CITIZENS & NORTHERN CORP
Form 10-K
March 01, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2009
OR
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: 0-16084

CITIZENS & NORTHERN CORPORATION
(Exact name of Registrant as specified in its charter)

PENNSYLVANIA	23-2451943
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

90-92 MAIN STREET, WELLSBORO, PA 16901
(Address of principal executive offices) (Zip code)
570-724-3411
(Registrant's telephone number including area code)

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

Title of Each Class	Name of Exchange Where Registered
Common Stock Par Value $1.00	The NASDAQ Stock Market LLC

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

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

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

Indicate by check mark whether the registrant 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 (Section 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 o No o

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions 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 aggregate market value of the registrant's common stock held by non-affiliates at June 30, 2009, the registrant’s most recently completed second fiscal quarter, was $144,560,917.

The number of shares of common stock outstanding at February 25, 2010 was 12,120,024.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s proxy statement for the annual meeting of its shareholders to be held April 20, 2010 are incorporated by reference into Parts III and IV of this report.

PART I

ITEM 1. BUSINESS

Citizens & Northern Corporation ("Corporation") is a holding company whose principal activity is community banking. The Corporation's principal office is located in Wellsboro, Pennsylvania. The largest subsidiary is Citizens & Northern Bank ("C&N Bank"). In 2005, the Corporation acquired Canisteo Valley Corporation and its subsidiary, First State Bank, a New York State chartered commercial bank with offices in Canisteo and South Hornell, NY. The First State Bank banking offices are located in the southern tier of New York State, in close proximity to many of the Corporation's northern Pennsylvania branch locations. Management considers the New York State branches to be part of the same community banking operating segment as the Pennsylvania locations; however, the separate New York State charter for First State Bank has been maintained because of certain regulatory advantages. The Corporation's other wholly-owned subsidiaries are Citizens & Northern Investment Corporation and Bucktail Life Insurance Company ("Bucktail"). Citizens & Northern Investment Corporation was formed in 1999 to engage in investment activities. Bucktail reinsures credit and mortgage life and accident and health insurance on behalf of C&N Bank.

C&N Bank is a Pennsylvania banking institution that was formed by the consolidation of Northern National Bank of Wellsboro and Citizens National Bank of Towanda on October 1, 1971. Subsequent mergers included: First National Bank of Ralston in May 1972; Sullivan County National Bank in October 1977; Farmers National Bank of Athens in January 1984; and First National Bank of East Smithfield in May 1990. On May 1, 2007, the Corporation completed its acquisition of Citizens Bancorp, Inc. ("Citizens") for an aggregate purchase price of $28,391,000 in cash and common stock. Also, Citizens Trust Company, the banking subsidiary of Citizens, was merged with and into C&N Bank as part of the transaction. C&N Bank has held its current name since May 6, 1975, at which time C&N Bank changed its charter from a national bank to a Pennsylvania bank.

C&N Bank and First State Bank (collectively, the "Banks") provide an extensive range of banking services, including deposit and loan products for personal and commercial customers. The Banks also maintain a trust division that provides a wide range of financial services, such as 401(k) plans, retirement planning, estate planning, estate settlements and asset management. In January 2000, C&N Bank formed a subsidiary, C&N Financial Services Corporation ("C&NFSC"). C&NFSC is a licensed insurance agency that provides insurance products to individuals and businesses. In 2001, C&NFSC added a broker-dealer division, which offers mutual funds, annuities, educational savings accounts and other investment products through registered agents. C&NFSC's operations are not significant in relation to the total operations of the Corporation.

All phases of the Banks' business are competitive. The Banks primarily compete in Tioga, Bradford, Sullivan, Lycoming, Potter, Cameron and McKean counties in Pennsylvania, and Steuben and Allegany counties in New York. The Banks compete with local commercial banks headquartered in our market area as well as other commercial banks with branches in our market area. Some of the banks that have branches in the Banks' market area are larger in overall size than the Banks. With respect to lending activities and attracting deposits, the Banks also compete with savings banks, savings and loan associations, insurance companies, regulated small loan companies and credit unions. Also, the Banks compete with mutual funds for deposits. C&N Bank competes with insurance companies, investment counseling firms, mutual funds and other business firms and individuals for trust, investment management, brokerage and insurance services. The Banks are generally competitive with all financial institutions in our service area with respect to interest rates paid on time and savings deposits, service charges on deposit accounts and interest rates charged on loans. The Banks serve a diverse customer base, and are not economically dependent on any small group of customers or on any individual industry.

Major initiatives within the last 5 years included the following:

- expanded trust and financial services capabilities, including investment management, employee benefits and insurance services;
- constructed and opened a branch facility in Jersey Shore, PA in 2005;
- closed on the merger with Canisteo Valley Corporation in 2005;
- constructed and opened a branch facility in Old Lycoming Township, PA, which opened in March 2006;

- constructed an administration building in Wellsboro, PA, which opened in March 2006;
- as described above, in May 2007, acquired Citizens Bancorp, Inc.;
- implemented an overdraft privilege program in 2008;
- underwent an operational process review in 2008, resulting in identification of opportunities for increases in revenue and decreases in expenses, including a net reduction in work force of 15.9%, to 297 full-time equivalent employees at December 31, 2008 from 353 at December 31, 2007

At December 31, 2009, C&N Bank had total assets of $1,276,365,000, total deposits of $886,937,000, net loans outstanding of $699,751,000 and 282 full-time equivalent employees. At December 31, 2009, First State Bank had total assets of $50,780,000, total deposits of $42,069,000, net loans outstanding of $13,587,000 and 11 full-time equivalent employees.

Most of the activities of the Corporation and its subsidiaries are regulated by federal or state agencies. The primary regulatory relationships are described as follows:

- The Corporation is a bank holding company formed under the provisions of Section 3 of the Federal Reserve Act. The Corporation is under the direct supervision of the Federal Reserve and must comply with the reporting requirements of the Federal Bank Holding Company Act.
- C&N Bank is a state-chartered, nonmember bank, supervised by the Federal Deposit Insurance Corporation and the Pennsylvania Department of Banking.
- Canisteo Valley Corporation is the holding company for First State Bank. The Federal Reserve is the primary regulator for Canisteo Valley Corporation.
- First State Bank is a state-chartered, Federal Reserve member bank, supervised by the Federal Reserve and the New York State Department of Banking.
- C&NFSC is a Pennsylvania corporation. The Pennsylvania Department of Insurance regulates C&NFSC's insurance activities. Brokerage products are offered through a third party networking agreement between C&N Bank and UVEST Financial Services, Inc.
- Bucktail is incorporated in the state of Arizona and supervised by the Arizona Department of Insurance.

Participation in the Troubled Asset Relief Program Capital Purchase Program

On October 3, 2008, the Emergency Economic Stabilization Act ("EESA") became law. The Troubled Asset Relief Program Capital Purchase Program ("TARP Capital Purchase Program") was established pursuant to the EESA in order to facilitate the investment by the U.S. Department of the Treasury ("Treasury") in senior preferred shares of qualifying banks, savings associations and certain bank and savings and loan holding companies. Pursuant to the TARP Capital Purchase Program, on January 16, 2009, the Corporation sold 26,440 shares of Series A preferred stock and a warrant to acquire 194,794 shares of common stock to the Treasury for an aggregate purchase price of $26.44 million.

As a result of the Corporation's participation in the TARP Capital Purchase Program, the Corporation has agreed to certain limitations on executive compensation. Additionally, on February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "ARRA"), which amended the EESA by, among other

things, directing Treasury to issue regulations implementing strict limitations on compensation paid or accrued by financial institutions, like the Corporation, participating in the TARP Program. Treasury issued the applicable implementing regulations, which became effective June 15, 2009, called "TARP Standards for Compensation and Corporate Governance." The limitations provided for in the implementing regulations are generally as follows: (1) limits on compensation that exclude incentives for senior executive officers (SEOs, as defined in the regulations) to take unnecessary and excessive risks that threaten the value of the Corporation; (2) provision for the recovery of any bonus, retention award, or incentive compensation paid to a SEO or the next twenty most highly compensated employees based on materially inaccurate statements of earnings, revenues, gains, or other criteria; (3) prohibition on making any golden parachute payments to a SEO or any of the next five most highly compensated employees; (4) prohibition on the payments or accrual of bonus, retention awards, or incentive compensation to the five most highly compensated employees of the Corporation, subject to certain exceptions for payments made in the form of restricted stock; (5) prohibitions on employee compensation plans that would encourage manipulation of earnings reported by the Corporation to enhance an employee's compensation; (6) establishment of a compensation committee of independent directors to meet semi-annually to review employee compensation plans and the risks posed by these plans to the Corporation; (7) adoption of an excessive and luxury expenditure policy; (8) disclosure of perquisites offered to SEOs and certain highly compensated employees; (9) disclosure related to compensation consultant engagements; (10) prohibition on tax gross-ups to SEOs and certain highly compensated employees; (11) compliance with Federal securities rules and regulations regarding the submission of non-binding resolutions on SEO compensation to shareholders; and (12) establishment of the Office of the Special Master for TARP Executive Compensation (Special Master) to address the application of these rules, to TARP recipients and their employees. The implementation regulations also establish compliance reporting and recordkeeping requirements regarding the rule's executive compensation and corporate governance standards.

A copy of the Corporation's annual report on Form 10-K, quarterly reports on Form 10-Q, current events reports on Form 8-K, and amendments to these reports, will be furnished without charge upon written request to the Corporation's Treasurer at P.O. Box 58, Wellsboro, PA 16901. Copies of these reports will be furnished as soon as reasonably possible, after they are filed electronically with the Securities and Exchange Commission. The information is also available through the Corporation's web site at www.cnbankpa.com.

ITEM 1A. RISK FACTORS

The Corporation is subject to the many risks and uncertainties applicable to all banking companies, as well as risks specific to the Corporation's geographic locations. Although the Corporation seeks to effectively manage risks, and maintains a level of equity that exceeds the banking regulatory agencies' thresholds for being considered "well capitalized" (see Note 19 to the consolidated financial statements), management cannot predict the future and cannot eliminate the possibility of credit, operational or other losses. Accordingly, actual results may differ materially from management's expectations. Some of the Corporation's significant risks and uncertainties are discussed below.

Credit Risk from Lending Activities - A significant source of risk is the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Most of the Corporation's loans are secured, but some loans are unsecured. With respect to secured loans, the collateral securing the repayment of these loans may be insufficient to cover the obligations owed under such loans. Collateral values may be adversely affected by changes in economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, wide-spread disease, terrorist activity, environmental contamination and other external events. In addition, collateral appraisals that are out of date or that do not meet industry recognized standards may create the impression that a loan is adequately collateralized when it is not. The Corporation has adopted underwriting and credit monitoring procedures and policies, including regular reviews of appraisals and borrower financial statements, that management believes are appropriate to mitigate the risk of loss. Also, as discussed further in the "Provision and Allowance for Loan Losses" section of Management's Discussion and Analysis, the Corporation attempts to estimate the amount of losses that may be inherent in the portfolio through a quarterly evaluation process that includes several members of management and that addresses specifically identified problem loans, as well as other quantitative data and qualitative factors. Such risk management and accounting policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Interest Rate Risk - Business risk arising from changes in interest rates is an inherent factor in operating a banking organization. The Corporation's assets are predominantly long-term, fixed rate loans and debt securities. Funding for these assets comes principally from shorter-term deposits and borrowed funds. Accordingly, there is an inherent risk of lower future earnings or decline in fair value of the Corporation's financial instruments when interest rates change. Significant fluctuations in interest rates could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. For additional information regarding interest rate risk, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

Equity Securities Risk - The Corporation's equity securities portfolio consists of investments in stocks of banks and bank holding companies. Investments in bank stocks are subject to the risk factors affecting the banking industry, and that could cause a general market decline in the value of bank stocks. Also, losses could occur in individual stocks held by the Corporation because of specific circumstances related to each bank. These factors could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. For additional information regarding equity securities risk, including management's assessment of equity securities for other-than-temporary impairment as of December 31, 2008, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

4

Debt Securities Risk – As described in the Earnings Overview section of Management's Discussion and Analysis, the Corporation's earnings were materially impaired in 2009 and 2008 by securities losses. Much of the Corporation's 2009 and 2008 losses from trust-preferred securities and other securities stem from the much-publicized economic problems affecting the national and international economy, which have particularly hurt the banking industry. The Corporation has exposure to the possibility of future losses from investments in a senior tranche pooled trust-preferred security, trust-preferred securities issued by individual banks, private label collateralized mortgage obligations (CMOs), and other debt securities. For additional information regarding debt securities, see Note 7 to the consolidated financial statements.

Realization of Deferred Tax Asset – The Corporation recognizes deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax bases of assets and liabilities. At December 31, 2009, the net deferred tax asset was $22.0 million, up from a balance of approximately $16.4 million at December 31, 2008. The increase in net deferred tax asset resulted mainly from other-than-temporary impairment losses on securities for financial reporting purposes, which are not currently deductible for federal income tax reporting purposes. The net deferred tax asset balance at December 31, 2009 attributable to realized securities losses was $16.1 million, exclusive of a valuation allowance of $373,000.

The Corporation regularly reviews deferred tax assets for recoverability based on history of earnings, expectations for future earnings and expected timing of reversals of temporary differences. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carryback years, as well as future taxable income. Of the total deferred tax asset from realized losses on securities, a portion is from securities that, if the Corporation were to sell them, would be classified as capital losses for income tax reporting purposes. The valuation allowance at December 31, 2009 reflects the excess of the tax benefit that would be generated from selling all of the capital assets, over the amount that could be realized from available carryback and offset against capital gains generated in 2007 and 2008. Realization of the remaining $373,000 of tax benefits associated with capital assets is dependent upon realization of future capital gains. After adjustment for the valuation allowance on capital assets, management believes the recorded net deferred tax asset at December 31, 2009 is fully realizable; however, if management determines the Corporation will be unable to realize all or part of the net deferred tax asset, the Corporation would adjust the deferred tax asset, which would negatively impact earnings.

Federal Home Loan Bank of Pittsburgh Common Stock - We own common stock of the Federal Home Loan Bank of Pittsburgh, or the FHLB, in order to qualify for membership in the Federal Home Loan Bank system, which enables us to borrow funds under the Federal Home Loan Bank advance program. The carrying value and fair market value of our FHLB common stock, which is included in Other Assets in the consolidated balance sheet, was $8.6 million as of December 31, 2009. Published reports indicate that certain member banks of the Federal Home Loan Bank system may be subject to asset quality risks that could result in materially lower regulatory capital levels. In December 2008, the FHLB had notified its member banks that it had suspended dividend payments and the repurchase of capital stock until further notice is provided. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the FHLB, could be substantially diminished or reduced to zero. Consequently, given that there is no market for our FHLB common stock, we believe that there is a risk that our investment could be deemed other-than-temporarily impaired at some time in the future. If this occurs, it may adversely affect our results of operations and financial condition. If the FHLB were to cease operations, or if we were required to write-off our investment in the FHLB, our business, financial condition, liquidity, capital and results of operations may be materially adversely affected.

