NBT BANCORP INC
Form 10-Q
November 09, 2012

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

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2012.
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 0-14703

NBT BANCORP INC.
(Exact Name of Registrant as Specified in its Charter)

DELAWARE	16-1268674
(State of Incorporation)	(I.R.S. Employer Identification No.)

52 SOUTH BROAD STREET, NORWICH, NEW YORK 13815
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (607) 337-2265

None
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (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 x No o

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

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

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

As of October 31, 2012, there were 33,745,327 shares outstanding of the Registrant's common stock, $0.01 par value per share.

NBT BANCORP INC.

FORM 10-Q--Quarter Ended September 30, 2012

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Item 1 – FINANCIAL STATEMENTS

NBT Bancorp Inc. and Subsidiaries
Consolidated Balance Sheets (unaudited)

(In thousands, except share and per share data)	September 30, 2012	December 31, 2011
Assets		
Cash and due from banks	$ 137,747	$ 128,517
Short-term interest bearing accounts	2,693	864
Securities available for sale, at fair value	1,191,107	1,244,619
Securities held to maturity (fair value $62,401 and $72,198, respectively)	61,302	70,811
Trading securities	3,851	3,062
Federal Reserve and Federal Home Loan Bank stock	28,706	27,020
Loans and leases	4,251,119	3,800,203
Less allowance for loan and lease losses	70,734	71,334
Net loans and leases	4,180,385	3,728,869
Premises and equipment, net	77,326	74,541
Goodwill	152,251	132,029
Intangible assets, net	17,346	18,194
Bank owned life insurance	79,854	77,626
Other assets	96,348	92,254
Total assets	$ 6,028,916	$ 5,598,406
Liabilities		
Demand (noninterest bearing)	$ 1,187,502	$ 1,052,906
Savings, NOW, and money market	2,599,556	2,381,116
Time	1,018,957	933,127
Total deposits	4,806,015	4,367,149
Short-term borrowings	137,365	181,592
Long-term debt	367,144	370,344
Trust preferred debentures	75,422	75,422
Other liabilities	66,309	65,789
Total liabilities	5,452,255	5,060,296
Stockholders' equity		
Preferred stock, $0.01 par value. Authorized 2,500,000 shares at September 30, 2012 and December 31, 2011	-	-
Common stock, $0.01 par value. Authorized 100,000,000 shares at September 30, 2012 and 50,000,000 December 31, 2011; issued 39,305,131 at September 30, 2012 and 38,035,539 at December 31, 2011	393	380
Additional paid-in-capital	345,934	317,329
Retained earnings	351,261	329,981
Accumulated other comprehensive loss	(3,746)	(6,104)
Common stock in treasury, at cost, 5,562,454 and 4,878,829 shares at September 30, 2012 and December 31, 2011, respectively	(117,181)	(103,476)
Total stockholders' equity	576,661	538,110
Total liabilities and stockholders' equity	$ 6,028,916	$ 5,598,406

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Income (unaudited) (In thousands, except per share data)	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Interest, fee, and dividend income				
Interest and fees on loans and leases	$ 53,817	$ 50,991	$ 154,534	$ 152,977
Securities available for sale	6,550	7,771	21,024	23,622
Securities held to maturity	572	680	1,829	2,225
Other	348	342	1,153	1,275
Total interest, fee, and dividend income	61,287	59,784	178,540	180,099
Interest expense				
Deposits	4,544	5,352	14,521	17,690
Short-term borrowings	60	56	149	166
Long-term debt	3,640	3,621	10,801	10,783
Trust preferred debentures	436	394	1,319	1,683
Total interest expense	8,680	9,423	26,790	30,322
Net interest income	52,607	50,361	151,750	149,777
Provision for loan and lease losses	4,755	5,175	13,329	15,161
Net interest income after provision for loan and lease losses	47,852	45,186	138,421	134,616
Noninterest income				
Insurance and other financial services revenue	5,591	5,127	17,024	15,925
Service charges on deposit accounts	4,626	5,532	13,538	16,059
ATM and debit card fees	3,378	3,135	9,403	8,731
Retirement plan administration fees	2,718	2,295	7,462	6,734
Trust	2,242	2,090	6,683	6,384
Bank owned life insurance	639	674	2,228	2,369
Net securities gains	26	12	578	98
Other	2,407	1,329	8,449	3,881
Total noninterest income	21,627	20,194	65,365	60,181
Noninterest expense				
Salaries and employee benefits	26,641	25,068	78,358	74,107
Occupancy	4,437	3,887	13,150	12,396
Data processing and communications	3,352	3,054	10,041	9,085
Professional fees and outside services	2,735	2,215	7,848	6,369
Equipment	2,435	2,288	7,224	6,658
Office supplies and postage	1,597	1,531	4,842	4,418
FDIC expenses	939	920	2,812	3,381
Advertising	701	685	2,308	2,286
Amortization of intangible assets	870	782	2,530	2,286
Loan collection and other real estate owned	614	676	2,051	1,838
Merger expenses	558	155	1,895	155
Other	4,552	3,785	12,236	10,285
Total noninterest expense	49,431	45,046	145,295	133,264
Income before income tax expense	20,048	20,334	58,491	61,533
Income tax expense	5,513	5,117	17,049	17,354
Net income	$ 14,535	$ 15,217	$ 41,442	$ 44,179
Earnings per share				
Basic	$ 0.43	$ 0.46	$ 1.24	$ 1.30

Diluted	$ 0.43	$ 0.45	$ 1.23	$ 1.29

See accompanying notes to unaudited interim consolidated financial statements.

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Consolidated Statements of Comprehensive Income (unaudited) (In thousands)	Three months ended September 30, 2012	Three months ended September 30, 2011	Nine months ended September 30, 2012	Nine months ended September 30, 2011
Net income	$ 14,535	$ 15,217	$ 41,442	$ 44,179
Other comprehensive income, net of tax				
Unrealized net holding gains arising during the period (pre-tax amounts of $1,463,$5,978, $1,798 and $13,719)	878	3,609	1,079	8,284
Reclassification adjustment for net gains related to securities available for sale included in net income (pre-tax amounts of $26, $12, $578 and $98)	(16)	(7)	(347)	(59)
Pension and other benefits:				
Amortization of prior service cost and actuarial gains (pre-tax amounts of $989, $417, $2,702 and $1,248)	599	250	1,626	749
Total other comprehensive income	1,461	3,852	2,358	8,974
Comprehensive income	$ 15,996	$ 19,069	$ 43,800	$ 53,153

See accompanying notes to unaudited interim consolidated financial statements

NBT Bancorp Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity (unaudited)

(in thousands, except share and per share data)	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock in Treasury	Total
Balance at December 31, 2010	$ 380	$ 314,023	$ 299,797	$ (5,335)	$ (75,293)	$ 533,572
Net income	-	-	44,179	-	-	44,179
Cash dividends - $0.60 per share	-	-	(20,439)	-	-	(20,439)
Purchase of 1,458,609 treasury shares	-	-	-	-	(30,502)	(30,502)
Net issuance of 59,128 shares to employee benefit plans and other stock plans, including tax benefit	-	(420)	(137)	-	1,185	628
Stock-based compensation	-	2,436	-	-	-	2,436
Other comprehensive income	-	-	-	8,974	-	8,974
Balance at September 30, 2011	$ 380	$ 316,039	$ 323,400	$ 3,639	$ (104,610)	$ 538,848
Balance at December 31, 2011	$ 380	$ 317,329	$ 329,981	$ (6,104)	$ (103,476)	$ 538,110

Net income	-	-	41,442	-	-	41,442
Cash dividends - $0.60 per share	-	-	(19,966)	-	-	(19,966)
Purchase of 769,568 treasury shares	-	-	-	-	(15,490)	(15,490)
Net issuance of 1,269,592 shares for acquisition	13	25,811	-	-	-	25,824
Net issuance of 85,943 shares to employee benefit plans and other stock plans, including tax benefit	-	(764)	(196)	-	1,785	825
Stock-based compensation	-	3,558	-	-	-	3,558
Other comprehensive income	-	-	-	2,358	-	2,358
Balance at September 30, 2012	$ 393	$ 345,934	$ 351,261	$ (3,746)	$ (117,181)	$ 576,661

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Cash Flows (unaudited) (In thousands, except per share data)	Nine months ended September 30, 2012	2011
Operating activities		
Net income	$ 41,442	$ 44,179
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan and lease losses	13,329	15,161
Depreciation and amortization of premises and equipment	4,636	4,023
Net accretion on securities	1,766	939
Amortization of intangible assets	2,530	2,286
Stock based compensation	3,558	2,436
Bank owned life insurance income	(2,228)	(2,369)
Purchases of trading securities	(705)	(404)
Unrealized (gains) losses in trading securities	(84)	247
Deferred income tax benefit	(2,735)	(4,003)
Proceeds from sales of loans held for sale	37,922	3,257
Originations and purchases of loans held for sale	(47,263)	(2,445)
Net gains on sales of loans held for sale	(1,352)	(2)
Net security gains	(578)	(98)
Net gain on sales of other real estate owned	(602)	(712)
Net decrease in other assets	9,316	3,499
Net (decrease) increase in other liabilities	(1,213)	1,532
Net cash provided by operating activities	57,739	67,526
Investing activities		
Net cash provided by (used in) acquisitions	53,121	(1,000)
Securities available for sale:		
Proceeds from maturities, calls, and principal paydowns	381,160	360,358
Proceeds from sales	1,791	118
Purchases	(329,378)	(387,855)
Securities held to maturity:		
Proceeds from maturities, calls, and principal paydowns	24,428	39,766
Purchases	(14,959)	(14,580)
Net increase in loans	(234,330)	(115,065)
Net (increase) decrease in Federal Reserve and FHLB stock	(672)	226
Purchases of premises and equipment	(4,805)	(5,677)
Proceeds from sales of other real estate owned	2,411	2,073
Net cash used in investing activities	(121,233)	(121,636)
Financing activities		
Net increase in deposits	156,761	130,712
Net decrease in short-term borrowings	(44,227)	(1,149)
Repayments of long-term debt	(3,350)	(2,143)
Issuance of long-term debt	-	156
Excess tax benefit from exercise of stock options	(13)	(95)
Proceeds from the issuance of shares to employee benefit plans and other stock plans	838	723
Purchase of treasury stock	(15,490)	(30,502)
Cash dividends and payment for fractional shares	(19,966)	(20,439)
Net cash provided by financing activities	74,553	77,263

Net increase in cash and cash equivalents	11,059	23,153
Cash and cash equivalents at beginning of period	129,381	168,792
Cash and cash equivalents at end of period	$ 140,440	$ 191,945

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Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	$26,951	$30,774
Income taxes paid	18,457	22,537
Noncash investing activities:		
Loans transferred to OREO	$1,503	$1,110
Acquisitions:		
Fair value of assets acquired	$257,865	$3,460
Fair value of liabilities assumed	285,012	3,426
Fair value of debt issued in purchase combination	150	2,460

See accompanying notes to unaudited interim consolidated financial statements.

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NBT BANCORP INC. and Subsidiaries
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2012

Note 1.Description of Business

NBT Bancorp Inc. (the “Registrant”) is a registered financial holding company incorporated in the State of Delaware in 1986, with its principal headquarters located in Norwich, New York. The Registrant is the parent holding company of NBT Bank, N.A. (the “Bank”), NBT Financial Services, Inc. (“NBT Financial”), NBT Holdings, Inc. (“NBT Holdings”), CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II (the “Trusts”). Through the Bank, the Company is focused on community banking operations. Through NBT Financial, the Company operates EPIC Advisors, Inc. (“EPIC”), a retirement plan administrator. Through NBT Holdings, the Company operates Mang Insurance Agency, LLC (“Mang”), a full-service insurance agency. The Trusts were organized to raise additional regulatory capital and to provide funding for certain acquisitions. The Registrant’s primary business consists of providing commercial banking and financial services to customers in its market area. The principal assets of the Registrant are all of the outstanding shares of common stock of its direct subsidiaries, and its principal sources of revenue are the management fees and dividends it receives from the Bank, NBT Financial, and NBT Holdings.

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

Note 2. Basis of Presentation

The accompanying unaudited interim consolidated financial statements include the accounts of the Registrant and its wholly owned subsidiaries, the Bank, NBT Financial and NBT Holdings. Collectively, the Registrant and its subsidiaries are referred to herein as “the Company.” All intercompany transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

Note 3.Acquisition

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

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

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

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

The fair values for most loans acquired from Hampshire were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. To estimate the fair value of collateral dependent problem loans, we analyzed the value of the underlying collateral of the loans, assuming the fair values of the loans were derived from the eventual sale of the collateral. We discounted those values using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral. There was no carryover of Hampshire First's allowance for credit losses associated with the loans we acquired as the loans were initially recorded at fair value.

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

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

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

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

The fair value of savings and transaction deposit accounts acquired from Hampshire was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. Certificates of deposit were

valued by comparing the contractual cost of the portfolio to an identical portfolio bearing current market rates. The projected cash was calculated by discounting their contractual cash flows at a market rate for a certificate of deposit with a corresponding maturity.

