ARROW FINANCIAL CORP
Form 10-Q
May 10, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2011
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 0-12507

ARROW FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

New York	22-2448962
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

250 GLEN STREET, GLENS FALLS, NEW YORK 12801
(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: (518) 745-1000

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 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. x Yes No

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

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

Large accelerated filer	Accelerated filer x
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding as of April 29, 2011
Common Stock, par value $1.00 per share	11,404,757

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)(Unaudited)

	March 31, 2011	December 31, 2010	March 31, 2010
ASSETS			
Cash and Due from Banks	$ 29,798	$ 25,961	$ 28,509
Interest-Bearing Deposits at Banks	47,205	5,118	61,253
Investment Securities:			
Available-for-Sale	544,789	517,364	426,251
Held-to-Maturity (Approximate Fair Value of $149,895 at March 31, 2011, $162,713 at December 31, 2010 and $170,755 at March 31, 2010)	147,217	159,938	168,574
Other Investments	7,702	8,602	8,939
Loans	1,135,743	1,145,508	1,121,147
Allowance for Loan Losses	(14,745)	(14,689)	(14,183)
Net Loans	1,120,998	1,130,819	1,106,964
Premises and Equipment, Net	19,256	18,836	18,469
Other Real Estate and Repossessed Assets, Net	60	58	116
Goodwill	20,550	15,783	15,269
Other Intangible Assets, Net	4,350	1,458	1,361
Accrued Interest Receivable	7,132	6,512	7,558
Other Assets	29,347	17,887	18,032
Total Assets	$1,978,404	$1,908,336	$1,861,295
LIABILITIES			
Noninterest-Bearing Deposits	$ 214,853	$ 214,393	$ 197,331
NOW Accounts	621,412	569,076	533,435
Savings Deposits	405,850	382,130	350,022
Time Deposits of $100,000 or More	122,157	120,330	142,330
Other Time Deposits	243,847	248,075	246,577
Total Deposits	1,608,119	1,534,004	1,469,695
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	57,762	51,581	62,908
Other Short-Term Borrowings	1,647	1,633	1,602
Federal Home Loan Bank Advances	110,000	130,000	140,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000

Accrued Interest Payable	1,755	1,957	2,091
Other Liabilities	19,933	16,902	19,195
Total Liabilities	1,819,216	1,756,077	1,715,491
STOCKHOLDERS EQUITY			
Preferred Stock, $5 Par Value; 1,000,000 Shares Authorized	---	---	---
Common Stock, $1 Par Value; 20,000,000 Shares Authorized (15,625,512 Shares Issued at March 31, 2011 and at December 31, 2010, and 15,170,399 Shares Issued at March 31, 2010)	15,626	15,626	15,170
Additional Paid-in Capital	193,733	191,068	178,798
Retained Earnings	27,020	24,577	26,785
Unallocated ESOP Shares (122,882 Shares at March 31, 2011, 132,296 Shares at December 31, 2010, and 92,009 Shares at March 31, 2010)	(2,700)	(2,876)	(1,976)
Accumulated Other Comprehensive Loss	(5,439)	(6,423)	(5,082)
Treasury Stock, at Cost (4,101,039 Shares at March 31, 2011, 4,237,435 Shares at December 31, 2010, and 4,130,332 Shares at March 31, 2010)	(69,052)	(69,713)	(67,891)
Total Stockholders Equity	159,188	152,259	145,804
Total Liabilities and Stockholders Equity	$1,978,404	$1,908,336	$1,861,295

See Notes to Unaudited Consolidated Interim Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Per Share Amounts) (Unaudited)

	Three Months Ended March 31,	
	2011	2010
INTEREST AND DIVIDEND INCOME		
Interest and Fees on Loans	$15,015	$16,163
Interest on Deposits at Banks	22	40
Interest and Dividends on Investment Securities:		
Fully Taxable	3,350	3,971
Exempt from Federal Taxes	1,504	1,477
Total Interest and Dividend Income	19,891	21,651
INTEREST EXPENSE		
NOW Accounts	1,331	1,423
Savings Deposits	503	540
Time Deposits of $100,000 or More	667	716
Other Time Deposits	1,352	1,486
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	24	30
Federal Home Loan Bank Advances	1,316	1,604
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	144	141
Total Interest Expense	5,337	5,940
NET INTEREST INCOME	14,554	15,711
Provision for Loan Losses	220	375
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	14,334	15,336
NONINTEREST INCOME		
Income from Fiduciary Activities	1,546	1,406
Fees for Other Services to Customers	1,915	1,856
Insurance Commissions	1,466	621
Net Gains on Securities Transactions	542	---
Net Gains on Sale of Loans	51	21
Other Operating Income	100	114
Total Noninterest Income	5,620	4,018
NONINTEREST EXPENSE		
Salaries and Employee Benefits	7,202	6,602
Occupancy Expense, Net	1,918	1,777
FDIC Assessments	513	494
Other Operating Expense	2,686	2,667
Total Noninterest Expense	12,319	11,540
INCOME BEFORE PROVISION FOR INCOME TAXES	7,635	7,814
Provision for Income Taxes	2,354	2,399
NET INCOME	$ 5,281	$ 5,415
Average Shares Outstanding:		
Basic	11,334	11,260
Diluted	11,347	11,301

Per Common Share:		
Basic Earnings	$ .47	$ .48
Diluted Earnings	.47	.48

Shares and Per Share Amounts have been restated for the September 2010 3% stock dividend.

