior to its exercise, and returning your proxy or voting your proxy by telephone or through the Internet will not affect your right to vote in person if you attend the meeting and revoke the proxy.

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

HMN FINANCIAL, INC.

BY ORDER OF THE BOARD OF DIRECTORS

Cindy K. Hamlin
Secretary

Rochester, Minnesota

March 22, 2013

PROXY STATEMENT

ABOUT THE ANNUAL MEETING

This proxy statement is furnished in connection with the solicitation on behalf of the board of directors of HMN Financial, Inc. of proxies to be used at the annual meeting of stockholders, which will be held at the Rochester Golf and Country Club, located at 3100 W. Country Club Road, Rochester, Minnesota, on April 23, 2013, at 10:00 a.m., local time, and any adjournments or postponements of the meeting. The accompanying notice of annual meeting and this proxy statement are expected to be mailed to stockholders on or about March 22, 2013.

Certain information provided herein relates to Home Federal Savings Bank, a wholly owned subsidiary of our company referred to as the bank.

The board of directors requests that you vote on the proposals described in this proxy statement. You are invited to attend the meeting, but you do not need to attend the meeting to cast your vote.

What is the purpose of the annual meeting?

At the annual meeting, we will ask our stockholders to vote on five matters:

1. to elect three members of our board of directors, to serve until the conclusion of the third succeeding annual meeting of stockholders or until their successors have been duly elected and qualified;
2. an advisory (non-binding) vote for the approval of the compensation of executives, as disclosed in this proxy statement;
3. an advisory (non-binding) vote on the frequency of the advisory (non-binding) vote for the approval of the compensation of executives, as disclosed in this proxy statement;
4. to approve the amendment of our certificate of incorporation, as amended, to increase the number of authorized shares of common stock from 11,000,000 shares, \$0.01 par value per share, to 16,000,000 shares, \$0.01 par value per share; and
5. to ratify the appointment of KPMG LLP as our independent registered public accounting firm for 2013;

as well as to transact other business that may properly be brought before the meeting. Following the formal portion of the meeting, our management will report on our performance and answer questions from our stockholders.

Who is entitled to vote on the proposals to be considered at the meeting and described in this proxy statement?

Common stock is our only authorized and outstanding security entitled to vote on the proposals described in this proxy statement at the annual meeting. In this proxy statement, when we refer to stockholder, we are referring to our common stockholders, unless stated otherwise herein. Holders of record of our common stock as of the close of business on February 26, 2013, the record date, will be entitled to one vote for each share of common stock then held. As of February 26, 2013, we had 4,423,589 shares of common stock issued and outstanding. The number of issued and outstanding shares excludes shares held in our treasury.

Who is entitled to attend the meeting?

Subject to space availability, all stockholders as of the record date, or their duly appointed proxies, may attend the meeting. Since seating is limited, admission to the meeting will be on a first-come, first-served basis. Registration will begin at 9:30 a.m. If you plan to attend the

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

meeting, please note that you will be asked to present valid picture identification, such as a driver's license or passport. Cameras, recording devices and other electronic devices are not permitted at the meeting.

Please also note that if you hold your shares in street name (that is, through a broker or other nominee), you will need to bring a copy of a brokerage statement reflecting your stock ownership as of the record date.

What constitutes a quorum?

The presence, in person or by proxy, of one third of the outstanding shares of common stock entitled to vote constitutes a quorum for purposes of the meeting. Abstentions, votes withheld and broker-non votes will be counted for the purpose of determining the presence of a quorum.

How do I vote?

If you are a registered stockholder, proxies in the accompanying form that are properly signed and duly returned to us, voted by telephone or through the Internet in accordance with the voting instructions set forth below, and not revoked, will be voted in the manner specified. We encourage you to vote by telephone or on the Internet, if possible, to reduce the costs of tabulating the vote.

To vote by Internet:

- a. Go to the web site at <http://www.eproxy.com/hmnf>.
- b. Please have your proxy card and the last four digits of your social security number or tax identification number and create an electronic ballot.
- c. Follow the simple instructions provided.

To vote by telephone:

- a. Call toll free 1-800-560-1965.
- b. Please have your proxy card and the last four digits of your social security number or tax identification number.
- c. Follow the simple instructions provided.

To vote by mail:

- a. Mark, sign and date your proxy card.
- b. Return it in the enclosed postage paid envelope.

If you are a registered stockholder and attend the annual meeting, you may deliver your proxy in person.

If you hold your shares in street name, meaning you hold them through an account with a bank or broker, your ability to vote over the Internet or by telephone depends on your bank's or broker's voting procedures. Please follow the directions that your bank or broker provides.

All shares of our common stock represented at the meeting by properly executed proxies, duly delivered to our corporate secretary prior to or at the meeting, and not revoked, will be voted at the meeting in accordance with the instructions specified on the proxies.

What happens if no instructions are indicated on my proxy?

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

If no instructions are indicated, properly executed proxies will be voted as follows:

for the nominees for director listed below;

for the approval of the compensation of executives, as disclosed in this proxy statement;

for a period of one year for the frequency of the non-binding advisory vote to approve the compensation of executives;

for the amendment of our certificate of incorporation, as amended, to increase the number of authorized shares of common stock from 11,000,000 shares, \$0.01 par value per share, to 16,000,000 shares, \$0.01 par value per share; and

for the ratification of the appointment of our independent registered public accounting firm.

As of the date of this proxy statement, the board does not know of any matters, other than those described in the notice of annual meeting and this proxy statement, that are to come before the meeting. If any other matters are properly presented at the meeting for action, the persons named in the enclosed form of proxy and acting thereunder will have, to the extent permitted by law, the discretion to vote on these matters in accordance with their best judgment.

May I revoke my proxy or change my vote?

A proxy given pursuant to this solicitation may be revoked at any time before it is voted. Proxies may be revoked by filing with our corporate secretary, at or before the meeting, a written notice of revocation bearing a later date than the date on the proxy. A vote may be changed by duly executing a proxy dated a later date than the earlier proxy and relating to the same shares and delivering it to our corporate secretary at or before the meeting. Attendance at the meeting will not by itself revoke a previously granted proxy.

What is the recommendation of the board of directors on voting my shares?

Our board of directors recommends a vote as follows:

for the election of the three nominated directors;

for the advisory (non-binding) vote to approve the compensation of executives, as disclosed in this proxy statement;

for a period of one year for the advisory (non-binding) vote for the frequency of the advisory (non-binding) vote to approve the compensation of executives;

for the amendment of our certificate of incorporation, as amended, to increase the number of authorized shares of common stock from 11,000,000 shares, \$0.01 par value per share, to 16,000,000 shares, \$0.01 par value per share; and

for the ratification of KPMG LLP as our independent registered public accounting firm.

If any other matters come up for a vote at the meeting, the proxy holders will vote in line with the recommendations of the board of directors or, if there is no recommendation, at their own discretion.

What vote is required to approve each item?

If there is a quorum at the annual meeting, the matters to be voted upon by the stockholders require the following votes for such matter to be approved:

Election of Directors (Proposal 1). Directors are elected by a plurality of the votes cast at the meeting, therefore, the three director nominees who receive the greatest number of votes cast by the common stockholders will be elected. For this purpose, a properly executed proxy marked *withheld* with respect to the election of director nominees will be counted for purposes of determining whether there is a quorum, but will have no effect on the outcome of the vote on the election of directors.

Advisory Vote on Approval of Executive Compensation (Proposal 2). We will consider the stockholders to have approved the compensation of our executive officers, on an advisory, non-binding basis, if this proposal receives the affirmative vote of holders of at least a majority of the common stock for which votes are cast at the annual meeting. The advisory vote to approve the compensation of our executive officers is not binding on the board, but the compensation committee of the board will consider the vote of the stockholders when considering future executive compensation arrangements. A properly executed proxy marked *abstain* and a broker non-vote (discussed in more detail below) with respect to this proposal will not

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

impact the outcome of this vote.

Advisory Vote on Frequency of Advisory Vote on Approval of Executive Compensation (Proposal 3). The frequency that receives the highest number of votes cast at the annual meeting will constitute the non-binding advisory recommendation of the stockholders as to the frequency of future advisory, non-binding, votes on executive officer compensation. The advisory vote as to

the frequency of the advisory vote to approve, on a non-binding basis, the compensation paid to our executive officers is not binding on the board, but the compensation committee of the board will consider the vote of the stockholders when considering whether the future votes to approve, on an advisory, non-binding basis, the compensation of our executive officers should occur every one, two or three years. A properly executed proxy marked *abstain* or a broker non-vote with respect to this proposal will not impact the outcome of this vote.

Increase in Authorized Common Stock (Proposal 4). The affirmative vote of holders of at least the majority of our outstanding common stock is required to approve the amendment to the certificate of incorporation, as amended, to increase our authorized shares of common stock from 11,000,000 shares, \$0.01 par value per share, to 16,000,000 shares, \$0.01 par value per share. A properly executed proxy marked *abstain* or a broker non-vote with respect to this proposal will have the same effect as a vote *against*.

Ratification of Independent Registered Public Accounting Firm (Proposal 5). The affirmative vote of holders of at least the majority of the common stock for which votes are cast at the annual meeting is required for ratification of the appointment of KPMG LLP as our independent registered public accounting firm for 2013. A properly executed proxy marked *abstain* and a broker non-vote with respect to this proposal will not impact the outcome of this vote.

Generally, for all other items that properly come before the meeting, the affirmative vote of a majority of the common stock for which votes are cast at the annual meeting is required for approval. A properly executed proxy marked *abstain* and a broker non-vote with respect to any such item will not impact the outcome of this vote.

What is the effect of abstentions and broker non-votes?

If stockholders indicate on their proxy that they wish to abstain from voting on a particular proposal, including brokers holding their customers shares of record who cause abstentions to be recorded, these shares are considered present and entitled to vote at the meeting for purposes of determining a quorum, but are not considered present or votes cast for purposes of calculating the vote with respect to that proposal. A proxy marked *abstain* on Proposals 2, 3 and 5 will not impact the outcome of those proposals. A proxy marked *abstain* on Proposal 4 will have the same effect as a vote *against* on the outcome of that proposal.

Although our shares of common stock are traded on the NASDAQ Global Market, we are subject to certain rules and regulations of the New York Stock Exchange, including those relating to the ability of brokers to vote on certain matters. If a stockholder does not give a broker holding the stockholder's shares instructions as to how to vote the shares, the broker has authority under New York Stock Exchange rules to vote those shares for or against routine matters that are not contested. For purposes of this proxy statement, the only routine matter is the ratification of KPMG LLP as our independent registered public accounting firm. Brokers cannot vote on their customers' behalf on non-routine proposals. Therefore, a broker non-vote occurs when a broker holding shares for a beneficial owner does not vote on a particular proposal because the broker does not have or does not exercise discretionary voting power with respect to that item and has not received voting instructions from the beneficial owner. If a broker returns a non-vote proxy indicating a lack of authority to vote on a proposal, then the shares covered by such a non-vote proxy will be deemed present at the meeting for purposes of determining a quorum, but not present or a vote cast for purposes of calculating the vote with respect to that proposal. Therefore, broker non-votes will have no effect on Proposals 1, 2, 3 and 5. Because a majority of the outstanding shares of our common stock must vote on Proposal 4, broker non-votes have the same effect as a vote *against* for purposes of the outcome of that proposal.

May the meeting be adjourned?

If a quorum is not present at the meeting, the chairman of the meeting, or the stockholders present, by vote of a majority of the shares entitled to vote by stockholders that are present in person or represented by proxy, may adjourn the meeting. At any adjourned meeting at which a quorum is present, any business may be transacted which might have been transacted at the meeting as originally called.

Who pays the expenses incurred in connection with the solicitation of proxies?

We will bear the cost of solicitation of proxies. We will reimburse brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy materials to the beneficial owners of common stock. In addition to solicitation by mail, our directors and officers, as well as employees of the bank, may solicit proxies personally or by telephone without additional compensation.

How may I obtain additional copies of the annual report?

Our 2012 annual report, including financial statements, is enclosed. The annual report is also available online at www.hmnf.com or www.proxydocs.com/hmnf. For additional printed copies, which are available without charge, please request copies in writing to 1016 Civic Center Drive N.W., Rochester, Minnesota 55901-6057, Attention: Corporate Secretary.

What is the deadline for submitting a stockholder proposal for the 2014 annual meeting?

We must receive stockholder proposals intended to be presented at the 2014 annual meeting of stockholders that are requested to be included in the proxy statement for that meeting at our principal executive office no later than November 22, 2013. The inclusion of any stockholder proposals in the proxy materials will be subject to the requirements of the proxy rules adopted under the Securities Exchange Act of 1934, as amended (the Exchange Act), including Rule 14a-8. We must receive any other stockholder proposals (including director nominations) intended to be presented at the 2014 annual meeting of stockholders in writing at our principal executive office no later than 90 days in advance of the meeting (or if we do not publicly announce our annual meeting date 100 days in advance of the meeting date, by the close of business on the 10th day following the day on which notice of the meeting is mailed to stockholders or publicly made). We currently anticipate that our 2014 annual meeting of stockholders will be held on or about April 22, 2014; therefore, we must receive notice of any business to be brought before that meeting by January 22, 2014. Written copies of all stockholder proposals should be sent to our principal executive offices at 1016 Civic Center Drive N.W., Rochester, Minnesota 55901-6057, Attention: Corporate Secretary.

What does it mean if I receive more than one proxy card or instruction form?

This means that your shares are registered differently and are held in more than one account. To ensure that all shares are voted, please either vote each account over the Internet or by telephone, or sign and return by mail all proxy cards. We encourage you to register all of your shares in the same name and address by contacting our transfer agent, Wells Fargo Shareowner Services, at 1-800-401-1957. If you hold your shares through an account with a bank or broker, you should contact your bank or broker and request consolidation.

I share an address with another stockholder, how can I change the number of copies of the proxy statement that we receive?