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Note 4.Subsequent Event

On October 7, 2012, the Company and Alliance Financial Corporation ("Alliance") entered into a definitive agreement and plan of merger pursuant to which Alliance will merge with and into NBT Bancorp, with NBT Bancorp continuing as the surviving corporation. The agreement also provides for Alliance Bank, N.A., a wholly-owned subsidiary of Alliance, to be merged with and into the Bank following completion of the merger. Alliance, with assets of approximately $1.4 billion at June 30, 2012, is headquartered in Syracuse, N.Y. Its primary subsidiary, Alliance Bank, N.A., is a nationally-chartered community bank with 28 banking locations in central New York. The transaction is valued at approximately $233.4 million, to be paid in the form of shares of the Company's common stock. Subject to the required approvals of NBT Bancorp and Alliance shareholders, requisite regulatory approvals and other customary closing conditions, the merger is expected to be completed in the early 2013.

Note 5.Use of Estimates

Preparing financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period, as well as the disclosures provided. Actual results could differ from those estimates. Estimates associated with the allowance for loan losses, other real estate owned ("OREO"), income taxes, pension expense, fair values of financial instruments and status of contingencies are particularly susceptible to material change in the near term.

The allowance for loan losses is the amount which, in the opinion of management, is necessary to absorb probable losses inherent in the loan portfolio. The allowance is determined based upon numerous considerations, including local and national economic conditions, the growth and composition of the loan portfolio with respect to the mix between the various types of loans and their related risk characteristics, a review of the value of collateral supporting the loans, comprehensive reviews of the loan portfolio by the independent loan review staff and management, as well as consideration of volume and trends of delinquencies, nonperforming loans, and loan charge-offs. As a result of the review of these factors and historical and current indicators, required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses.

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

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize loan losses, future additions or reductions to the allowance for loan losses may be necessary based on changes in economic conditions or changes in the values of properties securing loans in the process of foreclosure. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination which may not be currently available to management. In determining that we will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated.

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OREO consists of properties acquired through foreclosure or by acceptance of a deed in lieu of foreclosure. These assets are recorded at the lower of fair value of the asset acquired less estimated costs to sell or “cost” (cost is defined as the fair value less costs to sell at initial foreclosure). At the time of foreclosure, or when foreclosure occurs in-substance, the excess, if any, of the loan over the fair value of the assets received, less estimated selling costs, is charged to the allowance for loan losses and any subsequent valuation write-downs are charged to other expense. Operating costs associated with the properties are charged to expense as incurred. Gains on the sale of OREO are included in income when title has passed and the sale has met the minimum down payment requirements prescribed by U.S. GAAP.

Income taxes are accounted for under the asset and liability method. The Company files consolidated tax returns on the accrual basis. Deferred income taxes are recognized for the future tax consequences and benefits attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the available carryback period. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. Based on available carrybacks and expected future income, gross deferred tax assets will ultimately be realized and a valuation allowance was not deemed necessary at September 30, 2012 or December 31, 2011. The effect of a change in tax rates on deferred taxes is recognized in income in the period that includes the enactment date. Uncertain tax positions are recognized only when it is more likely than not (likelihood of greater than 50%), based on technical merits, that the position would be sustained upon examination by taxing authorities. Tax positions that meet the more likely than not threshold are measured using a probability-weighted approach as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement.

Management is required to make various assumptions in valuing its pension assets and liabilities. These assumptions include the expected long-term rate of return on plan assets, the discount rate, and the rate of increase in future compensation levels. Changes to these assumptions could impact earnings in future periods. The Company takes into account the plan asset mix, funding obligations, and expert opinions in determining the various assumptions used to compute pension expense. The Company also considers relevant indices and market interest rates in selecting an appropriate discount rate. A cash flow analysis for expected benefit payments from the plan is performed each year to assist in selecting the discount rate. In addition, the Company reviews expected inflationary and merit increases to compensation in determining the expected rate of increase in future compensation levels.

Management is required to make various assumptions in determining the fair values of financial instruments. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company’s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Management is required to make various assumptions in determining the credit risk involved in issuing contingent obligations such as standby letters of credit, commercial letters of credit, and other lines of credit. Since commitments to extend credit and unused lines of credit may expire without being fully drawn upon, this amount does not necessarily represent future cash commitments. Based on historical experience and economic factors, the Company makes estimates of future cash commitments from these contingent obligations to determine their fair value and establish an allowance if necessary.

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Beginning in June 2012 with the acquisition of Hampshire First Bank, the Bank offers interest rate swap agreements to its customers. These agreements allow the Bank's customers to effectively fix the interest rate on a variable rate loan by entering into a separate agreement. Simultaneous with the execution of such an agreement with a customer, the Bank enters into a matching interest rate swap agreement with an unrelated third party provider, which allows the Bank to continue to receive the historical variable rate under the loan agreement with the customer. The agreement with the third party is not a hedge contract therefore changes in fair value are recorded through earnings. Assets and liabilities associated with the agreements are recorded in other assets and other liabilities on the balance sheet. Gains and losses are recorded as other noninterest income. The Bank is not subject to any fee or penalty should the customer elect to terminate the interest rate swap agreement prior to maturity. The Bank is exposed to credit loss equal to the fair value of the derivatives (not the notional amount of the derivatives) in the event of nonperformance by the counterparty to the interest rate swap agreements. Additionally, the Bank receives a fee from the customer that is recognized when the Bank has fulfilled its obligations under each agreement, which is generally upon execution of the agreement with the Bank's customer. Since the terms of the two interest rate swap agreements are identical, the income statement impact to the Bank is limited to the fees it receives from the customer. The Bank recognized minimal fee income for the nine months ended September 30, 2012. At September 30, 2012, the Bank maintained a $1.6 million deposit with the counterparty to collateralize the swap agreements.

Note 6.Commitments and Contingencies

The Company is a party to financial instruments in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuating interest rates. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit. Exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to make loans and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit origination guidelines, portfolio maintenance and management procedures as other credit and off-balance sheet products. Commitments to extend credit and unused lines of credit totaled $861.7 million at September 30, 2012 and $764.9 million at December 31, 2011. Since commitments to extend credit and unused lines of credit may expire without being fully drawn upon, this amount does not necessarily represent future cash commitments. Collateral obtained upon exercise of the commitment is determined using management's credit evaluation of the borrower and may include accounts receivable, inventory, property, land and other items.

The Company guarantees the obligations or performance of customers by issuing standby letters of credit to third parties. These standby letters of credit are frequently issued in support of third party debt, such as corporate debt issuances, industrial revenue bonds and municipal securities. The credit risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination guidelines, portfolio maintenance and management procedures as other credit and off-balance sheet products. Typically, these instruments have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash commitments. Standby letters of credit totaled $33.0 million at September 30, 2012 and $26.8 million at December 31, 2011. As of September 30, 2012, the fair value of standby letters of credit was not significant to the Company's consolidated financial statements.

The Company has also entered into commercial letter of credit agreements on behalf of its customers. Under these agreements, the Company, on the request of its customer, opens the letter of credit and makes a commitment to honor draws made under the agreement, whereby the beneficiary is normally the provider of goods and/or services and the Company essentially replaces the customer as the payee. The credit risk involved in issuing commercial letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination guidelines, portfolio maintenance and management procedures as other credit and off-balance sheet products. Typically, these agreements vary in terms and the total amounts do not necessarily represent future cash commitments. Commercial letters of credit totaled $8.3 million at September 30, 2012 and

$15.2 million at December 31, 2011. As of September 30, 2012, the fair value of commercial letters of credit was not significant to the Company's consolidated financial statements.

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Note 7. Allowance for Loan Losses and Credit Quality of Loans

Allowance for Loan Losses

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

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

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

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

Commercial Real Estate – The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and other non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition, and a

detailed analysis of the borrower’s underlying cash flows. These loans are typically originated in amounts of no more than 80% of the appraised value of the property.

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

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

Business Banking - The Company offers a variety of loan options to meet the specific needs of our business banking customers including term loans, business banking mortgages and lines of credit. Such loans are generally less than $350 thousand and are made available to businesses for working capital such as inventory and receivables, business expansion, equipment purchases, and agricultural needs. Generally, a collateral lien is placed on equipment or other assets owned by the borrower such as inventory and/or receivables. These loans carry a higher risk than commercial loans due to the smaller size of the borrower and lower levels of capital. To reduce the risk, the Company obtains personal guarantees of the owners for a majority of the loans.

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

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

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

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

Allowance for Loan Loss Calculation

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

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

After a thorough consideration of the factors discussed above, any required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These charges or credits are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions and reductions of the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above. The following table illustrates the changes in the allowance for loan losses by portfolio segment for the three and nine months ended September 30, 2012 and September 30, 2011:

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Allowance for Loan Losses
(in thousands)

	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
Balance as of June 30, 2012	$ 37,495	$ 27,235	$ 5,943	$ 61	$ 70,734
Charge-offs	(1,904)	(3,446)	(480)	-	(5,830)
Recoveries	492	574	9	-	1,075
Provision	1,734	2,213	809	(1)	4,755
Ending Balance as of September 30, 2012	$ 37,817	$ 26,576	$ 6,281	$ 60	$ 70,734
Balance as of June 30, 2011	$ 39,147	$ 25,718	$ 5,373	$ 246	$ 70,484
Charge-offs	(1,694)	(3,526)	(45)	-	(5,265)
Recoveries	367	571	2	-	940
Provision	1,073	3,533	588	(19)	5,175
Ending Balance as of September 30, 2011	$ 38,893	$ 26,296	$ 5,918	$ 227	$ 71,334

	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
Balance as of December 31, 2011	$ 38,831	$ 26,049	$ 6,249	$ 205	$ 71,334
Charge-offs	(4,685)	(11,237)	(1,130)	-	(17,052)
Recoveries	1,180	1,918	25	-	3,123
Provision	2,491	9,846	1,137	(145)	13,329
Ending Balance as of September 30, 2012	$ 37,817	$ 26,576	$ 6,281	$ 60	$ 70,734
Balance as of December 31, 2010	$ 40,101	$ 26,126	$ 4,627	$ 380	$ 71,234
Charge-offs	(7,153)	(10,420)	(558)	-	(18,131)
Recoveries	1,262	1,803	5	-	3,070
Provision	4,683	8,787	1,844	(153)	15,161
Ending Balance as of September 30, 2011	$ 38,893	$ 26,296	$ 5,918	$ 227	$ 71,334

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The following tables illustrate the allowance for loan losses and the recorded investment by portfolio segment as of September 30, 2012 and December 31, 2011:

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

	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
As of September 30, 2012					
Allowance for loan losses	$ 37,817	$ 26,576	$ 6,281	$ 60	$ 70,734
Allowance for loans individually evaluated for impairment	2,720	-	-		2,720
Allowance for loans collectively evaluated for impairment	$ 35,097	$ 26,576	$ 6,281	$ 60	$ 68,014
Ending balance of loans	$ 1,992,891	$ 1,607,780	$ 650,448		$ 4,251,119
Ending balance of loans individually evaluated for impairment	13,017	-	-		13,017
Ending balance of loans collectively evaluated for impairment	$ 1,979,874	$ 1,607,780	$ 650,448		$ 4,238,102
As of December 31, 2011					
Allowance for loan losses	$ 38,831	$ 26,049	$ 6,249	$ 205	$ 71,334
Allowance for loans individually evaluated for impairment	175	-	-		175
Allowance for loans collectively evaluated for impairment	$ 38,656	$ 26,049	$ 6,249	$ 205	$ 71,159
Ending balance of loans	$ 1,702,577	$ 1,516,115	$ 581,511		$ 3,800,203
Ending balance of loans individually evaluated for impairment	6,219	-	-		6,219
Ending balance of loans collectively evaluated for impairment	$ 1,696,358	$ 1,516,115	$ 581,511		$ 3,793,984

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Credit Quality of Loans

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

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

The following table illustrates the Company’s nonaccrual loans by loan class:

Loans on Nonaccrual Status
As of September 30, 2012

(In thousands)	September 30, 2012	December 31, 2011
Commercial Loans		
Commercial	$ 6,915	$ 1,699
Commercial Real Estate	6,432	4,868
Agricultural	2,587	3,307
Agricultural Real Estate	1,195	2,067
Business Banking	5,921	7,446
	23,050	19,387
Consumer Loans		
Indirect	1,703	1,550
Home Equity	8,126	7,931
Direct	257	378
	10,086	9,859
Residential Real Estate Mortgages	9,525	9,044
Total Nonaccrual	$ 42,661	$ 38,290

The increase in nonaccrual commercial and commercial real estate loans from December 31, 2011 to September 30, 2012 was due primarily to one commercial relationship which moved to nonaccrual status during the first quarter. This relationship has been reviewed quarterly and as a result was specifically reserved for by the Company

during the first and second quarters of 2012.

