BERKSHIRE HILLS BANCORP INC
Form 10-Q
November 09, 2010

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, 2010

¨ 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: 000-51584

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 ¨

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 ¨ No ¨

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

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

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

Yes ¨ No x

The Registrant had 14,044,403 shares of common stock, par value $0.01 per share, outstanding as of November 3, 2010.

BERKSHIRE HILLS BANCORP, INC.
FORM 10-Q

INDEX

		Page
PART I.	FINANCIAL INFORMATION	
Item 1.	Consolidated Financial Statements (unaudited)	
	Consolidated Balance Sheets as of September 30, 2010 and December 31, 2009	3
	Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2010 and 2009	4
	Consolidated Statements of Changes in Stockholders’ Equity for the Nine Months Ended September 30, 2010 and 2009	5
	Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2010 and 2009	6
	Notes to Consolidated Financial Statements	7
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	29
	Selected Financial Data	33
	Average Balances and Average Yields/Rates	34
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	42
Item 4.	Controls and Procedures	42
PART II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	43
Item 1A.	Risk Factors	43
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	44
Item 3.	Defaults Upon Senior Securities	44
Item 4.	Removed and Reserved	45
Item 5.	Other Information	45
Item 6.	Exhibits	45
Signatures		46

PART I
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	September 30, 2010	December 31, 2009
Assets		
Cash and due from banks	$ 26,817	$ 25,770
Short-term investments	11,565	6,838
Total cash and cash equivalents	38,382	32,608
Trading security	17,398	15,880
Securities available for sale, at fair value	315,213	324,345
Securities held to maturity (fair values of $58,790 and $58,567)	57,476	57,621
Federal Home Loan Bank stock and other restricted securities	23,120	23,120
Total securities	413,207	420,966
Loans held for sale	3,445	4,146
Residential mortgages	638,829	609,007
Commercial mortgages	895,519	851,828
Commercial business loans	226,625	186,044
Consumer loans	293,136	314,779
Total loans	2,054,109	1,961,658
Less: Allowance for loan losses	(31,836)	(31,816)
Net loans	2,022,273	1,929,842
Premises and equipment, net	37,858	37,390
Other real estate owned	2,900	30
Goodwill	161,725	161,725
Other intangible assets	12,071	14,375
Cash surrender value of bank-owned life insurance policies	38,170	36,904
Other assets	68,408	62,438
Total assets	$ 2,798,439	$ 2,700,424
Liabilities		
Demand deposits	$ 278,165	$ 276,587
NOW deposits	213,734	197,176
Money market deposits	609,255	532,840
Savings deposits	220,564	208,597
Time deposits	747,029	771,562
Total deposits	2,068,747	1,986,762
Short-term debt	96,125	83,860
Long-term Federal Home Loan Bank advances	197,687	207,344
Junior subordinated debentures	15,464	15,464

Total borrowings	309,276	306,668
Other liabilities	37,501	22,413
Total liabilities	2,415,524	2,315,843
Stockholders' equity		
Common stock ($0.01 par value; 26,000,000 shares authorized; 15,848,825 shares issued and 14,035,838 shares outstanding in 2010; 15,848,825 shares issued and 13,916,094 shares outstanding in 2009)	158	158
Additional paid-in capital	337,670	338,822
Unearned compensation	(2,114)	(1,318)
Retained earnings	102,270	99,033
Accumulated other comprehensive loss	(9,204)	(2,968)
Treasury stock, at cost (1,812,987 shares in 2010 and 1,932,731 shares in 2009)	(45,865)	(49,146)
Total stockholders' equity	382,915	384,581
Total liabilities and stockholders' equity	$ 2,798,439	$ 2,700,424

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

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Interest and dividend income				
Loans	$ 24,917	$ 25,034	$ 73,354	$ 76,836
Securities and other	3,546	3,426	10,554	10,269
Total interest and dividend income	28,463	28,460	83,908	87,105
Interest expense				
Deposits	6,512	8,045	20,195	25,195
Borrowings and junior subordinated debentures	2,267	3,250	6,861	10,310
Total interest expense	8,779	11,295	27,056	35,505
Net interest income	19,684	17,165	56,852	51,600
Non-interest income				
Deposit, loan and interest rate swap fees	3,279	3,286	10,270	8,220
Insurance commissions and fees	2,316	2,337	8,986	10,180
Wealth management fees	1,090	1,369	3,406	3,671
Total fee income	6,685	6,992	22,662	22,071
Other	230	272	714	1,092
Loss on sale of securities, net	-	(5)	-	(4)
Non-recurring income	-	1	-	1,178
Total non-interest income	6,915	7,260	23,376	24,337
Total net revenue	26,599	24,425	80,228	75,937
Provision for loan losses	2,000	4,300	6,526	9,000
Non-interest expense				
Compensation and benefits	10,870	9,757	32,827	28,011
Occupancy and equipment	2,988	2,674	8,986	8,661
Technology and communications	1,458	1,371	4,214	4,026
Marketing and professional services	1,253	1,446	3,666	3,648
Supplies, postage and delivery	520	702	1,635	2,087
FDIC premiums and assessments	893	669	2,540	3,748
Other real estate owned	100	15	127	177
Amortization of intangible assets	768	833	2,304	2,499
Non-recurring expenses	-	-	21	601
Other	1,244	1,477	3,994	3,917
Total non-interest expense	20,094	18,944	60,314	57,375
Income before income taxes	4,505	1,181	13,388	9,562
Income tax expense (benefit)	1,081	(741)	3,220	1,426
Net income	$ 3,424	$ 1,922	$ 10,168	$ 8,136
Less: Cumulative preferred stock dividend and accretion	-	-	-	1,030
Less: Deemed dividend resulting from preferred stock repayment	-	-	-	2,954
Net income available to common stockholders	$ 3,424	$ 1,922	$ 10,168	$ 4,152
Basic earnings per common share	$ 0.25	$ 0.14	$ 0.73	$ 0.32

