BERKSHIRE HILLS BANCORP INC
Form 10-Q
November 12, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: September 30, 2013

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

For the transition period from to

Commission File Number: 001-15781

BERKSHIRE HILLS BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3510455**

(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
24 North Street, Pittsfield, Massachusetts	**01201**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(413) 443-5601**

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer o	Accelerated Filer x
Non-Accelerated Filer o	Smaller Reporting Company o

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

The Registrant had 25,037,224 shares of common stock, par value $0.01 per share, outstanding as of November 6, 2013.

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PART I

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	September 30, 2013	December 31, 2012
Assets		
Cash and due from banks	$ 61,149	$ 63,382
Short-term investments	15,710	34,862
Total cash and cash equivalents	76,859	98,244
Trading security	15,330	16,893
Securities available for sale, at fair value	684,716	466,169
Securities held to maturity (fair values of $48,080 and $52,490)	46,925	51,024
Federal Home Loan Bank stock and other restricted securities	42,342	39,785
Total securities	789,313	573,871
Loans held for sale, at fair value	27,064	85,368
Residential mortgages	1,313,609	1,324,251
Commercial mortgages	1,366,104	1,413,544
Commercial business loans	668,983	600,126
Consumer loans	675,147	650,733
Total loans	4,023,843	3,988,654
Less: Allowance for loan losses	(33,248)	(33,208)
Net loans	3,990,595	3,955,446
Premises and equipment, net	83,136	86,461
Other real estate owned	3,561	1,929
Goodwill	256,871	255,199
Other intangible assets	15,030	19,059
Cash surrender value of bank-owned life insurance policies	100,299	88,198
Deferred tax assets, net	61,617	57,729
Other assets	45,911	75,305
Total assets	$ 5,450,256	$ 5,296,809
Liabilities		
Demand deposits	$ 669,878	$ 673,921
NOW deposits	352,762	379,880
Money market deposits	1,357,201	1,439,632
Savings deposits	438,135	436,387
Time deposits	1,064,049	1,170,589
Total deposits	3,882,025	4,100,409
Short-term debt	590,000	163,150
Long-term Federal Home Loan Bank advances	150,022	195,321

Subordinated notes		89,663		89,617
Total borrowings		829,685		448,088
Other liabilities		65,351		81,047
Total liabilities		4,777,061		4,629,544
Stockholders equity				
Common stock ($.01 par value; 50,000,000 shares authorized and 26,525,466 shares issued and 24,952,204 shares outstanding in 2013; 26,525,466 shares issued and 25,148,522 shares outstanding in 2012)		265		265
Additional paid-in capital		587,041		585,360
Unearned compensation		(4,211)		(3,035)
Retained earnings		135,991		122,014
Accumulated other comprehensive loss		(7,029)		(2,979)
Treasury stock, at cost (1,573,262 shares in 2013 and 1,376,944 shares in 2012)		(38,862)		(34,360)
Total stockholders equity		673,195		667,265
Total liabilities and stockholders equity	$	5,450,256	$	5,296,809

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

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Interest and dividend income				
Loans	$ 50,025	$ 39,497	$ 142,549	$ 113,335
Securities and other	4,479	3,626	12,533	11,116
Total interest and dividend income	54,504	43,123	155,082	124,451
Interest expense				
Deposits	5,278	5,628	15,693	16,612
Borrowings and junior subordinated notes	3,357	2,270	10,479	6,416
Total interest expense	8,635	7,898	26,172	23,028
Net interest income	45,869	35,225	128,910	101,423
Non-interest income				
Loan related income	1,308	1,340	6,669	3,990
Mortgage banking income	444	4,306	4,790	6,553
Deposit related fees	4,559	3,775	13,623	11,238
Insurance commissions and fees	2,473	2,742	7,877	8,256
Wealth management fees	2,137	1,774	6,471	5,431
Total fee income	10,921	13,937	39,430	35,468
Other	832	375	1,722	885
Gain on sale of securities, net	361		1,366	7
Non-recurring gain		1		43
Total non-interest income	12,114	14,313	42,518	36,403
Total net revenue	57,983	49,538	171,428	137,826
Provision for loan losses	3,178	2,500	8,278	6,750
Non-interest expense				
Compensation and benefits	18,506	15,992	54,398	45,219
Occupancy and equipment	5,614	4,599	17,119	13,484
Technology and communications	3,304	2,302	9,775	6,518
Marketing and promotion	590	419	1,831	1,548
Professional services	1,757	1,327	5,011	4,185
FDIC premiums and assessments	856	907	2,574	2,458
Other real estate owned and foreclosures	138	42	445	215
Amortization of intangible assets	1,307	1,314	4,029	3,982
Merger, restructuring and conversion related expenses	6,516	2,214	12,355	10,522
Other	4,196	3,046	12,665	8,409
Total non-interest expense	42,784	32,162	120,202	96,540
Income from continuing operations before income taxes	12,021	14,876	42,948	34,536
Income tax expense	3,917	4,847	12,342	10,040
Net income from continuing operations	8,104	10,029	30,606	24,496
Loss from discontinued operations before income taxes (including gain on disposal of $63 in 2012)				(261)
Income tax expense				376
Net loss from discontinued operations				(637)
Net income	$ 8,104	$ 10,029	$ 30,606	$ 23,859
Basic earnings per share:				

Continuing operations	$	0.33	$	0.46	$	1.23	$	1.14
Discontinued operations								(0.03)
Total basic earnings per share	$	0.33	$	0.46	$	1.23	$	1.11
Diluted earnings per share:								
Continuing operations	$	0.33	$	0.46	$	1.22	$	1.13
Discontinued operations								(0.03)
Total diluted earnings per share	$	0.33	$	0.46	$	1.22	$	1.10
Weighted average common shares outstanding:								
Basic		24,748		21,921		24,835		21,541
Diluted		24,873		22,031		25,001		21,635

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

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)	**Three Months Ended September 30, 2013**	**Three Months Ended September 30, 2012**	**Nine Months Ended September 30, 2013**	**Nine Months Ended September 30, 2012**
Net income	$ 8,104	$ 10,029	$ 30,606	$ 23,859
Other comprehensive income, before tax:				
Changes in unrealized gains and losses on securities available-for-sale	(443)	2,103	(13,141)	4,790
Changes in unrealized gains and losses on derivative hedges	(1,152)	(1,015)	6,446	(3,219)
Changes in unrealized gains and losses on terminated swaps	236	235	707	706
Changes in unrealized gains and losses on pension				(257)
Income taxes related to other comprehensive income:				
Changes in unrealized gains and losses on securities available-for-sale	163	(765)	4,920	(1,729)
Changes in unrealized gains and losses on derivative hedges	472	413	(2,584)	1,358
Changes in unrealized gains and losses on terminated swaps	(95)	(97)	(398)	(226)
Total other comprehensive (loss) income	(819)	874	(4,050)	1,423
Total comprehensive income	$ 7,285	$ 10,903	$ 26,556	$ 25,282

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

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(In thousands)	**Common stock Shares**	**Common stock Amount**	**Additional paid-in capital**	**Unearned compen-sation**	**Retained earnings**	**Accumulated other comp-rehensive loss**	**Treasury stock**	**Total**
Balance at December 31, 2011	21,148	$ 229	$ 494,304	$ (2,790)	$ 109,477	$ (4,885)	$ (42,970)	$ 553,365
Comprehensive income:								
Net income					23,859			23,859
Other comprehensive income						1,423		1,423
Total comprehensive income								25,282
Acquisition of The Connecticut Bank and Trust Company	965	9	21,981					21,990
Cash dividends declared ($0.34 per share)					(11,147)			(11,147)
Forfeited shares	(8)		11	169			(180)	
Exercise of stock options	18				(82)		458	376
Restricted stock grants	108		(280)	(2,434)			2,714	
Stock-based compensation				1,410				1,410
Net tax benefit related to stock-based compensation			40					40
Other, net	(18)						(395)	(395)
Balance at September 30, 2012	22,213	$ 238	$ 516,056	$ (3,645)	$ 122,107	$ (3,462)	$ (40,373)	$ 590,921
Balance at December 31, 2012	25,148	$ 265	$ 585,360	$ (3,035)	$ 122,014	$ (2,979)	$ (34,360)	$ 667,265
Comprehensive income:								
Net income					30,606			30,606
Other comprehensive loss						(4,050)		(4,050)
Total comprehensive income								26,556
Cash dividends declared ($0.54 per share)					(13,587)			(13,587)
Treasury stock purchased	(480)						(12,249)	(12,249)
Forfeited shares	(55)		218	1,256			(1,474)	
Exercise of stock options	235				(3,042)		6,063	3,021
Restricted stock grants	159		(677)	(3,817)			4,494	
Stock-based compensation			726	1,385				2,111
Net tax benefit related to stock-based compensation			1,428					1,428
Other, net	(55)		(14)				(1,336)	(1,350)
Balance at September 30, 2013	24,952	$ 265	$ 587,041	$ (4,211)	$ 135,991	$ (7,029)	$ (38,862)	$ 673,195

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

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Nine months ended September 30, 2013	2012
Cash flows from operating activities:		
Net income	$ 30,606	$ 23,859
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	8,278	6,750
Net amortization of securities	1,199	1,496
Change in unamortized net loan costs and premiums	(7,152)	(849)
Premises and equipment depreciation and amortization expense	5,382	4,553
Stock-based compensation expense	2,111	1,410
Accretion of purchase accounting entries, net	(17,732)	(5,303)
Amortization of other intangibles	4,029	4,182
Excess tax loss from stock-based payment arrangements	(1,428)	(40)
Income from cash surrender value of bank-owned life insurance policies	(2,101)	(1,895)
Gain on sales of securities, net	(1,366)	(50)
Net decrease (increase) in loans held for sale	58,304	(64,979)
Loss on disposition of assets	3,880	1,753
(Gain) loss on sale of real estate	(48)	197
Net change in other	21,640	16,924
Net cash provided by (used in) operating activities	105,602	(11,992)
Cash flows from investing activities:		
Net decrease in trading security	381	361
Proceeds from sales of securities available for sale	8,592	32,473
Proceeds from maturities, calls and prepayments of securities available for sale	91,153	70,499
Purchases of securities available for sale	(331,269)	(108,281)
Proceeds from maturities, calls and prepayments of securities held to maturity	6,857	28,569
Purchases of securities held to maturity	(2,758)	(20,384)
Net increase in loans	(23,930)	(255,657)
Net cash used for divestiture		(48,890)
Purchase of bank owned life insurance	(10,000)	
Proceeds from sale of Federal Home Loan Bank stock	2,361	1,900
Purchase of Federal Home Loan Bank stock	(4,918)	
Purchase of premises and equipment, net	(8,916)	(15,542)
Acquisitions, net of cash paid		(58,150)
Proceeds from sale of other real estate	1,790	2,265
Net cash used in investing activities	(270,657)	(370,837)

(continued)

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

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONCLUDED)

(In thousands)	**Nine months ended September 30, 2013**	**2012**
Cash flows from financing activities:		
Net (decrease) increase in deposits	(216,539)	139,265
Proceeds from Federal Home Loan Bank advances and other borrowings	935,656	433,618
Issuance of long-term debt, net		74,138
Repayments of Federal Home Loan Bank advances and other borrowings	(554,060)	(247,195)
Net proceeds from reissuance of treasury stock		376
Purchase of treasury stock	(12,249)	
Exercise of stock options	3,021	
Excess tax loss from stock-based payment arrangements	1,428	40
Common stock cash dividends paid	(13,587)	(11,147)
Net cash provided by financing activities	143,670	389,095
Net change in cash and cash equivalents	(21,385)	6,266
Cash and cash equivalents at beginning of year	98,244	75,782
Cash and cash equivalents at end of year	$ 76,859	$ 82,048
Supplemental cash flow information:		
Interest paid on deposits	$ 15,707	$ 17,113
Interest paid on borrowed funds	10,550	5,664
Income taxes (refunded) paid, net	(4,023)	4,761
Acquisition of non-cash assets and liabilities:		
Assets acquired		343,114
Liabilities assumed	(1,672)	(253,155)
Other non-cash changes:		
Other net comprehensive (loss) income	(4,050)	1,423
Real estate owned acquired in settlement of loans	3,374	(1,453)

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

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NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and contain all adjustments, consisting solely of normal, recurring adjustments, necessary for a fair presentation of results for such periods.

