NBT BANCORP INC
Form 10-K
March 01, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2012

COMMISSION FILE NUMBER: 0-14703

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

Delaware	16-1268674
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

52 SOUTH BROAD STREET
NORWICH, NEW YORK 13815
(Address of principal executive office) (Zip Code)
(607) 337-2265 (Registrant's telephone number, including area code)

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

Title of each class:	Name of each exchange on which registered:
Common Stock, par value $0.01 per share	The NASDAQ Stock Market LLC
Stock Purchase Rights Pursuant to Stockholders Rights Plan	

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive

proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

Based on the closing price of the registrant's common stock as of June 30, 2012, the aggregate market value of the voting stock, common stock, par value, $0.01 per share, held by non-affiliates of the registrant is $688,194,085.

The number of shares of common stock outstanding as of February 15, 2013, was 33,795,298.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its Annual Meeting of Stockholders to be held on May 7, 2013 are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this Form 10-K.

NBT BANCORP INC.
FORM 10-K – Year Ended December 31, 2012

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PART I

ITEM 1. Business

NBT Bancorp Inc. (the "Registrant" or the "Company") is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The Company, on a consolidated basis, at December 31, 2012 had assets of $6.0 billion and stockholders' equity of $582.3 million. Return on average assets and return on average equity were 0.93% and 9.72%, respectively, for the year ending December 31, 2012. The Company had net income of $54.6 million or $1.62 per diluted share for 2012 and the fully taxable equivalent ("FTE") net interest margin was 3.86% for the same year.

The principal assets of the Registrant consist of all of the outstanding shares of common stock of its subsidiaries, including: NBT Bank, National Association (the "Bank"), NBT Financial Services, Inc. ("NBT Financial"), NBT Holdings, Inc. ("NBT Holdings"), Hathaway Agency, Inc., and CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II (collectively, the "Trusts"). The Company's principal sources of revenue are the management fees and dividends it receives from the Bank, NBT Financial and NBT Holdings.

The Company's business, primarily conducted through the Bank but also through its other subsidiaries, consists of providing commercial banking and financial services to customers in its market area, which includes central and upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts and the greater Burlington, Vermont area. The Company has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services. The Company's business philosophy is to operate as a community bank with local decision-making, principally in non-metropolitan markets, providing a broad array of banking and financial services to retail, commercial, and municipal customers. The financial condition and operating results of the Company are dependent on its net interest income which is the difference between the interest and dividend income earned on its earning assets, primarily loans and investments, and the interest expense paid on its interest bearing liabilities, primarily consisting of deposits and borrowings. Among other factors, net income is also affected by provisions for loan losses and noninterest income, such as service charges on deposit accounts, insurance and other financial services fees, trust revenue, and gains/losses on securities sales, bank owned life insurance income, ATM and debit card fees, and retirement plan administration fees as well as noninterest expense, such as salaries and employee benefits, occupancy, equipment, data processing and communications, professional fees and outside services, office supplies and postage, amortization, loan collection and other real estate owned expenses, advertising, FDIC expenses, and other expenses.

Substantially all of the Company's business activities are with customers located in the United States and are summarized by state below:

	Interest Income		Noninterest Income		Total Revenue	
New York	55	%	27	%	82	%
Pennsylvania	7	%	4	%	11	%
New Hampshire	2	%	0	%	2	%
Vermont	3	%	0	%	3	%
Massachusetts	1	%	1	%	2	%
	68	%	32	%	100	%

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	Commercial	Consumer	Residential Real Estate	Total Loan Portfolio
New York	35 %	30 %	10 %	75 %
Pennsylvania	5 %	6 %	3 %	14 %
New Hampshire	4 %	0 %	1 %	5 %
Vermont	3 %	1 %	1 %	5 %
Massachusetts	0 %	1 %	0 %	1 %
	47 %	38 %	15 %	100 %

	Secured By Real Estate	Not Secured By Real Estate
New York	55 % (a)	45 %
Pennsylvania	69 % (b)	31 %
New Hampshire	86 % (c)	14 %
Vermont	55 % (d)	45 %
Massachusetts	80 % (e)	20 %

(a) Loans secured by real estate primarily in central and upstate New York
(b) Loans secured by real estate primarily in northeastern Pennsylvania
(c) Loans secured by real estate primarily in southern New Hampshire
(d) Loans secured by real estate primarily in the Burlington, Vermont area
(e) Loans secured by real estate primarily in western Massachusetts

Like the rest of the nation, the market areas that the Company serves are still experiencing economic challenges. A variety of factors (e.g., any substantial rise in inflation or rise in unemployment rates, decrease in consumer confidence, international economic conditions, natural disasters, war, or political instability) may affect both the Company's markets and the national market. The Company will continue to emphasize managing its funding costs and lending and investment rates to effectively maintain profitability. In addition, the Company will continue to seek and maintain relationships that can generate fee income that is not directly tied to lending relationships. We anticipate that this approach should help mitigate profit fluctuations that are caused by movements in interest rates, business and consumer loan cycles, and local economic factors.

On June 8, 2012, the Company acquired all of the outstanding common shares of Hampshire First Bank ("Hampshire First"). The five banking centers operated by Hampshire First located in Manchester, Londonderry, Nashua, Keene and Portsmouth, New Hampshire continue to do business under the Hampshire First name as a division of the Bank. This business combination is a strategic extension of the Company's franchise.

On October 7, 2012, the Company and Alliance Financial Corporation ("Alliance") entered into a definitive agreement and plan of merger pursuant to which Alliance will merge with and into NBT Bancorp, with NBT Bancorp continuing as the surviving corporation. The agreement also provides for Alliance Bank, National Association, a wholly owned subsidiary of Alliance, to be merged with and into the Bank following completion of the merger. Alliance, with assets of approximately $1.4 billion at December 31, 2012, is headquartered in Syracuse, New York. Its primary subsidiary, Alliance Bank, National Association, is a nationally chartered community bank with 26 banking locations in central New York. The transaction is valued at approximately $233.4 million, to be paid in the form of shares of the Company's common stock. Subject to the required approvals of NBT Bancorp and Alliance shareholders, requisite regulatory approvals (which were received in the first quarter of 2013) and other customary closing conditions, the merger is expected to be completed in March 2013.

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NBT Bank, N.A.

The Bank is a full service commercial bank formed in 1856, which provides a broad range of financial products to individuals, corporations and municipalities throughout the central and upstate New York, northeastern Pennsylvania, western Massachusetts, southern New Hampshire and greater Burlington, Vermont market areas.

Through its network of branch locations, the Bank offers a wide range of products and services tailored to individuals, businesses, and municipalities. Deposit products offered by the Bank include demand deposit accounts, savings accounts, negotiable order of withdrawal (“NOW”) accounts, money market deposit accounts (“MMDA”), and certificate of deposit (“CD”) accounts. The Bank offers various types of each deposit account to accommodate the needs of its customers with varying rates, terms, and features. Loan products offered by the Bank include consumer loans, home equity loans, mortgages, small business loans and commercial loans, with varying rates, terms and features to accommodate the needs of its customers. The Bank also offers various other products and services through its branch network such as trust and investment services and financial planning and life insurance services. In addition to its branch network, the Bank also offers access to certain products and services online enabling customers to check balances, transfer funds, pay bills, view statements, apply for loans and access various other product and service information. The Bank provides 24-hour access to an automated telephone line whereby customers can check balances, obtain interest information, transfer funds, request statements, and perform various other activities.

The Bank conducts business through three geographic divisions, NBT Bank, Pennstar Bank, and Hampshire First Bank. At year end 2012, the NBT Bank division had 95 divisional offices and 115 automated teller machines (ATMs), located primarily in central and upstate New York, the Burlington, Vermont area, and Berkshire County, Massachusetts. At December 31, 2012, the NBT Bank division had total loans of approximately $3.5 billion, or 81% of total loans, and total deposits of $3.7 billion, or 77% of total deposits. Revenue for the NBT Bank division totaled $224 million for the year ended December 31, 2012. At year end 2012, the Pennstar Bank division had 35 divisional offices and 44 ATMs, located primarily in northeastern Pennsylvania. At December 31, 2012, the Pennstar Bank division had total loans of $587 million, or 14% of total loans, and total deposits of $949 million, or 20% of total deposits. Revenue for the Pennstar Bank division totaled $34 million for the year ended December 31, 2012. At year end 2012, the Hampshire First Bank division had five divisional offices and four ATMs, located primarily in southern New Hampshire. At December 31, 2012, the Hampshire First Bank division had total loans of approximately $217 million, or 5% of total loans, and total deposits of $202 million, or 4% of total deposits. Revenue for the Hampshire First Bank division totaled $7 million for the year ended December 31, 2012.

NBT Financial Services, Inc.

Through NBT Financial Services, the Company operates EPIC Advisors, Inc. (“EPIC”), a retirement plan administrator. Through EPIC, the Company offers services including retirement plan consulting and recordkeeping services. EPIC’s headquarters are located in Rochester, New York.

NBT Holdings, Inc.

Through NBT Holdings, the Company operates Mang Insurance Agency, LLC (“Mang”), a full-service insurance agency acquired by the Company on September 1, 2008. Mang’s headquarters are in Norwich, New York. Through Mang, the Company offers a full array of insurance products, including personal property and casualty, business liability and commercial insurance, tailored to serve the specific insurance needs of individuals as well as businesses in a range of industries operating in the markets served by the Company.

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The Trusts

The Trusts were organized to raise additional regulatory capital and to provide funding for certain acquisitions. CNBF Capital Trust I (“Trust I”) and NBT Statutory Trust I are Delaware statutory business trusts formed in 1999 and 2005, respectively, for the purpose of issuing trust preferred securities and lending the proceeds to the Company. In connection with the acquisition of CNB Bancorp, Inc., the Company formed NBT Statutory Trust II (“Trust II”) in February 2006 to fund the cash portion of the acquisition as well as to provide regulatory capital. The Company raised $51.5 million through Trust II in February 2006. The Company guarantees, on a limited basis, payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities. The Trusts are variable interest entities (VIEs) for which the Company is not the primary beneficiary, as defined by Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”). In accordance with FASB ASC, the accounts of the Trusts are not included in the Company’s consolidated financial statements.

Operating Subsidiaries of the Bank

The Bank has five operating subsidiaries, NBT Capital Corp., Pennstar Bank Services Company, Broad Street Property Associates, Inc., NBT Services, Inc., and CNB Realty Trust. NBT Capital Corp., formed in 1998, is a venture capital corporation formed to assist young businesses to develop and grow primarily in the markets they serve. Pennstar Bank Services Company, formed in 2002, provides administrative and support services to the Pennstar Bank division of the Bank. Broad Street Property Associates, Inc., formed in 2004, is a property management company. NBT Services, Inc., formed in 2004, has a 44% ownership interest in Land Record Services, LLC. Land Record Services, LLC, a title insurance agency, offers mortgagee and owner’s title insurance coverage to both retail and commercial customers. CNB Realty Trust, formed in 1998, is a real estate investment trust.

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Competition

The financial services industry, including commercial banking, is highly competitive, and we encounter strong competition for deposits, loans and other financial products and services in our market area. The increasingly competitive environment is the result of changes in regulation, changes in technology and product delivery systems, additional financial service providers, and the accelerating pace of consolidation among financial services providers. The Company competes for loans, deposits, and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions, and other nonbank financial service providers.

The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems.

Some of the Company's competitors have fewer regulatory constraints and may have lower cost structures. In addition, some of the Company's competitors have assets, capital and lending limits greater than that of the Company, have greater access to capital markets and offer a broader range of products and services than the Company. These institutions may have the ability to finance wide-ranging advertising campaigns and may also be able to offer lower rates on loans and higher rates on deposits than the Company can offer. Some of these institutions offer services, such as credit cards and international banking, which the Company does not directly offer.

Various in-state market competitors and out-of-state banks continue to enter or have announced plans to enter or expand their presence in the market areas in which the Company currently operates. With the addition of new banking presences within our market, the Company expects increased competition for loans, deposits, and other financial products and services.

In order to compete with other financial services providers, the Company stresses the community nature of its banking operations and principally relies upon local promotional activities, personal relationships established by officers, directors, and employees with their customers, and specialized services tailored to meet the needs of the communities served. We also offer certain customer services, such as agricultural lending, that many of our larger competitors do not offer. While the Company's position varies by market, the Company's management believes that it can compete effectively as a result of local market knowledge, local decision making, and awareness of customer needs.

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The table below summarizes the Bank's deposits and market share by the twenty-eight counties of New York, Pennsylvania, New Hampshire, Vermont, and Massachusetts in which it had customer facilities as of June 30, 2012. Market share is based on deposits of all commercial banks, credit unions, savings and loans associations, and savings banks.

County	State	Deposits (in thousands)	Market Share		Market Rank	Number of Branches*	Number of ATMs*
Chenango	NY	$485,750	81.73	%	1	11	13
Fulton	NY	372,524	57.99	%	1	7	8
Schoharie	NY	188,604	48.54	%	1	4	4
Hamilton	NY	34,091	46.88	%	2	1	1
Delaware	NY	299,970	32.43	%	1	5	5
Montgomery	NY	211,783	32.00	%	2	5	5
Otsego	NY	302,772	30.64	%	2	9	12
Essex	NY	143,527	25.37	%	2	3	6
Susquehanna	PA	144,957	20.75	%	2	6	7
Wayne	PA	153,294	11.81	%	4	3	4
Broome	NY	258,967	11.45	%	3	8	11
Saint Lawrence	NY	125,478	11.19	%	3	5	6
Pike	PA	56,976	9.72	%	5	2	2
Oneida	NY	288,848	9.52	%	6	6	12
Lackawanna	PA	384,710	7.97	%	7	15	18
Tioga	NY	32,002	7.88	%	6	1	1
Clinton	NY	88,913	7.41	%	5	3	2
Herkimer	NY	37,182	6.34	%	6	2	1
Franklin	NY	27,082	5.96	%	5	1	1
Schenectady	NY	104,883	4.40	%	7	2	2
Berkshire	MA	130,493	4.24	%	7	5	5
Greene	NY	41,872	4.19	%	5	3	3
Saratoga	NY	127,962	3.65	%	10	3	4
Monroe	PA	86,385	3.63	%	8	5	7
Warren	NY	51,153	3.59	%	7	3	3
Cheshire	NH	27,177	2.15	%	7	1	0
Luzerne	PA	114,030	1.99	%	15	4	6
Hillsborough	NH	167,887	1.54	%	7	2	2
Albany	NY	141,956	1.12	%	10	4	6
Chittenden	VT	41,032	1.05	%	7	3	3
Rensselaer	NY	12,106	0.62	%	12	1	1
Rockingham	NH	25,864	0.49	%	15	2	2
		$4,710,230				135	163

Deposit market share data is based on the most recent data available (as of June 30, 2012). Source: SNL Financial LLC

* Branch and ATM data is as of December 31, 2012.

Supervision and Regulation

As a bank holding company, the Company is subject to extensive regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board” or “FRB”) as its primary federal regulator. The Company also has qualified for and elected to be registered with the FRB as a financial holding company. The Bank, as a nationally chartered bank, is subject to extensive regulation, supervision and examination by the Office of the Comptroller of the Currency (“OCC”) as its primary federal regulator and, as to certain matters, by the FRB, the Bureau of Consumer Financial Protection (“CFPB”), and the Federal Deposit Insurance Corporation (“FDIC”).

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The Company is also under the jurisdiction of the Securities and Exchange Commission ("SEC") and is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. A summary of material information regarding the laws and regulations applicable to the Company are below. This summary is not complete and the reader should refer to these laws and regulations for more information. Failure to comply with applicable laws and regulations could result in a range of sanctions and enforcement actions, including the imposition of civil money penalties, formal agreements and cease and desist orders. Applicable laws and regulations may change in the future and any such change could have a material adverse impact on the Company.

Federal Bank Holding Company Regulation

Transactions between the Bank and any of its affiliates, including the Company, are governed by sections 23A and 23B of the Federal Reserve Act ("FRA") and the FRB's implementing Regulation W. An "affiliate" of a bank includes any company or entity that controls, is controlled by, or is under common control with the bank. A subsidiary of a bank that is not also a depository institution is not treated as an affiliate of the bank for purposes of sections 23A and 23B, unless the subsidiary is also controlled through a non-bank chain of ownership by affiliates or controlling shareholders of the bank, the subsidiary is a financial subsidiary that operates under the expanded authority granted to national banks under the Financial Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act ("GLB Act"), or the subsidiary engages in other activities that are not permissible for a bank to engage in directly (except insurance agency subsidiaries). Generally, sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by placing quantitative and qualitative limitations on covered transactions between a bank and with any one affiliate as well as all affiliates of the bank in the aggregate, and requiring that such transactions be on terms that are consistent with safe and sound banking practices.

Under the GLB Act, a financial holding company may engage in certain financial activities that a bank holding company may not otherwise engage in under the Bank Holding Company Act ("BHC Act"). In addition to engaging in banking and activities closely related to banking as determined by the FRB by regulation or order prior to November 11, 1999, a financial holding company may engage in activities that are financial in nature or incidental to financial activities, or activities that are complementary to a financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLB Act and the rules promulgated thereunder require all financial institutions, including the Company and the Bank, to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request, and establish procedures and practices to protect customer data from unauthorized access. In addition, the Fair Credit Reporting Act ("FCRA"), as amended by the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"), includes many provisions affecting the Company, Bank, and/or their affiliates, including provisions concerning obtaining consumer reports, furnishing information to consumer reporting agencies, maintaining a program to prevent identity theft, sharing of certain information among affiliated companies, and other provisions. The FACT Act requires persons subject to FCRA to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The CFPB and the Federal Trade Commission ("FTC") have extensive rulemaking authority under the FACT Act, and the Company and the Bank are subject to the rules that have been promulgated under the FACT Act, including rules regarding limitations on affiliate marketing and implementation of programs to identify, detect and mitigate certain identity theft red flags. The Company has developed policies and procedures for itself and its subsidiaries, including the Bank, and believes it is in compliance with all privacy, information sharing, and notification provisions of the GLB Act and the FACT Act. The Bank is also subject to data security standards and data breach notice requirements, chiefly those issued by the OCC.

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Federal Reserve System Regulation

The Company is subject to capital adequacy guidelines of the FRB. The guidelines apply on a consolidated basis and require bank holding companies to maintain a minimum ratio of Tier 1 capital to total average assets (or "leverage ratio") of 4%. For the most highly rated bank holding companies, the minimum ratio is 3%. The FRB capital adequacy guidelines also require bank holding companies to maintain a minimum ratio of Tier 1 capital to risk-weighted assets of 4% and a minimum ratio of qualifying total capital to risk-weighted assets of 8%. As of December 31, 2012, the Company's leverage ratio was 8.54%, its ratio of Tier 1 capital to risk-weighted assets was 11.00%, and its ratio of qualifying total capital to risk-weighted assets was 12.25%. The FRB may set higher minimum capital requirements for bank holding companies whose circumstances warrant it, such as companies anticipating significant growth or facing unusual risks. The FRB has not advised the Company of any special capital requirement applicable to it.

Any holding company whose capital does not meet the minimum capital adequacy guidelines is considered to be undercapitalized and is required to submit an acceptable plan to the FRB for achieving capital adequacy. Such a company's ability to pay dividends to its shareholders and expand its lines of business through the acquisition of new banking or nonbanking subsidiaries also could be restricted.

Pursuant to Federal Reserve Board regulations and supervisory policies that were largely codified in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), bank holding companies also are expected to serve as a source of financial and managerial strength to their subsidiary depository institutions. Therefore, to the extent the Bank is in need of capital, the Company could be expected to provide additional capital to the Bank, including, potentially, raising new capital for that purpose.

Office of Comptroller of the Currency Regulation

The Bank is supervised and regularly examined by the OCC. The various laws and regulations administered by the OCC affect corporate practices such as payment of dividends, incurring debt, and acquisition of financial institutions and other companies. It also affects business practices, such as payment of interest on deposits, the charging of interest on loans, types of business conducted and location of offices. The OCC generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be undercapitalized. Undercapitalized institutions are subject to growth limitations and are required to submit a capital restoration plan to the OCC. If a depository institution fails to submit an acceptable capital restoration plan, it is treated as if it is "significantly undercapitalized." Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

The Bank is subject to leverage and risk-based capital requirements and minimum capital guidelines of the OCC that are similar to those applicable to the Company. As of December 31, 2012, the Bank was in compliance with all minimum capital requirements and met the requirements to be considered well-capitalized. As of that date, the Bank's leverage ratio was 7.62%, its ratio of Tier 1 capital to risk-weighted assets was 9.83%, and its ratio of qualifying total capital to risk-weighted assets was 11.08%.

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Insurance of Deposit Accounts

The Bank is a member of the Deposit Insurance Fund ("DIF") and deposit accounts at the Bank are insured by the FDIC, generally up to the maximum amount permitted by law. The Dodd-Frank Act permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor per insured institution, retroactive to January 1, 2008. Under the Dodd-Frank Act, qualifying non-interest bearing transaction accounts had unlimited deposit insurance through December 31, 2012, but these accounts now return to general deposit insurance limits.

The deposits of the Bank are insured up to regulatory limits by the FDIC. The Federal Deposit Insurance Reform Act of 2005 gave the FDIC increased flexibility in assessing premiums on banks and savings associations, including the Bank, to pay for deposit insurance and in managing its deposit insurance reserves. The FDIC currently maintains a risk-based assessment system under which assessment rates vary based on the level of risk posed by institutions to the DIF. In February 2011, the FDIC issued new rules that took effect April 1, 2011 to change the way the FDIC differentiates risk and sets appropriate assessment rates.

Those rules also redefined the deposit insurance assessment base, as required by the Dodd-Frank Act, from an institution's domestic deposits to an institution's average consolidated total assets minus average tangible equity. FDIC assessment expenses totaled approximately $3.5 million in 2012 as compared with $3.8 million 2011.

In addition to the FDIC deposit insurance, the Federal Deposit Insurance Act provides for additional assessments to be imposed on insured depository institutions to pay for the cost of Financing Corporation ("FICO") funding. The FICO assessments are adjusted quarterly to reflect changes in the assessment base of the DIF and do not vary depending upon a depository institution's capitalization or supervisory evaluation. The Company incurred approximately $0.3 million in FICO expenses in 2012 and $0.4 million in 2011.

Under FDIC regulations, no FDIC-insured bank can accept brokered deposits unless it is well capitalized, or is adequately capitalized and receives a waiver from the FDIC. In addition, these regulations prohibit any bank that is not well capitalized from paying an interest rate on brokered deposits in excess of three-quarters of one percentage point over certain prevailing market rates. As of December 31, 2012, the Bank's total brokered deposits were $68.2 million.

Federal Home Loan Bank

The Bank is also a member of the Federal Home Loan Bank ("FHLB") of New York, which provides a central credit facility primarily for member institutions for home mortgage and neighborhood lending. The Bank is subject to the rules and requirements of the FHLB, including the requirement to acquire and hold shares of capital stock in the FHLB in an amount at least equal to the sum of 0.35% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year. The Bank was in compliance with the rules and requirements of the FHLB at December 31, 2012.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

On July 21, 2010, President Obama signed into law the Dodd-Frank Act. This law significantly changed the bank regulatory landscape and impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress.

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The so-called Collins Amendment to the Dodd-Frank Act requires bank holding companies with assets greater than $500 million to be subject to the same capital requirements as insured depository institutions, meaning, for instance, that such bank holding companies will not be able to count trust preferred securities issued after May 19, 2010 as Tier 1 capital. The Company has not issued any trust preferred securities after May 19, 2010. The Collins Amendment also directs the appropriate federal banking supervisors, subject to recommendations by the Financial Stability Oversight Council, to develop capital requirements for all insured depository institutions, depository institution holding companies and systemically important non-bank financial companies to address systemically risky activities.

The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called "golden parachute" payments. The legislation also authorizes the SEC to promulgate rules that would allow stockholders to nominate their own candidates using the company's proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules requiring the reporting of incentive-based compensation and prohibiting excessive incentive-based compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded or not. In April 2011, the FRB, along with other federal banking supervisors, issued a joint notice of proposed rulemaking implementing those requirements.