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The following tables set forth information with regard to past due and nonperforming loans by loan class as of September 30, 2012 and December 31, 2011:

Age Analysis of Past Due Financing Receivables
As of September 30, 2012
(in thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Non-Accrual	Current	Recorded Total Loans
Commercial Loans							
Commercial	$707	$149	$ -	$856	$ 6,915	$594,775	$602,546
Commercial Real Estate	1,455	138	-	1,593	6,432	1,012,695	1,020,720
Agricultural	-	-	-	-	2,587	64,187	66,774
Agricultural Real Estate	-	-	-	-	1,195	35,348	36,543
Business Banking	1,114	555	80	1,749	5,921	258,638	266,308
	3,276	842	80	4,198	23,050	1,965,643	1,992,891
Consumer Loans							
Indirect	9,406	1,729	978	12,113	1,703	948,803	962,619
Home Equity	5,478	888	573	6,939	8,126	561,143	576,208
Direct	705	130	47	882	257	67,814	68,953
	15,589	2,747	1,598	19,934	10,086	1,577,760	1,607,780
Residential Real Estate Mortgages	2,240	170	1,285	3,695	9,525	637,228	650,448
	$21,105	$3,759	$ 2,963	$27,827	$ 42,661	$4,180,631	$4,251,119

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Age Analysis of Past Due Financing Receivables
As of December 31, 2011
(in thousands)

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

There were no material commitments to extend further credit to borrowers with nonperforming loans. Within nonaccrual loans, there are approximately $2.3 million and $4.0 million of troubled debt restructured loans at September 30, 2012 and December 31, 2011, respectively. This decrease was due primarily to the migration of certain commercial loans to accruing status during the first nine months of 2012.

Impaired loans, which primarily consist of nonaccruing commercial, commercial real estate, agricultural, agricultural real estate and business banking loans were $25.9 million at September 30, 2012 and $22.4 million at December 31, 2011.

The methodology used to establish the allowance for loan losses on impaired loans incorporates specific allocations on loans analyzed individually. Classified loans with outstanding balances of $500 thousand or more are evaluated for impairment through the Company's quarterly status review process. In determining that we will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated. For loans that are impaired as defined by accounting standards, impairment is measured by one of three methods: 1) the fair value of collateral less cost to sell, 2) present value of expected future cash flows or 3) the loan's observable market price. All impaired loans are reviewed on a quarterly basis for changes in the measurement of

impairment. Any change to the previously recognized impairment loss is recognized as a change to the allowance account and recorded in the consolidated statement of income as a component of the provision for credit losses. At September 30, 2012, $6.1 million of the total impaired loans had a specific reserve allocation of $2.7 million compared to $.5 million of impaired loans at December 31, 2011 which had a specific reserve allocation of $0.2 million.

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The following table provides additional information on impaired loans and specific reserve allocations as of September 30, 2012 and December 31, 2011:

	September 30, 2012			December 31, 2011		
(in thousands)	Recorded Investment Balance (Book)	Unpaid Principal Balance (Legal)	Related Allowance	Recorded Investment Balance (Book)	Unpaid Principal Balance (Legal)	Related Allowance
With no related allowance recorded:						
Commercial Loans						
Commercial	$851	$1,257		$1,243	$2,723	
Commercial Real Estate	6,432	8,396		4,868	7,165	
Agricultural	2,587	3,567		3,307	4,166	
Agricultural Real Estate	1,195	1,382		2,067	2,288	
Business Banking	5,921	8,078		7,446	9,976	
Total Commercial Loans	16,986	22,680		18,931	26,318	
Consumer Loans						
Home Equity	1,777	1,879		2,000	2,103	
Residential Real Estate Mortgages	1,105	1,275		1,040	1,125	
	$19,868	$25,834		$21,971	$29,546	
With an allowance recorded:						
Commercial Loans						
Commercial	$6,064	$6,113	$2,720	$456	$808	$175
Commercial Real Estate	-	-	-	-	-	-
Agricultural	-	-	-	-	-	-
Agricultural Real Estate	-	-	-	-	-	-
	6,064	6,113	2,720	456	808	175
Total:	$25,932	$31,947	$2,720	$22,427	$30,354	$175

The increase in commercial loans with a related allowance recorded from December 31, 2011 to September 30, 2012 is primarily due to the impairment of two commercial relationships during the nine months ended September 30, 2012.

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The following table summarizes the average recorded investments on impaired loans and the interest income recognized for the three months ended September 30, 2012 and September 30, 2011:

	For the three months ended					
	September 30, 2012			September 30, 2011		
	Average Recorded	Interest Income Recognized		Average Recorded	Interest Income Recognized	
(in thousands)	Investment	Accrual	Cash	Investment	Accrual	Cash
With no related allowance recorded:						
Commercial Loans						
Commercial	$854	$9	$9	$1,794	$3	$3
Commercial Real Estate	6,732	16	16	6,106	14	14
Agricultural	2,627	51	51	3,516	59	59
Agricultural Real Estate	1,348	3	3	1,874	34	34
Business Banking	6,169	70	70	7,655	101	101
Consumer Loans						
Home Equity	1,783	18	18	2,312	26	26
Residential Real Estate Mortgages	1,111	17	17	1,059	26	26
	$20,624	$184	$184	$24,316	$263	$263
With an allowance recorded:						
Commercial Loans						
Commercial	$6,091	$34	$34	$520	$19	$19
Commercial Real Estate	-	-	-	-	-	-
Agricultural	-	-	-	23	1	1
Agricultural Real Estate	-	-	-	-	-	-
	$6,091	$34	$34	$543	$20	$20
Total:	$26,715	$218	$218	$24,859	$283	$283

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The following table summarizes the average recorded investments on impaired loans and the interest income recognized for the nine months ended September 30, 2012 and September 30, 2011:

	For the nine months ended					
	September 30, 2012			September 30, 2011		
	Average Recorded	Interest Income Recognized		Average Recorded	Interest Income Recognized	
(in thousands)	Investment	Accrual	Cash	Investment	Accrual	Cash
With no related allowance recorded:						
Commercial Loans						
Commercial	$1,319	$23	$23	$2,625	$76	$76
Commercial Real Estate	6,564	48	48	4,728	59	59
Agricultural	2,873	159	159	2,903	104	104
Agricultural Real Estate	1,734	13	13	1,622	72	72
Business Banking	6,824	166	166	5,662	203	203
Consumer Loans						
Home Equity	1,840	66	66	1,851	84	84
Residential Real Estate Mortgages	1,066	73	73	887	53	53
	$22,220	$548	$548	$20,278	$651	$651
With an allowance recorded:						
Commercial Loans						
Commercial	$4,178	$43	$43	$991	$68	$68
Commercial Real Estate	-	-	-	382	-	-
Agricultural	-	-	-	1,055	68	68
Agricultural Real Estate	-	-	-	475	18	18
	$4,178	$43	$43	$2,903	$154	$154
Total:	$26,397	$591	$591	$23,181	$805	$805

There has been significant disruption and volatility in the financial and capital markets since the second half of 2008. Turmoil in the mortgage industry adversely impacted both domestic and global economies and led to a significant credit and liquidity crisis in many domestic markets. These conditions were attributable to a variety of factors, in particular the fallout associated with subprime mortgage loans (a type of lending we have never actively pursued). The disruption was exacerbated by the decline of the real estate and housing market. However, in the markets in which the Company does business, the disruption has been somewhat delayed and less significant than in the national market. For example, our real estate market has not suffered the extreme declines seen nationally and our unemployment rate, while notably higher than in prior periods, is still below the national average.

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

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

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Commercial Grading System

For commercial and agricultural loans, the Company uses a grading system that relies on quantifiable and measurable characteristics when available. This would include comparison of financial strength to available industry averages, comparison of transaction factors (loan terms and conditions) to loan policy, and comparison of credit history to stated repayment terms and industry averages. Some grading factors are necessarily more subjective such as economic and industry factors, regulatory environment, and management. Classified commercial loans consist of loans graded substandard and below. All classified loans with outstanding balances of $500 thousand or more are evaluated individually for impairment through the quarterly review process. The grading system for commercial and agricultural loans is as follows:

- Doubtful

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

- Substandard

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

- Special Mention

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

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- Pass

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

Business banking Grading System

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

- Classified

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

- Non-classified

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

Consumer and Residential Mortgage Grading System

Consumer and Residential Mortgage loans are graded as either Performing or Nonperforming. Nonperforming loans are loans that are 1) over 90 days past due and interest is still accruing, 2) on nonaccrual status or 3) restructured. All loans not meeting any of these three criteria are considered Performing.

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The following tables illustrate the Company's credit quality by loan class as of September 30, 2012 and December 31, 2011:

Credit Quality Indicators
As of September 30, 2012

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Pass	$565,546	$ 948,966	$59,545	$ 32,213	$1,606,270
Special Mention	11,371	23,967	13	3	35,354
Substandard	22,656	47,787	7,168	4,327	81,938
Doubtful	2,973	-	48	-	3,021
Total	$602,546	$ 1,020,720	$66,774	$ 36,543	$1,726,583

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$251,284	$251,284
Classified	15,024	15,024
Total	$266,308	$266,308

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$959,938	$ 567,509	$68,649	$1,596,096
Nonperforming	2,681	8,699	304	11,684
Total	$962,619	$ 576,208	$68,953	$1,607,780

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$639,638	$639,638
Nonperforming	10,810	10,810
Total	$650,448	$650,448

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Credit Quality Indicators
As of December 31, 2011

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

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

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 870,270	$ 560,760	$ 72,849	$ 1,503,879
Nonperforming	2,833	8,885	518	12,236
Total	$ 873,103	$ 569,645	$ 73,367	$ 1,516,115

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 571,704	$ 571,704
Nonperforming	9,807	9,807
Total	$ 581,511	$ 581,511

Modifications

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

When the Company modifies a loan, management evaluates any possible impairment based on the present value of the expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If management determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized by segment or class of loan as applicable, through an allowance estimate or a charge-off to the allowance. Segment and class status is determined by the loan's classification at origination.

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There were no new modifications made during the three month period ending September 30, 2012. During the three month period ending September 30, 2012 there were no defaults on loans modified within the previous 12 months.

Modifications made during the three month period ending September 30, 2011 consisted of three commercial loans totaling $0.8 million. For all such modifications, the pre and post outstanding recorded investment amount remained unchanged. During the three month period ending September 30, 2011 there were no defaults on previously modified loans.

Modifications made during the nine month period ending September 30, 2012 consisted of one commercial loan totaling $1.0 million and one residential real estate mortgage totaling $0.2 million. For all such modifications, the pre and post outstanding recorded investment amount remained unchanged. During the nine month period ending September 30, 2012 there were no defaults on loans modified within the previous 12 months.

Modifications during the nine month period ending September 30, 2011 consisted of twenty-five home equity modifications totaling $2.3 million and four residential real estate mortgages totaling $0.8 million, in addition to the three aforementioned commercial loan modifications. For all such modifications, the pre and post outstanding recorded investment amount remained unchanged. During the nine months ended September 30, 2011, there were six home equity loans classified as TDRs totaling $0.6 million and two residential real estate loans classified as TDRs totaling $0.4 million that defaulted on their renegotiated terms.

Note 8.Earnings Per Share

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

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

Three months ended September 30,	2012	2011
(in thousands, except per share data)		
Basic EPS:		
Weighted average common shares outstanding	33,619	33,324
Net income available to common shareholders	14,535	15,217
Basic EPS	$ 0.43	$ 0.46
Diluted EPS:		
Weighted average common shares outstanding	33,619	33,324
Dilutive effect of common stock options and restricted stock	342	243
Weighted average common shares and common share equivalents	33,961	33,567
Net income available to common shareholders	14,535	15,217
Diluted EPS	$ 0.43	$ 0.45

Nine months ended September 30,	2012	2011
(in thousands, except per share data)		
Basic EPS:		
Weighted average common shares outstanding	33,293	33,897
Net income available to common shareholders	41,442	44,179
Basic EPS	$1.24	$1.30
Diluted EPS:		
Weighted average common shares outstanding	33,293	33,897
Dilutive effect of common stock options and restricted stock	333	262
Weighted average common shares and common share equivalents	33,626	34,159
Net income available to common shareholders	41,442	44,179
Diluted EPS	$1.23	$1.29

There were 1,176,670 stock options for the quarter ended September 30, 2012 and 1,651,159 stock options for the quarter ended September 30, 2011 that were not considered in the calculation of diluted earnings per share since the stock options' exercise price was greater than the average market price during these periods.

There were 1,197,417 stock options for the nine months ended September 30, 2012 and 1,239,021 stock options for the nine months ended September 30, 2011 that were not considered in the calculation of diluted earnings per share since the stock options' exercise price was greater than the average market price during these periods.

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Note 9.Defined Benefit Postretirement Plans

The Company has a qualified, noncontributory, defined benefit pension plan covering substantially all of its employees at September 30, 2012. Benefits paid from the plan are based on age, years of service, compensation and social security benefits, and are determined in accordance with defined formulas. The Company's policy is to fund the pension plan in accordance with Employee Retirement Income Security Act ("ERISA") standards. Assets of the plan are invested in publicly traded stocks and bonds. Prior to January 1, 2000, the Company's plan was a traditional defined benefit plan based on final average compensation. On January 1, 2000, the plan was converted to a cash balance plan with grandfathering provisions for existing participants.

In addition to the pension plan, the Company also provides supplemental employee retirement plans to certain current and former executives. These supplemental employee retirement plans and the defined benefit pension plan are collectively referred to herein as "Pension Benefits."