In addition, these interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X, and accordingly, certain information and footnote disclosures normally included in financial statements prepared according to U.S. GAAP have been omitted.

The results for any interim period are not necessarily indicative of results for the full year. These consolidated financial statements should be read in conjunction with the audited financial statements and note disclosures for Berkshire Hills Bancorp, Inc. (the Company) previously filed with the Securities and Exchange Commission in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

Reclassifications

Certain items in prior financial statements have been reclassified to conform to the current presentation.

Out of Period Adjustments

For the quarter ended September 30, 2013, the Company recorded a correction of an error to recognize $2.2 million in prior period interest income earned on loans acquired in bank acquisitions, of which $1.3 million relates to prior years. Additionally, the Company recorded a correction of an error related to its accounting for a state income tax credit. The correction increased other income by $613 thousand and increased the income tax provision by $1.2 million during the quarter. The adjustment relating to prior years included $505 thousand in other income and $998 thousand in the income tax provision. After evaluating the quantitative and qualitative aspects of these adjustments, the Company concluded that its prior period financial statements were not materially misstated and, therefore, no restatement was required.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Offsetting Assets and Liabilities

In December 2011, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2011-11, Disclosures About Offsetting Assets and Liabilities. This project began as an attempt to converge the offsetting requirements under U.S. GAAP and International Financial Reporting Standards (IFRS). However, as the FASB and International Accounting Standards Board were not able to reach a converged solution with regards to offsetting requirements, they each developed convergent disclosure requirements to assist in reconciling differences in the offsetting requirements under U.S. GAAP and IFRS. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. ASU No. 2011-11 also requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The provisions of ASU No. 2013-01 limit the scope of the new balance sheet offsetting disclosures to the following financial instruments, to the extent they are offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the statement of financial position: (1) derivative financial instruments; (2) repurchase agreements and reverse repurchase agreements; and (3) securities borrowing and securities lending transactions. The Company adopted the provisions of ASU No. 2011-11 and ASU No. 2013-01 effective January 1, 2013. As the provisions of ASU No. 2011-11 and ASU No. 2013-01 only impacted the disclosure requirements related to the offsetting of assets and liabilities and information about instruments and transactions eligible for offset in the statement of financial position, the adoption had no impact on the Company s consolidated statements of income and condition. See Note 12 to the Consolidated Financial Statements for the disclosures required by ASU No. 2011-11 and ASU No. 2013-01.

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Reclassifications Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income, to improve the transparency of reporting these reclassifications. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 requires an entity to disaggregate the total change of each component of other comprehensive income and separately present reclassification adjustments and current period other comprehensive income. The provisions of ASU No. 2013-02 also require that entities present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line item affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, entities would instead cross reference to the related note to the financial statements for additional information. The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the Company provided these required disclosures in the notes to the Consolidated Financial Statements, the adoption of ASU No. 2013-02 had no impact on the Company s consolidated statements of income and condition. See Note 8 to the Consolidated Financial Statements for the disclosures required by ASU No. 2013-02.

Future Application of Accounting Pronouncements

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The provisions of ASU No. 2013-11 require an entity to present an unrecognized tax benefit, or portion thereof, in the statement of financial position as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward, with certain exceptions related to availability. ASU No. 2013-11 is effective for interim and annual reporting periods beginning after December 15, 2013. The adoption of ASU No. 2013-11 is not expected to have a material impact on the Company s Consolidated Financial Statements.

NOTE 3. TRADING SECURITY

The Company holds a tax advantaged economic development bond that is being accounted for at fair value. The security had an amortized cost of $13.2 million and $13.6 million, and a fair value of $15.3 million and $16.9 million, at September 30, 2013 and December 31, 2012, respectively. As discussed further in Note 12 - Derivative Financial Instruments and Hedging Activities, the Company has entered into a swap contract to swap-out the fixed rate of the security in exchange for a variable rate. The Company does not purchase securities with the intent of selling them in the near term, and there are no other securities in the trading portfolio at September 30, 2013.

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NOTE 4. SECURITIES AVAILABLE FOR SALE AND HELD TO MATURITY

The following is a summary of securities available for sale and held to maturity:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2013				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	$ 80,961	$ 2,328	$ (1,901)	$ 81,388
Government-guaranteed residential mortgage-backed securities	74,261	452	(458)	74,255
Government-sponsored residential mortgage-backed securities	443,058	2,415	(5,732)	439,741
Corporate bonds	40,973	50	(1,791)	39,232
Trust preferred securities	16,946	1,124	(1,766)	16,304
Other bonds and obligations	3,257		(131)	3,126
Total debt securities	659,456	6,369	(11,779)	654,046
Equity securities:				
Marketable equity securities	27,683	3,367	(380)	30,670
Total securities available for sale	687,139	9,736	(12,159)	684,716
Securities held to maturity				
Municipal bonds and obligations	5,885			5,885
Government-sponsored residential mortgage-backed securities	74	4		78
Tax advantaged economic development bonds	40,620	1,463	(312)	41,771
Other bonds and obligations	346			346
Total securities held to maturity	46,925	1,467	(312)	48,080
Total	$ 734,064	$ 11,203	$ (12,471)	$ 732,796
December 31, 2012				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	$ 79,498	$ 5,359	$ (100)	$ 84,757
Government-guaranteed residential mortgage-backed securities	42,305	805	(18)	43,092
Government-sponsored residential mortgage-backed securities	275,940	2,732	(79)	278,593
Corporate bonds	9,998	117	(108)	10,007
Trust preferred securities	21,784	1,089	(1,916)	20,957
Other bonds and obligations	3,459	17	(4)	3,472
Total debt securities	432,984	10,119	(2,225)	440,878
Marketable equity securities	22,467	3,187	(363)	25,291
Total securities available for sale	455,451	13,306	(2,588)	466,169
Securities held to maturity				
Municipal bonds and obligations	8,295			8,295
	76	7		83

Government-sponsored residential mortgage-backed securities								
Tax advantaged economic development bonds		41,678		1,837		(378)		43,137
Other bonds and obligations		975						975
Total securities held to maturity		51,024		1,844		(378)		52,490
Total	$	506,475	$	15,150	$	(2,966)	$	518,659

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The amortized cost and estimated fair value of available for sale (AFS) and held to maturity (HTM) securities, segregated by contractual maturity at September 30, 2013 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable. Equity securities have no maturity and are also shown in total.

	Available for sale		Held to maturity	
(In thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Within 1 year	$ 2,999	$ 3,038	$ 2,606	$ 2,606
Over 1 year to 5 years	7,681	7,728	3,485	3,532
Over 5 years to 10 years	53,747	52,338	27,256	28,196
Over 10 years	77,710	76,946	13,504	13,668
Total bonds and obligations	142,137	140,050	46,851	48,002
Marketable equity securities	27,683	30,670		
Residential mortgage-backed securities	517,319	513,996	74	78
Total	$ 687,139	$ 684,716	$ 46,925	$ 48,080

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Securities with unrealized losses, segregated by the duration of their continuous unrealized loss positions, are summarized as follows:

	Less Than Twelve Months		Over Twelve Months		Total	
(In thousands)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
September 30, 2013						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	$ 1,901	$ 15,076	$	$	$ 1,901	$ 15,076
Government-guaranteed residential mortgage-backed securities	458	51,678			458	51,678
Government-sponsored residential mortgage-backed securities	5,732	262,285			5,732	262,285
Corporate bonds	1,791	29,183			1,791	29,183
Trust preferred securities			1,766	1,837	1,766	1,837
Other bonds and obligations	131	2,937			131	2,937
Total debt securities	10,013	361,159	1,766	1,837	11,779	362,996
Marketable equity securities	66	1,704	314	1,686	380	3,390
Total securities available for sale	10,079	362,863	2,080	3,523	12,159	366,386
Securities held to maturity						
Tax advantaged economic development bonds	33	9,513	279	8,042	312	17,555
Total securities held to maturity	33	9,513	279	8,042	312	17,555
Total	$ 10,112	$ 372,376	$ 2,359	$ 11,565	$ 12,471	$ 383,941
December 31, 2012						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	$ 100	$ 4,140	$	$	$ 100	$ 4,140
Government guaranteed residential mortgage-backed securities	18	5,108			18	5,108
Government-sponsored residential mortgage-backed securities	69	31,433	10	5,366	79	36,799
Corporate bonds			108	6,892	108	6,892
Trust preferred securities	1	2,754	1,915	1,686	1,916	4,440
Other bonds and obligations	4	2,055			4	2,055
Total debt securities	192	45,490	2,033	13,944	2,225	59,434
Marketable equity securities	90	1,410	273	1,727	363	3,137
Total securities available for sale	282	46,900	2,306	15,671	2,588	62,571

Securities held to maturity						
Tax advantaged economic development bonds	378	8,129			378	8,129
Total securities held to maturity	378	8,129			378	8,129
Total	$ 660	$ 55,029	$ 2,306	$ 15,671	$ 2,966	$ 70,700

Debt Securities

The Company expects to recover its amortized cost basis on all debt securities in its AFS and HTM portfolios. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of September 30, 2013, prior to this recovery. The Company s ability and intent to hold these securities until recovery is supported by the Company s strong capital and liquidity positions as well as its historically low portfolio turnover. The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company s AFS and HTM portfolios were not other-than-temporarily impaired at September 30, 2013:

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AFS municipal bonds and obligations

At September 30, 2013, 24 of the total 139 securities in the Company s portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 11.2% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the third quarter of 2013. All securities are performing.

AFS residential mortgage-backed securities

At September 30, 2013, 65 out of the total 207 securities in the Company s portfolios of AFS residential mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 1.93% of the amortized cost of securities in unrealized loss positions within the AFS portfolio. The Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) guarantee the contractual cash flows of all of the Company s residential mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the past quarter. All securities are performing.

AFS corporate bonds

At September 30, 2013, 6 out of the total 9 securities in the Company s portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represented 5.8% of the amortized cost of the securities. All 6 securities remain investment grade rated and the market value of the securities supports the Company s amortized value. All securities are performing.

AFS trust preferred securities

At September 30, 2013, 2 out of the total 6 securities in the Company s portfolio of AFS trust preferred securities were in unrealized loss positions. Aggregate unrealized losses represented 49% of the amortized cost of securities in unrealized loss positions. The Company s evaluation of the present value of expected cash flows on these securities supports its conclusions about the recoverability of the securities amortized cost basis. Of the 6 securities, 4 securities contain at least one below investment grade rating by the three major rating agencies. The Company reviews the financial strength of all of the single issue trust issuers and has concluded that the amortized cost remains supported by the market value of these securities and they are performing.