FDIC Insurance Assessments - During 2008 and continuing in 2009, higher levels of bank failures have dramatically increased resolution costs of the Federal Deposit Insurance Corporation, or the FDIC, and depleted the deposit insurance fund. In addition, the FDIC and the U.S. Congress have taken action to increase federal deposit insurance coverage, placing additional stress on the deposit insurance fund. In order to maintain a strong funding position and

restore reserve ratios of the deposit insurance fund, the FDIC increased assessment rates of insured institutions uniformly by seven cents for every $100 of deposits beginning with the first quarter of 2009, with additional changes beginning April 1, 2009, which require riskier institutions to pay a larger share of premiums by factoring in rate adjustments based on secured liabilities and unsecured debt levels. To further support the rebuilding of the deposit insurance fund, the FDIC imposed a special assessment on each insured institution, equal to five basis points of the institution's total assets minus Tier 1 capital as of September 30, 2009. For our banks, there was an aggregate charge of $589,000, which was recorded as a pre-tax charge during the second quarter of 2009. The FDIC has indicated that future special assessments are possible, although it has not determined the magnitude or timing of any future assessments. In December 2009, we paid a pre-payment of the FDIC's estimated assessment total for the next three years for our banks, totaling approximately $5.5 million. This amount was included in Other Assets in the consolidated balance sheet at December 31, 2009, and will be amortized, subject to adjustments imposed by the FDIC, over the next three years.

We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. If there are additional bank or financial institution failures, we may be required to pay even higher FDIC premiums. Our expenses for 2009 were significantly and adversely affected by the increased premiums and the special assessment. These increases and assessment and any future increases in insurance premiums or additional special assessments may materially adversely affect our results of operations.

Breach of Information Security and Technology Dependence - The Corporation relies on software, communication, and information exchange on a variety of computing platforms and networks and over the Internet. Despite numerous safeguards, the Corporation cannot be certain that all of its systems are entirely free from vulnerability to attack or other technological difficulties or failures. The Corporation relies on the services of a variety of vendors to meet its data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and the Corporation could be exposed to claims from customers. Any of these results could have a material adverse effect on the Corporation’s financial condition, results of operations or liquidity.

Limited Geographic Diversification - The Corporation grants commercial, residential and personal loans to customers primarily in the Pennsylvania Counties of Tioga, Bradford, Sullivan, Lycoming, Potter, Cameron and McKean, and in Steuben and Allegany Counties in New York State. Although the Corporation has a diversified loan portfolio, a significant portion of its debtors’ ability to honor their contracts is dependent on the local economic conditions within the region. Deterioration in economic conditions could adversely affect the quality of the Corporation's loan portfolio and the demand for its products and services, and accordingly, could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Growth Strategy – In recent years, the Corporation has expanded its operations by acquisitions and by building and opening new branches. The Corporation’s future financial performance will depend on its ability to execute its strategic plan and manage its future growth. Failure to execute these plans could have a material adverse effect on the Corporation’s financial condition, results of operations or liquidity.

Competition - All phases of the Corporation’s business are competitive. Some competitors are much larger in total assets and capitalization than the Corporation, have greater access to capital markets and can offer a broader array of financial services. There can be no assurance that the Corporation will be able to compete effectively in its markets. Furthermore, developments increasing the nature or level of competition could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Government Regulation and Monetary Policy - The Corporation and the banking industry are subject to extensive regulation and supervision under federal and state laws and regulations. The requirements and limitations imposed by such laws and regulations limit the manner in which the Corporation conducts its business, undertakes new investments and activities and obtains financing. These regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit the Corporation's shareholders. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation in the future, none of which is in the control of the Corporation. Significant new laws or changes in, or repeals of, existing laws could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects short-term interest rates and credit conditions, and any unfavorable change in these conditions could have a material adverse effect on the Corporation's financial condition, results of operations or liquidity.

Participation in the TARP Capital Purchase Program - Pursuant to the TARP Capital Purchase Program, on January 16, 2009, the Corporation sold 26,440 shares of Series A preferred stock and a warrant to acquire 194,794 shares of

common stock to the Treasury for an aggregate purchase price of $26.44 million. As a TARP Participant, the Corporation is subject to limits on executive compensation (described in Item 1 of Form 10-K) which could limit the Corporation's ability to attract and retain qualified management personnel. Also, because of participation in the TARP Program, the Corporation is subject to limitations on payment of dividends on common stock, which include a requirement that permission from the Treasury must be obtained to pay dividends greater than $0.24 per share (per quarter) on its common stock. Further, until January 16, 2012 (unless prior to that date, the Corporation has redeemed the preferred stock issued to the Treasury in whole or the Treasury has transferred all of the preferred stock to third parties) the Treasury's consent is required for any repurchases of common stock, except for repurchases of shares in connection with employee benefit plans in the ordinary course of business consistent with past practice.

Bank Secrecy Act and Related Laws and Regulations - These laws and regulations have significant implications for all financial institutions. They increase due diligence requirements and reporting obligations for financial institutions, create new crimes and penalties, and require the federal banking agencies, in reviewing merger and other acquisition transactions, to consider the effectiveness of the parties to such transactions in combating money laundering activities. Even innocent noncompliance and inconsequential failure to follow the regulations could result in significant fines or other penalties, which could have a material adverse impact on the Corporation's financial condition, results of operations or liquidity.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

The Banks own each of their properties, except for the facility located at 2 East Mountain Avenue, South Williamsport, which is leased. All of the properties are in good condition. None of the owned properties are subject to encumbrance.

A listing of properties is as follows:

Main administrative offices:

90-92 Main Street Wellsboro, PA 16901	or	10 Nichols Street Wellsboro, PA 16901

Facilities management office:
13 Water Street
Wellsboro, PA 16901

Branch offices – C&N Bank:

428 S. Main Street Athens, PA 18810	514 Main Street Laporte, PA 18626	2 East Mountain Avenue South Williamsport, PA 17702
10 N. Main Street Coudersport, PA 16915	4534 Williamson Trail Liberty, PA 16930	41 Main Street Tioga, PA 16946
111 W. Main Street Dushore, PA 18614	1085 Main Street Mansfield, PA 16933	428 Main Street Towanda, PA 18848
Main Street East Smithfield, PA 18817	RR 2 Box 3036 Monroeton, PA 18832	Courthouse Square Troy, PA 16947
104 Main Street Elkland, PA 16920	3461 Route 405 Highway Muncy, PA 17756	90-92 Main Street Wellsboro, PA 16901
135 East Fourth Street Emporium, PA 15834	100 Maple Street	1510 Dewey Avenue Williamsport, PA 17701

	Port Allegany, PA 16743	
230 Railroad Street Jersey Shore, PA 17740	24 Thompson Street Ralston, PA 17763	130 Court Street Williamsport, PA 17701
102 E. Main Street Knoxville, PA 16928	1827 Elmira Street Sayre, PA 18840	Route 6 Wysox, PA 18854

First State Bank offices:

3 Main Street Canisteo, NY 14823	6250 County Route 64, East Avenue Extension Hornell, NY 14843

ITEM 3. LEGAL PROCEEDINGS

The Corporation and the Banks are involved in various legal proceedings incidental to their business. Management believes the aggregate liability, if any, resulting from such pending and threatened legal proceedings will not have a material adverse effect on the Corporation's financial condition or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

During the fourth quarter of 2009, no matters were submitted to a vote of security holders, through the solicitation of proxies or otherwise.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

QUARTERLY SHARE DATA

Trades of the Corporation's stock are executed through various brokers who maintain a market in the Corporation's stock. The Corporation's stock is listed on the NASDAQ Capital Market with the trading symbol CZNC. As of December 31, 2009, there were 2,619 shareholders of record of the Corporation's common stock.

The following table sets forth the high and low sales prices of the common stock during 2009 and 2008.

	2009			2008		
	High	Low	Dividend Declared Per Quarter	High	Low	Dividend Declared Per Quarter
First quarter	$ 20.94	$ 14.06	$ 0.24	$ 21.00	$ 16.85	$ 0.24
Second quarter	22.46	16.46	0.24	20.50	15.82	0.24
Third quarter	22.06	14.50	0.24	25.80	16.13	0.24
Fourth quarter	15.14	8.15	0.00	25.45	17.18	0.24

In December 2009, the Corporation announced that the Board of Directors was delaying until January 2010 a decision regarding the size of the dividend on common stock to be declared for the fourth quarter of 2009. This was a departure from the Corporation's customary practice which had been to declare a dividend for the fourth quarter of the year in mid-December, with a dividend payment date in mid- to late January. In January 2010, the Board of Directors declared a dividend of $0.08 per share on common stock, which was paid in February 2010. Since the $.08 dividend was declared in 2010, it is not included in the table above.

Future dividend payments will depend upon maintenance of a strong financial condition, future earnings and capital and regulatory requirements. Also, the Corporation, C&N Bank and First State Bank are subject to restrictions on the amount of dividends that may be paid without approval of banking regulatory authorities. These restrictions are described in Note 19 to the consolidated financial statements. Specifically, under guidance issued in 2009 by the Federal Reserve, until further notice the Corporation must consult the Federal Reserve before declaring dividends on either common or preferred stock. Further, pursuant to participation in the TARP Program, the Corporation may continue to pay dividends on its common stock, subject to the following requirements and limitations: (1) all accrued and unpaid dividends for all past dividend periods on the preferred stock issued to the Treasury must be fully paid;

and (2) consent of the Treasury is required for any increase above $0.24 per quarter in the per share dividends on common shares until January 16, 2012, unless prior to that date, the Corporation has redeemed the preferred stock issued to the Treasury in whole or the Treasury has transferred all of the preferred stock to third parties.

On August 21, 2008, the Corporation announced the extension and amendment of a plan that permits the repurchase of shares of its outstanding common stock, up to an aggregate total of $10 million, through August 31, 2009. The Board of Directors authorized repurchase from time to time at prevailing market prices in open market or in privately negotiated transactions as, in management's sole opinion, market conditions warrant and based on stock availability, price and the Corporation's financial performance. At August 31, 2009, the stock repurchase program expired and no repurchases were made in 2009.

Pursuant to participation in the TARP Program, until January 16, 2012 (unless prior to that date, the Corporation has redeemed the preferred stock issued to the Treasury in whole or the Treasury has transferred all of the preferred stock to third parties) the Treasury's consent is required for any repurchases of common stock, except for repurchases of shares in connection with employee benefit plans in the ordinary course of business consistent with past practice.

PERFORMANCE GRAPH

Set forth below is a chart comparing the Corporation's cumulative return to stockholders against the cumulative return of the Russell 2000 and a Peer Group Index of similar banking organizations selected by the Corporation for the five-year period commencing December 31, 2004 and ended December 31, 2009. The index values are market-weighted dividend-reinvestment numbers, which measure the total return for investing $100.00 five years ago. This meets Securities & Exchange Commission requirements for showing dividend reinvestment share performance over a five-year period and measures the return to an investor for placing $100.00 into a group of bank stocks and reinvesting any and all dividends into the purchase of more of the same stock for which dividends were paid.

COMPARISON OF 5-YEAR CUMULATIVE RETURN

Citizens & Northern Corporation

	Period Ending					
Index	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
Citizens & Northern Corporation	100.00	99.12	89.53	76.17	89.58	45.10
Russell 2000	100.00	104.55	123.76	121.82	80.66	102.58
Citizens & Northern Peer Group*	100.00	96.66	100.68	90.98	79.39	76.52

The C&N peer group consists of banks headquartered in Pennsylvania with total assets of $500 million to $1.3 billion. This peer group consists of 1st Summit Bancorp of Johnstown, Inc., Johnstown; ACNB Corporation, Gettysburg; AmeriServ Financial, Inc., Johnstown; Bryn Mawr Bank Corporation, Bryn Mawr; CCFNB Bancorp, Inc., Bloomsburg; Citizens Financial Services, Inc., Mansfield; CNB Financial Corporation, Clearfield; Codorus Valley Bancorp, York; Comm Bancorp, Inc., Clarks Summit; Dimeco, Inc., Honesdale; DNB Financial Corporation, Downingtown; ENB Financial Corp., Ephrata; Fidelity D & D Bancorp, Inc., Dunmore; First Keystone Corporation, Berwick; FNB Bancorp, Inc., Newtown; Franklin Financial Services Corporation, Chambersburg; Kish Bancorp, Inc., Reedsville; Mid Penn Bancorp, Inc., Millersburg; Norwood Financial Corp., Honesdale; Orrstown Financial Services, Inc., Shippensburg; Penns Woods Bancorp, Inc., Williamsport; Penseco Financial Services Corporation, Scranton; QNB Corp., Quakertown; Republic First Bancorp, Inc., Philadelphia; Somerset Trust Holding Company, Somerset; Union National Financial Corporation, Lancaster; and VIST Financial Corp., Wyomissing.

The data for this graph was obtained from SNL Financial L.C.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information concerning the Stock Incentive Plan and Independent Directors Stock Incentive Plan, both of which have been approved by the Corporation's shareholders. The figures shown in the table below are as of December 31, 2009.

	Number of Securities to be Issued Upon Exercise of Outstanding Options	Weighted-average Exercise Price of Outstanding Options	Number of Securities Remaining for Future Issuance Under Equity Compensation Plans
Equity compensation plans approved by shareholders	306,358	$ 20.53	524,311
Equity compensation plans not approved by shareholders	0	N/A	0

More details related to the Corporation's equity compensation plans are provided in Notes 1 and 13 to the consolidated financial statements.