Also, the Company provides certain health care benefits for retired employees. Benefits are accrued over the employees' active service period. Only employees that were employed by the Company on or before January 1, 2000 are eligible to receive postretirement health care benefits. The plan is contributory for participating retirees, requiring participants to absorb certain deductibles and coinsurance amounts with contributions adjusted annually to reflect cost sharing provisions and benefit limitations called for in the plan. Eligibility is contingent upon the direct transition from active employment status to retirement without any break in employment from the Company. Employees also must be participants in the Company's medical plan prior to their retirement. The Company funds the cost of postretirement health care as benefits are paid. The Company elected to recognize the transition obligation on a delayed basis over twenty years. These postretirement benefits are referred to herein as "Other Benefits."

The components of expense for Pension Benefits and Other Benefits are set forth below (in thousands):

	Pension Benefits Three months ended September 30,		Other Benefits Three months ended September 30,	
Components of net periodic benefit cost:	2012	2011	2012	2011
Service cost	$ 757	$ 668	$ 6	$ 5
Interest cost	774	874	40	57
Expected return on plan assets	(1,676)	(1,914)	-	-
Net amortization	992	408	(3)	9
Total cost	$ 847	$ 36	$ 43	$ 71

	Pension Benefits Nine months ended September 30,		Other Benefits Nine months ended September 30,	
Components of net periodic benefit cost:	2012	2011	2012	2011
Service cost	$ 2,270	$ 2,003	$ 16	$ 15
Interest cost	2,322	2,621	119	171
Expected return on plan assets	(5,026)	(5,742)	-	-
Net amortization	2,710	1,221	(8)	27
Total cost	$ 2,276	$ 103	$ 127	$ 213

The Company is not required to make contributions to the plans in 2012, and did not do so during the nine months ended September 30, 2012.

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Market conditions can result in an unusually high degree of volatility and increase the risks and short term liquidity associated with certain investments held by the Company's defined benefit pension plan ("the Plan") which could impact the value of these investments.

Note 10.Trust Preferred Debentures

CNBF Capital Trust I is a Delaware statutory business trust formed in 1999, for the purpose of issuing $18 million in trust preferred securities and lending the proceeds to the Company. NBT Statutory Trust I is a Delaware statutory business trust formed in 2005, for the purpose of issuing $5 million in trust preferred securities and lending the proceeds to the Company. NBT Statutory Trust II is a Delaware statutory business trust formed in 2006, for the purpose of issuing $50 million in trust preferred securities and lending the proceeds to the Company to provide funding for the acquisition of CNB Bancorp, Inc. These three statutory business trusts are collectively referred herein to as "the Trusts." The Company guarantees, on a limited basis, payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities. The Trusts are variable interest entities ("VIEs") for which the Company is not the primary beneficiary, as defined by U.S. GAAP. In accordance with U.S. GAAP, the accounts of the Trusts are not included in the Company's consolidated financial statements.

As of September 30, 2012, the Trusts had the following issues of trust preferred debentures, all held by the Trusts, outstanding (dollars in thousands):

Description	Issuance Date	Trust Preferred Securities Outstanding	Interest Rate	Trust Preferred Debt Owed To Trust	Final Maturity date
CNBF Capital Trust I	June 1999	18,000	3-month LIBOR plus 2.75%	$ 18,720	August 2029
NBT Statutory Trust I	November 2005	5,000	3-month LIBOR plus 1.40%	5,155	December 2035
NBT Statutory Trust II	February 2006	50,000	3-month LIBOR plus 1.40%	51,547	March 2036

The Company owns all of the common stock of the Trusts, which have issued trust preferred securities in conjunction with the Company issuing trust preferred debentures to the Trusts. The terms of the trust preferred debentures are substantially the same as the terms of the trust preferred securities.

Note 11.Fair Value Measurements and Fair Value of Financial Instruments

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

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

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

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

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

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

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

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

For the three and nine month periods ending September 30, 2012, the Company has made no transfers of assets between Level 1 and Level 2, and has had no Level 3 activity.

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The following tables set forth the Company's financial assets and liabilities measured on a recurring basis that were accounted for at fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands):

September 30, 2012:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2012
Assets:				
Securities Available for Sale:				
U.S. Treasury	$ 64,662	$ -	$ -	$ 64,662
Federal Agency	-	296,158	-	296,158
State & municipal	-	92,504	-	92,504
Mortgage-backed	-	279,596	-	279,596
Collateralized mortgage obligations	-	446,887	-	446,887
Other securities	9,210	2,090	-	11,300
Total Securities Available for Sale	$ 73,872	$ 1,117,235	$ -	$ 1,191,107
Trading Securities	3,851	-	-	3,851
Interest Rate Swaps	-	1,490	-	1,490
Total	$ 77,723	$ 1,118,725	$ -	$ 1,196,448
Liabilities:				
Interest Rate Swaps	$ -	$ 1,490	$ -	$ 1,490
Total	$ -	$ 1,490	$ -	$ 1,490

December 31, 2011:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2011
Assets:				
Securities Available for Sale:				
U.S. Treasury	$ 82,233	$ -	$ -	$ 82,233
Federal Agency	-	255,846	-	255,846
State & municipal	-	104,789	-	104,789
Mortgage-backed	-	325,397	-	325,397
Collateralized mortgage obligations	-	465,475	-	465,475
Other securities	8,825	2,054	-	10,879
Total Securities Available for Sale	$ 91,058	$ 1,153,561	$ -	$ 1,244,619
Trading Securities	3,062	-	-	3,062

Total	$ 94,120	$ 1,153,561	$ -	$ 1,247,681

Certain common equity securities are reported at fair value utilizing Level 1 inputs (exchange quoted prices). The majority of the other investment securities are reported at fair value utilizing Level 2 inputs. The prices for these instruments are obtained through an independent pricing service or dealer market participants with whom the Company has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricing. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond’s terms and conditions, among other things. Management reviews the methodologies used in pricing the securities by its third party providers.

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U.S. GAAP requires disclosure of assets and liabilities measured and recorded at fair value on a nonrecurring basis such as goodwill, loans held for sale, other real estate owned, lease residuals, collateral-dependent impaired loans, mortgage servicing rights, and held-to-maturity securities. The only nonrecurring fair value measurement recorded during the nine month period ended September 30, 2012 was related to impaired loans. The Company uses the fair value of underlying collateral, less costs to sell, to estimate the specific reserves for collateral dependent impaired loans. Based on the valuation techniques used, the fair value measurements for collateral dependent impaired loans are classified as Level 3.

The following table sets forth information with regard to estimated fair values of financial instruments at September 30, 2012 and December 31, 2011. This table excludes financial instruments for which the carrying amount approximates fair value. Financial instruments for which the fair value approximates carrying value include cash and cash equivalents, securities available for sale, trading securities, accrued interest receivable, non-maturity deposits, short-term borrowings, accrued interest payable, and interest rate swaps.

		September 30, 2012		December 31, 2011	
(In thousands)	Fair Value Hierarchy	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets					
Securities held to maturity	2	61,302	62,401	70,811	72,198
Net loans	3	4,180,385	4,298,990	3,728,869	3,821,640
Financial liabilities					
Time deposits	2	1,018,957	1,028,110	933,127	942,437
Long-term debt	2	367,144	418,349	370,344	427,107
Trust Preferred Debentures	3	75,422	57,123	75,422	55,980

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company’s entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company’s financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, the Company has a substantial trust and investment management operation that contributes net fee income annually. The trust and investment management operation is not considered a financial instrument, and its value has not been incorporated into the fair value estimates. Other significant assets and liabilities include the benefits resulting from the low-cost funding of deposit liabilities as compared to the cost of borrowing funds in the market, and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimate of fair value.

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Securities Held to Maturity
The fair value of the Company's investment securities held to maturity is primarily measured using information from a third party pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

Net Loans
The fair value of the Company's loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made for the same remaining maturities. Loans were first segregated by type, and then further segmented into fixed and variable rate and loan quality categories. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

Time Deposits
The fair value of time deposits was estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments. The fair values of the Company's time deposit liabilities do not take into consideration the value of the Company's long-term relationships with depositors, which may have significant value.

Long-Term Debt
The fair value of long-term debt was estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

Trust Preferred Debentures
The fair value of trust preferred debentures has been estimated using a discounted cash flow analysis.

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Note 12.Securities

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

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
September 30, 2012				
U.S. Treasury	$63,747	$915	$-	$ 64,662
Federal Agency	294,503	1,655	-	296,158
State & municipal	87,786	4,718	-	92,504
Mortgage-backed	264,073	15,523	-	279,596
Collateralized mortgage obligations	440,383	6,504	-	446,887
Other securities	8,711	2,668	79	11,300
Total securities available for sale	$1,159,203	$31,983	$79	$ 1,191,107
December 31, 2011				
U.S. Treasury	$81,006	$1,228	$-	$ 82,234
Federal Agency	254,983	879	16	255,846
State & municipal	99,176	5,624	11	104,789
Mortgage-backed	310,767	14,629	-	325,396
Collateralized mortgage obligations	459,067	6,458	51	465,474
Other securities	8,935	2,021	76	10,880
Total securities available for sale	$1,213,934	$30,839	$154	$ 1,244,619

In the available for sale category at September 30, 2012, federal agency securities were comprised of Government-Sponsored Enterprise (“GSE”) securities; mortgaged-backed securities were comprised of GSE securities with an amortized cost of $246.6 million and a fair value of $260.3 million and US Government Agency securities with an amortized cost of $17.5 million and a fair value of $19.3 million; collateralized mortgage obligations were comprised of GSE securities with an amortized cost of $387.5 million and a fair value of $394.2 million and US Government Agency securities with an amortized cost of $50.9 million and a fair value of $52.7 million.

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

Others securities primarily represent marketable equity securities.

Proceeds from the sales of securities available for sale were $1.8 million during the nine months ended September 30, 2012, and gains on the sales were $0.4 million. Proceeds from the sales of securities available for sale were nominal during the nine month period ending September 30, 2011, and gains on these sales were negligible.

Securities with amortized costs totaling $1.2 billion at September 30, 2012 and December 31, 2011, were pledged to secure public deposits and for other purposes required or permitted by law. Additionally, at September 30, 2012 and December 31, 2011, securities available for sale with an amortized cost of $210.4 million and $141.7 million, respectively, were pledged as collateral for securities sold under repurchase agreements.

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

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
September 30, 2012				
Mortgage-backed	$ 1,252	$ 203	$ -	$ 1,455
State & municipal	60,050	896	-	60,946
Total securities held to maturity	$ 61,302	$ 1,099	$ -	$ 62,401
December 31, 2011				
Mortgage-backed	$ 1,447	$ 213	$ -	$ 1,660
State & municipal	69,364	1,174	-	70,538
Total securities held to maturity	$ 70,811	$ 1,387	$ -	$ 72,198

The following table sets forth information with regard to investment securities with unrealized losses at September 30, 2012 and December 31, 2011:

	Less than 12 months			12 months or longer			Total		
Security Type:	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions
September 30, 2012									
U.S. Treasury	$ -	$ -	-	$ -	$ -	-	$ -	$ -	-
Federal agency	-	-	-	-	-	-	-	-	-
State & municipal	-	-	-	-	-	-	-	-	-
Mortgage-backed	-	-	-	-	-	-	-	-	-
Collateralized mortgage obligations	-	-	-	-	-	-	-	-	-
Other securities	-	-	-	169	(79)	1	169	(79)	1
Total securities with unrealized losses	$ -	$ -	-	$ 169	$ (79)	1	$ 169	$ (79)	1
December 31, 2011									
U.S. Treasury	$ -	$ -	-	$ -	$ -	-	$ -	$ -	-
Federal agency	34,996	(16)	3	-	-	-	34,996	(16)	3
State & municipal	957	(10)	3	377	(1)	2	1,334	(11)	5
Mortgage-backed	-	-	-	-	-	-	-	-	-
Collateralized mortgage obligations	27,368	(51)	3	-	-	-	27,368	(51)	3
Other securities	645	(76)	2	-	-	-	645	(76)	2
Total securities with unrealized losses	$ 63,966	$ (153)	11	$ 377	$ (1)	2	$ 64,343	$ (154)	13

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Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses or in other comprehensive income, depending on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into (a) the amount representing the credit loss and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes.

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

Management has the intent to hold the securities classified as held to maturity until they mature, at which time it is believed the Company will receive full value for the securities. Furthermore, as of September 30, 2012, management also had the intent to hold, and will not be required to sell, the securities classified as available for sale for a period of time sufficient for a recovery of cost, which may be until maturity. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether or not it will receive the contractual principal and interest on certain securities. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. As of September 30, 2012, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment losses have been realized in the Company's consolidated statements of income.

The following tables set forth information with regard to contractual maturities of debt securities at September 30, 2012:

(In thousands)	Amortized cost	Estimated fair value
Debt securities classified as available for sale		
Within one year	$ 26,616	$ 26,807
From one to five years	262,685	265,541
From five to ten years	273,272	282,328
After ten years	587,919	605,131
	$ 1,150,492	$ 1,179,807
Debt securities classified as held to maturity		
Within one year	$ 24,501	$ 24,577
From one to five years	27,735	28,476
From five to ten years	6,380	6,459
After ten years	2,686	2,889
	$ 61,302	$ 62,401

Maturities of mortgage-backed, collateralized mortgage obligations and asset-backed securities are stated based on their estimated average lives. Actual maturities may differ from estimated average lives or contractual maturities

because, in certain cases, borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

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Except for U.S. Government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of consolidated stockholders' equity at September 30, 2012.