Diluted earnings per common share	$	0.25	$	0.14	$	0.73	$	0.32
Weighted average common shares outstanding:								
Basic		13,865		13,806		13,852		12,977
Diluted		13,893		13,857		13,883		13,145

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

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands)	Common stock Shares	Common stock Amount	Preferred stock	Additional paid-in capital	Unearned compen-sation	Retained earnings	Accumulated other comp-rehensive loss	Treasury stock	Total
Balance at December 31, 2008	12,253	$ 142	$ 36,822	$ 307,620	$ (1,905)	$ 127,773	$ (11,574)	$ (50,453)	$ 408,425
Comprehensive income:									
Net income	-	-	-	-	-	8,136	-	-	8,136
Other net comprehensive income	-	-	-	-	-	-	8,195	-	8,196
Total comprehensive income									16,332
Redemption of preferred stock, including deemed dividend of $2,954	-	-	(37,046)	-	-	(2,954)	-	-	(40,000)
Preferred stock discount accretion and dividends	-	-	224	-	-	(1,030)	-	-	(806)
Repurchase of warrant issued with preferred stock	-	-	-	(1,040)	-	-	-	-	(1,040)
Issuance of common stock, net of issuance costs of $2,266	1,610	16	-	32,349	-	-	-	-	32,365
Cash dividends declared ($0.48 per share)	-	-	-	-	-	(6,161)	-	-	(6,161)
Forfeited shares	(9)	-	-	(30)	227	-	-	(197)	-
Exercise of stock options	20	-	-	-	-	(189)	-	505	316
Restricted stock grants	57	-	-	(131)	(1,309)	-	-	1,440	-
Stock-based compensation	-	-	-	42	1,041	-	-	-	1,083

Other, net	(3)	-	-	(7)	-	(63)	-	(138)	(209)
Balance at September 30, 2009	13,928	$ 158	$ -	$ 338,803	$ (1,946)	$ 125,512	$ (3,379)	$ (48,843)	$ 410,305
Balance at December 31, 2009	13,916	$ 158	$ -	$ 338,822	$ (1,318)	$ 99,033	$ (2,968)	$ (49,146)	$ 384,581
Comprehensive income:									
Net income	-	-	-	-	-	10,168	-	-	10,168
Other net comprehensive loss	-	-	-	-	-	-	(6,236)	-	(6,236)
Total comprehensive income									3,932
Cash dividends declared ($0.48 per share)	-	-	-	-	-	(6,741)	-	-	(6,741)
Forfeited shares	(13)	-	-	4	254	-	-	(258)	-
Exercise of stock options	24	-	-	-	-	(206)	-	609	403
Restricted stock grants	132	-	-	(1,160)	(2,201)	-	-	3,361	-
Stock-based compensation	-	-	-	4	1,151	-	-	-	1,155
Other, net	(23)	-	-	-	-	16	-	(431)	(415)
Balance at September 30, 2010	14,036	$ 158	$ -	$ 337,670	$ (2,114)	$ 102,270	$ (9,204)	$ (45,865)	$ 382,915

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

BERKSHIRE HILLS BANCORP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Nine Months Ended September 30, 2010	2009
Cash flows from operating activities:		
Net income	$ 10,168	$ 8,136
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	6,526	9,000
Net amortization of securities	1,942	1,187
Change in unamortized net loan costs and premiums	872	664
Premises depreciation and amortization expense	2,832	2,846
Stock-based compensation expense	1,155	1,083
Amortization of other intangibles	2,304	2,499
Income from cash surrender value of bank-owned life insurance policies	(884)	(901)
Loss on sales of securities, net	-	4
Net decrease in loans held for sale	701	268
Net change in other	(1,117)	(3,882)
Net cash provided by operating activities	24,499	20,904
Cash flows from investing activities:		
Trading security:		
Proceeds from maturities, calls and prepayments	327	-
Securities available for sale:		
Sales	3,159	11,479
Proceeds from maturities, calls and prepayments	88,626	42,072
Purchases	(82,653)	(120,221)
Securities held to maturity:		
Proceeds from maturities, calls and prepayments	15,967	12,237
Purchases	(15,823)	(17,900)
Loan (originations) and principal repayments, net	(102,854)	12,563
Proceeds from surrender of bank-owned life insurance	2,217	-
Purchase of bank-owned life insurance	(2,599)	-
Capital expenditures	(3,347)	(1,787)
Net cash used by investing activities	(96,980)	(61,557)
Cash flows from financing activities:		
Net increase in deposits	81,985	137,238
Proceeds from Federal Home Loan Bank advances and other borrowings	212,505	85,000
Repayments of Federal Home Loan Bank advances and other borrowings	(209,897)	(184,602)
Net proceeds from common stock issuance	-	32,365
Net proceeds from reissuance of treasury stock	403	316
Common stock cash dividends paid	(6,741)	(6,161)
Net impact of preferred stock and warrant including repurchase and dividends	-	(41,846)
Net cash provided by financing activities	78,255	22,310
Net change in cash and cash equivalents	5,774	(18,343)