At September 30, 2013, $1.6 million of the total unrealized losses was attributable to a $2.8 million investment in a Mezzanine Class B tranche of a $360 million pooled trust preferred security collateralized by banking and insurance entities. The Company evaluated the security, with a Level 3 fair value of $1 million, for potential other-than-temporary-impairment (OTTI) at September 30, 2013 and determined that OTTI was not evident based on both the Company s ability and intent to hold the security until the recovery of its remaining amortized cost and the protection from credit loss afforded by $46 million in excess subordination above current and projected losses. The security is performing.

AFS other bonds and obligations

At September 30, 2013, 4 of the total 8 securities in the Company s portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 4.3% of the amortized cost of securities in unrealized loss positions. The securities are investment grade rated and there were no material underlying credit downgrades during the second quarter of 2013. All securities are performing.

HTM tax advantaged economic development bonds

At September 30, 2013, 2 of the total 8 securities in the Company s portfolio of tax advantaged economic development bonds were in an unrealized loss position. Aggregate unrealized losses represented 1.7% of the amortized cost of securities in unrealized loss positions. The Company has the intent of maintaining these bonds to recovery. These securities are performing.

Marketable Equity Securities

In evaluating its marketable equity securities portfolio for OTTI, the Company considers its ability to more likely than not hold an equity security to recovery. The Company additionally considers other various factors including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI is recognized immediately through earnings.

At September 30, 2013, 3 out of the total 21 securities in the Company s portfolio of marketable equity securities were in an unrealized loss position. The unrealized loss represented 10.1% of the amortized cost of the securities. The Company has the ability and intent to hold the securities until a recovery of their cost basis and does not consider the securities other-than-temporarily impaired at September 30, 2013. As new information becomes available in future periods, changes to the Company s assumptions may be warranted and could lead to a different conclusion regarding the OTTI of these securities.

NOTE 5. LOANS

The Company s loan portfolio is segregated into the following segments: residential mortgage, commercial mortgage, commercial business, and consumer. Residential mortgage loans include classes for 1- 4 family owner occupied and construction loans. Commercial mortgage loans include construction, single and multi-family, and commercial real estate classes. Commercial business loans include asset based lending loans, lease financing and other commercial business loan classes. Consumer loans include home equity, direct and indirect auto and other. These portfolio segments each have unique risk characteristics that are considered when determining the appropriate level for the allowance for loan losses.

A substantial portion of the loan portfolio is secured by real estate in western Massachusetts, southern Vermont, northeastern New York, and in the Bank s New England lending areas. The ability of many of the Bank s borrowers to honor their contracts is dependent, among other things, on the specific economy and real estate markets of these areas.

Total loans include business activity loans and acquired loans. Acquired loans are those loans acquired from the acquisitions of Beacon Federal Bancorp, Inc., The Connecticut Bank and Trust Company, Legacy Bancorp, Inc., and Rome Bancorp, Inc. The following is a summary of total loans:

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			September 30, 2013		
(In thousands)		**Business Activity Loans**		**Acquired Loans**	**Total**
Residential mortgages					
1-4 family	$	940,626	$	347,788	$ 1,288,414
Construction		19,813		5,382	25,195
Total residential mortgages		960,439		353,170	1,313,609
Commercial mortgages:					
Construction		89,240		15,298	104,538
Single and multi-family		63,718		67,987	131,705
Commercial real estate		842,163		287,698	1,129,861
Total commercial mortgages		995,121		370,983	1,366,104
Commercial business loans:					
Asset based lending		275,776		3,341	279,117
Other commercial business loans		312,572		77,294	389,866
Total commercial business loans		588,348		80,635	668,983
Total commercial loans		1,583,469		451,618	2,035,087
Consumer loans:					
Home equity		228,345		76,181	304,526
Other		169,901		200,720	370,621
Total consumer loans		398,246		276,901	675,147
Total loans	$	2,942,154	$	1,081,689	$ 4,023,843

			December 31, 2012		
(In thousands)		**Business Activity Loans**		**Acquired Loans**	**Total**
Residential mortgages:					
1-4 family	$	870,322	$	427,210	$ 1,297,532
Construction		20,344		6,375	26,719
Total residential mortgages		890,666		433,585	1,324,251
Commercial mortgages:					
Construction		150,694		17,131	167,825
Single and multi-family		43,332		80,488	123,820
Commercial real estate		768,867		353,032	1,121,899
Total commercial mortgages		962,893		450,651	1,413,544
Commercial business loans:					
Asset based lending		255,265		2,830	258,095
Other commercial business loans		234,662		107,369	342,031
Total commercial business loans		489,927		110,199	600,126
Total commercial loans		1,452,820		560,850	2,013,670
Consumer loans:					
Home equity		205,892		119,509	325,401
Other		76,258		249,074	325,332
Total consumer loans		282,150		368,583	650,733
Total loans	$	2,625,636	$	1,363,018	$ 3,988,654

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The carrying amount of the acquired loans at September 30, 2013 totaled $1.08 billion. These loans consisted of loans determined to be impaired at the time of acquisition, which are accounted for in accordance with ASC Topic 310-30, with a carrying amount of $35.1 million and loans that were considered not impaired at the acquisition date with a carrying amount of $1.04 billion.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer.*

(In thousands)	**Three months ended September 30, 2013**	**2012**
Balance at beginning of period	$ 3,328	$ 2,554
Acquisitions		
Sales		
Reclassification from nonaccretable difference for loans with improved cash flows	2,125	
Changes in expected cash flows that do not affect nonaccretable difference		
Accretion	(1,547)	(806)
Balance at end of period	$ 3,906	$ 1,748

(In thousands)	**Nine months ended September 30, 2013**	**2012**
Balance at beginning of period	$ 8,247	$ 1,277
Acquisitions		2,816
Sales	(301)	
Reclassification from nonaccretable difference for loans with improved cash flows	2,125	
Changes in expected cash flows that do not affect nonaccretable difference		
Accretion	(6,165)	(2,345)
Balance at end of period	$ 3,906	$ 1,748

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The following is a summary of past due loans at September 30, 2013 and December 31, 2012:

Business Activity Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
September 30, 2013							
Residential mortgages:							
1-4 family	$ 3,006	$ 380	$ 8,751	$ 12,137	$ 928,489	$ 940,626	$ 2,379
Construction	51		152	203	19,610	19,813	
Total	3,057	380	8,903	12,340	948,099	960,439	2,379
Commercial mortgages:							
Construction			3,176	3,176	86,064	89,240	
Single and multi-family	194	150	513	857	62,861	63,718	
Commercial real estate	2,174		6,302	8,476	833,687	842,163	393
Total	2,368	150	9,991	12,509	982,612	995,121	393
Commercial business loans:							
Asset based lending					275,776	275,776	
Other commercial business loans	642	392	1,805	2,839	309,733	312,572	1
Total	642	392	1,805	2,839	585,509	588,348	1
Consumer loans:							
Home equity	462	13	1,939	2,414	225,931	228,345	757
Other	556	179	415	1,150	168,751	169,901	233
Total	1,018	192	2,354	3,564	394,682	398,246	990
Total	$ 7,085	$ 1,114	$ 23,053	$ 31,252	$ 2,910,902	$ 2,942,154	$ 3,763

Business Activity Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2012							
Residential mortgages:							
1-4 family	$ 4,105	$ 1,291	$ 8,061	$ 13,457	$ 856,865	$ 870,322	$ 1,563
Construction		210	48	258	20,086	20,344	48
Total	4,105	1,501	8,109	13,715	876,951	890,666	1,611
Commercial mortgages:							
Construction			4,668	4,668	146,026	150,694	
Single and multi-family	616		27	643	42,689	43,332	
Commercial real estate	1,183	1,727	8,231	11,141	757,726	768,867	1,195
Total	1,799	1,727	12,926	16,452	946,441	962,893	1,195
Commercial business loans							
Asset based lending					255,265	255,265	

Other commercial business loans	745	372	3,427	4,544	230,118	234,662	159
Total	745	372	3,427	4,544	485,383	489,927	159
Consumer loans:							
Home equity	828	300	1,856	2,984	202,908	205,892	424
Other	546	55	248	849	75,409	76,258	69
Total	1,374	355	2,104	3,833	278,317	282,150	493
Total	$ 8,023	$ 3,955	$ 26,566	$ 38,544	$ 2,587,092	$ 2,625,636	$ 3,458

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Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
September 30, 2013							
Residential mortgages:							
1-4 family	$ 1,618	$ 228	$ 2,562	$ 4,408	$ 343,380	$ 347,788	$ 599
Construction	164	78	465	707	4,675	5,382	465
Total	1,782	306	3,027	5,115	348,055	353,170	1,064
Commercial mortgages:							
Construction	90		1,360	1,450	13,848	15,298	1,360
Single and multi-family	414	190	1,806	2,410	65,577	67,987	499
Commercial real estate	217	524	5,832	6,573	281,125	287,698	2,938
Total	721	714	8,998	10,433	360,550	370,983	4,797
Commercial business loans:							
Asset based lending					3,341	3,341	
Other commercial business loans	571	222	2,147	2,940	74,354	77,294	1,198
Total	571	222	2,147	2,940	77,695	80,635	1,198
Consumer loans:							
Home equity	417	188	707	1,312	74,869	76,181	326
Other	2,918	778	1,826	5,522	195,198	200,720	345
Total	3,335	966	2,533	6,834	270,067	276,901	671
Total	$ 6,409	$ 2,208	$ 16,705	$ 25,322	$ 1,056,367	$ 1,081,689	$ 7,730

Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2012							
Residential mortgages:							
1-4 family	$ 1,817	$ 585	$ 2,523	$ 4,925	$ 422,285	$ 427,210	$ 1,555
Construction					6,375	6,375	
Total	1,817	585	2,523	4,925	428,660	433,585	1,555
Commercial mortgages:							
Construction			1,056	1,056	16,075	17,131	1,056
Single and multi-family	194	1,328	746	2,268	78,220	80,488	746
Commercial real estate	1,532	2,024	11,062	14,618	338,414	353,032	10,176
Total	1,726	3,352	12,864	17,942	432,709	450,651	11,978
Commercial business loans:							
Asset based lending					2,830	2,830	
Other commercial business loans	422	577	2,177	3,176	104,193	107,369	1,764
Total	422	577	2,177	3,176	107,023	110,199	1,764

Consumer loans:							
Home equity	1,689	169	89	1,947	117,562	119,509	52
Other	2,624	365	271	3,260	245,814	249,074	171
Total	4,313	534	360	5,207	363,376	368,583	223
Total	$ 8,278	$ 5,048	$ 17,924	$ 31,250	$ 1,331,768	$ 1,363,018	$ 15,520

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The following is summary information pertaining to non-accrual loans at September 30, 2013 and December 31, 2012:

(In thousands)	September 30, 2013		
	Business Activity Loans	Acquired Loans	Total
Residential mortgages:			
1-4 family	$ 6,525	$ 1,962	$ 8,487
Total	6,525	1,962	8,487
Commercial mortgages:			
Construction	3,176		3,176
Single and multi-family	513	1,308	1,821
Other	5,909	2,894	8,803
Total	9,598	4,202	13,800
Commercial business loans:			
Other commercial business loans	1,804	949	2,753
Total	1,804	949	2,753
Consumer loans:			
Home equity	1,182	382	1,564
Other	182	1,481	1,663
Total	1,364	1,863	3,227
Total non-accrual loans	$ 19,291	$ 8,976	$ 28,267