The Dodd-Frank Act created the new CFPB with wide-ranging powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. As the Company is below this threshold, the OCC continues to exercise primary examination authority over the Bank with regard to compliance with federal consumer protection laws and regulations. The Dodd-Frank Act also weakened the federal preemption rules that have been applicable to national banks and federal savings associations, and gave state attorneys general certain powers to enforce rules issued by the CFPB. Further, pursuant to Federal Reserve regulations mandated by the Dodd-Frank Act, effective October 1, 2011, interchange fees on debit card are limited to a maximum of 21 cents per transaction plus 5 basis points of the transaction amount. A debit card issuer may recover an additional one cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements prescribed by the Federal Reserve. Issuers that, together with their affiliates, have less than $10 billion in assets, such as the Company, are exempt from the debit card interchange fee standards. The FRB also adopted requirements in the final rule that issuers include two unaffiliated networks for routing debit transactions that are applicable to the Company and the Bank.

The scope and impact of many of the Dodd-Frank Act's provisions will be determined over time as regulations are issued and become effective. As a result, we cannot predict the ultimate impact of the Act on the Company or the Bank at this time, including the extent to which it could increase costs or limit our ability to pursue business opportunities in an efficient manner, or otherwise adversely affect our business, financial condition and results of operations. Nor can we predict the impact or substance of other future legislation or regulation. However, it is expected that they at a minimum will increase our operating and compliance costs. As continued rules and regulations are issued, the Company may need to dedicate additional resources to ensure compliance, which may increase its costs of operations and adversely impact its earnings.

Basel III Amendments to Capital Adequacy Requirements

The current U.S. federal bank regulatory agencies' risk-based capital guidelines are based upon the 1988 capital accord ("Basel I") of the Basel Committee on Banking Supervision ("Basel Committee"). The Basel Committee is a committee of central banks and bank supervisors/regulators from the major industrialized countries that meet under the auspices of the Bank for International Settlements in Basel, Switzerland to develop broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply.

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In December 2010, the Basel Committee released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III." Basel III, when implemented by the U.S. bank regulatory agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity. The Basel III final capital framework, among other things, introduces as a new capital measure "Common Equity Tier 1", or "CET1", specifies that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, defines CET1 narrowly by requiring that most adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and expands the scope of the adjustments as compared to existing regulations.
While the Basel Committee initially called for the implementation of the Basel III final framework to commence January 1, 2013, final rules have not yet been implemented in the United States.

In June 2012, the Federal Banking Agencies issued a notice of proposed rulemaking ("NPR") to implement Basel III in the United States. The Basel III NPR closely followed the Basel Committee's Basel III proposal in most respects. Although the NPR calls for implementation to begin in 2013, the Federal Banking Agencies have not yet finalized the proposal. The NPR would initially require banks and bank holding companies to meet the following minimum requirements:

- 3.5% CET1 to risk-weighted assets;
- 4.5% Tier 1 capital to risk-weighted assets; and
- 8.0% Total capital to risk-weighted assets.

Under the Basel III NPR, the minimum capital requirements would, in 2019, increase to the following:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital to risk-weighted assets; and
- 8.0% Total capital to risk-weighted assets.

The Basel III final framework and the NPR provides for a number of new deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

In addition to the Basel III NPR, the Federal Banking Agencies also released an NPR to implement the Basel II Standardized approach in the United States and make it applicable to almost all banking organizations in the United States. It incorporates aspects of the Basel Committee's Basel II standardized framework and provides alternatives to credit ratings for the treatment of certain exposures, consistent with the Dodd-Frank Act. The Standardized Approach NPR would increase the risk sensitivity of the Federal Banking Agencies' general risk-based capital requirements for determining risk-weighted assets (i.e., the denominator of a banking organization's risk-based capital ratios) by proposing revised methodologies for determining risk-weighted assets for:

- Residential mortgage exposures by applying a more risk-sensitive treatment that would risk-weight an exposure based on certain loan characteristics, underwriting standards, and its loan-to-value ratio in a range between 35% and 200%, compared to current classification at 50%;

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Certain commercial real estate credit facilities that finance the acquisition, development, or construction of real property by assigning a higher 150% risk weight;

Exposures that are more than 90 days past due or on nonaccrual (excluding sovereign and residential mortgage exposures) by assigning a higher 150% risk weight;

Exposures to foreign sovereigns, foreign banks, and foreign public sector entities by basing the risk weight for each exposure type on the OECD's country risk classification of the sovereign entity so as to follow Dodd-Frank's requirement not to use credit ratings; and

More favorable capital treatment for derivatives and repo-style transactions cleared through central counterparties.

The Standardized Approach NPR would also generally replace the use of credit ratings for securitization exposures with a formula-based approach under the existing gross up approach, or a new simplified supervisory formula approach (SSFA). The Standardized Approach NPR notes that the SSFA would generally result in relatively higher capital requirements for the more risky junior tranches of securitizations and relatively lower capital requirements for the most senior tranches. The Standardized Approach NPR would also provide greater recognition of credit risk mitigants, such as collateral and guarantees. For assets with newly eligible guarantees and eligible collateral, this will result in lower capital requirements. The changes in the Standardized Approach NPR are proposed to take effect January 1, 2015. However, banking organizations may choose to comply with the proposed requirements prior to that date.

The Dodd-Frank Act requires the Federal Reserve to adopt regulations imposing a continuing "floor" of the Basel I-based capital requirements in cases where the Basel II-based capital requirements and any changes in capital regulations resulting from Basel III otherwise would permit lower requirements. In June 2011, the Federal Reserve finalized regulations implementing this requirement.

Given that the Basel III rules are subject to implementation and change and the scope and content of capital regulations that U.S. federal banking agencies may adopt under the Dodd-Frank Act is uncertain, we cannot be certain of the impact new capital regulations will have on our capital ratios.

Consumer Protection Laws

Effective July 1, 2010, a new federal banking rule under the Electronic Fund Transfer Act prohibits financial institutions from charging consumers fees for paying overdrafts on ATM and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. Overdrafts on the payment of checks and regular electronic bill payments are not covered by this new rule. The adoption of this regulation by the Bank had a negative impact on the Company's service charge income of approximately $1.9 million in 2011.

Home mortgage lenders, including banks, are required under the Home Mortgage Disclosure Act to make available to the public expanded information regarding the pricing of home mortgage loans, including the "rate spread" between the annual percentage rate and the average prime offer rate for mortgage loans of a comparable type. The availability of this information has led to increased scrutiny of higher-priced loans at all financial institutions to detect illegal discriminatory practices and to the initiation of a limited number of investigations by federal banking agencies and the U.S. Department of Justice. The Company has no information that it or its affiliates is the subject of any HMDA investigation.

In addition, the Company is also subject to federal consumer protection statutes and regulations promulgated under these laws, including, but not limited to:

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

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- Fair Credit Reporting Act, governing the provision of consumer information to credit reporting agencies and the use of consumer information; and
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies.

On January 10, 2013, the CFPB issued a final rule implementing the ability-to-repay and qualified mortgage (QM) provisions of the Truth in Lending Act, as amended by the Dodd-Frank Act (the "QM Rule"). The ability-to-repay provision requires creditors to make reasonable, good faith determinations that borrowers are able to repay their mortgages before extending the credit based on a number of factors and consideration of financial information about the borrower from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of "qualified mortgage" are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for prime loans meeting the QM requirements, and a rebuttable presumption for higher-priced/subprime loans meeting the QM requirements. The definition of a "qualified mortgage" incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43% debt-to-income ratio for borrowers if the loan is to meet the QM definition, though some mortgages that meet GSE, FHA and VA underwriting guidelines may, for a period not to exceed seven years, meet the QM definition without being subject to the 43% debt-to-income limits. The QM Rule will become effective January 10, 2014.

USA PATRIOT Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act") imposes obligations on U.S. financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. Under Title III of the USA PATRIOT Act all financial institutions, including the Company and the Bank, are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. The USA PATRIOT Act also encourages information-sharing among financial institutions, regulators, and law enforcement authorities by providing an exemption from the privacy provisions of the GLB Act for financial institutions that comply with this provision. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank, or the BHC Act, which applies to the Company. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences for the institution. As of December 31, 2012, the Company and the Bank believe they are in compliance with the USA PATRIOT Act and regulations thereunder.

Community Reinvestment Act of 1977

The Bank has a responsibility under the Community Reinvestment Act of 1977 ("CRA") to help meet the credit needs of its communities, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. Regulators assess the Bank's record of compliance with the CRA. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit discrimination in lending practices on the basis of characteristics specified in those statutes. The Bank's failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities and the activities of the Company. The Bank's failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions against it by its regulators as well as other federal regulatory agencies and the Department of Justice. The Bank's latest CRA rating was "Satisfactory".

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Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 ("SOX") implemented a broad range of measures to increase corporate responsibility, enhance penalties for accounting and auditing improprieties at publicly traded companies, and protect investors by improving the accuracy and reliability of corporate disclosures pursuant to federal securities laws. SOX applies generally to companies that have securities registered under the Exchange Act, including publicly held bank holding companies such as the Company. SOX and/or its implementing regulations have, among other things, established new membership requirements and additional responsibilities for our audit committee, imposed restrictions on the relationship between us and our outside auditors (including restrictions on the types of non-audit services our auditors may provide to us), imposed additional responsibilities for our external financial statements on our chief executive officer and chief financial officer, expanded the disclosure requirements for our corporate insiders, required our management to evaluate our disclosure controls and procedures and our internal control over financial reporting, and required our auditors to issue a report on our internal control over financial reporting. In addition, the federal banking regulators have adopted generally similar requirements concerning the certification of financial statements by bank officials.

Employees

At December 31, 2012, the Company had 1,581 full-time equivalent employees. The Company's employees are not presently represented by any collective bargaining group. The Company considers its employee relations to be good.

Available Information

The Company's website is http://www.nbtbancorp.com. The Company makes available free of charge through its website its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed or furnished with the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act. We also make available through our website other reports filed with or furnished to the SEC under the Exchange Act, including our proxy statements and reports filed by officers and directors under Section 16(a) of that Act, as well as our Code of Business Conduct and Ethics and other codes/committee charters. The references to our website do not constitute incorporation by reference of the information contained in the website and such information should not be considered part of this document.

Any materials we file with the SEC may be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC, 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

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ITEM 1A. Risk Factors

There are risks inherent to the Company's business. The material risks and uncertainties that management believes affect the Company are described below. Any of the following risks could affect the Company's financial condition and results of operations and could be material and/or adverse in nature.

Deterioration in local economic conditions may negatively impact our financial performance.

The Company's success depends primarily on the general economic conditions of central and upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts and Burlington, Vermont and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in the upstate New York areas of Norwich, Oneonta, Amsterdam-Gloversville, Albany, Binghamton, Utica-Rome, Plattsburg, Glens Falls. and Ogdensburg-Massena, the northeastern Pennsylvania areas of Scranton, Wilkes-Barre and East Stroudsburg, Berkshire County, Massachusetts, southern New Hampshire and the greater Burlington, Vermont area. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources.

As a lender with the majority of our loans secured by real estate or made to businesses in New York, Pennsylvania, Massachusetts, New Hampshire and Vermont, a downturn in these local economies could cause significant increases in nonperforming loans, which could negatively impact our earnings. Declines in real estate values in our market areas could cause any of our loans to become inadequately collateralized, which would expose us to greater risk of loss. Additionally, a decline in real estate values could adversely impact our portfolio of residential and commercial real estate loans and could result in the decline of originations of such loans, as most of our loans, and the collateral securing our loans, are located in those areas.

Following completion of the Alliance merger, the Company will have more significant operations in central New York and be further subjected to such risks with respect to economic conditions in that area.

Variations in interest rates may negatively affect our financial performance.

The Company's earnings and financial condition are largely dependent upon net interest income, which is the difference between interest earned from loans and investments and interest paid on deposits and borrowings. The narrowing of interest rate spreads could adversely affect the Company's earnings and financial condition. The Company cannot predict with certainty or control changes in interest rates. Regional and local economic conditions and the policies of regulatory authorities, including monetary policies of the FRB, affect interest income and interest expense. High interest rates could also affect the amount of loans that the Company can originate because higher rates could cause customers to apply for fewer mortgages or cause depositors to shift funds from accounts that have a comparatively lower cost to accounts with a higher cost. The Company may also experience customer attrition due to competitor pricing. With short-term interest rates at historic lows and the current Federal Funds target rate at 25 bp, the Company's interest-bearing deposit accounts, particularly core deposits, are repricing at historic lows as well. With the current outlook of the FRB to maintain the Fed Funds target rate at 25 bp for another 24 to 28 months, the Company's challenge will be managing the magnitude and scope of the repricing. If the cost of interest-bearing deposits increases at a rate greater than the yields on interest-earning assets increase, net interest income will be negatively affected. Changes in the asset and liability mix may also affect net interest income. Similarly, lower interest rates cause higher yielding assets to prepay and floating or adjustable rate assets to reset to lower rates. If the Company is not able to reduce its funding costs sufficiently, due to either competitive factors or the maturity schedule of existing liabilities, then the Company's net interest margin will decline.

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Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Company's results of operations, any substantial or unexpected change in, or prolonged change in market interest rates could have a material adverse effect on the Company's financial condition and results of operations. See the section captioned "Net Interest Income" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 7A. Quantitative and Qualitative Disclosure About Market Risk located elsewhere in this report for further discussion related to the Company's management of interest rate risk.

Changes in the equity markets could materially affect the level of assets under management and the demand for other fee-based services.

Economic downturns could affect the volume of income from and demand for fee-based services. Revenues from the trust and benefit plan administration businesses depend in large part on the level of assets under management and administration. Market volatility that leads customers to liquidate investments, as well as lower asset values, can reduce our level of assets under management and administration and thereby decrease our investment management and administration revenues.

Our lending, and particularly our emphasis on commercial lending, exposes us to the risk of losses upon borrower default.

There are inherent risks associated with the Company's lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where the Company operates as well as those across the States of New York, Pennsylvania, Massachusetts, New Hampshire and Vermont, and the entire United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans. The Company is also subject to various laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Company to regulatory enforcement action that could result in the assessment of significant civil money penalties against the Company.

As of December 31, 2012, approximately 47% of the Company's loan portfolio consisted of commercial and industrial, agricultural, commercial construction and commercial real estate loans. These types of loans generally expose a lender to greater risk of non-payment and loss than residential real estate loans because repayment of the loans often depends on the successful operation of the property, the income stream of the borrowers and, for construction loans, the accuracy of the estimate of the property's value at completion of construction and the estimated cost of construction. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. Because the Company's loan portfolio contains a significant number of commercial and industrial, agricultural, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in nonperforming loans. An increase in nonperforming loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses and/or an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial condition and results of operations. See the section captioned "Loans" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations located elsewhere in this report for further discussion related to commercial and industrial, agricultural, construction and commercial real estate loans.

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

The Company maintains an allowance for loan losses, which is an allowance established through a provision for loan losses charged to expense, that represents management's best estimate of probable losses that could be incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political, environmental, and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Company's control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review the Company's allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, the Company will need additional provisions to increase the allowance for loan losses. These potential increases in the allowance for loan losses would result in a decrease in net income and, possibly, capital, and may have a material adverse effect on the Company's financial condition and results of operations. See the section captioned "Risk Management – Credit Risk" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations located elsewhere in this report for further discussion related to the Company's process for determining the appropriate level of the allowance for loan losses.

Strong competition within our industry and market area could hurt our performance and slow our growth.

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, and community banks within the various markets in which the Company operates. Additionally, various banks continue to enter or have announced plans to enter the market areas in which the Company currently operates. The Company also faces competition from many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of the Company's competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than the Company can.

The Company's ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- the ability to expand the Company's market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which the Company introduces new products and services relative to its competitors;
- customer satisfaction with the Company's level of service;

- industry and general economic trends; and
- the ability to attract and retain talented employees.

Failure to perform in any of these areas could significantly weaken the Company's competitive position, which could adversely affect the Company's growth and profitability, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

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We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations.

The Company, primarily through the Bank and certain non-bank subsidiaries, is subject to extensive federal regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not shareholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See the section captioned "Supervision and Regulation" which is located in Item 1. Business in the Company's Annual Report on Form 10-K.

Compliance with the Dodd-Frank Act and other regulatory reforms may increase our costs of operations and adversely impact our earnings and capital ratios

On July 21, 2010, President Obama signed the Dodd-Frank Act into law. The Dodd-Frank Act represented a significant overhaul of many aspects of the regulation of the financial services industry, and has significantly changed the bank regulatory landscape and impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. Among other things, the Dodd-Frank Act creates a new federal financial consumer protection agency, tightens capital standards, imposes clearing and margining requirements on many derivatives activities, and generally increases oversight and regulation of financial institutions and financial activities. It requires bank holding companies with assets greater than $500 million to be subject to minimum leverage and risk-based capital requirements and phases out the ability for bank holding companies to count trust preferred securities issued after May 19, 2010 as Tier 1 capital. The Company has not issued any trust preferred securities after May 19, 2010.

In addition, the Dodd-Frank Act significantly rolls back the federal preemption of state consumer protection laws that is currently enjoyed by federal savings associations and national banks by requiring that a state consumer financial law prevent or significantly interfere with the exercise of a federal savings association's or national bank's powers before it can be preempted, mandating that any preemption decision be made on a case by case basis rather than a blanket rule, and ending the applicability of preemption to subsidiaries and affiliates of national banks and federal savings associations. As a result, we may now be subject to state consumer protection laws in each state where we do business, and those laws may be interpreted and enforced differently in different states.

The scope and impact of many of the Dodd-Frank Act's provisions will be determined over time as regulations are issued and become effective. As a result, we cannot predict the ultimate impact of the Dodd-Frank Act on us at this time, including the extent to which it could increase costs or limit our ability to pursue business opportunities in an efficient manner, or otherwise adversely affect our business, financial condition and results of operations. However, it is expected that at a minimum they will increase our operating and compliance costs. The financial reform legislation and any rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and our business. We will apply resources to ensure that we are in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase our costs of operations and adversely impact our earnings.

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The Company is subject to liquidity risk which could adversely affect net interest income and earnings

The purpose of the Company's liquidity management is to meet the cash flow obligations of its customers for both deposits and loans. The primary liquidity measurement the Company utilizes is called Basic Surplus which captures the adequacy of the Company's access to reliable sources of cash relative to the stability of its funding mix of average liabilities. This approach recognizes the importance of balancing levels of cash flow liquidity from short and long-term securities with the availability of dependable borrowing sources which can be accessed when necessary. However, competitive pressure on deposit pricing could result in a decrease in the Company's deposit base or an increase in funding costs. In addition, liquidity will come under additional pressure if loan growth exceeds deposit growth. These scenarios could lead to a decrease in the Company's basic surplus measure below the minimum policy level of 5%. To manage this risk, the Company has the ability to purchase brokered time deposits, borrow against established borrowing facilities with other banks (Federal funds), and enter into repurchase agreements with investment companies. Depending on the level of interest rates, the Company's net interest income, and therefore earnings, could be adversely affected. See the section captioned "Liquidity Risk" in Item 7.

Our ability to service our debt, pay dividends and otherwise pay our obligations as they come due is substantially dependent on capital distributions from our subsidiaries.

The Company is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company's common stock and interest and principal on the Company's debt. Various federal and/or state laws and regulations limit the amount of dividends that the Bank may pay to the Company. Also, the Company's right to participate in a distribution of assets upon a subsidiary's liquidation or reorganization is subject to the prior claims of the subsidiary's creditors. In the event the Bank is unable to pay dividends to the Company, the Company may not be able to service debt, pay obligations or pay dividends on the Company's common stock. The inability to receive dividends from the Bank could have a material adverse effect on the Company's business, financial condition and results of operations.

A breach of information security, including as a result of cyber attacks, could disrupt our business and impact our earnings.

We depend upon data processing, communication and information exchange on a variety of computing platforms and networks, and over the internet. In addition, we rely on the services of a variety of vendors to meet our data processing and communication needs. Despite existing safeguards, we cannot be certain that all of our systems are free from vulnerability to attack or other technological difficulties or failures. If information security is breached or difficulties or failures occur, despite the controls we and our third party vendors have instituted, information can be lost or misappropriated, resulting in financial loss or costs to us or damages to others. Such costs or losses could exceed the amount of insurance coverage, if any, which would adversely affect our earnings.

We continually encounter technological change and the failure to understand and adapt to these changes could hurt our business.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing

these products and services to its customers. Failure to successfully keep pace with technological changes affecting the financial services industry could have a material adverse impact on the Company's business and, in turn, the Company's financial condition and results of operations.

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Provisions of our certificate of incorporation, bylaws and stockholder rights plan, as well as Delaware law and certain banking laws, could delay or prevent a takeover of us by a third party.

Provisions of the Company's certificate of incorporation and bylaws, the Company's stock purchase rights plan, the corporate law of the State of Delaware and state and federal banking laws, including regulatory approval requirements, could delay, defer or prevent a third party from acquiring the Company, despite the possible benefit to the Company's stockholders, or otherwise adversely affect the market price of the Company's common stock. These provisions include: supermajority voting requirements for certain business combinations; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to the Company's board of directors and for proposing matters that stockholders may act on at stockholder meetings. In addition, the Company is subject to Delaware law, which among other things prohibits the Company from engaging in a business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discouraging bids for the Company's common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of the Company's common stock. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors other than candidates nominated by the Board.

Negative developments in the housing market, financial industry and the domestic and international credit markets may adversely affect our operations and results.

Dramatic declines in the housing market over the past few years, with falling home prices and increasing foreclosures, continued high unemployment and under-employment, have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by financial institutions.

The economic pressure experienced by consumers during the recent fiscal recession and lack of confidence in the financial markets has adversely affected our business, financial condition and results of operations. In particular, we have seen increases in foreclosures in our markets, increases in expenses such as loan collection and OREO expenses, and a low reinvestment rate environment. While believe the financial crisis is slowly recovering, but we have not yet hit the bottom in many northeast markets. Therefore, we do not expect that the challenging conditions in the financial and housing markets are likely to improve in the near future. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions. In particular, we may be affected in one or more of the following ways:

- We currently face increased regulation of our industry and compliance with such regulation may increase our costs and limit our ability to pursue business opportunities;
- Our ability to borrow from other financial institutions or to access the debt or equity capital markets on favorable terms or at all could be adversely affected by further disruptions in the capital markets; or
- Competition in our industry could intensify as a result of the increasing consolidation of financial services companies in connection with current market conditions.

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We are subject to other-than-temporary impairment risk which could negatively impact our financial performance.

The Company recognizes an impairment charge when the decline in the fair value of equity, debt securities and cost-method investments below their cost basis are judged to be other-than-temporary. Significant judgment is used to identify events or circumstances that would likely have a significant adverse effect on the future use of the investment. The Company considers various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, forecasted recovery, the financial condition and near-term prospects of the investee, and whether the Company has the intent to sell and whether it is more likely than not it will be forced to sell the security in question. Information about unrealized gains and losses is subject to changing conditions. The values of securities with unrealized gains and losses will fluctuate, as will the values of securities that we identify as potentially distressed. Our current evaluation of other-than-temporary impairments reflects our intent to hold securities for a reasonable period of time sufficient for a forecasted recovery of fair value. However, our intent to hold certain of these securities may change in future periods as a result of facts and circumstances impacting a specific security. If our intent to hold a security with an unrealized loss changes, and we do not expect the security to fully recover prior to the expected time of disposition, we will write down the security to its fair value in the period that our intent to hold the security changes.

The process of evaluating the potential impairment of goodwill and other intangibles is highly subjective and requires significant judgment. The Company estimates the expected future cash flows of its various businesses and determines the carrying value of these businesses. The Company exercises judgment in assigning and allocating certain assets and liabilities to these businesses. The Company then compares the carrying value, including goodwill and other intangibles, to the discounted future cash flows. If the total of future cash flows is less than the carrying amount of the assets, an impairment loss is recognized based on the excess of the carrying amount over the fair value of the assets. Estimates of the future cash flows associated with the assets are critical to these assessments. Changes in these estimates based on changed economic conditions or business strategies could result in material impairment charges and therefore have a material adverse impact on the Company’s financial condition and performance.

The risks presented by acquisitions could adversely affect our financial condition and result of operations.