See Notes to Unaudited Consolidated Interim Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(In Thousands, Except Share and Per Share Amounts) (Unaudited)

	Common Shares Issued	Common Stock	Surplus	Retained Earnings	Unallo-cated ESOP Shares	Accumulated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2010	15,625,512	$15,626	$191,068	$24,577	$(2,876)	$ (6,423)	$(69,713)	$152,259
Comprehensive Income, Net of Tax:								
Net Income	---	---	---	5,281	---	---	---	5,281
Net Unrealized Securities Holding Gains Arising During the Period, Net of Tax (Pre-tax $1,948)	---	---	---	---	---	1,176	---	1,176
Reclassification Adjustment for Net Securities Gains Included in Net Income, Net of Tax (Pre-tax $542)	---	---	---	---	---	(327)	---	(327)
Amortization of Net Retirement Plan Actuarial Loss (Pre-tax $255)	---	---	---	---	---	154	---	154
Accretion of Net Retirement Plan Prior Service Credit (Pre-tax $31)	---	---	---	---	---	(19)	---	(19)
Other Comprehensive Income								984
Comprehensive Income								6,265
Cash Dividends Paid,	---	---	---	(2,838)	---	---	---	(2,838)

$.25 per Share								
Stock Options Exercised (14,717 Shares)	---	---	183	---	---	---	131	314
Shares Issued Under the Employee Stock Purchase Plan (4,721 Shares)	---	---	74	---	---	---	41	115
Shares Issued for Dividend Reinvestment Plans (18,896 Shares)	---	---	281	---	---	---	169	450
Stock-Based Compensation Expense	---	---	82	---	---	---	---	82
Purchase of Treasury Stock (31,385 Shares)	---	---	---	---	---	---	(752)	(752)
Acquisition of Subsidiary (129,447 Shares)	---	---	1,988	---	---	---	1,072	3,060
Allocation of ESOP Stock (9,414 Shares)	---	---	57	---	176	---	---	233
Balance at March 31, 2011	15,625,512	$15,626	$193,733	$27,020	$(2,700)	$(5,439)	$(69,052)	$159,188

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(In Thousands, Except Share and Per Share Amounts) (Unaudited)

	Common Shares Issued	Common Stock	Surplus	Retained Earnings	Unallo-cated ESOP Shares	Accumulated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2009	15,170,399	$15,170	$178,192	$24,100	$(2,204)	$ (6,640)	$(67,800)	$140,818
Comprehensive Income, Net of Tax:								
Net Income	---	---	---	5,415	---	---	---	5,415
Amortization of Net Retirement Plan Actuarial Loss (Pre-tax $252)	---	---	---	---	---	152	---	152
Accretion of Net Retirement Plan Prior Service Credit (Pre-tax $43)	---	---	---	---	---	(26)	---	(26)
Net Unrealized Securities Holding Gains Arising During the Period, Net of Tax (Pre-tax $2,369)	---	---	---	---	---	1,432	---	1,432
Other Comprehensive Income								1,558
Comprehensive Income								6,973
Cash Dividends Paid, $.24 per Share	---	---	---	(2,730)	---	---	---	(2,730)
Stock Options Exercised (11,518 Shares)	---	---	45	---	---	---	98	143
	---	---	68	---	---	---	38	106

Shares Issued Under the Employee Stock Purchase Plan (4,432 Shares)								
Stock-Based Compensation Expense	---	---	69	---	---	---	---	69
Tax Benefit for Disposition of Stock Options	---	---	31	---	---	---	---	31
Allocation of ESOP Stock (13,158 Shares)	---	---	108	---	228	---	---	336
Shares Issued for Dividend Reinvestment Plans (15,994 Shares)	---	---	285	---	---	---	136	421
Purchase of Treasury Stock (14,465 Shares)	---	---	---	---	---	---	(363)	(363)
Balance at March 31, 2010	15,170,399	$15,170	$178,798	$26,785	$(1,976)	$(5,082)	$(67,891)	$145,804

Cash dividends paid in 2010 have been restated for the September 2010 3% stock dividend.