(In thousands)	December 31, 2012		
	Business Activity Loans	Acquired Loans	Total
Residential mortgages:			
1-4 family	$ 6,498	$ 968	$ 7,466
Total	6,498	968	7,466
Commercial mortgages:			
Construction	4,668		4,668
Single and multi-family	27		27
Other	7,036	886	7,922
Total	11,731	886	12,617
Commercial business loans:			
Other commercial business loans	3,268	413	3,681
Total	3,268	413	3,681
Consumer loans:			
Home equity	1,432	37	1,469
Other	179	100	279
Total	1,611	137	1,748
Total non-accrual loans	$ 23,108	$ 2,404	$ 25,512

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Activity in the allowance for loan losses for the nine months ended September 30, 2013 and 2012 was as follows:

Business Activity Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
September 30, 2013						
Balance at beginning of period	$ 5,928	$ 18,863	$ 5,605	$ 1,466	$ 29	$ 31,891
Charged-off loans	1,180	3,293	1,631	815		6,919
Recoveries on charged-off loans	153	500	87	180		920
Provision for loan losses	1,827	779	1,472	2,309	(339)	6,048
Balance at end of period	$ 6,728	$ 16,849	$ 5,533	$ 3,140	$ (310)	$ 31,940
Individually evaluated for impairment	697	783	441	21		1,942
Collectively evaluated	6,031	16,066	5,092	3,119	(310)	29,998
Total	$ 6,728	$ 16,849	$ 5,533	$ 3,140	$ (310)	$ 31,940

Business Activity Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
September 30, 2012						
Balance at beginning of period	$ 3,150	$ 22,095	$ 4,540	$ 2,203	$ (90)	$ 31,898
Charged-off loans	1,590	3,207	116	1,297		6,210
Recoveries on charged-off loans	87	8	42	132		269
Provision for loan losses	4,922	731	267	2	95	6,017
Balance at end of period	$ 6,569	$ 19,627	$ 4,733	$ 1,040	$ 5	$ 31,974
Individually evaluated for impairment	663	1,653	342	107		2,765
Collectively evaluated	5,906	17,974	4,391	933	5	29,209
Total	$ 6,569	$ 19,627	$ 4,733	$ 1,040	$ 5	$ 31,974

Acquired Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
September 30, 2013						
Balance at beginning of period	$ 509	$ 390	$ 96	$ 314	$ 8	$ 1,317
Charged-off loans	437	933	200	886		2,456
Recoveries on charged-off loans	1	11	80	125		217
Provision for loan losses	360	806	430	705	(71)	2,230
Balance at end of period	$ 433	$ 274	$ 406	$ 258	$ (63)	$ 1,308
Individually evaluated for impairment	233	374				607
Collectively evaluated	200	(100)	406	258	(63)	701

Total	$ 433	$ 274	$ 406	$ 258	$ (63)	$ 1,308

Acquired Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
September 30, 2012						
Balance at beginning of period	$ 281	$ 158	$ 38	$ 87	$ (18)	$ 546
Charged-off loans	8	85	34	40		167
Recoveries on charged-off loans			4			4
Provision for loan losses	165	247	82	96	143	733
Balance at end of period	$ 438	$ 320	$ 90	$ 143	$ 125	$ 1,116
Individually evaluated for impairment	44					44
Collectively evaluated	394	320	90	143	125	1,072
Total	438	320	90	143	125	1,116

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Loans evaluated for impairment as of September 30, 2013 and December 31, 2012 were as follows:

Business Activity Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
September 30, 2013						
Loans receivable:						
Balance at end of period						
Individually evaluated for impairment	$ 6,816	$ 23,796	$ 1,315	$ 1,088		$ 33,015
Collectively evaluated	953,623	971,325	587,033	397,158		2,909,139
Total	$ 960,439	$ 995,121	$ 588,348	$ 398,246		$ 2,942,154

Business Activity Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
December 31, 2012						
Loans receivable:						
Balance at end of year						
Individually evaluated for impairment	$ 6,362	$ 30,287	$ 2,821	$ 1,218		$ 40,688
Collectively evaluated for impairment	884,304	932,606	487,106	280,932		2,584,948
Total	$ 890,666	$ 962,893	$ 489,927	$ 282,150		$ 2,625,636

Acquired Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
September 30, 2013						
Loans receivable:						
Balance at end of Period						
Individually evaluated for impairment	$ 1,750	$ 7,256	$ 186	$		$ 9,192
Collectively evaluated	351,420	363,727	80,449	276,901		1,072,497
Total	$ 353,170	$ 370,983	$ 80,635	$ 276,901		$ 1,081,689

Acquired Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
December 31, 2012						
Loans receivable:						
Balance at end of year						
Individually evaluated for impairment	$ 371	$ 886	$	$		$ 1,257
Collectively evaluated for impairment	433,214	449,765	110,199	368,583		1,361,761
Total	$ 433,585	$ 450,651	$ 110,199	$ 368,583		$ 1,363,018

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The following is a summary of impaired loans on non-accrual status at September 30, 2013:

Business Activity Loans

(In thousands)	Recorded Investment	At September 30, 2013 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	$ 1,359	$ 1,359	$
Commercial mortgages - single and multifamily	198	198	
Commercial mortgages - real estate	5,384	5,384	
Commercial mortgages - construction	1,238	1,238	
Other commercial business loans	32	32	
Consumer - home equity	430	430	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 2,488	$ 3,185	$ 697
Commercial mortgages - construction	179	224	45
Commercial mortgages - real estate	1,320	1,938	618
Commercial mortgages - construction		120	120
Other commercial business loans	318	759	441
Consumer - home equity	116	137	21
Total			
Residential mortgages	$ 3,847	$ 4,544	$ 697
Commercial mortgages	8,319	9,102	783
Commercial business	350	791	441
Consumer	546	567	21
Total impaired loans	$ 13,062	$ 15,004	$ 1,942

Acquired Loans

(In thousands)	Recorded Investment	At September 30, 2013 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Commercial mortgages - real estate	$ 2,504	$ 2,504	$
Other commercial business loans	186	186	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 1,132	$ 1,365	$ 233
Commercial mortgages - real estate	1,247	1,621	374
Total			
Residential mortgages	$ 1,132	$ 1,365	$ 233
Commercial mortgages	3,751	4,125	374
Commercial business	186	186	
Total impaired loans	$ 5,069	$ 5,676	$ 607

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The following is a summary of impaired loans on non-accrual status at December 31, 2012:

Business Activity Loans

(In thousands)	Recorded Investment	At December 31, 2012 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	$ 3,408	$ 3,408	$
Commercial mortgages - construction	2,730	2,730	
Commercial mortgages - single and multifamily			
Commercial mortgages - real estate	3,450	3,450	
Other commercial business loans	31	31	
Consumer - home equity	602	602	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 1,056	$ 1,343	$ 287
Commercial mortgages - construction	1,584	1,938	354
Commercial mortgages - single and multifamily			
Commercial mortgages - real estate	2,019	3,109	1,090
Other commercial business loans	1,135	2,340	1,205
Consumer - home equity	209	482	273
Total			
Residential mortgages	$ 4,464	$ 4,751	$ 287
Commercial mortgages	9,783	11,227	1,444
Commercial business	1,166	2,371	1,205
Consumer	811	1,084	273
Total impaired loans	$ 16,224	$ 19,433	$ 3,209

Acquired Loans

(In thousands)	Recorded Investment	At December 31, 2012 Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	$ 215	$ 215	
Commercial mortgages - real estate	886	886	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 101	$ 156	$ 55
Total			
Residential mortgages	$ 316	$ 371	$ 55
Commercial mortgages	886	886	
Total impaired loans	$ 1,202	$ 1,257	$ 55

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The following is a summary of the average recorded investment and interest income recognized on impaired loans as of September 30, 2013 and September 30, 2012:

Business Activity Loans

(in thousands)	Nine Months Ended September 30, 2013 Average Recorded Investment	Nine Months Ended September 30, 2013 Cash Basis Interest Income Recognized	Nine Months Ended September 30, 2012 Average Recorded Investment	Nine Months Ended September 30, 2012 Cash Basis Interest Income Recognized
With no related allowance:				
Residential mortgages - 1-4 family	$ 2,231	$ 57	$ 1,623	$ 22
Commercial-construction	2,029	30		
Commercial mortgages - single and multifamily	91	4	190	2
Commercial mortgages - real estate	6,077	59	2,644	48
Commercial business loans	692	20	15	
Consumer-home equity	904	8	249	1
With an allowance recorded:				
Residential mortgages - 1-4 family	$ 1,688	$ 21	$ 2,567	$ 27
Commercial-construction	1,938		4,736	
Commercial mortgages - single and multifamily	225	1	75	
Commercial mortgages - real estate	120		2,013	23
Commercial business loans	759		169	5
Consumer-home equity	58	1	421	
Total				
Residential mortgages	$ 3,919	$ 78	$ 4,190	$ 49
Commercial mortgages	10,480	94	9,658	73
Commercial business loans	1,451	20	184	5
Consumer loans	962	9	670	1
Total impaired loans	$ 16,812	$ 201	$ 14,702	$ 128

Acquired Loans

(in thousands)	Nine Months Ended September 30, 2013 Average Recorded Investment	Nine Months Ended September 30, 2013 Cash Basis Interest Income Recognized	Nine Months Ended September 30, 2012 Average Recorded Investment	Nine Months Ended September 30, 2012 Cash Basis Interest Income Recognized
With no related allowance:				
Residential mortgages - 1-4 family	$ 350	$ 0	$ 426	$
Commercial mortgages - real estate	1,761	24	274	15
Commercial business loans	183			
Consumer-home equity			25	
With an allowance recorded:				
Residential mortgages - 1-4 family	$ 697	$ 2	$ 13	$
Commercial mortgages - real estate	962	6		
Total				

Residential mortgages	$ 1,047	$ 2	$ 439	$
Commercial mortgages	2,723	30	274	15
Commercial business loans	183			
Consumer loans			25	
Total impaired loans	$ 3,953	$ 32	$ 738	$ 15

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Credit Quality Information

For the purpose of estimating the allowance for loan losses the Bank utilizes an eleven grade internal loan rating system for each of its commercial mortgage and commercial business loans as follows:

1 **Substantially Risk Free**

Borrowers in this category are of unquestioned credit standing and are at the pinnacle of credit quality. Credits in this category are generally cash secured with strong management depth and experience and exhibit a superior track record.

2 **Minimal Risk**

A relationship which provides an adequate return on investment to the Company, has been stable during the last three years and has a superior financial condition as determined by a comparison with the industry. In addition, management must be of unquestionable character and have strong abilities as measured by its long-term financial performance.

3 **Moderate Risk**

A relationship which does not appear to possess more than the normal degree of credit risk. Overall, the borrower s financial statements compare favorably with the industry. A strong secondary repayment source exists and the loan is performing as agreed.

4 **Better than Average Risk**

A relationship which possesses most of the characteristics found in the Moderate Risk category and ranges from definitely sound to those with minor risk characteristics. Operates in a reasonably stable industry that may be moderately affected by the business cycle and moderately open to changes. Has a satisfactory track record and the loan is performing as agreed.