The business strategy of the Company has included and may continue to include growth through acquisition from time to time. Any future acquisitions, including our pending acquisition of Alliance Bank, will be accompanied by the risks commonly encountered in acquisitions. These risks may include, among other things: our ability to realize anticipated cost savings, the difficulty of integrating operations and personnel, the loss of key employees, the potential disruption of our or the acquired company’s ongoing business in sucha a way that could result in decreased revenues, the inability of our management to maximize our financial and strategic position, the inability to maintain uniform standards, controls, procedures and policies, and the impairment of relationships with the acquired company’s employees and customers as a result of changes in ownership and management.

Our controls and procedures may fail or be circumvented, which may result in a material adverse effect on our business.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

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We are exposed to risk of environmental liabilities with respect to properties to which we obtain title.

A portion of our loan portfolio at December 31, 2012 was secured by real estate. In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a government entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation and remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. These costs and claims could adversely affect our business, results of operations and prospects.

We may be adversely affected by the soundness of other financial institutions including the FHLB of New York.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated if the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due us. There is no assurance that any such losses would not materially and adversely affect our business, financial condition or results of operations.

The Company owns common stock of FHLB of New York in order to qualify for membership in the FHLB system, which enables it to borrow funds under the FHLB of New York's advance program. The carrying value and fair market value of our FHLB of New York common stock was $21.9 million as of December 31, 2012.

There are 12 branches of the FHLB, including New York. The 12 FHLB branches are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB branch cannot meet its obligations to pay its share of the system's debt, other FHLB branches can be called upon to make the payment. Any such adverse effects on the FHLB of New York could adversely affect the value of our investment in its common stock and negatively impact our results of operations.

Trading activity in the Company's common stock could result in material price fluctuations.

The market price of the Company's common stock may fluctuate significantly in response to a number of factors including, but not limited to:

- Changes in securities analysts' expectations of financial performance;
- Volatility of stock market prices and volumes;
- Incorrect information or speculation;
- Changes in industry valuations;
- Variations in operating results from general expectations;

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- Actions taken against the Company by various regulatory agencies;
- Changes in authoritative accounting guidance by the Financial Accounting Standards Board or other regulatory agencies;
- Changes in general domestic economic conditions such as inflation rates, tax rates, unemployment rates, labor and healthcare cost trend rates, recessions, and changing government policies, laws and regulations; and
- Severe weather, natural disasters, acts of war or terrorism and other external events.

ITEM 1B. Unresolved Staff Comments

None.

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ITEM 2. Properties

The Company's headquarters are located at 52 South Broad Street, Norwich, New York 13815. The Company operated the following community banking branches and ATMs as of December 31, 2012:

County	Branches	ATMs	County	Branches	ATMs
NBT Bank Division			Pennstar Bank Division		
New York			Pennsylvania		
Albany County	4	6	Lackawanna County	15	18
Broome County	8	11	Luzerne County	4	6
Chenango County	11	13	Monroe County	5	7
Clinton County	3	2	Pike County	2	2
Delaware County	5	5	Susquehanna County	6	7
Essex County	3	6	Wayne County	3	4
Franklin County	1	1			
Fulton County	7	8			
Greene County	3	3			
Hamilton County	1	1			
Herkimer County	2	1			
Montgomery County	5	5			
Oneida County	6	12			
Otsego County	9	12			
Rensselaer County	1	1			
Saratoga County	3	4			
Schenectady County	2	2			
Schoharie County	4	4			
St. Lawrence County	5	6			
Tioga County	1	1			
Warren County	3	3			
Vermont					
Chittenden County	3	3			
Massachusetts					
Berkshire County	5	5			
New Hampshire					
Cheshire	1	0			
Hillsborough	2	2			
Rockingham	2	2			

The Company leases 53 of the above listed branches from third parties. The Company owns all other banking premises. The Company believes that its offices are sufficient for its present operations. All of the above ATMs are owned by the Company.

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ITEM 3. Legal Proceedings

The Bank has been named as a defendant in a purported class action lawsuit arising from its assessment and collection of overdraft fees on its checking account customers. The complaint was filed in the Supreme Court of the State of New York, County of Delaware, on September 12, 2011 and alleges that the Bank engaged in certain unfair practices and failed to make adequate disclosure to customers concerning its overdraft fee assessment practices. The complaint seeks certification of a class of national checking account holders who have incurred overdraft fees and a subclass of such customers who reside in New York. In addition, the complaint seeks actual and punitive damages, disgorgement, interest and costs including attorneys' fees. On May 15, 2012, Acting Supreme Court Judge for Delaware County, New York, John F. Lambert, dismissed in its entirety the plaintiff`s case. On June 20, 2012, the plaintiffs filed an appeal to the Appellate Division, Third Department. The Company believes the claims to be without merit and intends to defend the action vigorously.

There are no other material legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or any of its subsidiaries is a party or of which any of their property is subject.

ITEM 4. Mine Safety Disclosures

None.

PART II

ITEM 5. Market for Registrant's Common Equity, Related Stockholder matters and Issuer Purchases of Equity Securities

Market Information

The common stock of the Company, par value $0.01 per share (the "Common Stock"), is quoted on the Nasdaq Global Select Market under the symbol "NBTB." The following table sets forth the high and low sales prices and dividends declared for the Common Stock for the periods indicated:

	High	Low	Dividend
2012			
1st quarter	$ 24.10	$ 20.75	$ 0.20
2nd quarter	22.50	19.19	0.20
3rd quarter	22.89	19.91	0.20
4th quarter	22.45	18.92	0.20
2011			
1st quarter	$ 24.98	$ 21.55	$ 0.20
2nd quarter	23.32	20.62	0.20
3rd quarter	23.25	17.05	0.20
4th quarter	22.63	17.47	0.20

The closing price of the Common Stock on February 15, 2013 was $20.92.

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As of February 15, 2013, there were 6,582 shareholders of record of Common Stock. No unregistered securities were sold by the Company during the year ended December 31, 2012.

Stock Performance Graph

The following stock performance graph compares the cumulative total stockholder return (i.e., price change, reinvestment of cash dividends and stock dividends received) on our Common Stock against the cumulative total return of the NASDAQ Stock Market (U.S. Companies) Index and the Index for NASDAQ Financial Stocks. The stock performance graph assumes that $100 was invested on December 31, 2007. The graph further assumes the reinvestment of dividends into additional shares of the same class of equity securities at the frequency with which dividends are paid on such securities during the relevant fiscal year. The yearly points marked on the horizontal axis correspond to December 31 of that year. We calculate each of the referenced indices in the same manner. All are market-capitalization-weighted indices, so companies judged by the market to be more important (i.e., more valuable) count for more in all indices.

	Period Ending					
Index	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12
NBT Bancorp	$100.00	$126.56	$95.68	$117.56	$111.83	$106.30
NASDAQ Financial Stocks	$100.00	$70.88	$73.31	$83.70	$74.82	$88.10
NASDAQ Composite Index	$100.00	$60.04	$87.23	$103.04	$102.25	$120.35

Source: Bloomberg, L.P.

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Dividends

We depend primarily upon dividends from our subsidiaries for a substantial part of our revenue. Accordingly, our ability to pay dividends depends primarily upon the receipt of dividends or other capital distributions from our subsidiaries. Payment of dividends to the Company from the Bank is subject to certain regulatory and other restrictions. Under OCC regulations, the Bank may pay dividends to the Company without prior regulatory approval so long as it meets its applicable regulatory capital requirements before and after payment of such dividends and its total dividends do not exceed its net income to date over the calendar year plus retained net income over the preceding two years. At December 31, 2012, the Bank was in compliance with all applicable minimum capital requirements and had the ability to pay dividends of $21.3 million to the Company without the prior approval of the OCC.

If the capital of the Company is diminished by depreciation in the value of its property or by losses, or otherwise, to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets, no dividends may be paid out of net profits until the deficiency in the amount of capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets has been repaired. See the section captioned "Supervision and Regulation" in Item 1. Business and Note 16 – Stockholders' Equity in the notes to consolidated financial statements in included in Item 8. Financial Statements and Supplementary Data, which are located elsewhere in this report.

Stock Repurchase

Under previously disclosed stock repurchase plans, the Company purchased 769,568 shares of its common stock during the year ended December 31, 2012, for a total of $15.5 million at an average price of $20.13 per share. At December 31, 2012, there were 748,013 shares available for repurchase under a previously disclosed repurchase plan, which expires on December 31, 2013. There were no purchases during the fourth quarter of 2012.

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ITEM 6. Selected Financial Data

The following summary of financial and other information about the Company is derived from the Company's audited consolidated financial statements for each of the last five fiscal years ended December 31 and should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's consolidated financial statements and accompanying notes, included elsewhere in this report:

	Year ended December 31,				
(In thousands, except per share data)	2012	2011	2010	2009	2008
Interest, fee and dividend income	$239,397	$239,997	$255,738	$273,393	$294,414
Interest expense	35,194	39,721	53,210	76,924	108,368
Net interest income	204,203	200,276	202,528	196,469	186,046
Provision for loan losses	20,269	20,737	29,809	33,392	27,181
Noninterest income excluding securities gains	86,728	80,161	80,614	79,987	70,171
Securities gains, net	599	150	3,274	144	1,535
Noninterest expense	193,887	180,676	178,291	170,566	146,813
Income before income taxes	77,374	79,174	78,316	72,642	83,758
Net income	54,558	57,901	57,404	52,011	58,353
Per common share					
Basic earnings	$1.63	$1.72	$1.67	$1.54	$1.81
Diluted earnings	1.62	1.71	1.66	1.53	1.80
Cash dividends paid	0.80	0.80	0.80	0.80	0.80
Book value at year-end	17.24	16.23	15.51	14.69	13.24
Tangible book value at year-end	12.23	11.70	11.67	10.75	9.01
Average diluted common shares outstanding	33,719	33,924	34,509	33,903	32,427
Securities available for sale, at fair value	$1,147,999	$1,244,619	$1,129,368	$1,116,758	$1,119,665
Securities held to maturity, at amortized cost	60,563	70,811	97,310	159,946	140,209
Loans	4,277,616	3,800,203	3,610,006	3,645,398	3,651,911
Allowance for loan losses	69,334	71,334	71,234	66,550	58,564
Assets	6,042,259	5,598,406	5,338,856	5,464,026	5,336,088
Deposits	4,784,349	4,367,149	4,134,352	4,093,046	3,923,258
Borrowings	605,855	627,358	604,730	786,097	914,123
Stockholders' equity	582,273	538,110	533,572	505,123	431,845
Key ratios					
Return on average assets	0.93 %	1.06 %	1.05 %	0.96 %	1.11 %
Return on average equity	9.72	10.73	10.92	10.90	14.16
Average equity to average assets	9.55	9.90	9.63	8.79	7.83
Net interest margin	3.86	4.09	4.15	4.04	3.95
Dividend payout ratio	49.38	46.78	48.19	52.29	44.44
Tier 1 leverage	8.54	8.74	9.16	8.35	7.17
Tier 1 risk-based capital	11.00	11.56	12.44	11.34	9.75
Total risk-based capital	12.25	12.81	13.70	12.59	11.00

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Selected Quarterly Financial Data

(Dollars in thousands, except share and per share data)	2012				2011			
	Fourth	Third	Second	First	Fourth	Third	Second	First
Interest, fee and dividend income	$60,857	$61,287	$58,647	$58,606	$59,898	$59,784	$60,258	$60,057
Interest expense	8,404	8,680	8,896	9,214	9,399	9,423	10,094	10,805
Net interest income	52,453	52,607	49,751	49,392	50,499	50,361	50,164	49,252
Provision for loan losses	6,940	4,755	4,103	4,471	5,576	5,175	6,021	3,965
Noninterest income excluding net securities gains	21,941	21,601	20,585	22,601	20,078	20,182	19,802	20,099
Net securities gains	21	26	97	455	52	12	59	27
Noninterest expense	48,592	49,431	47,390	48,474	47,412	45,046	43,157	45,061
Net income	13,116	14,535	13,257	13,650	13,722	15,217	14,655	14,307
Basic earnings per share	$0.39	$0.43	$0.40	$0.41	$0.42	$0.46	$0.43	$0.42
Diluted earnings per share	$0.39	$0.43	$0.40	$0.41	$0.41	$0.45	$0.43	$0.41
Annualized net interest margin	3.83 %	3.90 %	3.82 %	3.90 %	3.98 %	4.14 %	4.13 %	4.11 %
Annualized return on average assets	0.86 %	0.97 %	0.92 %	0.97 %	0.97 %	1.12 %	1.09 %	1.08 %
Annualized return on average equity	9.01 %	10.13 %	9.66 %	10.12 %	10.09 %	11.21 %	10.86 %	10.78 %
Average diluted common shares outstanding	33,987	33,961	33,493	33,442	33,239	33,567	34,320	34,650

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ITEM 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

Certain statements in this filing and future filings by the Company with the SEC, in the Company's press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, contain forward-looking statements, as defined in the Private Securities Litigation Reform Act. These statements may be identified by the use of phrases such as "anticipate," "believe," "expect," "forecasts," "projects," "will," "would," "should," "could," "may," or other similar terms. There are a number of factors, many of which are beyond the Company's control that could cause actual results to differ materially from those contemplated by the forward looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities: (1) local, regional, national and international economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact; (2) changes in the level of non-performing assets and charge-offs; (3) changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements; (4) the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board; (5) inflation, interest rate, securities market and monetary fluctuations; (6) political instability; (7) acts of war or terrorism; (8) the timely development and acceptance of new products and services and perceived overall value of these products and services by users; (9) changes in consumer spending, borrowings and savings habits; (10) changes in the financial performance and/or condition of the Company's borrowers; (11) technological changes; (12) acquisitions and integration of acquired businesses; (13) the ability to increase market share and control expenses; (14) changes in the competitive environment among financial holding companies; (15) the effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiaries must comply including those under the Dodd-Frank Act; (16) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters; (17) changes in the Company's organization, compensation and benefit plans; (18) the costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews; (19) greater than expected costs or difficulties related to the integration of new products and lines of business; and (20) the Company's success at managing the risks involved in the foregoing items.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors including, but not limited to, those described above, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

Except as required by law, the Company does not undertake, and specifically disclaims any obligations to, publicly release any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

General

The financial review which follows focuses on the factors affecting the consolidated financial condition and results of operations of the Company and its wholly owned subsidiaries, the Bank, NBT Financial Services and NBT Holdings during 2012 and, in summary form, the preceding two years. Collectively, the Registrant and its subsidiaries are referred to herein as "the Company." Net interest margin is presented in this discussion on a fully taxable equivalent (FTE) basis. Average balances discussed are daily averages unless otherwise described. The audited consolidated financial statements and related notes as of December 31, 2012 and 2011 and for each of the years in the three-year

period ended December 31, 2012 should be read in conjunction with this review. Amounts in prior period consolidated financial statements are reclassified whenever necessary to conform to the 2012 presentation.

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Critical Accounting Policies

The Company has identified policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the allowance for loan losses, pension accounting, other-than-temporary impairment, provision for income taxes and intangible assets.

Management of the Company considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover credit losses inherent in the loan portfolio and the material effect that such judgments can have on the results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under adversely different conditions or assumptions, the allowance may need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provision for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Company's nonperforming loans and potential problem loans have a significant impact on the overall analysis of the adequacy of the allowance for loan losses. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral values were significantly lower, the Company's allowance for loan policy would also require additional provision for loan losses.

Management is required to make various assumptions in valuing its pension assets and liabilities. These assumptions include the expected rate of return on plan assets, the discount rate, and the rate of increase in future compensation levels. Changes to these assumptions could impact earnings in future periods. The Company takes into account the plan asset mix, funding obligations, and expert opinions in determining the various rates used to estimate pension expense. The Company also considers the Citigroup Pension Liability Index, market interest rates and discounted cash flows in setting the appropriate discount rate. In addition, the Company reviews expected inflationary and merit increases to compensation in determining the rate of increase in future compensation levels.

Management of the Company considers the accounting policy relating to other-than-temporary impairment to be a critical accounting policy. Management systematically evaluates certain assets for other-than-temporary declines in fair value, primarily investment securities. Management considers historical values and current market conditions as a part of the assessment. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings and the amount of the total other-than-temporary impairment related to other factors is generally recognized in other comprehensive income, net of applicable taxes.

The Company is subject to examinations from various taxing authorities. Such examinations may result in challenges to the tax return treatment applied by the Company to specific transactions. Management believes that the assumptions and judgments used to record tax-related assets or liabilities have been appropriate. Should tax laws change or the taxing authorities determine that management's assumptions were inappropriate, an adjustment may be required which could have a material effect on the Company's results of operations.

As a result of acquisitions, the Company has acquired goodwill and identifiable intangible assets. Goodwill represents the cost of acquired companies in excess of the fair value of net assets at the acquisition date. Goodwill is evaluated at least annually or when business conditions suggest that an impairment may have occurred. Goodwill will be reduced to its carrying value through a charge to earnings if impairment exists. Core deposits and other identifiable intangible assets are amortized to expense over their estimated useful lives. The determination of whether or not impairment exists is based upon discounted cash flow modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires them to select a discount rate that reflects the current return requirements of the market in relation to present risk-free interest rates, required equity market

premiums and Company-specific risk indicators, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates used to determine the carrying value of goodwill and identifiable intangible assets could have a material impact on the Company's results of operations.

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The Company's policies on the allowance for loan losses, pension accounting, provision for income taxes and intangible assets are disclosed in Note 1 to the consolidated financial statements. A more detailed description of the allowance for loan losses is included in the "Risk Management" section of this Form 10-K. All significant pension accounting assumptions, income tax assumptions, and intangible asset assumptions and detail are disclosed in Notes 18, 15 and 10, respectively, to the consolidated financial statements. All accounting policies are important, and as such, the Company encourages the reader to review each of the policies included in Note 1 to obtain a better understanding of how the Company's financial performance is reported.

Overview

Significant factors management reviews to evaluate the Company's operating results and financial condition include, but are not limited to: net income and earnings per share, return on assets and equity, net interest margin, noninterest income, operating expenses, asset quality indicators, loan and deposit growth, capital management, liquidity and interest rate sensitivity, enhancements to customer products and services, technology advancements, market share and peer comparisons. The following information should be considered in connection with the Company's results for the fiscal year ended December 31, 2012:

- Significant strategic expansion during 2012:
  - § Announced the planned acquisition of Alliance Financial Corporation, a $1.4 billion financial holding company headquartered in Syracuse, N.Y., expected to close in early 2013;
  - § Acquired and successfully integrated Hampshire First Bank during the second quarter of 2012; now operating 5 branches in southern New Hampshire; and
  - § Acquired three branches in Greene County, New York in January 2012.
- Net interest margin for 2012 declined 23 basis points as a result of the continued low rate environment on loans and investments.
- 2012 organic loan growth of 6.8%, offsetting aforementioned margin compression, driven by:
  - § Consumer loan growth of 10.7%; and
  - § Commercial loan growth of 8.7%.
- Asset quality indicators showed improvement from last year:
  - § Nonperforming loans to total loans was 0.98%, down from 1.09% for last year;
  - § Past due accruing loans to total loans was 0.71%, down from 0.89% for last year; and
  - § Net charge-off ratio was 0.55%, down from 0.56% for last year.
- Service charges on deposit accounts continued to decrease due primarily to a decrease in overdraft activity.

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The Company continued to experience pressure on net interest income in 2012 as low rates continued to have the effect of causing many assets to prepay or to be redeemed. As a result, reinvestment of cash flows in lower yielding assets has been the primary contributor to a decline in interest income in 2012. The yield on interest earning assets decreased from 4.88% in 2011 to 4.51% in 2012, with drops in the yields on loans and securities available for sale being the primary drivers. Rates paid on interest bearing liabilities also decreased in the low rate environment, which partially offset the decrease in earning asset yields. In particular, the decrease in rates paid on money market deposit accounts and time deposits contributed approximately $5.1 million to the decrease in interest expense in 2012 as compared with 2011. Average interest bearing liabilities increased approximately $237.9 million from 2011 to 2012, with the primary driver being the increase in interest bearing deposits from acquisition activity and organic deposit growth. The Company also took the following steps in 2012 in an effort to help offset the margin pressure created by the low interest rate environment:

- Continued the sale of conforming residential real estate mortgages in 2012, taking advantage of favorable interest rate conditions;

- Increased efforts to grow noninterest income with focus on organic growth of our trust, financial services and insurance businesses; and

- Continued strategic expansion into New Hampshire with the completed acquisition of Hampshire First Bank and into central New York with the planned acquisition of Alliance.

The Company reported net income of $54.6 million or $1.62 per diluted share for 2012, down 5.8% from net income of $57.9 million or $1.71 per diluted share for 2011. The provision for loan losses totaled $20.3 million for the year ended December 31, 2012, down $0.5 million, or 2.3%, from $20.7 million for the year ended December 31, 2011. The decrease in provision is attributable to the ongoing modeling of the required levels of reserves which considers historical charge-offs, loan growth and economic trends. Noninterest income increased $7.0 million, or 8.7%, from 2011 primarily due to an increase in other noninterest income of approximately $6.1 million. This increase was due in part to a $1.1 million payoff gain on a purchased commercial real estate loan. In addition, the Company recognized nonrecurring items totaling approximately $1.4 million during 2012 including a prepayment penalty fee related to a loss of a retirement plan client and flood related recoveries. Further, mortgage banking revenue increased approximately $2.6 million for the year ended December 31, 2012 as compared to the same period in 2011 as the Company sold certain residential mortgages as market conditions warranted. Noninterest expense for the year ended December 31, 2012 was $193.9 million, up from $180.7 million, or 7.3% for the year ended December 31, 2011.

2013 Outlook

The Company’s 2012 earnings reflected the Company’s continued ability to manage through the existing and near future economic conditions and challenges in the financial services industry, while investing in the Company’s future. The Company believes effects of the economic crisis still exist and, as a result, there will be certain challenges faced in 2013. Significant items that may have an impact on 2013 results include:

- The Company expects that it will experience additional margin compression from the 2012 fourth quarter net interest margin of 3.83%. We expect that payments representing interest and principal on currently outstanding loans and investments will continue to be reinvested at rates that are lower than the rates currently outstanding on those loans and investments. In addition, deposit and borrowing rates are historically low and there are minimal opportunities for them to be lowered. Furthermore, the industry as a whole must focus on asset growth to increase interest income, thereby creating general pricing pressure in the entire industry.

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- The Company experienced benefits from expiration of the statute of limitations of prior years' tax filings and state tax audit settlements in past years. The Company expects the tax rate to be more normalized in 2013 without those benefits.

- If asset quality trends continue to show improvement, the Company would eventually expect the level of provisioning to decrease. However, the economy may have an adverse affect on asset quality indicators, particularly indicators related to loans secured by real estate, which could adversely affect charge-offs, the allowance for loan losses, and the provision for loan losses.

- The cost of compliance as a result of the Dodd-Frank Act could continue to negatively impact certain fee generating products, which could negatively impact noninterest income and earnings.

- Competitive pressure on non-maturing deposits could result in an increase in interest expense if interest rates begin to rise.

- Our ability to integrate the operations and personnel and realize anticipated cost savings of the pending acquisition of Alliance may affect our results of operations in 2013.

The Company's 2013 outlook is subject to factors in addition to those identified above and those risks and uncertainties that could impact the Company's future results are explained in ITEM 1A. RISK FACTORS.

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Asset/Liability Management

The Company attempts to maximize net interest income and net income, while actively managing its liquidity and interest rate sensitivity through the mix of various core deposit products and other sources of funds, which in turn fund an appropriate mix of earning assets. The changes in the Company's asset mix and sources of funds, and the resulting impact on net interest income, on a fully tax equivalent basis, are discussed below. The following table includes the condensed consolidated average balance sheet, an analysis of interest income/expense and average yield/rate for each major category of earning assets and interest bearing liabilities on a taxable equivalent basis. Interest income for tax-exempt securities and loans has been adjusted to a taxable-equivalent basis using the statutory Federal income tax rate of 35%.