ITEM 6. SELECTED FINANCIAL DATA

	As of or for the Year Ended December 31,				
INCOME STATEMENT (In Thousands)	2009	2008	2007	2006	2005
Interest and fee income	$ 67,976	$ 74,237	$ 70,221	$ 64,462	$ 61,108
Interest expense	24,456	31,049	33,909	30,774	25,687
Net interest income	43,520	43,188	36,312	33,688	35,421
Provision for loan losses	680	909	529	672	2,026
Net interest income after provision for loan losses	42,840	42,279	35,783	33,016	33,395
Noninterest income excluding securities (losses)/gains and gains from sale of credit card loans	12,669	12,883	10,440	7,970	7,636
Net impairment losses recognized in earnings from available-for-sale securities	(85,363)	(10,088)	0	0	0
Realized gains on available-for-sale securities	1,523	750	127	5,046	1,802
Gain from sale of credit card loans	0	0	0	340	1,906
Noninterest expense	33,659	33,446	33,283	31,614	28,962
(Loss) income before income tax (credit) provision	(61,990)	12,378	13,067	14,758	15,777
Income tax (credit) provision	(22,655)	2,319	2,643	2,772	2,793
Net (loss) income	(39,335)	10,059	10,424	11,986	12,984
U.S. Treasury preferred dividends	1,428	0	0	0	0
Net (loss) income available to common shareholders	$ (40,763)	$ 10,059	$ 10,424	$ 11,986	$ 12,984
PER COMMON SHARE: (1)					
Basic earnings per share	$ (4.40)	$ 1.12	$ 1.19	$ 1.42	$ 1.53
Diluted earnings per share	$ (4.40)	$ 1.12	$ 1.19	$ 1.42	$ 1.52
Cash dividends declared per share	$ 0.72	$ 0.96	$ 0.96	$ 0.96	$ 0.93
Stock dividend	None	None	1%	1%	1%
Book value per common share at period-end	$ 10.46	$ 13.66	$ 15.34	$ 15.51	$ 15.58
Tangible book value per common share at period-end	$ 9.43	$ 12.22	$ 13.85	$ 15.13	$ 15.18
Weighted average common shares outstanding - basic	9,271,869	8,961,805	8,784,134	8,422,495	8,458,813
Weighted average common shares outstanding - diluted	9,271,869	8,983,300	8,795,366	8,448,169	8,517,598
END OF PERIOD BALANCES (In Thousands)					
Available-for-sale securities	$ 396,288	$ 419,688	$ 432,755	$ 356,665	$ 427,298
Gross loans	721,603	743,544	735,941	687,501	653,299
Allowance for loan losses	8,265	7,857	8,859	8,201	8,361
Total assets	1,321,795	1,281,637	1,283,746	1,127,368	1,162,954
Deposits	926,789	864,057	838,503	760,349	757,065

Borrowings	235,471	285,473	300,132	228,440	266,939
Stockholders' equity	152,410	122,026	137,781	129,888	131,968
Common stockholders' equity (stockholders' equity, excluding preferred stock)	126,661	122,026	137,781	129,888	131,968
AVERAGE BALANCES (In Thousands)					
Total assets	1,296,086	1,280,924	1,178,904	1,134,689	1,144,619
Earning assets	1,208,280	1,202,872	1,090,035	1,055,103	1,065,189
Gross loans	728,748	743,741	729,269	662,714	618,344
Deposits	886,703	847,714	812,255	750,982	702,404
Stockholders' equity	141,787	130,790	138,669	131,082	132,465
KEY RATIOS					
Return on average assets	-3.03%	0.79%	0.88%	1.06%	1.13%
Return on average equity	-27.74%	7.69%	7.52%	9.14%	9.80%
Average equity to average assets	10.94%	10.21%	11.76%	11.55%	11.57%
Net interest margin (2)	3.84%	3.77%	3.51%	3.42%	3.62%
Efficiency (3)	56.97%	57.40%	68.39%	71.73%	62.68%
Cash dividends as a % of diluted earnings per share	NM	85.71%	80.67%	67.61%	61.18%
Tier 1 leverage	9.77%	10.12%	10.91%	11.22%	10.62%
Tier 1 risk-based capital	16.65%	13.99%	15.46%	16.51%	16.52%
Total risk-based capital	17.84%	14.84%	16.52%	17.97%	18.19%
Tangible common equity/tangible assets	8.72%	8.61%	9.79%	11.27%	11.09%

ITEM 6. SELECTED FINANCIAL DATA, continued

NM = Not a meaningful ratio.

(1) All share and per share data have been restated to give effect to stock dividends and splits.
(2) Rates of return on tax-exempt securities and loans are calculated on a fully-taxable equivalent basis.
(3) The efficiency ratio is calculated by dividing total noninterest expense by the sum of net interest income (including income from tax-exempt securities and loans on a fully-taxable equivalent basis) and noninterest income excluding securities gains and gains from sale of credit card loans.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements in this section and elsewhere in this Annual Report on Form 10-K are forward-looking statements. Citizens & Northern Corporation and its wholly-owned subsidiaries (collectively, the Corporation) intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Reform Act of 1995. Forward-looking statements, which are not historical facts, are based on certain assumptions and describe future plans, business objectives and expectations, and are generally identifiable by the use of words such as, "should", “likely”, "expect", “plan”, "anticipate", “target”, “forecast”, and “goal”. These forward-looking statements are subject to risks and uncertainties that are difficult to predict, may be beyond management’s control and could cause results to differ materially from those expressed or implied by such forward-looking statements. Factors which could have a material, adverse impact on the operations and future prospects of the Corporation include, but are not limited to, the following:

- changes in monetary and fiscal policies of the Federal Reserve Board and the U.S. Government, particularly related to changes in interest rates
- changes in general economic conditions
- legislative or regulatory changes
- downturn in demand for loan, deposit and other financial services in the Corporation’s market area
- increased competition from other banks and non-bank providers of financial services
- technological changes and increased technology-related costs
- changes in accounting principles, or the application of generally accepted accounting principles.

These risks and uncertainties should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements.

EARNINGS OVERVIEW

For the year ended December 31, 2009, a net loss available to common shareholders was reported of $40,763,000, or $4.40 per share, while net income was $10,059,000 ($1.12 per share – basic and diluted) in 2008 and $10,424,000 ($1.19 per share – basic and diluted) in 2007. The net loss for the year ended December 31, 2009 included the impact of after-tax other-than-temporary impairment (OTTI) charges on available-for-sale securities (adjusted for realized gains on some securities subsequently sold) of $55,849,000. In 2008, the after-tax impact of OTTI charges was $6,638,000. There were no OTTI charges in 2007.

Core Earnings is an earnings performance measurement which the Corporation’s management has defined to exclude the effects of OTTI losses on available-for-sale securities and realized gains on securities for which OTTI has previously been recognized. Core Earnings is a performance measurement that is not based on U.S. generally accepted accounting principles. Management believes Core Earnings information is meaningful for evaluating the

Corporation's operating performance, because it excludes some of the impact of market volatility as it relates to investments in pooled trust-preferred securities and other securities. More information concerning Core Earnings, including a reconciliation to the Corporation's earnings results based on U.S. generally accepted accounting principles, is provided in the following section of Management's Discussion and Analysis. The Corporation's results for 2009 included positive Core Earnings available to common shareholders of $15,086,000 ($1.63 per diluted share), reduced by after-tax OTTI charges on available-for-sale securities (net of subsequent gains from selling some of the securities) of $55,849,000. In 2008, the Corporation had Core Earnings of $16,697,000 ($1.86 per diluted share), and Core Earnings for 2007 totaled $10,424,000 ($1.19 per diluted share).

Pre-tax OTTI charges totaled $85,363,000 in 2009 and $10,088,000 in 2008, with no OTTI charges in 2007. A summary of pre-tax OTTI charges is as follows:

(In Thousands)	2009	2008	2007
Pooled trust preferred securities - mezzanine tranches	$ (73,674)	$ (8,210)	$ 0
Marketable equity securities (bank stocks)	(6,324)	(1,878)	0
Trust preferred securities issued by individual institutions	(3,209)	0	0
Collateralized mortgage obligations	(2,156)	0	0
Net impairment losses recognized in earnings	$ (85,363)	$ (10,088)	$ 0

Pooled trust-preferred securities are very long-term (usually 30-year maturity) instruments, mainly issued by banks. The Corporation's investments in pooled trust-preferred securities are each made up of companies with geographic and size diversification. Almost all of the Corporation's pooled trust-preferred securities are composed of debt issued by banking companies, with lesser amounts issued by insurance companies and real estate investment trusts. Management evaluates the pooled trust-preferred securities for OTTI by estimating the cash flows expected to be received from each security, taking into account estimated levels of deferrals and defaults by the underlying issuers. In determining cash flows, management assumes all issuers currently deferring or in default would make no future payments, and assigns estimated future default levels for the remaining issuers in each security based on financial strength ratings assigned by a national ratings service. The Corporation's process for evaluating pooled trust-preferred securities for OTTI is described in more detail in Note 7 to the consolidated financial statements. After the impact of the impairment charges, the Corporation's cost basis in pooled trust-preferred securities at December 31, 2009 totaled $11.649 million, including senior tranche assets of $11.383 million and mezzanine tranche assets of $0.266 million. The estimated fair value at December 31, 2009 of pooled trust-preferred securities was $8.314 million.

As described in more detail in Notes 2 and 7 to the consolidated financial statements, the Corporation adopted new accounting principles in 2009, which resulted in the impairment of debt securities being separated into (a) the amount of the total impairment related to credit loss, which is recognized in the income statement, and (b) the amount of the total impairment related to all other factors, which is recognized in other comprehensive income. In 2009, the effect of the new principles was to increase impairment losses recognized in earnings by $3,451,000, and decrease the income tax provision by $1,173,000, resulting in a decrease in net income (larger net loss) of $2,275,000, or $0.25 per average common share.

STATEMENT REGARDING NON-GAAP FINANCIAL MEASUREMENT

This report contains supplemental financial information determined by a method other than in accordance with Accounting Principles Generally Accepted in the United States of America ("GAAP"). Management uses this non-GAAP measure in its analysis of the Corporation's performance. This measure, Core Earnings, excludes the effects of OTTI losses on available-for-sale securities and realized gains on securities for which OTTI has previously been recognized. Management believes the presentation of this financial measure, which excludes the impact of the specified items, provides useful supplemental information that is essential to a proper understanding of the financial results of the Corporation. The Core Earnings measure provides a method to assess operating performance excluding the impact of market volatility related to investments in pooled trust-preferred securities and other securities. This disclosure should not be viewed as a substitute for results determined in accordance with GAAP, nor is it necessarily comparable to non-GAAP performance measures that may be presented by other companies.

RECONCILIATION OF NON-GAAP MEASURE
(UNAUDITED)
(In thousands, except per-share data)

	2009		2008		2007	
	Net (Loss)/ Income	Diluted EPS	Net Income	Diluted EPS	Net Income	Diluted EPS
Net (loss) income available to common shareholders	$ (40,763)	$ (4.40)	$ 10,059	$ 1.12	$ 10,424	$ 1.19
Other-than-temporary impairment losses on available-for-sale securities	(85,363)		(10,088)		0	
Realized gains on assets previously written down	1,308		31		0	
Other-than-temporary impairment losses on available-for-sale securities, net of related gains	(84,055)		(10,057)		0	
Income taxes (1)	28,206		3,419		0	
Other-than-temporary impairment losses, net	(55,849)		(6,638)		0	
Core earnings available to common shareholders	$ 15,086	$ 1.63	$ 16,697	$ 1.86	$ 10,424	$ 1.19

(1) Income tax has been allocated to the non-core losses at 34%, adjusted for a valuation allowance of $373,000 in 2009 on deferred tax assets associated with losses from securities classified as capital assets for federal income tax reporting purposes. The valuation allowance is described in more detail in Note 15 to the consolidated financial statements.

2009 vs. 2008

The most significant changes in components of the Corporation's Core Earnings results for 2009, as compared to 2008, were as follows:

- The interest margin increased $332,000, or 0.8%. On a fully taxable-equivalent basis, the interest margin increased $1,032,000, or 2.3%. The interest margin has been positively impacted by lower short-term market interest rates, which have reduced interest rates paid on deposits and borrowings. The interest margin has also been positively impacted by increased levels of investments and high yields on municipal bonds. The interest margin has been negatively impacted by weak consumer loan demand, as average loans outstanding have shrunk approximately $15.0 million in 2009 as compared to 2008.

- The provision for loan losses was $229,000 lower in 2009 than in 2008. The ratio of nonperforming loans (including nonaccrual loans and loans 90 days or more past due and still accruing interest) and other real estate owned, as a percentage of assets, was 0.76% at December 31, 2009, higher than the 0.69% level at December 31, 2008, but still relatively low by historical standards.

- Non-interest income decreased $214,000, or 1.7%. In 2008, non-interest income included a gain of $533,000 from redemption of restricted shares of Visa, resulting from Visa's initial public offering. Also, in 2009, the Corporation received no dividend income on its investment in restricted stock issued by the Federal Home Loan Bank of Pittsburgh, while dividend income on this stock was $334,000 in 2008.

- Non-interest expense increased $213,000, or 0.6%. FDIC insurance assessments increased $1,784,000 in 2009, to $2,092,000 from $308,000. The higher FDIC assessments included the effects of premium increases and a special assessment of $589,000. Excluding FDIC costs, total non-interest expense was 4.7% lower in 2009 than in 2008.

- Core Earnings for 2009 were reduced by dividends on preferred stock issued to the U.S. Treasury under the TARP Capital Purchase Program of $1,428,000.

More detailed information concerning fluctuations in the Corporation's earnings results are provided in other sections of Management's Discussion and Analysis.

2008 vs. 2007

Net income available to common shareholders for the year ended December 31, 2008 was $10,059,000, or $1.12 per diluted share, as compared to net income of $10,424,000, or $1.19 per diluted share, in 2007. As defined above, Core Earnings per diluted share were $1.86 in 2008, as compared to $1.19 in 2007.

The most significant changes in components of the Corporation's Core Earnings results for 2008, as compared to 2007, were as follows:

- The interest margin was $6,876,000, or 18.9%, higher in 2008. The improved interest margin includes the impact of the Citizens Bancorp, Inc. acquisition, which was effective May 1, 2007. The interest margin was also positively impacted by lower market interest rates, which reduced interest rates paid on deposits and borrowings, and by higher earnings on the investment portfolio resulting from higher average total holdings of securities.

- Non-interest income increased $2,443,000, or 23.4%, in 2008 over 2007. Service charges on deposit accounts increased $1,888,000, or 73.8%, as a result of growth in deposit volumes from the Citizens Bancorp acquisition, as well as higher fees associated with a new overdraft privilege program. Also, in 2008, noninterest income included a gain of $533,000 from redemption of restricted shares of Visa, resulting from Visa's initial public offering.

OUTLOOK FOR 2010

As described in the "Earnings Overview" section above, the Corporation reported a net loss for 2009. Note 21 to the consolidated financial statements presents quarterly income statement data that shows there was a net loss in each of the first three quarters of 2009, primarily because of substantial securities write-downs, and positive net income of $4.242 million ($0.42 per diluted share) in the fourth quarter 2009. While management cannot guarantee there will be no additional securities losses, based on the relatively small ($0.266 million) remaining cost basis of mezzanine pooled trust-preferred securities as of December 31, 2009, we believe the vast majority of losses have been realized. Core Earnings (as defined above) results for 2009 reflect the impact of significant operational changes made in 2007 and 2008, including successful implementation of an overdraft privilege program, as well as other enhancements to noninterest revenue sources. Management also improved efficiency of various operational activities, which has resulted in significant expense reductions. In 2010, management expects the Corporation's earnings results to continue to reflect some of the positive effects of these changes.

A major variable that affects the Corporation's earnings is securities gains and losses. The Corporation's 2009 and 2008 losses from trust-preferred securities and other securities stem from the much-publicized economic problems affecting the national and international economy, which have particularly hurt the banking industry. Although management believes these conditions to be cyclical, the Corporation has exposure to the possibility of future losses from investments in a senior tranche pooled trust-preferred security, trust-preferred securities issued by individual banks, bank stocks, private label collateralized mortgage obligations (CMOs), and other securities. Note 7 to the consolidated financial statements provides more detail concerning the Corporation's investment securities.

In light of weak economic conditions, the Federal Reserve has taken actions that have driven interest rates down to very low levels by historical standards, including establishing the federal funds target rate at a range of 0% to 0.25% throughout 2009. Some recent economic reports reflect improvement in U.S. economic conditions, which could result in the Federal Reserve beginning to take actions designed to raise interest rates before the end of 2010. As described in more detail in Item 7A of this Form 10-K, the Corporation is liability sensitive, meaning that net interest income tends to increase when interest rates fall, but that net interest income tends to decrease when rates rise. One of the ways management monitors exposure to rising interest rates is by calculating the estimated impact of interest rate shocks (immediate changes in rates) at varying levels. Table XV in Item 7A presents information regarding the

estimated impact of immediate interest rate shocks of 100 basis points (1%), 200 basis points and 300 basis points on net interest income and on the market value of portfolio equity.