5 **Average Risk**

A relationship which possesses most of the characteristics found in the Better than Average Risk category but may have recently experienced a loss year often as a result of its operation in a cyclical industry. The relationship has smaller margins of debt service coverage with some elements of reduced strength. Good secondary repayment source exists and the loan is performing as agreed. Start-up businesses and construction loans will generally be assigned to this category as well.

6 **Acceptable Risk**

Borrowers in this category may be more highly leveraged than their industry peers and experience moderate losses relative to net worth. Trends and performance, e.g. sales and earnings, leverage, among other factors may be negative. Management s ability may be questionable, or perhaps untested. The industry may be experiencing either temporary or long term pressures. Collateral values are seen as more important in assessing risk than in higher quality loans. Failure to meet required line clean-up periods or other terms and conditions, including some slow payments may also predicate this grade.

7 **Special Mention**

A classification assigned to all relationships for credits with potential weaknesses which present a higher than normal credit risk, but not to the point of requiring a Substandard loan classification. No loss of principal or interest is anticipated. However, these credits are followed closely, and if necessary, remedial plans to reduce the Company s risk exposure are established.

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8 Substandard Performing

A classification assigned to a credit that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Substandard loans will be evaluated on at least a quarterly basis to determine if an additional allocation of the Company s allowance for loan loss is warranted.

9 Substandard Non-Performing

A classification given to Substandard credits which have deteriorated to the point that management has placed the accounts on non-accrual status due to delinquency exceeding 90 days or where the Company has determined that collection of principal and interest in full is unlikely.

10 Doubtful

Loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, highly questionable and improbable. Collection in excess of 50% of the balance owed is not expected.

11 Loss

Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be possible in the future.

The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, and home equity loans based on a three rating system: Pass, Special Mention and Substandard. Loans that are current within 59 days are rated Pass. Residential mortgages that are 60-89 days delinquent are rated Special Mention. Loans delinquent for 90 days or greater are rated Substandard and generally placed on non-accrual status.

Ratings for other consumer loans, including auto loans, are rated based on a two rating system. Loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Other consumer loans are placed on non-accrual at such time as they become Non-performing.

Acquired Loans Credit Quality Analysis

Upon acquiring a loan portfolio, our Internal Loan Review function assigns risk ratings to the acquired loans, utilizing the same methodology as it does with historical loans. This may differ from the risk rating policy of the predecessor company. Loans which are rated Substandard or worse according to the rating process outlined below are deemed to be credit impaired loans accounted for under ASC 310-30, regardless of whether they are classified as performing or non-performing.

The Bank utilizes an eleven grade internal loan rating system for each of its acquired commercial real estate, construction and commercial loans as outlined in the Credit Quality Information section of this Note. The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Residential mortgages that are current within 59 days are rated Pass. Residential mortgages that are 60   89 days delinquent are rated Special Mention. Residential mortgages delinquent for 90 days or greater are rated Substandard. Home equity loans are risk rated based on the same rating system as the Company   s residential mortgages. Other consumer loans are rated based on a two rating system. Other consumer loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Non-performing other consumer loans are deemed to be credit impaired loans accounted for under ASC 310-30.

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The Company subjects loans that do not meet the ASC 310-30 criteria to ASC 450-20 by collectively evaluating these loans for an allowance for loan loss. The Company applies a methodology similar to the methodology prescribed for originated loans, which includes the application of environmental factors to each category of loans. The methodology to collectively evaluate the acquired loans outside the scope of ASC 310-30 includes the application of a number of environmental factors that reflect management s best estimate of the level of incremental credit losses that might be recognized given current conditions. This is reviewed as part of the allowance for loan loss adequacy analysis. As the loan portfolio matures and environmental factors change, the loan portfolio will be reassessed each quarter to determine an appropriate reserve allowance.

A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time for ASC 310-30 loans. At September 30, 2013, the allowance for loan losses related to acquired loans was $1.3 million using the above mentioned criteria.

The Company presented several tables within this footnote separately for business activity loans and acquired loans in order to distinguish the credit performance of the acquired loans from the business activity loans.

The following table presents the Company s loans by risk rating at September 30, 2013 and December 31, 2012:

Business Activity Loans

Residential Mortgages

Credit Risk Profile by Internally Assigned Grade

	1-4 family		**Construction**		**Total residential mortgages**	
(In thousands)	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**
Grade:						
Pass	$ 931,495	$ 860,970	$ 19,661	$ 20,085	$ 951,156	$ 881,055
Special mention	380	1,291		210	380	1,501
Substandard	8,751	8,061	152	49	8,903	8,110
Total	$ 940,626	$ 870,322	$ 19,813	$ 20,344	$ 960,439	$ 890,666

Commercial Mortgages

Credit Risk Profile by Creditworthiness Category

	Construction		**Single and multi-family**		**Real estate**		**Total commercial mortgages**	
(In thousands)	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**
Grade:								

Pass	$ 84,064	$ 142,946	$ 59,815	$ 40,690	$ 770,714	$ 707,867	$ 914,593	$ 891,503
Special mention			141	$ 420	6,980	5,965	7,121	6,385
Substandard	5,176	7,748	3,762	2,222	63,827	54,930	72,765	64,900
Doubtful					642	105	642	105
Total	$ 89,240	$ 150,694	$ 63,718	$ 43,332	$ 842,163	$ 768,867	$ 995,121	$ 962,893

Commercial Business Loans

Credit Risk Profile by Creditworthiness Category

	Asset based lending		Other		Total commercial business loans	
(In thousands)	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**
Grade:						
Pass	$ 275,776	$ 255,265	$ 300,030	$ 219,172	$ 575,806	$ 474,437
Special mention			888	5,857	888	5,857
Substandard			10,806	9,541	10,806	9,541
Doubtful			848	92	848	92
Total	$ 275,776	$ 255,265	$ 312,572	$ 234,662	$ 588,348	$ 489,927

Consumer Loans

Credit Risk Profile Based on Payment Activity

	Home equity		Other		Total consumer loans	
(In thousands)	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**
Performing	$ 226,405	$ 204,460	$ 169,486	$ 76,079	$ 395,891	$ 280,539
Nonperforming	1,940	1,432	415	179	2,355	1,611
Total	$ 228,345	$ 205,892	$ 169,901	$ 76,258	$ 398,246	$ 282,150

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Acquired Loans

Residential Mortgages

Credit Risk Profile by Internally Assigned Grade

	1-4 family		Construction		Total residential mortgages	
(In thousands)	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**
Grade:						
Pass	$ 344,998	$ 424,102	$ 4,839	$ 6,375	$ 349,837	$ 430,477
Special mention	228	585	78		306	585
Substandard	2,562	2,523	465		3,027	2,523
Total	$ 347,788	$ 427,210	$ 5,382	$ 6,375	$ 353,170	$ 433,585

Commercial Mortgages

Credit Risk Profile by Creditworthiness Category

	Construction		Single and multi-family		Real estate		Total commercial mortgages	
(In thousands)	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**
Grade:								
Pass	$ 8,312	$ 10,142	$ 50,324	$ 57,305	$ 262,409	$ 318,809	$ 321,045	$ 386,256
Special mention	821	1,057	5,967	10,383	7,638	6,790	14,426	18,230
Substandard	6,165	5,932	11,198	12,800	17,651	27,433	35,014	46,165
Doubtful			498				498	
Total	$ 15,298	$ 17,131	$ 67,987	$ 80,488	$ 287,698	$ 353,032	$ 370,983	$ 450,651

Commercial Business Loans

Credit Risk Profile by Creditworthiness Category

	Asset based lending		Other		Total commercial business loans	
(In thousands)	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**	**Sept. 30, 2013**	**Dec. 31, 2012**
Grade:						
Pass	$ 3,341	$ 2,830	$ 66,344	$ 87,325	$ 69,685	$ 90,155
Special mention			2,829	7,444	2,829	7,444
Substandard			8,121	12,600	8,121	12,600
Total	$ 3,341	$ 2,830	$ 77,294	$ 107,369	$ 80,635	$ 110,199

Consumer Loans

Credit Risk Profile Based on Payment Activity

	Home equity		Other		Total consumer loans	
(In thousands)	Sept. 30, 2013	Dec. 31, 2012	Sept. 30, 2013	Dec. 31, 2012	Sept. 30, 2013	Dec. 31, 2012
Performing	$ 75,799	$ 119,472	$ 199,239	$ 248,974	$ 275,038	$ 368,446
Nonperforming	382	37	1,481	100	1,863	137
Total	$ 76,181	$ 119,509	$ 200,720	$ 249,074	$ 276,901	$ 368,583

The following table summarizes information about total loans rated Special Mention or lower as of September 30, 2013 and December 31, 2012.

	September 30, 2013			December 31, 2012		
(In thousands)	Business Activity Loans	Acquired Loans	Total	Business Activity Loans	Acquired Loans	Total
Non-Accrual	$ 19,291	$ 8,976	$ 28,267	$ 23,108	$ 2,405	$ 25,513
Substandard Accruing	77,027	40,218	117,245	61,745	59,243	120,988
Total Classified	96,318	49,194	145,512	84,853	61,648	146,501
Special Mention	8,582	18,527	27,109	14,097	26,793	40,890
Total Criticized	$ 104,900	$ 67,721	$ 172,621	$ 98,950	$ 88,441	$ 187,391

Troubled Debt Restructuring Loans

The Company s loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company s loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower s sustained repayment performance

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for a reasonable period, generally six months. TDRs are evaluated individually for impairment and may result in a specific allowance amount allocated to an individual loan.

There were no modifications identified for the three months ended September 30, 2013. The following tables include the recorded investment and number of modifications identified during the nine months ended September 30, 2013 and for the three and nine months ended September 30, 2012, respectively. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. The modifications for the nine months ending September 30, 2013 were attributable to interest rate concessions and maturity date extensions. The modifications for the nine months ending September 30, 2012 were attributable to maturity date extensions.

		Modifications by Class Nine months ending September 30, 2013	
(Dollars in thousands)	**Number of Modifications**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Troubled Debt Restructurings			
Residential - 1-4 Family	5	$ 941	$ 941
Residential - Construction	1	320	320
Commercial - Construction			
Commercial - Single and multifamily	2	2,366	2,406
Commercial - Other	10	3,882	3,450
Commercial business- ABL			
Commercial business - Other	4	100	100
Consumer- Home Equity			
Consumer- Other			
	22	$ 7,609	$ 7,217

		Modifications by Class Three months ending September 30, 2012	
(Dollars in thousands)	**Number of Modifications**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Troubled Debt Restructurings			
Residential- 1-4 Family	1	$ 70	$ 70

		Modifications by Class Nine months ending September 30, 2012	
(Dollars in thousands)	**Number of Modifications**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Troubled Debt Restructurings			
Residential- 1-4 Family	1	$ 70	$ 70

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The following table discloses the recorded investment and number of modifications for TDRs within the last year where a concession has been made, that then defaulted in the current reporting period. As of September 30, 2012, there were no loans that were restructured within the last twelve months that have subsequently defaulted.