See Notes to Unaudited Consolidated Interim Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands) (Unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Cash Flows from Operating Activities:		
Net Income	$ 5,281	$ 5,415
Adjustments to Reconcile Net Income to Net Cash Provided By Operating Activities:		
Provision for Loan Losses	220	375
Depreciation and Amortization	1,409	1,186
Compensation Expense for Allocated ESOP Shares	57	108
Gains on the Sale of Securities Available-for-Sale	(542)	---
Loans Originated and Held-for-Sale	(12,838)	(1,171)
Proceeds from the Sale of Loans Held-for-Sale	21,867	1,192
Net Gains on the Sale of Loans	(51)	(21)
Net Loss on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	---	5
Contributions to Pension Plans	(98)	(82)
Deferred Income Tax Benefit	(40)	(164)
Stock-Based Compensation Expense	82	69
Net Decrease (Increase) in Other Assets	146	(1,515)
Net Increase (Decrease) in Other Liabilities	1,860	(1,967)
Net Cash Provided By Operating Activities	17,353	3,430
Cash Flows from Investing Activities:		
Proceeds from the Sales of Securities Available-for-Sale	10,503	38
Proceeds from the Maturities and Calls of Securities Available-for-Sale	48,674	63,602
Purchases of Securities Available-for-Sale	(85,355)	(50,011)
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	12,648	1,891
Purchase of Securities Held-to-Maturity	---	(1,613)
Net Decrease (Increase) in Loans	486	(9,411)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	135	199
Purchases of Premises and Equipment	(801)	(46)
Acquisition of Subsidiary	(3,561)	---
Purchase of Bank-Owned Life Insurance	(12,833)	---
Net Decrease in Other Investments	900	---
Net Cash (Used In) Provided By Investing Activities	(29,204)	4,649
Cash Flows from Financing Activities:		
Net Increase in Deposits	74,115	26,129
Net Increase (Decrease) in Short-Term Borrowings	6,195	(9,398)
Federal Home Loan Bank Repayments	(20,000)	---
Purchase of Treasury Stock	(752)	(363)
Stock Options Exercised	314	---
Shares Issued under the Employee Stock Purchase Plan	115	249
Tax Benefit from Exercise of Stock Options	---	31

Treasury Stock Issued for Dividend Reinvestment Plans	450	421
Allocation of Common Stock Purchased by the ESOP	176	228
Cash Dividends Paid	(2,838)	(2,730)
Net Cash Provided By Financing Activities	57,775	14,567
Net Increase in Cash and Cash Equivalents	45,924	22,646
Cash and Cash Equivalents at Beginning of Period	31,079	67,116
Cash and Cash Equivalents at End of Period	$77,003	$89,762
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	$5,534	$6,102
Income Taxes	321	5,108
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	137	208
Net Unrealized Securities Holding Gains Arising During the Period, Net of Tax	1,178	1,432
Reclassification Adjustment for Net Securities Gains Included in Net Income, Net of Tax	327	---
Additional Shares Issued for Acquisition of Subsidiary	3,060	---
Change in Retirement Plans Net Loss and Prior Service Cost, Net of Tax	135	126
Fair Value of Assets from Acquisition of Subsidiary	7,688	---
Fair Value of Liabilities from Acquisition of Subsidiary	1,067	---

See Notes to Unaudited Consolidated Interim Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

FORM 10-Q

March 31, 2011

1. Accounting Policies

In the opinion of the management of Arrow Financial Corporation (Arrow), the accompanying unaudited consolidated interim financial statements contain all of the adjustments necessary to present fairly the financial position as of March 31, 2011, December 31, 2010 and March 31, 2010; the results of operations for the three-month periods ended March 31, 2011 and 2010; the changes in stockholders equity for the three-month periods ended March 31, 2011; and the cash flows for the three-month periods ended March 31, 2011 and 2010. All such adjustments are of a normal recurring nature. The preparation of financial statements requires the use of management estimates. The unaudited consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements of Arrow for the year ended December 31, 2010, included in Arrow s 2010 Form 10-K.

Recent Accounting Pronouncements:

ASU 2011-02, Receivables (Topic 310) A Creditor s determination of whether a Restructuring Is a Trouble Debt Restructuring. ASU 2011-02 provides additional guidance in evaluating whether a restructuring constitutes a troubled debt restructuring. Under this guidance, a creditor must separately conclude that both of the following exist: 1. The restructuring constitutes a concession. 2. The debtor is experiencing financial difficulties. The amendments in this Update are effective for the first interim or annual period beginning on or after June 15, 2011, and should be applied retrospectively to the beginning of the annual period of adoption. We have determined that this pronouncement will not have a material impact on our financial condition or results of operations.

ASU 2010-20, Receivables (Topic 310) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses & ASU 2011-01, Receivables (Topic 310) Deferral of the Effective Date of Disclosures about Trouble Debt Restructurings in Update No. 2010-20: The main objective of this guidance is to provide financial statement users with greater transparency about an entity s allowance for credit losses and the credit quality of its financing receivables. This pronouncement requires additional disclosures to assist financial statement users in assessing an entity s credit risk exposures and evaluating the adequacy of its allowance for credit losses. These new disclosures are required for interim and annual reporting periods ending on or after December 15, 2010, except for disclosures relating to loan modifications, which were subsequently extended to interim and annual filings after June 15, 2011. We are still evaluating the possible impact on our financial condition or results of operations.