Cash and cash equivalents at beginning of period		32,608		44,798
Cash and cash equivalents at end of period	$	38,382	$	26,455
Supplemental cash flow information:				
Interest paid on deposits		20,626		25,211
Interest paid on borrowed funds		6,888		10,579
Income taxes(refunded) paid, net		(117)		1,952

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

6

1. GENERAL

Basis of presentation and consolidation

The consolidated financial statements (the “financial statements”) of Berkshire Hills Bancorp, Inc. (the “Company” or “Berkshire”) have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q adopted by the Securities and Exchange Commission (“SEC”). Accordingly, these financial statements, including year-end consolidated balance sheet data presented, do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments necessary for a fair presentation are reflected in the interim financial statements and consist of normal recurring entries. These financial statements include the accounts of the Company and its wholly-owned subsidiaries, Berkshire Insurance Group, Inc. (“BIG”) and Berkshire Bank (the “Bank”), together with the Bank’s consolidated subsidiaries. One of the Bank’s consolidated subsidiaries is Berkshire Bank Municipal Bank, a New York chartered limited-purpose commercial bank. All significant inter-company transactions have been eliminated in consolidation. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results which may be expected for the year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009.

Business

Through its wholly-owned subsidiaries, the Company provides a variety of financial services to individuals, businesses, not-for-profit organizations, and municipalities in and around western Massachusetts, southern Vermont and northeastern New York. The Company also provides asset based middle market commercial lending throughout New England and its New York markets. Its primary deposit products are checking, NOW, money market, savings, and time deposit accounts. Its primary lending products are residential mortgages, commercial mortgages, commercial business loans and consumer loans. The Company offers electronic banking, cash management, and other transaction and reporting services; it also offers interest rate swap contracts to commercial customers. The Company offers private banking services and wealth management services including trust, financial planning, and investment services. The Company is an agent for complete lines of property and casualty, life, disability, and health insurance to individuals and businesses.

Business segments

An operating segment is a component of a business for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and evaluate performance. 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 Berkshire Bank and its subsidiaries, which provide commercial and consumer banking services. Insurance includes the activities of Berkshire Insurance Group, Inc., which provides commercial and consumer insurance services. The only other consolidated financial activity of the Company consists of the transactions of Berkshire Hills Bancorp, Inc.

Use of estimates

In preparing the financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheets and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses; the valuation of deferred tax assets; the estimates related to the initial measurement of goodwill and other intangible assets and subsequent impairment analyses; the determination of other-than-temporary impairment of securities; and the determination of the fair value of assets and liabilities.

Earnings Per Common Share

Earnings per common 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, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net income	$ 3,424	$ 1,922	$ 10,168	$ 8,136
Less: Cumulative preferred stock dividends and accretion	-	-	-	1,030
Less: Deemed dividend resulting from preferred stock repayment	-	-	-	2,954
Net income available to common stockholders	$ 3,424	$ 1,922	$ 10,168	$ 4,152
Average number of common shares outstanding	14,037	13,926	14,020	13,100
Less: average number of unvested stock award shares	(172)	(120)	(168)	(123)
Average number of basic shares outstanding	13,865	13,806	13,852	12,977
Plus: average number of dilutive unvested stock award shares	22	13	20	134
Plus: average number of dilutive stock options	6	38	11	34
Average number of diluted shares outstanding	13,893	13,857	13,883	13,145
Basic earnings per common share	$ 0.25	$ 0.14	$ 0.73	$ 0.32
Diluted earnings per common share	$ 0.25	$ 0.14	$ 0.73	$ 0.32

For the quarter ended September 30, 2010, 145 thousand shares of restricted stock and 117 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the quarter ended September 30, 2009, 107 thousand shares of restricted stock and 121 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations.

Recent accounting pronouncements

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 810, "Consolidation". New authoritative accounting guidance under ASC Topic 810 amends prior guidance to provide more relevant and reliable information to users of financial statements by enterprises involved with variable interest entities. This accounting guidance became effective for the Company on January 1, 2010 and did not have a significant impact on the Company's financial statements.

FASB ASC Topic 860, "Transfers and Servicing". New authoritative accounting guidance under ASC Topic 860 amends prior accounting guidance to enhance reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. The new authoritative accounting guidance eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. The new authoritative accounting guidance also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. This accounting guidance became effective for the Company on January 1, 2010 and did not have a significant impact on the Company's financial statements.

FASB Accounting Standards Update ("ASU") No. 2010-06, "Improving Disclosures about Fair Value Measurements". New authoritative accounting guidance under ASU No. 2010-06 provides guidance that requires more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, and (4) the transfers between Levels 1, 2, and 3. This guidance became effective for the Company on January 1, 2010 and did not have a material impact on the Company's financial statements.