The Corporation benefited in 2009 from a relatively low (by historical standards) provision for loan losses. Issues related to larger commercial borrowers can significantly affect the Corporation's provision for loan losses in any particular period. Accordingly, the amount of loan loss provision for 2010 will depend substantially on the credit status of the commercial portfolio. Although management is concerned about the condition of the national economy and the potential for problems in our market area, to date the Corporation has not experienced significant deterioration in loan delinquencies, or a noticeable change in volume of activity related to troubled loans or foreclosures. The Corporation has not originated interest only mortgages, loans without documentation of the borrowers' sources of income or net worth, or other types of subprime mortgage loans that have received negative publicity. However, if economic conditions deteriorate significantly, the Corporation may need to increase the provision for loan losses for the impact on the residential mortgage and consumer portions of the loan portfolio.

As referenced above, the Corporation implemented a new overdraft privilege program in 2008, and has recognized significant increases in non-interest income in 2008 and 2009 as compared to income from its prior overdraft process. Total revenue from overdrafts, net of waived or refunded fees and provision for charge-offs, amounted to $4,055,000 in 2009. Legislative and regulatory changes will affect the overdraft privilege program in the second half of 2010, as customers will be required to affirmatively document their consent to be assessed overdraft fees for ATM and one-time point-of-sale transactions. Also, potential legislative changes could limit the Corporation's ability to pay overdrafts and assess fees for all these types of transactions. Management cannot currently estimate the extent of reduction in revenue that could occur in the second half of 2010 as a result of these regulatory and potential legislative changes.

As described in more detail in Note 22 to the consolidated financial statements, in January 2009, the Corporation issued Preferred Stock and a Warrant to purchase up to 194,794 shares of common stock at an exercise price of $20.36 per share to the United States Department of the Treasury under the TARP Program. The Corporation sold the Preferred Stock and Warrant for an aggregate price of $26,440,000. The Preferred Stock pays a cumulative dividend rate of 5% per annum for the first five years and will reset to a rate of 9% per annum after year five. Pursuant to participation in the TARP Program, the Corporation may continue to pay dividends on its common stock, subject to the following requirements and limitations: (1) all accrued and unpaid dividends for all past dividend periods on the preferred stock issued to the Treasury must be fully paid; and (2) consent of the Treasury is required for any increase over $0.24 per quarter in the per share dividends on common shares until January 16, 2012, unless prior to that date, the Corporation has redeemed the preferred stock issued to the Treasury in whole or the Treasury has transferred all of the preferred stock to third parties. Also, until January 16, 2012 (unless prior to that date, the Corporation has redeemed the preferred stock issued to the Treasury in whole or the Treasury has transferred all of the preferred stock to third parties) the Treasury's consent is required for any repurchases of common stock, except for repurchases of shares in connection with employee benefit plans in the ordinary course of business consistent with past practice. Management is considering redemption of the Preferred Stock in 2010; however, our ability to do so is dependent upon approval from banking regulatory authorities and the Treasury.

In 2009, the Corporation issued approximately 3,090,000 shares of common stock, raising a total of $ 24,585,000, net of related offering costs. Of this total, 2,875,000 shares were issued at a price of $8.00 per share in a public offering that was completed in December 2009, and which resulted in net proceeds of $21,410,000 (included in the $24,585,000 for the year). The additional $3,175,000 was raised through issuance of shares under the Corporation's Dividend Reinvestment Plan. Although the Corporation maintained capital ratios that exceeded regulatory requirements to be considered well capitalized throughout 2009, the additional capital provides flexibility to absorb any additional, unexpected securities losses or other economic issues that might arise. Further, management believes the additional capital increases the likelihood the Corporation will be able to repay the TARP Preferred Stock in 2010, which would reduce ongoing Preferred Stock dividend costs, and improves the Corporation's ability to respond to any opportunities that could arise for branch or full-bank acquisitions. More information related to regulatory capital is provided in the Stockholder's Equity and Capital Adequacy section of Management's Discussion and Analysis.

Management estimates total capital purchases for 2010 to be approximately $1.6 million, with computer software and hardware the largest planned categories of expenditure. In comparison, total capital purchases totaled $ 1,253,000 in 2009, $998,000 in 2008 and $2,416,000 in 2007. Management does not expect capital expenditures to have a material, detrimental effect on the Corporation's financial condition in the year ending December 31, 2010.

CRITICAL ACCOUNTING POLICIES

The presentation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change is the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate and reasonable. The Corporation's methodology for determining the allowance for loan losses is described in a separate section later in Management's Discussion and Analysis. Given the very subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions, and could, therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in future years. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Corporation's debt securities. For most of the Corporation's debt securities, the Corporation receives estimated fair values of debt securities from an independent valuation service, or from brokers. In developing fair values, the valuation service and the brokers use estimates of cash flows, based on historical performance of similar instruments in similar interest rate environments. Based on experience, management is aware that estimated fair values of debt securities tend to vary among brokers and other valuation services. Accordingly, when selling debt securities, management typically obtains price quotes from more than one source.

As described in Note 6 to the consolidated financial statements, in 2008, the Corporation changed its method of valuing pooled trust-preferred securities from using price quotes received from pricing services, to a Level 3 (as described in the "FASB Accounting Standards Codification" (the "ASC") topic 820, "Fair Value Measurements and Disclosures") methodology, using discounted cash flows. At both December 31, 2009 and December 31, 2008, management calculated the fair values of pooled trust-preferred securities by applying discount rates to estimated cash flows for each security. Management estimated the cash flows expected to be received from each security, taking into account estimated levels of deferrals and defaults by the underlying issuers, and used discount rates considered reflective of a market participant's expectations regarding the extent of credit and liquidity risk inherent in the securities. Management's estimates of cash flows and discount rates used to calculate fair values of pooled trust-preferred securities were based on sensitive assumptions, and use of different assumptions could result in calculations of fair values that would be substantially different than the amounts calculated by management.

As described in Note 7 to the consolidated financial statements, management evaluates securities for OTTI. In making that evaluation, consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) whether the Corporation intends to sell the security or more likely than not will be required to sell the security before its anticipated recovery. Management's assessments of the likelihood and potential for recovery in value of securities are subjective and based on sensitive assumptions. Also, management's estimates of cash flows used to evaluate other-than-temporary impairment of pooled trust-preferred securities are based on sensitive assumptions, and use of different assumptions could produce different conclusions for each security. Note 7 to the consolidated financial statements includes details concerning significant changes made at September 30, 2009, as compared to the previous four quarterly analyses, that resulted in increased amounts of estimated future defaults on pooled trust-preferred securities.

NET INTEREST MARGIN

The Corporation's primary source of operating income is represented by the net interest margin. The net interest margin is equal to the difference between the amounts of interest income and interest expense. Tables I, II and III include information regarding the Corporation's net interest margin in 2009, 2008 and 2007. In each of these tables, the amounts of interest income earned on tax-exempt securities and loans have been adjusted to a fully taxable-equivalent basis. Accordingly, the net interest margin amounts presented in these tables exceed the amounts presented in the consolidated financial statements. The discussion that follows is based on amounts in the tables.

2009 vs. 2008

Interest income totaled $70,874,000 in 2009, a decrease of 7.3% from 2008. Income from available-for-sale securities decreased $1,912,000 (7.7%), while interest and fees from loans decreased $3,505,000, or 6.9%. As indicated in Table II, total average available-for-sale securities (at amortized cost) in 2009 fell to $439,823,000, a decrease of $9,408,000, or 2.1% from 2008. During 2009, the Corporation increased the size of its tax-exempt municipal security portfolio, while shrinking the taxable available-for-sale securities portfolio. The Corporation's yield on taxable securities fell in 2009 primarily because of low market interest rates, including the effects of management's decision to limit purchases of taxable securities to investments that mature or are expected to repay a substantial portion of principal within approximately four years or less. Also, interest rates on variable-rate trust preferred securities decreased consistent with short-term global interest rates. The average rate of return on available-for-sale securities was 5.24% for 2009 and 5.55% in 2008.

The average balance of gross loans decreased 2.0% to $728,748,000 in 2009 from $743,741,000 in 2008. Due to the challenging economic environment, the Corporation experienced contraction in the balance of its mortgage and consumer loan portfolios, with slight growth in average commercial and tax-exempt loan balances. The Corporation's yield on loans fell as rates on new loans as well as existing, variable-rate loans decreased. The average rate of return on loans was 6.54% in 2009 and 6.88% in 2008.

The average balance of interest-bearing due from banks, which in 2009 consisted primarily of balances held by the Federal Reserve, increased to $29,348,000 in 2009 from $2,385,000 in 2008. Also, the average balance of federal funds sold increased to $8,983,000 in 2009 from $5,038,000 in 2008. Although the rates of return are low, the Corporation maintained relatively high levels of these liquid assets in 2009 (as opposed to increasing long-term, available-for-sale securities at higher yields) due to management's concern about the possibility of substantial increases in interest rates in 2010 or 2011.

Interest expense fell $6,593,000, or 21.2%, to $24,456,000 in 2009 from $31,049,000 in 2008. Table II shows that the overall cost of funds on interest-bearing liabilities fell to 2.40% in 2009 from 3.05% in 2008.

Total average deposits (interest-bearing and noninterest-bearing) increased 4.6%, to $886,703,000 in 2009 from $847,714,000 in 2008. This increase came mainly in interest checking, money market, and individual retirement accounts and is partially offset by a reduction in the balance in certificates of deposit. Consistent with substantial reductions in short-term global interest rates, the average rates incurred on deposit accounts decreased significantly in 2009 as compared to 2008.

Total average borrowed funds decreased $34,275,000 to $260,413,000 in 2009 from $294,688,000 in 2008. During 2008 and 2009, the Corporation generally paid off long-term borrowings as they matured using the cash flow received from loans, mortgage-backed securities, and growth in deposit balances. The average rate on borrowed funds was 3.77% in 2009, down from 3.98% in 2008. This change primarily reflects lower rates being paid on customer repurchase agreements, which make up most of the Corporation's short-term borrowed funds.

As presented in Table II, the “interest rate spread” (excess of average rate of return on interest-bearing assets over average cost of funds on interest-bearing liabilities) was 3.47% in 2009, up significantly from 3.30% in 2008. As shown in Table III, changes in volume decreased net interest income by $89,000, and changes in rates increased net interest income by $1,121,000. The most significant components of changes in volume were decreases of $1,041,000 in interest and fees on loans and $1,379,000 in interest expense on borrowed funds. The most significant components of changes in rates were decreases of $1,934,000 in income on taxable available-for-sale securities, $2,464,000 in interest and fees on loans, and $5,138,000 in interest expense on deposits.

2008 vs. 2007

In May 2007, the Corporation acquired Citizens Bancorp, Inc. Included in this acquisition were all loans and deposits of Citizens Trust Company, its banking subsidiary. At the date of acquisition, the Corporation recorded an increase of $60,151,000 in net loans and $99,636,000 in total deposits.

In December 2007, management entered into a significant leveraged investment purchase transaction for two purposes: (1) to generate incremental positive net interest income, and (2) to reduce the magnitude of the Corporation's reduction in net interest income if interest rates rise significantly within the next few years. Specifically, the Corporation purchased mortgage-backed securities and a collateralized mortgage obligation for a total cost of approximately $86,000,000, which was funded mainly by two repurchase agreements (borrowings) of $40,000,000 each. The weighted-average initial book yield on the securities was 5.38%. The borrowings have a weighted-average interest rate of 3.94%, and mature in 2017. One of the borrowings is putable by the issuer at quarterly intervals starting in December 2010, and the other is putable quarterly starting in December 2012. Each of these borrowings contains an embedded cap, providing that on the quarterly anniversary of the transaction settlement date, if three-month LIBOR is higher than 5.15%, the Corporation's interest rate payable will decrease by twice the amount of the excess, down to a minimum rate of 0%. The embedded caps expire on the initial put dates in 2010 and 2012. Since the Corporation executed this transaction, three-month LIBOR has not exceeded 5.15%, and the embedded caps have not provided any reduction to overall interest expense.

The fully taxable equivalent net interest margin was $45,386,000 in 2008, $7,158,000 (18.7%) higher than in 2007. As shown in Table III, net increases in volume had the effect of increasing net interest income $2,417,000, and interest rate changes had the effect of increasing net interest income $4,741,000. Increases in volume of earning assets and interest-bearing liabilities were significantly affected by the acquisition of Citizens Bancorp as well as the leveraged investment purchase discussed above.

The most significant components of the volume changes in 2008 were an increase of $5,261,000 in interest income attributable to growth in the securities portfolio, an increase in interest income of $1,011,000 attributable to loan growth, and an increase in interest expense of $3,517,000 attributable to growth in long-term borrowings. Table III shows that changes in rates had the effect of decreasing interest income $2,062,000, and decreasing interest expense $6,803,000. As presented in Table II, the "interest rate spread" (excess of average rate of return on interest-bearing assets over average cost of funds on interest-bearing liabilities) was 3.30% in 2008, up significantly from 2.92% in 2007.

Interest income totaled $76,435,000 in 2008, an increase of 6.0%. Interest and fees from loans decreased $596,000, or 1.2%, while income from available-for-sale securities increased $5,009,000, or 25.1%. As indicated in Table II, the average balance of gross loans increased 2.0% to $743,741,000 in 2008 from $729,269,000 in 2007. Excluding the impact of the acquisition of Citizens Bancorp, average loans decreased 0.8%. The average rate of return on loans was 6.88%, down from 7.10% in 2007. Total average available-for-sale securities rose to $449,231,000, an increase of $96,423,000 or 27.3% from 2007. The leveraged investment purchase described above increased the average balance of securities by approximately $86,000,000. During 2008, proceeds from sales and maturities of securities were primarily reinvested into high-quality mortgage-backed and municipal securities. As a result of the turmoil in the municipal security market, the Corporation was able to grow its municipal security portfolio and increase its yield at attractive prices. The average rate of return on available-for-sale securities was 5.55%, down from 5.65% for 2007.

Interest expense fell $2,860,000, or 8.4%, to $31,049,000 from $33,909,000 in 2007. Table II shows that the overall cost of funds on interest-bearing liabilities fell to 3.05%, from 3.70% in 2007.

Total average deposits (interest-bearing and noninterest-bearing) increased 4.4%, to $847,714,000 from $812,255,000 in 2007. Excluding acquired Citizens Bancorp deposit accounts, total average deposits increased 1.2%. As short-term market interest rates fell throughout 2008, the Corporation's rates fell on interest-bearing checking accounts, money market deposit accounts, certificates of deposit, and individual retirement accounts. Rate changes caused a decrease in interest expense on deposits of $6,240,000, which was partially offset by an increase of $670,000 caused by increases in average balances.

The combined average total short-term and long-term borrowed funds increased $76,086,000 to $294,688,000 from $218,602,000 in 2007. This increase relates primarily to the leveraged investment purchase described above. Short-term borrowings are primarily customer repurchase agreements and overnight borrowings; the average rate on short-term borrowings fell to 2.37% from 3.98% in 2007. The average rate on long-term borrowings was 4.24%, up from 4.17% in 2007.