2. Comprehensive Income (In Thousands)

The following table presents the components, net of tax, of accumulated other comprehensive loss as of March 31, 2011, December 31, 2010 and March 31, 2010:

	March 31, 2011	December 31, 2010	March 31, 2010
Retirement Plan Net Loss	$(10,629)	$(10,610)	$(10,033)
Retirement Plan Prior Service Cost	586	432	369
Net Unrealized Securities Holding Gains	4,604	3,755	4,582
Total Accumulated Other Comprehensive Loss	$ (5,439)	$ (6,423)	$ (5,082)

3. Earnings Per Share (In Thousands, Except Per Share Amounts)

The following table presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted earnings per common share (EPS) for the three-month periods ended March 31, 2011 and 2010, as restated for the September 2010 3% stock dividend:

	Income (Numerator)	Shares (Denominator)	Per Share Amount
For the Three Months Ended March 31, 2011:			
Basic EPS	$5,281	11,334	$.47
Dilutive Effect of Stock Options	---	13	
Diluted EPS	$5,281	11,347	$.47
For the Three Months Ended March 31, 2010:			
Basic EPS	$5,415	11,260	$.48
Dilutive Effect of Stock Options	---	41	
Diluted EPS	$5,415	11,301	$.48

4. Investments, Debt and Equity Securities (In Thousands)

A summary of the amortized costs and the approximate fair values of securities at March 31, 2011, December 31, 2010 and March 31, 2010 are presented below. Amortized cost is reported net of other-than-temporary impairment charges.

Securities Available-for-Sale:

	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
March 31, 2011:				
U.S. Agency Securities	$105,252	$105,291	$ 126	$ 87
State and Municipal Obligations	98,546	98,648	113	11
Collateralized Mortgage Obligations	143,039	149,753	7,219	505
Mortgage-Backed Securities Residential	187,465	188,217	2,471	1,719
Corporate and Other Debt Securities	1,509	1,487	---	22
Mutual Funds and Equity Securities	1,354	1,393	66	27
Total Securities Available-for-Sale	$537,165	$544,789	$9,995	$2,371
December 31, 2010:				
U.S. Agency Securities	$ 97,943	$ 98,173	$ 326	$ 96
State and Municipal Obligations	89,471	89,528	72	15

Collateralized Mortgage Obligations	161,247	166,964	6,692	975
Mortgage-Backed Securities Residential	159,636	159,926	2,532	2,242
Corporate and Other Debt Securities	1,516	1,417	---	99
Mutual Funds and Equity Securities	1,333	1,356	70	47
Total Securities Available-for-Sale	$511,146	$517,364	$9,692	$3,474
March 31, 2010				
U.S. Agency Securities	$122,948	$123,350	$ 402	$ --
State and Municipal Obligations	19,026	19,075	53	4
Collateralized Mortgage Obligations	187,504	192,853	6,030	681
Mortgage-Backed Securities Residential	86,350	88,387	2,329	292
Corporate and Other Debt Securities	1,427	1,290	---	137
Mutual Funds and Equity Securities	1,409	1,296	46	159
Total Securities Available-for-Sale	$418,664	$426,251	$8,860	$1,273

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4. Investments, Debt and Equity Securities, continued

Securities Held-to-Maturity:

	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
March 31, 2011:				
State and Municipal Obligations	$146,217	$148,895	$2,839	$161
Corporate and Other Debt Securities	1,000	1,000	---	---
Total Securities Held-to-Maturity	$147,217	$149,895	$2,839	$161
December 31, 2010:				
State and Municipal Obligations	$158,938	$161,713	$2,911	$136
Corporate and Other Debt Securities	1,000	1,000	---	---
Total Securities Held-to-Maturity	$159,938	$162,713	$2,911	$136
March 31, 2010				
State and Municipal Obligations	$167,574	$169,755	$2,583	$402
Corporate and Other Debt Securities	1,000	1,000	---	---
Total Securities Held-to-Maturity	$168,574	$170,755	$2,583	$402

As reported in the Consolidated Balance Sheets, Other Investments include Federal Home Loan Bank of New York (FHLBNY) and Federal Reserve Bank (FRB) stock, which are reported at cost. FHLBNY and FRB stock are restricted investment securities and amounted to $6,843 and $859 at March 31, 2011, respectively and $7,743 and $859 at December 31, 2010, respectively. The required level of FHLBNY stock is based on the amount of FHLBNY borrowings and is pledged to secure those borrowings. While some Federal Home Loan Banks have stopped paying dividends and repurchasing stock upon reductions in debt levels, the FHLBNY continues to pay dividends and repurchase its stock. Accordingly, we have not recognized any impairment on our holdings of FHLBNY common stock. However, the FHLBNY has reported impairment issues among its holdings of mortgage-backed securities.

A summary of the maturities of securities as of March 31, 2011 is presented below. Mutual funds and equity securities, which have no stated maturity, are not included in the table below. Collateralized mortgage obligations and other mortgage-backed-securities are included in the schedule based on their expected average lives. Actual maturities will differ from the table below because issuers may have the right to call or prepay obligations with or without prepayment penalties.