Table 1. Average Balances and Net Interest Income

	2012			2011			2010		
(Dollars in thousands)	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
ASSETS									
Short-term interest bearing accounts	$66,207	$179	0.27%	$101,224	$269	0.27%	$137,818	$354	0.26%
Securities available for sale (1)	1,177,969	28,904	2.45%	1,123,215	33,319	2.97%	1,088,376	38,759	3.56%
Securities held to maturity (1)	65,582	3,583	5.46%	81,558	4,350	5.33%	128,727	6,104	4.74%
Investment in FRB and FHLB Banks	28,358	1,378	4.86%	27,089	1,389	5.13%	31,850	1,821	5.72%
Loans (2)	4,053,420	209,370	5.17%	3,677,931	205,318	5.58%	3,629,047	214,258	5.90%
Total interest earning assets	$5,391,536	$243,414	4.51%	$5,011,017	$244,645	4.88%	$5,015,818	$261,296	5.21%
Other assets	483,248			434,924			438,516		
Total assets	$5,874,784			$5,445,941			$5,454,334		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Money market deposit accounts	$1,116,583	$2,054	0.18%	$1,070,003	$3,592	0.34%	$1,092,789	$6,273	0.57%
NOW deposit accounts	709,889	1,854	0.26%	685,542	2,313	0.34%	709,920	2,938	0.41%
Savings deposits	680,092	522	0.08%	602,918	635	0.11%	552,660	797	0.14%
Time deposits	993,117	14,418	1.45%	913,330	16,480	1.80%	985,504	20,346	2.06%
Total interest bearing deposits	$3,499,681	$18,848	0.54%	$3,271,793	$23,020	0.70%	$3,340,873	$30,354	0.91%
Short-term borrowings	165,742	188	0.11%	153,965	205	0.13%	158,280	402	0.25%
Trust preferred debentures	75,422	1,730	2.29%	75,422	2,092	2.77%	75,422	4,140	5.49%
Long-term debt	368,270	14,428	3.92%	370,035	14,404	3.89%	469,509	18,314	3.90%
Total interest bearing liabilities	$4,109,115	$35,194	0.86%	$3,871,215	$39,721	1.03%	$4,044,084	$53,210	1.32%
Demand deposits	1,139,896			966,282			805,594		
Other liabilities	64,551			69,063			79,182		
Stockholders' equity	561,222			539,381			525,474		

Total liabilities and stockholders' equity	$5,874,784	$5,445,941	$5,454,334
Net interest income (FTE)	208,220	204,924	208,086
Interest rate spread	3.65%	3.85%	3.89%
Net interest margin	3.86%	4.09%	4.15%
Taxable equivalent adjustment	4,017	4,648	5,558
Net interest income	$204,203	$200,276	$202,528

1. Securities are shown at average amortized cost.

2. For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding. The interest collected thereon is included in interest income based upon the characteristics of the related loans.

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2012 OPERATING RESULTS AS COMPARED TO 2011 OPERATING RESULTS

Net Interest Income

While the rate paid on interest bearing liabilities decreased 17 basis points, the yield on interest earning assets declined 37 basis points compared to the same period for 2011, resulting in margin compression for the year ended December 31, 2012. The yield on securities available for sale was 2.45% for the year ended December 31, 2012, compared with 2.97% for the year ended December 31, 2011. This decrease was due primarily to the reinvestment of cash flows from maturing securities and cash received from branch acquisitions in 2011 and the first quarter of 2012 into lower yielding securities in the current rate environment. The average balance of securities available for sale for the year ended December 31, 2012 was $1.2 billion, up approximately $54.8 million, or 4.9%, from the year ended December 31, 2011. This increase was due primarily to reinvestment of cash flows from held to maturity securities into available for sale securities, and investment of liquidity from branch acquisition activity and deposit growth. The yield on loans was 5.17% for the year ended December 31, 2012, compared with 5.58% for the year ended December 31, 2011. The average balance of loans for the year ended December 31, 2012 was $4.1 billion, up approximately $375.5 million (including approximately $124.3 million from acquisitions), or 10.2%, from the year ended December 31, 2011. The reduction in yields on earning assets was partially offset by a reduction in rates paid on interest bearing liabilities. The rate on time deposits was 1.45% for the year ended December 31, 2012, compared with 1.80% for the year ended December 31, 2011. The rate on money market deposit accounts was 0.18% for the year ended December 31, 2012, compared with 0.34% for the year ended December 31, 2011. The following table presents changes in interest income, on a FTE basis, and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

Table 2. Analysis of Changes in Taxable Equivalent Net Interest Income

	Increase (Decrease) 2012 over 2011			Increase (Decrease) 2011 over 2010		
(In thousands)	Volume	Rate	Total	Volume	Rate	Total
Short-term interest-bearing accounts	$ (95)	$ 5	$ (90)	$ (97)	$ 12	$ (85)
Securities available for sale	1,562	(5,977)	(4,415)	1,207	(6,647)	(5,440)
Securities held to maturity	(871)	104	(767)	(2,445)	691	(1,754)
Investment in FRB and FHLB Banks	63	(74)	(11)	(256)	(176)	(432)
Loans	20,057	(16,005)	4,052	2,855	(11,795)	(8,940)
Total interest income	20,716	(21,947)	(1,231)	1,264	(17,915)	(16,651)
Money market deposit accounts	150	(1,688)	(1,538)	(128)	(2,553)	(2,681)
NOW deposit accounts	80	(539)	(459)	(98)	(527)	(625)
Savings deposits	74	(187)	(113)	68	(230)	(162)
Time deposits	1,353	(3,415)	(2,062)	(1,421)	(2,445)	(3,866)
Short-term borrowings	15	(32)	(17)	(11)	(186)	(197)
	-	(362)	(362)	-	(2,048)	(2,048)

Trust preferred debentures						
Long-term debt	(69)	93	24	(3,872)	(38)	(3,910)
Total interest expense	1,603	(6,130)	(4,527)	(5,462)	(8,027)	(13,489)
Change in FTE net interest income	$ 19,113	$ (15,817)	$ 3,296	$ 6,726	$ (9,888)	$ (3,162)

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Loans and Corresponding Interest and Fees on Loans

The average balance of loans increased by approximately $375.5 million, or 10.2%, from 2011 to 2012. The yield on average loans decreased from 5.58% in 2011 to 5.17% in 2012, as loan rates declined due to the historically low rate environment in 2012. Interest income from loans on a FTE basis increased 1.97%, from $205.3 million in 2011 to $209.4 million in 2012. This increase was due to the increase in average loan balances noted above, and was partially offset by the decrease in yields.

Total loans increased $477.4 million, or 12.6% (6.8% organic growth) from December 31, 2011 to December 31, 2012. In June 2012, the Company acquired Hampshire First Bank in New Hampshire, including approximately $219 million in loans, which contributed to this loan growth. Commercial loans increased $83.5 million, or 13.7%, from $611.3 million at December 31, 2011 to $694.8 million at December 31, 2012, due to strong originations in 2012, particularly in our upstate New York markets and Vermont, as well as approximately $29.9 million acquired from the aforementioned acquisition. Commercial real estate loans increased $183.9 million, or 20.7%, from $888.9 million at December 31, 2011 to $1.1 billion at December 31, 2012, in large part due to strong originations in our upstate New York markets as well as originations from new markets, particularly Vermont. The Company also acquired approximately $149.8 million in commercial real estate loans from the aforementioned acquisition. Real estate construction and development loans increased $29.1 million from $94.0 million at December 31, 2011 to $123.1 million at December 31, 2012 due to the addition of a few large, commercial development loans during 2012 primarily from existing customers within our footprint. Residential real estate loans increased $69.6 million (including approximately $32.7 million from the aforementioned acquisition), from $581.5 million at December 31, 2011 to $651.1 million at December 31, 2012. The Company sold more fixed rate mortgages during 2012 than 2011 as market conditions in 2011 were not as favorable for such sales. Consumer loans increased $101.4 million from $946.5 million at December 31, 2011 to $1.0 billion at December 31, 2012 in large part due to strong originations in our upstate New York markets as well as originations from new markets. Home equity loans increased modestly in 2012.

The following table reflects the loan portfolio by major categories as of December 31 for the years indicated:

Table 3. Composition of Loan Portfolio

	December 31,				
(In thousands)	2012	2011	2010	2009	2008
Residential real estate mortgages	$651,107	$581,511	$548,394	$618,334	$722,723
Commercial	694,799	611,298	577,731	571,107	572,059
Commercial real estate	1,072,807	888,879	844,458	739,395	669,720
Real estate construction and development	123,078	93,977	45,444	67,168	67,859
Agricultural and agricultural real estate	112,687	108,423	112,738	122,466	113,566
Consumer	1,047,856	946,470	905,563	923,343	878,381
Home equity	575,282	569,645	575,678	603,585	627,603
Total loans	$4,277,616	$3,800,203	$3,610,006	$3,645,398	$3,651,911

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Residential real estate mortgages consist primarily of loans secured by first or second deeds of trust on primary residences. Loans in the commercial and agricultural categories, including commercial and agricultural real estate mortgages, consist primarily of short-term and/or floating rate loans made to small and medium-sized entities. Consumer loans consist primarily of indirect installment credit to individuals, of which approximately 73% is secured by automobiles and other personal property including marine, recreational vehicles and manufactured housing. Consumer loans also consist of direct installment loans to individuals secured by similar collateral. Indirect installment loans represent $939.2 million of total consumer loans at December 31, 2012, or 89.6%. Installment credit for automobiles accounts for approximately 70% of total consumer loans. Although automobile loans have generally been originated through dealers, all applications submitted through dealers are subject to the Company's normal underwriting and loan approval procedures. Real estate construction and development loans include commercial construction and development and residential construction loans. Commercial construction loans are for small and medium sized office buildings and other commercial properties and residential construction loans are primarily for projects located in upstate New York and northeastern Pennsylvania.

Risks associated with the commercial real estate portfolio include the ability of borrowers to pay interest and principal during the loan's term, as well as the ability of the borrowers to refinance at the end of the loan term.

The following table, Maturities and Sensitivities of Certain Loans to Changes in Interest Rates, summarizes the maturities of the commercial and agricultural and real estate construction and development loan portfolios and the sensitivity of those loans to interest rate fluctuations at December 31, 2012. Scheduled repayments are reported in the maturity category in which the contractual payment is due.

Table 4. Maturities and Sensitivities of Certain Loans to Changes in Interest Rates

	Remaining maturity at December 31, 2012			
(In thousands)	Within One Year	After One Year But Within Five Years	After Five Years	Total
Floating/adjustable rate				
Commercial, commercial real estate, agricultural, and agricultural real estate	$399,415	$ 256,599	$613,602	$1,269,616
Real estate construction and development	37,146	29,632	14,155	80,933
Total floating rate loans	436,561	286,231	627,757	1,350,549
Fixed rate				
Commercial, commercial real estate, agricultural, and agricultural real estate	59,547	303,369	247,761	610,677
Real estate construction and development	15,581	12,345	14,219	42,145
Total fixed rate loans	75,128	315,714	261,980	652,822
Total	$511,689	$ 601,945	$889,737	$2,003,371

Securities and Corresponding Interest and Dividend Income

The average balance of the amortized cost for securities available for sale increased $54.8 million, or 4.9%, from 2011 to 2012. The yield on average securities available for sale was 2.45% for 2012 compared to 2.97% in 2011.

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The average balance of securities held to maturity decreased from $81.6 million in 2011 to $65.6 million in 2012. At December 31, 2012, securities held to maturity were comprised primarily of tax-exempt municipal securities. The yield on securities held to maturity increased from 5.33% in 2011 to 5.46% in 2012.
The average balance of FRB and FHLB stock increased to $28.4 million in 2012 from $27.1 million in 2011 due in large part to the aforementioned acquisition of Hampshire First. The yield from investments in FRB and FHLB banks decreased from 5.13% in 2011 to 4.86% in 2012.

Table 5. Securities Portfolio

	As of December 31,					
	2012		2011		2010	
(In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale						
U.S. Treasury	$63,668	$64,425	$81,006	$82,234	$91,338	$91,280
Federal Agency	281,398	282,814	254,983	255,846	350,641	349,750
State & Municipal	82,675	86,802	99,176	104,789	113,821	114,937
Mortgage-backed	237,461	250,281	310,767	325,396	233,861	244,808
Collateralized mortgage obligations	443,972	449,723	459,067	465,474	293,565	297,888
Corporate	-	-	-	-	20,005	20,489
Other securities	11,210	13,954	8,935	10,880	8,059	10,216
Total securities available for sale	$1,120,384	$1,147,999	$1,213,934	$1,244,619	$1,111,290	$1,129,368
Securities held to maturity						
Mortgage-backed	$1,168	$1,352	$1,447	$1,660	$1,719	$1,919
State & Municipal	59,395	60,183	69,364	70,538	95,591	96,840
Total securities held to maturity	$60,563	$61,535	$70,811	$72,198	$97,310	$98,759

In the available for sale category at December 31, 2012, federal agency securities were comprised of Government-Sponsored Enterprise ("GSE") securities; mortgaged-backed securities were comprised of GSEs with an amortized cost of $221.1 million and a fair value of $232.3 million and U.S. Government Agency securities with an amortized cost of $16.4 million and a fair value of $18.0 million; collateralized mortgage obligations ("CMOs") were comprised of GSEs with an amortized cost of $399.2 million and a fair value of $403.6 million and US Government Agency securities with an amortized cost of $44.8 million and a fair value of $46.2 million. At December 31, 2012, all of the mortgaged-backed securities held to maturity were comprised of U.S. Government Agency securities.

Our mortgage backed securities, U.S. agency notes, and CMOs are all "prime/conforming" and are guaranteed by Fannie Mae, Freddie Mac, the FHLB, the Federal Farm Credit Banks, or Ginnie Mae ("GNMA"). GNMA securities are considered equivalent to U.S. Treasury securities, as they are backed by the full faith and credit of the U.S. government. Currently, there are no securities backed by subprime mortgages in our investment portfolio.

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The following tables set forth information with regard to contractual maturities of debt securities at December 31, 2012:

(In thousands)	Amortized cost	Estimated fair value	Weighted Average Yield
Debt securities classified as available for sale			
Within one year	$ 26,678	$ 26,788	1.83 %
From one to five years	193,142	195,953	1.69 %
From five to ten years	311,575	319,229	2.53 %
After ten years	577,779	592,075	2.33 %
Total	$ 1,109,174	$ 1,134,045	
Debt securities classified as held to maturity			
Within one year	$ 25,184	$ 25,258	2.76 %
From one to five years	27,413	28,118	3.79 %
From five to ten years	5,425	5,434	4.54 %
After ten years	2,541	2,725	5.05 %
Total	$ 60,563	$ 61,535	

Funding Sources and Corresponding Interest Expense

The Company utilizes traditional deposit products such as time, savings, NOW, money market, and demand deposits as its primary source for funding. Other sources, such as short-term FHLB advances, federal funds purchased, securities sold under agreements to repurchase, brokered time deposits, and long-term FHLB borrowings are utilized as necessary to support the Company’s growth in assets and to achieve interest rate sensitivity objectives. The average balance of interest-bearing liabilities increased $237.9 million from 2011, totaling $4.1 billion in 2012. The rate paid on interest-bearing liabilities decreased from 1.03% in 2011 to 0.86% in 2012. This decrease in rates, offset by an increase in average balances, caused a decrease in interest expense of $4.5 million, or 11.4%, from $39.7 million in 2011 to $35.2 million in 2012.

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Deposits

Average interest bearing deposits increased $227.9 million, or 7.0%, from 2011 to 2012, due primarily to the acquisition of Hampshire First in June 2012. Average time deposits increased $79.8 million, or 8.7%, during 2012 as compared to 2011. Average money market deposits increased $46.6 million or 4.4% during 2012 when compared to 2011. Average NOW accounts increased $24.3 million or 3.6% during 2012 as compared to 2011. The average balance of savings accounts increased $77.2 million or 12.8% during 2012 when compared to 2011. The average balance of demand deposits increased $173.6 million, or 18.0%, from $966.3 million in 2011 to $1.1 billion in 2012. This growth in demand deposits was driven principally by increases in accounts from retail, municipal, and commercial customers spurred by strategic expansion into new markets.

The rate paid on average interest-bearing deposits decreased from 0.70% during 2011 to 0.54% in 2012. The decrease in the rate on interest-bearing deposits was driven primarily by pricing decreases from money market accounts and time deposits, which are sensitive to interest rate changes. The pricing decreases for these products resulted from the FRB maintaining a historic low Fed Funds target rate as well as an overall decrease in all interest rates. The rate paid for money market deposit accounts decreased from 0.34% during 2011 to 0.18% during 2012. The rate paid for NOW accounts decreased from 0.34% during 2011 to 0.26% during 2012. The rate paid for savings deposits decreased from 0.11% in 2011 to 0.08% in 2012 and the rate paid on time deposits decreased from 1.80% during 2011 to 1.45% during 2012.
The following table presents the maturity distribution of time deposits of $100,000 or more at December 31:

Table 6. Maturity Distribution of Time Deposits of $100,000 or More

	December 31,	
(In thousands)	2012	2011
Within three months	$ 69,205	$ 45,242
After three but within twelve months	96,644	85,465
After one but within three years	153,453	148,653
Over three years	33,027	26,338
Total	$ 352,329	$ 305,698

Borrowings

Average short-term borrowings increased slightly to $165.7 million in 2012 from $154.0 million in 2011. The average rate paid on short-term borrowings decreased from 0.13% in 2011 to 0.11% in 2012, which was primarily driven by the FRB maintaining a historic low Fed Funds target rate of 0.25% (which directly impacts short-term borrowing rates). Average long-term debt decreased from $370.0 million in 2011 to $368.3 million in 2012.

The average balance of trust preferred debentures remained at $75.4 million in 2012 compared to 2011. The average rate paid for trust preferred debentures in 2012 was 2.29%, down from 2.77% in 2011. The decrease in rate on the trust preferred debentures is due primarily to the reset of interest rate terms in two trust preferred debentures to variable rate from fixed rate. The third trust preferred debenture reset to a variable rate in a prior year and therefore, all associated interest expense on trust preferred debentures is now at a variable rate.

Short-term borrowings consist of Federal funds purchased and securities sold under repurchase agreements, which generally represent overnight borrowing transactions, and other short-term borrowings, primarily FHLB advances, with original maturities of one year or less. The Company has unused lines of credit and access to brokered deposits available for short-term financing of approximately $1.3 billion and $1.1 billion at December 31, 2012 and 2011, respectively. Securities collateralizing repurchase agreements are held in safekeeping by non-affiliated financial institutions and are under the Company's

control. Long-term debt, which is comprised primarily of FHLB advances, are collateralized by the FHLB stock owned by the Company, certain of its mortgage-backed securities and a blanket lien on its residential real estate mortgage loans.

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Noninterest Income

Noninterest income is a significant source of revenue for the Company and an important factor in the Company's results of operations. The following table sets forth information by category of noninterest income for the years indicated:

	Years ended December 31,		
(In thousands)	2012	2011	2010
Insurance and other financial services revenue	$ 22,387	$ 20,843	$ 18,867
Service charges on deposit accounts	18,225	21,464	24,041
ATM and debit card fees	12,358	11,642	10,035
Retirement plan administration fees	10,097	8,918	10,356
Trust	9,172	8,864	7,722
Bank owned life insurance income	3,077	3,085	3,316
Net securities gains	599	150	3,274
Other	11,412	5,345	6,277
Total noninterest income	$ 87,327	$ 80,311	$ 83,888

Noninterest income for the year ended December 31, 2012 was $87.3 million, up 8.7% or $7.0 million, compared with $80.3 million for the same period in 2011, primarily due to an increase in other noninterest income. Insurance and other financial services revenue increased approximately $1.5 million for the year ended December 31, 2012, compared to the year ended December 31, 2011. This increase was due primarily to the acquisition of an insurance agency in 2011 as well as organic growth in commercial product lines. Retirement plan administration fees increased approximately $1.2 million for the year ended December 31, 2012, compared to the year ended December 31, 2011, due primarily to an increase in customer base. ATM and debit card fees increased approximately $0.7 million for the year ended December 31, 2012, compared to the year ended December 31, 2011, due primarily to an increase in card usage and customer base. Other noninterest income increased approximately $6.1 million for the year ended December 31, 2012 as compared to December 31, 2011. This increase was due in part to a $1.1 million payoff gain on a purchased commercial real estate loan. In addition, the Company recognized nonrecurring items totaling approximately $1.4 million during 2012 including a prepayment penalty fee related to a previously disclosed loss of a retirement plan client and flood related recoveries. Further, mortgage banking revenue increased approximately $2.6 million for the year ended December 31, 2012 as compared to the same period in 2011, as the Company sold certain residential mortgages as market conditions warranted. The Company sold approximately $65.2 million residential mortgages during 2012, as compared to sales of approximately $13.5 million during 2011, while also experiencing more favorable gains during 2012. The Company also realized net securities gains of approximately $0.6 million during the year ended December 31, 2012, as compared to $0.2 million for the same period in 2011. These increases were partially offset by a decrease in service charges on deposit accounts of approximately $3.2 million, or 15.1%, for the year ended December 31, 2012, compared with the same period in 2011 primarily due to a decrease in overdraft fee income.

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Noninterest Expense

Noninterest expenses are also an important factor in the Company's results of operations. The following table sets forth the major components of noninterest expense for the years indicated:

	Years ended December 31,		
(In thousands)	2012	2011	2010
Salaries and employee benefits	$ 104,815	$ 99,212	$ 93,718
Occupancy	17,415	16,363	15,350
Data processing and communications	13,437	12,271	12,347
Professional fees and outside services	10,463	8,921	9,032
Equipment	9,627	8,864	8,317
Office supplies and postage	6,489	6,073	6,102
FDIC expenses	3,832	4,267	6,081
Advertising	2,889	3,460	3,487
Amortization of intangible assets	3,394	3,046	3,072
Loan collection and other real estate owned	2,560	2,631	3,036
Merger expenses	2,608	804	-
Prepayment penalty on long-term debt	-	-	4,526
Other	16,358	14,764	13,223
Total noninterest expense	$ 193,887	$ 180,676	$ 178,291

Noninterest expense for the year ended December 31, 2012 was $193.9 million, up $13.2 million or 7.3%, for the same period in 2011, primarily due to an increase in employee salaries and benefits, professional fees, and acquisition expenses. Salaries and employee benefits increased $5.6 million, or 5.6%, for the year ended December 31, 2012, compared with the same period in 2011. This increase was due primarily to increases in full-time-equivalent employees from acquisitions, merit increases, and increased pension expense. Professional fees and outside services increased $1.5 million, or 17.3%, for the year ended December 31, 2012 as compared to 2011. Data processing and communications, occupancy, and equipment expenses increased approximately $3.0 million collectively, or 7.9%, for the year ended December 31, 2012 as compared to 2011, due primarily to increased activity from recent expansion into new markets. The Company incurred approximately $2.6 million in merger related expenses for the year ended December 31, 2012, as compared to $0.8 million for the same period in 2011. These increases were partially offset by a decrease in Federal Deposit Insurance Corporation ("FDIC") expenses of approximately $0.4 million for the year ended December 31, 2012 as compared to the year ended December 31, 2011. This decrease was due to the FDIC redefining the deposit insurance assessment base effective the second quarter of 2011. In addition, advertising expenses were down approximately $0.6 million in 2012 as compared with 2011 due in large part to expense reduction initiatives.

Income Taxes

Income tax expense for the year ended December 31, 2012 was $22.8 million, up from $21.3 million for the same period in 2011. The effective tax rate was 29.5% for the year ended December 31, 2012, compared to 26.9% for the same period in 2011. The relatively low effective tax rate in 2011 was driven primarily by a reduction in tax expense as a result of the settlement of a New York State tax audit during the fourth quarter of 2011.

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The income tax expense on the Company's income was different than the income tax expense at the Federal statutory rate of 35% due primarily to tax exempt income and, to a lesser extent, the effect of state income taxes and Federal low income housing tax credits.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are recorded when identified, which is generally in the third quarter of the subsequent year for U.S. federal and state provisions.

The amount of income taxes the Company pays is subject at times to ongoing audits by federal and state tax authorities, which often result in proposed assessments. The Company's estimate for the potential outcome for any uncertain tax issue is highly judgmental. The Company believes that it has adequately provided for any reasonably foreseeable outcome related to these matters. However, future results may include favorable or unfavorable adjustments to the estimated tax liabilities in the period the assessments are proposed or resolved or when statutes of limitation on potential assessments expire. As a result, the Company's effective tax rate may fluctuate significantly on a quarterly or annual basis.