Generally, we are sending only one copy of the proxy materials to eligible stockholders who share a single address unless we received instructions to the contrary from any stockholder at that address. This practice, known as householding, is designed to reduce our printing and postage costs. We will promptly deliver a separate copy of proxy materials to any stockholder who requests one by contacting our corporate secretary by telephone at (507) 535-1205, or by mail to our principal executive offices at 1016 Civic Center Drive N.W., Rochester, Minnesota 55901-6057, Attention: Corporate Secretary. If you are a registered stockholder residing at an address with another registered stockholder and you wish to receive a separate proxy in the future, or if the registered stockholders at that address currently are receiving multiple copies of the proxy materials and you wish to receive a single copy, you may contact our corporate secretary at the telephone number or address set forth above. If you are a stockholder whose shares are held by a bank, broker or other nominee, you can request information about householding from your bank, broker or other nominee.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this proxy statement may constitute forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. These statements are often identified by such forward-looking terminology as expect, intend, look, believe, anticipate, estimate, project, seek, may, will, would, could, should, trend, target, and goal or similar statements or variations thereof; our possible future business and financing needs; and any other statements, projections or assumptions that are not historical facts. Factors that may cause actual results to differ from our assumptions and expectations include those set forth in our most recent filings on Forms 10-K and 10-Q with the Securities and Exchange Commission. All forward-looking statements are qualified by, and should be considered in conjunction with, such cautionary statements. For additional discussion of the risks and uncertainties applicable to us, see the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2012.

PROPOSAL 1 - ELECTION OF DIRECTORS

Background

Our certificate of incorporation, as amended, provides that the board of directors shall fix the number of directors from time to time. The size of the board has been set at nine members, subject to the power of the board to increase the size of the board at any time. As discussed in more detail below, as of the scheduled dividend payment date of May 15, 2012, we had failed to pay dividends on the Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) for six quarters. Therefore, under the terms of the certificate of designations for the Preferred Stock, commencing on May 15, 2012, the authorized number of directors of our board automatically increased by two and holders of Preferred Stock (together with any voting parity stock which may be outstanding) have the right to elect at any annual or special meeting two representatives to our board of directors. Proxies solicited by this proxy statement relate solely to nominees to our board for election by holders of our common stock and cannot be voted for more persons than the three nominees names below.

The board members to be elected by the holders of common stock are divided into three classes. The terms of three members of the board, Mr. Fogarty, Ms. Kolling, and Mr. McDonald, will expire at the conclusion of the meeting. Ms. Kolling will have completed her fourth three year term and reached board term limits as defined in the by-laws. The board has nominated Mr. Fogarty and Mr. McDonald, both current members of the board of directors, whose current terms will expire at the conclusion of the meeting, and Wendy S. Shannon, for election as directors to serve terms to expire at the conclusion of the third succeeding annual meeting of stockholders after their election, with each to hold office following each nominee's election and qualification until his or her successor has duly been elected and qualified. Ms. Shannon was recommended to the nominating and governance committee by the members of that committee and was evaluated along with other potential director nominees. It is intended that the proxies solicited on behalf of the board (other than proxies in which the vote is withheld as to one or more nominees) will be voted at the meeting for the election of the nominees identified in this paragraph. If any nominee is unable to serve, the shares of common stock represented by all of these proxies will be voted for the election of a substitute as the board may recommend.

The board knows of no reason why any of the nominees, if elected, might be unable to serve. Except as described herein, there are no arrangements or understandings between any director or nominee and any other person pursuant to which the director or nominee was selected.

Selection of Director Nominees

Director Qualifications. The board, acting through the governance and nominating committee, is responsible for selecting director nominees. The board and the governance and nominating committee believe that the board as a whole and its members individually should possess a combination of skills, professional

experience, and business judgment necessary to oversee our company's current and future operations and represent stockholders' interests. The attributes that the board believes every director nominee should possess include:

notable or significant business or public service achievement and experience;

familiarity with, knowledge of, or experience in, the commercial banking industry;

familiarity with, knowledge of, or experience in, managing risk;

the highest character and integrity;

knowledge and understanding of the business and social environment in the primary geographical areas in which we operate;

an understanding of their obligation to represent the interests of all shareholders;

freedom from conflicts of interest that would interfere with their ability to discharge their duties or that would violate any applicable laws or regulations;

capability of working in a collegial manner with persons of diverse educational, business and cultural backgrounds; and

ability to devote the necessary time to discharge their duties, taking into account memberships on other boards and other responsibilities.

Procedures Regarding Director Candidates Recommended by Stockholders. As set forth in its charter, the governance and nominating committee will consider director candidates recommended by stockholders if the recommended director candidate would be eligible to serve as a director under our by-laws. Our by-laws require that directors have their primary domicile in a county where the bank has a full service branch. This requirement may be waived by a majority of the board so long as a majority of the directors currently serving on the board have their primary domicile in a county where the bank has a full service branch. Our by-laws also require that each director must receive (or have been deemed to receive) any approval, waiver or non-objection required by the company's and the bank's federal regulators. This qualification requirement may be waived by a majority of the board in its sole discretion.

In order to be considered by the governance and nominating committee, a stockholder recommendation of a director candidate must set forth all information relating to the candidate that is required to be disclosed in solicitations of proxies for election of directors in an election contest, or is otherwise required, pursuant to Regulation 14A under the Exchange Act (including the potential director's written consent to being named in the proxy statement as a nominee and to serving as a director if elected).

The governance and nominating committee will consider director candidates recommended by stockholders in the same manner that it considers all director candidates. This consideration will include an assessment of each candidate's experience, integrity, competence, diversity, skills and dedication in the context of the needs of the board. Each candidate will be evaluated in the context of the board as a whole, with the objective of recommending a group of nominees that can best perpetuate the success of the business and represent stockholder interest through the exercise of sound judgment based on a diversity of experience.

Rather than recommending director candidates to the governance and nominating committee, stockholders may directly nominate a person for election to the board by complying with the procedures set forth in our by-laws, any applicable rules and regulations of the Securities and Exchange Commission and any applicable laws. For more information regarding the submission of stockholder nominations of director candidates, please refer to the section entitled "Stockholder Proposals," as well as the Q&A appearing at the beginning of this proxy statement.

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

Candidates Elected by the Holders of Preferred Stock Upon Failure to Pay Dividends. As discussed in more detail in our Annual Report on Form 10-K filed for the year ended December 31, 2012, we issued Preferred Stock to the United States Department of the Treasury (Treasury) as part of the Troubled Asset Relief Program

(TARP) Capital Purchase Program (the CPP). Pursuant to the terms of the Preferred Stock, since the accumulated dividends on the Preferred Stock have not been paid for an aggregate of six quarterly dividend periods, the number of our directors automatically increased by two and the holders of the Preferred Stock have the right to elect two directors to fill the newly created directorships at our annual meeting of stockholders (or at a special meeting called for that purpose prior to such annual meeting) and at each subsequent annual meeting of stockholders until all accrued and unpaid dividends for all past dividend periods on all outstanding Preferred Stock have been declared and paid in full. Treasury sold the Preferred Stock to unaffiliated third party investors on February 8, 2013. Prior to such time, Treasury had not exercised its right to elect two representatives to our board. We have been advised by the Board of Governors of the Federal Reserve (the FRB) that the unaffiliated third party investors that purchased substantially all the Preferred Stock from Treasury have, as a condition to their investment in the Preferred Stock, entered into passivity commitments with the FRB pursuant to which they have waived, unless they obtain prior FRB consent, the right to elect two representatives to our board of directors.

Any director elected by the holders of Preferred Stock may be removed at any time, with or without cause, and any vacancy created thereby may be filled, only by affirmative vote of the holders of a majority of the shares of Preferred Stock, voting separately as a class. Any vacancy in the office of any preferred director for any reason other than removal, may be filled by the remaining preferred director for an unexpired term in respect of which such vacancy occurred.

Board Diversity. Neither the governance and nominating committee nor the board has a formal policy with regard to the consideration of diversity in identifying director nominees. However, the governance and nominating committee considers diversity on the board in evaluating potential director nominees and believes that diverse perspectives are represented on the board, within the constraints of our by-law requirement that generally directors must have their primary domicile in a county where the bank has a full service branch.

Board of Directors

The following table sets forth certain information regarding each director or director nominee:

| Name | Age | Position | Director Since |
|--------------------------------|-----|--|----------------|
| <i>Nominated for Election:</i> | | | |
| Michael J. Fogarty | 74 | Director | 2002 |
| Malcolm W. McDonald | 76 | Director | 2004 |
| Wendy S. Shannon | 59 | Nominee | N/A |
| <i>Term expiring in 2013:</i> | | | |
| Michael J. Fogarty | 74 | Director | 2002 |
| Susan K. Kolling | 61 | Senior Vice President and Director of the company and the bank | 2001 |
| Malcolm W. McDonald | 76 | Director | 2004 |
| <i>Term expiring in 2014:</i> | | | |
| Allen J. Berning | 58 | Director | 2011 |
| Karen L. Himle | 57 | Director | 2005 |
| Bernard R. Nigon | 64 | Director | 2011 |
| <i>Term expiring in 2015:</i> | | | |
| Bradley C. Krehbiel | 54 | President and Director of the company and the bank | 2009 |
| Hugh C. Smith | 73 | Chairman and Director | 2009 |
| Mark E. Utz | 52 | Director | 2012 |

Allen J. Berning is currently a director and has been working as an independent consultant. He is the former Chief Executive Officer of Hardcore Computer, Inc., a computer design and manufacturing company.

Prior to joining Hardcore Computer in 2007, Mr. Berning served as Chairman and Chief Executive Officer of Pemstar, Inc., an engineering and medical device manufacturing company, since founding the company in 1994. Prior to 1994, he held various engineering and management positions throughout his 15 year career with IBM.

Mr. Berning, having founded Pemstar and serving as its Chief Executive Officer for 13 years and then serving as the Chief Executive Officer of Hardcore Computer for over 4 years, brings extensive experience and perspective to our board, assisting it in assessing risk, evaluating opportunities and identifying resources essential to our success. Mr. Berning has resided in the Rochester, Minnesota area for more than 30 years, providing him with an understanding and appreciation for the business and social atmosphere of the bank's largest market.

Michael J. Fogarty has been an insurance agent with C.O. Brown Agency, Inc., an insurance agency located in Rochester, Minnesota, for over 40 years. He currently serves as a Vice President for C.O. Brown Agency, Inc.

Mr. Fogarty brings to our board extensive business experience from selling risk protection and financial products, which provides our board with perspective in its oversight of the company's financial services business. Mr. Fogarty's experience with risk protection products also assists our board in its identification and oversight of company risks. Mr. Fogarty's 8 years of experience on our board has given him insight into, and perspective on, our company's operations, which assists our board in its oversight of our company.

Karen L. Himle is the owner of a family farming operation, established in 1882, located in Monroe, Nebraska. She is the former Vice President of University Relations for the University of Minnesota, a position she held from January 2007 until January 2011. From 2004 to January 2006, she served as the Executive Vice President of Children's Hospitals and Clinics of Minnesota, an independent, not-for-profit health care system, and President of Children's Hospitals and Clinics Foundation, the fundraising arm of Children's Hospitals and Clinics of Minnesota. From 2002 to 2004, Ms. Himle served as an independent consultant. From 1985 to 2002, she held various positions, including Senior Vice President Corporate and Government Affairs, at The St. Paul Companies, Inc., a worldwide provider of commercial property-liability insurance and reinsurance products and services. In addition, Ms. Himle serves on the board of directors for Himle, Rapp and Co., a public relations and public affairs firm, and on the Minnesota Orchestral Association Board of Directors, the University of Nebraska Foundation Board of Trustees, and the Board of Directors of Crossways International.

Ms. Himle has held senior executive positions in complex enterprises in both the public and private sectors over her 30-year career. She brings to our board the management experience and insight that she has developed over her career, which assists our board in its oversight of the management of our company. In addition, Ms. Himle provides our board with experience and insight with respect to government affairs, risk protection and financial service products.

Susan K. Kolling served as a Vice President of the bank from 1992 to 1994 and has served as a Senior Vice President of the company and the bank since 1995. In addition, from 1997 to 2003, Ms. Kolling was an owner of Kolling Family Corp., which is doing business as Valley Home Improvement, a retail lumber yard. Ms. Kolling became a director of Kolling Family Corp. in 2004.

Ms. Kolling has been an employee or officer of our bank for over 40 years. She brings to our board the unique perspective of her long tenure with our bank and assists our board in understanding and overseeing the bank's, and the company's, operations. As a former owner of a family business, Ms. Kolling also helps our board understand the banking needs of family businesses and contributes to the oversight of the bank's cash management operations.

Bradley C. Krehbiel has served as President of the bank since January 2009 and President of the company since April 2010. He has also served as the Chief Executive Officer of the bank and the company since April 2012. Prior to that, he had been the Executive Vice President of the bank since 2004. Mr. Krehbiel joined the bank as Vice President of Business Banking in 1998. Prior to his employment at the bank, Mr. Krehbiel held several positions in the financial services industry, including six years as a private banking consultant.

Mr. Krehbiel brings to our board the financial services industry insights and perspectives gained through his extensive financial services industry experience, including as a private banking consultant. In addition, as an executive of our banking subsidiary for over twelve years, Mr. Krehbiel contributes a unique understanding of, and perspective on, our banking operations to our board.

Malcolm W. McDonald served as a member of the Board of Directors and Senior Vice President of Space Center, Inc., an industrial real estate firm located in St. Paul, Minnesota, from 1977 until his retirement in 2002. He also served as Vice President of First National Bank of St. Paul from 1960 to 1977. He is a director or trustee of several nonprofit foundations and organization, including a member and Vice Chair of the Investment Advisory Council of the Minnesota State Board of Investment, Trustee Emeritus of the Amherst H. Wilder Foundation, member of the Emeritus Council of the Minnesota Historical Foundation, Emeritus Trustee of the Minnesota State Fair Foundation and a former member of the board, Vice President and Trustee Emeritus of the Grotto Foundation and, among others, has served on the boards of directors of the Guthrie Theatre, Minnesota Orchestra and the Bigelow Foundation. Mr. McDonald was also a member of the Board of Directors of Scherer Brothers Lumber Company, a privately held full-service lumber yard. From 1974 to 1994, he was an Adjunct Professor at the University of St. Thomas Graduate Program of Management in St. Paul, Minnesota.