Maturities of Debt Securities:	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within One Year:				

U.S. Agency Securities	$ 43,756	$ 43,847	$ ---	$ ---
State and Municipal Obligations	73,685	73,723	20,175	20,338
Collateralized Mortgage Obligations	8,333	8,420	---	---
Mortgage-Backed Securities Residential	2,478	2,552	---	---
Total	128,252	128,542	20,175	20,338
From 1 - 5 Years:				
U.S. Agency Securities	61,496	61,444	---	---
State and Municipal Obligations	20,986	21,043	51,001	51,724
Collateralized Mortgage Obligations	104,972	110,992	---	---
Mortgage-Backed Securities Residential	136,410	136,531	---	---
Corporate and Other Debt Securities	178	179	---	---
Total	324,042	330,189	51,001	51,724
From 5 - 10 Years:				
State and Municipal Obligations	1,125	1,132	---	---
Collateralized Mortgage Obligations	29,734	30,341	63,997	65,590
Mortgage-Backed Securities Residential	29,932	30,253	---	---
Total	60,791	61,726	63,997	65,590

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4. Investments, Debt and Equity Securities, continued

Maturities of Debt Securities, continued	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Over 10 Years:				
State and Municipal Obligations	2,750	2,750	11,044	11,243
Mortgage-Backed Securities Residential	18,645	18,881	---	---
Corporate and Other Debt Securities	1,331	1,308	1,000	1,000
Total	22,726	22,939	12,044	12,243
Total Debt Securities	$535,811	$543,396	$147,217	$149,895

The fair value of securities pledged to secure repurchase agreements amounted to $57,762 and $51,581 at March 31, 2011 and December 31, 2010, respectively. The fair value of securities pledged to secure public and trust deposits and for other purposes totaled $452,417 and $382,142 at March 31, 2011 and December 31, 2010, respectively. Other mortgage-backed securities at March 31, 2011 and December 31, 2010 included $1,325 and $1,598, respectively, of loans previously securitized by Arrow, which it continues to service.

Temporarily Impaired Securities

March 31, 2011	Less than 12 Months		12 Months or Longer		Total	
Available-for-Sale Portfolio:	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Agency Securities	$52,909	$ 87	$ ---	$ ---	$52,909	$ 87
State & Municipal Obligations	6,481	11	---	---	6,481	11
Collateralized Mortgage Obligations	24,335	503	1,069	2	25,404	505
Mortgage-Backed Securities Residential	96,520	1,688	5,410	31	101,930	1,719
Corporate & Other Debt Securities	---	---	309	22	309	22
Mutual Funds and Equity Securities	---	---	1,115	27	1,115	27
Total Securities Available-for-Sale	$180,245	$ 2,289	$7,903	$ 82	$188,148	$2,371
Held-to-Maturity Portfolio						
State & Municipal Obligations	$ ---	$ ---	$10,167	$161	$10,167	$161

The table above for March 31, 2011 consists of 93 securities where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any deterioration of the credit worthiness of the issuing entities. All of the CMO s are agency backed and are all rated AAA, as are the mortgage-backed securities. The municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, credit analysis shows no widespread deterioration in the credit worthiness of the municipalities. Corporate and other debt securities consist of one private placement trust preferred, and one trust preferred pool. The private placement trust preferred is rated AAA by Standard & Poor s; the trust preferred pool is rated investment grade, with the privately issued securities securing the note performing. Subsequent to March 31, 2011, there were no securities downgraded below investment grade.

The unrealized losses on these temporarily impaired securities are primarily the result of changes in interest rates for fixed rate securities where the interest rate received is less than the current rate available for new offerings of similar securities, changes in market spreads as a result of shifts in supply and demand, and/or changes in the level of prepayments for mortgage related securities. Because we do not currently intend to sell any of our temporarily impaired securities, and because it is not more likely than not that we would be required to sell the securities prior to recovery, the impairment is considered temporary.

4. Investments, Debt and Equity Securities, continued

Temporarily Impaired Securities

December 31, 2010	Less than 12 Months		12 Months or Longer		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
Available-for-Sale Portfolio:	Value	Losses	Value	Losses	Value	Losses
U.S. Agency Securities	$ 23,928	$ 72	$ 5,976	$ 24	$ 29,904	$ 96
State & Municipal Obligations	11,632	11	2,432	4	14,064	15
Collateralized Mortgage Obligations	32,027	975	---	---	32,027	975
Mortgage-Backed Securities - Residential	69,461	1,957	12,129	285	81,590	2,242
Corporate & Other Debt Securities	283	48	949	51	1,232	99
Mutual Funds and Equity Securities	1,095	47	---	---	1,095	47
Total Securities Available-for-Sale	$138,426	$3,110	$21,486	$364	$159,912	$3,474
Held-to-Maturity Portfolio						
State & Municipal Obligations	$6,449	$ 73	$4,552	$ 63	$11,001	$136

The table above for December 31, 2010 consists of 104 securities where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any deterioration of the credit worthiness of the issuing entities. Agency-backed CMOs are all rated AAA, as are the mortgage-backed securities. The municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, third party credit analysis shows no deterioration in the credit worthiness of the municipalities. Corporate and other debt securities consist of one private placement trust preferred, and one trust preferred pool. The private placement trust preferred is rated AAA by Standard & Poor s; the trust preferred pool is rated investment grade, with the privately issued securities securing the note performing. Subsequent to December 31, 2010, there were no securities downgraded below investment grade.