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Risk Management – Credit Risk

Credit risk is managed through a network of loan officers, credit committees, loan policies, and oversight from the senior credit officers and Board of Directors. Management follows a policy of continually identifying, analyzing, and grading credit risk inherent in each loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits in the commercial loan portfolio is performed by the independent loan review function. These components of the Company's underwriting and monitoring functions are critical to the timely identification, classification, and resolution of problem credits.

Table 7. Nonperforming Assets

	As of December 31,									
(Dollars in thousands)	2012	%	2011	%	2010	%	2009	%	2008	%
Nonaccrual loans										
Commercial and agricultural loans and real estate	$20,923	53 %	$17,506	46 %	$24,402	57 %	$25,521	66 %	$15,891	66 %
Real estate mortgages	8,083	20 %	8,090	21 %	8,338	20 %	6,140	16 %	3,803	16 %
Consumer	8,440	21 %	8,724	23 %	8,765	21 %	6,249	16 %	3,468	14 %
Troubled debt restructured loans	2,230	6 %	3,970	10 %	962	2 %	836	2 %	1,029	4 %
Total nonaccrual loans	39,676	100 %	38,290	100 %	42,467	100 %	38,746	100 %	24,191	100 %
Loans 90 days or more past due and still accruing										
Commercial and agricultural loans and real estate	148	6 %	50	2 %	94	4 %	59	2 %	12	1 %
Real estate mortgages	330	13 %	763	24 %	919	40 %	602	24 %	770	33 %
Consumer	1,970	81 %	2,377	74 %	1,312	56 %	1,865	74 %	1,523	66 %
Total loans 90 days or more past due and still accruing	2,448	100 %	3,190	100 %	2,325	100 %	2,526	100 %	2,305	100 %
Total nonperforming loans	42,124		41,480		44,792		41,272		26,496	
Other real estate owned	2,276		2,160		901		2,358		665	
	$44,400		$43,640		$45,693		$43,630		$27,161	

Total nonperforming assets					
Total nonperforming loans to loans	0.98 %	1.09 %	1.24 %	1.13 %	0.73 %
Total nonperforming assets to total assets	0.73 %	0.78 %	0.86 %	0.80 %	0.51 %
Total allowance for loan losses to nonperforming loans	164.60 %	171.97 %	159.03 %	161.25 %	221.03 %

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Total nonperforming assets were $44.4 million at December 31, 2012, compared to $43.6 million at December 31, 2011. Nonperforming loans at December 31, 2012 were $42.1 million or 0.98% of total loans compared with $41.5 million or 1.09% at December 31, 2011. The Company recorded a provision for loan losses of $20.3 million for the year ended December 31, 2012 compared with $20.7 million for the year ended December 31, 2011. Net charge-offs to average loans for the year ended December 31, 2012 were 0.55%, compared with 0.56% for the year ended December 31, 2011. The allowance for loan losses was 164.60% of non-performing loans at December 31, 2012 as compared to 171.97% at December 31, 2011.

Impaired loans, which primarily consist of nonaccruing commercial, commercial real estate, agricultural, agricultural real estate loans and business banking loans, as well as certain consumer and residential real estate mortgage loans that have been modified in a troubled debt restructuring ("TDR"), increased to $26.0 million at December 31, 2012 as compared to $22.4 million at December 31, 2011. At December 31, 2012, $8.4 million of the total impaired loans had a specific reserve allocation of $2.8 million compared to $0.5 million of impaired loans at December 31, 2011 which had a specific reserve allocation of $0.2 million.

Nonaccruing TDRs decreased from approximately $4.0 million at December 31, 2011 to approximately $2.2 million at December 31, 2012, due primarily several large commercial and agricultural credits returning to accrual status during 2012.

The allowance for loan losses is maintained at a level estimated by management to provide adequately for risk of probable losses inherent in the current loan portfolio. The adequacy of the allowance for loan losses is continuously monitored. It is assessed for adequacy using a methodology designed to ensure the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan portfolio.

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the inherent uncertainty in evaluating the levels of the allowance required to cover credit losses in the portfolio and the material effect that such judgments can have on the consolidated results of operations.

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectibility of the portfolio. For individually analyzed loans, these include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectibility. These factors include: past loss experience; size, trend, composition, and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions to the allowance for loan losses are made periodically by charges to the provision for loan losses. These charges are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions to the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above.

Total net charge-offs for 2012 were $22.3 million as compared with $20.6 million for 2011. Net charge-offs to average loans was 0.55% for 2012 as compared with 0.56% for 2011. Gross charge-offs increased to $26.5 million for 2012 from $24.5 million for 2011. Recoveries increased from $3.9 million for the year ended December 31, 2011 to $4.2 million for the year ended December 31, 2012.

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Table 8. Allowance for Loan Losses

(Dollars in thousands)	2012		2011		2010		2009		2008	
Balance at January 1	$ 71,334		$ 71,234		$ 66,550		$ 58,564		$ 54,183	
Loans charged-off										
Commercial and agricultural	8,750		8,971		12,969		11,500		14,464	
Residential real estate mortgages	1,906		1,310		1,176		705		543	
Consumer*	15,848		14,207		15,692		17,609		11,985	
Total loans charged-off	26,504		24,488		29,837		29,814		26,992	
Recoveries										
Commercial and agricultural	1,641		1,438		1,922		1,508		1,411	
Residential real estate mortgages	38		6		43		133		68	
Consumer*	2,556		2,407		2,747		2,767		2,713	
Total recoveries	4,235		3,851		4,712		4,408		4,192	
Net loans charged-off	22,269		20,637		25,125		25,406		22,800	
Provision for loan losses	20,269		20,737		29,809		33,392		27,181	
Balance at December 31	$ 69,334		$ 71,334		$ 71,234		$ 66,550		$ 58,564	
Allowance for loan losses to loans outstanding at end of year	1.62	%	1.88	%	1.97	%	1.83	%	1.60	%
Net charge-offs to average loans outstanding	0.55	%	0.56	%	0.69	%	0.70	%	0.64	%

* Consumer charge-off and recoveries include consumer and home equity.

In addition to the nonperforming loans discussed above, the Company has also identified approximately $79.6 million in potential problem loans at December 31, 2012 as compared to $96.9 million at December 31, 2011. Potential problem loans are loans that are currently performing, with a possibility of loss if weaknesses are not corrected. Such loans may need to be disclosed as nonperforming at some time in the future. Potential problem loans are classified by the Company's loan rating system as "substandard." At December 31, 2012, there were 17 potential problem loans that equaled or exceeded $1.0 million, totaling $41.1 million in aggregate, compared to 24 potential problem loans exceeding $1.0 million, totaling $59.8 million at December 31, 2011. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses. To mitigate this risk, the Company maintains a diversified loan portfolio, has no significant concentration in any particular industry, and originates loans primarily within its footprint.

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The following table sets forth the allocation of the allowance for loan losses by category, as well as the percentage of loans in each category to total loans, as prepared by the Company. This allocation is based on management's assessment of the risk characteristics of each of the component parts of the total loan portfolio as of a given point in time and is subject to changes as and when the risk factors of each such component part change. The allocation is not indicative of either the specific amounts of the loan categories in which future charge-offs may be taken, nor should it be taken as an indicator of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

Table 9. Allocation of the Allowance for Loan Losses

	December 31,									
	2012		2011		2010		2009		2008	
(Dollars in thousands)	Allowance	Category Percent of Loans	Allowance	Category Percent of Loans	Allowance	Category Percent of Loans	Allowance	Category Percent of Loans	Allowance	Category Percent of of Loans
Commercial and agricultural	$ 35,624	47 %	$ 38,831	45 %	$ 40,101	44 %	$ 36,599	41 %	$ 33,231	39 %
Real estate mortgages	6,252	15 %	6,249	15 %	4,627	15 %	3,002	17 %	3,143	20 %
Consumer	27,162	38 %	26,049	40 %	26,126	41 %	26,664	42 %	21,908	41 %
Unallocated	296	0 %	205	0 %	380	0 %	285	0 %	282	0 %
Total	$ 69,334	100 %	$ 71,334	100 %	$ 71,234	100 %	$ 66,550	100 %	$ 58,564	100 %

The Company's accounting policy relating to the allowance for loan losses requires a review of each significant loan type within the loan portfolio, considering asset quality trends for each type, including, but not limited to, delinquencies, nonaccruals, historical charge-off experience, and specific economic factors (e.g. milk prices are considered when reviewing agricultural loans). Based on this review, management believes the reserve allocations are adequate to address any trends in asset quality indicators. As a result of the general improvement and stabilization of asset quality indicators in 2012, as well as the aforementioned review of the loan portfolio, the allowance to loan losses decreased and the allowance for loan losses as a percentage of total loans decreased from 1.88% as of December 31, 2011 to 1.62% as of December 31, 2012. Excluding approximately $219.6 million of acquired loans as of December 31, 2012, the allowance for loan losses as a percentage of total loans was 1.72% at December 31, 2012. These acquired loans were recorded at fair value on the date of acquisition, with no carryover of the related allowance for loan losses. Generally, the fair value discount represents expected credit losses, net of market interest rate adjustments. The discount on loans receivable will be amortized to interest income over the estimated remaining life of the acquired loans using the level yield method.

At December 31, 2012, approximately 59% of the Company's loans were secured by real estate located in central and northern New York, northeastern Pennsylvania, western Massachusetts, southern New Hampshire and the Burlington, Vermont area. Accordingly, the ultimate collectibility of a substantial portion of the Company's portfolio is susceptible to changes in market conditions of those areas. Management is not aware of any material concentrations of credit to any industry or individual borrowers.

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Subprime mortgage lending, which has been the riskiest sector of the residential housing market, is not a market that the Company has ever actively pursued. The market does not apply a uniform definition of what constitutes “subprime” lending. Our reference to subprime lending relies upon the “Statement on Subprime Mortgage Lending” issued by the OTS and the other federal bank regulatory agencies (the “Agencies”), on June 29, 2007, which further referenced the “Expanded Guidance for Subprime Lending Programs,” or the Expanded Guidance, issued by the Agencies by press release dated January 31, 2001. In the Expanded Guidance, the Agencies indicated that subprime lending does not refer to individual subprime loans originated and managed, in the ordinary course of business, as exceptions to prime risk selection standards. The Agencies recognize that many prime loan portfolios will contain such accounts. The Agencies also excluded prime loans that develop credit problems after acquisition and community development loans from the subprime arena. According to the Expanded Guidance, subprime loans are other loans to borrowers which display one or more characteristics of reduced payment capacity. Five specific criteria, which are not intended to be exhaustive and are not meant to define specific parameters for all subprime borrowers and may not match all markets or institutions’ specific subprime definitions, are set forth, including having a FICO score of 660 or below. Based upon the definition and exclusions described above, the Company is a prime lender. Within the loan portfolio, there are loans that, at the time of origination, had FICO scores of 660 or below. However, since the Company is a portfolio lender, it reviews all data contained in borrower credit reports and does not base underwriting decisions solely on FICO scores. We believe the aforementioned loans, when made, were amply collateralized and otherwise conformed to our prime lending standards.

Liquidity Risk

Liquidity involves the ability to meet the cash flow requirements of customers who may be depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. The Asset Liability Committee (ALCO) is responsible for liquidity management and has developed guidelines which cover all assets and liabilities, as well as off balance sheet items that are potential sources or uses of liquidity. Liquidity policies must also provide the flexibility to implement appropriate strategies. Requirements change as loans grow, deposits and securities mature, and payments on borrowings are made. Liquidity management includes a focus on interest rate sensitivity management with a goal of avoiding widely fluctuating net interest margins through periods of changing economic conditions.

The primary liquidity measurement the Company utilizes is called “Basic Surplus,” which captures the adequacy of its access to reliable sources of cash relative to the stability of its funding mix of average liabilities. This approach recognizes the importance of balancing levels of cash flow liquidity from short and long-term securities with the availability of dependable borrowing sources which can be accessed when necessary. At December 31, 2012, the Company’s Basic Surplus measurement was 9.0% of total assets, or $540 million, which was above the Company’s minimum of 5% (calculated at $302 million of period end total assets at December 31, 2012) set forth in its liquidity policies.

This Basic Surplus approach enables the Company to adequately manage liquidity from both operational and contingency perspectives. By tempering the need for cash flow liquidity with reliable borrowing facilities, the Company is able to operate with a more fully invested and, therefore, higher interest income generating securities portfolio. The makeup and term structure of the securities portfolio is, in part, impacted by the overall interest rate sensitivity of the balance sheet. Investment decisions and deposit pricing strategies are impacted by the liquidity position. At December 31, 2012, the Company considered its Basic Surplus position to be strong. However, certain events may adversely impact the Company’s liquidity position in 2013. Improvement in the economy may increase demand for equity related products or increase competitive pressure on deposit pricing, which, in turn, could result in a decrease in the Company’s deposit base or increase funding costs. Additionally, liquidity will come under additional pressure if loan growth exceeds deposit growth in 2013. These scenarios could lead to a decrease in the Company’s Basic Surplus measure below the minimum policy level of 5%. To manage this risk, the Company has the ability to

purchase brokered time deposits, borrow against established borrowing facilities with other banks (Federal funds), and enter into repurchase agreements with investment companies. The additional liquidity that could be provided by these measures was $1.1 billion at December 31, 2012. In addition, the Bank has enhanced its "Borrower-in-Custody" program with the FRB with the addition of the ability to pledge automobile loans. At December 31, 2012, the Bank had the capacity to borrow $539 million from this program.

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At December 31, 2012 and 2011, FHLB advances outstanding totaled $339.4 million and $342.8 million, respectively. The Bank is a member of the FHLB system and had additional borrowing capacity from the FHLB of approximately $418 million at December 31, 2012 and $323 million at December 31, 2011. In addition, unpledged securities could have been used to increase borrowing capacity at the FHLB by an additional $282 million at December 31, 2012 or used to collateralize other borrowings, such as repurchase agreements.

At December 31, 2012, a portion of the Company's loans and securities were pledged as collateral on borrowings. Therefore, future growth of earning assets will depend upon the Company's ability to obtain additional funding, through growth of core deposits and collateral management, and may require further use of brokered time deposits, or other higher cost borrowing arrangements.

Net cash flows provided by operating activities totaled $89.1 million in 2012 and $83.8 million in 2011. The critical elements of net operating cash flows include net income, adjusted for non-cash income and expense items such as the provision for loan losses, deferred income tax expense, depreciation and amortization, and cash flows generated through changes in other assets and liabilities.

Net cash flows used by investing activities totaled $127.1 million and $175.5 million in 2012 and 2011, respectively. Critical elements of investing activities are loan and investment securities transactions. The change in cash flows from investing activities was due primarily to the decrease in available for sale securities purchases, which totaled $483.9 million in 2012 as compared with $648.0 million in 2011. This was partially offset by a net increase in loans of approximately $277.7 million during 2012 as compared with $172.9 million in 2011.

Net cash flows provided by financing activities totaled $72.3 million in 2012 and net cash flows used in financing activities totaled $52.3 million in 2011. The critical elements of financing activities are proceeds from deposits, borrowings, and stock issuances. In addition, financing activities are impacted by dividends and treasury stock transactions.

In connection with its financing and operating activities, the Company has entered into certain contractual obligations. The Company's future minimum cash payments, excluding interest, associated with its contractual obligations pursuant to its borrowing agreements, operating leases, and other obligations at December 31, 2012 are as follows:

Contractual Obligations
(In thousands)

	Payments Due by Period						
	2013	2014	2015	2016	2017	Thereafter	Total
Long-term debt obligations	$119,502	$2,610	$250	$70,000	$100,000	$75,130	$367,492
Trust preferred debentures	-	-	-	-	-	75,422	75,422
Operating lease obligations	5,727	5,453	4,714	4,309	4,063	28,314	52,580
Retirement plan obligations	5,462	5,467	5,519	8,009	6,192	30,491	61,140
Lease obligations	161	161	161	105	30	-	618
Data processing commitments	8,436	7,677	7,546	2,907	2,064	-	28,629
Total contractual obligations	$139,288	$21,368	$18,190	$85,330	$112,349	$209,357	$585,881

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Commitments to Extend Credit

The Company makes contractual commitments to extend credit, which include unused lines of credit, which are subject to the Company's credit approval and monitoring procedures. At December 31, 2012 and 2011, commitments to extend credit in the form of loans, including unused lines of credit, amounted to $841.7 million and $764.9 million, respectively. In the opinion of management, there are no material commitments to extend credit, including unused lines of credit that represent unusual risks. All commitments to extend credit in the form of loans, including unused lines of credit, expire within one year.

Standby Letters of Credit

The Company does not issue any guarantees that would require liability-recognition or disclosure, other than its stand-by letters of credit. The Company guarantees the obligations or performance of customers by issuing stand-by letters of credit to third parties. These stand-by letters of credit are frequently issued in support of third party debt, such as corporate debt issuances, industrial revenue bonds, and municipal securities. The risk involved in issuing stand-by letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet products. Typically, these instruments have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. At December 31, 2012 and 2011, outstanding stand-by letters of credit were approximately $37.5 million and $26.8 million, respectively. The fair value of the Company's stand-by letters of credit at December 31, 2012 and 2011 was not significant. The following table sets forth the commitment expiration period for stand-by letters of credit at December 31, 2012:

Commitment Expiration of Standby Letters of Credit		
Within one year	$	23,250
After one but within three years		12,868
After three but within five years		873
After five years		519
Total	$	37,510

Interest Rate Swaps

Beginning in June 2012 with the acquisition of Hampshire First Bank, the Bank offers interest rate swap agreements to its customers. These agreements allow the Bank's customers to effectively fix the interest rate on a variable rate loan by entering into a separate agreement. Simultaneous with the execution of such an agreement with a customer, the Bank enters into a matching interest rate swap agreement with an unrelated third party provider, which allows the Bank to continue to receive the historical variable rate under the loan agreement with the customer. The agreement with the third party is not a hedge contract therefore changes in fair value are recorded through earnings. Assets and liabilities associated with the agreements are recorded in other assets and other liabilities on the balance sheet. Gains and losses are recorded as other noninterest income. The Bank is not subject to any fee or penalty should the customer elect to terminate the interest rate swap agreement prior to maturity. The Bank is exposed to credit loss equal to the fair value of the derivatives (not the notional amount of the derivatives) in the event of nonperformance by the counterparty to the interest rate swap agreements. Additionally, the Bank receives a fee from the customer that is recognized when the Bank has fulfilled its obligations under each agreement, which is generally upon execution of the agreement with the Bank's customer. Since the terms of the two interest rate swap agreements are identical, the income statement impact to the Bank is limited to the fees it receives from the customer. The Bank recognized minimal fee income in 2012. At December 31, 2012, the Bank maintained a $2.0 million deposit with the counterparty to collateralize the swap agreements.

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Loans Serviced for Others and Loans Sold with Recourse

The total amount of loans serviced by the Company for unrelated third parties was approximately $308.1 million and $301.9 million at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, the Company had approximately $1.2 million of mortgage servicing rights. At December 31, 2012 and 2011, the Company serviced $13.7 million and $16.2 million, respectively, of agricultural loans sold with recourse. Due to sufficient collateral on these loans, no reserve is considered necessary at December 31, 2012 and 2011.

Capital Resources

Consistent with its goal to operate a sound and profitable financial institution, the Company actively seeks to maintain a "well-capitalized" institution in accordance with regulatory standards. The principal source of capital to the Company is earnings retention. The Company's capital measurements are in excess of both regulatory minimum guidelines and meet the requirements to be considered well-capitalized.

The Company's principal source of funds to pay interest on trust preferred debentures and pay cash dividends to its shareholders are dividends from its subsidiaries. Various laws and regulations restrict the ability of banks to pay dividends to their shareholders. Generally, the payment of dividends by the Company in the future as well as the payment of interest on the capital securities will require the generation of sufficient future earnings by its subsidiaries.

The Bank also is subject to substantial regulatory restrictions on its ability to pay dividends to the Company. Under OCC regulations, the Bank may not pay a dividend, without prior OCC approval, if the total amount of all dividends declared during the calendar year, including the proposed dividend, exceeds the sum of its retained net income to date during the calendar year and its retained net income over the preceding two years. At December 31, 2012, approximately $21.3 million of the total stockholders' equity of the Bank was available for payment of dividends to the Company without approval by the OCC. The Bank's ability to pay dividends also is subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements.

Stock Repurchase Plan

Under previously disclosed stock repurchase plans, the Company purchased 769,568 shares of its common stock during the year ended December 31, 2012, for a total of $15.5 million at an average price of $20.13 per share. At December 31, 2012, there were 748,013 shares available for repurchase under a previously disclosed repurchase plan, which expires on December 31, 2013.

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2011 OPERATING RESULTS AS COMPARED TO 2010 OPERATING RESULTS

Net Interest Income

On a tax equivalent basis, the Company's net interest income for 2011 was $204.9 million, down from $208.1 million for 2010. The Company's net interest margin decreased to 4.09% for 2011 from 4.15% for 2010. The decrease in the net interest margin resulted primarily from the decrease in the yields on interest-earning assets as cash flows from maturing assets were redeployed at lower rates in the current interest rate environment. The yield on earning assets decreased 33 basis points (bp), from 5.21% for 2010 to 4.88% for 2011, driven primarily by a decrease in the yield earned on loans, which declined from 5.90% in 2010 to 5.58% in 2011. In addition, the yield earned on securities available for sale decreased from 3.56% in 2010 to 2.97% in 2011, which also drove the decrease in the yield on earning assets in 2011. Average earning assets decreased marginally from 2010 to 2011 and had little impact on the net interest margin. Meanwhile, the rate paid on interest bearing liabilities decreased 29 bp, from 1.32% for 2010 to 1.03% for 2011, and was the primary driver of the decrease in interest expense. The rate paid on time deposits decreased from 2.06% in 2010 to 1.80% in 2011. In addition, the rate paid on money market deposit accounts decreased from 0.57% in 2010 to 0.34% in 2011. Average interest-bearing liabilities decreased $172.9 million from 2010 to 2011 which also contributed to the decrease in interest expense. In 2010, the Company paid down certain long term borrowings, which was the primary driver of the decrease in interest-bearing liabilities in 2011.

Loans and Corresponding Interest and Fees on Loans

The average balance of loans increased by approximately $48.9 million, or 1.3%, from 2010 to 2011. The yield on average loans decreased from 5.90% in 2010 to 5.58% in 2011, as loan rates declined due to the historically low rate environment in 2011. Interest income from loans on a FTE basis decreased 4.2%, from $214.3 million in 2010 to $205.3 million in 2011. This decrease was due to the decrease in yield as noted above, and was partially offset by the increase in average loan balances.

Total loans increased $190.2 million, or 5.3% (4.1% organic growth) from December 31, 2010 to December 31, 2011. In October 2011, the Company acquired four branches in Berkshire County, Massachusetts, including approximately $39.9 million in loans, which contributed to this loan growth. Commercial loans increased $33.6 million, or 5.8%, from $577.7 million at December 31, 2010 to $611.3 million at December 31, 2011, due to strong originations in 2011, particularly in our upstate New York markets and Vermont, as well as approximately $3.8 million acquired from the aforementioned branch acquisitions. Commercial real estate loans increased $44.4 million, or 5.3%, from $844.5 million at December 31, 2010 to $888.9 million at December 31, 2011, in large part due to strong originations in our upstate New York markets as well as originations from new markets. The Company also acquired approximately $14.5 million in commercial real estate loans from the aforementioned branch acquisitions. Real estate construction and development loans increased $48.6 million from $45.4 million at December 31, 2010 to $94.0 million at December 31, 2011 due to the addition of a few large, commercial development loans during 2011 primarily from existing customers within our footprint. Residential real estate loans increased $33.1 million, or 6.0%, from $548.4 million at December 31, 2010 to $581.5 million at December 31, 2011. The Company sold more fixed rate mortgages during 2010 than 2011 as market conditions in 2011 were not as favorable for such sales. Consumer loans increased $40.9 million or 4.5% from $905.6 million at December 31, 2010 to $946.5 million at December 31, 2011 in large part due to strong originations in our upstate New York markets as well as originations from new markets. Despite the acquisition of approximately $20.8 million in home equity loans as part of the aforementioned acquisitions, home equity loans decreased by $6.0 million, or 1.0%, from December 31, 2010 to December 31, 2011. While originations were up in 2011 over 2010, the low rate environment contributed to consumers paying off or refinancing their home equity loans with lower rate products such as traditional mortgages.