NBT BANCORP INC. AND SUBSIDIARIES
Item 2 -- MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this discussion and analysis is to provide a concise description of the financial condition and results of operations of NBT Bancorp Inc. and its wholly owned consolidated subsidiaries, NBT Bank, N.A. (the "Bank"), NBT Financial Services, Inc. ("NBT Financial"), and NBT Holdings, Inc. ("NBT Holdings") (collectively referred to herein as the "Company"). This discussion will focus on results of operations, financial condition, capital resources and asset/liability management. Reference should be made to the Company's consolidated financial statements and footnotes thereto included in this Form 10-Q as well as to the Company's Annual Report on Form 10-K for the year ended December 31, 2011 for an understanding of the following discussion and analysis. Operating results for the three and nine month periods ended September 30, 2012 are not necessarily indicative of the results of the full year ending December 31, 2012 or any future period.

Forward-looking Statements

Certain statements in this filing and future filings by the Company with the Securities and Exchange Commission, in the Company's press releases or other public or shareholder communications, contain forward-looking statements, as defined in the Private Securities Litigation Reform Act. These statements may be identified by the use of phrases such as "anticipate," "believe," "expect," "forecasts," "projects," "could," or other similar terms. There are a number of factors, r of which are beyond the Company's control, that could cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following: (1) competitive pressures among depository and other financial institutions may increase significantly; (2) revenues may be lower than expected; (3) changes in the interest rate environment may affect interest margins; (4) general economic conditions, either nationally or regionally, may be less favorable than expected, resulting in, among other things, a deterioration in credit quality and/or a reduced demand for credit; (5) legislative or regulatory changes, including changes in accounting standards or tax laws, may adversely affect the businesses in which the Company is engaged; (6) competitors may have greater financial resources and develop products that enable such competitors to compete more successfully than the Company; (7) adverse changes may occur in the securities markets or with respect to inflation; (8) acts of war or terrorism; (9) the costs and effects of litigation and of unexpected or adverse outcomes in such litigation; (10) internal control failures; (11) the successful completion and integration of acquisitions; and (12) the Company's success in managing the risks involved in the foregoing.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors, including those described above and other factors discussed in the Company's annual and quarterly reports previously filed with the Securities and Exchange Commission, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

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

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Critical Accounting Policies

Management of the Company considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the judgment in evaluating the level of the allowance required to cover credit losses inherent in the loan portfolio and the material effect that such judgments can have on the results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under different conditions or assumptions, the allowance may need to be increased or decreased. For example, if historical loan loss experience significantly changed or if current economic conditions deteriorated or improved, particularly in the Company's primary market area, provisions for loan losses may be increased or decreased to adjust the allowance. In addition, the assumptions and estimates relating to loss experience, ability to collect and economic conditions used in the internal reviews of the Company's nonperforming loans and potential problem loans has a significant impact on the overall analysis of the adequacy of the allowance for loan losses. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral valuations were significantly changed, the Company's allowance for loan policy may require increases or decreases in the provision for loan losses.

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

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

Pending Acquisition

On October 7, 2012, the Company and Alliance Financial Corporation ("Alliance") entered into a definitive agreement and plan of merger pursuant to which Alliance will merge with and into NBT Bancorp, with NBT Bancorp continuing as the surviving corporation. The agreement also provides for Alliance Bank, N.A., a wholly-owned subsidiary of Alliance, to be merged with and into the Bank following completion of the merger. Alliance, with assets of approximately $1.4 billion at June 30, 2012, is headquartered in Syracuse, N.Y. Its primary subsidiary, Alliance Bank, N.A., is a nationally-chartered community bank with 28 banking locations in central New York. The transaction is valued at approximately $233.4 million, to be paid in the form of shares of the Company's common stock. Subject to the required approvals of NBT Bancorp and Alliance shareholders, requisite regulatory approvals and other customary closing conditions, the merger is expected to be completed in the early 2013.

Overview

Significant factors management reviews to evaluate the Company's operating results and financial condition include, but are not limited to: net income and earnings per share, return on assets and equity, net interest margin, noninterest income, operating expenses, asset quality indicators, loan and deposit growth, capital management, liquidity and interest rate sensitivity, enhancements to customer products and services, technology advancements, market share and

peer comparisons. The following information should be considered in connection with the Company's results for the first nine months of 2012:

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- Net income for the nine months ended September 30, 2012 was $41.4 million, down $2.7 million, or 6.2%, from the nine months ended September 30, 2011. Net income per diluted share for the nine months ended September 30, 2012 was $1.23 per share, down from $1.29 for the nine months ended September 30, 2011.

- Net interest margin (on a fully taxable equivalent basis ("FTE")) was 3.87% for the nine months ended September 30, 2012 as compared to 4.13% for the same period in 2011.

- Capital ratios at September 30, 2012 declined slightly when compared to December 31, 2011:

  - Tier 1 Leverage ratio decreased from 8.74% to 8.51%
  - Tier 1 Capital ratio decreased from 11.56% to 10.82%
  - Total Risk-Based Capital Ratio decreased from 12.81% to 12.07%

- Past due loans as a percentage of total loans showed significant improvement to 0.65% at September 30, 2012, as compared with 0.89% at December 31, 2011.

- Net charge-offs improved to 0.47% of average loans for the first nine months of 2012, down 9 bps from 0.56% for the year ended December 31, 2011.

- The provision for loan losses was $13.3 million for the nine months ended September 30, 2012, down from $15.2 million for the same period in 2011.

- Annualized return on average assets was 0.95% for the nine months ended September 30, 2012, down from 1.09% for the nine months ended September 30, 2011.

- Annualized return on average equity was 9.97% for the nine months ended September 30, 2012, down from 10.95% for the nine months ended September 30, 2011.

- Continued strategic expansion in the first nine months of 2012:

  - In New York: Completed the acquisition of three branches in Greene County and customer balances of a branch in Schoharie County on January 21, 2012.
  - In Massachusetts: Opened a fifth Massachusetts branch in Lenox on February 7, 2012.
  - Successfully completed the acquisition of Hampshire First Bank on June 8, 2012.
  - Announced the planned acquisition of Alliance Financial Corporation, a $1.4 billion financial holding company headquartered in Syracuse, N.Y., expected to close in early 2013.

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The following table depicts several annualized measurements of performance using U.S. GAAP net income that management reviews in analyzing the Company's performance. Returns on average assets and average equity measure how effectively an entity utilizes its total resources and capital, respectively. Net interest margin, which is the net federal taxable equivalent (FTE) interest income divided by average earning assets, is a measure of an entity's ability to utilize its earning assets in relation to the cost of funding. Interest income for tax-exempt securities and loans is adjusted to a taxable equivalent basis using the statutory Federal income tax rate of 35%.

2012	First Quarter		Second Quarter		Third Quarter		Nine Months	
Return on average assets (ROAA)	0.97	%	0.92	%	0.97	%	0.95	%
Return on average equity (ROAE)	10.12	%	9.66	%	10.13	%	9.97	%
Net Interest Margin	3.90	%	3.82	%	3.90	%	3.87	%
2011								
Return on average assets (ROAA)	1.08	%	1.09	%	1.12	%	1.09	%
Return on average equity (ROAE)	10.78	%	10.86	%	11.21	%	10.95	%
Net Interest Margin	4.11	%	4.13	%	4.14	%	4.13	%

Net Interest Income

Net interest income is the difference between interest income on earning assets, primarily loans and securities, and interest expense on interest bearing liabilities, primarily deposits and borrowings. Net interest income is affected by the interest rate spread, the difference between the yield on earning assets and cost of interest bearing liabilities, as well as the volumes of such assets and liabilities. Net interest income is one of the key determining factors in a financial institution's performance as it is the principal source of earnings.

FTE net interest income increased $2.1 million during the three months ended September 30, 2012, compared to the same period of 2011. The Company experienced a decrease in the yield on interest earning assets of 37 bp to 4.53% for the three months ended September 30, 2012 from 4.90% for the same period in 2011. This decrease was partially offset by a decrease of 16 bp on the rate paid on interest bearing liabilities for the three months ended September 30, 2012 as compared to the same period in 2011. The interest rate spread decreased to 3.70% during the three months ended September 30, 2012 compared to 3.91% for the same period in 2011. The net interest margin decreased by 24 bp to 3.90% for the three months ended September 30, 2012, compared with 4.14% for the same period in 2011.

For the three months ended September 30, 2012, total interest income increased $1.5 million, or 2.5%, from the same period in 2011 as a result of the increase in average earning assets, attributed to aforementioned acquisition activity and strong organic loan growth. Average interest earning assets increased approximately $533.8 million, or 10.8%, for the three months ended September 30, 2012 as compared to the same period in 2011. The growth in average earning assets was partially offset by a decrease in the yield earned on earning assets. The yield on securities available for sale decreased 56 bp to 2.39% for the three months ended September 30, 2012 from 2.95% for the three months ended September 30, 2011. This decrease was due to the decreasing rate environment from September 30, 2011 to September 30, 2012 resulting in reinvestment of cash flows from maturing securities and cash received from branch acquisitions in 2011 and the first quarter of 2012 into lower yielding securities. In addition, the yield on loans decreased 39 bp to 5.12% for the three months ended September 30, 2012 from 5.51% for the three months ended September 30, 2011.

For the three months ended September 30, 2012, total interest expense decreased $0.7 million, or 7.9%, from the three months ended September 30, 2011. This decrease was due primarily to a decrease in the rate paid on average interest bearing liabilities from 0.99% for the three months ended September 30, 2011 to 0.83% for the three months ended September 30, 2012. The rate paid on average interest bearing deposits decreased 16 bp from 0.67% for the three months ended September 30, 2011 to 0.51% for the same period in 2012. The rate paid on average time deposits decreased from 1.75% for the three months ended September 30, 2011 to 1.35% for the three months ended September 30, 2012. The rate paid on average money market deposit accounts decreased from 0.31% for the three months ended September 30, 2011 to 0.18% for the three months ended September 30, 2012. Going forward, additional rate reductions on deposits could be more difficult as deposit rates are at or near their floors.

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Average interest bearing liabilities increased approximately $378.0 million, or 10.0%, for the three months ended September 30, 2012 as compared to the same period in 2011, which partially offset the decrease in total interest expense attributed to the decrease in the rates on interest bearing liabilities. The primary driver of this offset was an increase in average time deposits and savings deposits due to the aforementioned acquisition as well as organic deposit growth for the three months ended September 30, 2012 as compared with the three months ended September 30, 2011.

FTE net interest income increased $1.5 million during the nine months ended September 30, 2012, compared to the same period of 2011. The Company experienced a decrease in the yield on interest earning assets of 40 bp to 4.54% for the nine months ended September 30, 2012 from 4.94% for the same period in 2011. This decrease was partially offset by a decrease of 17 bp on the rate paid on interest bearing liabilities for the nine months ended September 30, 2012 as compared to the same period in 2011. The interest rate spread decreased to 3.67% during the nine months ended September 30, 2012 compared to 3.89% for the same period in 2011. The net interest margin decreased by 26 bp to 3.87% for the nine months ended September 30, 2012, compared with 4.13% for the same period in 2011.

For the nine months ended September 30, 2012, total interest income decreased $1.6 million, or 0.9%, from the same period in 2011 as a result of the decrease in the yield earned on earning assets. The yield on securities available for sale decreased 55 bp to 2.51% for the nine months ended September 30, 2012 from 3.06% for the nine months ended September 30, 2011. This decrease was due to the decreasing rate environment from September 30, 2011 to September 30, 2012 resulting in reinvestment of cash flows from maturing securities and cash received from branch acquisitions in 2011 and the first quarter of 2012 into lower yielding securities. In addition, the yield on loans decreased 42 bp to 5.21% for the nine months ended September 30, 2012 from 5.63% for the nine months ended September 30, 2011. Average interest earning assets increased approximately $371.8 million, or 7.5%, for the nine months ended September 30, 2012 as compared to the same period in 2011, which partially offset the decrease in total interest income attributed to the decrease in the yields on earning assets. This increase in average earning assets was attributed to aforementioned acquisition activity, as well as strong organic loan growth.

For the nine months ended September 30, 2012, total interest expense decreased $3.5 million, or 11.6%, from the nine months ended September 30, 2011. This decrease was due primarily to a decrease in the rate paid on average interest bearing liabilities from 1.05% for the nine months ended September 30, 2011 to 0.88% for the nine months ended September 30, 2012. The rate paid on average interest bearing deposits decreased 17 bp from 0.73% for the nine months ended September 30, 2011 to 0.56% for the same period in 2012. The rate paid on average time deposits decreased from 1.83% for the nine months ended September 30, 2011 to 1.50% for the nine months ended September 30, 2012. The rate paid on average money market deposit accounts decreased from 0.37% for the nine months ended September 30, 2011 to 0.20% for the nine months ended September 30, 2012. Going forward, additional rate reductions on deposits could be more difficult as deposit rates are at or near their floors.

Average interest bearing liabilities increased approximately $232.5 million, or 6.0%, for the nine months ended September 30, 2012 as compared to the same period in 2011, which partially offset the decrease in total interest expense attributed to the decrease in the rates on interest bearing liabilities. The primary driver of this offset was an increase in average time deposits and savings deposits for the nine months ended September 30, 2012 as compared with the nine months ended September 30, 2011.