Temporarily Impaired Securities

March 31, 2010	Less than 12 Months		12 Months or Longer		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
Available-for-Sale Portfolio:	Value	Losses	Value	Losses	Value	Losses
State & Municipal Obligations	$ 1,228	$ 4	$ ---	$ --	$ 1,228	$ 4
Collateralized Mortgage Obligations	50,183	681	---	---	50,183	681
Mortgage-Backed Securities Residential	36,561	292	626	---	37,187	292
Corporate & Other Debt Securities	---	---	1,249	137	1,249	137
Mutual Funds and Equity Securities	943	151	40	8	983	159
Total Securities Available-for-Sale	$88,915	$1,128	$1,915	$145	$90,830	$1,273
Held-to-Maturity Portfolio						
State & Municipal Obligations	$11,812	$239	$7,911	$163	$19,723	$402

The table above for March 31, 2010 consists of 93 securities where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any deterioration of the credit worthiness of the issuing entities. Agency-backed CMOs are all rated AAA, as are the mortgage-backed securities. The municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, credit analysis shows no deterioration in the credit worthiness of the municipalities. Corporate and other debt securities consist of one private placement trust preferred, and one trust preferred pool. The private placement trust preferred is rated AAA by Standard & Poor s; the trust preferred pool is rated investment grade, with the privately issued securities securing the note performing. Subsequent to March 31, 2010, there were no securities downgraded below investment grade.

4. Investments, Debt and Equity Securities, continued

Other-Than-Temporary Impairment

On a quarterly basis, Arrow performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment. A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. If impaired, Arrow then assesses whether the unrealized loss is other-than-temporary. An unrealized loss on a debt security is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. As a result, the credit loss component of an other-than-temporary impairment write-down for debt securities is recorded in earnings while the remaining portion of the impairment loss is recognized, net of tax, in other comprehensive income provided that Arrow does not intend to sell the underlying debt security and it is more-likely-than not that Arrow would not have to sell the debt security prior to recovery.

At March 31, 2011 and December 31, 2010 mutual funds and equity securities included shares of one common stock that had been deemed to be other-than-temporarily impaired. The common stock had a book value of $1,469 prior to the recognition of $375 in losses charged to earnings for the year ended December 31, 2009. The approximate fair value for this security was $1,068, $1,050 and $943 at March 31, 2011, December 31, 2010 and March 31, 2010, respectively.

5. Loans

Loan balances outstanding as of March 31, 2011, December 31, 2010 and March 31, 2010 consisted of the following:

Loans

As of March 31, 2011, December 31, 2010 and March 31, 2010

	March 31, 2011	December 31, 2010	March 31, 2010
Commercial	$ 97,391	$ 97,621	$ 95,036
Commercial real estate:			
Commercial real estate construction	7,284	7,090	15,622
Commercial real estate other	232,875	214,291	203,553
Consumer:			
Consumer other	6,156	6,482	6,497
Consumer automobile	324,500	334,656	318,440
Residential prime	467,537	485,368	481,999
Total	$1,135,743	$1,145,508	$1,121,147

Supplemental Information:			
Loans held for sale at period-end, included in the above balances	1,316	10,294	---

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5. Loans, continued

Credit Quality Indicators

The following table provides information about loan credit quality at March 31, 2011 and December 31, 2010:

Credit Quality Indicators
As of March 31, 2011

Commercial Credit Exposure
Credit Risk Profile by Creditworthiness Category

Indicator	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other
Satisfactory	$90,570	$5,577	$204,994
Special Mention	3,557	---	7,265
Substandard	3,264	1,707	20,616
Doubtful	---	---	---
Total	$97,391	$7,284	$232,875

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer-Other	Consumer-Auto	Residential-Prime
Performing	$6,102	$324,500	$464,843
Nonperforming	54	---	2,694
Total	$6,156	$324,500	$467,537

Credit Quality Indicators
As of December 31, 2010

Commercial Credit Exposure
Credit Risk Profile by Creditworthiness Category

Indicator	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other
Satisfactory	$94,290	$5,117	$187,070
Special Mention	160	---	7,318
Substandard	3,171	1,973	19,903
Doubtful	---	---	---
Total	$97,621	$7,090	$214,291

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer-Other	Consumer-Auto	Residential-Prime
Performing	$6,477	$333,847	$483,725
Nonperforming	5	809	1,643
Total	$6,482	$334,656	$485,368

We use an internally developed system of five credit quality indicators to rate the credit worthiness of each commercial loan. The system has eight levels of credit quality (the first four have been combined in the preceding table), defined as follows: 1) Satisfactory - Satisfactory borrowers have acceptable financial condition with satisfactory record of earnings and sufficient historical and projected cash flow to service the debt. Borrowers have satisfactory repayment histories and primary and secondary sources of repayment can be clearly identified; 2) Special Mention - Loans in this category have potential weaknesses that deserve management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution s credit position at some future date. Special mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Loans which might be assigned this risk rating include loans to borrowers with deteriorating financial strength and/or earnings record, loans with potential for problems due to weakening economic or market conditions, loans subject to an inadequate loan agreement, loans with insufficient or flawed documentation, loans where the loan officer lacks sufficient expertise to properly control the account, and other deviations from prudent lending practice; 3) Substandard - Loans classified as substandard are inadequately protected by the current sound net worth or paying capacity of the borrower or the collateral pledged, if any. Loans in this category have well defined weaknesses that jeopardize the repayment. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