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Securities and Corresponding Interest and Dividend Income

The average balance of the amortized cost for securities available for sale increased $34.8 million, or 3.2%, from 2010 to 2011. The yield on average securities available for sale was 2.97% for 2011 compared to 3.56% in 2010.

The average balance of securities held to maturity decreased from $128.7 million in 2010 to $81.6 million in 2011. At December 31, 2011, securities held to maturity were comprised primarily of tax-exempt municipal securities. The yield on securities held to maturity increased from 4.74% in 2010 to 5.33% in 2011.

The average balance of FRB and FHLB stock decreased to $27.1 million in 2011 from $31.9 million in 2010 due to a decrease in FHLB borrowings. The yield from investments in FRB and FHLB Banks decreased from 5.72% in 2010 to 5.13% in 2011.

Deposits

Average interest bearing deposits decreased $69.1 million, or 2.1%, from 2010 to 2011. Average time deposits decreased $72.2 million or 7.3% during 2011 as compared to 2010. The decrease in average time deposits resulted primarily from decreases in brokered and retail certificates of deposite due to lower interest rates. Average money market deposits decreased $22.8 million or 2.1% during 2011 when compared to 2010. Average NOW accounts decreased $24.4 million or 3.4% during 2011 as compared to 2010. This decrease was due primarily to a decrease in municipal NOW accounts. The average balance of savings accounts increased $50.3 million or 9.1% during 2011 when compared to 2010. The average balance of demand deposits increased $160.7 million, or 19.9%, from $805.6 million in 2010 to $966.3 million in 2011. This growth in demand deposits was driven principally by increases in accounts from retail, municipal, and commercial customers spurred by strategic expansion into new markets.

The rate paid on average interest-bearing deposits decreased from 0.91% during 2010 to 0.70% in 2011. The decrease in the rate on interest-bearing deposits was driven primarily by pricing decreases from money market accounts and time deposits, which are sensitive to interest rate changes. The pricing decreases for these products resulted from decreases in short-term rates driven by the cuts made to the Federal Funds Target rate by the FRB during 2009 as well as an overall decrease in all interest rates. The rate paid for money market deposit accounts decreased from 0.57% during 2010 to 0.34% during 2011. The rate paid for NOW accounts decreased from 0.41% during 2010 to 0.34% during 2011. The rate paid for savings deposits decreased from 0.14% in 2010 to 0.11% in 2011 and the rate paid on time deposits decreased from 2.06% during 2010 to 1.80% during 2011.

Borrowings

Average short-term borrowings decreased slightly to $154.0 million in 2011 from $158.3 million in 2010. The average rate paid on short-term borrowings decreased from 0.25% in 2010 to 0.13% in 2011, which was primarily driven by the FRB maintaining a historic low Fed Funds target rate of 0.25% (which directly impacts short-term borrowing rates). Average long-term debt decreased from $469.5 million in 2010 to $370.0 million in 2011, which resulted from the strategic pay-down of long-term debt in 2010 to lower interest expense in 2011 and future years.

The average balance of trust preferred debentures remained at $75.4 million in 2011 compared to 2010. The average rate paid for trust preferred debentures in 2011 was 2.77%, down from 5.49% in 2010. The decrease in rate on the trust preferred debentures is due primarily to the reset of interest rate terms in two trust preferred debentures to variable rate from fixed rate. The third trust preferred debenture reset to a variable rate in a prior year and therefore, all associated interest expense on trust preferred debentures is now at a variable rate.

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Short-term borrowings consist of Federal funds purchased and securities sold under repurchase agreements, which generally represent overnight borrowing transactions, and other short-term borrowings, primarily FHLB advances, with original maturities of one year or less. The Company has unused lines of credit and access to brokered deposits available for short-term financing of approximately $1.1 billion and $1.0 billion at December 31, 2011 and 2010, respectively. Securities collateralizing repurchase agreements are held in safekeeping by non-affiliated financial institutions and are under the Company's control. Long-term debt, which is comprised primarily of FHLB advances, are collateralized by the FHLB stock owned by the Company, certain of its mortgage-backed securities and a blanket lien on its residential real estate mortgage loans.

Noninterest Income

Noninterest income for the year ended December 31, 2011 was $80.3 million, down $3.6 million or 4.3% from $83.9 million for the year ended December 31, 2010. The decrease in noninterest income was due primarily to a decrease in net securities gains of approximately $3.1 million for the year ended December 31, 2011 as compared to the year ended December 31, 2010 due to the sale of two equity positions and certain CMO's during 2010. In addition, the Company experienced a decrease in service charges on deposit accounts of approximately $2.6 million as a result of a decrease in overdraft activity due to the effects of a full year of new regulations regarding overdraft fees, as well as decreased activity due to the state of the economy. Retirement plan administration fees decreased by $1.4 million, or 13.9%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010, driven by the loss of one large client in the fourth quarter of 2010. These decreases were partially offset by an increase in insurance and other financial services revenue of $2.0 million, or 10.5%, for the year ended December 31, 2011 as compared to the same period in 2010. This increase was due primarily to the acquisition of an insurance agency during the second quarter of 2011 and an increase in brokerage commission revenue from new business. ATM and debit card fees increased approximately $1.6 million, or 16.0%, for the year ended December 31, 2011 as compared to the same period in 2010 due to an increase in card usage as well as a change in the fee structure on foreign ATM transactions. In addition, trust revenue increased approximately $1.1 million, or 14.8%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010, due primarily to the addition of new business, including from markets where we have recently expanded, as well as an increase in the fair market value of trust assets under administration.

Noninterest Expense

Noninterest expense for the year ended December 31, 2011 was $180.7 million, up from $178.3 million, or 1.3%, for the year ended December 31, 2010. Salaries and employee benefits increased $5.5 million, or 5.9%, for the year ended December 31, 2011 compared with the year ended December 31, 2010. This increase was due primarily to increases in full-time-equivalent employees driven primarily by strategic expansion efforts, merit increases, and other employee benefits. In addition, occupancy expenses increased approximately $1.0 million, or 6.6%, for the year ended December 31, 2011 as compared to the year ended December 31, 2010, primarily due to continued expansion and expenses related to the harsh winter in early 2011. Other operating expenses also increased approximately $2.3 million, or 17.7%, for the year ended December 31, 2011 compared with the year ended December 31, 2010 primarily as a result of flood related expenses totaling approximately $0.4 million and merger related expenses totaling approximately $0.8 million in 2011, with no other significant drivers. During the year ended December 31, 2010, the Company incurred debt prepayment penalties totaling $4.5 million to pay off long-term debt, which partially offset the aforementioned increases in noninterest expense. The increases in noninterest expense were also partially offset by a decrease in FDIC premium expenses of approximately $1.8 million during the year ended December 31, 2011, as compared with the year ended December 31, 2010, due to the FDIC redefining the deposit insurance assessment base.

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Recent Accounting Pronouncements

ASU 2011-11, "Balance Sheet (Topic 210) - "Disclosures about Offsetting Assets and Liabilities." ASU 2011-11 amends Topic 210, "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. In October 2012, the FASB limited the scope to derivatives, repurchase and reverse purchase agreements, and securities borrowing and lending agreements subject to master netting arrangements or similar agreements. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and is not expected to have a significant impact on the Company's financial statements.

ASU 2012-02 "Intangibles – Goodwill and Other (Topic 350) – Testing Indefinite-Lived Intangible Assets for Impairment." ASU 2012-02 gives entities the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that an indefinite-lived intangible asset is impaired. If, after assessing the totality of events or circumstances, an entity determines it is more likely than not that an indefinite-lived intangible asset is impaired, then the entity must perform the quantitative impairment test. If, under the quantitative impairment test, the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in ASU 2011-08. ASU 2012-02 is effective for the Company beginning January 1, 2013 (early adoption permitted) and is not expected to have a significant impact on the Company's financial statements.

ITEM 7A. Quantitative and Qualitative Disclosure About Market Risk

Interest rate risk is the most significant market risk affecting the Company. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company's business activities or are immaterial to the results of operations.

Interest rate risk is defined as an exposure to a movement in interest rates that could have an adverse effect on the Company's net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or reprice on a different basis than earning assets. When interest-bearing liabilities mature or reprice more quickly than earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income.

In an attempt to manage the Company's exposure to changes in interest rates, management monitors the Company's interest rate risk. Management's asset/liability committee (ALCO) meets monthly to review the Company's interest rate risk position and profitability, and to recommend strategies for consideration by the Board of Directors. Management also reviews loan and deposit pricing, and the Company's securities portfolio, formulates investment and funding strategies, and oversees the timing and implementation of transactions to assure attainment of the Board's objectives in the most effective manner. Notwithstanding the Company's interest rate risk management activities, the potential for changing interest rates is an uncertainty that can have an adverse effect on net income.

In adjusting the Company's asset/liability position, the Board and management attempt to manage the Company's interest rate risk while minimizing the net interest margin compression. At times, depending on the level of general interest rates, the relationship between long and short-term interest rates, market conditions and competitive factors, the Board and management may determine to increase the Company's interest rate risk position somewhat in order to increase its net interest margin. The Company's results of operations and net portfolio values remain vulnerable to

changes in interest rates and fluctuations in the difference between long and short-term interest rates

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The primary tool utilized by ALCO to manage interest rate risk is a balance sheet/income statement simulation model (interest rate sensitivity analysis). Information such as principal balance, interest rate, maturity date, cash flows, next repricing date (if needed), and current rates is uploaded into the model to create an ending balance sheet. In addition, ALCO makes certain assumptions regarding prepayment speeds for loans and mortgage related investment securities along with any optionality within the deposits and borrowings. The model is first run under an assumption of a flat rate scenario (i.e. no change in current interest rates) with a static balance sheet over a 12-month period. Two additional models are run in which a gradual increase of 200 bp and a gradual decrease of 100 bp takes place over a 12 month period with a static balance sheet. Under these scenarios, assets subject to prepayments are adjusted to account for faster or slower prepayment assumptions. Any investment securities or borrowings that have callable options embedded into them are handled accordingly based on the interest rate scenario. The resultant changes in net interest income are then measured against the flat rate scenario.

In the declining rate scenario, net interest income is projected to decrease slightly when compared to the forecasted net interest income in the flat rate scenario through the simulation period. The decrease in net interest income is a result of earning assets repricing downward, given potential higher prepayments and lower reinvestment rates, slightly faster than the interest bearing liabilities that are at or near their floors. In the rising rate scenarios, net interest income is projected to experience a decline from the flat rate scenario; however, the potential impact on earnings is dependent on the ability to lag deposit repricing on NOW, savings, MMDA, and CD accounts. Net interest income for the next twelve months in the +200/-100 bp scenarios, as described above, is within the internal policy risk limits of not more than a 7.5% change in net interest income. The following table summarizes the percentage change in net interest income in the rising and declining rate scenarios over a 12-month period from the forecasted net interest income in the flat rate scenario using the December 31, 2012 balance sheet position:

Table 10. Interest Rate Sensitivity Analysis

Change in interest rates (In basis points)	Percent change in net interest income
+200	(1.85%)
-100	(1.29%)

The Company anticipates that under the current low rate environment, on a monthly basis, interest income is expected to decrease at a faster rate than interest expense given the potential higher prepayments and reinvestment into lower rates as deposit rates are at or near their respective floors. In order to protect net interest income from anticipated net interest margin compression in 2013, the Company will continue to focus on increasing earning assets through loan growth, asset mix of loans and investments, and leverage opportunities.

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ITEM 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
NBT Bancorp Inc.:

We have audited the accompanying consolidated balance sheets of NBT Bancorp Inc. and subsidiaries (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2012. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of NBT Bancorp Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 1, 2013 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/S/ KPMG LLP

Albany, New York
March 1, 2013

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Consolidated Balance Sheets

(In thousands, except share and per share data)	As of December 31, 2012	2011
Assets		
Cash and due from banks	$157,094	$128,517
Short-term interest bearing accounts	6,574	864
Securities available for sale, at fair value	1,147,999	1,244,619
Securities held to maturity (fair value $61,535 and $72,198)	60,563	70,811
Trading securities	3,918	3,062
Federal Reserve and Federal Home Loan Bank stock	29,920	27,020
Loans	4,277,616	3,800,203
Less allowance for loan losses	69,334	71,334
Net loans	4,208,282	3,728,869
Premises and equipment, net	77,875	74,541
Goodwill	152,373	132,029
Intangible assets, net	16,962	18,194
Bank owned life insurance	80,702	77,626
Other assets	99,997	92,254
Total assets	$6,042,259	$5,598,406
Liabilities		
Demand (noninterest bearing)	$1,242,712	$1,052,906
Savings, NOW, and money market	2,558,376	2,381,116
Time	983,261	933,127
Total deposits	4,784,349	4,367,149
Short-term borrowings	162,941	181,592
Long-term debt	367,492	370,344
Trust preferred debentures	75,422	75,422
Other liabilities	69,782	65,789
Total liabilities	5,459,986	5,060,296
Stockholders' equity		
Preferred stock, $0.01 par value; authorized 2,500,000 shares at December 31, 2012 and 2011	-	-
Common stock, $0.01 par value. Authorized 100,000,000 shares at December 31, 2012 and 50,000,000 at December 31, 2011; issued 39,305,131 at December 31, 2012 and 38,035,539 at December 31, 2011	393	380
Additional paid-in-capital	346,692	317,329
Retained earnings	357,558	329,981
Accumulated other comprehensive loss	(5,880)	(6,104)
Common stock in treasury, at cost, 5,529,781 and 4,878,829 shares at December 31, 2012 and 2011, respectively	(116,490)	(103,476)
Total stockholders' equity	582,273	538,110
Total liabilities and stockholders' equity	$6,042,259	$5,598,406

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Income

(In thousands, except per share data)	Years ended December 31, 2012	2011	2010
Interest, fee, and dividend income			
Interest and fees on loans	$208,458	$204,370	$213,429
Securities available for sale	27,005	31,083	36,167
Securities held to maturity	2,378	2,886	3,968
Other	1,556	1,658	2,174
Total interest, fee, and dividend income	239,397	239,997	255,738
Interest expense			
Deposits	18,848	23,020	30,354
Short-term borrowings	188	205	402
Long-term debt	14,428	14,404	18,314
Trust preferred debentures	1,730	2,092	4,140
Total interest expense	35,194	39,721	53,210
Net interest income	204,203	200,276	202,528
Provision for loan losses	20,269	20,737	29,809
Net interest income after provision for loan losses	183,934	179,539	172,719
Noninterest income			
Insurance and other financial services revenue	22,387	20,843	18,867
Service charges on deposit accounts	18,225	21,464	24,041
ATM and debit card fees	12,358	11,642	10,035
Retirement plan administration fees	10,097	8,918	10,356
Trust	9,172	8,864	7,722
Bank owned life insurance income	3,077	3,085	3,316
Net securities gains	599	150	3,274
Other	11,412	5,345	6,277
Total noninterest income	87,327	80,311	83,888
Noninterest expense			
Salaries and employee benefits	104,815	99,212	93,718
Occupancy	17,415	16,363	15,350
Data processing and communications	13,437	12,271	12,347
Professional fees and outside services	10,463	8,921	9,032
Equipment	9,627	8,864	8,317
Office supplies and postage	6,489	6,073	6,102
FDIC expenses	3,832	4,267	6,081
Advertising	2,889	3,460	3,487
Amortization of intangible assets	3,394	3,046	3,072
Loan collection and other real estate owned	2,560	2,631	3,036
Merger expenses	2,608	804	-
Prepayment penalty on long-term debt	-	-	4,526
Other	16,358	14,764	13,223
Total noninterest expense	193,887	180,676	178,291
Income before income tax expense	77,374	79,174	78,316
Income tax expense	22,816	21,273	20,912
Net income	$54,558	$57,901	$57,404
Earnings per share			
Basic	$1.63	$1.72	$1.67
Diluted	1.62	1.71	1.66

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Comprehensive Income

	Years ended December 31,		
(In thousands)	2012	2011	2010
Net income	$54,558	$57,901	$57,404
Other comprehensive (loss) income, net of tax			
Unrealized net holding (losses) gains arising during the year (pre-tax amounts of $(2,471), $12,757, and $(6,660))	(1,492)	7,703	(4,021)
Reclassification adjustment for net gains related to securities available for sale included in net income (pre-tax amounts of $599, $150, and $3,274)	(362)	(90)	(1,977)
Amortization of prior service cost and actuarial gains (pre-tax amounts of $3,593, $1,665, and $1,768)	2,092	999	1,060
Increase in unrecognized actuarial loss and prior service cost (pre-tax amounts of $(24), $(15,546), and $(2,596))	(14)	(9,381)	(1,560)
Total other comprehensive income (loss)	224	(769)	(6,498)
Comprehensive income	$54,782	$57,132	$50,906

See accompanying notes to consolidated financial statements

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Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2012, 2011, and 2010 (In thousands except share and per share data)	Common stock	Additional paid-in-capital	Retained earnings	Accumulated other comprehensive (loss) income	Common stock in treasury	Total
Balance at December 31, 2009	$380	$311,164	$270,232	$ 1,163	$(77,816)	$505,123
Net income	-	-	57,404	-	-	57,404
Cash dividends - $0.80 per share	-	-	(27,577)	-	-	(27,577)
Net issuance of 23,810 common shares	-	-	-	-	(477)	(477)
Net issuance of 141,146 shares to employee stock plans, including tax benefit	-	(923)	(262)	-	3,000	1,815
Stock-based compensation	-	3,782	-	-	-	3,782
Other comprehensive loss	-	-	-	(6,498)	-	(6,498)
Balance at December 31, 2010	$380	$314,023	$299,797	$ (5,335)	$(75,293)	$533,572
Net income	-	-	57,901	-	-	57,901
Cash dividends - $0.80 per share	-	-	(27,063)	-	-	(27,063)
Purchase of 1,458,609 treasury shares	-	-	-	-	(30,502)	(30,502)
Net issuance of 112,512 shares to employee stock plans, including tax benefit	-	62	(654)	-	2,319	1,727
Stock-based compensation	-	3,244	-	-	-	3,244
Other comprehensive loss	-	-	-	(769)	-	(769)
Balance at December 31, 2011	$380	$317,329	$329,981	$ (6,104)	$(103,476)	$538,110
Net income	-	-	54,558	-	-	54,558
Cash dividends - $0.80 per share	-	-	(26,712)	-	-	(26,712)
Purchase of 769,568 treasury shares	-	-	-	-	(15,490)	(15,490)
Net issuance of 1,269,592 shares for acquisition	13	25,811	-	-	-	25,824
Net issuance of 118,616 shares to employee stock plans, including tax benefit	-	(812)	(269)	-	2,476	1,395
Stock-based compensation	-	4,364	-	-	-	4,364
Other comprehensive income	-	-	-	224	-	224
Balance at December 31, 2012	$393	$346,692	$357,558	$ (5,880)	$(116,490)	$582,273

See accompanying notes to consolidated financial statements

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Consolidated Statements of Cash Flows

(In thousands)	Years ended December 31, 2012	2011	2010
Operating activities			
Net income	$54,558	$57,901	$57,404
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	20,269	20,737	29,809
Depreciation and amortization of premises and equipment	6,276	5,463	5,327
Net accretion on securities	2,408	1,597	1,468
Amortization of intangible assets	3,394	3,046	3,072
Stock based compensation	4,364	3,244	3,782
Bank owned life insurance income	(3,077)	(3,085)	(3,316)
Trading security purchases	(753)	(447)	(184)
Unrealized (gains) losses in trading securities	(103)	193	(214)
Deferred income tax benefit	(10)	(9,478)	(14,955)
Proceeds from sale of loans held for sale	65,160	13,545	83,143
Originations of loans held for sale	(66,252)	(14,167)	(80,469)
Net gains on sales of loans held for sale	(2,469)	(329)	(911)
Net security gains	(599)	(151)	(3,274)
Net gains on sales of other real estate owned	(988)	(2,531)	(517)
Net decrease (increase) in other assets	6,804	(3,579)	6,627
Net increase in other liabilities	(128)	11,806	2,645
Net cash provided by operating activities	88,854	83,765	89,437
Investing activities			
Net cash provided by acquisitions	52,871	81,467	-
Securities available for sale:			
Proceeds from maturities, calls, and principal paydowns	573,828	541,555	511,394
Proceeds from sales	1,790	2,437	103,253
Purchases	(483,858)	(648,048)	(635,319)
Securities held to maturity:			
Proceeds from maturities, calls, and principal paydowns	31,506	47,186	112,399
Purchases	(20,193)	(20,736)	(48,701)
Net (increase) decrease in loans	(277,530)	(172,920)	7,292
Net (increase) decrease in Federal Reserve and FHLB stock	(1,886)	226	8,733
Proceeds from bank owned life insurance	-	758	2,767
Purchases of premises and equipment, net	(6,994)	(9,954)	(6,510)
Proceeds from sales of other real estate owned	3,616	2,531	3,186
Net cash (used in) provided by investing activities	(126,850)	(175,498)	58,494
Financing activities			
Net increase in deposits	135,095	87,992	41,306
Net (decrease) increase in short-term borrowings	(18,651)	22,158	3,457
Proceeds from issuance of long-term debt	-	156	-
Repayments of long-term debt	(3,354)	(2,146)	(184,824)
Excess tax benefit from exercise of stock options	8	341	140
Proceeds from the issuance of shares to employee benefit plans and other stock plans	1,387	1,386	1,675
Purchase of treasury stock	(15,490)	(30,502)	(477)
Cash dividends and payments for fractional shares	(26,712)	(27,063)	(27,577)

Net cash provided by (used in) financing activities	72,283	52,322	(166,300)
Net increase (decrease) in cash and cash equivalents	34,287	(39,411)	(18,369)
Cash and cash equivalents at beginning of year	129,381	168,792	187,161
Cash and cash equivalents at end of year	$163,668	$129,381	$168,792

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Supplemental disclosure of cash flow information	Years ended December 31,		
Cash paid during the year for:	2012	2011	2010
Interest	$35,344	$40,135	$54,668
Income taxes, net of refund	25,512	31,258	37,033
Noncash investing activities:			
Loans transferred to other real estate owned	$2,734	$2,927	$1,212
Acquisitions:			
Fair value of assets acquired	$258,467	$67,020	$-
Fair value of liabilities assumed	285,012	148,487	-
Fair value of debt issued in purchase combination	502	2,460	-

See accompanying notes to consolidated financial statements.

NBT BANCORP INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(1) Summary of Significant Accounting Policies

The accounting and reporting policies of NBT Bancorp Inc. ("NBT Bancorp") and its subsidiaries, NBT Bank, National Association ("NBT Bank"), NBT Holdings, Inc., and NBT Financial Services, Inc., conform, in all material respects, to accounting principles generally accepted in the United States of America ("GAAP") and to general practices within the banking industry. Collectively, NBT Bancorp and its subsidiaries are referred to herein as "the Company."

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Estimates associated with the allowance for loan losses, other real estate owned (OREO), income taxes, pension expense, fair values of financial instruments and status of contingencies and other-than-temporary impairment on investments are particularly susceptible to material change in the near term.

The following is a description of significant policies and practices:

Consolidation

The accompanying consolidated financial statements include the accounts of NBT Bancorp and its wholly owned subsidiaries mentioned above. All material intercompany transactions have been eliminated in consolidation. Amounts previously reported in the consolidated financial statements are reclassified whenever necessary to conform to the current year's presentation. In the "Parent Company Financial Information," the investment in subsidiaries is recorded using the equity method of accounting.

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The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under GAAP. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities ("VIEs") are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in an entity is present when an enterprise has a variable interest, or a combination of variable interests, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. The Company's wholly owned subsidiaries CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II are VIEs for which the Company is not the primary beneficiary. Accordingly, the accounts of these entities are not included in the Company's consolidated financial statements.