FASB ASU No. 2010-20, “Receivables (Topic 310), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses”. In July 2010, the FASB issued ASU 2010-20 which requires an entity to provide disclosures that facilitate financial statement users’ evaluation of (1) the nature of credit risk inherent in the entity’s loan portfolio (2) how that risk is analyzed and assessed in arriving at the allowance for loan and lease losses and (3) the changes and reasons for those changes in the allowance for loan and lease losses. For public entities, the disclosures as of the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. The adoption of this guidance will require significant additional disclosures in the December 31, 2010 financial statements and subsequent financial statements.

2. TRADING ACCOUNT 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 $14.7 million and $15.0 million and a fair value of $17.4 million and $15.9 million at September 30, 2010 and December 31, 2009, respectively. As discussed further in Note 10-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, 2010.

3. 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, 2010				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	$ 80,654	$ 4,175	$ (22)	$ 84,807
Government guaranteed residential mortgage-backed securities	21,551	398	-	21,949
Government-sponsored residential mortgage-backed securities	142,502	3,581	(76)	146,007
Corporate bonds	26,430	191	(54)	26,567
Trust preferred securities	22,253	361	(1,726)	20,888
Other bonds and obligations	421	2	-	423
Total debt securities	293,811	8,708	(1,878)	300,641
Equity securities:				
Marketable equity securities	15,374	53	(855)	14,572
Total securities available for sale	309,185	8,761	(2,733)	315,213
Securities held to maturity				
Municipal bonds and obligations	6,592	-	-	6,592
Government-sponsored residential mortgage-backed securities	84	4	-	88
Tax advantaged economic development bonds	50,627	1,425	(115)	51,937
Other bonds and obligations	173	-	-	173
Total securities held to maturity	57,476	1,429	(115)	58,790
Total	$ 366,661	$ 10,190	$ (2,848)	$ 374,003
December 31, 2009				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	$ 73,277	$ 1,836	$ (329)	$ 74,784
Government guaranteed residential mortgage-backed securities	12,923	224	(116)	13,031
Government-sponsored residential mortgage-backed securities	179,674	4,714	(143)	184,245
Corporate bonds	36,941	641	(245)	37,337
Trust preferred securities	9,285	-	(2,370)	6,915
Other bonds and obligations	5,481	9	(20)	5,470
Total debt securities	317,581	7,424	(3,223)	321,782
Equity securities:				
Marketable equity securities	2,679	55	(171)	2,563
Total securities available for sale	320,260	7,479	(3,394)	324,345

Securities held to maturity				
Municipal bonds and obligations	14,737	-	-	14,737
Government-sponsored residential mortgage-backed securities	139	3	-	142
Tax advantaged economic development bonds	42,572	951	(8)	43,515
Other bonds and obligations	173	-	-	173
Total securities held to maturity	57,621	954	(8)	58,567
Total	$ 377,881	$ 8,433	$ (3,402)	$ 382,912

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, 2010 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	$ 24,029	$ 24,254	$ 3,699	$ 3,699
Over 1 year to 5 years	3,374	3,329	1,701	1,701
Over 5 years to 10 years	24,600	25,339	30,742	31,509
Over 10 years	77,755	79,763	21,250	21,793
Total bonds and obligations	129,758	132,685	57,392	58,702
Marketable equity securities	15,374	14,572	-	-
Residential mortgage-backed securities	164,053	167,956	84	88
Total	$ 309,185	$ 315,213	$ 57,476	$ 58,790

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, 2010						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	$ 4	$ 2,217	$ 18	$ 1,237	$ 22	$ 3,454
Government-sponsored residential mortgage-backed securities	76	24,990	-	-	76	24,990
Corporate bonds	4	5,000	50	2,945	54	7,945
Trust preferred securities	-	-	1,726	5,485	1,726	5,485
Other bonds and obligations	-	-	-	319	-	319
Total debt securities	84	32,207	1,794	9,986	1,878	42,193
Marketable equity securities	840	12,175	15	1,485	855	13,660
Total securities available for sale	924	44,382	1,809	11,471	2,733	55,853
Securities held to maturity						
Government-sponsored residential mortgage-backed securities	-	-	-	15	-	15
Tax advantaged economic development bonds	-	-	115	1,413	115	1,413
Total securities held to maturity	-	-	115	1,428	115	1,428
Total	$ 924	$ 44,382	$ 1,924	$ 12,899	$ 2,848	$ 57,281
December 31, 2009						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	$ 17	$ 2,984	$ 312	$ 7,128	$ 329	$ 10,112
Government guaranteed residential mortgage-backed securities	116	5,113	-	-	116	5,113
Government-sponsored residential mortgage-backed securities	143	21,610	-	-	143	21,610
Corporate bonds	-	-	245	2,748	245	2,748
Trust preferred securities	-	-	2,370	6,915	2,370	6,915
Other bonds and obligations	-	-	20	440	20	440
Total debt securities	276	29,707	2,947	17,231	3,223	46,938
Marketable equity securities	-	-	171	1,104	171	1,104
Total securities available for sale	276	29,707	3,118	18,335	3,394	48,042

Securities held to maturity												
Tax advantaged economic development bonds		8		1,569		-		-		8		1,569
Total securities held to maturity		8		1,569		-		-		8		1,569
Total	$	284	$	31,276	$	3,118	$	18,335	$	3,402	$	49,611

12

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, 2010, 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 historical 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, 2010:

AFS municipal bonds and obligations

At September 30, 2010, 4 out of a total of 142 securities in the Company’s portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented less than 1% of the amortized cost of securities in unrealized loss positions. The 4 securities in unrealized loss positions are all investment grade rated and all have insurance except for one bond, which is AAA rated. There were no material underlying credit downgrades during 2010. All securities are considered performing.