TABLE I - ANALYSIS OF INTEREST INCOME AND EXPENSE

(In Thousands)	Years Ended December 31, 2009	2008	2007	Increase/(Decrease) 2009/2008	2008/2007
INTEREST INCOME					
Available-for-sale securities:					
Taxable	$ 16,497	$ 20,347	$ 15,954	$ (3,850)	$ 4,393
Tax-exempt	6,542	4,604	3,988	1,938	616
Total available-for-sale securities	23,039	24,951	19,942	(1,912)	5,009
Held-to-maturity securities,					
Taxable	21	23	24	(2)	(1)
Trading securities	64	129	98	(65)	31
Interest-bearing due from banks	61	33	87	28	(54)
Federal funds sold	15	120	211	(105)	(91)
Loans:					
Taxable	45,236	48,933	49,670	(3,697)	(737)
Tax-exempt	2,438	2,246	2,105	192	141
Total loans	47,674	51,179	51,775	(3,505)	(596)
Total Interest Income	70,874	76,435	72,137	(5,561)	4,298
INTEREST EXPENSE					
Interest-bearing deposits:					
Interest checking	901	1,047	1,830	(146)	(783)
Money market	2,004	4,162	6,018	(2,158)	(1,856)
Savings	272	335	343	(63)	(8)
Certificates of deposit	6,672	8,993	10,786	(2,321)	(1,793)
Individual Retirement Accounts	4,796	4,777	5,906	19	(1,129)
Other time deposits	6	6	7	0	(1)
Total interest-bearing deposits	14,651	19,320	24,890	(4,669)	(5,570)
Borrowed funds:					
Short-term	544	986	1,923	(442)	(937)
Long-term	9,261	10,743	7,096	(1,482)	3,647
Total borrowed funds	9,805	11,729	9,019	(1,924)	2,710
Total Interest Expense	24,456	31,049	33,909	(6,593)	(2,860)
Net Interest Income	$ 46,418	$ 45,386	$ 38,228	$ 1,032	$ 7,158

(1) Interest income from tax-exempt securities and loans has been adjusted to a fully taxable-equivalent basis, using the Corporation's marginal federal income tax rate of 34%.

(2) Fees on loans are included with interest on loans and amounted to $1,176,000 in 2009, $1,061,000 in 2008 and $985,000 in 2007.

Table Il - Analysis of Average Daily Balances and Rates
(Dollars in Thousands)

	Year Ended 12/31/2009 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2008 Average Balance	Rate of Return/ Cost of Funds %	Year Ended 12/31/2007 Average Balance	Rate of Return/ Cost of Funds %
EARNING ASSETS						
Available-for-sale securities, at amortized cost:						
Taxable	$ 342,332	4.82%	$ 379,999	5.35%	$ 290,743	5.49%
Tax-exempt	97,491	6.71%	69,232	6.65%	62,065	6.43%
Total available-for-sale securities	439,823	5.24%	449,231	5.55%	352,808	5.65%
Held-to-maturity securities, Taxable	373	5.63%	408	5.64%	412	5.83%
Trading securities	1,005	6.37%	2,069	6.23%	1,665	5.89%
Interest-bearing due from banks	29,348	0.21%	2,385	1.38%	1,864	4.67%
Federal funds sold	8,983	0.17%	5,038	2.38%	4,017	5.25%
Loans:						
Taxable	689,275	6.56%	709,377	6.90%	696,667	7.13%
Tax-exempt	39,473	6.18%	34,364	6.54%	32,602	6.46%
Total loans	728,748	6.54%	743,741	6.88%	729,269	7.10%
Total Earning Assets	1,208,280	5.87%	1,202,872	6.35%	1,090,035	6.62%
Cash	17,042		19,299		19,485	
Unrealized gain/loss on securities	(24,334)		(24,877)		(324)	
Allowance for loan losses	(7,914)		(8,765)		(8,697)	
Bank premises and equipment	25,239		27,044		26,767	
Intangible Asset - Core Deposit Intangible	669		1,113		1,287	
Intangible Asset - Goodwill	11,953		12,023		8,864	
Other assets	65,151		52,215		41,487	
Total Assets	$ 1,296,086		$ 1,280,924		$ 1,178,904	
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	$ 104,444	0.86%	$ 82,795	1.26%	$ 75,488	2.42%
Money market	200,982	1.00%	193,800	2.15%	183,178	3.29%
Savings	69,002	0.39%	67,276	0.50%	62,976	0.54%
Certificates of deposit	226,913	2.94%	238,316	3.77%	242,822	4.44%
Individual Retirement Accounts	154,340	3.11%	139,321	3.43%	131,158	4.50%
Other time deposits	1,276	0.47%	1,306	0.46%	1,283	0.55%
Total interest-bearing deposits	756,957	1.94%	722,814	2.67%	696,905	3.57%
Borrowed funds:						
Short-term	38,731	1.40%	41,524	2.37%	48,373	3.98%
Long-term	221,682	4.18%	253,164	4.24%	170,229	4.17%
Total borrowed funds	260,413	3.77%	294,688	3.98%	218,602	4.13%
	1,017,370	2.40%	1,017,502	3.05%	915,507	3.70%

Total Interest-bearing Liabilities						
Demand deposits	129,746		124,900		115,350	
Other liabilities	7,183		7,732		9,378	
Total Liabilities	1,154,299		1,150,134		1,040,235	
Stockholders' equity, excluding other comprehensive income/loss	158,120		147,535		140,035	
Other comprehensive income/loss	(16,333)		(16,745)		(1,366)	
Total Stockholders' Equity	141,787		130,790		138,669	
Total Liabilities and Stockholders' Equity	$ 1,296,086		$ 1,280,924		$ 1,178,904	
Interest Rate Spread		3.47%		3.30%		2.92%
Net Interest Income/Earning Assets		3.84%		3.77%		3.51%
Total Deposits (Interest-bearing and Demand)	$ 886,703		$ 847,714		$ 812,255	

(1) Rates of return on tax-exempt securities and loans are calculated on a fully-taxable equivalent basis, using the Corporation’s marginal federal income tax rate of 34%.

(2) Nonaccrual loans are included in the loan balances above.

TABLE III - ANALYSIS OF VOLUME AND RATE CHANGES

(In Thousands)	Year Ended 12/31/09 vs. 12/31/08			Year Ended 12/31/08 vs. 12/31/07		
	Change in Volume	Change in Rate	Total Change	Change in Volume	Change in Rate	Total Change
EARNING ASSETS						
Available-for-sale securities:						
Taxable	$ (1,916)	$ (1,934)	$ (3,850)	$ 4,788	$ (395)	$ 4,393
Tax-exempt	1,896	42	1,938	473	143	616
Total available-for-sale securities	(20)	(1,892)	(1,912)	5,261	(252)	5,009
Held-to-maturity securities, Taxable	(2)	0	(2)	0	(1)	(1)
Trading securities	(68)	3	(65)	25	6	31
Interest-bearing due from banks	78	(50)	28	19	(73)	(54)
Federal funds sold	54	(159)	(105)	44	(135)	(91)
Loans:						
Taxable	(1,362)	(2,335)	(3,697)	896	(1,633)	(737)
Tax-exempt	321	(129)	192	115	26	141
Total loans	(1,041)	(2,464)	(3,505)	1,011	(1,607)	(596)
Total Interest Income	(999)	(4,562)	(5,561)	6,360	(2,062)	4,298
INTEREST-BEARING LIABILITIES						
Interest-bearing deposits:						
Interest checking	235	(381)	(146)	163	(946)	(783)
Money market	149	(2,307)	(2,158)	332	(2,188)	(1,856)
Savings	9	(72)	(63)	22	(30)	(8)
Certificates of deposit	(413)	(1,908)	(2,321)	(197)	(1,596)	(1,793)
Individual Retirement Accounts	489	(470)	19	350	(1,479)	(1,129)
Other time deposits	0	0	0	0	(1)	(1)
Total interest-bearing deposits	469	(5,138)	(4,669)	670	(6,240)	(5,570)
Borrowed funds:						
Short-term	(62)	(380)	(442)	(244)	(693)	(937)
Long-term	(1,317)	(165)	(1,482)	3,517	130	3,647
Total borrowed funds	(1,379)	(545)	(1,924)	3,273	(563)	2,710
Total Interest Expense	(910)	(5,683)	(6,593)	3,943	(6,803)	(2,860)
Net Interest Income	$ (89)	$ 1,121	$ 1,032	$ 2,417	$ 4,741	$ 7,158

(1) Changes in interest income on tax-exempt securities and loans are presented on a fully taxable-equivalent basis, using the Corporation's marginal federal income tax rate of 34%.

(2) The change in interest due to both volume and rates has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

NON-INTEREST INCOME
Years 2009, 2008 and 2007

The table below presents a comparison of non-interest income and excludes realized gains (losses) on available for sale securities, which are discussed in the "Earnings Overview" section of Management's Discussion and Analysis.

TABLE IV - COMPARISON OF NON-INTEREST INCOME

(In Thousands)	2009	% Change	2008	% Change	2007
Service charges on deposit accounts	$ 4,791	7.7	$ 4,447	73.8	$ 2,559
Service charges and fees	796	2.4	777	10.4	704
Trust and financial management revenue	3,262	(5.3)	3,443	0.1	3,440
Insurance commissions, fees and premiums	293	(11.7)	332	(25.6)	446
Increase in cash surrender value of life insurance	501	(33.9)	758	5.4	719
Other operating income	3,026	(3.2)	3,126	21.5	2,572
Total other operating income before realized losses on available-for-sale securities, net	$ 12,669	(1.7)	$ 12,883	23.4	$ 10,440

2009 vs. 2008

Total non-interest income, as shown in Table IV, decreased $214,000 or 1.7% in 2009 compared to 2008. Items of significance are as follows:

- Service charges on deposit accounts increased $344,000, or 7.7%, in 2009 as compared to 2008. In 2009, overdraft fee revenues associated with a new overdraft privilege program implemented in the first quarter of 2008 increased $335,000.

- Trust and financial management revenue decreased $181,000, or 5.3%, in 2009 as compared to 2008. Trust and financial management revenues are significantly affected by the value of assets under management which have been generally lower throughout most of 2009. Since the second quarter of 2009, the market values of equity securities have recovered a substantial portion of prior losses in value. As a result, total trust assets under management of $605,062,000 are 9.9% higher than one year earlier.

- The increase in the cash surrender value of life insurance decreased $257,000, or 33.9%, in 2009 over 2008. The decrease primarily relates to the changes in the earnings credit rate for the underlying contracts.

- Other operating income decreased $100,000, or 3.2%, in 2009 as compared to 2008. In 2009, the Corporation received no dividend income on its investment in restricted stock issued by the Federal Home Loan Bank of Pittsburgh, while dividend income on this stock was $334,000 in 2008. In 2009, other operating income included $306,000 of rental revenues from the temporary operation of a foreclosed commercial real estate property, as well as a gain of $325,000 on disposition of the property. In 2008, this category included a gain of $533,000 from the redemption of restricted shares of Visa, resulting from Visa's initial public offering.

2008 vs. 2007

- Service charges on deposit accounts increased $1,888,000, or 73.8%, in 2008 as compared to 2007. A new overdraft privilege program implemented in early 2008 represents substantially all of the category increase.

- Service charges and fees increased $73,000, or 10.4%, in 2008 over 2007. The category increase reflects the effect of an increase in the number of ATMs, including those from the Citizens Trust acquisition. Also, the impact of a new fee schedule adopted in the last quarter of 2007 contributed to the increase in ATM fees.

- Trust and financial management revenue includes the trust operations acquired in 2007 as part of Citizens Trust, as well as the new trust operations (started in 2007) for the New York State operations. These new trust operations represent $570,000, or 16.6%, of the aggregate trust and financial management revenues in 2008. Aggregate trust revenues have been heavily impacted by the valuation of assets under management. Assets under management amounted to $550,496,000 at December 31, 2008. The 2008 valuation was 16.5% lower than one year earlier primarily due to recent declines in the stock market.

- Insurance commissions, fees and premiums have decreased $114,000, or 25.6% in 2008 as compared to 2007. The decrease primarily relates to the reduction in credit-related insurance product revenues for Bucktail Life Insurance.

- The increase in the cash surrender value of life insurance increased $39,000, or 5.4%, in 2008 over 2007. Bank owned life insurance acquired with Citizens Trust increased $59,000 to represent a full year of earnings in 2008.

- Other operating income reflects a net increase of $554,000, or 21.5%, in 2008 over 2007. The most significant increase was a gain of $533,000 in 2008 from the redemption of restricted shares of Visa, resulting from Visa's initial public offering. Also, interchange fees related to debit card transactions provided an increase of $238,000 (37.8%) in 2008, which is primarily attributed to the additional volume for the Citizens Trust Company branches. Other operating income was offset by a decrease in dividends on Federal Home Loan Bank of Pittsburgh stock of $196,000 in 2008 due to the suspension of such dividends during the last quarter.

NON-INTEREST EXPENSE
Years 2009, 2008 and 2007

As shown in Table V below, total non-interest expense increased $213,000 or 0.6% in 2009 compared to 2008. In 2008, the total non-interest expense increased $163,000 or 0.5% compared to 2007. Changes of significance are discussed in the narrative that follows:

TABLE V - COMPARISON OF NON-INTEREST EXPENSE

(In Thousands)	2009	% Change	2008	% Change	2007
Salaries and wages	$ 12,737	(12.5)	$ 14,561	1.8	$ 14,302
Pensions and other employee benefits	3,956	(5.9)	4,202	(0.0)	4,204
Occupancy expense, net	2,741	(4.2)	2,861	8.6	2,634
FDIC Assessments	2,092	579.2	308	224.2	95
Furniture and equipment expense	2,679	0.7	2,661	(4.6)	2,789
Pennsylvania shares tax	1,272	8.8	1,169	24.1	942
Other operating expense	8,182	6.5	7,684	(7.6)	8,317
Total Other Expense	$ 33,659	0.6	$ 33,446	0.5	$ 33,283

2009 vs. 2008

Salaries and wages decreased $1,824,000, or 12.5%. The decrease in salaries and wages reflects the reductions in personnel from an operational process review initiated in 2008. In addition, salaries and wages for 2009 includes a reduction of $848,000 in certain incentive and other compensation costs.

Pension and other employee benefit costs decreased $246,000 in 2009 with $209,000 attributed to a 50% reduction in the employer matching contribution to the Savings and Retirement Plan. Also, the 2008 termination of the defined

benefit plan reduced pension costs by an additional $85,000 in 2009.

FDIC Insurance costs increased $1,784,000 to $2,092,000 in 2009. The 2009 FDIC insurance costs reflect the impact of higher rates and higher levels of insured deposits, as well as additional costs of $589,000 associated with a special assessment imposed by the FDIC.

Other operating expense increased $498,000, or 6.5%. This category includes many varieties of expenses, with the most significant increases and decreases in some of the individual expenses, as follows:

- Other operating expenses include an increase of $353,000 in foreclosed real estate expenses in 2009, primarily associated with one large commercial property.