5. Loans, continued

Substandard loans may include loans which are likely to require liquidation of collateral to effect repayment, and other loans where character or ability to repay has become suspect. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard; 4) Doubtful - Loans classified as doubtful have all of the weaknesses inherent in those classified as substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, conditions, and values highly questionable and improbable. Although possibility of loss is extremely high, classification of these loans as loss has been deferred due to specific pending factors or events which may strengthen the value (i.e. possibility of additional collateral, injection of capital, collateral liquidation, debt restructure, economic recovery, etc). Loans classified as doubtful need to be placed on non-accrual; and 5) Loss - Loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. As of the date of the balance sheet, all loans in this category have been charged-off to the allowance for loan losses. However, this classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Commercial loans are evaluated on an annual basis, unless the credit quality indicator falls to a level of 5 or below, when the loan is evaluated quarterly. The credit quality indictor is one of the factors used to determine any loss, as further described in this footnote.

Past Due Loans

The following table provides an analysis of the age of the recorded investment in loans that are past due as of March 31, 2011 and December 31, 2010. Consistent with regulatory instructions, Arrow considers an amortizing loan past due 30 or more days only if the borrower is two or more payments past due. Matured loans and all other loans are considered past due 30 or more days based on the payment due date. Nonaccrual loans are included in the first three columns, unless the loan is past due less than 30 days.

Age Analysis of Past Due Loans
As of March 31, 2011

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
Commercial	$ 406	$ 478	$ 91	$ 975	$ 96,416	$ 97,391
Commercial Real Estate:						
Commercial Real Estate construction	---	---	---	---	7,284	7,284
Commercial Real Estate other	1,436	403	59	1,898	230,977	232,875
Consumer:						
Consumer-other	36	6	33	75	6,081	6,156
Consumer-auto	2,878	671	377	3,926	320,574	324,500
Residential-prime	1,233	559	2,593	4,385	463,152	467,537
Total	$5,989	$2,117	$3,153	$11,259	$1,124,484	$1,135,743

Age Analysis of Past Due Loans
As of December 31, 2010

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
Commercial	$ 591	$ 377	$ 79	$ 1,047	$ 96,572	$ 97,619
Commercial Real Estate:						
Commercial Real Estate construction	---	---	---	---	7,090	7,090
Commercial Real Estate other	483	---	254	737	213,554	214,291
Consumer:						
Consumer-other	5	---	---	5	6,477	6,482
Consumer-auto	3,542	1,547	508	5,597	329,061	334,658
Residential-prime	212	1,884	1,145	3,241	482,127	485,368
Total	$4,833	$3,808	$1,986	$10,627	$1,134,881	$1,145,508

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5. Loans, continued

Nonaccrual Loans and Loans Past Due 90 or More Days and Still Accruing Interest

Arrow designates certain loans as nonaccrual and suspends the accrual of interest and the amortization of net deferred fees or costs when payment of interest and/or principal is due and unpaid for a period of nonperformance (generally 90 days for consumer installment loans, 120 days for home equity lines of credit and 150 days for other residential real estate loans) or the likelihood of repayment is uncertain in the opinion of management. The nonaccrual status for all commercial loans is evaluated on a loan-by-loan basis. The balance of any accrued interest deemed uncollectible at the date the loan is placed on nonaccrual status is reversed against earnings for interest accrued during the calendar year and against the allowance for loan losses for prior accrued interest. A loan is returned to accrual status at the later of the date when the past due status of the loan falls below the threshold for nonaccrual status or management deems that it is likely that the borrower will repay all interest and principal. For payments received while the loan is on nonaccrual status, we may recognize interest income on a cash basis if the repayment of the remaining principal and accrued interest is deemed likely. We had no material commitments to make additional advances to borrowers with nonperforming loans at March 31, 2011 or 2010.

The following table presents information concerning loans on nonaccrual status and loans past due 90 or more days and still accruing interest at March 31, 2011 and December 31, 2010:

Loans on Nonaccrual Status and Past Due 90 or More Days and Still Accruing Interest

As of March 31, 2011 and December 31, 2010

	March 31, 2011		December 31, 2010	
	Nonaccrual	90 Days Past Due	Nonaccrual	90 Days Past Due
Commercial	$ 105	$---	$ 94	$ ---
Commercial real estate:				
Commercial real estate - construction	---	---	---	---
Commercial real estate - other	1,180	---	2,237	83
Consumer:				
Consumer other	11	22	5	---
Consumer auto	377	---	809	---
Residential prime	2,623	71	916	727
Total nonaccrual loans and loans past due 90 or more days and still accruing interest	$4,296	$93	$4,061	$810

Impaired Loans

We evaluate restructured loans and all nonaccrual loans over $250 thousand individually for impairment. We determine impairment primarily by evaluating the fair value of all collateral and secondarily by analysis of all other cash-flows available to the borrower to satisfy all contractual loan payments. For return to accrual status and for payments received after the loan has been designated as impaired, we use the same analysis as applied to nonaccrual loans, as described above.