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Average Balances and Net Interest Income

The following tables include the condensed consolidated average balance sheet, an analysis of interest income/expense and average yield/rate for each major category of earning assets and interest bearing liabilities on a taxable equivalent basis. Interest income for tax-exempt securities and loans has been adjusted to a taxable-equivalent basis using the statutory Federal income tax rate of 35%.

Three Months ended September 30,

	2012				2011			
(dollars in thousands)	Average Balance	Interest	Yield/ Rates		Average Balance	Interest	Yield/ Rates	
ASSETS								
Short-term interest bearing accounts	$10,392	$11	0.43	%	$25,088	$11	0.17	%
Securities available for sale (1)(excluding unrealized gains or losses)	1,168,326	7,023	2.39	%	1,120,083	8,317	2.95	%
Securities held to maturity (1)	62,746	861	5.46	%	74,482	1,026	5.46	%
Investment in FRB and FHLB Banks	28,706	337	4.67	%	27,022	329	4.84	%
Loans and leases (2)	4,197,046	54,046	5.12	%	3,686,693	51,227	5.51	%
Total interest earning assets	$5,467,216	$62,278	4.53	%	$4,933,368	$60,910	4.90	%
Other assets	504,194				442,275			
Total assets	$5,971,410				$5,375,643			
LIABILITIES AND STOCKHOLDERS' EQUITY								
Money market deposit accounts	$1,111,624	495	0.18	%	$1,036,572	$811	0.31	%
NOW deposit accounts	686,768	377	0.22	%	631,284	483	0.30	%
Savings deposits	706,927	149	0.08	%	615,168	170	0.11	%
Time deposits	1,035,868	3,523	1.35	%	882,896	3,888	1.75	%
Total interest bearing deposits	$3,541,187	$4,544	0.51	%	$3,165,920	$5,352	0.67	%
Short-term borrowings	178,277	60	0.13	%	172,370	56	0.13	%
Trust preferred debentures	75,422	436	2.30	%	75,422	394	2.07	%
Long-term debt	367,146	3,640	3.94	%	370,349	3,621	3.88	%
Total interest bearing liabilities	$4,162,032	$8,680	0.83	%	$3,784,061	$9,423	0.99	%
Demand deposits	1,173,638				983,318			
Other liabilities	64,860				69,860			
Stockholders' equity	570,880				538,404			
Total liabilities and stockholders' equity	$5,971,410				$5,375,643			
Net interest income (FTE)		53,598				51,487		
Interest rate spread			3.70	%			3.91	%
Net interest margin			3.90	%			4.14	%
Taxable equivalent adjustment		991				1,126		
Net interest income		$52,607				$50,361		

(1)Securities are shown at average amortized cost

(2)For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding

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Nine Months ended September 30,						
	2012			2011		
(dollars in thousands)	Average Balance	Interest	Yield/ Rates	Average Balance	Interest	Yield/ Rates
ASSETS						
Short-term interest bearing accounts	$ 64,040	$ 131	0.27 %	$ 97,973	$ 191	0.26 %
Securities available for sale (1)(excluding unrealized gains or losses)	1,196,389	22,483	2.51 %	1,105,777	25,330	3.06 %
Securities held to maturity (1)	67,237	2,757	5.48 %	84,660	3,353	5.29 %
Investment in FRB and FHLB Banks	27,874	1,022	4.90 %	27,112	1,084	5.34 %
Loans and leases (2)	3,982,486	155,230	5.21 %	3,650,667	153,678	5.63 %
Total interest earning assets	$ 5,338,026	$ 181,623	4.54 %	$ 4,966,189	$ 183,636	4.94 %
Other assets	476,575			428,959		
Total assets	$ 5,814,601			$ 5,395,148		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Money market deposit accounts	$ 1,105,616	1,646	0.20 %	$ 1,070,971	$ 2,937	0.37 %
NOW deposit accounts	695,502	1,387	0.27 %	667,012	1,745	0.35 %
Savings deposits	675,346	391	0.08 %	599,173	517	0.12 %
Time deposits	988,596	11,097	1.50 %	911,161	12,491	1.83 %
Total interest bearing deposits	$ 3,465,060	$ 14,521	0.56 %	$ 3,248,317	$ 17,690	0.73 %
Short-term borrowings	170,903	149	0.12 %	153,857	166	0.14 %
Trust preferred debentures	75,422	1,319	2.34 %	75,422	1,683	2.98 %
Long-term debt	368,592	10,801	3.91 %	369,930	10,783	3.90 %
Total interest bearing liabilities	$ 4,079,977	$ 26,790	0.88 %	$ 3,847,526	$ 30,322	1.05 %
Demand deposits	1,116,210			940,332		
Other liabilities	63,232			67,968		
Stockholders' equity	555,182			539,322		
Total liabilities and stockholders' equity	$ 5,814,601			$ 5,395,148		
Net interest income (FTE)		154,833			153,314	
Interest rate spread			3.67 %			3.89 %
Net interest margin			3.87 %			4.13 %
Taxable equivalent adjustment		3,083			3,537	
Net interest income		$ 151,750			$ 149,777	

(1)Securities are shown at average amortized cost

(2)For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding

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The following table presents changes in interest income and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

Analysis of Changes in Taxable Equivalent Net Interest Income

Three months ended September 30,

	Increase (Decrease) 2012 over 2011		
(in thousands)	Volume	Rate	Total
Short-term interest bearing accounts	$ (36)	$ 36	$ -
Securities available for sale	2,072	(3,366)	(1,294)
Securities held to maturity	(164)	(1)	(165)
Investment in FRB and FHLB Banks	62	(54)	8
Loans and leases	20,892	(18,073)	2,819
Total interest income	22,826	(21,458)	1,368
Money market deposit accounts	353	(669)	(316)
NOW deposit accounts	231	(337)	(106)
Savings deposits	115	(136)	(21)
Time deposits	2,865	(3,230)	(365)
Short-term borrowings	2	2	4
Trust preferred debentures	-	42	42
Long-term debt	(158)	177	19
Total interest expense	3,408	(4,151)	(743)
Change in FTE net interest income	$ 19,418	$ (17,307)	$ 2,111

Nine months ended September 30,

	Increase (Decrease) 2012 over 2011		
(in thousands)	Volume	Rate	Total
Short-term interest bearing accounts	$ (74)	$ 14	$ (60)
Securities available for sale	2,927	(5,774)	(2,847)
Securities held to maturity	(775)	179	(596)
Investment in FRB and FHLB Banks	45	(107)	(62)
Loans and leases	17,726	(16,174)	1,552
Total interest income	19,849	(21,862)	(2,013)
Money market deposit accounts	152	(1,443)	(1,291)
NOW deposit accounts	115	(473)	(358)
Savings deposits	92	(218)	(126)
Time deposits	1,491	(2,885)	(1,394)
Short-term borrowings	25	(42)	(17)
Trust preferred debentures	-	(364)	(364)
Long-term debt	(49)	67	18

Total interest expense	1,826	(5,358)	(3,532)
Change in FTE net interest income	$ 18,023	$ (16,504)	$ 1,519

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Noninterest Income

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
(in thousands)				
Insurance and other financial services revenue	$ 5,591	$ 5,127	$ 17,024	$ 15,925
Service charges on deposit accounts	4,626	5,532	13,538	16,059
ATM and debit card fees	3,378	3,135	9,403	8,731
Retirement plan administration fees	2,718	2,295	7,462	6,734
Trust	2,242	2,090	6,683	6,384
Bank owned life insurance	639	674	2,228	2,369
Net securities gains	26	12	578	98
Other	2,407	1,329	8,449	3,881
Total noninterest income	$ 21,627	$ 20,194	$ 65,365	$ 60,181

Noninterest income for the three months ended September 30, 2012 was $21.6 million, up 7.1% or $1.4 million, compared with $20.2 million for the same period in 2011. Insurance and other financial services revenue increased approximately $0.5 million for the three months ended September 30, 2012, compared to the three months ended September 30, 2011. This increase was due primarily to organic growth in commercial product lines. Retirement plan administration fees increased approximately $0.4 million for the three months ended September 30, 2012, compared to the three months ended September 30, 2011, due primarily to an increase in customer base. Other noninterest income increased approximately $1.1 million for the three months ended September 30, 2012 as compared to the three months ended September 30, 2011. This increase was due primarily to an increase in mortgage banking activity during the three months ended September 30, 2012 as compared with the three months ended September 30, 2011. The Company sold approximately $6.8 million residential mortgages during the three months ended September 30, 2012, as compared to no sales during the same period in 2011. These increases were partially offset by a decrease in service charges on deposit accounts of approximately $0.9 million, or 16.4%, for the three months ended September 30, 2012, compared with the same period in 2011 primarily due to a decrease in overdraft fee income.

Noninterest income for the nine months ended September 30, 2012 was $65.4 million, up 8.6% or $5.2 million, compared with $60.2 million for the same period in 2011. Insurance and other financial services revenue increased approximately $1.1 million for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011. This increase was due primarily to the acquisition of an insurance agency during the second quarter of 2011 as well as organic growth in commercial product lines. ATM and debit card fees increased approximately $0.7 million for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, due primarily to an increase in card usage and customer base. Retirement plan administration fees increased approximately $0.7 million for the nine months ended September 30, 2012, compared to the nine months ended September 30, 2011, due primarily to an increase in customer base. Other noninterest income increased approximately $4.6 million for the nine months ended September 30, 2012 as compared to September 30, 2011. This increase was due in part to a $1.1 million payoff gain on a purchased commercial real estate loan, as well as a prepayment penalty fee collected of $0.8 million during the nine months ended September 30, 2012 related to a previously disclosed loss of a retirement plan client. In addition, mortgage banking revenue increased approximately $2.0 million for the nine months ended September 30, 2012 as compared to the same period in 2011 as the Company sold certain residential mortgages as market conditions warranted. The Company sold approximately $39.3 million

residential mortgages during the first nine months of 2012, as compared to no sales during the first nine months of 2011. The Company also realized net securities gains of approximately $0.6 million during the nine months ended September 30, 2012, as compared to $0.1 million for the same period in 2011. These increases were partially offset by a decrease in service charges on deposit accounts of approximately $2.5 million, or 15.7%, for the nine months ended September 30, 2012, compared with the same period in 2011 primarily due to a decrease in overdraft fee income.

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Noninterest Expense

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

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
(in thousands)				
Salaries and employee benefits	$ 26,641	$ 25,068	$ 78,358	$ 74,107
Occupancy	4,437	3,887	13,150	12,396
Data processing and communications	3,352	3,054	10,041	9,085
Professional fees and outside services	2,735	2,215	7,848	6,369
Equipment	2,435	2,288	7,224	6,658
Office supplies and postage	1,597	1,531	4,842	4,418
FDIC expenses	939	920	2,812	3,381
Advertising	701	685	2,308	2,286
Amortization of intangible assets	870	782	2,530	2,286
Loan collection and other real estate owned	614	676	2,051	1,838
Merger	558	155	1,895	155
Other	4,552	3,785	12,236	10,285
Total noninterest expense	$ 49,431	$ 45,046	$ 145,295	$ 133,264

Noninterest expense for the three months ended September 30, 2012 was $49.4 million, up $4.4 million or 9.7%, for the same period in 2011. Salaries and employee benefits increased $1.6 million, or 6.3%, for the three months ended September 30, 2012, compared with the same period in 2011. This increase was due primarily to increases in full-time-equivalent employees from acquisitions, merit increases, and increased pension expenses. Occupancy expenses for the three months ended September 30, 2012 increased $0.6 million, or 14.1%, over the same period in 2011 primarily due to aforementioned expansion. Professional fees and outside services increased approximately $0.5 million, or 23.5%, for the three months ended September 30, 2012 as compared to the same period in 2011, due primarily to a nonrecurring consulting fee incurred during the period. Merger related expenses totaled $0.6 million for the three months ended September 30, 2012 as compared with $0.2 for the same period in 2011, which also contributed to the increase in noninterest expense for the period. Other operating expenses increased $0.8 million for the three months ended September 30, 2012 as compared to the same period in 2011.

Noninterest expense for the nine months ended September 30, 2012 was $145.3 million, up $12.0 million or 9.0%, for the same period in 2011. Salaries and employee benefits increased $4.3 million, or 5.7%, for the nine months ended September 30, 2012, compared with the same period in 2011. This increase was due primarily to increases in full-time-equivalent employees from acquisitions, merit increases, and increased pension expenses. Professional fees and outside services increased $1.5 million, or 23.2%, for the nine months ended September 30, 2012 as compared to the same period in 2011. Data processing and communications expenses increased approximately $1.0 million, or 10.5%, for the nine months ended September 30, 2012 as compared to the same period in 2011, due primarily to expansion into new markets. Merger related expenses totaled $1.9 million in the first nine months of 2012, as compared to $0.2 million for the same period in 2011. Other operating expenses increased $2.0 million in the first nine months of 2012 as compared with the same period in 2011. These increases were partially offset by a decrease in Federal Deposit Insurance Corporation ("FDIC") expenses of approximately $0.6 million for the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011. This decrease was due to the FDIC redefining the deposit insurance assessment base effective the second quarter of 2011.