	Modifications that Subsequently Defaulted Three months ending September 30, 2013		
	Number of Contracts		Recorded Investment
Troubled Debt Restructurings			
Commercial - Single and multifamily	1	$	37
Commercial - Other	5		929
Commercial business- Other	1		
	7	$	966

	Modifications that Subsequently Defaulted Nine months ending September 30, 2013		
	Number of Contracts		Recorded Investment
Troubled Debt Restructurings			
Commercial - Single and multifamily	5	$	261
Commercial - Other	5		929
Commercial business- Other	1		
	11	$	1,190

The following table presents the Company s TDR activity for the three and nine months ended September 30, 2013 and September 30, 2012:

	Three months ending September 30,			
(In thousands)		2013		2012
Balance at beginning of the period	$	10,160	$	2,107
Principal Payments		(55)		(1)
TDR Status Change (1)				
Other Reductions (2)		156		
Newly Identified TDRs				70
Balance at end of the period	$	10,261	$	2,176

	Nine months ending September 30,			
(In thousands)		2013		2012
Balance at beginning of the period	$	4,626	$	1,264
Principal Payments		(92)		(6)
TDR Status Change (1)		(1,164)		(1,125)
Other Reductions (2)		(325)		
Newly Identified TDRs		7,216		2,043
Balance at end of the period	$	10,261	$	2,176

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(1) TDR Status change classification represents TDR loans with a specified interest rate equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk and the loan was on current payment status and not impaired based on the terms specified by the restructuring agreement.

(2) Other Reductions classification consists of transfer to other real estate owned and charge-offs to loans.

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The evaluation of certain loans individually for specific impairment includes loans that were previously classified as TDRs or continue to be classified as TDRs.

NOTE 6. DEPOSITS

A summary of time deposits is as follows:

(In thousands)	September 30, 2013	December 31, 2012
Time less than $100,000	$ 501,846	$ 548,895
Time $100,000 or more	562,203	621,694
Total time deposits	$ 1,064,049	$ 1,170,589

NOTE 7. BORROWED FUNDS

Borrowed funds at September 30, 2013 and December 31, 2012 are summarized, as follows:

	September 30, 2013		December 31, 2012	
(in thousands, except rates)	Principal	Weighted Average Rate	Principal	Weighted Average Rate
Short-term borrowings:				
Advances from the FHLBB	$ 590,000	0.30%	$ 153,150	0.28%
Other Borrowings			10,000	1.96
Total short-term borrowings:	590,000	0.30	163,150	0.38
Long-term borrowings:				
Advances from the FHLBB	150,022	1.23	195,321	1.18
Subordinated notes	74,199	7.00	74,153	7.00
Junior subordinated notes	15,464	2.11	15,464	2.16
Total long-term borrowings:	239,685	3.07	284,938	2.76
Total	$ 829,685	1.10%	$ 448,088	1.89%

The Bank also maintains a $3.0 million secured line of credit with the FHLBB that bears a daily adjustable rate calculated by the FHLBB. There was no outstanding balance on the FHLBB line of credit for the periods ended September 30, 2013 and December 31, 2012.

The Bank is approved to borrow on a short-term basis from the Federal Reserve Bank of Boston as a non-member bank. The Bank has pledged certain loans and securities to the Federal Reserve Bank to support this arrangement. No borrowings with the Federal Reserve Bank of Boston took place for the periods ended September 30, 2013 and December 31, 2012.

Long-term FHLBB advances consist of advances with an original maturity of more than one year. The advances outstanding at September 30, 2013 include callable advances totaling $5.0 million, and amortizing advances totaling $5.5 million. The advances outstanding at December 31, 2012 include callable advances totaling $5.0 million, and amortizing advances totaling $5.6 million. All FHLBB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.

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A summary of maturities of FHLBB advances as of September 30, 2013 and December 31, 2012 is as follows:

	September 30, 2013		December 31, 2012	
(in thousands, except rates)	Principal	Weighted Average Rate	Principal	Weighted Average Rate
Fixed rate advances maturing:				
2013	$ 518,039	0.33%	$ 186,448	0.32%
2014	120,082	0.69	20,280	3.04
2015				
2016	1,599	0.79	1,645	0.80
2017 and beyond	5,361	3.82	5,478	3.87
Total fixed rate advances	$ 645,081	0.43%	$ 213,851	0.67%
Variable rate advances maturing:				
2013	$ 19,941	1.93%	$ 59,620	1.33%
2014	10,000	0.33	10,000	0.39
2015	20,000	0.32	20,000	0.41
2016	10,000	0.32	10,000	0.41
2017 and beyond	35,000	0.90	35,000	0.97
Total variable rate advances	$ 94,941	0.87%	$ 134,620	0.96%
Total FHLBB advances	$ 740,022	0.49%	$ 348,471	0.78%

On September 28, 2012, the Company issued $75.0 million of 6.875% fixed to floating rate subordinated notes (the notes) through a private placement at a discount of 1.15%. The Company will pay interest on the subordinated notes at each March 28 and September 28 through September 28, 2022, and thereafter on each March 28, June 28**,** September 28 and December 28. The maturity date of the notes is September 28, 2027, although the Company may redeem some or all of the subordinated notes beginning on the interest payment date of September 28, 2022 and on any interest payment date thereafter. From and including September 28, 2012 to but excluding September 28, 2022, the notes will bear interest at the rate of 6.875% per year and will be payable semi-annually in arrears on March 28 and September 28 of each year. From and including September 28, 2022, the notes will bear an interest rate per annum equal to the three-month LIBOR rate plus 511.3 basis points, payable quarterly on each March 28, June 28, September 28 and December 28, commencing on December 28, 2022, through the maturity date or the early redemption date of the notes.

The Company holds 100% of the common stock of Berkshire Hills Capital Trust I (Trust I) which is included in other assets with a cost of $0.5 million. The sole asset of Trust I is $15.5 million of the Company s junior subordinated debentures due in 2035. These debentures bear interest at a variable rate equal to LIBOR plus 1.85% and had a rate of 2.11% and 2.16% at September 30, 2013 and December 31, 2012, respectively. The Company has the right to defer payments of interest for up to five years on the debentures at any time, or from time to time, with certain limitations, including a restriction on the payment of dividends to stockholders while such interest payments on the debentures have been deferred. The Company has not exercised this right to defer payments. The Company has the right to redeem the debentures at par value. Trust I is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, Trust I is not consolidated into the Company s financial statements.

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NOTE 8. STOCKHOLDERS EQUITY

The Bank s actual and required capital ratios were as follows:

	September 30, 2013	December 31, 2012	FDIC Minimum to be Well Capitalized
Total capital to risk weighted assets	11.9%	11.8%	10.0%
Tier 1 capital to risk weighted assets	10.1	10.0	6.0
Tier 1 capital to average assets	8.1	7.5	5.0

At each date shown, Berkshire Bank met the conditions to be classified as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table above.

Accumulated other comprehensive income

Components of accumulated other comprehensive loss are as follows:

(In thousands)	September 30, 2013	December 31, 2012
Other accumulated comprehensive income/(loss), before tax:		
Net unrealized holding (loss) gain on AFS securities	$ (2,423)	$ 10,718
Net loss on effective cash flow hedging derivatives	(4,509)	(10,955)
Net loss on terminated swap	(3,472)	(4,179)
Net unrealized holding loss on pension plans	(1,265)	(1,265)
Income taxes related to items of accumulated other comprehensive (loss)/income:		
Net unrealized holding (loss) gain on AFS securities	914	(4,006)
Net loss on effective cash flow hedging derivatives	1,813	4,397
Net loss on terminated swap	1,403	1,801
Net unrealized holding loss on pension plans	510	510
Accumulated other comprehensive loss	$ (7,029)	$ (2,979)

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The following table presents the components of other comprehensive loss for the three and nine months ended September 30, 2013 and September 30, 2012:

(In thousands)	**Before Tax**	**Tax Effect**	**Net of Tax**
Three Months Ended September 30, 2013			
Net unrealized holding loss on AFS securities:			
Net unrealized (loss) gain arising during the period	$ (804)	$ 309	$ (495)
Less: reclassification adjustment for losses (gains) realized in net income	361	(146)	215
Net unrealized holding (loss) gain on AFS securities	(443)	163	(280)
Net loss on cash flow hedging derivatives:			
Net unrealized (loss) gain arising during the period	(1,954)	796	(1,158)
Less: reclassification adjustment for losses (gains) realized in net income	802	(324)	478
Net loss on cash flow hedging derivatives	(1,152)	472	(680)
Net loss on terminated swap:			
Net unrealized loss arising during the period			
Less: reclassification adjustment for losses (gains) realized in net income	236	(95)	141
Net gain (loss) on terminated swap	236	(95)	141
Other Comprehensive Loss	$ (1,359)	$ 540	$ (819)
Three Months Ended September 30, 2012			
Net unrealized holding gain on AFS securities:			
Net unrealized gain (loss) arising during the period	$ 2,102	$ (765)	$ 1,337
Less: reclassification adjustment for losses (gains) realized in net income	1		1
Net unrealized holding gain on AFS securities	2,103	(765)	1,338
Net loss on cash flow hedging derivatives:			
Net unrealized (loss) gain arising during the period	(1,886)	762	(1,124)
Less: reclassification adjustment for losses (gains) realized in net income	871	(349)	522
Net loss on cash flow hedging derivatives	(1,015)	413	(602)
Net gain on terminated swap:			
Net unrealized gain arising during the period	(2,420)		(2,420)
Less: reclassification adjustment for losses (gains) realized in net income	2,655	(97)	2,558
Net gain on terminated swap	235	(97)	138
Net unrealized holding loss on pension plans			
Net unrealized loss arising during the period			
Less: reclassification adjustment for (gains) losses realized in net income			
Net unrealized holding loss on pension plans			
Other Comprehensive Loss	$ 1,323	$ (449)	$ 874

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(In thousands)	Before Tax	Tax Effect	Net of Tax
Nine Months Ended September 30, 2013			
Net unrealized holding loss on AFS securities:			
Net unrealized (loss) gain arising during the period	$ (14,507)	$ 5,471	$ (9,036)
Less: reclassification adjustment for losses (gains) realized in net income	1,366	(551)	815
Net unrealized holding gain (loss) on AFS securities	(13,141)	4,920	(8,221)
Net gain on cash flow hedging derivatives:			
Net unrealized gain (loss) arising during the period	3,733	(1,489)	2,244
Less: reclassification adjustment for losses (gains) realized in net income	2,713	(1,095)	1,618
Net gain on cash flow hedging derivatives	6,446	(2,584)	3,862
Net gain on terminated swap:			
Net unrealized loss arising during the period	236		236
Less: reclassification adjustment for (gains) losses realized in net income	471	(398)	73
Net gain on terminated swap	707	(398)	309
Other Comprehensive Loss	$ (5,988)	$ 1,938	$ (4,050)
Nine Months Ended September 30, 2012			
Net unrealized holding gain on AFS securities:			
Net unrealized gain (loss) arising during the period	$ 4,748	$ (1,713)	$ 3,035
Less: reclassification adjustment for losses (gains) realized in net income	42	(16)	26
Net unrealized holding gain on AFS securities	4,790	(1,729)	3,061
Net loss on cash flow hedging derivatives:			
Net unrealized (loss) gain arising during the period	(5,875)	2,427	(3,448)
Less: reclassification adjustment for losses (gains) realized in net income	2,656	(1,069)	1,587
Net loss on cash flow hedging derivatives	(3,219)	1,358	(1,861)
Net gain on terminated swap:			
Net unrealized (loss) gain arising during the period	(4,605)		(4,605)
Less: reclassification adjustment for losses (gains) realized in net income	5,311	(226)	5,085
Net gain on terminated swap	706	(226)	480
Net unrealized holding loss on pension plans			
Net unrealized (loss) arising during the period	(257)		(257)
Less: reclassification adjustment for losses (gains) realized in net income			
Net unrealized holding loss on pension plans	(257)		(257)
Other Comprehensive Income	$ 2,020	$ (597)	$ 1,423