Based on his 42-year career in financial services management and commercial real estate, Mr. McDonald brings to our board extensive knowledge and experience in lending, investing and audit functions, as well as a deep understanding of the importance of the role of banking in a community. Based on his service on numerous public-company, private-company and nonprofit boards of directors, Mr. McDonald also brings to our board his extensive understanding of corporate governance, including board committee structures and executive succession planning, as well as significant experience in risk oversight.

Bernard R. Nigon, from 1985 until his retirement in 2010, was an audit partner with McGladrey LLP. He began his career with McGladrey in 1975. He is a Certified Public Accountant and a member of the American Institute of Certified Public Accountants and the Minnesota Society of Certified Public Accountants.

Mr. Nigon has extensive accounting and financial reporting experience, having practiced with a national accounting firm and examined the financial records of both public and private companies for over 35 years. His experience and expertise assists the board in understanding and addressing complex accounting and financial reporting issues.

Wendy Shannon is currently an assistant professor at Winona State University and Interim Director of Human Resources for Rochester Public Schools. She is the former Superintendent of the Byron School District, a position she held from 1999 through June 2012. Prior to 1999, Dr. Shannon served as the Executive Director of the Zumbro Education District; Management Development Specialist, Minnesota Department of Transportation; Facilitator for Minnesota Educational Effectiveness Program, Director Principal Leadership Program; and a secondary education teacher. Dr. Shannon is a member of the Board of Directors of the Rochester Area Foundation, Board of Trustees of Olmsted Medical Center, Member and former Chair, United Way of Olmsted County, and Chair of the Chancellor's Advisory and Advocacy Committee, University of Minnesota, Rochester.

Dr. Shannon has 36 years of extensive experience as a leader in nonprofit, government and education settings in the Rochester area. She has management, process, strategic planning and human resource skills that contribute to strengthening organizations and the community.

Hugh C. Smith was a member of the Mayo Clinic medical staff from 1972 until his retirement in 2007. During this time he served in various capacities, including as Professor of Medicine, Mayo Clinic College of Medicine, a medical school, and Chair, Cardiovascular Division at Mayo Clinic, a full-service, not-for-profit medical practice. Dr. Smith also served as Chief Executive Officer and chair of the Finance Committee, Mayo Clinic-Rochester, from 1999 through 2006; Vice President, Mayo Foundation, 2002 through 2006; and Chair, Rochester Board of Governors, Mayo Clinic, 1999 to through 2006. Dr. Smith is a member of the Board of Directors of Dartmouth Hitchcock Medical Center, Blue Cross Blue Shield Minnesota, and Rochester Area Foundation. He completed his terms as a member of the Board of Directors of Hormel Foods Corporation in November 2011, and recently joined the Chancellor's Advisory and Advocacy Committee, University of Minnesota, Rochester.

Dr. Smith brings extensive executive management experience to our board, having served as a Chief Executive Officer directing more than 2,000 physicians and scientists and over 35,000 employees. Based on his service on public company and non-profit boards of directors, Dr. Smith also brings to our board his extensive understanding of corporate governance and significant experience in risk oversight. Dr. Smith is active in the Rochester, Minnesota community and brings to our board a strong understanding of that community, its leaders, its financial services needs and its exposure to economic risks.

Mark E. Utz, since 1991, has been an attorney at Wendland Utz, Ltd. (Wendland Utz) where he advises clients on business, real estate and estate planning matters. Mr. Utz is the President and a shareholder of Wendland Utz. Prior to 1991, he was an attorney in the tax department at Arthur Andersen in Chicago. He is a Board Certified Real Property Law Specialist, which is a certification issued by the Minnesota State Bar Association. Mr. Utz is a member of the Board of Directors of the Rochester Area Foundation, Rochester Area Economic Development, Inc., the Greater Rochester Advocates for Universities and Colleges, the Minnesota Zoo and serves as the chair of the Rochester Area Chamber of Commerce Government Forums Committee.

Mr. Utz has extensive experience in counseling clients on a number of legal issues, including those related to corporate and real estate matters through his practice as an attorney for over 25 years. His experience and expertise assists the board in understanding and addressing corporate law and corporate governance issues that impact us. Mr. Utz is active in the Rochester, Minnesota community and brings to our board a strong understanding of that community, its leaders, its financial services needs and its exposure to economic risks.

The board recommends that stockholders vote *for* the election of the three candidates

nominated for election as indicated above.

PROPOSAL 2 - ADVISORY (NON-BINDING) VOTE ON EXECUTIVE COMPENSATION

In December 2008, we participated in the CPP under the TARP. The American Recovery and Reinvestment Act of 2009, signed into law on February 17, 2009, included a provision requiring CPP participants, during the period in which any obligation arising from assistance provided under the CPP remains outstanding, to permit a separate stockholder vote to approve the compensation of executives, as disclosed pursuant to the compensation rules of the Securities and Exchange Commission. This requirement applied to any proxy, consent, or authorization for an annual meeting of the participant's stockholders for which proxies will be solicited for the election of directors or a special meeting in lieu of such an annual meeting. Under this legislation, the stockholder vote was not binding on the board of directors of the CPP participant, and could not be construed as overruling any decision by the participant's board of directors.

Due to the sale of the Preferred Stock by Treasury on February 8, 2013, as of that date, we are no longer subject, among other requirements, to the corporate governance obligations arising under the CPP. Therefore, we are no longer subject to the non-binding shareholder vote to approve the compensation of our executive officers, as disclosed in the proxy statement, as required by the American Recovery and Reinvestment Act of 2009. However, the previously enacted Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act), added Section 14A to the Exchange Act, which requires that we provide our stockholders with the opportunity to vote to approve, on an advisory (non-binding) basis, the compensation of our named executive officers as described in detail under the heading Compensation Discussion and Analysis (CD&A), and in other related tables and disclosures in this proxy statement and we are now subject to this requirement.

In accordance with Section 14A of the Exchange Act, stockholders are being given the opportunity to vote to approve on an advisory, non-binding, basis the compensation of our executives, as disclosed in this proxy statement, including the information presented under Compensation Discussion and Analysis and in the compensation tables and related material under the heading 2012 Executive Compensation .

This is an advisory vote only, and neither the company nor our board of directors will be bound to take action based upon the outcome. While the vote is advisory, the compensation committee will consider the vote of the stockholders when considering future executive compensation arrangements.

We are presenting this proposal, which gives you as a stockholder the opportunity to vote to approve our executive officer compensation as disclosed in this proxy statement by voting for or against the following resolution:

RESOLVED, that the stockholders approve, on an advisory basis, the compensation of the company's named executive officers as disclosed in the proxy statement for the 2013 Annual Meeting of Stockholders pursuant to the compensation disclosure rules of the Securities and Exchange Commission, including the Compensation Discussion and Analysis, the 2012 Summary Compensation Table and the other related tables and disclosures.

The board recommends that stockholders vote *for* the approval of the compensation awarded to the executives, as disclosed in this proxy statement.

PROPOSAL 3 - ADVISORY (NON-BINDING) VOTE ON THE FREQUENCY OF THE ADVISORY (NON-BINDING) VOTE ON EXECUTIVE COMPENSATION

Section 14A of the Exchange Act (which was added by the Dodd-Frank Act) also requires that we provide our stockholders with the opportunity to vote, on an advisory (non-binding) basis, as to whether the non-binding advisory vote on our executive officer compensation should occur every one, two, or three years. Because your vote is advisory, it will not be binding upon the company, the compensation committee or the board. However, the board will take into account the outcome of the vote when deciding the frequency of the non-binding advisory vote on our executive officer compensation in the future.

After careful consideration, our board has determined that an annual advisory vote on executive compensation will allow our stockholders to provide us with their direct input on our compensation philosophy, policies and practices as disclosed in the proxy statement every year. Additionally, an annual advisory vote on executive compensation is consistent with our policy of seeking input from, and engaging in discussions with, our stockholders on corporate governance matters and our executive compensation philosophy, policies and practices and continues the practice of submitting the annual advisory vote as we did when we were subject to the American Recovery and Reinvestment Act of 2009.

You may cast your vote on your preferred voting frequency by choosing the option of one year, two years, three years or abstain. While we believe our recommendation that an advisory vote on executive compensation every year is appropriate at this time, we may determine that a different frequency is appropriate, either in response to the vote of our stockholders on this proposal or for other reasons.

The board recommends a vote *for* 1 Year as the preferred frequency for advisory votes on executive compensation.

PROPOSAL 4 - AMENDMENT TO CERTIFICATE OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK

We are asking you to approve an amendment to our certificate of incorporation, as amended, to increase the number of authorized shares of our common stock. No change is being proposed to the authorized number of shares of our preferred stock. Our certificate of incorporation, as amended, provides for the authorization of 11,000,000 shares of common stock, \$0.01 par value per share. The board has approved, and recommends that all common stockholders approve, the proposed amendment to our certificate of incorporation, as amended, to increase the authorized shares of common stock from 11,000,000 to 16,000,000 shares, \$0.01 par value per share. The discussion regarding this proposal is qualified in its entirety by reference to the complete text of the proposed amendment to Paragraph A of Article FOURTH of our certificate of incorporation, as amended, which is attached to this proxy statement as [Appendix A](#) and incorporated into this proxy statement by reference. We urge you to read carefully this proposed amendment to Paragraph A of Article FOURTH that is set forth in [Appendix A](#) in its entirety because this summary may not contain all the information about this amendment that is important to you.

Background of Proposal

The board of directors believes that it is in our best interest to increase the number of authorized but unissued shares of common stock in order to meet our possible future business and financing needs as they arise. While management has no current specific plans, agreements or understandings for the issuance of the additional shares, our board of directors believes that the availability of these additional shares will provide us with the capability and flexibility to issue common stock for a variety of purposes that the board of directors may deem advisable in the future. These purposes could include, among other things, raising additional capital, funding employee benefit plans, acquisitions of assets or businesses, or for other corporate and business purposes.

We are required by federal regulatory authorities to maintain adequate levels of capital to support our operations and protect depositors of the bank. As a result of significant losses in recent years, elevated levels of nonperforming and other classified assets, regulatory requirements, including the individual minimum capital requirement (the IMCR) imposed by the Office of the Comptroller of the Currency (the OCC) on the bank (requiring that the bank's core capital ratio be maintained at not less than 8.5%, beginning December 31, 2011, which was in excess of our core capital ratio of 7.14% at December 31, 2011), a Supervisory Agreement entered into by the bank with the OCC (among other things, restricting dividends to the company and growth in assets), and a Supervisory Agreement entered into by the company with the FRB (among other things, restricting dividends to stockholders and requiring preparation and maintenance of a consolidated capital plan), and other capital demands, such as our preferred stock dividend requirements (which due to deferral since February 2011 have been accumulating and compounding at a stated rate of 5% per annum, increasing to 9% per annum in February 2014), it has been necessary for us to increase the bank's capital and core capital ratio. In order to improve and maintain its capital ratios and comply with the bank IMCR and the Supervisory Agreements, the bank has, among other things, been working to improve its financial results, reduce non-performing assets, and decrease the asset size of the bank. From December 31, 2008 to December 31, 2012, our assets decreased \$492 million, from \$1,145 million to \$653 million. We anticipate this strategic direction to continue throughout 2013. These reductions in assets decrease our ability to earn net interest income, our primary source of income. As a result of a decrease in assets and improved financial results, at December 31, 2012, the bank's core capital to adjusted total assets ratio had improved to 9.68%

Depending upon the operating performance of the bank, the need for continued compliance with the Supervisory Agreements and the IMCR, and our other liquidity and capital needs, we may find it prudent subject to prevailing market conditions and other factors, or necessary if required by federal banking regulators, to raise additional capital through the issuance of additional shares of our common stock or other equity securities. In addition to the requirements of the IMCR and the Supervisory Agreements, regulators have placed increasing emphasis on the amount of common equity as a component of core bank capital, and proposed capital regulations incorporating specific levels of common equity capital. Proposed regulations would also require regulatory capital to meet required levels on a consolidated basis. Additional capital would also potentially permit the

company to return to a strategy of growing bank assets. Depending on circumstances, if we were to raise capital, we may deploy it to the bank for general banking purposes, or may retain some or all of such capital at the holding company level.

As of the record date, 4,423,589 shares of our common stock were issued and outstanding and an additional 121,965 shares of common stock are reserved for issuance under the 2009 Equity Incentive Plan, 60,540 shares of common stock are reserved for issuance upon the exercise of outstanding options granted pursuant to our equity compensation plans, and 833,333 shares of common stock are reserved for issuance upon the exercise of an outstanding warrant held by Treasury. Therefore, 5,560,573 shares of authorized common stock remain currently available for issuance by us, including 4,705,073 shares of common stock held in treasury.

The following table sets forth a summary of the foregoing information with respect to our authorized common stock:

| Currently Authorized Common Stock | Currently Outstanding Common Stock ⁽¹⁾ | Common Stock Currently Reserved for Issuance ⁽²⁾ | Common Stock Held in our Treasury | Common Stock Currently Available for Issuance ⁽³⁾ | Proposed Authorized Common Stock ⁽⁴⁾ | Common Stock Potentially Available for Issuance ⁽⁵⁾ |
|-----------------------------------|---|---|-----------------------------------|--|---|--|
| 11,000,000 | 4,423,589 | 1,015,838 | 4,705,073 | 5,560,573 | 16,000,000 | 10,560,573 |

(1) As of the close of business on the record date.

(2) Consists of 121,965 shares of common stock reserved for issuance under our 2009 Equity Incentive Plan, 60,540 shares of common stock reserved for issuance upon the exercise of outstanding options issued under our equity compensation plans, and 833,333 shares that are subject to an unexercised warrant held by Treasury.

(3) This number includes 4,705,073 shares of common stock held in treasury.

(4) The number of authorized shares of common stock, if this Proposal 4 is approved by our stockholders.

(5) The number of shares of common stock available for issuance, if this Proposal 4 is approved by our stockholders.