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Income Taxes

Income tax expense for the three month period ended September 30, 2012 was $5.5 million, up from $5.1 million for the same period in 2011. The effective tax rate was 27.5% for the three months ended September 30, 2012, compared to 25.2% for the same period in 2011. Income tax expense for the nine month period ended September 30, 2012 was $17.0 million, down from $17.4 million for the same period in 2011. The effective tax rate was 29.1% for the nine months ended September 30, 2012, compared to 28.2% for the same period in 2011. The decrease in the effective tax rate was due primarily to a decrease in tax exempt income from municipal securities in 2012.

ANALYSIS OF FINANCIAL CONDITION

Securities

Average total earning securities increased $36.5 million, or 3.1%, for the three months ended September 30, 2012 when compared to the same period in 2011. The average balance of securities available for sale increased $48.2 million, or 4.3%, for the three months ended September 30, 2012 when compared to the same period in 2011. This increase was due primarily to the increase in liquidity provided by deposits acquired in the aforementioned acquisitions. The average balance of securities held to maturity decreased $11.7 million, or 15.8%, for the three months ended September 30, 2012, compared to the same period in 2011. This decrease was due primarily to the scheduled run-off of municipal securities in the held to maturity portfolio. The average total securities portfolio represents 22.5% of total average earning assets for the three months ended September 30, 2012, down from 24.2% for the same period in 2011.

Average total earning securities increased $73.2 million, or 6.1%, for the nine months ended September 30, 2012 when compared to the same period in 2011. The average balance of securities available for sale increased $90.6 million, or 8.2%, for the nine months ended September 30, 2012 when compared to the same period in 2011. This increase was due primarily to the increase in liquidity provided by deposits acquired in the aforementioned acquisitions. The average balance of securities held to maturity decreased $17.4 million, or 20.6%, for the nine months ended September 30, 2012, compared to the same period in 2011. This decrease was due primarily to the scheduled run-off of municipal securities in the held to maturity portfolio. The average total securities portfolio represents 23.7% of total average earning assets for the nine months ended September 30, 2012, down from 24.0% for the same period in 2011.

The following table details the composition of securities available for sale, securities held to maturity and regulatory investments for the periods indicated:

	September 30, 2012		December 31, 2011	
Mortgage-backed securities:				
With maturities 15 years or less	20	%	21	%
With maturities greater than 15 years	2	%	3	%
Collateral mortgage obligations	35	%	35	%
Municipal securities	12	%	13	%
US agency notes	28	%	25	%
Other	3	%	3	%
Total	100	%	100	%

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

Loans

A summary of loans, net of deferred fees and origination costs, by category for the periods indicated follows:

(In thousands)	September 30, 2012	December 31, 2011
Residential real estate mortgages	$ 650,448	$ 581,511
Commercial	697,213	611,298
Commercial real estate mortgages	1,083,675	888,879
Real estate construction and development	99,181	93,977
Agricultural and agricultural real estate mortgages	112,822	108,423
Consumer	1,031,572	946,470
Home equity	576,208	569,645
Total loans and leases	$ 4,251,119	$ 3,800,203

Total loans increased by $450.9 million, or 11.9%, at September 30, 2012 from December 31, 2011, and represent approximately 70.5% of assets, as compared to 67.9% of total assets at December 31, 2011. Commercial real estate loans increased approximately $194.8 million from December 31, 2011 to September 30, 2012, primarily from the acquisition of Hampshire First Bank in June 2012. Commercial loans increased approximately $85.9 million, or 14.1%, from December 31, 2011 to September 30, 2012, primarily from strong organic loan growth. Residential real estate loans increased by approximately $68.9 million, or 11.9%, from December 31, 2011 to September 30, 2012, due primarily organic loan growth, as well as the acquisition of Hampshire First Bank. Consumer loans increased approximately $85.1 million, or 9.0%, due primarily to strong organic growth.

Allowance for Loan Losses, Provision for Loan Losses, and Nonperforming Assets

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

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

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For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectibility of the portfolio. For individually analyzed loans, these factors include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company’s exposure to credit loss reflect a thorough current assessment of a number of factors, which could affect collectibility. These factors include: past loss experience; the size, trend, composition, and nature of the loans; changes in lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company’s market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company’s allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgment about information available to them at the time of their examination, which may not be currently available to management.

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

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The following table reflects changes to the allowance for loan losses for the periods presented. The allowance is increased by provisions for losses charged to operations and is reduced by net charge-offs. Charge-offs are made when the ability to collect loan principal within a reasonable time becomes unlikely. Any recoveries of previously charged-off loans are credited directly to the allowance for loan losses.

Allowance For Loan and Lease Losses

(dollars in thousands)	Three months ended September 30, 2012				September 30, 2011			
Balance, beginning of period	$70,734				$ 70,484			
Recoveries	1,075				940			
Chargeoffs	(5,830	)			(5,265	)		
Net chargeoffs	(4,755	)			(4,325	)		
Provision for loan losses	4,755				5,175			
Balance, end of period	$70,734				$ 71,334			
Composition of Net Chargeoffs								
Commercial and agricultural	$(1,412	)	30	%	$ (1,327	)	31	%
Real estate mortgage	(471	)	10	%	(43	)	1	%
Consumer	(2,872	)	60	%	(2,955	)	68	%
Net chargeoffs	$(4,755	)	100	%	$ (4,325	)	100	%
Annualized net chargeoffs to average loans and leases	0.45	%			0.47	%		

Allowance For Loan and Lease Losses

(dollars in thousands)	Nine months ended September 30, 2012				September 30, 2011			
Balance, beginning of period	$71,334				$ 71,234			
Recoveries	3,123				3,070			
Chargeoffs	(17,052	)			(18,131	)		
Net chargeoffs	(13,929	)			(15,061	)		
Provision for loan losses	13,329				15,161			
Balance, end of period	$70,734				$ 71,334			
Composition of Net Chargeoffs								
Commercial and agricultural	$(3,505	)	25	%	$ (5,891	)	39	%
Real estate mortgage	(1,105	)	8	%	(553	)	4	%
Consumer	(9,319	)	67	%	(8,617	)	57	%
Net chargeoffs	$(13,929	)	100	%	$ (15,061	)	100	%
Annualized net chargeoffs to average loans and leases	0.47	%			0.55	%		

Nonperforming assets consist of nonaccrual loans, loans 90 days or more past due and still accruing, restructured loans, OREO, and nonperforming securities. Loans are generally placed on nonaccrual when principal or interest payments become ninety days past due, unless the loan is well secured and in the process of collection. Loans may also be placed on nonaccrual when circumstances indicate that the borrower may be unable to meet the contractual principal or interest payments. OREO represents property acquired through foreclosure and is valued at the lower of the carrying amount or fair value, less any estimated disposal costs. Nonperforming securities include securities which management believes are other-than-temporarily impaired, are carried at their estimated fair value and are not accruing interest.

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Nonperforming Assets

(Dollars in thousands)	September 30, 2012		December 31, 2011	
Nonaccrual loans	Amount	%	Amount	%
Commercial and agricultural loans and real estate	$22,572	53 %	$17,506	46 %
Real estate mortgages	8,505	20 %	8,090	21 %
Consumer	9,325	22 %	8,724	23 %
Troubled debt restructured loans	2,259	5 %	3,970	10 %
Total nonaccrual loans	42,661	100 %	38,290	100 %
Loans 90 days or more past due and still accruing				
Commercial and agricultural loans and real estate	80	3 %	50	2 %
Real estate mortgages	1,285	43 %	763	24 %
Consumer	1,598	54 %	2,377	75 %
Total loans 90 days or more past due and still accruing	2,963	100 %	3,190	100 %
Total nonperforming loans	45,624		41,480	
Other real estate owned (OREO)	1,863		2,160	
Total nonperforming assets	47,487		43,640	
Total nonperforming loans to total loans and leases	1.07 %		1.09 %	
Total nonperforming assets to total assets	0.79 %		0.78 %	
Total allowance for loan and lease losses to nonperforming loans	155.04 %		171.97 %	

Loans over 60 days past due but not over 90 days past due were 0.09% of total loans as of September 30, 2012, compared to 0.14% of total loans as of December 31, 2011. In addition to nonperforming loans, the Company has also identified approximately $81.6 million in potential problem loans at September 30, 2012 as compared to $96.9 million at December 31, 2011. At September 30, 2012, potential problem loans primarily consisted of commercial real estate and commercial and agricultural loans. Potential problem loans are loans that are currently performing, but known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in classification of such loans as nonperforming at some time in the future. Potential problem loans are typically defined as loans that are performing but are classified by the Company's loan rating system as "substandard." Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses.

The Company recorded a provision for loan losses of $4.8 million during the third quarter of 2012 compared with $5.2 million during the third quarter of 2011. Annualized net charge-offs to average loans for the three months ended September 30, 2012 were 0.45%, compared with 0.47% for three months ended September 30, 2011. The Company's allowance for loan losses decreased to 1.66% of loans at September 30, 2012, compared with 1.88% at December 31, 2011. This reduction reflects the improved asset quality indicators noted above, as well as the addition of the Hampshire First loans that were recorded at fair value at acquisition. As acquired loans do not have a related allowance recorded, this resulted in a decrease of 9 basis points in the allowance for loan losses as a percentage of total loans as of September 30, 2012. Specific reserves on impaired loans totaled $2.7 million at September 30, 2012 and $0.2 million at December 31, 2011. General allocations decreased to $68.0 million at September 30, 2012 from $71.1 million at December 31, 2011.

The Company recorded a provision for loan losses of $13.3 million during the nine months ended September 30, 2012 compared with $15.2 million during the nine months ended September 30, 2011. Annualized net charge-offs to

average loans for the nine months ended September 30, 2012 were 0.47%, compared with 0.55% for nine months ended September 30, 2011.

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Subprime mortgage lending, which has been the riskiest sector of the residential housing market, is not a market that the Company has ever actively pursued. The market does not apply a uniform definition of what constitutes “subprime” lending. Our reference to subprime lending relies upon the “Statement on Subprime Mortgage Lending” issued by the Office of Thrift Supervision and the other federal bank regulatory agencies, or the Agencies, on September 29, 2007, which further referenced the “Expanded Guidance for Subprime Lending Programs,” or the Expanded Guidance, issued by the Agencies by press release dated January 31, 2001. In the Expanded Guidance, the Agencies indicated that subprime lending does not refer to individual subprime loans originated and managed, in the ordinary course of business, as exceptions to prime risk selection standards. The Agencies recognize that many prime loan portfolios will contain such accounts. The Agencies also excluded prime loans that develop credit problems after acquisition and community development loans from the subprime arena. According to the Expanded Guidance, subprime loans are other loans to borrowers which display one or more characteristics of reduced payment capacity. Five specific criteria, which are not intended to be exhaustive and are not meant to define specific parameters for all subprime borrowers and may not match all markets or institutions’ specific subprime definitions, are set forth, including having a FICO score of 660 or below. Based upon the definition and exclusions described above, management believes that the Company is a prime lender. Within the loan portfolio, there are loans that, at the time of origination, had FICO scores of 660 or below. However, since the Company is a portfolio lender, it reviews all data contained in borrower credit reports and does not base underwriting decisions solely on FICO scores. We believe the aforementioned loans, when made, were amply collateralized and otherwise conformed to our prime lending standards. The Company has not originated Alt A loans or no interest loans.

Deposits

Total deposits were $4.8 billion at September 30, 2012, up $438.9 million, or 10.0%, from December 31, 2011, due primarily to the acquisition of Hampshire First Bank in June 2012 as well as strong organic deposit growth. Savings, NOW and money market accounts increased to $2.6 billion as of September 30, 2012 as compared with $2.4 billion at December 31, 2011. Time deposits increased $85.8 million, or 9.2%, from December 31, 2011 to September 30, 2012. Demand deposits increased by $134.6 million, or 12.8%, from December 31, 2011 to September 30, 2012.

Total average deposits for the three months ended September 30, 2012 increased $565.6 million, or 13.6%, from the same period in 2011, due primarily to recent branch acquisitions as well as the aforementioned acquisition. Average savings accounts increased $91.8 million, or 14.9%, for the three month period ending September 30, 2012 as compared to the same period in 2011. This increase in average savings accounts was primarily due to recent branch acquisitions, the aforementioned acquisition, and a run-off of time deposit accounts into savings accounts, due to a decline in interest rates offered on time deposits. Average time deposits increased $153.0 million, or 17.3%, for the three months ended September 30, 2012 from the same period in 2011, due to recent branch acquisitions as well as the aforementioned acquisition, partially offset by a run-off to savings accounts. Average demand deposit accounts increased $190.3 million, or 19.4%, for the three months ended September 30, 2012 as compared to the same period in 2011. This was due primarily to an increasing customer base, as the Company continues to expand into new markets.

Total average deposits for the nine months ended September 30, 2012 increased $392.6 million, or 9.4%, from the same period in 2011, due primarily to recent branch acquisitions as well as the aforementioned acquisition. Average savings accounts increased $76.2 million, or 12.7%, for the nine month period ending September 30, 2012 as compared to the same period in 2011. This increase in average savings accounts was primarily due to recent branch acquisitions as well as a run-off of time deposit accounts into savings accounts, due to a decline in interest rates offered on time deposits. Average time deposits increased $77.4 million, or 8.5%, for the nine months ended September 30, 2012 from the same period in 2011, due to recent branch acquisitions partially offset by a run-off to savings accounts. Average demand deposit accounts increased $175.9 million, or 18.7%, for the nine months ended September 30, 2012 as compared to the same period in 2011. This was due primarily to an increasing customer base, as the Company continues to expand into new markets.