AFS and HTM residential mortgage-backed securities

At September 30, 2010, 7 out of a total of 102 securities in the Company’s portfolios of AFS residential mortgage-backed and 2 out of a total of 4 securities in the Company’s portfolios of HTM residential mortgage-backed were in unrealized loss positions. Aggregate unrealized losses represented less than 1% of the amortized cost of securities in unrealized loss positions within both portfolios. 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 2010. All securities are considered performing.

AFS corporate bonds

At September 30, 2010, 3 out of a total of 14 securities in the Company’s portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represented less than 1% of the amortized cost of the securities. The securities are investment grade rated, and there was no material underlying credit downgrade during the third quarter of 2010. The securities are considered performing.

AFS trust preferred securities

At September 30, 2010, 4 out of a total of 7 securities in the Company’s portfolio of AFS trust preferred securities were in unrealized loss positions. Aggregate unrealized losses represented 24% 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 bases.

At September 30, 2010, $1.5 million of the total unrealized losses was attributable to a $2.6 million investment in a Mezzanine Class B tranche of a $360 million pooled trust preferred security issued by banking and insurance entities. The Company evaluated the security, with a Level 3 fair value of $1.1 million, for potential other-than-temporary-impairment (“OTTI”) at September 30, 2010 and determined that OTTI was not evident based on both the Company’s more likely than not ability to hold the security until the recovery of its remaining amortized cost and the protection from credit loss afforded by $35 million in excess subordination above current and projected losses.

The security is considered performing.

AFS other bonds and obligations

At September 30, 2010, 4 out of a total of 7 securities in the Company's portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented less than 1% of the book value of the securities in unrealized loss positions. The securities are investment grade rated and there were no material underlying credit downgrades during 2010. All securities are considered performing.

HTM tax advantaged economic development bonds

At September 30, 2010, 1 out of a total of 11 securities in the Company's portfolio of tax advantaged economic development bonds was in an unrealized loss position. Aggregate unrealized loss represented 8% of the amortized cost of the security in unrealized loss positions. The security is performing to terms and there were no underlying internal credit downgrades during 2010. The security is considered performing.

Marketable Equity Securities

In evaluating its marketable equity securities portfolio for OTTI, the Company considers its more likely than not ability to hold an equity security to recovery of its cost basis in addition to various other 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, 2010, 10 out of a total of 14 securities in the Company's portfolio of marketable equity securities were in an unrealized loss position. The unrealized loss represented 6% of the cost of the impaired securities. The Company has the intent and ability to hold the securities until a recovery of their cost bases and does not consider the securities other-than-temporarily impaired at September 30, 2010. 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.

4. LOANS

Loans consist of the following:

(In thousands)	September 30, 2010	December 31, 2009
Total residential mortgages	$ 638,829	$ 609,007
Commercial mortgages:		
Construction	114,854	110,703
Single and multi-family	80,987	80,624
Commercial real estate	699,678	660,501
Total commercial mortgages	895,519	851,828
Commercial business loans:		
Asset-based lending	68,143	-
Other commercial business loans	158,482	186,044
Total commercial business loans	226,625	186,044
Total commercial loans	1,122,144	1,037,872
Consumer loans:		
Auto	43,757	76,861
Home equity and other	249,379	237,918
Total consumer loans	293,136	314,779

Total loans	$	2,054,109	$	1,961,658

14

5. LOAN LOSS ALLOWANCE

Activity in the allowance for loan losses is as follows:

(In thousands)	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Balance at beginning of period	$ 31,848	$ 22,917	$ 31,816	$ 22,908
Charged-off loans	(2,121)	(2,955)	(8,468)	(7,889)
Recoveries on charged-off loans	109	35	1,962	278
Net loans charged-off	(2,012)	(2,920)	(6,506)	(7,611)
Provision for loan losses	2,000	4,300	6,526	9,000
Balance at end of period	$ 31,836	$ 24,297	$ 31,836	$ 24,297

Impaired loans totaled $16.4 million and $56.9 million at September 30, 2010 and December 31, 2009, respectively. Based on collateral values or discounted cash flow analyses, impaired loans with a carrying value of $10.0 million and $29.9 million were determined to require a valuation allowance of $2.7 million and $6.4 million at September 30, 2010 and December 31, 2009, respectively.

6. DEPOSITS

A summary of time deposits is as follows:

(In thousands)	September 30, 2010	December 31, 2009
Time less than $100,000	$ 376,275	$ 381,141
Time $100,000 or more	370,754	390,421
Total time deposits	$ 747,029	$ 771,562

7. STOCKHOLDERS' EQUITY

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

	September 30, 2010	December 31, 2009	FDIC Minimum to be Well Capitalized
Total capital to risk weighted assets	10.8%	10.7%	10.0%
Tier 1 capital to risk weighted assets	9.5	9.5	6.0
Tier 1 capital to average assets	8.1	7.9	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.