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The following table presents the gross changes in each component of accumulated other comprehensive income, for the three and nine months ended September 30, 2013 and September 30, 2012:

(in thousands)	Net unrealized holding (loss) gain on AFS Securities	Net loss on effective cash flow hedging derivatives	Net loss on terminated swap	Net unrealized holding loss on pension plans	Total
Three Months Ended September 30, 2013					
Balance at Beginning of Period	$ (1,980)	$ (3,357)	$ (3,708)	$ (1,265)	$ (10,310)
Other Comprehensive Loss Before reclassifications	(804)	(1,954)			(2,758)
Amounts Reclassified from Accumulated other comprehensive income	361	802	236		1,399
Total Other Comprehensive Income	(443)	(1,152)	236		(1,359)
Balance at End of Period	$ (2,423)	$ (4,509)	$ (3,472)	$ (1,265)	$ (11,669)
Three Months Ended September 30, 2012					
Balance at Beginning of Period	$ 8,986	$ (11,087)	$ (4,650)	$ (932)	$ (7,683)
Other Comprehensive Loss Before reclassifications	2,102	(1,886)	(2,420)		(2,204)
Amounts Reclassified from Accumulated other comprehensive income	1	871	2,655		3,527
Total Other Comprehensive Income	2,103	(1,015)	235		1,323
Balance at End of Period	$ 11,089	$ (12,102)	$ (4,415)	$ (932)	$ (6,360)
Nine Months Ended September 30, 2013					
Balance at Beginning of Period	$ 10,718	$ (10,955)	$ (4,179)	$ (1,265)	$ (5,681)
Other Comprehensive Loss Before reclassifications	(14,507)	3,733	236		(10,538)
Amounts Reclassified from Accumulated other comprehensive income	1,366	2,713	471		4,550
Total Other Comprehensive Income	(13,141)	6,446	707		(5,988)
Balance at End of Period	$ (2,423)	$ (4,509)	$ (3,472)	$ (1,265)	$ (11,669)
Nine Months Ended September 30, 2012					
Balance at Beginning of Period	$ 6,299	$ (8,883)	$ (5,121)	$ (675)	$ (8,380)
Other Comprehensive Loss Before reclassifications	4,748	(5,875)	(4,605)	(257)	(5,989)
Amounts Reclassified from Accumulated other comprehensive income	42	2,656	5,311		8,009
Total Other Comprehensive Income	4,790	(3,219)	706	(257)	2,020
Balance at End of Period	$ 11,089	$ (12,102)	$ (4,415)	$ (932)	$ (6,360)

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The following table presents the amounts reclassified out of each component of accumulated other comprehensive income for the three and nine months ended September 30, 2013 and September 30, 2012:

(in thousands)	Three Months Ended September 30, 2013		2012		Affected Line Item in the Statement Where Net Income Is Presented
Realized gains (losses) on AFS securities:					
	$	361	$	1	Non-interest income
		(146)			Tax expense
		215		1	Net of tax
Realized gains on cash flow hedging derivatives					
		802		871	Interest income
		(324)		(349)	Tax expense
		478		522	Net of tax
Amortization of realized gains on terminated swap					
		236		2,655	Interest income
		(95)		(97)	Tax expense
		141		2,558	Net of tax
Total reclassifications for the period	$	834	$	3,081	Net of tax

[redacted]					
Realized gains (losses) on AFS securities:					
[redacted]					
		(551)		(16)	Tax expense
[redacted]					
[redacted]					
		2,713		2,656	Interest income
[redacted]					
		1,618		1,587	Net of tax
[redacted]					
Amortization of realized gains on terminated swap					
[redacted]					
		(398)		(226)	Tax expense
[redacted]					
Total reclassifications for the period	$	2,506	$	6,698	Net of tax

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NOTE 9. EARNINGS PER SHARE

Earnings per share have been computed based on the following (average diluted shares outstanding are calculated using the treasury stock method):

(In thousands, except per share data)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Net income from continuing operations	$ 8,104	$ 10,029	$ 30,606	$ 24,496
Loss from discontinued operations before income taxes (including gain on disposal of $63)				(261)
Income tax expense				376
Net loss from discontinued operations				(637)
Net income	$ 8,104	$ 10,029	$ 30,606	$ 23,859
Average number of common shares issued	26,525	23,825	26,525	23,438
Less: average number of treasury shares	1,519	1,614	1,403	1,653
Less: average number of unvested stock award shares	258	290	287	244
Average number of basic common shares outstanding	24,748	21,921	24,835	21,541
Plus: dilutive effect of unvested stock award shares	46	72	60	1
Plus: dilutive effect of stock options outstanding	79	38	106	93
Average number of diluted common shares outstanding	24,873	22,031	25,001	21,635
Basic earnings per share:				
Continuing operations	$ 0.33	$ 0.46	$ 1.23	$ 1.14
Discontinued operations				(0.03)
Total basic earnings per share	$ 0.33	$ 0.46	$ 1.23	$ 1.11
Diluted earnings per share:				
Continuing operations	$ 0.33	$ 0.46	$ 1.22	$ 1.13
Discontinued operations				(0.03)
Total diluted earnings per share	$ 0.33	$ 0.46	$ 1.22	$ 1.10

For the nine months ended September 30, 2013, 239 thousand shares of restricted stock and 464 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the nine months ended September 30, 2012, 218 thousand shares of restricted stock and 350 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations.

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NOTE 10. STOCK-BASED COMPENSATION PLANS

A combined summary of activity in the Company s stock award and stock option plans for the nine months ended September 30, 2013 is presented in the following table:

	Non-vested Stock Awards Outstanding		Stock Options Outstanding	
(Shares in thousands)	**Number of Shares**	**Weighted-Average Grant Date Fair Value**	**Number of Shares**	**Weighted-Average Exercise Price**
Balance, December 31, 2012	244	$ 21.69	688	$ 18.13
Granted	159	24.07		
Stock options exercised			(235)	12.88
Stock awards vested	(95)	19.51		
Forfeited	(55)	22.74	(8)	18.24
Balance, September 30, 2013	253	$ 23.08	445	$ 20.50
Exercisable options, September 30, 2013			379	$ 22.80

During the nine months ended September 30, 2013 and 2012, proceeds from stock option exercises totaled $3.0 million and $376 thousand, respectively. During the nine months ended September 30, 2013, there were 95 thousand shares issued in connection with vested stock awards. During the nine months ended September 30, 2012, there were 68 thousand shares issued in connection with vested stock awards. All of these shares were issued from available treasury stock. Stock-based compensation expense totaled $2.1 million and $1.4 million during the nine months ended September 30, 2013 and 2012, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

NOTE 11. OPERATING SEGMENTS

The Company has two reportable operating segments, Banking and Insurance, which are delineated by the consolidated subsidiaries of Berkshire Hills Bancorp, Inc. Banking includes the activities of the Bank and its subsidiaries, which provide retail and commercial banking, along with wealth management and investment services. Insurance includes the activities of BIG, which provides retail and commercial insurance services. The only other consolidated financial activity of the Company is the Parent, which consists of the transactions of Berkshire Hills Bancorp, Inc. Management fees for corporate services provided by the Bank to BIG and the Parent are eliminated.

The accounting policies of each reportable segment are the same as those of the Company. The Insurance segment and the Parent reimburse the Bank for administrative services provided to them. Income tax expense for the individual segments is calculated based on the activity of the segments, and the Parent records the tax expense or benefit necessary to reconcile to the consolidated total. The Parent does not allocate capital costs. Average assets include securities available-for-sale based on amortized cost.

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A summary of the Company s operating segments was as follows:

(In thousands)	Banking	Insurance	Parent	Eliminations	Total Consolidated
Three months ended September 30, 2013					
Net interest income	$ 46,808	$	$ (939)	$	$ 45,869
Provision for loan losses	3,178				3,178
Non-interest income	9,645	2,469	9,033	(9,033)	12,114
Non-interest expense	40,229	1,981	572	2	42,784
Income before income taxes	13,046	488	7,522	(9,035)	12,021
Income tax expense (benefit)	4,313	188	(584)		3,917
Net income	$ 8,733	$ 300	$ 8,106	$ (9,035)	$ 8,104
Average assets (in millions)	$ 5,259	$ 28	$ 736	$ (735)	$ 5,287
Three months ended September 30, 2012					
Net interest income (expense)	$ 35,505	$	$ (280)	$	$ 35,225
Provision for loan losses	2,500				2,500
Non-interest income	11,571	2,742	10,294	(10,294)	14,313
Non-interest expense	29,608	2,021	533		32,162
Income before income taxes	14,968	721	9,481	(10,294)	14,876
Income tax expense (benefit)	5,105	290	(548)		4,847
Net income	$ 9,863	$ 431	$ 10,029	$ (10,294)	$ 10,029
Average assets (in millions)	$ 4,409	$ 29	$ 501	$ (368)	$ 4,572
Nine months ended September 30, 2013					
Net interest income	$ 131,796	$	$ 12,114	$ (15,000)	$ 128,910
Provision for loan losses	8,278				8,278
Non-interest income	34,664	7,851	18,523	(18,520)	42,518
Non-interest expense	112,181	6,152	1,868	1	120,202
Income before income taxes	46,001	1,699	28,769	(33,521)	42,948
Income tax expense (benefit)	13,521	656	(1,835)		12,342
Net income	$ 32,480	$ 1,043	$ 30,604	$ (33,521)	$ 30,606
Average assets (in millions)	$ 5,212	$ 27	$ 746	$ (743)	$ 5,242
Nine months ended September 30, 2012					
Net interest income (expense)	$ 102,095	$	$ (672)	$	$ 101,423
Provision for loan losses	6,750				6,750
Non-interest income	28,147	8,256	25,546	(25,546)	36,403
Non-interest expense	88,061	6,329	2,150		96,540
Income before income taxes	35,431	1,927	22,724	(25,546)	34,536
Income tax expense (benefit)	10,400	775	(1,135)		10,040
Net income from continuing operations	$ 25,031	$ 1,152	$ 23,859	$ (25,546)	$ 24,496
Income from discontinued operations berofre income taxes (including gain on disposal of $63)	(261)				(261)
Income tax expense	376				376
Net loss from discontinued operations	$ (637)	$	$	$	$ (637)
Net income	$ 24,394	$ 1,152	$ 23,859	$ (25,546)	$ 23,859
Average assets (in millions)	$ 4,185	$ 30	$ 492	$ (405)	$ 4,302

NOTE 12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

As of September 30, 2013, the Company held derivatives with a total notional amount of $787.7 million. That amount included $325.0 million in interest rate swap derivatives that were designated as cash flow hedges for accounting purposes. The Company also had economic hedges and non-hedging derivatives totaling $428.5 million and $34.2 million, respectively, which are not designated as hedges for accounting purposes and are therefore recorded at fair value. Economic hedges included interest rate swaps totaling $379.7 million, and $48.8 million in forward commitment contracts.