The proposed increase in the number of authorized shares of common stock represents an increase in authorized shares of 5,000,000 shares, or 45%. This increase would give our board of directors authority to issue additional shares of common stock from time to time without delay or further action by the stockholders, except as may be required by applicable law, our certificate of incorporation, or the rules of Nasdaq. The proposed amendment to Paragraph A of Article FOURTH does not change the terms of our common stock. The additional shares of common stock to be authorized by the proposed amendment to Paragraph A of Article FOURTH will have the same voting rights, the same rights to dividends and distributions and will be identical in all other respects, including the absence of preemptive rights, to the common stock now authorized. Approval of the proposed amendment to Paragraph A of Article FOURTH will not affect the rights of the holders of our currently outstanding common stock, except for incidental effects that would only occur as a result of increasing the number of shares of common stock outstanding, such as dilution of the earnings per share and dilution of voting rights of current holders of common stock. Based on our current common stock trading price, the issuance of additional common stock would be expected to dilute the per share book value of our common stock, and could, depending on the size, valuation and diversity of any issuance, result in a change in control of the company and the bank. The approval of the proposed amendments to Paragraph A of Article FOURTH will not affect the rights of the holders of the Preferred Stock.

Anti-Takeover Issues

This proposal has not been made in response to, and is not being presented to deter, any effort to obtain control of the company and is not being proposed as an anti-takeover measure. Nevertheless, the proposed increase in the number of authorized shares of common stock could, in certain circumstances, discourage or make it more difficult to effect a change in control of the company. For example, we could issue additional shares to dilute the voting power of, create voting impediments for, or otherwise frustrate the efforts of persons seeking to take over or gain control of the company, whether or not the change in control is favored by a majority of our unaffiliated stockholders. We could also privately place shares of common stock with purchasers who would side with our board in opposing a hostile takeover bid.

Text of the Amendment

Appendix A to this proxy statement shows the proposed amendments to Paragraph A of Article FOURTH of our certificate of incorporation, as amended, to increase the authorized shares of common stock, with deletions indicated by strike-outs and additions indicated by underlining. If this proposal is approved by our stockholders, we will amend our certificate of incorporation, as amended, to reflect the revisions contemplated by this proposal as set forth in Appendix A and the resulting amended certificate of incorporation will become effective upon its filing with the Secretary of State of the State of Delaware, which is anticipated to occur promptly after the meeting.

The Board of Directors unanimously recommends that stockholders vote *for* approval of the proposed amendment to our certificate of incorporation to increase the total number of authorized shares of common stock.

**PROPOSAL 5 - RATIFICATION OF APPOINTMENT OF
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Upon the recommendation of the audit committee, the board of directors has appointed KPMG LLP, an independent registered public accounting firm, to be our independent registered public accounting firm for 2013, subject to ratification by the stockholders. KPMG LLP has audited the financial statements of our company or the bank since 1966. Representatives of KPMG LLP are expected to attend the meeting to respond to appropriate questions and to make a statement, if they so desire.

In connection with the engagement of KPMG LLP, we entered into an engagement agreement with KPMG LLP that sets forth the terms pursuant to which KPMG LLP will perform its audit services. That agreement is subject to alternative dispute resolution procedures and an exclusion of punitive damages.

While it is not required to do so, the audit committee is submitting the appointment of KPMG LLP for ratification in order to ascertain the view of the stockholders. If the stockholders do not ratify the appointment, the audit committee will review the appointment.

**The board recommends that stockholders vote *for* the ratification of
the appointment of KPMG LLP as our 2013 independent registered public accounting firm.**

CORPORATE GOVERNANCE

Board Leadership Structure and Role in Risk Oversight

The board of directors is committed to its role in providing objective risk oversight of the company. The structure and responsibilities of the board's membership, leadership and committees is a critical aspect of our corporate governance to fulfill this role.

The company's corporate governance guidelines require that a substantial majority of the board shall be independent directors and the board believes its process of selecting and nominating a diverse membership with a combination of skills, professional experience and business judgment is an important element in accomplishing its risk oversight responsibility. The board does not have a policy on separating the offices of Chairman of the Board and Chief Executive Officer since it believes it should be free to make the choice from time to time that is in the best interests of the company and its stockholders. While there is no policy, it is the current practice of the board to have the Chairman be an independent board member. Currently, Dr. Smith serves as the Chairman of the Board and Mr. Krehbiel serves as Chief Executive Officer and President of the company and the bank and as a director. The board believes this is the most appropriate structure for the company at this time and contributes to objective risk oversight because it makes use of Dr. Smith's experience on our board and his extensive understanding of corporate governance and risk oversight that he developed from his service on public company and non-profit boards of directors, while freeing Mr. Krehbiel to focus his energies on the operations of the company and the bank.

The chairs of board committees are selected by the full board based on their experience and expertise, including consideration of their understanding of the risk oversight associated with their respective committee. The board of directors and the audit, compensation and nominating and governance committees of the board coordinate with each other, through the leadership of Dr. Smith and the committee chairs, to provide enterprise-wide risk oversight of management and the company's operations. In addition, our board formed an ad hoc oversight committee to provide oversight as it relates to the implementation of and compliance with the Supervisory Agreements and predecessor informal regulatory actions. Our committees address risk-related matters during their meetings and the committee chairs regularly report to the full board on risk-related matters, providing the full board with integrated insight about our management of strategic, credit, interest rate, financial reporting, technology, liquidity, compliance, operational and reputational risks. In addition, our banking subsidiary has its own board of directors and audit, loan, information technology, compliance and asset/liability management committees whose responsibilities include risk management for the bank. The management and committees of our banking subsidiary also provide reports to our board of directors regarding activities related to risk management.

At meetings of the board of directors and its committees, directors receive regular updates from management regarding risk management. The chief financial officer, chief operating officer and other senior management of our banking subsidiary, who are responsible for instituting risk management practices that are consistent with our overall business strategy and risk tolerance, report directly to Mr. Krehbiel and lead management's risk discussions at board and committee meetings. Outside of formal meetings, the board, its committees and individual board members have full access to senior executives and management for, among other purposes, discussions of risks facing our company and the management of those risks.

Committees of the Board of Directors

The board of directors has standing audit, compensation, executive, and governance and nominating committees. The directors' current committee memberships are indicated in the following table:

| Director | Audit Committee | Compensation Committee | Executive Committee | Nominating and Governance Committee |
|---------------------|----------------------------|-----------------------------------|--------------------------------|--|
| Allen J. Berning | - | Member | Alternate | Chair |
| Michael J. Fogarty | Member | - | Alternate | Member |
| Karen L. Himle | Alternate | Chair | Alternate | - |
| Susan K. Kolling | - | - | Member | - |
| Bradley C. Krehbiel | - | - | Member | - |
| Bernard R. Nigon | Chair | - | Alternate | - |
| Malcolm W. McDonald | Member | - | Alternate | Member |
| Hugh C. Smith | Alternate | Member | Member | - |
| Mark E. Utz | - | Member | Alternate | Member |

Audit Committee. The audit committee oversees our financial reporting process by, among other things, recommending and taking action to oversee the independence of the independent registered public accounting firm and selecting and appointing the independent registered public accounting firm. The board has determined that all members of the audit committee are independent as that term is defined in the applicable Nasdaq listing standards and regulations of the Securities and Exchange Commission and that all members are financially literate as required by the applicable Nasdaq listing standards. In addition, the board has determined that Mr. Nigon has the financial experience required by the applicable Nasdaq listing standards and is an audit committee financial expert as defined by applicable regulations of the Securities and Exchange Commission. The responsibilities of the audit committee are set forth in the audit committee charter, which is available on our website at www.hmnf.com. The audit committee reviews and reassesses its charter annually.

Compensation Committee. The compensation committee reviews and reports to the board on matters concerning compensation plans and the compensation of certain executives, as well as administering our 2009 Equity Incentive Plan. The board has determined that all members of the compensation committee are independent as that term is defined in the applicable Nasdaq listing standards. The responsibilities of the compensation committee are set forth in the compensation committee charter. The compensation committee charter is available on our website at www.hmnf.com. The compensation committee reviews and reassesses its charter annually.

Executive Committee. The executive committee acts on issues arising between regular board meetings. The executive committee possesses the powers of the full board between meetings of the board.

Governance and Nominating Committee. The governance and nominating committee selects candidates as nominees for election as directors and advises and makes recommendations to the board on other matters concerning directorship and corporate governance practices, including succession plans for our executive officers. The board has determined that all members of the governance and nominating committee are independent as that term is defined in the applicable Nasdaq listing standards. The responsibilities of the governance and nominating committee are set forth in the governance and nominating committee charter, which is available on our website at www.hmnf.com. The governance and nominating committee reviews and reassesses its charter annually.

Board and Committee Meetings

The board held ten meetings during 2012. The audit committee held five meetings during 2012. The compensation committee held five meetings during 2012. The executive committee held no meetings during 2012. The governance and nominating committee held six meetings during 2012. Each of our directors attended at least 75% of the meetings of the board and all committees on which the director served.

Director Independence

The board has determined that none of our directors except for Mr. Krehbiel and Ms. Kolling, who are employees of the bank, have a material relationship with our company other than service as a director (either directly or as a partner, stockholder or officer of an organization that has a material relationship with our company). Mr. Utz is the president and a shareholder of more than 10% equity interest in Wendland Utz, which provided certain legal services to the company over the past few years. We concluded that the services provided by Mr. Utz did not impact his independence under the applicable Nasdaq listing standards due to the total amount of fees paid by the company to Wendland Utz. As discussed in more detail under Certain Transactions below, certain of our directors have loans with the bank. The board concluded that such loans did not impact any of the directors' independence under the applicable Nasdaq listing standards. Therefore, all of our directors, except for Mr. Krehbiel and Ms. Kolling, are independent within the meaning of applicable Nasdaq listing standards.

Code of Business Conduct and Ethics

We adopted a Code of Business Conduct and Ethics applicable to all of our directors and employees, including our senior management and financial reporting employees. This code is available on our website at www.hmnf.com.

Stockholder Communication with the Board

The board of directors provides a process for stockholders to send communications to the board or any of the directors. Stockholders may send written communications to the board or any of the directors c/o Chief Financial Officer, HMN Financial, Inc., 1016 Civic Center Drive N.W., Rochester, Minnesota 55901-6057. All communications will be compiled by the Chief Financial Officer and submitted to the board or the individual directors on a periodic basis. Communications directed to the board in general will be forwarded to the appropriate director(s) to address the matter.

Director Attendance at Annual Meetings

Directors are expected to attend the annual meeting of stockholders. In 2012, all of our directors attended the annual meeting of stockholders.

Stockholder Proposals

Under our by-laws, certain procedures are provided that a stockholder must follow to introduce an item of business at an annual meeting of stockholders or to nominate persons for election as directors. These procedures provide, generally, that stockholders desiring to bring a proper subject of business before the meeting, or to make nominations for directors, must do so by a written notice received not later than 90 days in advance of the meeting (or if we do not publicly announce our annual meeting date 100 days in advance of the meeting date, by the close of business on the 10th day following the day on which notice of the meeting is mailed to stockholders or publicly made) by our corporate secretary containing the name and address of the stockholder as they appear on our books and the class and number of shares owned by the stockholder. If the notice relates to an item of business it also must include a representation that the stockholder intends to appear in person or by proxy at the meeting. Notice of an item of business shall include a brief description of the proposed business and a description of all arrangements or understandings between the stockholder and any other person or persons (including their names) in connection with the proposal of business by the stockholder and any material interest of the stockholder in the business. If the notice relates to a nomination for director, it must set forth the name and address of any nominee(s), any other information regarding each nominee as would have been required to be included in a proxy statement filed pursuant to the proxy rules of the Securities and Exchange Commission had each nominee been nominated by the board, and the consent of each nominee to be named in the proxy statement and to serve on the board.

The chairman of the meeting may refuse to allow the transaction of any business not presented, or to acknowledge the nomination of any person not made, in compliance with the foregoing procedures. Copies of our by-laws are available from our corporate secretary.

Compensation Committee Interlocks and Insider Participation

During 2012, the compensation committee was comprised of Ms. Himle and Messrs. Berning, Smith, and Utz. None of the members is an executive officer, employee or former employee of our company, and no interlocking relationship exists between the board or compensation committee and the board of directors or compensation committee of any other company.

Related Person Transaction Approval Policy

Our board of directors has adopted a written policy for related person transactions, which sets forth our policies and procedures for the review, approval or ratification of transactions subject to the policy with related persons who are subject to the policy. Our policy applies to any transaction, arrangement or relationship or any series of similar transactions, arrangements or relationships that have a financial aspect and in which we are a participant and a related person has a direct or indirect interest. Our policy, however, exempts the following:

our payment of compensation to a related person for that person's service to us in the capacities that give rise to the person's status as a related person;

transactions available to all of our employees or all of our stockholders on the same terms;

any extension of credit by our banking subsidiary in which a related person has a direct or indirect interest and which complies with the requirements of Regulation O under Title 12 of the Code of Federal Regulations and has been approved by either the board of directors of our banking subsidiary or its loan committee; and

transactions, which when aggregated with the amount of all other transactions between the related person and our company, involve less than \$120,000 in a fiscal year.

We consider the following people to be related persons under the policy:

all of our executive officers and directors;

any nominee for director;

any immediate family member of any of our directors, nominees for director or executive officers; and

any holder of more than 5% of our common stock, or an immediate family member of the holder.

The audit committee of our board of directors must approve any related person transaction subject to this policy before commencement of the related party transaction. The committee will analyze the following factors, in addition to any other factors the committee deems appropriate, in determining whether to approve a related party transaction:

whether the terms are fair to our company;

whether the transaction is material to our company;

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

the role the related person has played in arranging the related person transaction;

the structure of the related person transaction; and

the interests of all related persons in the related person transaction.

The committee may, in its sole discretion, approve or deny any related person transaction. Approval of a related party transaction may be conditioned upon our company and the related person taking any actions that the committees deems appropriate.

If one of our executive officers becomes aware of a related person transaction that has not previously been approved under the policy:

if the transaction is pending or ongoing, it will be submitted to the audit committee promptly and the committee will consider the transaction in light of the standards of approval listed above. Based on this evaluation, the committee will consider all options, including approval, ratification, amendment, denial or termination of the related person transaction; and

if the transaction is completed, the committee will evaluate the transaction in accordance with the same standards to determine whether rescission of the transaction is appropriate and feasible.

There were no related person transactions in 2012 required to be reported in this proxy statement.