8. 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, 2010 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 as of December 31, 2009	99	$ 24.49	430	$ 23.35
Granted	132	16.65	-	-
Stock options exercised	-	-	(24)	16.75
Stock awards vested	(49)	24.81	-	-
Forfeited	(13)	19.53	(65)	16.75
Expired	-	-	(151)	27.73
Balance as of September 30, 2010	169	$ 18.69	190	$ 22.97

During the nine months ended September 30, 2010, proceeds from stock option exercises totaled $403 thousand. During the nine months ended September 30, 2010, there were 49 thousand shares issued in connection with vested stock awards. All of these shares were issued from available treasury stock. Stock-based compensation expense totaled $1.2 million and $1.1 million during the nine months ended September 30, 2010 and 2009, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

9. 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 Berkshire Bank and its subsidiaries, which provide commercial and consumer banking services. Insurance includes the activities of Berkshire Insurance Group, Inc. which provides commercial and consumer 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 Berkshire Insurance Group, Inc. 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.

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

(In thousands)	Banking	Insurance	Parent	Eliminations	Total Consolidated
Three months ended September 30, 2010					
Net interest income (expense)	$ 19,897	$ -	$ (213)	$ -	$ 19,684
Provision for loan losses	2,000	-	-	-	2,000
Non-interest income	4,584	2,331	3,678	(3,678)	6,915
Non-interest expense	17,558	2,323	212	1	20,094
Income before income taxes	4,923	8	3,253	(3,679)	4,505
Income tax expense (benefit)	1,248	5	(172)	-	1,081
Net income	$ 3,675	$ 3	$ 3,425	$ (3,679)	$ 3,424
Average assets (in millions)	$ 2,724	$ 33	$ 360	$ (349)	$ 2,768
Three months ended September 30, 2009					
Net interest income (expense)	$ 17,419	$ -	$ (254)	-	$ 17,165
Provision for loan losses	4,300	-	-	-	4,300
Non-interest income	4,905	2,354	-	1	7,260
Non-interest expense	15,996	2,501	448	(1)	18,944
Income (loss) before income taxes	2,028	(147)	(702)	2	1,181
Income tax expense (benefit)	(393)	(60)	(289)	1	(741)
Net income (loss)	$ 2,421	$ (87)	$ (413)	$ 1	$ 1,922
Average assets (in millions)	$ 2,634	$ 34	$ 392	$ (393)	$ 2,667
Nine months ended September 30, 2010					
Net interest income (expense)	$ 57,495	$ -	$ (643)	$ -	$ 56,852
Provision for loan losses	6,526	-	-	-	6,526
Non-interest income	14,348	9,028	11,012	(11,012)	23,376
Non-interest expense	52,601	6,933	778	2	60,314
Income before income taxes	12,716	2,095	9,591	(11,014)	13,388
Income tax expense (benefit)	2,938	860	(579)	1	3,220
Net income	$ 9,778	$ 1,235	$ 10,170	$ (11,015)	$ 10,168
Average assets (in millions)	$ 2,667	$ 32	$ 362	$ (350)	$ 2,711
Nine months ended September 30, 2009					
Net interest income (expense)	$ 52,456	$ -	$ (856)	$ -	$ 51,600
Provision for loan losses	9,000	-	-	-	9,000
Non-interest income	14,087	10,249	-	1	24,337
Non-interest expense	48,816	7,598	962	(1)	57,375
Income (loss) before income taxes	8,727	2,651	(1,818)	2	9,562
Income tax expense (benefit)	1,085	1,087	(746)	-	1,426
Net income (loss)	$ 7,642	$ 1,564	$ (1,072)	$ 2	$ 8,136
Average assets (in millions)	$ 2,639	$ 33	$ 324	$ (323)	$ 2,673

10. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

As of September 30, 2010, the Company held derivatives with a total notional amount of $519 million. Of this total, interest rate swaps with a combined notional amount of $160 million were designated as cash flow hedges and $287 million have been designated as economic hedges. The remaining $72 million notional amount represents commitments to originate residential mortgage loans for sale and commitments to sell residential mortgage loans, which are also accounted for as derivative financial instruments. At September 30, 2010, no derivatives were designated as hedges of net investments in foreign operations. Additionally, the Company does not use derivatives for trading or speculative purposes.

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, 2010.

The Company pledged collateral to derivative counterparties in the form of cash totaling $7.5 million and securities with an amortized cost of $31.9 million and a fair value of $33.0 million as of September 30, 2010. No collateral was posted from counterparties to the Company as of September 30, 2010. The Company may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions. Currently, there are no contingent features that would require the Company to post additional collateral.