Segment Report

The Company's operations are primarily in the community banking industry and include the provision of traditional banking services. The Company also provides other services through its subsidiaries such as insurance, retirement plan administration, and trust administration. The Company operates solely in the geographical regions of central and upstate New York, northeastern Pennsylvania, western Massachusetts, southern New Hampshire and Burlington, Vermont. The Company has no reportable operating segments.

Cash Equivalents

The Company considers amounts due from correspondent banks, cash items in process of collection, and institutional money market mutual funds to be cash equivalents for purposes of the consolidated statements of cash flows.

Securities

The Company classifies its securities at date of purchase as either available for sale, held to maturity or trading. Held to maturity debt securities are those that the Company has the ability and intent to hold until maturity. Available for sale securities are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, on available for sale securities are excluded from earnings and are reported in stockholders' equity and the statement of comprehensive income as a component of accumulated other comprehensive income or loss. Held to maturity securities are recorded at amortized cost. Trading securities are recorded at fair value, with net unrealized gains and losses recognized in income. Transfers of securities between categories are recorded at fair value at the date of transfer. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses or in other comprehensive income, depending on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into (a) the amount representing the credit loss and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes.

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In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the historical and implied volatility of the fair value of the security.

Non-marketable equity securities are carried at cost.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the interest method. Dividend and interest income are recognized when earned. Realized gains and losses on securities sold are derived using the specific identification method for determining the cost of securities sold.

Investments in Federal Reserve and Federal Home Loan Bank ("FHLB") stock are required for membership in those organizations and are carried at cost since there is no market value available.

Loans

Loans are recorded at their current unpaid principal balance, net of unearned income and unamortized loan fees and expenses, which are amortized under the effective interest method over the estimated lives of the loans. Interest income on loans is accrued based on the principal amount outstanding.

Lease receivables primarily represent automobile financing to customers through direct financing leases and are carried at the aggregate of the lease payments receivable and the estimated residual values, net of unearned income and net deferred lease origination fees and costs. Net deferred lease origination fees and costs are amortized under the effective interest method over the estimated lives of the leases. The estimated residual value related to the total lease portfolio is reviewed and if there has been a decline in the estimated fair value of the total residual value that is judged by management to be other-than-temporary a loss is recognized. Adjustments related to such other-than-temporary declines in estimated fair value are recorded in noninterest expense in the consolidated statements of income.

For all loan classes within the Company's loan portfolio, loans are placed on nonaccrual status when timely collection of principal and interest in accordance with contractual terms is doubtful. Loans are transferred to nonaccrual status generally when principal or interest payments become ninety days delinquent, unless the loan is well secured and in the process of collection, or sooner when management concludes circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan losses.

If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. For all loan classes within the Company's loan portfolio, nonaccrual loans are returned to accrual status when they become current as to principal and interest and demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. For loans in all portfolios, the principal amount is charged off in full or in part as soon as management determines, based on available facts, that the collection of principal in full is improbable. For commercial loans, management considers specific facts and circumstances relative to individual credits in making such a determination. For consumer and residential loan classes, management uses specific guidance and thresholds from the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy.

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Commercial type loans are considered impaired when it is probable that the borrower will not repay the loan according to the original contractual terms of the loan agreement, and all loan types are considered impaired if the loan is restructured in a troubled debt restructuring (“TDR”). In determining that we will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated.

A loan is considered to be a TDR when the Company grants a concession to the borrower because of the borrower’s financial condition that the Company would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of all or a portion of principal or interest, or other modifications at interest rates that are less than the current market rate for new obligations with similar risk. TDR loans are nonaccrual loans; however, they can be returned to accrual status after a period of performance, generally evidenced by six months of compliance with their modified terms.

Allowance for Loan Losses

The allowance for loan losses is the amount which, in the opinion of management, is necessary to absorb probable losses inherent in the loan portfolio. The allowance is determined based upon numerous considerations, including local and regional conditions, the growth and composition of the loan portfolio with respect to the mix between the various types of loans and their related risk characteristics, a review of the value of collateral supporting the loans, comprehensive reviews of the loan portfolio by the independent loan review staff and management, as well as consideration of volume and trends of delinquencies, nonperforming loans, and loan charge-offs. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. As a result of tests of adequacy, required additions to the allowance for loan losses are made periodically by charges to the provision for loan losses.

The allowance for loan losses related to impaired loans is based on discounted cash flows using the loan’s initial effective interest rate or the fair value of the collateral for certain loans where repayment of the loan is expected to be provided solely by the underlying collateral (collateral dependent loans). The Company’s impaired loans are generally collateral dependent. The Company considers the estimated cost to sell, on a discounted basis, when determining the fair value of collateral in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loans.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize loan losses, future additions to the allowance for loan losses may be necessary based on changes in economic conditions or changes in the values of properties securing loans in the process of foreclosure. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination which may not be currently available to management.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation of premises and equipment is determined using the straight-line method over the estimated useful lives of the respective assets. Expenditures for maintenance, repairs, and minor replacements are charged to expense as incurred.

Other Real Estate Owned

OREO consists of properties acquired through foreclosure or by acceptance of a deed in lieu of foreclosure. These assets are recorded at the lower of fair value of the asset acquired less estimated costs to sell or "cost" (defined as the fair value at initial foreclosure). At the time of foreclosure, or when foreclosure occurs in-substance, the excess, if any, of the loan over the fair market value of the assets received, less estimated selling costs, is charged to the allowance for loan losses and any subsequent valuation write-downs are charged to other expense. In connection with the determination of the allowance for loan losses and the valuation of other real estate owned, management obtains appraisals for properties. Operating costs associated with the properties are charged to expense as incurred. Gains on the sale of OREO are included in income when title has passed and the sale has met the minimum down payment requirements prescribed by GAAP. The balance of OREO at December 31, 2012 and 2011 was approximately $2.3 million and $2.2 million, respectively.

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Acquired Loans

Acquired loans are initially measured at fair value as of the acquisition date without carryover of historical allowance for loan losses.

For loans that meet the criteria stipulated in ASC 310-30, the Company shall recognize the accretable yield, which is defined as the excess of all cash flows expected at acquisition over the initial fair value of the loan, as interest income on a level-yield basis over the expected remaining life of the loan. The excess of the loan's contractually required payments over the cash flows expected to be collected is the nonaccretable difference. The nonaccretable difference shall not be recognized as an adjustment of yield, a loss accrual, or a valuation allowance. Decreases in the expected cash flows in subsequent periods require the establishment of an allowance for loan losses. Improvements in expected cash flows in future periods result in a reduction of the nonaccretable discount, with such amount reclassified as part of the accretable yield and subsequently recognized in interest income over the remaining lives of the acquired loans on a level-yield basis if the amount and timing of future cash flows is reasonably estimable.

Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, the Company may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable yield. As such, charge-offs on acquired loans are first applied to the nonaccretable difference and then to any allowance for loan losses recognized subsequent to acquisition.

For loans that meet the criteria stipulated in ASC 310-20, the Company shall amortize/accrete into interest income the premium/discount determined at the date of purchase on a level-yield basis over the life of the loan. Subsequent to the acquisition date, the methods utilized to estimate the required allowance for loan losses are similar to originated loans. Loans accounted for under ASC 310-20 are placed on nonaccrual status when past due in accordance with the Company's nonaccrual policy.

Subsequent to acquisition the estimate of cash flows expected to be collected on loans accounted for in accordance with ASC 310-20 is periodically re-assessed. These re-assessments involve the use of key assumptions and estimates, similar to those used in the initial estimate of fair value. A decrease in expected cash flows in subsequent periods may indicate that the loan pool is impaired, which would require the establishment of an allowance for loan losses by a charge to the provision for credit losses.

An acquired loan may be resolved either through receipt of payment (in full or in part) from the borrower, the sale of the loan to a third party, or foreclosure of the collateral. In the event of a sale of the loan, a gain or loss on sale is recognized and reported within noninterest income based on the difference between the sales proceeds and the carrying amount of the loan. In other cases, individual loans are removed from the pool based on comparing the amount received from its resolution (fair value of the underlying collateral less costs to sell in the case of a foreclosure) with its outstanding balance. Any difference between these amounts is recorded as a charge-off through the allowance for loan losses. Acquired loans subject to modification are not removed from the pool even if those loans would otherwise be deemed troubled debt restructurings as the pool, and not the individual loan, represents the unit of account.

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Goodwill and Other Intangible Assets

Goodwill and intangible assets that have indefinite useful lives are not amortized, but are tested at least annually for impairment. Intangible assets that have finite useful lives are amortized over their useful lives. Core deposit intangibles at the Company are amortized using the sum-of-the-years'-digits method. Covenants not to compete are amortized on a straight-line basis. Customer lists are amortized using an accelerated method.

When facts and circumstances indicate potential impairment of amortizable intangible assets, the Company evaluates the recoverability of the asset carrying value, using estimates of undiscounted future cash flows over the remaining asset life. Any impairment loss is measured by the excess of carrying value over fair value. Goodwill impairment tests are performed on an annual basis or when events or circumstances dictate. In these tests, the fair values of each reporting unit, or segment, is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated. If so, the implied fair value of the reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value.

Treasury Stock

Treasury stock acquisitions are recorded at cost. Subsequent sales of treasury stock are recorded on an average cost basis. Gains on the sale of treasury stock are credited to additional paid-in-capital. Losses on the sale of treasury stock are charged to additional paid-in-capital to the extent of previous gains, otherwise charged to retained earnings.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in income tax expense.

Stock-Based Compensation

We maintain various long-term incentive stock benefit plans under which we grant stock options, restricted stock awards, and restricted stock units to certain directors and key employees. We recognize compensation expense in our income statement over the requisite service period, based on the grant-date fair value of the award. The fair values of options are estimated using the Black-Scholes option pricing model. For restricted stock awards and units, we recognize compensation expense ratably over the vesting period for the fair value of the award, measured at the grant date.

The Company's stock-based employee compensation plan is described in Note 18 "Employee Benefit Plans," of this Report.

Interest Rate Swaps

Beginning in June 2012 with the acquisition of Hampshire First Bank, the Bank offers interest rate swap agreements to its customers. These agreements allow the Bank's customers to effectively fix the interest rate on a variable rate loan by entering into a separate agreement. Simultaneous with the execution of such an agreement with a customer, the Bank enters into a matching interest rate swap agreement with an unrelated third party provider, which allows the Bank to continue to receive the historical variable rate under the loan agreement with the customer. The agreement with the third party is not a hedge contract therefore changes in fair value are recorded through earnings. Assets and liabilities associated with the agreements are recorded in other assets and other liabilities on the balance sheet. Gains and losses are recorded as other noninterest income. The Bank is not subject to any fee or penalty should the customer elect to terminate the interest rate swap agreement prior to maturity. The Bank is exposed to credit loss equal to the fair value of the derivatives (not the notional amount of the derivatives) in the event of nonperformance by the counterparty to the interest rate swap agreements. Additionally, the Bank receives a fee from the customer that is recognized when the Bank has fulfilled its obligations under each agreement, which is generally upon execution of the agreement with the Bank's customer. Since the terms of the two interest rate swap agreements are identical, the income statement impact to the Bank is limited to the fees it receives from the customer.

Other Financial Instuments

The Company is a party to certain other financial instruments with off-balance-sheet risk such as commitments to extend credit, unused lines of credit, as well as certain mortgage loans sold to investors with recourse. The Company's policy is to record such instruments when funded.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Under the standby letters of credit, the Company is required to make payments to the beneficiary of the letters of credit upon request by the beneficiary contingent upon the customer's failure to perform under the terms of the underlying contract with the beneficiary. Standby letters of credit typically have one year expirations with an option to renew upon annual review. The Company typically receives a fee for these transactions. The fair value of stand-by letters of credit is recorded upon inception.

Loan Sales and Loan Servicing

The Company originates and services residential mortgage loans for consumers and sells 15-year, 20-year and 30-year residential real estate mortgages in the secondary market when the interest rate environment is determined to be favorable by management, while retaining servicing rights on the sold loans. Loan sales are recorded when the sales are funded. Mortgage servicing rights are recorded at fair value upon sale of the loan. Loans held for sale are recorded at the lower of cost or market.

Repurchase Agreements

Repurchase agreements are accounted for as secured financing transactions since the Company maintains effective control over the transferred securities and the transfer meets the other criteria for such accounting. Obligations to repurchase securities sold are reflected as a liability in the Consolidated Balance Sheets. The securities underlying the agreements are delivered to a custodial account for the benefit of the dealer or bank with whom each transaction is

executed. The dealers or banks, who may sell, loan or otherwise dispose of such securities to other parties in the normal course of their operations, agree to resell to the Company the same securities at the maturities of the agreements.

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Earnings Per Share

Basic earnings per share ("EPS") excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as the Company's dilutive stock options and restricted stock).

Subsequent Events

The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

Comprehensive Income

At the Company, comprehensive income represents net income plus other comprehensive income (loss), which consists primarily of the net change in unrealized gains or losses on securities available for sale for the period and changes in the funded status of employee benefit plans. Accumulated other comprehensive (loss) income represents the net unrealized gains or losses on securities available for sale and the previously unrecognized portion of the funded status of employee benefit plans, net of income taxes, as of the consolidated balance sheet dates.

Pension Costs

The Company maintains a noncontributory, defined benefit pension plan covering substantially all employees, as well as supplemental employee retirement plans covering certain executives and a defined benefit postretirement healthcare plan that covers certain employees. Costs associated with these plans, based on actuarial computations of current and future benefits for employees, are charged to current operating expenses.

Trust Operations

Assets held by the Company in a fiduciary or agency capacity for its customers are not included in the accompanying consolidated balance sheets, since such assets are not assets of the Company. Trust income is recognized on the accrual method based on contractual rates applied to the balances of trust accounts.

Fair Value Measurements

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value measurements are not adjusted for transaction costs. A fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

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Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The types of instruments valued based on quoted market prices in active markets include most U.S. government and agency securities, many other sovereign government obligations, liquid mortgage products, active listed equities and most money market securities. Such instruments are generally classified within level 1 or level 2 of the fair value hierarchy. The Company does not adjust the quoted price for such instruments.

The types of instruments valued based on quoted prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most investment-grade and high-yield corporate bonds, less liquid mortgage products, less liquid agency securities, less liquid listed equities, state, municipal and provincial obligations, and certain physical commodities. Such instruments are generally classified within level 2 of the fair value hierarchy.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate will be used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

(2) Merger and Acquisition Activity

Acquisition of Alliance Financial Corporation

On October 7, 2012, NBT Bancorp and Alliance Financial Corporation ("Alliance") entered into a definitive agreement and plan of merger pursuant to which Alliance will merge with and into NBT Bancorp, with NBT Bancorp continuing as the surviving corporation. The agreement also provides for Alliance Bank, National Association ("Alliance Bank"), a wholly owned subsidiary of Alliance, to be merged with and into NBT Bank following completion of the merger. Alliance, with assets of approximately $1.4 billion at December 31, 2012, is headquartered in Syracuse, N.Y. Its primary subsidiary, Alliance Bank, is a nationally chartered community bank with 26 banking locations in central New York. The transaction is valued at approximately $233.4 million, to be paid in the form of shares of the Company's common stock. Subject to the required approvals of NBT Bancorp and Alliance shareholders, requisite regulatory approvals (which were received in early 2013) and other customary closing conditions, the merger is expected to be completed in early 2013.

Acquisition of Hampshire First Bank

On June 8, 2012, the Company acquired all of the outstanding common shares of Hampshire First Bank ("Hampshire First"). The five banking centers operated by Hampshire First located in Manchester, Londonderry, Nashua, Keene and Portsmouth, New Hampshire continue to do business under the Hampshire First name as a division of the

Bank. This business combination is a strategic extension of the Company's franchise.

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Hampshire First shareholders received approximately 1.3 million shares of the Company's common stock and $17.2 million in cash. On the acquisition date, Hampshire First had approximately 2.8 million outstanding common shares. Under the terms of the merger agreement between the Company, NBT Bank and Hampshire First, the Company paid $15.00 per share for 35% of the outstanding Hampshire First common shares, while the remaining 65% of outstanding Hampshire First shares received 0.7019 shares of the Company's common stock for each share. The Company's common stock issued in this exchange were valued at $20.34 per share based on the average of the daily closing price of the Company's common stock for the ten trading days immediately prior to June 8, 2012. The Company paid $2.6 million in cash to retire outstanding Hampshire First stock options and warrants.

The results of Hampshire First's operations are included in the Consolidated Statements of Income from the date of acquisition. In connection with the merger, the consideration paid, the assets acquired, and the liabilities assumed were recorded at fair value on the date of acquisition, as summarized in the following tables, in thousands, as of June 8, 2012

Consideration Paid:	
NBT Bancorp common stock issued to Hampshire First common stockholders	$25,824
Cash consideration paid to Hampshire First common stockholders	14,616
Cash consideration paid for Hampshire First employee stock options and warrants	2,583
Total consideration paid	$43,023
Recognized Amounts of Identifiable Assets Acquired and (Liabilities Assumed), At Fair Value:	
Cash and short term investments	$22,149
Loans	218,801
Federal Home Loan Bank common stock	1,014
Core deposit intangibles	797
Other assets	12,926
Deposits	(228,198)
Borrowings	(41)
Other liabilities	(2,848)
Total identifiable net assets	$24,600
Goodwill	$18,423

The fair values for most loans acquired from Hampshire First were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. The Company acquired the loan portfolio at a fair value discount of approximately $5.7 million. The discount represents expected credit losses, net of market interest rate adjustments. The discount on loans receivable will be amortized to interest income over the estimated remaining life of the acquired loans using the level yield method.

To estimate the fair value of collateral dependent problem loans, we analyzed the value of the underlying collateral of the loans, assuming the fair values of the loans were derived from the eventual sale of the collateral. We discounted those values using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral. There was no carryover of Hampshire First's allowance for credit losses associated with the loans we acquired as the loans were initially recorded at fair value.

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Information about the acquired loan portfolio as of June 8, 2012 is as follows (in thousands):

Contractually required principal and interest at acquisition	$226,631
Contractual cash flows not expected to be collected	(7,985)
Expected cash flows at acquisition	218,646
Interest component of expected cash flows (accretable premium)	155
Fair value of acquired loans	$218,801

The core deposit intangible asset recognized as part of the Hampshire First merger is being amortized over its estimated useful life of approximately ten years utilizing an accelerated method.

The goodwill is not amortized for book purposes and is not deductible for tax purposes.

The fair value of savings and transaction deposit accounts acquired from Hampshire First was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. Certificates of deposit were valued by comparing the contractual cost of the portfolio to an identical portfolio bearing current market rates. The projected cash was calculated by discounting their contractual cash flows at a market rate for a certificate of deposit with a corresponding maturity.

In addition to the goodwill and intangible assets from the Hampshire First merger noted above, the Company also acquired approximately $1.9 million of goodwill and $1.4 million of other intangible assets from other acquisition activity during 2012.

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(3)Earnings Per Share

The following is a reconciliation of basic and diluted earnings per share for the years presented in the consolidated statements of income:

	Years ended December 31,								
	2012			2011			2010		
(In thousands, except per share data)	Net income	Weighted average shares	Per share amount	Net income	Weighted average shares	Per share amount	Net income	Weighted average shares	Per share amount
Basic earnings per share	$54,558	33,379	$1.63	$57,901	33,662	$1.72	$57,404	34,275	$1.67
Effect of dilutive securities									
Stock based compensation		340			262			234	
Diluted earnings per share	$54,558	33,719	$1.62	$57,901	33,924	$1.71	$57,404	34,509	$1.66

There were approximately 1,193,000, 1,258,000, and 1,309,000 weighted average stock options for the years ended December 31, 2012, 2011, and 2010, respectively, that were not considered in the calculation of diluted earnings per share since the stock options' exercise prices were greater than the average market price during these periods.

(4) Federal Reserve Bank Requirement

The Company is required to maintain reserve balances with the Federal Reserve Bank of New York. The required average total reserve for NBT Bank for the 14-day maintenance period ending December 26, 2012 was $35.2 million.

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(5)Securities

The amortized cost, estimated fair value, and unrealized gains and losses of securities available for sale are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
December 31, 2012				
U.S. Treasury	$63,668	$757	$-	$64,425
Federal Agency	281,398	1,507	91	282,814
State & municipal	82,675	4,127	-	86,802
Mortgage-backed	237,461	12,820	-	250,281
Collateralized mortgage obligations	443,972	5,751	-	449,723
Corporate	-	-	-	-
Other securities	11,210	2,832	88	13,954
Total securities available for sale	$1,120,384	$27,794	$179	$1,147,999
December 31, 2011				
U.S. Treasury	$81,006	$1,228	$-	$82,234
Federal Agency	254,983	879	16	255,846
State & municipal	99,176	5,624	11	104,789
Mortgage-backed	310,767	14,629	-	325,396
Collateralized mortgage obligations	459,067	6,458	51	465,474
Corporate	-	-	-	-
Other securities	8,935	2,021	76	10,880
Total securities available for sale	$1,213,934	$30,839	$154	$1,244,619

In the available for sale category at December 31, 2012, federal agency securities were comprised of Government-Sponsored Enterprise (“GSE”) securities; mortgaged-backed securities were comprised of GSEs with an amortized cost of $221.1 million and a fair value of $232.3 million and US Government Agency securities with an amortized cost of $16.4 million and a fair value of $18.0 million; Collateral Mortgage Obligations (“CMOs”) were comprised of GSEs with an amortized cost of $399.2 million and a fair value of $403.6 million and U.S. Government Agency securities with an amortized cost of $44.8 million and a fair value of $46.2 million. At December 31, 2012, all of the mortgaged-backed securities held to maturity were comprised of U.S. Government Agency securities.

In the available for sale category at December 31, 2011, federal agency securities were comprised of GSE securities; mortgaged-backed securities were comprised of GSEs with an amortized cost of $290.2 million and a fair value of $303.0 million and U.S. Government Agency securities with an amortized cost of $20.5 million and a fair value of $22.4 million; CMOs were comprised of GSEs with an amortized cost of $398.3 million and a fair value of $402.4 million and U.S. Government Agency securities with an amortized cost of $60.8 million and a fair value of $63.1 million.

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The following table sets forth information with regard to sales transactions of securities available for sale:

	Years ended December 31		
(In thousands)	2012	2011	2010
Proceeds from sales	$ 1,790	$ 2,437	$ 103,253
Gross realized gains	$ 442	$ 7	$ 3,170
Gross realized losses	-	(165)	(25)
Net securities gains (losses)	$ 442	$ (158)	$ 3,145

In addition to gains (losses) from sales transactions, the Company also recorded gains from calls on securities available for sale of approximately $0.2 million for the year ended December 31, 2012, $0.3 million for the year ended December 31, 2011, and $0.1 million for the year ended December 31, 2010.

At December 31, 2012 and 2011, securities available for sale with amortized costs totaling $1.2 billion, respectively, were pledged to secure public deposits and for other purposes required or permitted by law. Additionally, at December 31, 2012, securities available for sale with an amortized cost of $209.0 million were pledged as collateral for securities sold under the repurchase agreements.

The amortized cost, estimated fair value, and unrealized gains and losses of securities held to maturity are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
December 31, 2012				
Mortgage-backed	$1,168	$184	$-	$1,352
State & municipal	59,395	788	-	60,183
Total securities held to maturity	$60,563	$972	$-	$61,535
December 31, 2011				
Mortgage-backed	$1,447	$213	$-	$1,660
State & municipal	69,364	1,174	-	70,538
Total securities held to maturity	$70,811	$1,387	$-	$72,198

At December 31, 2012 and 2011, all of the mortgaged-backed securities held to maturity were comprised of U.S. Government Agency securities.