Certain Transactions

The bank follows a policy of granting loans to eligible directors, officers, employees and members of their immediate families for the financing of their personal residences and for consumer purposes. As of December 31, 2012, the aggregate amount of the bank's loans to directors, executive officers, and affiliates of directors or executive officers was approximately \$3.1 million or 5.02% of our stockholders' equity. All of these loans were current as of December 31, 2012. For the period beginning January 1, 2012, all of the loans to directors and executive officers (i) were made in the ordinary course of business, (ii) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons not related to us or the bank, and (iii) did not involve more than the normal risk of collectability or other unfavorable features.

Independent Registered Public Accounting Firm Fees

The following table presents fees for professional audit services rendered by KPMG LLP for the audit of our annual financial statements for 2012 and 2011, and fees for other services rendered by KPMG LLP relating to these fiscal years.

| Description of Fees | 2012 | 2011 |
|---|-------------------|-------------------|
| Audit Fees ⁽¹⁾ | \$ 198,000 | \$ 181,000 |
| Audit-Related Fees ⁽²⁾ | 42,500 | 45,000 |
| Total Audit and Audit-Related Fees | \$ 240,500 | \$ 226,000 |

(1) Audit fees consisted of the annual audit and quarterly reviews of our consolidated financial statements, statutory audit, and assistance with and review of documents filed with the Securities and Exchange Commission.

(2) Audit-related fees consisted of employee benefit plan audits and audit of compliance with HUD-assisted programs.

Approval of Independent Registered Public Accounting Firm Services and Fees

The audit committee pre-approved 100% of the services provided by KPMG LLP, our independent registered public accounting firm. KPMG LLP provided no other services to the company, other than those noted above.

The audit committee's current practice on pre-approval of services performed by the independent registered public accounting firm is to approve annually all audit services and, on a case-by-case basis, recurring permissible non-audit services to be provided by the independent registered public accounting firm during the fiscal year. The audit committee reviews each non-audit service to be provided and assesses the impact of the service on the registered public accounting firm's independence. In addition, the audit committee may pre-approve other non-audit services during the year on a case-by-case basis. Pursuant to a policy adopted by the audit committee, the chair of the audit committee is authorized to pre-approve certain limited non-audit services described in Section 10A(i)(1)(B) of the Exchange Act. Mr. Nigon, as the chair of the audit committee, did not pre-approve any non-audit services pursuant to this authority in 2012.

Report of the Audit Committee

The audit committee has (i) reviewed and discussed our audited financial statements for 2012 with our management; (ii) discussed with our independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards No. 61, as amended, as adopted by the Public Company Accounting Oversight Board (PCAOB) in Rule 3200T, as currently in effect; (iii) received the written disclosures and the letter from our independent registered public accounting firm required by the applicable requirements of the PCAOB regarding the independent accountant's communications with the audit committee concerning independence; and (iv) has discussed with our independent registered public accounting firm its independence. Based on the review and discussions with management and our independent registered public accounting firm referred to above, the audit committee recommended to the board that the audited financial statements be included in our annual report on Form 10-K for the fiscal year ended December 31, 2012, and filed with the Securities and Exchange Commission.

The Audit Committee

Bernard R. Nigon

Michael J. Fogarty

Malcolm W. McDonald

SECURITY OWNERSHIP OF MANAGEMENT AND CERTAIN BENEFICIAL OWNERS

The following table sets forth, as of February 26, 2013, the beneficial ownership of: (i) each stockholder known by management to beneficially own more than five percent of the outstanding common stock, (ii) each of the current executive officers listed in our summary compensation table, (iii) each director and director nominee, and (iv) all directors and executive officers as a group. Unless otherwise indicated, the listed beneficial owner has sole voting power and investment power with respect to the shares of common stock and maintains an address at 1016 Civic Center Drive N.W., Rochester, Minnesota 55901-6057. At February 26, 2013, there were 4,423,589 shares of common stock issued and outstanding.

| Name and Address (if required) of Beneficial Owner | Amount and Nature of Beneficial Ownership ⁽¹⁸⁾ | Percentage of Outstanding Shares |
|---|--|-------------------------------------|
| United States Department of the Treasury ⁽¹⁾ 1500 Pennsylvania Ave., NW Washington, D.C. 20220 | 833,333 | 15.9% |
| HMN Financial, Inc. Employee Stock Ownership Plan ⁽²⁾ | 727,613 | 16.4 |
| Dimensional Fund Advisors LP ⁽³⁾ Palisades West, Building One 6300 Bee Cave Road Austin, TX 78746 | 348,128 | 7.9 |
| Tontine Financial Partners, L.P. ⁽⁴⁾ 55 Railroad Avenue Greenwich, CT 06830 | 339,604 | 7.7 |
| Directors, director nominees and executive officers: | | |
| Allen J. Berning ⁽⁵⁾ | 10,000 | * |
| Jon J. Eberle ⁽⁶⁾⁽¹⁹⁾ | 68,459 | 1.5 |
| Michael J. Fogarty ⁽⁷⁾ | 6,500 | * |
| Karen L. Himle ⁽⁸⁾ | 16,200 | * |
| Dwain C. Jorgensen ⁽⁹⁾⁽¹⁹⁾ | 84,458 | 1.9 |
| Susan K. Kolling ⁽¹⁰⁾⁽¹⁹⁾ | 81,902 | 1.8 |
| Bradley C. Krehbiel ⁽¹¹⁾⁽¹⁹⁾ | 93,768 | 2.1 |
| Malcolm W. McDonald ⁽¹²⁾ | 26,993 | * |
| Lawrence D. McGraw ⁽¹³⁾⁽¹⁹⁾ | 33,900 | * |
| Bernard R. Nigon ⁽¹⁴⁾ | 7,500 | * |
| Wendy S. Shannon | 0 | * |
| Hugh C. Smith ⁽¹⁵⁾ | 18,000 | * |
| Mark Utz ⁽¹⁶⁾ | 700 | * |
| All directors, director nominees and executive officers of the company as a group (*13 persons) ⁽¹⁷⁾ | 455,245 | 10.2 |

* Less than 1% Owned

(1) Represents shares of common stock covered by a warrant that is currently exercisable. The United States Department of the Treasury has agreed not to exercise any voting rights with respect to shares of our common stock issued under the warrant.

(2) As reported on a Schedule 13G/A dated January 30, 2013, and filed on January 30, 2013. The amount reported represents shares of common stock held by the HMN Financial, Inc. Employee Stock Ownership Plan, known as the ESOP. As reported on a Form 5 dated January 30, 2013, and filed January 30, 2013, 377,074 of the 727,613 shares of common stock beneficially owned by the ESOP have been allocated to accounts of participants. First Bankers Trust Services, Inc., Quincy, Illinois, the trustee of the ESOP, may be deemed to beneficially own the shares of common stock held by the ESOP. First Bankers Trust expressly disclaims beneficial ownership of these shares. Participants in the ESOP are entitled to instruct the trustee as to the voting of shares of common stock allocated to their accounts under the ESOP. Unallocated shares or allocated shares for which no voting instructions are received are voted by the trustee in the same proportion as allocated shares for which instructions have been received from participants. The ESOP has sole voting power for 350,539 of the shares it holds, and shared voting power for 377,074 of the shares it holds.

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

(3) As reported on a Schedule 13G/A dated February 8, 2013, and filed on February 11, 2013. Dimensional Fund Advisors LP is an investment adviser. The amount reported represents shares of common stock held in various advisory accounts. No account has an

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

interest relating to more than 5% of the outstanding shares of common stock. Dimensional Fund Advisors LP exercises sole dispositive power for 348,128 of the shares it holds and sole voting power with respect to 345,628 of the shares. In its role as investment advisor, Dimensional Fund Advisors, LP may be deemed to be the beneficial owner of the shares held by it. Dimensional Fund Advisors, LP expressly disclaims beneficial ownership of these shares.

- (4) As reported on a Schedule 13D/A dated May 10, 2012, filed on May 11, 2012. Tontine Financial Partners, L.P. is an investment management firm. Tontine Financial Partners, L.P. does not have either voting or dispositive power with respect the shares. Tontine Management, LLC, the general partner of Tontine Financial Partners, L.P., has the power to direct the affairs of Tontine Financial Partners, L.P., including decisions respecting the receipt of dividends from, and the disposition of the proceeds from the sale of, the shares.
- (5) Includes 10,000 shares of common stock held jointly with his spouse.
- (6) Includes 52,927 shares of common stock held directly, 11,892 shares of common stock allocated to Mr. Eberle's account under our employee stock ownership plan and 3,640 shares of common stock covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013.
- (7) Includes 4,500 shares of common stock held in a fiduciary capacity and 2,000 shares of common stock held in a fiduciary capacity jointly with his spouse.
- (8) Includes 1,200 shares of common stock held directly and 15,000 shares of common stock covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013.
- (9) Includes 50,156 shares of common stock held directly, 2,150 shares of common stock held by the IRA account of Mr. Jorgensen's spouse, 10,048 shares of common stock under the bank's 401(k) plan, 18,524 shares of common stock allocated to Mr. Jorgensen's account under our employee stock ownership plan and 3,580 shares of common stock covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013.
- (10) Includes 54,767 shares of common stock held directly, 16,193 shares of common stock allocated to Ms. Kolling's account under our employee stock ownership plan, 7,162 shares of common stock held under the bank's 401(k) plan and 3,780 shares of common stock covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013.
- (11) Includes 79,757 shares of common stock held directly, 9,471 shares of common stock allocated to Mr. Krehbiel's account under our employee stock ownership plan and 4,540 shares of common stock covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013.
- (12) Includes 11,993 shares of common stock held directly and 15,000 shares of common stock covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013.
- (13) Includes 33,062 shares of common stock held directly and 838 shares of common stock allocated to Mr. McGraw's account under our employee stock ownership plan.
- (14) Includes 7,500 shares of common stock held directly.
- (15) Includes 9,000 shares of common stock held directly and 9,000 shares of common stock covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013.
- (16) Includes 700 shares of common stock held directly.

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

- (17) Includes shares of common stock held directly, as well as shares of common stock held jointly with family members (if these shares are deemed to be beneficially owned by the director or officer), shares of common stock held in retirement accounts, shares of common stock held by these individuals in their accounts under the bank's 401(k) plan, shares of common stock allocated to the ESOP accounts of the group members, shares of common stock held in a fiduciary capacity or by certain family members and shares covered by options that are currently exercisable or exercisable within 60 days of February 26, 2013, with respect to which shares the persons included may be deemed to have sole or shared voting and/or investment power.
- (18) Beneficial ownership of our Preferred Stock is not reflected in the table above. These securities do not have the right to vote generally in the election of directors. These securities have certain limited voting rights in certain instances affecting the Preferred Stock directly, including the right to elect two representatives to the company's board of directors in the event of the company's failure to pay six or more quarterly stated dividends on the Preferred Stock. We have been advised by the FRB that the unaffiliated third party investors that hold substantially all the Preferred Stock beginning February 8, 2013 have, as a condition to their investment in the Preferred Stock, entered into passivity commitments with the FRB pursuant to which they have, among other things, waived, unless they obtain prior FRB consent, the right to elect two representatives to our board of directors.
- (19) The above table reflects shares of restricted stock held by Messrs. Krehbiel, Eberle, McGraw and Jorgensen and Ms. Kolling that were granted during the time we were subject to certain TARP restrictions. Because the combined amount received by Treasury from the sale of the Preferred Stock plus the preferred dividends previously paid to them by HMN was approximately 82% of the original amount of financial assistance we received, 25% of the vested shares subject to these restricted stock awards (rounding down to the nearest 25% increment) are nontransferable (except for permitted sales to satisfy tax obligations), and will remain so indefinitely and must, in accordance with Treasury policy, be cancelled. The table does not reflect the reduced share ownership of Messrs. Krehbiel, Eberle, McGraw and Jorgensen and Ms. Kolling as those cancellations have not yet occurred, and as to unvested shares of restricted stock, will not occur until vesting and other events effecting the amount to be cancelled have occurred.

2012 DIRECTOR COMPENSATION

All of our directors also serve as directors of our banking subsidiary. During 2012, non-employee members of our board of directors were entitled to receive the following cash fees for their services to us and our banking subsidiary:

| | Description of Fees | | | |
|---------------------------------------|-----------------------------|-------------------------------|---------------------------------------|------------------------------|
| | Chairman of the Board | Non- employee Directors | Chairman of the Audit Committee | Other Committee Chairs |
| Monthly fee | \$ 3,333 | \$ 1,250 | - | - |
| Board meeting attendance fee | \$ 1,000 | \$ 500 | - | - |
| Audit Committee attendance fee | - | \$ 500 | \$1,500 | - |
| Other board committee attendance fees | - | \$ 300 | - | \$ 900 |

Our 2012 schedule for fees payable to non-employee members of our board of directors did not change from our 2011 schedule following the compensation committee's determination that such fees should not be increased between the periods. In accordance with the fee schedule set forth above, our non-employee directors received the following total compensation for their service during 2012 on our board of directors:

| Non-Employee Director | Fees Earned or Paid in Cash (\$) ⁽¹⁾ | Option Awards (\$) ⁽²⁾ | Total (\$) |
|------------------------------------|--|-----------------------------------|------------|
| Allen J. Berning | 26,050 | - | 26,050 |
| Michael J. Fogarty | 26,300 | - | 26,300 |
| Karen L. Himle | 24,850 | - | 24,850 |
| Malcolm W. McDonald | 28,800 | - | 28,800 |
| Bernard R. Nigon | 31,000 | - | 31,000 |
| Mahlon C. Schneider ⁽³⁾ | 11,800 | - | 11,800 |
| Hugh C. Smith | 61,400 | - | 61,400 |
| Mark E. Utz ⁽⁴⁾ | 17,000 | - | 17,000 |

(1) Pursuant to our Directors Deferred Compensation Plan, we allow directors to defer receipt of their fees until January 30 of the calendar year immediately following the date in which they cease to be a member of the board. We pay deferred fees over a yearly period of ten years or less. Deferred fees earn interest at a rate equal to our bank subsidiary's cost of funds on November 30 of each year in which the fees are deferred. A director who is one of our employees receives no separate compensation for services as a director. As of December 31, 2012, former director Mr. Schneider had a deferred fee balance of \$134,758 and former director Mr. DeBoer had a deferred fee balance of \$191,800.