Information about interest rate swap agreements and non-hedging derivative assets and liabilities at September 30, 2010, 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	$ 105,000	2.9	0.36%	4.00%	$ (9,470)
Forward-starting interest rate swaps on FHLBB borrowings	40,000	3.0	-	3.13	(667)
Interest rate swaps on junior subordinated debentures	15,000	3.6	2.19	5.54	(1,437)
Total cash flow hedges	160,000				(11,574)
Economic hedges:					
Interest rate swap on industrial revenue bond	14,672	19.2	0.63	5.09	(2,926)
Interest rate swaps on loans with commercial loan customers	135,989	6.7	2.91	6.12	(12,546)
Reverse interest rate swaps on loans with commercial loan customers	135,989	6.7	6.12	2.91	12,514
Total economic hedges	286,650				(2,958)
Non-hedging derivatives:					
Commitments to originate residential mortgage loans to be sold	36,356	0.2			(54)
Commitments to sell residential mortgage loans	36,356	0.2			59
Total non-hedging derivatives	72,712				5
Total	$ 519,362				$ (14,527)

Information about interest rate swap agreements and non-hedging derivative assets and liabilities at December 31, 2009, 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	$ 145,000	4.7	0.28%	4.15%	$ (8,874)
Interest rate swaps on junior subordinated debentures	15,000	4.4	2.12	5.54	(668)
Total cash flow hedges	160,000				(9,542)
Economic hedges:					
Interest rate swap on industrial revenue bond	15,000	19.9	0.60	5.09	(1,018)
Interest rate swaps on loans with commercial loan customers	93,962	7.0	2.50	6.32	(2,887)
Reverse interest rate swaps on loans with commercial loan customers	93,962	7.0	6.32	2.50	2,962
Total economic hedges	202,924				(943)
Non-hedging derivatives:					
Commitments to originate residential mortgage loans to be sold	22,668	0.2			(273)
Commitments to sell residential mortgage loans	22,668	0.2			305
Total non-hedging derivatives	45,336				32
Total	$ 408,260				$ (10,453)

Cash flow hedges

The effective portion of unrealized changes in the fair value of derivatives accounted for as cash flow hedges are reported in other comprehensive income and subsequently reclassified to earnings when gains or losses are realized. 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.

The Company has entered into several interest rate swaps with an aggregate notional amount of $105 million to convert the LIBOR based floating interest rates on a $105 million portfolio of FHLBB advances to fixed rates, with the objective of fixing the Company's monthly interest expense on these borrowings. In the third quarter of 2010, Berkshire terminated $40 million notional amount of interest rate swaps that were used to convert floating based FHLBB advances to a fixed rate. Berkshire has retained the floating rate advances. Management's decision to terminate the swaps was based on its assessment that these hedges were no longer needed to execute management's strategy for balance sheet management.

The Company has also entered into four forward-starting interest rate swaps each with a notional value of $10 million. Two of these swaps take effect in April 2012 and the other two take effect in April 2013. All swaps have a one year duration. 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.

The Company has also entered into an interest rate swap with a notional value of $15 million to convert the floating rate 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.

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 hedges of cash flows, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2010	2009	2010	2009
Interest rate swaps on FHLBB borrowings:				
Unrealized (loss) gain recognized in accumulated other comprehensive loss	$ (1,794)	$ (1,886)	$ (7,098)	$ 4,957
Elimination of unrealized loss for termination of swaps	5,448	-	5,448	-
Realized loss recognized in accumulated other comprehensive loss for termination of swaps	(6,382)	-	(6,382)	-
Reclassification of realized loss from accumulated other comprehensive loss to interest expense for termination of swaps	84	-	84	-
Reclassification of realized gain from accumulated other comprehensive loss to other	-	-	-	(741)

non-interest income for termination of swaps								
Reclassification of unrealized (gain) loss from accumulated other comprehensive loss to other non-interest income for hedge ineffectiveness		-		(103)		-		62
Net tax (expense) benefit on items recognized in accumulated other comprehensive loss		(1,236)		846		2,545		(1,600)
Interest rate swaps on junior subordinated debentures:								
Unrealized (loss) gain recognized in accumulated other comprehensive loss		(287)		(248)		(769)		333
Net tax benefit (expense) on items recognized in accumulated other comprehensive loss		490		103		319		(124)
Other comprehensive (loss) income recorded in accumulated other comprehensive loss, net of reclassification adjustments and tax effects	$	(3,677)	$	(1,288)	$	(5,853)	$	2,887
Net interest expense recognized in interest expense on hedged FHLBB borrowings	$	1,281	$	(1,258)	$	4,102	$	(3,228)
Net interest expense recognized in interest expense on junior subordinated debentures	$	125	$	(119)	$	380	$	(292)

19

The Company's accumulated other comprehensive loss totaled $9.2 million at September 30, 2010. Of this loss, $17.9 million was attributable to accumulated losses on cash flow hedges, net of deferred taxes of $5.5 million, and $6.0 million was attributable to accumulated gains on available-for-sale securities, net of deferred taxes of $2.8 million.

The Company's accumulated other comprehensive loss totaled $3.0 million at December 31, 2009. Of this loss, $5.2 million was attributable to accumulated losses on cash flow hedges, net of deferred taxes of $4.3 million, and $2.2 million was attributable to accumulated gains on available-for-sale securities, net of deferred taxes of $1.8 million.

Hedge ineffectiveness on interest rate swaps designated as cash flow hedges was immaterial to the Company's financial statements during the nine months ended September 30, 2010 and 2009. 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 $5.3 million will be reclassified as an increase to interest expense.

Economic hedges and non-hedging derivatives

The Company has an interest rate swap with a $14.7 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 institution counterparties totaled $(32) thousand as of September 30, 2010 and were not material to the financial statements. The interest income and expense on these mirror image swaps exactly offset each other.

The Company enters into commitments with certain of its retail customers to originate fixed rate mortgage loans and simultaneously enters into an agreement to sell these fixed rate mortgage loans to the Federal National Mortgage Association. These commitments are considered derivative financial instruments and are recorded at fair value with any changes in fair value recorded through earnings.