Impaired Loans
As of March 31, 2011 and December 31, 2010

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2011					
With no related allowance recorded:					
Commercial real estate	$ 998	$ 998	$---	$ 998	$---
Residential real estate	1,779	1,779	---	1,779	23
Total Impaired Loans	$2,777	$2,777	---	$2,777	$23
December 31, 2010					
With no related allowance recorded:					
Commercial real estate	$1,986	$1,986	$---	$1,937	$116
Residential Real Estate	252	252	---	254	9
Total Impaired Loans	$2,238	$2,238	$---	$2,191	$125

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5. Loans, continued

Allowance for Loan Losses

Through the provision for loan losses, an allowance is maintained that reflects our best estimate of probable incurred loan losses related to specifically identified loans and losses for categories of loans in the remaining portfolio. Actual loan losses are charged against this allowance when loans are deemed uncollectible.

We use a two-step process to determine the provision for loans losses and the amount of the allowance for loan losses. We evaluate impaired commercial and commercial real estate loans over $250 thousand individually, as described above, while we evaluate the remainder of the portfolio on a pooled basis as described below.

Homogenous Loan Pools: Under our pooled analysis, we group homogeneous loans as follows, each with its own estimated loss-rate:

i)

Secured and unsecured commercial loans,

ii)

Secured construction and development loans,

iii)

Secured commercial loans non-owner occupied,

iv)

Secured commercial loans owner occupied,

v)

One to four family residential real estate loans,

vi)

Home equity loans,

vii)

Indirect loans low risk tiers (based on credit scores), viii)

Indirect loans high risk tiers, and

ix)

Other consumer loans.

Within the group of other commercial and commercial real estate loans, we sub-group loans based on our internal system of risk-rating, which is applied to all commercial and commercial real estate loans. We establish loss rates for each of these pools.

Estimated losses reflect consideration of all significant factors that affect the collectability of the portfolio as of March 31, 2011. In our evaluation, we do both a quantitative and qualitative analysis of the homogeneous pools.

Quantitative Analysis: Quantitatively, we determine the historical loss rate for each homogeneous loan pool. During the past five years we have had little charge-off activity on loans secured by residential real estate. Indirect consumer lending (principally automobile loans) represents a significant component of our total loan portfolio and is the only category of loans that has a history of losses that lends itself to a trend analysis. We have had one small loss on commercial real estate loans in the past five years. Losses on commercial loans (other than those secured by real estate) are also historically low, but can vary widely from year-to-year; this is the most complex category of loans in our loss analysis.

Our net charge-offs for the past five years have been at or near historical lows for our Company. Annualized net charge-offs have ranged from .04% to .09% of average loans during this period.

Qualitative Analysis: While historical loss experience provides a reasonable starting point for our analysis, historical losses, or even recent trends in losses, do not by themselves form a sufficient basis to determine the appropriate level for the allowance. Therefore, we have also considered and adjusted historical loss factors for qualitative and environmental factors that are likely to cause credit losses associated with our existing portfolio. These included:

Changes in the volume and severity of past due, nonaccrual and adversely classified loans

Changes in the nature and volume of the portfolio and in the terms of loans

Changes in the value of the underlying collateral for collateral dependent loans

Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses

Changes in the quality of the loan review system

Changes in the experience, ability, and depth of lending management and other relevant staff

Changes in international, national, regional, and local economic and business conditions and developments that affect the collectibility of the portfolio

The existence and effect of any concentrations of credit, and changes in the level of such concentrations

The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio or pool

For each homogeneous loan pool, we estimate a loss factor expressed in basis points for each of the qualitative factors above, and for historical credit losses. We update and change, if necessary, the loss-rates assigned to various pools based on the analysis of loss trends and the change in qualitative and environmental factors.

5. <u>Loans, continued</u>

From June 2004 to June 2006, the Federal Reserve Bank increased prevailing short-term rates in an effort to slow down national economic growth and check potential increases in the inflation rate. However, from August 2007 through December 2008, the Federal Reserve Bank began to cut rates in response to the growing financial crisis in credit markets and evidence of a significant economic recession. In our market area there was little impact from these developments in credit markets and the national economy on unemployment rates, job growth and business failures until the last quarter of 2008; overall, our market area has not experienced in the past five quarters the degree of negative impact on lending, credit and property values that the U.S. as a whole has experienced, although this may change in upcoming periods.

Due to the imprecise nature of the loan loss estimation process and ever changing economic conditions, the risk attributes of our portfolio may not be adequately captured in data related to the formula-based loan loss components used to determine allocations in our analysis of the adequacy of the allowance for loan losses. Management, therefore, has established and held an unallocated portion within the allowance for loan losses reflecting the uncertainty of future economic conditions within our market area. This unallocated portion of the allowance was $1.1 million, or 7.6% of the total allowance for loan losses, at March 31, 2011.

The following summari