(2) Prior to 2010, we granted a 15,000 share stock option to each director when he or she became a member of the board. Options outstanding as of December 31, 2012, totaled 15,000 for each of Mr. McDonald, Ms. Himle and Mr. Smith. The exercise prices of the outstanding options range from \$4.77 to \$30.00.

(3) Term on the board of directors expired in May 2012.

(4) Elected to the board of directors in May 2012.

COMPENSATION DISCUSSION AND ANALYSIS

Overview

This Compensation Discussion and Analysis provides information about the 2012 compensation program for our named executive officers, who are:

Bradley C. Krehbiel, President and Chief Executive Officer of the company and bank,

Jon J. Eberle, Chief Financial Officer, Senior Vice President and Treasurer of the company and Chief Financial Officer, Executive Vice President and Treasurer of the bank,

Lawrence D. McGraw, Chief Operating Officer and Executive Vice President of the bank,

Dwain C. Jorgensen, Senior Vice President of the company and bank, and

Susan K. Kolling, Senior Vice President of the company and bank.

Compensation to our executive officers is provided by our banking subsidiary. We have not separately provided compensation to our executive officers since our formation, and do not anticipate paying any compensation to these officers unless we become actively involved in the operation or acquisition of businesses other than our banking subsidiary. As of December 31, 2012, we had no executive officers other than our five named executive officers.

The compensation committee of our board of directors establishes and administers the compensation and benefits program for executive officers and directors. The compensation committee has designed our executive compensation program to achieve the following primary goals:

to attract and retain a highly qualified and coordinated workforce of executives who have the skills, experience and work ethic required to effectively achieve our goals and objectives; and

to align executives' interests with the creation and maintenance of long-term stockholder value.

Beginning in 2009 and continuing until the sale by Treasury of the Preferred Stock to unrelated third party investors on February 8, 2013, our compensation program for named executive officers was affected by our participation in the CPP. Under the CPP, limitations were imposed on certain elements of compensation and benefits payable to certain named executive officers and other highly compensated employees, as described below. The total direct compensation (salary plus incentive compensation) for our named executive officers that were also one of the five most highly compensated employees in 2012 consisted of their base salaries, supplemented by restricted stock awards whose fair market value as of the grant date was equal to approximately 10% of their respective base salaries. As a result of the sale by the Treasury of the Preferred Stock to unrelated third party investors, as of February 8, 2013, we are no longer subject to these compensation limitations. However, as discussed in more detail below, our compensation actions continue to be affected by the Supervisory Agreements and a portion of the shares subject to restricted stock awards granted during the period of our participation in the CPP remain subject to future forfeiture.

Restrictions on Compensation Based on Participation in the Capital Purchase Program

During the period prior to February 8, 2013 when we were a participant in the CPP (which included all of 2012), we were required to comply with certain limitations on executive compensation and compensation practices that affected our named executive officers and certain other highly compensated employees. These executive compensation requirements that were applicable to us during 2012:

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

prohibited any bonus, retention award or incentive compensation to our five most highly compensated employees (who are not necessarily our five named executive officers) unless it is in the form of long-term restricted common stock that does not vest in the first two years after it is issued and that cannot be transferred except as permitted under a schedule based on the redemption, repurchase by us, or sale by Treasury of the Preferred Stock;

prohibited payment of severance for any reason to our named executive officers and our next five most highly compensated employees;

required us to recover from our named executive officers and the next 20 most highly compensated employees any bonus, retention award or incentive compensation when based on materially inaccurate earnings, revenues, gains or other criteria;

prohibited incentive compensation to named executive officers that encourages unnecessary and excessive risks that threaten the value of our company;

prohibited any compensation plan that would encourage manipulation of our reported earnings to enhance the compensation of any of our employees;

prohibited tax gross ups to any named executive officer or the next 20 most highly compensated employees;

precluded us from claiming a deduction in an applicable tax year for federal income tax purposes for remuneration in excess of \$500,000 to a named executive officer, as calculated in accordance with Section 162(m)(5) of the Internal Revenue Code; and

required the compensation committee to review incentive compensation arrangements for our named executive officers with our senior risk officer to assess and limit arrangements which encourage unnecessary or excessive risks that could threaten the value of our company, to meet semiannually with the senior risk officer to review the relationship between our company's risk management policies and practices and the named executive officers' incentive compensation arrangements, and to certify to the foregoing in our proxy statement.

Some of the requirements listed above affected the design of our compensation program and the compensation arrangements for our executive officers during 2012. We structured our bonus and incentive compensation arrangements with our named executive officers to provide for the recovery of any payments based on materially inaccurate financial statements or any other materially inaccurate performance metrics, in accordance with these CPP requirements. The right to recover these payments is not dependent upon the occurrence of a restatement of our financial results or of any misconduct.

While most of these requirements applied to our named executive officers, and in many cases to some number of additional highly compensated employees, the limitation on bonuses, retention awards and incentive compensation applied to our five most highly compensated employees. Even though Mr. Jorgensen and Ms. Kolling are named executive officers, they were not among our five most highly compensated employees for 2012. As a result, they were not subject to the restrictions on bonus, retention, and other incentive compensation awards during 2012.

Restrictions on Compensation Based on Entry into Supervisory Agreements.

Under the Supervisory Agreements, we and our banking subsidiary are not permitted, without the prior written consent of the applicable regulator, to enter into any new contractual arrangement or to renew or revise any existing contractual arrangement related to compensation or benefits with any director or certain executive officers. The Supervisory Agreements also prohibit any golden parachute payment unless such payment complies with the applicable rules and regulations of the Federal Deposit Insurance Corporation.

Compensation Program Design and Operation

Program Design. Under the CPP requirements that were applicable to us in 2012, the compensation committee sought to achieve the goals of our executive compensation program by providing for a competitive base salary and long-term equity incentive awards in the form of restricted stock whose grant date fair value generally could not exceed one-third of the annual total direct compensation (which consists of base salary and the grant date fair value of restricted stock awards granted in a particular year) of our named executive officers who are also among our five most highly compensated employees. The compensation committee's philosophy is that over the long term, base salaries should be competitive with those of similarly-sized publicly held financial institutions that operate in the upper-Midwest and against whom we may compete for executive talent.

Subject to the restrictions imposed on compensation that applied to us during 2012 under the CPP, the compensation committee considered many factors in determining our 2012 compensation program for executive officers, including data on competitive compensation practices and amounts, our overall performance compared to expected results and the contributions of each executive officer to achieving our strategic goals. Although we do not have formal stock ownership guidelines, the compensation committee does consider the value and vesting timetable of outstanding equity awards held by executive officers in determining the timing and amount of new equity awards. While the compensation committee may from time to time establish specific performance objectives for the receipt of incentive compensation, our compensation program is essentially a discretionary system in which the compensation committee uses competitive compensation data and independent compensation consultant reports, and draws upon the business experience, business judgment and general knowledge of its members to evaluate compensation matters collaboratively and subjectively.

In designing our compensation program, we have also considered the accounting treatment in our financial statements and the tax impact on us and on our executive officers of various potential elements of compensation. In the past, we have modified the mix of our compensation elements based on changes in financial accounting treatment (such as changing the nature of equity compensation awards partially in response to changes in accounting for equity compensation) and included compensation elements with favorable tax treatment for our employees (such as employer 401(k) contributions), and we may do so again in the future. However, we do not consider accounting and tax matters as primary factors in managing our compensation program.

At our last annual meeting of stockholders, as required by our participation in the CPP, we asked our stockholders to approve, by advisory vote, the compensation of our named executive officers, as disclosed in the Compensation Discussion and Analysis, the compensation tables, and the related disclosures contained in our proxy statement for that annual meeting. The proposal was approved by our stockholders. In light of this approval and the requirements of the CPP and the Supervisory Agreements, the compensation committee did not make changes in our compensation policies and practices during 2012.

Roles of Committee and Management. The compensation committee consists exclusively of independent non-employee directors, and has the full authority to determine all elements of the compensation for Mr. Krehbiel and to approve all elements of the compensation of our other executive officers. In approving compensation actions for the other executive officers, the compensation committee receives regular input and recommendations from Mr. Krehbiel, and ascribes significant weight to his recommendations. Our chief financial officer and his staff, together with outside professionals, assist the compensation committee in evaluating the financial, accounting and tax treatment of existing and potential elements of our executive compensation program.

Compensation Consultant. The compensation committee has the authority to retain independent compensation consultants to assist in the evaluation of executive officer compensation. In late 2010, the compensation committee engaged Blanchard Consulting Group as its independent compensation consultant. Blanchard Consulting Group is engaged to assist the compensation committee in refining the committee's compensation philosophy, defining characteristics of peer financial institutions and identifying particular peer group entities, compiling peer group compensation data, analyzing the elements of compensation, developing incentive compensation systems and ensuring compliance with the compensation restrictions under the CPP and other regulatory requirements. The compensation committee has assessed the independence of Blanchard Consulting Group pursuant to the rules of the U.S. Securities and Exchange Commission and concluded that no conflict of interest exists that would prevent Blanchard Consulting Group from independently representing the compensation committee.

Determining Market Competitive Compensation. With Blanchard Consulting Group's assistance, in the first quarter of 2012, the compensation committee identified the following twenty-one publicly traded financial institutions in the Upper Midwest that are comparable to us in asset size and performance and with whom we may compete for executive talent for purposes of obtaining data on competitive compensation practices:

| | | |
|----------------------------|---|--|
| Meta Financial Group, Inc. | First Business Financial Services, Inc. | Community Bank Shares of Indiana, Inc. |
| NASB Financial, Inc. | Reliance Bancshares, Inc. | Southern Missouri Bancorp, Inc. |
| MBT Financial Corp. | Tri City Bankshares Corporation | Blue Valley Ban Corp. |
| West Bancorporation, Inc. | Baylake Corp. | Guaranty Federal Bancshares |
| HF Financial Corp. | Ames National Corporation | Tower Financial Corporation |
| Hawthorn Bancshares, Inc. | Indiana Community Bancorp | NorthWest Indiana Bancorp |
| CFS Bancorp, Inc. | United Bancorp, Inc. | PSB Holdings, Inc. |

At the time the peer group was identified, our total assets were at the 36th percentile within the peer group, and our number of branches was at the 47th percentile. Six members of the peer group were participants in the CPP at the time of their selection for the peer group.

The compensation committee uses the peer group as one of its tools for assessing the competitiveness of the compensation paid to our executive officers and for purposes of making its compensation decisions. The compensation committee's philosophy is to generally target base salaries and total direct compensation for our named executive officers at or below the median for comparable positions at companies within the peer group, reserving to itself the discretion to position an individual's base salary or total direct compensation above or below the peer group's median based on the individual's experience, performance and level of responsibilities.

Elements of Compensation and Compensation Actions

Executive officer compensation includes the following elements:

Base Salary. The base salary amount is the fixed portion of each executive's annual compensation and, under CPP requirements that were applicable to us during 2012, was required to represent 66%-100% of the total annual potential compensation of our five most highly compensated employees. Salary levels are based primarily on the executive's responsibilities and experience, and the market compensation paid by the companies in our peer group. Ordinarily, base salaries are reviewed annually, and adjusted from time to time to realign salaries with market levels and individual responsibilities, performance and experience.

Based on our consultations with our compensation consultant and the peer group data received, the compensation limitations applicable to us due to our participation in the CPP during 2012 and under the Supervisory Agreements, Mr. Krehbiel's base salary was set at \$290,185 for 2012. For 2012, Mr. Krehbiel's base salary was approximately 88% of his total direct compensation.

For 2012, Messrs. Jorgensen, McGraw and Eberle and Ms. Kolling's base salaries were set at \$117,053, \$190,000, \$190,000, and \$129,114, respectively. Mr. Jorgensen's and Ms. Kolling's base salaries reflect raises consistent with our 2012 salary guidelines for employees generally. Mr. McGraw and Mr. Eberle received increases reflecting increasing management duties. For 2012, the percentage of base salary for these named executive officers as compared to total direct compensation ranged from 89% to 91%. All of our named executive officers received 2% increases in base salary in 2013, which is consistent with our 2013 salary guidelines for employees generally.

Bonus, Retention Awards, and Incentive Compensation. Long-term restricted stock grants are granted under our 2009 Equity Incentive Plan and for fiscal 2012 were the only form of bonus, retention award or incentive compensation that we were permitted to provide to our five most highly compensated employees, including three of our named executive officers, under requirements related to the CPP. In accordance with CPP requirements, restricted stock awards to these most highly compensated employees generally could not vest prior to the second anniversary of the applicable grant date. Even after restricted stock awards to these most highly compensated employees vested, the shares of stock subject to the award would generally not become transferable any time earlier than is proportional, in 25% increments, to the repayment that the Treasury receives of the

financial assistance we received under the CPP. Because the combined amount received by Treasury from the sale of the Preferred Stock plus the preferred dividends previously paid to them by HMN was approximately 82% of the original amount of financial assistance we received, 25% of the shares of restricted stock that were awarded (rounding down to the nearest 25% increment) to our five most highly compensated employees while the Treasury held the Preferred Stock will remain nontransferable indefinitely and must, in accordance with Treasury policy, be cancelled. One exception to this nontransferability requirement is that a portion of the vested but otherwise nontransferable shares subject to these restricted stock awards may be sold to pay taxes incurred as a result of the vesting of the shares. Certain restricted stock awards to Messrs. Krehbiel, Eberle, McGraw and Jorgensen, and Ms. Kolling are subject to this cancellation requirement because these individuals received grants of restricted stock during a time when they were among our five most highly compensated employees while Treasury held the Preferred Stock.

The issuance of restricted stock is designed to provide a long-term retention incentive for executive officers, align their interests with the creation and maintenance of long-term stockholder value and reward them for managing our performance to increase stockholder value. The compensation committee's philosophy is that restricted stock grants also may encourage executive officers to balance the risk of losses in stockholder value against the potential for gains in stockholder values when evaluating business decisions. As a result, the executive officers may adopt strategies that strike a better balance between the potential for stock price appreciation and the risk that a failed strategy will lead to a stock price decline.