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, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Economic hedges				
Interest rate swap on industrial revenue bond:				
Net interest expense recognized in interest and dividend income on securities	$ (166)	$ (170)	$ (500)	$ (493)
Unrealized (loss) gain recognized in other non-interest income	(614)	(500)	(1,908)	1,506
Interest rate swaps on loans with commercial loan customers:				
Unrealized gain recognized in other non-interest income	3,081	1,445	9,659	348
Reverse interest rate swaps on loans with commercial loan customers:				
Unrealized loss recognized in other non-interest income	(3,081)	(1,445)	(9,659)	(348)
(Unfavorable) favorable change in credit valuation adjustment recognized in other non-interest income	$ (54)	$ (29)	$ (107)	$ 93
Non-hedging derivatives				
Commitments to originate residential mortgage loans to be sold:				
Unrealized loss recognized in other non-interest income	$ (54)	$ (14)	$ (239)	$ (357)
Commitments to sell residential mortgage loans:				
Unrealized gain recognized in other non-interest income	$ 59	$ 62	$ 268	$ 463

11. FAIR VALUE MEASUREMENTS

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities that are carried at fair value.

Recurring fair value measurements

The following table summarizes assets and financial liabilities measured at fair value on a recurring basis as of September 30, 2010 and December 31, 2009, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value. There were no transfers between levels during the nine months ended September 30, 2010.

(In thousands)	September 30, 2010 Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading account security	$ -	$ -	$ 17,398	$ 17,398
Available-for-sale securities:				
Municipal bonds and obligations	-	84,807	-	84,807
Governmentguaranteed residential mortgage-backed securities	-	21,949	-	21,949
Government-sponsored residential mortgage-backed securities	-	146,007	-	146,007
Corporate bonds	-	26,567	-	26,567
Trust preferred securities	-	19,752	1,136	20,888
Other bonds and obligations	-	423	-	423
Marketable equity securities	13,041	-	1,531	14,572
Derivative assets	-	12,573	-	12,573
Derivative liabilities	-	27,046	54	27,100

(In thousands)	December 31, 2009 Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading account security	$ -	$ -	$ 15,880	$ 15,880
Available-for-sale securities:				
Municipal bonds and obligations	-	74,784	-	74,784
Government guaranteed residential mortgage-backed securities	-	13,031	-	13,031
Government-sponsored residential mortgage-backed securities	-	184,245	-	184,245
Corporate bonds	-	37,337	-	37,337
Trust preferred securities	-	6,051	864	6,915
Other bonds and obligations	-	5,470	-	5,470
Marketable equity securities	1,411	-	1,152	2,563
Derivative assets	-	3,267	-	3,267
Derivative liabilities	-	13,447	273	13,720

Trading Security at Fair Value. The Company holds one security designated as a trading security. It is a tax advantaged economic development bond issued by the Company to a local nonprofit organization which provides wellness and health programs. The determination of the fair value for this security is determined based on a discounted cash flow methodology. Certain inputs to the fair value calculation are unobservable and there is little to no market activity in the security, therefore, the security meets the definition of a Level 3 security and has been classified as such.

Securities Available for Sale. AFS securities classified as Level 1 consist of publicly-traded equity securities for which the fair values can be obtained through quoted market prices in active exchange markets. AFS securities classified as Level 2 include most of the Company’s debt securities. The pricing on Level 2 was primarily sourced from third-party pricing services and is based on models that consider standard input factors such as dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and condition, among other things. The Company holds one trust preferred security and two limited partnership securities in its AFS portfolio which are classified as Level 3.

The securities' fair values are based on unobservable issuer-provided financial information and discounted cash flow models derived from the underlying structured pool.

Derivative Assets and Liabilities. The valuation of the Company's interest rate swaps is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings.

Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of September 30, 2010, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The Company enters into various commitments to originate residential mortgage loans for sale and commitments to sell residential mortgage loans. Such commitments are considered to be derivative financial instruments and are carried at estimated fair value on the consolidated balance sheets.

The estimated fair value of commitments to originate residential mortgage loans for sale is adjusted to reflect estimates for fall-out rates, associated servicing and origination costs. These assumptions are considered significant unobservable inputs resulting in a Level 3 classification. As of September 30, 2010, liabilities derived from commitments to originate residential mortgage loans for sale totaled $54 thousand. The estimated fair values of commitments to sell residential mortgage loans were calculated by reference to prices quoted by the Federal National Mortgage Association in secondary markets. These valuations result in a Level 2 classification. As of September 30, 2010, assets derived from commitments to sell residential mortgage loans totaled $59 thousand.

The table below presents the changes in Level 3 assets that were measured at fair value on a recurring basis at September 30, 2010 and 2009.

(In thousands)	Assets Trading Account Security	Assets Securities Available for Sale	Liabilities Derivative Liabilities
Balance as of December 31, 2009	$ 15,880	$ 2,016	$ (273)
Unrealized gain recognized in other non-interest income	46	-	241
Unrealized gain included in accumulated other comprehensive loss	-	267	-
Amortization of trading account security	(110)		
Balance as of March 31, 2010	$ 15,816	$ 2,283	$ (32)
Unrealized gain (loss) recognized in other non-interest income	1,206	-	