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The following table sets forth information with regard to investment securities with unrealized losses at December 31, 2012 and 2011, segregated according to the length of time the securities had been in a continuous unrealized loss position:

	Less than 12 months			12 months or longer			Total		
Security Type:	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions
December 31, 2012									
U.S. Treasury	$ -	$ -	-	$ -	$ -	-	$ -	$ -	-
Federal agency	39,906	(91)	4	-	-	-	39,906	(91)	4
State & municipal	-	-	-	-	-	-	-	-	-
Mortgage-backed	-	-	-	-	-	-	-	-	-
Collateralized mortgage obligations	23	-	2	-	-	-	23	-	2
Other securities	468	(6)	1	167	(82)	1	635	(88)	2
Total securities with unrealized losses	$ 40,397	$ (97)	7	$ 167	$ (82)	1	$ 40,564	$ (179)	8
December 31, 2011									
U.S. Treasury	$ -	$ -	-	$ -	$ -	-	$ -	$ -	-
Federal agency	34,996	(16)	3	-	-	-	34,996	(16)	3
State & municipal	957	(10)	3	377	(1)	2	1,334	(11)	5
Mortgage-backed	-	-	-	-	-	-	-	-	-
Collateralized mortgage obligations	27,368	(51)	3	-	-	-	27,368	(51)	3
Other securities	645	(76)	2	-	-	-	645	(76)	2
Total securities with unrealized losses	$ 63,966	$ (153)	11	$ 377	$ (1)	2	$ 64,343	$ (154)	13

Management has the intent to hold the securities classified as held to maturity until they mature, at which time it is believed the Company will receive full value for the securities. Furthermore, as of December 31, 2012, management also had intent to hold, and will not be required to sell, the securities classified as available for sale for a period of time sufficient for a recovery of cost, which may be until maturity. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether or not it will receive the contractual principal and interest on certain securities. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. As of December 31, 2012, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment losses have been realized in the Company's consolidated statements of income.

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The following tables set forth information with regard to contractual maturities of debt securities at December 31, 2012:

(In thousands)	Amortized cost	Estimated fair value
Debt securities classified as available for sale		
Within one year	$ 26,678	$ 26,788
From one to five years	193,142	195,953
From five to ten years	311,575	319,229
After ten years	577,779	592,075
	$ 1,109,174	$ 1,134,045
Debt securities classified as held to maturity		
Within one year	$ 25,184	$ 25,258
From one to five years	27,413	28,118
From five to ten years	5,425	5,434
After ten years	2,541	2,725
	$ 60,563	$ 61,535

Maturities of mortgage-backed, CMOs and asset-backed securities are stated based on their estimated average lives. Actual maturities may differ from estimated average lives or contractual maturities because, in certain cases, borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Except for U.S. Government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of consolidated stockholders' equity at December 31, 2012 and 2011.

(6) Loans

A summary of loans, net of deferred fees and origination costs, by category is as follows:

(In thousands)	At December 31, 2012	2011
Residential real estate mortgages	$ 651,107	$ 581,511
Commercial	694,799	611,298
Commercial real estate	1,072,807	888,879
Real estate construction and development	123,078	93,977
Agricultural and agricultural real estate mortgages	112,687	108,423
Consumer	1,047,856	946,470
Home equity	575,282	569,645
Total loans	$ 4,277,616	$ 3,800,203

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Included in the above loans are net deferred loan origination costs totaling $0.9 million and $1.6 million at December 31, 2012 and 2011, respectively. The Company had residential loans held for sale totaling $3.8 million as of December 31, 2012 and $2.7 million as of December 31, 2011.

FHLB advances are collateralized by a blanket lien on the Company's residential real estate mortgages.

(7) Allowance for Loan Losses and Credit Quality of Loans

Allowance for Loan Losses

The allowance for loan losses is maintained at a level estimated by management to provide adequately for risk of probable losses inherent in the current loan portfolio. The adequacy of the allowance for loan losses is continuously monitored. It is assessed for adequacy using a methodology designed to ensure the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan portfolio.

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into three portfolio segments, each with different risk characteristics and methodologies for assessing risk. Each portfolio segment is broken down into class segments where appropriate. Class segments contain unique measurement attributes, risk characteristics and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type, and risk characteristics define each class segment. The following table illustrates the portfolio and class segments for the Company's loan portfolio:

Portfolio	Class
Commercial Loans	Commercial
	Commercial Real Estate
	Agricultural
	Agricultural Real Estate
	Business Banking
Consumer Loans	Indirect
	Home Equity
	Direct
Residential Real Estate Mortgages	

COMMERCIAL LOANS

Commercial – The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans by the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable and is generally less liquid than real estate. To reduce the risk, management also attempts to secure real estate as collateral and obtain personal guarantees of the borrowers.

Commercial Real Estate – The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and other non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition, and a detailed analysis of the borrower's underlying cash flows. These loans are typically originated in amounts of no more than 80% of the appraised value of the property.

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Agricultural – The Company offers a variety of agricultural loans to meet the needs of our agricultural customers including term loans, time notes, and lines of credit. These loans are made to purchase livestock, purchase and modernize equipment, and finance seasonal crop expenses. Generally, a collateral lien is placed on the livestock, equipment, produce inventories, and/or receivables owned by the borrower. These loans may carry a higher risk than commercial and agricultural real estate loans due to the industry price volatility and the perishable nature of the underlying collateral. To reduce these risks, management may attempt to secure these loans with additional real estate collateral, obtain personal guarantees of the borrowers, or obtain government loan guarantees to provide further support.

Agricultural Real Estate – The Company offers real estate loans to our agricultural customers to finance farm related real estate purchases, refinancings, expansions, and improvements to agricultural properties. Agricultural real estate loans are made to finance the purchases and improvements of farm properties that generally consist of barns, production facilities, and land. The agricultural real estate loans are secured by first liens on the farm real estate. Because they are secured by land and buildings, these loans may be less risky than agricultural loans. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition, and a detailed analysis of the borrower's underlying cash flows. These loans are typically originated in amounts of no more than 75% of the appraised value of the property. Government loan guarantees may be obtained to provide further support.

Business Banking - The Company offers a variety of loan options to meet the specific needs of our small business customers including term loans, small business mortgages and lines of credit. Such loans are generally less than $500 thousand and are made available to businesses for working capital such as inventory and receivables, business expansion, equipment purchases, and agricultural needs. Generally, a collateral lien is placed on equipment or other assets owned by the borrower such as inventory and/or receivables. These loans carry a higher risk than commercial loans due to the smaller size of the borrower and lower levels of capital. To reduce the risk, the Company obtains personal guarantees of the owners for a majority of the loans.

CONSUMER LOANS

Indirect – The Company maintains relationships with many dealers primarily in the communities that we serve. Through these relationships, the company finances the purchases of automobiles and recreational vehicles (such as campers, boats, etc.) indirectly through dealer relationships. Approximately 70% of the indirect relationships represent automobile financing. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to six years, based upon the nature of the collateral and the size of the loan. The majority of indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Home Equity – The Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Consumers are able to borrower up to 85% of the equity in their homes. The Company originates home equity lines of credit and second mortgage loans (loans secured by a second lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position with respect to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Direct – The Company offers a variety of consumer installment loans to finance vehicle purchases, mobile home purchases and personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed or a customer's deposit account. In addition to installment loans, the Company also offers personal lines of credit and overdraft

protection. A minimal amount of loans are unsecured, which carry a higher risk of loss.

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RESIDENTIAL REAL ESTATE LOANS

Residential real estate loans consist primarily of loans secured by first or second deeds of trust on primary residences. We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. When market conditions are favorable, for longer term, fixed-rate residential mortgages without escrow, the Company retains the servicing, but sells the right to receive principal and interest to Freddie Mac when market conditions are favorable. This practice allows the Company to manage interest rate risk, liquidity risk, and credit risk. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower), or have private mortgage insurance. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period.

Allowance for Loan Loss Calculation

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the inherent uncertainty in evaluating the levels of the allowance required to cover credit losses in the portfolio and the material effect that such judgments can have on the consolidated results of operations.

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectibility of the portfolio. For individually analyzed loans, these include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectibility. These factors include: past loss experience; size, trend, composition, and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make loan grade changes as well as recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions to the allowance for loan losses are made periodically by charges to the provision for loan losses. These charges are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions to the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above. The following table illustrates the changes in the allowance for loan losses by portfolio segment for the years ended December 31, 2012 and 2011

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Allowance for Loan Losses
(in thousands)

Years ended December 31	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
Balance as of December 31, 2011	$ 38,831	$ 26,049	$ 6,249	$ 205	$ 71,334
Charge-offs	(8,750)	(15,848)	(1,906)	-	(26,504)
Recoveries	1,641	2,556	38	-	4,235
Provision	3,902	14,405	1,871	91	20,269
Ending Balance as of December 31, 2012	$ 35,624	$ 27,162	$ 6,252	$ 296	$ 69,334
Balance as of December 31, 2010	$ 40,101	$ 26,126	$ 4,627	$ 380	$ 71,234
Charge-offs	(8,969)	(14,209)	(1,310)	-	(24,488)
Recoveries	1,438	2,406	7	-	3,851
Provision	6,261	11,726	2,925	(175)	20,737
Ending Balance as of December 31, 2011	$ 38,831	$ 26,049	$ 6,249	$ 205	$ 71,334
Balance as of December 31, 2009	$ 36,599	$ 26,664	$ 3,002	$ 285	$ 66,550
Charge-offs	(12,969)	(15,692)	(1,176)	-	(29,837)
Recoveries	1,922	2,747	43	-	4,712
Provision	14,549	12,407	2,758	95	29,809
Ending Balance as of December 31, 2010	$ 40,101	$ 26,126	$ 4,627	$ 380	$ 71,234

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The following table illustrates the allowance for loan losses and the recorded investment by portfolio segment as of December 31, 2012 and 2011:

Allowance for Loan Losses and Recorded Investment in Loans
(in thousands)

	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
As of December 31, 2012					
Allowance for loan losses	$ 35,624	$27,162	$6,252	$296	$69,334
Allowance for loans individually evaluated for impairment	$ 2,848	$-	$-		$2,848
Allowance for loans collectively evaluated for impairment	$ 32,776	$27,162	$6,252	$296	$66,486
Ending balance of loans	$ 2,003,371	$1,623,138	$651,107		$4,277,616
Ending balance of loans individually evaluated for impairment	$ 11,972	$-	$-		$11,972
Ending balance of loans collectively evaluated for impairment	$ 1,991,399	$1,623,138	$651,107		$4,265,644
As of December 31, 2011					
Allowance for loan losses	$ 38,831	$26,049	$6,249	$205	$71,334
Allowance for loans individually evaluated for impairment	$ 175	$-	$-		$175
Allowance for loans collectively evaluated for impairment	$ 38,656	$26,049	$6,249	$205	$71,159
Ending balance of loans	$ 1,702,577	$1,516,115	$581,511		$3,800,203
Ending balance of loans individually evaluated for impairment	$ 6,219	$-	$-		$6,219
Ending balance of loans collectively evaluated for impairment	$ 1,696,358	$1,516,115	$581,511		$3,793,984

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Credit Quality of Loans

For all loan classes within the Company's loan portfolio, loans are placed on nonaccrual status when timely collection of principal and interest in accordance with contractual terms is doubtful. Loans are transferred to nonaccrual status generally when principal or interest payments become ninety days delinquent, unless the loan is well secured and in the process of collection, or sooner when management concludes or circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan losses.

If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. For all loan classes within the Company's loan portfolio, nonaccrual loans are returned to accrual status when they become current as to principal and interest and demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. For loans in all portfolios, the principal amount is charged off in full or in part as soon as management determines, based on available facts, that the collection of principal in full is improbable. For commercial loans, management considers specific facts and circumstances relative to individual credits in making such a determination. For consumer and residential loan classes, management uses specific guidance and thresholds from the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy.

The following table illustrates the Company's nonaccrual loans by loan class as of December 31, 2012 and 2011:

Loans on Nonaccrual Status
As of December 31, 2012

(In thousands)	December 31, 2012	December 31, 2011
Commercial Loans		
Commercial	$ 4,985	$ 1,699
Commercial Real Estate	7,977	4,868
Agricultural	699	3,307
Agricultural Real Estate	1,038	2,067
Business Banking	6,738	7,446
	21,437	19,387
Consumer Loans		
Indirect	1,557	1,550
Home Equity	7,247	7,931
Direct	266	378
	9,070	9,859
Residential Real Estate Mortgages	9,169	9,044
Total Nonaccrual	$ 39,676	$ 38,290

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The following table sets forth information with regard to past due and nonperforming loans by loan class:

Age Analysis of Past Due Loans
As of December 31, 2012
(in thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Non-Accrual	Current	Recorded Total Loans and Leases
Commercial							
Commercial	$-	$-	$ -	$-	$ 4,985	$556,496	$561,481
Commercial Real Estate	126	-	-	126	7,977	966,692	974,795
Agricultural	22	-	-	22	699	63,037	63,758
Agricultural Real Estate	108	-	103	211	1,038	36,128	37,377
Business Banking	3,019	708	45	3,772	6,738	355,450	365,960
	3,275	708	148	4,131	21,437	1,977,803	2,003,371
Consumer							
Indirect	10,956	2,477	1,205	14,638	1,557	964,802	980,997
Home Equity	6,065	1,223	681	7,969	7,247	560,066	575,282
Direct	717	144	84	945	266	65,648	66,859
	17,738	3,844	1,970	23,552	9,070	1,590,516	1,623,138
Residential Real Estate Mortgages	1,839	725	330	2,894	9,169	639,044	651,107
	$22,852	$5,277	$ 2,448	$30,577	$ 39,676	$4,207,363	$4,277,616

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Age Analysis of Past Due Loans

As of December 31, 2011
(in thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Non-Accrual	Current	Recorded Total Loans and Leases
Commercial Loans							
Commercial	$663	$50	$ -	$713	$ 1,699	$508,662	$511,074
Commercial Real Estate	1,942	-	-	1,942	4,868	828,089	834,899
Agricultural	77	13	-	90	3,307	63,140	66,537
Agricultural Real Estate	-	-	50	50	2,067	31,809	33,926
Business Banking	1,871	1,024	-	2,895	7,446	245,800	256,141
	4,553	1,087	50	5,690	19,387	1,677,500	1,702,577
Consumer Loans							
Indirect	12,141	2,584	1,283	16,008	1,550	855,545	873,103
Home Equity	5,823	1,277	954	8,054	7,931	553,660	569,645
Direct	831	191	140	1,162	378	71,827	73,367
	18,795	4,052	2,377	25,224	9,859	1,481,032	1,516,115
Residential Real Estate							
Mortgages	2,003	139	763	2,905	9,044	569,562	581,511
	$25,351	$5,278	$ 3,190	$33,819	$ 38,290	$3,728,094	$3,800,203

There were no material commitments to extend further credit to borrowers with nonperforming loans. Within nonaccrual loans, there were approximately $2.2 million and $4.0 million of TDR loans at December 31, 2012 and 2011, respectively.

Impaired loans, which primarily consist of nonaccruing commercial, commercial real estate, agricultural, agricultural real estate and business banking loans, as well as certain consumer and residential real estate loans that have been modified in a TDR were $26.0 million at December 31, 2012 and $22.4 million at December 31, 2011.

The methodology used to establish the allowance for loan losses on impaired loans incorporates specific allocations on loans analyzed individually. Classified loans, including all TDRs and commercial loans that are graded substandard or below, with outstanding balances of $500 thousand or more are evaluated for impairment through the Company's quarterly status review process. In determining that we will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated. For loans that are evaluated for impairment, impairment is measured by one of three methods: 1) the fair value of collateral less cost to

sell, 2) present value of expected future cash flows or 3) the loan's observable market price. These impaired loans are reviewed on a quarterly basis for changes in the measurement of impairment. For impaired loans measured using the present value of expected cash flow method, any change to the previously recognized impairment loss is recognized as a change to the allowance account and recorded in the consolidated statement of income as a component of the provision for credit losses. At December 31, 2012, $8.4 million of the total impaired loans had a specific reserve allocation of $2.8 million compared to $0.5 million of impaired loans at December 31, 2011 which had a specific reserve allocation of $0.2 million.

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The following provides additional information on impaired loans for the years ended December 31, 2012 and 2011:

Impaired Loans

(in thousands)	December 31, 2012 Recorded Investment Balance (Book)	December 31, 2012 Unpaid Principal Balance (Legal)	December 31, 2012 Related Allowance	December 31, 2011 Recorded Investment Balance (Book)	December 31, 2011 Unpaid Principal Balance (Legal)	December 31, 2011 Related Allowance
With no related allowance recorded:						
Commercial Loans						
Commercial	$ 650	$ 709		$ 1,243	$ 2,723	
Commercial Real Estate	3,909	4,753		4,868	7,165	
Agricultural	699	1,019		3,307	4,166	
Agricultural Real Estate	1,038	1,225		2,067	2,288	
Business Banking	6,738	9,269		7,446	9,976	
Total Commercial Loans	13,034	16,975		18,931	26,318	
Consumer Loans						
Home Equity	2,553	2,657		2,000	2,103	
Residential Real Estate Mortgages	2,011	2,308		1,040	1,125	
	17,598	21,940		21,971	29,546	
With an allowance recorded:						
Commercial Loans						
Commercial	$ 4,335	$ 4,340	$ 2,241	$ 456	$ 808	$ 175
Commercial Real Estate	4,068	5,689	607	-	-	-
Agricultural	-	-	-	-	-	-
Agricultural Real Estate	-	-	-	-	-	-
	8,403	10,029	2,848	456	808	175
Total:	$ 26,001	$ 31,969	$ 2,848	$ 22,427	$ 30,354	$ 175

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The following table summarizes the average recorded investments on impaired loans and the interest income recognized for the years ended December 31, 2012, 2011 and 2010:

	December 31, 2012			December 31, 2011			December 31, 2010		
	Average Recorded	Interest Income Recognized		Average Recorded	Interest Income Recognized		Average Recorded	Interest Income Recognized	
(in thousands)	Investment	Accrual	Cash	Investment	Accrual	Cash	Investment	Accrual	Cash
With no related allowance recorded:									
Commercial Loans									
Commercial	$1,421	$25	$25	$2,322	$94	$94	$1,898	$113	$113
Commercial Real Estate	6,167	70	70	4,794	163	163	4,219	317	317
Agricultural	2,611	368	368	3,013	133	133	2,990	82	82
Agricultural Real Estate	1,575	86	86	1,719	109	109	1,929	150	150
Business Banking	6,636	227	227	6,121	266	266	4,959	234	234
Consumer Loans									
Home Equity	1,877	66	66	1,904	91	91	-	-	-
Residential Real Estate Mortgages	1,143	73	73	926	58	58	132	6	6
	$21,429	$915	$915	$20,798	$914	$914	$16,127	$902	$902
With an allowance recorded:									
Commercial Loans									
Commercial	$4,217	$43	$43	$861	$86	$86	$2,366	$118	$118
Commercial Real Estate	339	-	-	287	-	-	1,234	-	-
Agricultural	-	-	-	791	68	68	1,386	150	150
Agricultural Real Estate	-	-	-	357	18	18	816	67	67
	$4,556	$43	$43	$2,295	$172	$172	$5,802	$335	$335
Total:	$25,985	$958	$958	$23,094	$1,086	$1,086	$21,929	$1,237	$1,237

There has been significant disruption and volatility in the financial and capital markets since the second half of 2008. Turmoil in the mortgage market adversely impacted both domestic and global markets and led to a significant credit and liquidity crisis in many domestic markets. These market conditions were attributable to a variety of factors, in particular the fallout associated with subprime mortgage loans (a type of lending we have never actively pursued). The disruption was exacerbated by the decline of the real estate and housing market. However, in the markets in which the Company does business, the disruption has been less significant than in the national market. For

example, our real estate market has not suffered the extreme declines seen nationally and our unemployment rate, while notably higher than in prior periods, is still below the national average.

While we continue to adhere to prudent underwriting standards, as a lender we may be adversely impacted by general economic weaknesses and, in particular, a sharp downturn in the housing market nationally. Decreases in real estate values could adversely affect the value of property used as collateral for our loans. Adverse changes in the economy may have a negative effect on the ability of our borrowers to make timely loan payments, which would have an adverse impact on our earnings. A further increase in loan delinquencies would decrease our net interest income and adversely impact our loan loss experience, causing increases in our provision and allowance for loan losses.

The Company has developed an internal loan grading system to evaluate and quantify the Bank's loan portfolio with respect to quality and risk. The system focuses on, among other things, financial strength of borrowers, experience and depth of management, primary and secondary sources of repayment, payment history, nature of the business, outlook on particular industries. The internal grading system enables the Company to monitor the quality of the entire loan portfolio on a continuous basis and provide management with an early warning system, enabling recognition and response to problem loans and potential problem loans.
Commercial Grading System

For commercial and agricultural loans, the Company uses a grading system that relies on quantifiable and measurable characteristics when available. This would include comparison of financial strength to available industry averages, comparison of transaction factors (loan terms and conditions) to loan policy, and comparison of credit history to stated repayment terms and industry averages. Some grading factors are necessarily more subjective such as economic and industry factors, regulatory environment, and management. The grading system for commercial and agricultural loans is as follows:

- 4 – Doubtful

A doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral, and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Because of high probability of loss, nonaccrual treatment is required for doubtful assets.

- 3 – Substandard

Substandard loans have a high probability of payment default, or they have other well-defined weaknesses. They require more intensive supervision by bank management. Substandard loans are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. For some substandard loans, the likelihood of full collection of interest and principal may be in doubt and should be placed on nonaccrual. Although substandard assets in the aggregate will have a distinct potential for loss, an individual asset's loss potential does not have to be distinct for the asset to be rated substandard.

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- 2 – Special Mention

Special Mention loans have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the Company's position at some future date. These loans pose elevated risk, but their weakness does not yet justify a substandard classification. Borrowers may be experiencing adverse operating trends (declining revenues or margins) or may be struggling with an ill-proportioned balance sheet (e.g., increasing inventory without an increase in sales, high leverage, tight liquidity). Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a special mention rating. Although a Special Mention loan has a higher probability of default than a pass asset, its default is not imminent.

- 1 – Pass

Loans graded as Pass encompass all loans not graded as Doubtful, Substandard, or Special Mention. Pass loans are in compliance with loan covenants, and payments are generally made as agreed. Pass loans range from superior quality to fair quality.

Business Banking Grading System

Business Banking loans are graded as either Classified or Non-classified:

- Classified

Classified loans are inadequately protected by the current worth and paying capacity of the obligor or, if applicable, the collateral pledged. These loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt, or in some cases make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Classified loans have a high probability of payment default, or a high probability of total or substantial loss. These loans require more intensive supervision by management and are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. When the likelihood of full collection of interest and principal may be in doubt; classified loans are considered to have a nonaccrual status. In some cases, classified loans are considered uncollectible and of such little value that their continuance as assets is not warranted.

- Non-classified

Loans graded as Non-classified encompass all loans not graded as Classified. Non-classified loans are in compliance with loan covenants, and payments are generally made as agreed.

Consumer and Residential Mortgage Grading System

Consumer and Residential Mortgage loans are graded as either Performing or Nonperforming. Nonperforming loans are loans that are 1) over 90 days past due and interest is still accruing or 2) on nonaccrual status. All loans not meeting any of these three criteria are considered Performing.

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The following tables illustrates the Company's credit quality by loan class for the years ended December 31, 2012 and 2011:

Credit Quality Indicators
As of December 31, 2012

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Pass	$ 522,985	$ 901,928	$ 57,347	$ 33,472	$ 1,515,732
Special Mention	18,401	32,135	13	3	50,552
Substandard	17,351	40,732	6,362	3,902	68,347
Doubtful	2,744	-	36	-	2,780
Total	$ 561,481	$ 974,795	$ 63,758	$ 37,377	$ 1,637,411

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 342,528	$ 342,528
Classified	23,432	23,432
Total	$ 365,960	$ 365,960

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 978,235	$ 567,354	$ 66,509	$ 1,612,098
Nonperforming	2,762	7,928	350	11,040
Total	$ 980,997	$ 575,282	$ 66,859	$ 1,623,138

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 641,608	$ 641,608
Nonperforming	9,499	9,499
Total	$ 651,107	$ 651,107

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Credit Quality Indicators
As of December 31, 2011

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Pass	$ 470,332	$ 758,673	$ 58,481	$ 28,927	$ 1,316,413
Special Mention	10,346	24,478	42	10	34,876
Substandard	29,940	51,748	7,945	4,989	94,622
Doubtful	456	-	69	-	525
Total	$ 511,074	$ 834,899	$ 66,537	$ 33,926	$ 1,446,436

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 237,887	$ 237,887
Classified	18,254	18,254
Total	$ 256,141	$ 256,141

Consumer Credit Exposure