The compensation committee began using restricted stock grants as an element of the overall compensation program in 2004, when the accounting requirements for expensing stock options changed and the difference in the financial statement impact between granting awards of restricted stock and granting option awards was reduced. At that time, the compensation committee began issuing restricted stock grants instead of stock options due to the change in accounting treatment of stock options, the relatively long remaining vesting and exercise periods of the then outstanding stock options, and the committee's belief that grants of restricted stock awards provide a stronger retention incentive than stock options because executives are assured of realizing value as the stock vests over time. No stock options have been issued to executive officers since 2004.

On January 27, 2012, the compensation committee authorized restricted stock grants to Messrs. Krehbiel, Eberle, and McGraw of 13,225 shares, 8,750 shares, and 8,750 shares, respectively. The grant date value of each restricted stock award to these named executive officers was limited under the CPP requirements and could not exceed one-half of the executive officer's base salary for the calendar year. Based on competitive data and analyses provided by our compensation consultant and other considerations involved with the named executive officer's respective position, the compensation committee decided to provide 2012 restricted stock awards with a grant date value of approximately 10% of base salary to Mr. Krehbiel, Mr. Eberle, and Mr. McGraw. The compensation committee generally approves equity-based awards at a meeting early in the first quarter of each fiscal year, after our year-end financial results have been released.

Historically, we have also awarded nominal cash bonuses based on years of service and annual holiday bonuses to all employees, including our executives. Holiday bonuses were discontinued in 2011. We also reserve the right to pay bonus compensation under other circumstances.

In 2012, the compensation committee approved discretionary cash retention awards to Mr. Jorgensen and Ms. Kolling, neither of whom were subject to the CPP limitation on bonus, retention and incentive awards during 2012 because they were not among our five most highly paid employees. The compensation committee approved a total award for Mr. Jorgensen of \$5,738 and a total award for Ms. Kolling of \$9,494. These cash-based awards, which are payable in three equal annual installments, are provided for retention purposes and to lessen the usage of shares under our 2009 Equity Incentive Plan. An installment will vest and be paid if the officer remains employed on December 31 of each year and has been continuously employed throughout the year, subject to accelerated vesting of an installment in the event of death or disability during the calendar year. The vested portion of the cash retention award will be paid on January 31 in the year following the year in which vesting occurs.

Benefits. The compensation committee's philosophy is that a competitive benefits package contributes to executive retention and well-being. Our executive officers participate on an equal, nondiscriminatory basis with all other employees in our medical insurance plan, medical reimbursement plan, childcare plan, long-term disability plan and group life insurance plan. If an executive officer retires after 15 years of service, we will continue to pay the employer portion of his or her health insurance coverage until he or she reaches the age of 65. This benefit will no longer be available to employees after December 31, 2013.

Our executive officers also participate along with other employees, on a nondiscriminatory basis, in a 401(k) plan with a 25% match on employee contributions up to 8% of the employee's salary.

Our executive officers also participate on a nondiscriminatory basis in our Employee Stock Ownership Plan (ESOP). All of our employees are eligible to participate in the ESOP after they complete one year of service as defined by the plan. The ESOP holds shares of our common stock that secure a loan for the funds that were used to acquire the ESOP shares. Each year the security interest is released from a fixed number of shares as a fixed amount of the loan is amortized. The shares that are released from the security interest are allocated to eligible participant accounts based on the percentage of the participant's compensation (subject to limits) to the entire compensation of all plan participants. The value of the ESOP contributions vary based on the price of our common stock and represents less than 2% of each executive's base salary amount.

The compensation committee considers the benefits granted to executive officers when determining executive officer compensation amounts and comparing compensation amounts to other executives at similar companies, and considers the value of the ESOP contributions when it considers the mix between cash and equity compensation.

Change in Control Compensation. We have entered into change-in-control agreements with each of our named executive officers, other than Mr. McGraw. The change-in-control agreements are discussed in more detail below under 2012 Executive Compensation Change-in-Control Agreements. The compensation committee's philosophy is that change-in-control agreements are appropriate to induce executives to remain with our company in the event of a proposed or anticipated change in control or through a change in control to facilitate an orderly transition to new ownership. The change-in-control agreements also assist us in recruiting and retaining executives by providing executives with appropriate economic security, given the relatively limited number of alternative employers in our industry and geographic area, against loss of employment following a change in control.

Compensation Actions for 2013

Since Treasury sold the Preferred Stock to unaffiliated third parties on February 8, 2013, as of that date, we are no longer subject to the CPP restrictions described on page 33 of this proxy statement. While we are no longer subject to these restrictions, the board of the directors and the compensation committee did not materially alter our compensation program for 2013.

Recovery of Performance-Based Compensation

The Sarbanes-Oxley Act requires recovery of certain incentive and equity compensation from our principal executive officer and principal financial officer in the event of restatement of financial results due to misconduct. The audit committee is responsible for determining if bonus or stock compensation paid to the principal executive officer or principal financial officer should be recovered in the event of a restatement.

COMPENSATION COMMITTEE REPORT

The compensation committee certifies that at least every six months, it has

discussed, evaluated and reviewed with the senior risk officer the named executive officer compensation plans and has made all reasonable efforts to ensure that such plans do not encourage the named executive officers to take unnecessary and excessive risks that threaten the value of our company;

discussed, evaluated and reviewed with the senior risk officer the employee compensation plans and has made all reasonable efforts to limit any unnecessary risks these plans pose to the company; and

discussed, evaluated and reviewed the employee compensation plans to eliminate any features of these plans that would encourage the manipulation of reported earnings of our company to enhance the compensation of any of our company's employees.

In addition, the compensation committee certifies that it has made reasonable efforts to identify and limit any features of the named executive officer compensation plans that could lead named executive officers to take unnecessary and excessive risks that could threaten the value of our company and has made reasonable efforts to identify and limit any features of the employee compensation plans that pose risks to our company in an effort to ensure that our company is not unnecessarily exposed to risks.

Based on, among other factors, the committee's assessment of the principal risks to which our company is subject, its evaluation of the existing compensation arrangements for our named executive officers in accordance with the limitations imposed under the CPP and the Supervisory Agreements, the relatively significant portion of total compensation represented by base salary and the CPP limitation on the use of variable forms of compensation, the discretion to award incentive compensation exercisable by the company, the customary use of non-financial objectives in determining a significant portion of any incentive compensation, the use of restricted stock as a significant component of equity incentive compensation and the sole component in recent years, the required vesting periods included in equity awards, the holding period required after vesting for restricted stock grants subject to the requirements related to the CPP, and the clawback requirements to which incentive compensation is now subject, the compensation committee concluded that our compensation plans for our named executive officers are not reasonably likely to encourage unnecessary or excessive risk, including behavior focused on short-term results rather than long-term value creation, that would threaten the value of our company.

Based on, among other factors, the elements of our employees' compensation, the relatively significant portion of total compensation represented by base salary for our employees, the discretion to award incentive compensation exercisable by the company, the use of non-financial objectives in determining a significant portion of any incentive compensation, the use of restricted stock as a significant component of equity incentive compensation and the sole component in recent years, the required vesting periods included in equity awards, executive and management oversight of our operations and our systems of internal controls over financial reporting, the compensation committee concluded that our employee compensation plans are not reasonably likely to encourage behavior focused on short-term results rather than long-term value creation or encourage the manipulation of our reported earnings to enhance the compensation of any of our employees.

The compensation committee has discussed and reviewed the compensation discussion and analysis with management. Based upon this review and discussion, the compensation committee recommended to the board of directors that the compensation discussion and analysis be included in this proxy statement.

Members of The Compensation Committee

Karen L. Himle

Allen J. Berning

Hugh C. Smith

Mark E. Utz

2012 EXECUTIVE COMPENSATION

Summary Compensation Table

| Name and Principal Position | Year | Salary (\$) | Bonus (\$) ⁽¹⁾⁽²⁾ | Stock Awards (\$) ⁽³⁾ | All Other Compensation (\$) ⁽⁴⁾ | Total (\$) |
|---|------|-------------|------------------------------|----------------------------------|--|------------|
| Bradley C. Krehbiel <i>President and Chief Executive Officer of the company and bank</i> | 2012 | 290,185 | 0 | 28,963 | 9,976 | 329,124 |
| | 2011 | 264,500 | 0 | 75,000 | 13,360 | 352,860 |
| | 2010 | 264,500 | 150 | 92,400 | 19,051 | 376,101 |
| Jon J. Eberle <i>Senior Vice President, Chief Financial Officer and Treasurer of the company and Executive Vice President, Chief Financial Officer and Treasurer of the bank</i> | 2012 | 190,000 | 0 | 19,163 | 6,311 | 215,474 |
| | 2011 | 175,000 | 0 | 45,000 | 5,388 | 225,388 |
| | 2010 | 165,500 | 150 | 57,750 | 7,655 | 231,055 |
| Lawrence D. McGraw <i>Executive Vice President and Chief Operating Officer of the bank</i> | 2012 | 190,000 | 0 | 19,163 | 6,138 | 215,301 |
| | 2011 | 175,000 | 0 | 60,000 | 3,842 | 238,842 |
| | 2010 | 139,202 | 20,050 | 0 | 3,221 | 162,473 |
| Dwain C. Jorgensen <i>Senior Vice President of the company and the bank</i> | 2012 | 117,053 | 7,512 | 0 | 3,962 | 128,527 |
| | 2011 | 114,758 | 5,600 | 0 | 3,620 | 123,978 |
| | 2010 | 112,508 | 150 | 16,800 | 4,495 | 133,953 |
| Susan K. Kolling <i>Senior Vice President of the company and the bank</i> | 2012 | 129,114 | 11,404 | 0 | 4,750 | 145,268 |
| | 2011 | 126,582 | 8,240 | 0 | 3,994 | 138,816 |
| | 2010 | 124,100 | 150 | 24,720 | 5,699 | 154,669 |

(1) Other than the \$20,000 signing bonus paid to Mr. McGraw upon the commencement of his employment in 2010 and the retention awards that vested to Mr. Jorgensen and Ms. Kolling in 2011 and 2012, these amounts represent the nominal cash bonuses we paid to all employees for holidays and years of service. In 2011, holiday bonuses for all employees were eliminated. We generally pay bonuses for a fiscal year in the first quarter of the following fiscal year. Holiday and years of service bonuses are generally paid in December.

(2) In 2012, Mr. Jorgensen was granted a cash retention bonus of \$5,738 and Ms. Kolling was granted a cash retention bonus of \$9,494. These cash retention awards vest equally over a 3 year period provided the officer remains employed with us on December 31st of each year. In 2011, Mr. Jorgensen was granted a cash retention bonus of \$16,800 and Ms. Kolling was granted a cash retention bonus of \$24,720. These cash retention awards vest equally over a 3 year period provided the officer remains employed with us on December 31st of each year.

(3) The amount reported is the aggregate grant-date fair market value computed in accordance with FASB Accounting Standards Codification, or ASC, Topic 718. See footnote 13 in the notes to the consolidated financial statements included in our annual report for the assumptions made in determining the fair value of stock awards in accordance with ASC Topic 718.

(4) All other compensation consists of the following:

| Name | Employer 401(k) Contribution (\$) | Value of Common Stock Allocated to ESOP (\$) | Employer Paid Life Insurance Premiums (\$) | Dividends Received on Vested Restricted Stock (\$) | Perquisites and Other Personal Benefits (\$) ^(a) | Total (\$) |
|---------------------|--|--|---|---|--|------------|
| Bradley C. Krehbiel | | | | | | |
| 2012 | | | | 0 | | |
| | 4,900 | 2,585 | 456 | | 2,035 | 9,976 |
| 2011 | 4,900 | 1,369 | 347 | 640 | 6,104 | 13,360 |
| 2010 | 3,732 | 1,929 | 350 | 1,596 | 11,444 | 19,051 |
| Jon J. Eberle | | | | | | |
| 2012 | | | | 0 | 168 | |
| | 3,803 | 1,966 | 374 | | | 6,311 |
| 2011 | 3,500 | 978 | 345 | 565 | 0 | 5,388 |
| 2010 | 2,794 | 1,319 | 342 | 1,410 | 1,790 | 7,655 |
| Lawrence D. McGraw | | | | | | |
| 2012 | | | | 0 | 0 | |
| | 3,800 | 1,964 | 374 | | | 6,138 |
| 2011 | 3,500 | 0 | 342 | 0 | 0 | 3,842 |
| 2010 | 2,984 | 0 | 237 | 0 | 0 | 3,221 |
| Dwain C. Jorgensen | | | | | | |
| 2012 | | | | 0 | 0 | |
| | 2,453 | 1,268 | 241 | | | 3,962 |
| 2011 | 2,296 | 641 | 235 | 448 | 0 | 3,620 |
| 2010 | 2,253 | 887 | 233 | 1,122 | 0 | 4,495 |
| Susan K. Kolling | | | | | | |
| 2012 | | 1,423 | | 0 | 309 | |
| | 2,753 | | 265 | | | 4,750 |
| 2011 | 2,532 | 707 | 259 | 476 | 20 | 3,994 |
| 2010 | 2,500 | 985 | 258 | 1,185 | 771 | 5,699 |

(a) Perquisites and other personal benefits include the payment of unused personal time off in excess of carryover limits in 2012, 2011, and 2010.

Change-In-Control Agreements

As a result of the sale by Treasury of all of the Preferred Stock on February 8, 2013, as of that date and provided any such payment complies with the requirements of the Supervising Agreements, we are no longer precluded from making payments to our named executive officers under change-in-control severance agreements between our banking subsidiary and each of Messrs. Krehbiel, Eberle and Jorgensen and Ms. Kolling. These May 27, 2008 agreements originally had a two-year term, but are automatically extended on a year to year basis thereafter unless either applicable party gives contrary written notice 180 days prior to the expiration date each year. No such notice has been given, so by their terms, these agreements have been extended to May 30, 2014. These agreements are designed to assist us in maintaining a stable and competent management team.