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Borrowed Funds

The Company's borrowed funds consist of short-term borrowings and long-term debt. Short-term borrowings totaled $137.4 million at September 30, 2012 compared to $181.6 million at December 31, 2011. This decrease was due primarily to a decrease in retail repurchase account balances. Long-term debt was $367.1 million at September 30, 2012, as compared to $370.3 million at December 31, 2011. For more information about the Company's borrowing capacity and liquidity position, see "Liquidity Risk" below.

Capital Resources

Stockholders' equity of $576.7 million represented 9.56% of total assets at September 30, 2012, compared with $538.1 million, or 9.61% as of December 31, 2011. Under previously disclosed stock repurchase plans, the Company purchased 769,568 shares of its common stock during the nine month period ended September 30, 2012, for a total of $15.5 million at an average price of $20.13 per share. At September 30, 2012, there were 748,013 shares available for repurchase under a previously disclosed repurchase plan, which expires on December 31, 2013.

The Board of Directors considers the Company's earnings position and earnings potential when making dividend decisions. The Company does not have a target dividend pay out ratio.

As the capital ratios in the following table indicate, the Company remained "well capitalized" at September 30, 2012 under applicable bank regulatory requirements. Capital measurements are well in excess of regulatory minimum guidelines and meet the requirements to be considered well capitalized for all periods presented. Tier 1 leverage, Tier 1 capital and Total risk-based capital ratios have regulatory minimum guidelines of 3%, 4% and 8% respectively, with requirements to be considered well capitalized of 5%, 6% and 10%, respectively.

Capital Measurements		September 30, 2012			December 31, 2011	
Tier 1 leverage ratio		8.51	%		8.74	%
Tier 1 capital ratio		10.82	%		11.56	%
Total risk-based capital ratio		12.07	%		12.81	%
Cash dividends as a percentage of net income		48.18	%		46.74	%
Per common share:						
Book value	$	17.09		$	16.23	
Tangible book value	$	12.06		$	11.70	

Liquidity and Interest Rate Sensitivity Management

Market Risk

Interest rate risk is the primary market risk affecting the Company. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company's business activities. Interest rate risk is defined as an exposure to a movement in interest rates that could have an adverse effect on the Company's net interest income. Net interest income is susceptible to interest rate risk to the degree that interest bearing liabilities mature or reprice on a different basis than earning assets. When interest bearing liabilities mature or reprice more quickly than earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when earning assets mature or reprice more quickly than interest bearing liabilities, falling interest rates could result in a decrease in net interest income.

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

In adjusting the Company’s asset/liability position, the Board and management attempt to manage the Company’s interest rate risk while minimizing net interest margin compression. At times, depending on the level of general interest rates, the relationship between long- and short-term interest rates, market conditions and competitive factors, the Board and management may determine to increase the Company’s interest rate risk position somewhat in order to increase its net interest margin. The Company’s results of operations and net portfolio values remain vulnerable to changes in interest rates and fluctuations in the difference between long- and short-term interest rates. Assuming interest rates remain at or near current historical lows, net interest margin will continue to experience compression. Additional rate reductions on deposits are becoming more difficult as deposit rates are at or near their floors, and with asset yields continuing to reprice at lower rates, this could result in additional margin pressure as well as a decrease in net interest income.

The primary tool utilized by ALCO to manage interest rate risk is a balance sheet/income statement simulation model (interest rate sensitivity analysis). Information such as principal balance, interest rate, maturity date, cash flows, next repricing date (if needed), and current rates is uploaded into the model to create an ending balance sheet. In addition, ALCO makes certain assumptions regarding prepayment speeds for loans and mortgage related investment securities along with any optionality within the deposits and borrowings.

The model is first run under an assumption of a flat rate scenario (i.e. no change in current interest rates) with a static balance sheet over a 12-month period. Two additional models are run with static balance sheets: (1) a gradual increase of 200 bp, and (2) a gradual decrease of 100 bp taking place over a 12-month period. Under these scenarios, assets subject to prepayments are adjusted to account for faster or slower prepayment assumptions. Any investment securities or borrowings that have callable options embedded into them are handled accordingly based on the interest rate scenario. The resulting changes in net interest income are then measured against the flat rate scenario.

In the declining rate scenario, net interest income is projected to decrease when compared to the forecasted net interest income in the flat rate scenario through the simulation period. The decrease in net interest income is a result of earning assets repricing downward at a faster rate than interest bearing liabilities. The inability to effectively lower deposit rates will likely reduce or eliminate the benefit of lower interest rates. In the rising rate scenarios, net interest income is projected to experience a decline from the flat rate scenario. Net interest income is projected to remain at lower levels than in a flat rate scenario through the simulation period primarily due to a lag in assets repricing while funding costs increase. The potential impact on earnings is dependent on the ability to lag deposit repricing. If short-term rates continue to increase, the Company expects competitive pressures will likely lead to core deposit pricing increases, which will likely continue compression of the net interest margin.

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Net interest income for the next 12 months in the + 200/- 100 bp scenarios, as described above, is within the internal policy risk limits of not more than a 7.5% change in net interest income. The following table summarizes the percentage change in net interest income in the rising and declining rate scenarios over a 12-month period from the forecasted net interest income in the flat rate scenario using the September 30, 2012 balance sheet position:

Interest Rate Sensitivity Analysis

Change in interest rates (in bp points)	Percent change in net interest income
+200	(1.92%)
-100	(1.16%)

Liquidity Risk

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

The primary liquidity measurement the Company utilizes is called the Basic Surplus, which captures the adequacy of its access to reliable sources of cash relative to the stability of its funding mix of average liabilities. Basic Surplus is calculated by subtracting short-term liabilities from liquid assets. This approach recognizes the importance of balancing levels of cash flow liquidity from short- and long-term securities with the availability of dependable borrowing sources which can be accessed when necessary. At September 30, 2012, the Company's Basic Surplus measurement was 9.7% of total assets or $585 million as compared to the December 31, 2011 Basic Surplus of 11.7% or $654 million, and was above the Company's minimum of 5% or $301 million set forth in its liquidity policies.

This Basic Surplus approach enables the Company to adequately manage liquidity from both operational and contingency perspectives. By tempering the need for cash flow liquidity with reliable borrowing facilities, the Company is able to operate with a more fully invested and, therefore, higher interest income generating securities portfolio. The makeup and term structure of the securities portfolio is, in part, impacted by the overall interest rate sensitivity of the balance sheet. Investment decisions and deposit pricing strategies are impacted by the liquidity position.

The Company's primary source of funds is the Bank. Certain restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends. The approval of the Office of Comptroller of the Currency (OCC) is required to pay dividends when a bank fails to meet certain minimum regulatory capital standards or when such dividends are in excess of a subsidiary bank's earnings retained in the current year plus retained net profits for the preceding two years (as defined in the regulations). At September 30, 2012, approximately $30.7 million of the total stockholders' equity of the Bank was available for payment of dividends to the Company without approval by the OCC. The Bank's ability to pay dividends is also subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements. Under the General Corporation Law of the State of Delaware, the Company may declare and pay dividends either out of its surplus or, in case there is no surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

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At September 30, 2012 and December 31, 2011, FHLB advances outstanding totaled $339 million. The Bank is a member of the FHLB system and had additional borrowing capacity from the FHLB of approximately $394 million at September 30, 2012 and $323 million at December 31, 2011. In addition, unpledged securities could have been used to increase borrowing capacity at the FHLB by an additional $326 million at September 30, 2012, or used to collateralize other borrowings, such as repurchase agreements. At September 30, 2012 the Bank also had additional borrowing capacity from unused collateral at the Federal Reserve of $522 million.

Recent Accounting Pronouncements

In September 2011, the FASB issued ASU No. 2011-08 "Intangibles – Goodwill and Other (Topic 350) – Testing Goodwill for Impairment". ASU 2011-08 is intended to reduce complexity and costs of performing goodwill impairment tests by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of a reporting unit. The amendments in ASU 2011-08 also improve previous guidance by expanding upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Also, the amendments improve the examples of events and circumstances that an entity having a reporting unit with a zero or negative carrying amount should consider in determining whether to measure an impairment loss, if any, under the second step of the goodwill impairment test. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of the standard did not have a significant impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04 "Fair Value Measurement (Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs." ASU 2011-04 changes the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Consequently, the amendments in this update result in common fair value measurement and disclosure requirements in GAAP and IFRSs (International Financial Reporting Standards). ASU 2011-04 is effective prospectively during interim and annual periods beginning on or after December 15, 2011. The adoption of the standard did not have a significant impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-03 "Transfers and Servicing (Topic 860) - Reconsideration of Effective Control for Repurchase Agreement." ASU 2011-03 removes from the assessment of effective control the criterion relating to the transferor's ability to repurchase or redeem financial assets on substantially the agreed terms, even in the event of default by the transferee. ASU 2011-03 is effective for the first interim or annual period beginning on or after December 15, 2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. The adoption of the standard did not have a significant impact on the Company's consolidated financial statements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information called for by Item 3 is contained in the Liquidity and Interest Rate Sensitivity Management section of the Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the Chief Executive Officer and Chief

Financial Officer concluded that, as of September 30, 2012, the Company's disclosure controls and procedures were effective.

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There were no changes made in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1 – LEGAL PROCEEDINGS

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

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

Item 1A – RISK FACTORS

Management of the Company urges the reader to understand and consider the following updated risk factor in addition to those disclosed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the Securities and Exchange Commission on February 29, 2012.

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

The business strategy of the Company has included and may continue to include growth through acquisition from time to time. Any acquisitions, including our recently completed acquisition of Hampshire First and pending acquisition of Alliance, will be accompanied by the risks commonly encountered in acquisitions including, among other things: our ability to realize anticipated cost savings and avoid unanticipated costs relating to the merger, the difficulty of integrating operations and personnel, the potential disruption of our or the acquired company’s ongoing business, the inability of our management to maximize our financial and strategic position, the inability to maintain uniform standards, controls, procedures and policies, and the impairment of relationships with the acquired company’s employees and customers as a result of changes in ownership and management. These risks may prevent the Company from fully realizing the anticipated benefits of an acquisition or cause the realization of such benefits to take longer than expected.

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2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Not applicable

(b) Not applicable

(c) The table below sets forth the information with respect to purchases made by the Company (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the quarter ended September 30, 2012:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares That May Yet be Purchased Under The Plans (1)
1/1/12 - 1/31/12	-	$ -	-	1,517,581
2/1/12 - 2/29/12	-	-	-	1,517,581
3/1/12 - 3/31/12	-	-	-	1,517,581
4/1/12 - 4/30/12	-	-	-	1,517,581
5/1/12 - 5/31/12	423,026	20.17	423,026	1,094,555
6/1/12 - 6/30/12	346,542	20.08	346,542	748,013
7/1/12 - 7/31/12	-	-	-	748,013
8/1/12 - 8/31/12	-	-	-	748,013
9/1/12 - 9/30/12	-	-	-	748,013
Total	769,568	$ 20.13	769,568	748,013

1. Under previously disclosed stock repurchase plans, the Company purchased 769,568 shares of its common stock during the nine month period ended September 30, 2012, for a total of $15.5 million at an average price of $20.13 per share. At September 30, 2012, there were 748,013 shares available for repurchase under a previously disclosed repurchase plan, which expires on December 31, 2013.

Item 3 – DEFAULTS UPON SENIOR SECURITIES

None

Item 4 – MINE SAFETY DISCLOSURES

None

Item 5 – OTHER INFORMATION

None

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Item 6 – EXHIBITS

2.1 Agreement and Plan of Merger, dated as of October 7, 2012, by and between NBT Bancorp Inc. and Alliance Financial Corporation (filed as Exhibit 2.1 to Registrant’s Current Report on Form 8-K filed on October 9, 2012 and incorporated herein by reference).

3.1 Certificate of Incorporation of NBT Bancorp Inc. as amended through May 2, 2012.

3.2 By-laws of NBT Bancorp Inc. as amended and restated through July 23, 2001 (filed as Exhibit 3.2 to Registrant's Form 10-K for the year ended December 31, 2008, filed on March 2, 2009 and incorporated herein by reference).

3.3 Certificate of Designation of the Series A Junior Participating Preferred Stock (filed as Exhibit A to Exhibit 4.1 of the Registration's Form 8-K, file Number 0-14703, filed on November 18, 2004, and incorporated herein by reference).

4.1 Specimen common stock certificate for NBT's common stock (filed as exhibit 4.3 to the Registrant's Amendment No. 1 to Registration Statement on Form S-4 filed on December 27, 2005 and incorporated herein by reference).

4.2 Rights Agreement, dated as of November 15, 2004, between NBT Bancorp Inc. and Registrar and Transfer Company, as Rights Agent (filed as Exhibit 4.1 to Registrant's Form 8-K, file number 0-14703, filed on November 18, 2004, and incorporated by reference herein).

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Written Statement of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Written Statement of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, this 9th day of November 2012.

NBT BANCORP INC.

By: /s/ Michael J. Chewens
Michael J. Chewens, CPA
Senior Executive Vice President
Chief Financial Officer

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