- Attorney fees increased $71,000 in 2009, primarily as a result of commercial loan collection activities.
- Professional fees associated with an operational process review initiated in 2008 decreased $211,000; however, fees associated with the overdraft privilege program increased $42,000 in 2009.
- Amortization of core deposit intangibles decreased $228,000 in 2009.
- Operating expenses in 2008 were reduced by an insurance claim recovery of $174,000 related to expense that had originally been recorded in the third quarter of 2007.

2008 vs. 2007

Salaries and wages increased $259,000, or 1.8%. The primary increase in salaries is associated with the 2008 accruals for various incentive compensation programs of $816,000 more than the related 2007 incentives. Other compensation costs, primarily severance related costs, increased $174,000 in 2008. Salaries and wages associated with staff additions from the Citizens Bancorp acquisition have been more than fully offset by reductions in personnel that have taken place over the last half of 2007 and during the year 2008.

Pensions and other employee benefits decreased $2,000; however, within this category, there were several significant changes, summarized as follows:

- Group health insurance expense was $271,000 higher in 2008, mainly because an experience-related refund reduced expense in 2007.
- Employer contributions expense associated with the Savings & Retirement Plan (a 401(k) plan) and Employee Stock Ownership Plan was $184,000 higher in 2008 than in 2007. The increased expense relates primarily to the Corporation's increase in employer matching contributions in connection with its decision, discussed earlier, to terminate its defined benefit pension plan.
- Payroll tax expense decreased $99,000. In the first quarter 2007, the Corporation recorded payroll tax expense associated with incentive bonuses that were determined based on 2006 performance and paid in January 2007. There were no incentive bonuses awarded based on 2007 performance, and accordingly, no bonus-related payroll tax expense was recorded in 2008. In addition, reduced payroll taxes for 2008 were associated with the reductions in personnel discussed above.
- Defined benefit pension plan expense decreased $415,000, as a result of the decision to freeze and terminate the plan, effective December 31, 2007. The Corporation funded and settled its obligations under the Plan, and recorded a gain of $71,000 from settlement, in 2008.

Occupancy expense increased $227,000, or 8.6%. Approximately $110,000 of the increase relates to the addition of the Citizens Trust Company operations. Also, utility costs, real estate taxes and building maintenance costs were higher in 2008 compared to 2007.

Pennsylvania shares tax expense increased $227,000, or 24.1%, mainly due to the addition of Citizens Trust Company's historic asset and equity values to the tax base.

FDIC insurance costs increased to $308,000 in 2008, or $213,000 higher than in 2007.

Other operating expense decreased $ 633,000, or 7.6%. This category includes many varieties of expenses, with significant increases and decreases in some of the individual expenses, as follows:

- Decrease in operating expenses of $348,000 from the recovery of $174,000 in 2008 from an insurance claim related to costs recorded in the third quarter of 2007.

- Decrease of $221,000 related to core system conversion expense incurred in 2007 to convert the computer systems used for both the New York State locations and the Citizens Bancorp locations to the same core computer system used by C&N Bank.

- Decrease of $145,000 related to a loss on disposition of telephone equipment recorded in 2007.

- Settlement of certain sales tax issues in 2008 reduced overall costs by $94,000 associated with recovered costs or related consulting fees in 2007.

- Costs associated with other real estate (OREO) property activity decreased $50,000 due to improved disposition activity and one large recovery of $21,000 in 2008.

- Professional services increased $403,000 in 2008, mainly because $530,000 was incurred for two projects initiated to enhance non-interest income (overdraft privilege program discussed above) and to improve the bank operating structure, as well as future efficiency and profitability.

- Amortization of core deposit intangibles increased $107,000, including an increase of $128,000 attributable to the Citizens Bancorp acquisition.

INCOME TAXES

In 2009, the credit for income tax was ($22,655,000), or 36.6% of the pre-tax loss. In 2009, the amount of income tax currently refundable was approximately $4,508,000. A large portion of the 2009 credit for income tax was deferred, and related to securities write-downs that were not currently deductible for income tax reporting purposes. In 2008, the provision for income tax was $2,319,000, or 18.7% of pre-tax income, and in 2007, the provision for income tax was $2,643,000 or 20.2% of pre-tax income. Fluctuations in the tax provision/pre-tax income rate for these periods include the impact of changes in the average holdings of tax-exempt securities and loans.

The Corporation recognizes deferred tax assets and liabilities based on differences between the financial statement carrying amounts and the tax bases of assets and liabilities. At December 31, 2009, the net deferred tax asset was $22.0 million, up from a balance of approximately $16.4 million at December 31, 2008. The increase in net deferred tax asset resulted mainly from other-than-temporary impairment losses on securities for financial reporting purposes, which are not currently deductible for federal income tax reporting purposes. The net deferred tax asset balance at December 31, 2009 attributable to realized securities losses was $16.1 million, exclusive of a valuation allowance of $373,000.

The Corporation regularly reviews deferred tax assets for recoverability based on history of earnings, expectations for future earnings and expected timing of reversals of temporary differences. Realization of deferred tax assets ultimately depends on the existence of sufficient taxable income, including taxable income in prior carryback years, as well as future taxable income. Of the total deferred tax asset from realized losses on securities, a portion is from securities that, if the Corporation were to sell them, would be classified as capital losses for income tax reporting purposes. The valuation allowance at December 31, 2009 reflects the excess of the tax benefit that would be generated from selling all of the capital assets, over the amount that could be realized from available carryback and offset against capital gains generated in 2007 and 2008. Realization of the remaining $373,000 of tax benefits associated with capital assets is dependent upon realization of future capital gains. After adjustment for the valuation allowance on capital assets, management believes the recorded net deferred tax asset at December 31, 2009 is fully realizable; however, if management determines the Corporation will be unable to realize all or part of the net deferred tax asset, the Corporation would adjust the deferred tax asset, which would negatively impact earnings.

A more complete analysis of income taxes is presented in Note 15 to the consolidated financial statements.

FINANCIAL CONDITION

Significant changes in the average balances of the Corporation's earning assets and interest-bearing liabilities are described in the Net Interest Margin section of Management's Discussion and Analysis. That discussion provides useful information regarding changes in the Corporation's balance sheet over the 2-year period ended December 31, 2009, including discussions of available-for-sale securities, loans, deposits and borrowings. Other significant balance sheet items - the allowance for loan losses and stockholders' equity - are discussed in separate sections of Management's Discussion and Analysis. Other Assets increased significantly at December 31, 2009, to $30,678,000 from $15,943,000 at December 31, 2008. Included in Other Assets at December 31, 2009 were two large amounts that were not recurring from the prior year: (1) estimated balance receivable for income taxes paid in 2009, as well as carry-back for recovery of some tax paid for 2006-2008, totaling $8.1 million, and (2) prepayment of FDIC assessments totaling $5.5 million, representing the FDIC's estimate of premiums for the next three years.

Table VI shows the composition of the investment portfolio at December 31, 2009, 2008 and 2007. Comparison of the amortized cost totals of available-for-sale securities at each year-end presented reflects an increase from $442,835,000 at December 31, 2007 to $454,707,000 at December 31, 2008 followed by a reduction of $57,652,000 to $397,055,000 at December 31, 2009. In 2008, the main increases were in mortgage-backed securities and municipal bonds. In 2009, the Corporation shrank its available-for-sale investment portfolio through a combination of sales, not reinvesting cash flow from amortizing securities, and recognition of OTTI on certain securities. This overall contraction was partially offset by purchases of agency bonds, agency collateralized mortgage obligations, and municipal bonds with relatively short expected lives. Changes in the investment portfolio are discussed in more detail in the Net Interest Margin section of Management's Discussion and Analysis. As discussed in more detail in Note 7 to the financial statements, the Corporation reported realized losses from available-for-sale securities of $83,840,000, including the effect of other-than-temporary impairment write-downs of pooled trust-preferred securities by $73,674,000, equity securities by $6,324,000, trust preferred securities issued by individual institutions by $3,209,000 and collateralized mortgage obligations by $2,156,000. Management has reviewed the Corporation's holdings as of December 31, 2009, and concluded that – with the exception of the securities that have been written down through earnings – the remaining unrealized losses are considered temporary. Notes 6 and 7 to the consolidated financial statements provide more detail concerning the Corporation's processes for evaluating securities for other-than-temporary impairment, and for valuation of trust-preferred securities. Management will continue to closely monitor the status of impaired securities in 2010.

The total of loans outstanding (without consideration of the allowance for loan losses) has slowed in 2009 with total growth of $68,304,000 from the balance at December 31, 2005 to the total outstanding of $721,603,000 at December 31, 2009. Of the total increase, $60,151,000 came from balances acquired from Citizens Bancorp, Inc. (2007). Excluding the effects of the acquisition, total loans fell (3.0%) in 2009, grew slightly (1.0%) in 2008, fell slightly (1.7%) in 2007, and grew 5.2% in 2006. Loan volumes are heavily dependent on economic conditions in the Corporation's market area, and are significantly influenced by interest rates. Prior to 2009, the Corporation experienced overall growth in commercial and consumer mortgage lending over the previous 3 years. In 2009, the Corporation experienced a net decrease in residential mortgage loans ($13,012,000) with more residential mortgage originations than in previous years sold into the secondary market. Also, in the last two years, consumer loans have decreased $17,991,000 to the December 31, 2009 balance of $19,202,000. The Corporation has not originated interest only mortgages, loans without documentation of the borrowers' sources of income or net worth, or other types of exotic mortgage loans that have made headlines in recent years, and which have led some lenders and investors to realize significant losses from these types of instruments.

Table VIII presents loan maturity data as of November 30, 2009 (the last date in 2009 for which the Corporation ran the interest rate simulation model used to generate the loan maturities information included in Table VIII). The interest rate simulation model classifies certain loans under different categories than they appear in Table VII. Fixed

rate loans are included in Table VIII based on their contractually scheduled principal repayments, while variable rate loans are included based on contractual principal repayments, with the remaining balance reflected in the Table as of the date of the next change in rate. Table VIII shows that approximately 45% of the loan portfolio is fixed rate. Of the 55% of the portfolio made up of variable rate loans, a significant portion (31%) will re-price after more than one year. Variable rate loans re-pricing after more than one year include significant amounts of residential and commercial real estate loans. The Corporation's substantial investment in long-term, fixed rate loans and variable rate loans with extended periods until re-pricing is one of the major concerns management attempts to address through interest rate risk management practices. See Part II, Item 7A for a more detailed discussion of the Corporation's interest rate risk.

Total future capital purchases in 2010 are estimated at approximately $1.6 million. Management does not expect capital expenditures to have a material, detrimental effect on the Corporation's financial condition during 2010.

TABLE VI - INVESTMENT SECURITIES
(In Thousands)

	As of December 31,					
	2009		2008		2007	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
AVAILABLE-FOR-SALE SECURITIES:						
Obligations of other U.S. Government agencies	$ 48,949	$ 48,993	$ 15,500	$ 16,201	$ 32,199	$ 32,723
Obligations of states and political subdivisions	109,109	104,990	80,838	74,223	63,340	60,449
Mortgage-backed securities	150,700	156,378	171,453	173,856	149,796	150,416
Collateralized mortgage obligations:						
Issued by U.S. Government agencies	47,083	47,708	24,082	24,262	22,829	22,649
Private label	15,465	15,494	46,537	43,972	47,251	46,856
Corporate bonds	1,000	1,041	1,000	1,117	2,468	2,581
Trust preferred securities issued by individual institutions	7,043	6,018	10,436	7,601	10,658	10,504
Collateralized debt obligations:						
Pooled trust preferred securities - senior tranches	11,383	8,199	11,938	8,642	12,354	12,313
Pooled trust preferred securities - mezzanine tranches	266	115	70,826	50,272	78,802	70,824
Other collateralized debt obligations	690	690	692	692	693	693
Total debt securities	391,688	389,626	433,302	400,838	420,390	410,008
Marketable equity securities	5,367	6,662	21,405	18,850	22,445	22,747
Total	$ 397,055	$ 396,288	$ 454,707	$ 419,688	$ 442,835	$ 432,755
HELD-TO-MATURITY SECURITIES:						
Obligations of the U.S. Treasury	$ 300	$ 302	$ 304	$ 320	$ 307	$ 321
Obligations of other U.S. Government agencies	0	0	100	104	99	105
Mortgage-backed securities	0	0	2	2	3	3
Total	$ 300	$ 302	$ 406	$ 426	$ 409	$ 429

The following table shows the amortized cost and maturity distribution of the available-for-sale debt securities portfolio, along with weighted-average yields, at December 31, 2009:

(In Thousands, Except for Percentages)	Within One Year	Yield	One-Five Years	Yield	Five-Ten Years	Yield	After Ten Years	Yield	Total
AVAILABLE-FOR-SALE SECURITIES:									
Obligations of other U.S. Government agencies	$ 0	0.00%	$ 16,022	2.14%	$ 31,914	4.01%	$ 1,013	1.64%	$ 48,949
Obligations of states and political subdivisions	1,166	1.44%	7,195	1.81%	3,588	4.59%	97,160	4.63%	109,109
Mortgage-backed securities	132	3.77%	108	3.66%	7,275	4.15%	143,185	4.94%	150,700
Collateralized mortgage obligations:									
Issued by U.S. Government agencies	0	0.00%	165	3.95%	5,282	2.16%	41,636	4.03%	47,083
Private label	0	0.00%	0	0.00%	11,964	4.66%	3,501	5.67%	15,465
Corporate bonds	0	0.00%	1,000	8.09%	0	0.00%	0	0.00%	1,000
Trust preferred securities issued by individual institutions	0	0.00%	799	3.70%	0	0.00%	6,244	9.34%	7,043
Collateralized debt obligations:									
Pooled trust preferred securities - senior tranches	0	0.00%	0	0.00%	0	0.00%	11,383	7.05%	11,383
Pooled trust preferred securities - mezzanine tranches	0	0.00%	0	0.00%	0	0.00%	266	5.11%	266
Other collateralized debt obligations	0	0.00%	0	0.00%	0	0.00%	690	0.00%	690
Total	$ 1,298	1.68%	$ 25,289	2.35%	$ 60,023	4.03%	$ 305,078	4.87%	$ 391,688
HELD-TO-MATURITY SECURITIES,									
Obligations of the U.S. Treasury	$ 300	5.28%	$ 0	0.00%	$ 0	0.00%	$ 0	0.00%	$ 300

TABLE VII - FIVE-YEAR SUMMARY OF LOANS BY TYPE

	2009	%	2008	%	2007	%	2006	%	2005	%
Real estate - residential mortgage	$ 420,365	58.25	$ 433,377	58.29	$ 441,692	60.02	$ 387,410	56.35	$ 361,857	55.39
Real estate - commercial mortgage	163,483	22.66	165,979	22.32	144,742	19.67	178,260	25.93	153,661	23.52
Real estate - construction	26,716	3.70	24,992	3.36	22,497	3.06	10,365	1.51	5,552	0.85
Consumer	19,202	2.66	26,732	3.60	37,193	5.05	35,992	5.24	31,559	4.83
Agricultural	3,848	0.53	4,495	0.60	3,553	0.48	2,705	0.39	2,340	0.36
Commercial	49,753	6.90	48,295	6.50	52,241	7.10	39,135	5.69	69,396	10.62
Other	638	0.09	884	0.12	1,010	0.14	1,227	0.18	1,871	0.29
Political subdivisions	37,598	5.21	38,790	5.21	33,013	4.48	32,407	4.71	27,063	4.14
Total	721,603	100.00	743,544	100.00	735,941	100.00	687,501	100.00	653,299	100.00

Less: allowance for loan losses	(8,265)	(7,857)	(8,859)	(8,201)	(8,361)
Loans, net	$ 713,338	$ 735,687	$ 727,082	$ 679,300	$ 644,938

TABLE VIII – LOAN MATURITY DISTRIBUTION
(In Thousands) As of November 30, 2009

	Fixed Rate Loans				Variable or Adjustable Rate Loans			
	1 Year or Less	1-5 Years	>5 Years	Total	1 Year or Less	1-5 Years	>5 Years	Total
Real Estate	$ 1,289	$ 34,907	$ 236,778	$ 272,974	$ 96,240	$ 206,803	$ 572	$ 303,615
Commercial	10,892	16,926	7,809	35,627	72,299	16,364	1,881	90,544
Consumer	4,177	9,570	4,562	18,309	452	28	0	480
Total	$ 16,358	$ 61,403	$ 249,149	$ 326,910	$ 168,991	$ 223,195	$ 2,453	$ 394,639

PROVISION AND ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is maintained at a level which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectability of the loan portfolio. In evaluating collectability, management considers a number of factors, including the status of specific impaired loans, trends in historical loss experience, delinquency trends, credit concentrations, and economic conditions within the Corporation's market area. Allowances for impaired loans are determined based on collateral values or the present value of estimated cash flows. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries.