The agreements provide for a cash payment equal to two times the sum of (i) the employee's prior year base salary and (ii) bonus prior to termination in the event that their employment is terminated in connection with a change of control. A change of control occurs under the agreements if any person other than the executive, us, or one of our benefit plans acquires or becomes the beneficial owner of 35% or more of our outstanding stock entitled to vote in a general election of directors; a majority of the members of our board are replaced as a result of an actual or threatened election contest; a reorganization, merger or consolidation of us is consummated that changes our ownership by 35% or

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

more; or our stockholders approve a complete liquidation or dissolution of us or disposition of substantially all of our assets. These named executive officers will also be eligible for the cash payment if they voluntarily terminate employment within one year after a change in control has occurred if their duties, responsibilities, base salary, or benefits are reduced or if their principal place of employment is relocated more than 35 miles from its current location. These agreements also provide that these named executive officers will participate in the health, disability and life insurance plans and programs that they were entitled to immediately prior to termination for one year after termination. The amounts payable pursuant to these agreements will be reduced by the amount of any severance pay that the employees receive from the bank, its

subsidiaries or its successors. Based on their prior year base salary and bonus amounts, if their employment had been terminated as of December 31, 2012, under circumstances giving rise to the salary payment described above (and the payments had then been permitted), Mr. Krehbiel would have been entitled to receive approximately \$580,000, Mr. Eberle would have been entitled to receive approximately \$380,000, Mr. Jorgensen would have been entitled to receive approximately \$246,000 and Ms. Kolling would have been entitled to receive approximately \$277,000. The agreements provide that if the cash payments under the agreements together with any other compensation payments triggered by the change in control would constitute a parachute payment under Section 280G of the Internal Revenue Code, the cash payments under the agreements will be reduced to the largest amount as would result in no portion of the payment being subject to an excise tax under the Code. Pursuant to the Supervisory Agreements, any payment made under the change-in-control agreements must comply with the applicable rules and regulations of the Federal Deposit Insurance Corporation.

Grants of Plan-Based Awards in 2012

| Name | Grant Date | All Other Stock Awards: Number of Shares of Stock or Units (#) ⁽¹⁾⁽²⁾ | Grant Date Fair Value of Stock (\$) ⁽³⁾ |
|---------------------|------------------|--|--|
| Bradley C. Krehbiel | January 27, 2012 | 13,225 | 28,963 |
| Jon J. Eberle | January 27, 2012 | 8,750 | 19,163 |
| Lawrence D. McGraw | January 27, 2012 | 8,750 | 19,163 |

(1) Of Mr. Krehbiel's stock award, 6,612 shares will vest on January 27, 2014 and 6,613 shares will vest on January 27, 2015. Of Mr. Eberle's stock award, 4,375 will vest on January 27, 2014 and 4,375 shares will vest on January 27, 2015. Of Mr. McGraw's stock award, 4,375 shares will vest on January 27, 2014 and 4,375 shares will vest on January 27, 2015.

(2) As discussed in greater detail on page 33, CPP rules require that because the proceeds received by Treasury from the sale of our Preferred Stock were less than the amount of financial assistance provided to us under the CPP, 25% of the shares subject to these restricted stock awards are indefinitely nontransferable and therefore subject to cancellation. However, as these awards vest, CPP rules permit each recipient to sell a number of shares during the year in which vesting occurs that will generate proceeds sufficient to pay taxes associated with the vesting of the shares. If a recipient so elects, the 25% cancellation factor will be applied to the net after-tax number of shares rather than the gross number of shares.

(3) Based on a market value of \$2.19 on January 27, 2012.

Outstanding Equity Awards

The following tables summarize the outstanding option grants and stock awards at December 31, 2012, of the named executive officers and the value of the restricted stock that vested in 2012.

Outstanding Equity Awards at December 31, 2012

| Name | Option Awards | | | | Stock Awards | |
|---------------------|---|---|----------------------------|------------------------|--|--|
| | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | Option Exercise Price (\$) | Option Expiration Date | Number of Shares or Units of Stock That Have Not Vested (#) ⁽¹⁾ | Market Value of Shares or Units of Stock That Have Not Vested (\$) ⁽²⁾⁽³⁾ |
| Bradley C. Krehbiel | 4,540 | 0 | 27.66 | 03/02/2014 | 43,825 | 152,073 |
| Jon J. Eberle | 3,640 | 0 | 27.66 | 03/02/2014 | 27,250 | 94,558 |
| Lawrence D. McGraw | 0 | 0 | 0 | | 28,750 | 99,763 |
| Dwain C. Jorgensen | 3,580 | 0 | 27.66 | 03/02/2014 | 1,019 | 3,536 |
| Susan K. Kolling | 3,780 | 0 | 27.66 | 03/02/2014 | 1,498 | 5,198 |

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

- (1) Of Mr. Krehbiel's stock awards, 5,600 shares vested on January 26, 2013, 12,500 shares vested on January 27, 2013, 19,112 shares will vest on January 27, 2014, and 6,613 shares will vest on January 27, 2015. Of Mr. Eberle's stock awards, 3,500 shares vested on January 26, 2013, 7,500 shares vested on January 27, 2013, 11,875 shares will vest on January 27, 2014 and 4,375 shares will vest on January 27, 2015. Of Mr. McGraw's stock awards, 10,000 shares vested on January 27, 2013, 14,375 shares will vest on January 27, 2014, and 4,375 shares will vest on January 27, 2015. Of Mr. Jorgensen's stock awards, 1,019 shares vested on January 26, 2013. Of Ms. Kolling's stock awards, 1,498 shares vested on January 26, 2013.

(2) Represents market value of underlying securities at year end of \$3.47, which is the closing price of the common stock on the last trading day of 2012.

(3) For descriptions of the material terms of the restricted stock awards identified above, see Elements of Compensation and Compensation Actions herein.
2012 Restricted Stock Vesting

| Name | Stock Awards | |
|---------------------|--|--|
| | Number of Shares Acquired on Vesting (#) ⁽¹⁾ | Value Realized on Vesting (\$) ⁽²⁾ |
| Bradley C. Krehbiel | 16,135 | 40,926 |
| Jon J. Eberle | 10,459 | 26,815 |
| Lawrence D. McGraw | 0 | 0 |
| Dwain C. Jorgensen | 3,601 | 10,764 |
| Susan K. Kolling | 5,848 | 16,002 |

(1) Despite the fact that these shares have vested, certain shares received by Messrs. Krehbiel, Eberle, McGraw and Jorgensen and Ms. Kolling remain subject to the CPP rule discussed on page 33 and in note 2 to the Grants of Plan-Based Awards Table making 25% of these shares indefinitely nontransferable and therefore subject to cancellation. None of the shares were sold during 2012 to pay taxes associated with the vesting, as permitted by CPP rules.

(2) Based on market value of our common stock on the relevant vesting date.

2012 Pension Benefits

| Name | Plan Name | Number of Years Credited Service (#) | Present Value of Accumulated Benefit (\$) | Payments During Last Fiscal Year (\$) |
|---------------------|--------------|--|--|--|
| Bradley C. Krehbiel | FIRF | 3 years, 2 months | 14,401 | 0 |
| Jon J. Eberle | FIRF | 6 years, 11 months | 15,363 | 0 |
| Dwain C. Jorgensen | FIRF | 27 years, 1 month | 287,837 | 0 |
| Susan K. Kolling | FIRF | 28 years, 9 months | 216,151 | 0 |

Our employees who were employed by us as of September 1, 2002 are included in the Financial Institutions Retirement Fund (FIRF), a multi-employer comprehensive pension plan. This non-contributory defined benefit retirement plan covers all employees who have met minimum service requirements. Employees become 100% vested in the pension plan after five years of eligible service. Our policy is to fund the minimum amounts required by the plan, and for 2012, we made a contribution of \$172,000 to the plan. On September 1, 2002, benefits for all of the existing participants under the plan were frozen, and as a result, no additional benefits have been earned and no new employees have been enrolled in the plan after that date. At age 65, Mr. Krehbiel will be entitled to annual payments of \$2,567, Mr. Eberle will be entitled to annual payments of \$4,141, Mr. Jorgensen will be entitled to annual payments of \$28,247, and Ms. Kolling will be entitled to annual payments of \$23,779. The annual benefit amount is calculated based on the employees base salary for the five years prior to the plan being frozen.

OTHER EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2012, for compensation plans under which equity securities may be issued.

| Plan Category | (a) Number of Securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted-average exercise price of outstanding options, warrants and rights | (c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) ⁽¹⁾ |
|--|--|--|---|
| Equity compensation plans approved by stockholders | 60,540 | \$ 22.40 | 121,965 |
| Equity compensation plans not approved by stockholders | 0 | 0 | 0 |
| Total | 60,540 | \$ 22.40 | 121,965 |

⁽¹⁾ Includes securities available for future issuance under stockholder approved compensation plans other than upon the exercise of an option, warrant or right, as follows: 121,965 shares under the company's 2009 Equity Incentive Plan.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors and executive officers to file initial reports of ownership and reports of changes in ownership with the Securities and Exchange Commission. Directors and executive officers are required by Securities and Exchange Commission regulations to furnish us with copies of all Section 16(a) forms they file. Based solely on a review of the copies of the forms furnished to us and written representations from our directors and executive officers, all Section 16(a) filing requirements were met for 2012.

ADDITIONAL INFORMATION

We are furnishing our annual report, including financial statements, for the year ended December 31, 2012, to each stockholder with this proxy statement. **Stockholders who wish to obtain an additional copy of our annual report, or a copy of our Current Report on Form 10-K filed with the Securities and Exchange Commission, for the year ended December 31, 2012, may do so without charge by writing to Chief Financial Officer, 1016 Civic Center Drive N.W., Rochester, Minnesota 55901-6057. The annual report is also available online at www.hmnf.com or www.proxydocs.com/hmnf.**

HMN FINANCIAL, INC.
By Order of the Board of Directors

Cindy K. Hamlin

Secretary

Dated: March 22, 2013

Paragraph A of Article FOURTH of the company's certificate of incorporation, as amended, would be amended as follows:

FOURTH:

A. The total number of shares of all classes of stock which the Corporation shall have authority to issue is ~~44.5~~ sixteen million five hundred thousand (16,500,000) consisting of:

1. Five hundred thousand (500,000) shares of Preferred Stock, \$.01 par value per share (the Preferred Stock); and
2. ~~Eleven~~ Sixteen million (16,000,000) shares of Common Stock, \$.01 par value per share (the Common Stock).

A-1

Shareowner Services

P.O. Box 64945

St. Paul, MN 55164-0945

COMPANY #

Vote by Internet, Telephone or Mail

24 Hours a Day, 7 Days a Week

Your phone or Internet vote authorizes the named

proxies to vote your shares in the same manner as if you marked,

signed and returned your proxy card.

INTERNET www.eproxy.com/hmnf

Use the Internet to vote your proxy until 11:59 p.m. (CT) on April 22, 2013. Please have your proxy card and the last four digits of your Social Security Number or Tax Identification Number available. Follow the simple instructions to obtain your records and create an electronic ballot.

PHONE 1-800-560-1965

Use a touch-tone telephone to vote your proxy until 11:59 p.m. (CT) on April 22, 2013. Please have your proxy card and the last four digits of your Social Security Number or Tax Identification Number available. Follow the simple instructions the voice provides you.

MAIL Mark, sign and date your proxy card and return it in the postage-paid envelope provided.

If you vote your proxy by Internet or by Telephone, you do NOT need to mail back your Proxy Card.

TO VOTE BY MAIL AS THE BOARD OF DIRECTORS RECOMMENDS ON ALL ITEMS BELOW,

SIMPLY SIGN, DATE, AND RETURN THIS PROXY CARD.

The Board of Directors Recommends a Vote FOR Each of the Nominees In Proposal 1 and a Vote FOR Proposals 2,

4 and 5 and a Vote of 1 YEAR for Proposal 3.

| | | | |
|-------------------------------------|--|--|-----------------------------------|
| 1. The election of three directors: | 01 Michael J. Fogarty 02 Malcolm W. McDonald 03 Wendy S. Shannon | " Vote FOR all nominees (except as marked) | " Vote WITHHELD from all nominees |
|-------------------------------------|--|--|-----------------------------------|

(Instructions: To withhold authority to vote for any indicated nominee,

write the number(s) of the nominee(s) in the box provided to the right.)

| | |
|--|--|
| 2. Advisory approval of our executive compensation | " For " Against " Abstain |
| 3. Advisory approval of the frequency of the advisory vote of our executive compensation | " 1 Year " 2 Years " 3 Years " Abstain |
| 4. Approval to amend our certificate of incorporation to increase the number of authorized shares of common stock from 11,000,000 shares, \$0.01 par value per share, to 16,000,000 shares, \$0.01 par value per share | " For " Against " Abstain |

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

5. Ratification of the appointment of KPMG LLP as the independent registered public accounting firm for 2013 For Against Abstain

NOTE: In their discretion, the proxies are authorized to vote on any other business that may properly come before the Annual Meeting, or any adjournments or postponements thereof.

THIS PROXY WHEN PROPERLY EXECUTED WILL BE VOTED AS DIRECTED OR, IF NO DIRECTION IS GIVEN, WILL BE VOTED AS THE BOARD RECOMMENDS.

Address Change? Mark box, sign, and indicate changes below:

Date _____

Signature(s) in Box

Please sign exactly as your name(s) appears on Proxy. If held in joint tenancy, all persons should sign. Trustees, administrators, etc., should include title and authority. Corporations should provide full name of corporation and title of authorized officer signing the Proxy.

HMN FINANCIAL, INC.
ANNUAL MEETING OF STOCKHOLDERS

Tuesday, April 23, 2013

10:00 a.m.

Rochester Golf & Country Club

3100 W. Country Club Road

Rochester, Minnesota

HMN Financial, Inc.

1016 Civic Center Drive N.W.

Rochester, Minnesota 55901-6057

For directions to the Annual Meeting, please call (507) 535-1205.

proxy

This proxy is solicited by the Board of Directors for use at the Annual Meeting on Tuesday, April 23, 2013.

The shares of stock you hold in your account will be voted as you specify on the reverse side.

Edgar Filing: HMN FINANCIAL INC - Form DEF 14A

If no choice is specified, the proxy will be voted FOR each of the nominees in Proposal 1 and FOR Proposals 2, 4 and 5 and for 1 YEAR on Proposal 3 and in the discretion of the proxies on all other matters.

By signing the proxy, you revoke all prior proxies and appoint Bradley C. Krehbiel and Jon J. Eberle, and each of them with full power of substitution, to vote your shares on the matters shown on the reverse side and any other matters which may come before the Annual Meeting and all adjournments or postponements of such Annual Meeting.

See reverse for voting instructions.