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As part of the Company s risk management strategy, the Company enters into interest rate swap agreements to mitigate the interest rate risk inherent in certain of the Company s assets and liabilities. Interest rate swap agreements involve the risk of dealing with both Bank customers and institutional derivative counterparties and their ability to meet contractual terms. The agreements are entered into with counterparties that meet established credit standards and contain master netting and collateral provisions protecting the at-risk party. The derivatives program is overseen by the Risk Management Committee of the Company s Board of Directors. Based on adherence to the Company s credit standards and the presence of the netting and collateral provisions, the Company believes that the credit risk inherent in these contracts was not significant at September 30, 2013.

The Company pledged collateral to derivative counterparties in the form of cash totaling $1.8 million and securities with an amortized cost of $28.0 million and a fair value of $28.3 million as of September 30, 2013. The Company does not typically require its commercial customers to post cash or securities as collateral on its program of back-to-back economic hedges. However certain language is written into the ISDA and loan documents where, in default situations, the Bank is allowed to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Company may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions.

Information about derivative assets and liabilities at September 30, 2013, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Rate Paid	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLBB borrowings	$ 100,000	2.2	0.27%	3.13%	$ (3,463)
Forward-starting interest rate swaps on FHLBB borrowings	210,000	5.4		1.80%	(715)
Interest rate swaps on junior subordinated notes	15,000	0.9	2.11%	5.54%	(331)
Total cash flow hedges	325,000				(4,509)
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	13,227	16.4	0.55%	5.09%	(2,273)
Interest rate swaps on loans with commercial loan customers	183,214	5.6	2.44%	4.83%	7,660
Reverse interest rate swaps on loans with commercial loan customers	183,214	5.6	4.83%	2.44%	(7,769)
Forward sale commitments	48,844	0.2			(822)
Total economic hedges	428,499				(3,204)
Non-hedging derivatives:					
Interest rate lock commitments	34,195	0.2			976
Total non-hedging derivatives	34,195				976
Total	$ 787,693				$ (6,737)

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Information about derivative assets and liabilities at December 31, 2012, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Rate Paid	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLBB borrowings	$ 115,000	1.6	0.35%	3.47%	$ (4,608)
Forward-starting interest rate swaps on FHLBB borrowings	140,000	5.4		2.37%	(5,810)
Interest rate swaps on junior subordinated notes	15,000	1.4	2.16%	5.54%	(704)
Total cash flow hedges	270,000				(11,122)
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	13,609	16.9	0.58%	5.09%	(3,473)
Interest rate swaps on loans with commercial loan customers	205,319	5.1	2.54%	5.28%	(15,219)
Reverse interest rate swaps on loans with commercial loan customers	205,319	5.1	5.28%	0.11%	14,746
Forward sale commitments	335,548	0.1			(1,336)
Total economic hedges	759,795				(5,282)
Non-hedging derivatives:					
Interest rate lock commitments	282,752	0.2			6,258
Total non-hedging derivatives	282,752				6,258
Total	$ 1,312,547				$ (10,146)

Cash flow hedges

The effective portion of unrealized changes in the fair value of derivatives accounted for as cash flow hedges is reported in other comprehensive income and subsequently reclassified to earnings in the same period or periods during which the hedged transaction is forecasted to affect earnings. Each quarter, the Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or transaction. The ineffective portion of changes in the fair value of the derivatives is recognized directly in earnings.

As of September 30, 2013, the Company has entered into several interest rate swaps with an aggregate notional amount of $100.0 million to convert the LIBOR based floating interest rates on a $100.0 million portfolio of FHLBB advances to fixed rates. The objective is to fix the Company s monthly interest expense on these borrowings.

The Company has also entered into twelve forward-starting interest rate swap contracts with a combined notional value of $210.0 million as of September 30, 2013. In 2014, nine of the remaining twelve forward starting swaps will become effective; of these, two have a duration of three years, four have durations of four years, and the final three have durations of five years. The last three forward starting swaps will become effective in 2015, two of which have a duration of four years and the other of which has a duration of seven years. This hedge strategy converts the LIBOR based rate of interest on certain FHLB advances to fixed interest rates, thereby protecting the Company from floating interest rate variability.

As of September 30, 2013, the Company has an interest rate swap with a notional value of $15.0 million to convert the floating rate of interest on its junior subordinated debentures to a fixed rate of interest. The purpose of the hedge was to protect the Company from the risk of variability arising from the floating rate interest on the debentures.

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Amounts included in the Consolidated Statements of Income and in the other comprehensive income section of the Consolidated Statements of Changes in Stockholders Equity related to interest rate derivatives designated as cash flow hedges, were as follows:

(In thousands)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Interest rate swaps on FHLBB borrowings:				
Unrealized (loss) gain recognized in accumulated other comprehensive loss	$ (2,155)	$ (1,210)	$ 3,280	$ (770)
Reclassification of unrealized gain (loss) from accumulated other comprehensive loss to interest expense	803	(871)	2,713	(2,656)
Reclassification of unrealized gain from accumulated other comprehensive loss to other non-interest expense for termination of swaps	236	235	707	706
Reclassification of unrealized deferred tax benefit from accumulated other comprehensive loss to tax expense for terminated swaps	(95)	(98)	(395)	(226)
Net tax benefit (expense) on items recognized in accumulated other comprehensive loss	597	441	(2,358)	1,448
Interest rate swaps on junior subordinated debentures:				
Unrealized (loss) gain recognized in accumulated other comprehensive loss	(9)	919	(14)	(137)
Reclassification of unrealized loss from accumulated other comprehensive loss to interest expense	131	148	387	363
Net tax (expense) benefit on items recognized in accumulated other comprehensive loss	(47)	(28)	(149)	(108)
Other comprehensive (loss) income recorded in accumulated other comprehensive loss, net of reclassification adjustments and tax effects	$ (539)	$ (464)	$ 4,171	$ (1,380)
Net interest expense recognized in interest expense on hedged FHLBB borrowings	$ 913	$ 1,121	$ 3,232	$ 3,327
Net interest expense recognized in interest expense on junior subordinated notes	$ 131	$ 148	$ 387	$ 363

Hedge ineffectiveness on interest rate swaps designated as cash flow hedges was immaterial to the Company s financial statements during the three months ended September 30, 2013 and 2012. The Company does not anticipate material events or transactions within the next twelve months that are likely to result in a reclassification of unrealized gains or losses from accumulated other comprehensive loss to earnings.

Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on the Company s variable-rate liabilities. During the next twelve months, the Company estimates that $4.9 million will be reclassified as an increase to interest expense.

Economic hedges

As of September 30, 2013, the Company has an interest rate swap with a $13.2 million notional amount to swap out the fixed rate of interest on an economic development bond bearing a fixed rate of 5.09%, currently within the Company s trading portfolio under the fair value option, in exchange for a LIBOR-based floating rate. The intent of the economic hedge is to improve the Company s asset sensitivity to changing interest rates in anticipation of favorable average floating rates of interest over the 21-year life of the bond. The fair value changes of the economic development bond are mostly offset by fair value changes of the related interest rate swap.

The Company also offers certain derivative products directly to qualified commercial borrowers. The Company economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third-party financial institutions. The transaction allows the Company s customer to convert a variable-rate loan to a fixed rate loan. Because the Company acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts mostly offset each other in earnings. Credit valuation adjustments arising from the difference in credit worthiness of the commercial loan and financial

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institution counterparties totaled $100 thousand as of September 30, 2013. The interest income and expense on these mirror image swaps exactly offset each other.

The Company utilizes forward sale commitments to hedge interest rate risk and the associated effects on the fair value of interest rate lock commitments and loans held for sale. The forward sale commitments are accounted for as derivatives with changes in fair value recorded in current period earnings.

The company uses the following types of forward sale commitments contracts:

- Best efforts loan sales,
- Mandatory delivery loan sales, and
- To Be Announced (TBA) mortgage-backed securities sales.

A best efforts contract refers to a loan sale agreement where the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. The Company may enter into a best efforts contract once the price is known, which is shortly after the potential borrower s interest rate is locked.

A mandatory delivery contract is a loan sale agreement where the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. Generally, the Company may enter into mandatory delivery contracts shortly after the loan closes with a customer.

The Company may sell TBA mortgage-backed securities to hedge the changes in fair value of interest rate lock commitments and held for sale loans, which do not have corresponding best efforts or mandatory delivery contracts. These security sales transactions are closed once mandatory contracts are written. On the closing date the price of the security is locked-in, and the sale is paired-off with a purchase of the same security. Settlement of the security purchase/sale transaction is done with cash on a net-basis.

Non-hedging derivatives

The Company enters into interest rate lock commitments (IRLCs) for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance. Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. The IRLCs are free-standing derivatives which are carried at fair value with changes recorded in noninterest income in the Company s consolidated statements of income. Changes in the fair value of IRLCs subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time.

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Amounts included in the Consolidated Statements of Income related to economic hedges and non-hedging derivatives were as follows:

(In thousands)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Economic hedges				
Interest rate swap on industrial revenue bond:				
Unrealized (loss) gain recognized in other non-interest income	$ (32)	$ (24)	$ 740	$ (1,118)
Interest rate swaps on loans with commercial loan customers:				
Unrealized gain recognized in other non-interest income	154	859	6,704	4,119
Reverse interest rate swaps on loans with commercial loan customers:				
Unrealized loss recognized in other non-interest income	(154)	(859)	(6,704)	(4,119)
(Unfavorable) favorable change in credit valuation adjustment recognized in other non-interest income	(5)	(31)	332	(22)
Forward Commitments:				
Unrealized (loss) recognized in other non-interest income	(822)	(4,669)	(822)	(4,669)
Realized gain in other non-interest income	231	(943)	8,377	(943)
Non-hedging derivatives				
Interest rate lock commitments				
Unrealized gain recognized in other non-interest income	976	7,833	976	7,833
Realized gain in other non-interest income	$ (63)	$ 2,784	$ (3,423)	$ 6,873

Assets and Liabilities Subject to Enforceable Master Netting Arrangements

Interest Rate Swap Agreements (Swap Agreements)

The Company enters into swap agreements to facilitate the risk management strategies for commercial banking customers. The Company mitigates this risk by entering into equal and offsetting swap agreements with highly rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company s consolidated statements of condition. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral generally in the form of marketable securities is received or posted by the counterparty with net liability positions, respectively, in accordance with contract thresholds. The Company had net asset positions with its commercial banking counterparties totaling $8.0 million and $14.7 million as of September 30, 2013 and December 31, 2012, respectively. The Company had net liability positions with its financial institution counterparties totaling $16.1 million and $29.8 million as of September 30, 2013 and December 31, 2012, respectively. At September 30, 2013, the Company also had a net liability position of $0.3 million with its commercial banking counterparties as compared to zero liability at December 31, 2012. The collateral posted by the Company that covered liability positions was $14.6 million and $29.8 million as of September 30, 2013 and December 31, 2012, respectively.

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The following table presents the assets and liabilities subject to an enforceable master netting arrangement as of September 30, 2013 and December 31, 2012:

Offsetting of Financial Assets and Derivative Assets

(in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Gross Amounts Not Offset in the Statements of Condition: Cash Collateral Received	Net Amount
As of September 30, 2013						
Interest Rate Swap Agreements:						
Institutional counterparties	$	$	$	$	$	$
Commercial counterparties	8,009		8,009			8,009
Total	$ 8,009	$	$ 8,009	$	$	$ 8,009

Offsetting of Financial Liabilities and Derivative Liaibilities

[redacted]						
As of September 30, 2013						
[redacted]						
Institutional counterparties	$ (16,087)	$ 1,536	$ (14,551)	$ 12,851	$ 1,700	$
[redacted]						