There are two major components of the allowance – (1) "FASB Accounting Standards Codification" (the "ASC") topic 310 (formerly SFAS 114) allowances – on larger loans, mainly commercial purpose, determined on a loan-by-loan basis; and (2) ASC topic 450 (formerly SFAS 5) allowances – estimates of losses incurred on the remainder of the portfolio, determined based on collective evaluation of impairment for various categories of loans. FASB ASC 450 allowances include a portion based on historical net charge-off experience, and a portion based on evaluation of qualitative factors.

Each quarter, management performs a detailed assessment of the allowance and provision for loan losses. A management committee referred to as the Watch List Committee performs this assessment. Quarterly, the Watch List Committee and the applicable Lenders discuss each loan relationship under review, and reach a consensus on the appropriate FASB ASC 310 estimated loss amount for the quarter. The Watch List Committee's focus is on ensuring that all pertinent facts have been considered, and that the FASB ASC 310 loss amounts are reasonable. The assessment process includes review of certain loans reported on the "Watch List." All loans, which Lenders or the Credit Administration staff has assigned a risk rating of Special Mention, Substandard, Doubtful or Loss, are included in the Watch List. The scope of loans evaluated individually for impairment (FASB ASC 310 evaluation) include all loan relationships greater than $200,000 for C&N Bank loans, and $50,000 for First State Bank, for which there is at least one extension of credit graded Special Mention, Substandard, Doubtful or Loss. Also, loan relationships less than $200,000 in the aggregate, but with an estimated loss of $100,000 or more, are individually evaluated for impairment.

Since 2007, the Banks' Risk Management personnel performed annual, independent credit reviews of large credit relationships. In prior years, outside consulting firms were retained to perform such functions. Management gives substantial consideration to the classifications and recommendations of the credit reviewers in determining the allowance for loan losses.

The FASB ASC 450 component of the allowance includes estimates of losses incurred on loans that have not been individually evaluated for impairment. Management uses loan categories included in the Call Report (a quarterly report filed by FDIC-insured banks) to identify categories of loans with similar risk characteristics, and multiplies the loan balances for each category as of each quarter-end by two different factors to determine the FASB ASC 450 allowance amounts. These two factors are based on: (1) historical net charge-off experience, and (2) qualitative factors. The sum of the allowance amounts calculated for each risk category, including both the amount based on historical net charge-off experience and the amount based on evaluation of qualitative factors, is equal to the total FASB ASC 450 component of the allowance.

The historical net charge-off portion of the FASB ASC 450 allowance component is calculated by the Accounting Department as of the end of the applicable quarter. For each loan classification category used in the Call Report, the Accounting Department multiplies the outstanding balance as of the quarter-end (excluding loans individually evaluated for impairment) by the ratio of net charge-offs to average quarterly loan balances for the previous three calendar years. Prior to the fourth quarter 2005, C&N Bank had utilized the ratio of net charge-offs to average

balances over a five-year period in calculating the historical loan loss experience portion of the allowance portfolio. Management made the change to the three-year assumption, which had very little effect on the allowance valuation as of December 31, 2005, mainly because management believes net charge-off experience over a 3-year period may be more representative of losses existing in the portfolio as of the balance sheet date.

Management also calculates the effects of specific qualitative factors criteria to determine a percentage increase or decrease in the FASB ASC 450 allowance, in relation to the historical net charge-off percentage. The qualitative factors analysis involves assessment of changes in factors affecting the portfolio, to provide for estimated differences between losses currently inherent in the portfolio and the amounts determined based on recent historical loss rates and from identification of losses on specific individual loans. A management committee referred to as the Qualitative Factors Committee meets quarterly, near the end of the final month of each quarter. The Qualitative Factors Committee discusses several qualitative factors, including economic conditions, lending policies, changes in the portfolio, risk profile of the portfolio, competition and regulatory requirements, and other factors, with consideration given to how the factors affect three distinct parts of the loan portfolio: Commercial, Mortgage and Consumer. During or soon after completion of the meeting, each member of the Committee prepares an update to his or her recommended percentage adjustment for each qualitative factor, and average qualitative factor adjustments are calculated for Commercial, Mortgage and Consumer loans. The Accounting Department multiplies the outstanding balance as of the quarter-end (excluding loans individually evaluated for impairment) by the applicable qualitative factor percentages, to determine the portion of the FASB ASC 450 allowance attributable to qualitative factors. Average qualitative factors used in calculating the FASB ASC 450 portion of the allowance did not change significantly (by more than a few basis points) for any category over the course of 2009.

The allocation of the allowance for loan losses table (Table X) includes the FASB ASC 310 component of the allowance on the line item called “Impaired Loans.” FASB ASC 450 estimated losses, including both the portion determined based on historical net charge-off results, as well as the portion based on management’s assessment of qualitative factors, are allocated in Table X to the applicable categories of commercial, consumer mortgage and consumer loans. As of December 31, 2009, the FASB ASC 310 valuation allowance on impaired loans includes $716,000 related to two unrelated commercial relationships. Table X reflects an allowance on commercial loans of $2,677,000 at December 31, 2009 comparable to the $2,654,000 at December 31, 2008. The large increase from $1,870,000 at December 31, 2007, is mainly associated with an increase in the FASB ASC 450 allowance attributable to growth of the commercial sector.

The allowance for loan losses was $8,265,000 at December 31, 2009 up from $7,857,000 at December 31, 2008, though in line with the balances of $8,859,000 at December 31, 2007 and $8,201,000 at December 31, 2006. As shown in Table IX, net charge-offs in 2009 of $272,000 were down substantially from $1,911,000 in 2008. Net charge-offs in 2008 were substantially higher by comparison than other recent historical levels of $458,000 in 2007 and $832,000 in 2006. The increase in net charge-offs for 2008 included $1,414,000 attributed to four large commercial relationships that had been classified as impaired at December 31, 2007. Table IX also shows the provision for loan losses decreased to $680,000 in 2009 from $909,000 in 2008, and favorable to the five year average of $963,000. The total amount of the provision for loan losses for each year is determined based on the amount required to maintain an appropriate allowance in light of all of the factors described above.

Table XI presents information related to past due and impaired loans. As of December 31, 2009, total impaired loans amounted to $5,947,000 which represents a small increase from $5,665,000 in 2008, though down from previous year levels of $6,218,000 in 2007, $8,011,000 in 2006 and $8,216,000 in 2005. Nonaccrual loans increased to $9,092,000 at December 31, 2009, the highest level within the last five years, from $7,200,000 at December 31, 2008 primarily due to the recent addition of a few larger commercial relationships. Over the period 2005-2009, each period includes a few large commercial relationships that have required significant monitoring and workout efforts. As a result, a limited number of relationships may significantly impact category fluctuations within Table XI. Management believes it has been conservative in its decisions concerning identification of impaired loans, estimates of loss, and nonaccrual status; however, the actual losses realized from these relationships could vary materially from the allowances calculated as of December 31, 2009. Management continues to closely monitor its commercial loan relationships for possible credit losses, and will adjust its estimates of loss and decisions concerning nonaccrual status, if appropriate.

Tables IX through XII present historical data related to the allowance for loan losses

TABLE IX - ANALYSIS OF THE ALLOWANCE FOR LOAN LOSSES

(In Thousands)	Years Ended December 31,				
	2009	2008	2007	2006	2005
Balance, beginning of year	$ 7,857	$ 8,859	$ 8,201	$ 8,361	$ 6,787
Charge-offs:					
Real estate loans	149	1,457	196	611	264
Installment loans	293	254	216	259	224
Credit cards and related plans	0	5	5	22	198
Commercial and other loans	36	323	127	200	298
Total charge-offs	478	2,039	544	1,092	984
Recoveries:					
Real estate loans	8	20	8	27	14
Installment loans	104	83	41	65	61
Credit cards and related plans	0	4	9	25	30
Commercial and other loans	94	21	28	143	50
Total recoveries	206	128	86	260	155
Net charge-offs	272	1,911	458	832	829
Allowance for loan losses recorded in acquisition	0	0	587	0	377
Provision for loan losses	680	909	529	672	2,026
Balance, end of year	$ 8,265	$ 7,857	$ 8,859	$ 8,201	$ 8,361

TABLE X - ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES BY TYPE

(In Thousands)	2009	2008	2007	2006	2005
Commercial	$ 2,677	$ 2,654	$ 1,870	$ 2,372	$ 2,705
Consumer mortgage	3,859	3,920	4,201	3,556	2,806
Impaired loans	1,126	456	2,255	1,726	2,374
Consumer	281	399	533	523	476
Unallocated	322	428	0	24	0
Total Allowance	$ 8,265	$ 7,857	$ 8,859	$ 8,201	$ 8,361

The above allocation is based on estimates and subjective judgments and is not necessarily indicative of the specific amounts or loan categories in which losses may occur.

TABLE XI – PAST DUE AND IMPAIRED LOANS
(In Thousands)

	2009	2008	2007	2006	2005
Impaired loans without a valuation allowance	$ 3,257	$ 3,435	$ 857	$ 2,674	$ 910
Impaired loans with a valuation allowance	2,690	2,230	5,361	5,337	7,306
Total impaired loans	$ 5,947	$ 5,665	$ 6,218	$ 8,011	$ 8,216
Valuation allowance related to impaired loans	$ 1,126	$ 456	$ 2,255	$ 1,726	$ 2,374
Total nonaccrual loans	$ 9,092	$ 7,200	$ 6,955	$ 8,506	$ 6,365
Total loans past due 90 days or more and still accruing	$ 31	$ 1,305	$ 1,200	$ 1,559	$ 1,369

TABLE XII - FIVE-YEAR HISTORY OF LOAN LOSSES (In Thousands)

	2009	2008	2007	2006	2005	Average
Average gross loans	$ 728,748	$ 743,741	$ 729,269	$ 662,714	$ 618,344	$ 696,563
Year-end gross loans	721,603	743,544	735,941	687,501	653,299	708,378
Year-end allowance for loan losses	8,265	7,857	8,859	8,201	8,361	8,309
Year-end nonaccrual loans	9,092	7,200	6,955	8,506	6,365	7,624
Year-end loans 90 days or more past due and still accruing	31	1,305	1,200	1,559	1,369	1,093
Net charge-offs	272	1,911	458	832	829	860
Provision for loan losses	680	909	529	672	2,026	963
Earnings coverage of charge-offs	(145)	5	23	14	16	1
Allowance coverage of charge-offs	30	4	19	10	10	10
Net charge-offs as a % of provision for loan losses	40.00%	210.23%	86.58%	123.81%	40.92%	89.30%
Net charge-offs as a % of average gross loans	0.04%	0.26%	0.06%	0.13%	0.13%	0.12%
Net income (loss)	(39,335)	10,059	10,424	11,986	12,984	1,224

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

Table XIII presents the Corporation's significant fixed and determinable contractual obligations as of December 31, 2009
by payment date. The payment amounts represent the principal amounts of time deposits and borrowings, and do not include interest.

TABLE XIII – CONTRACTUAL OBLIGATIONS
(In Thousands)

1 Year	1-3	3-5	Over 5

Contractual Obligations	or Less	Years	Years	Years	Total
Time deposits	$ 233,754	$ 117,545	$ 44,763	$ 51	$ 396,113
Short-term borrowings,					
Repurchase agreements	5,000	0	0	0	5,000
Long-term borrowings:					
Federal Home Loan Bank of Pittsburgh	47,140	38,547	4,206	13,849	103,742
Repurchase agreements	0	7,500	5,000	80,000	92,500
Total	$ 285,894	$ 163,592	$ 53,969	$ 93,900	$ 597,355

In addition to the amounts described in Table XIII, the Corporation has obligations related to deposits without a stated maturity with outstanding principal balances totaling $530,676,000 at December 31, 2009. The Corporation also has obligations related to overnight customer repurchase agreements with principal balances totaling $34,229,000 at December 31, 2009.

The Corporation's significant off-balance sheet arrangements consist of commitments to extend credit and standby letters of credit. Off-balance sheet arrangements are described in Note 16 to the consolidated financial statements.

LIQUIDITY

Liquidity is the ability to quickly raise cash at a reasonable cost. An adequate liquidity position permits the Corporation to pay creditors, compensate for unforeseen deposit fluctuations and fund unexpected loan demand. At December 31, 2009, the Corporation maintained overnight interest-bearing deposits with the Federal Reserve Bank of Philadelphia and other correspondent banks totaling $73,818,000.

The Corporation maintains overnight borrowing facilities with several correspondent banks that provide a source of day-to-day liquidity. Also, the Corporation maintains borrowing facilities with the Federal Home Loan Bank of Pittsburgh, secured by various mortgage loans.

The Corporation has a line of credit with the Federal Reserve Bank of Philadelphia's Discount Window. Management intends to use this line of credit as a contingency funding source. As collateral for the line, the Corporation has pledged available-for-sale securities with a carrying value of $27,938,000 at December 31, 2009.

The Corporation's outstanding, available, and total credit facilities are presented in the following table.

TABLE XIV – CREDIT FACILITIES

(In Thousands)	Outstanding At December 31,		Available At December 31,		Total Credit At December 31,	
	2009	2008	2009	2008	2009	2008
Federal Home Loan Bank of Pittsburgh	$ 133,602	$ 159,547	$ 210,954	$ 238,806	$ 344,556	$ 398,353
Federal Reserve Bank Discount Window	0	0	25,802	63,698	25,802	63,698
Other correspondent banks	0	0	29,722	30,726	29,722	30,726
Total credit facilities	$ 133,602	$ 159,547	$ 266,478	$ 333,230	$ 400,080	$ 492,777

At December 31, 2009, the Corporation's outstanding credit facilities with the Federal Home Loan Bank of Pittsburgh consisted of long-term borrowings with a total notional amount of $103,602,000 and a letter of credit in the amount of $30 million.

Additionally, the Corporation uses repurchase agreements placed with brokers to borrow funds secured by investment assets, and uses "RepoSweep" arrangements to borrow funds from commercial banking customers on an overnight basis. If required to raise cash in an emergency situation, the Corporation could sell non-pledged investment securities to meet its obligations. At December 31, 2009, the carrying value of non-pledged available-for-sale securities was $63,110,000.

Management believes the Corporation is well-positioned to meet its short-term and long-term obligations.

STOCKHOLDERS' EQUITY AND CAPITAL ADEQUACY

The Corporation and the Banks are subject to various regulatory capital requirements administered by the federal banking agencies. Details concerning the Corporation's and the Banks' regulatory capital amounts and ratios are presented in Note 19 to the consolidated financial statements. As reflected in Note 19, at December 31, 2009 and 2008, the ratios of total capital to risk-weighted assets, tier 1 capital to risk-weighted assets and tier 1 capital to average total assets are well in excess of regulatory capital requirements.

In January 2009, the Corporation issued Preferred Stock and a Warrant to purchase up to 194,794 shares of common stock at an exercise price of $20.36 per share to the United States Department of the Treasury under the TARP Program. The Corporation sold the Preferred Stock and Warrant for an aggregate price of $26,440,000. The Preferred Stock pays a cumulative dividend rate of 5% per annum for the first five years and will reset to a rate of 9% per annum after year five. Pursuant to participation in the TARP Program, the Corporation may continue to pay dividends on its common stock, subject to the following requirements and limitations: (1) all accrued and unpaid dividends for all past dividend periods on the preferred stock issued to the Treasury must be fully paid; and (2) consent of the Treasury is required for any increase over $0.24 per quarter in the per share dividends on common shares until January 16, 2012, unless prior to that date, the Corporation has redeemed the preferred stock issued to the Treasury in whole or the Treasury has transferred all of the preferred stock to third parties. Also, until January 16, 2012 (unless prior to that date, the Corporation has redeemed the preferred stock issued to the Treasury in whole or the Treasury has transferred all of the preferred stock to third parties) the Treasury's consent is required for any repurchases of common stock, except for repurchases of shares in connection with employee benefit plans in the ordinary course of business consistent with past practice. Management is considering redemption of the Preferred Stock in 2010; however, our ability to do so is dependent upon approval from banking regulatory authorities and the Treasury.

In 2009, the Corporation issued approximately 3,090,000 shares of common stock, raising a total of $24,585,000, net of related offering costs. Of this total, 2,875,000 shares were issued at a price of $8.00 per share in a public offering that was completed in December 2009, and which resulted in net proceeds of $21,410,000 (included in the $24,585,000 for the year). The additional $3,175,000 was raised through the issuance of shares under our dividend reinvestment plan. Although the Corporation maintained capital ratios that exceeded regulatory requirements to be considered well capitalized throughout 2009, the additional capital provides flexibility to absorb any additional, unexpected securities losses or other economic issues that might arise. Further, management believes the additional capital increases the likelihood the Corporation will be able to repay the TARP Preferred Stock in 2010, which would reduce ongoing Preferred Stock dividend costs, and improves the Corporation's ability to respond to any opportunities that could arise for branch or full-bank acquisitions.

Future dividend payments will depend upon maintenance of a strong financial condition, future earnings and capital and regulatory requirements. In addition to the restrictions imposed by participation in TARP (described above), the Corporation, C&N Bank and First State Bank are subject to restrictions on the amount of dividends that may be paid without approval of banking regulatory authorities. These restrictions are described in Note 19 to the consolidated financial statements. Also, under guidance issued in 2009 by the Federal Reserve, until further notice the Corporation must consult the Federal Reserve before declaring dividends on either common or preferred stock.

The Corporation's total stockholders' equity is affected by fluctuations in the fair values of available-for-sale securities. The difference between amortized cost and fair value of available-for-sale securities, net of deferred income tax, is included in "Accumulated Other Comprehensive (Loss) Income" within stockholders' equity. The balance in Accumulated Other Comprehensive (Loss) Income related to unrealized gains or losses on available-for-sale securities, net of deferred income tax, amounted to ($522,000) at December 31, 2009 and ($23,120,000) at December 31, 2008. Changes in accumulated other comprehensive income are excluded from earnings and directly increase or decrease stockholders' equity. If available-for-sale securities are deemed to be other-than-temporarily impaired, unrealized losses are recorded as a charge against earnings, and amortized cost for the affected securities is reduced. Note 7 to the consolidated financial statements provides additional information concerning management's evaluation of available-for-sale securities for other-than-temporary impairment at December 31, 2009.

Stockholders' equity is also affected by the underfunded or overfunded status of defined benefit pension and postretirement plans. The balance in Accumulated Other Comprehensive (Loss) Income related to underfunded defined benefit plans, net of deferred income tax, was ($369,000) at December 31, 2009 and ($94,000) at December

31, 2008.

COMPREHENSIVE INCOME (LOSS)

Comprehensive income or loss is a measure of the change in equity of a corporation, excluding transactions with owners in their capacity as owners (such as proceeds from issuances of stock and dividends). The difference between net income and comprehensive income is termed "Other Comprehensive Income (Loss)". Comprehensive income or loss should not be construed to be a measure of net income. For the Corporation, other comprehensive income includes unrealized gains and losses on available-for-sale securities, net of deferred income tax. The amount of unrealized gains or losses reflected in comprehensive income may vary widely from period-to-period, depending on the financial markets as a whole and how the portfolio of available-for-sale securities is affected by interest rate movements. The change in accumulated other comprehensive income attributable to the underfunded or overfunded status of defined benefit plans is also included in other comprehensive income. In 2009, total comprehensive loss was $14,634,000, while in 2008 total comprehensive loss was $6,098,000, and in 2007 total comprehensive income was $2,754,000. Other comprehensive income (loss) amounted to $24,701,000 in 2009, ($16,157,000) in 2008 and ($7,670,000) in 2007.

INFLATION

The Corporation is significantly affected by the Federal Reserve Board's efforts to control inflation through changes in short-term interest rates. Beginning in September 2007, in response to concerns about weakness in the U.S. economy, the Federal Reserve lowered the fed funds target rate numerous times; in December 2008, it took the unusual step of establishing a target range of 0% to 0.25%, which it has maintained through the end of 2009. Also, the Federal Reserve has injected massive amounts of liquidity into the nation's monetary system through a variety of programs.

The current low short-term rate environment and liquidity injections could, in the future, lead to inflationary pressures which would force the Fed to change course and begin raising rates, which management would expect to be adverse to the Corporation's cost of funds and net interest margin. Although management cannot predict future changes in the rates of inflation, management monitors the impact of economic trends, including any indicators of inflationary pressures, in managing interest rate and other financial risks.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 1 to the consolidated financial statements for a description of recent accounting pronouncements and their recent or potential future effects on the Corporation's financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

Market risk is the risk of loss arising from adverse changes in market rates and prices of the Corporation's financial instruments. In addition to the effects of interest rates, the market prices of the Corporation's debt securities within the available-for-sale securities portfolio are affected by fluctuations in the risk premiums (amounts of spread over risk-free rates) demanded by investors.

Management cannot control changes in market prices of securities based on fluctuations in the risk premiums demanded by investors, nor can management control the volume of deferrals or defaults by other entities on trust-preferred securities. However, management attempts to limit the risk that economic conditions would force the Corporation to sell securities for realized losses by maintaining a strong capital position (discussed in the "Stockholders' Equity and Capital Adequacy" section of Management's Discussion and Analysis) and ample sources of liquidity (discussed in the "Liquidity" section of Management's Discussion and Analysis).

The Corporation's two major categories of market risk are interest rate risk and equity securities risk, which are discussed in the following sections.

INTEREST RATE RISK

Business risk arising from changes in interest rates is an inherent factor in operating a bank. The Corporation's assets are predominantly long-term, fixed rate loans and debt securities. Funding for these assets comes principally from shorter-term deposits and borrowed funds. Accordingly, there is an inherent risk of lower future earnings or decline in fair value of the Corporation's financial instruments when interest rates change.

The Corporation uses a simulation model to calculate the potential effects of interest rate fluctuations on net interest income and the market value of portfolio equity. For purposes of these calculations, the market value of portfolio equity includes the fair values of financial instruments, such as securities, loans, deposits and borrowed funds, and the book values of nonfinancial assets and liabilities, such as premises and equipment and accrued expenses. The model

measures and projects potential changes in net interest income, and calculates the discounted present value of anticipated cash flows of financial instruments, assuming an immediate increase or decrease in interest rates. Management ordinarily runs a variety of scenarios within a range of plus or minus 50-300 basis points of current rates.

The Corporation's Board of Directors has established policy guidelines for acceptable levels of interest rate risk, based on an immediate increase or decrease in interest rates. The policy provides limits at +/- 100, 200 and 300 basis points from current rates for fluctuations in net interest income from the baseline (flat rates) one-year scenario. The policy also limits acceptable market value variances from the baseline values based on current rates.

Table XV, which follows this discussion, is based on the results of the simulation model as of November 30, 2009 and November 30, 2008. The 2009 figures include a pro forma adjustment to increase equity by $21,410,000, which represents the proceeds received from the Corporation's sale of common stock in December 2009 net of issuance costs. The table also includes pro forma adjustments to reflect the Corporation's December 2009 purchases of several investment securities that were consistent with management's decision to limit purchases of taxable securities to investments that mature or are expected to repay a substantial portion of principal within approximately four years or less. The securities purchased totaled approximately $22,382,000 and included obligations of U.S. Government agencies and a collateralized mortgage obligation issued by a U.S. Government agency.

As indicated in the table, the Corporation is liability sensitive, and therefore net interest income and market value generally increase when interest rates fall and decrease when interest rates rise. The table shows that as of November 30, 2009, the changes in net interest income and changes in market value were within the policy limits in all scenarios. As of November 30, 2008, the changes in net interest income were within the policy limits in all scenarios, and changes in market value were within the policy limits in all scenarios except an immediate rate increase of 300 basis points.

In December 2007, the Corporation entered into repurchase agreements (borrowings) totaling $80 million to fund the purchase of investment securities. In addition to generating positive earnings from the spread of the return on the investment securities over the current cost of the borrowings, the transaction reduces the magnitude of the Corporation's overall liability sensitive position. Specifically, the borrowings include embedded caps providing that, if 3-month LIBOR were to exceed 5.15%, the interest rate payable on the repurchase agreements would fall, down to a minimum of 0%, based on parameters included in the repurchase agreements. The embedded cap on one of the $40 million borrowings expires in December 2010, and the embedded cap on the other $40 million borrowing expires in December 2012.

Three-month LIBOR has not exceeded 5.15% since the embedded caps were acquired; therefore, they have not affected interest expense to date. The 3-month LIBOR was 0.26% at November 30, 2009 and 2.22% at November 30, 2008. Since the embedded caps are effective only when 3-month LIBOR exceeds 5.15%, the Corporation would be unable to realize an interest expense reduction in any scenario at November 2009 and would be unable to realize an interest expense reduction in any scenario at November 2008 except an immediate rate increase of 300 basis points.

The model makes estimates, at each level of interest rate change, regarding cash flows from principal repayments on loans and mortgage-backed securities and call activity on other investment securities. Actual results could vary significantly from these estimates, which could result in significant differences in the calculations of projected changes in net interest margin and market value of portfolio equity. Also, the model does not make estimates related to changes in the composition of the deposit portfolio that could occur due to rate competition, and the table does not necessarily reflect changes that management would make to realign the portfolio as a result of changes in interest rates.

TABLE XV - THE EFFECT OF HYPOTHETICAL CHANGES IN INTEREST RATES
November 30, 2009 Data
(In Thousands)

	Period Ending November 30, 2010				
Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+300	$ 70,171	$ 34,669	$ 35,502	-12.0%	20.0%
+200	67,254	29,536	37,718	-6.5%	15.0%
+100	64,419	24,412	40,007	-0.8%	10.0%
0	61,041	20,700	40,341	0.0%	0.0%
-100	57,581	19,579	38,002	-5.8%	10.0%
-200	55,240	19,215	36,025	-10.7%	15.0%
-300	54,360	19,008	35,352	-12.4%	20.0%

	Market Value of Portfolio Equity at November 30, 2009		
Basis Point Change in Rates	Present Value Equity	Present Value % Change	Present Value Risk Limit
+300	$ 98,045	-28.8%	45.0%
+200	116,071	-15.8%	35.0%
+100	131,202	-4.8%	25.0%
0	137,770	0.0%	0.0%
-100	137,307	-0.3%	25.0%
-200	146,347	6.2%	35.0%
-300	172,390	25.1%	45.0%

November 30, 2008 Data
(In Thousands)

	Period Ending November 30, 2009				
Basis Point Change in Rates	Interest Income	Interest Expense	Net Interest Income (NII)	NII % Change	NII Risk Limit
+300	$ 78,329	$ 40,471	$ 37,858	-12.3%	20.0%
+200	75,939	35,404	40,535	-6.2%	15.0%
+100	73,487	31,528	41,959	-2.9%	10.0%
0	71,031	27,839	43,192	0.0%	0.0%
-100	67,988	24,738	43,250	0.1%	10.0%
-200	64,702	22,465	42,237	-2.2%	15.0%
-300	62,034	21,909	40,125	-7.1%	20.0%

Market Value of Portfolio Equity at November 30, 2008		
Present Value	Present Value	Present Value

Basis Point Change in Rates	Equity	% Change	Risk Limit
+300	$ 54,899	-50.9%	45.0%
+200	74,010	-33.9%	35.0%
+100	92,314	-17.5%	25.0%
0	111,889	0.0%	0.0%
-100	126,637	13.2%	25.0%
-200	134,146	19.9%	35.0%
-300	145,401	30.0%	45.0%

EQUITY SECURITIES RISK

The Corporation's equity securities portfolio consists of investments in stock of banks and bank holding companies. Investments in bank stocks are subject to risk factors that affect the banking industry in general, including credit risk, competition from non-bank entities, interest rate risk and other factors, which could result in a decline in market prices. Also, losses could occur in individual stocks held by the Corporation because of specific circumstances related to each bank. Most U.S. bank stock values fell significantly during late 2008 and 2009. As discussed further in Note 7 of the consolidated financial statements, the Corporation recognized OTTI charges on bank stocks totaling $6,324,000 during 2009.

During the fourth quarter of 2009, management decided to sell some bank stocks and liquidate the Corporation's portfolio of non-bank equity securities and mutual funds. This decision was made primarily to generate capital losses, which could be carried back and offset against capital gains generated in 2006, 2007 and 2008 to realize tax refunds. As a result of these sales, the Corporation's aggregate exposure to equities is significantly lower than in prior periods.

Equity securities held as of December 31, 2009 and December 31, 2008 are presented in Table XIV. Table XIV presents quantitative data concerning the effects of a decline in fair value of the Corporation's equity securities of 10% or 20%. The data in Table XIV does not reflect the effects of any appreciation in value that may occur, nor does it present the Corporat