ARROW FINANCIAL CORP
Form 10-Q
August 07, 2013

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 June 30, 2013

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)	(I.R.S. Employer Identification No.)

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 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. 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 such shorter period that the registrant was required to submit and post such files). x 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.
Large accelerated filer Accelerated filer x Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes 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 July 31, 2013
Common Stock, par value $1.00 per share	12,052,744

ARROW FINANCIAL CORPORATION
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PART I - Financial Information

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

	June 30, 2013	December 31, 2012	June 30, 2012
ASSETS			
Cash and Due From Banks	$32,706	$37,076	$31,391
Interest-Bearing Deposits at Banks	11,894	11,756	26,360
Investment Securities:			
Available-for-Sale	501,574	478,698	431,010
Held-to-Maturity (Approximate Fair Value of $252,691 at June 30, 2013, $248,252 at December 31, 2012, and $261,574 at June 30, 2012)	248,914	239,803	252,902
Federal Home Loan Bank and Federal Reserve Bank Stock	6,136	5,792	4,479
Loans	1,204,734	1,172,341	1,146,641
Allowance for Loan Losses	(14,678)	(15,298)	(15,211)
Net Loans	1,190,056	1,157,043	1,131,430
Premises and Equipment, Net	29,301	28,897	24,823
Other Real Estate and Repossessed Assets, Net	1,175	1,034	837
Goodwill	22,003	22,003	22,003
Other Intangible Assets, Net	4,384	4,492	4,608
Accrued Interest Receivable	5,708	5,486	5,712
Other Assets	29,318	30,716	31,421
Total Assets	$2,083,169	$2,022,796	$1,966,976
LIABILITIES			
Noninterest-Bearing Deposits	$261,910	$247,232	$248,224
NOW Accounts	754,371	758,287	691,001
Savings Deposits	494,586	442,363	437,568
Time Deposits of $100,000 or More	87,369	93,375	108,277
Other Time Deposits	181,669	189,898	219,813
Total Deposits	1,779,905	1,731,155	1,704,883
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	14,738	12,678	16,097
Federal Home Loan Bank Overnight Advances	40,000	29,000	—
Federal Home Loan Bank Term Advances	30,000	30,000	30,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000
Accrued Interest Payable	493	584	898
Other Liabilities	20,426	23,554	23,158
Total Liabilities	1,905,562	1,846,971	1,795,036
STOCKHOLDERS' EQUITY			
Preferred Stock, $5 Par Value; 1,000,000 Shares Authorized	—	—	—
Common Stock, $1 Par Value; 20,000,000 Shares Authorized (16,416,163 Shares Issued at June 30, 2013 and December 31, 2012 and	16,416	16,416	16,094

16,094,277 Shares Issued at June 30, 2012)			
Additional Paid-in Capital	219,772	218,650	209,354
Retained Earnings	30,625	26,251	28,951
Unallocated ESOP Shares (95,172 Shares at June 30, 2013, 102,890 Shares at December 31, 2012 and 105,211 Shares at June 30, 2012)	(1,900)	(2,150)	(2,250)
Accumulated Other Comprehensive Loss	(11,739)	(8,462)	(6,289)
Treasury Stock, at Cost (4,277,680 Shares at June 30, 2013, 4,288,617 Shares at December 31, 2012, and 4,223,388 Shares at June 30, 2012)	(75,567)	(74,880)	(73,920)
Total Stockholders' Equity	177,607	175,825	171,940
Total Liabilities and Stockholders' Equity	$2,083,169	$2,022,796	$1,966,976

See Notes to Unaudited Interim Consolidated 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
INTEREST AND DIVIDEND INCOME				
Interest and Fees on Loans	$12,650	$13,628	$25,433	$27,586
Interest on Deposits at Banks	19	36	46	57
Interest and Dividends on Investment Securities:				
Fully Taxable	1,639	2,480	3,435	5,118
Exempt from Federal Taxes	1,501	1,389	2,891	2,710
Total Interest and Dividend Income	15,809	17,533	31,805	35,471
INTEREST EXPENSE				
NOW Accounts	786	976	1,564	2,035
Savings Deposits	277	329	545	686
Time Deposits of $100,000 or More	305	569	624	1,177
Other Time Deposits	505	1,074	1,059	2,220
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	6	5	9	11
Federal Home Loan Bank Advances	199	172	372	369
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	145	154	289	313
Total Interest Expense	2,223	3,279	4,462	6,811
NET INTEREST INCOME	13,586	14,254	27,343	28,660
Provision for Loan Losses	100	240	200	520
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	13,486	14,014	27,143	28,140
NONINTEREST INCOME				
Income From Fiduciary Activities	1,758	1,601	3,332	3,223
Fees for Other Services to Customers	2,371	2,054	4,653	4,014
Insurance Commissions	2,176	2,107	4,204	3,996
Gain on Securities Transactions	13	143	540	645
Net Gain on Sales of Loans	498	537	1,105	894
Other Operating Income	255	366	411	595
Total Noninterest Income	7,071	6,808	14,245	13,367
NONINTEREST EXPENSE				
Salaries and Employee Benefits	7,637	7,794	15,258	15,697
Occupancy Expenses, Net	2,119	1,970	4,395	3,994
FDIC Assessments	267	256	531	511
Other Operating Expense	3,251	2,631	6,501	5,595
Total Noninterest Expense	13,274	12,651	26,685	25,797
INCOME BEFORE PROVISION FOR INCOME TAXES	7,283	8,171	14,703	15,710
Provision for Income Taxes	2,076	2,577	4,315	4,828
NET INCOME	$5,207	$5,594	$10,388	$10,882
Average Shares Outstanding:				
Basic	12,021	11,994	12,026	12,000

Diluted	12,038	12,009	12,044	12,019
Per Common Share:				
Basic Earnings	$0.43	$0.47	$0.86	$0.91
Diluted Earnings	0.43	0.47	0.86	0.91

Share and Per Share Amounts have been restated for the September 2012 2% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net Income	$5,207	$5,594	$10,388	$10,882
Other Comprehensive Income (Loss), Net of Tax:				
Net Unrealized Securities Holding (Losses) Gains Arising During the Period	(3,643)	445	(3,423)	347
Reclassification Adjustment for Securities Gains Included in Net Income	(8)	(86)	(326)	(389)
Amortization of Net Retirement Plan Actuarial Loss	236	229	472	457
Accretion of Net Retirement Plan Prior Service Credit	—	(5)	—	(9)
Other Comprehensive Income (Loss)	(3,415)	583	(3,277)	406
Comprehensive Income	$1,792	$6,177	$7,111	$11,288

See Notes to Unaudited Interim Consolidated 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 Stock	Additional Paid-In Capital	Retained Earnings	Unallo-cated ESOP Shares	Accumu-lated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2012	$16,416	$218,650	$26,251	$(2,150)	$(8,462)	$(74,880)	$175,825
Net Income	—	—	10,388	—	—	—	10,388
Other Comprehensive (Loss) Income	—	—	—	—	(3,277)	—	(3,277)
Cash Dividends Paid, $.50 per Share [1]	—	—	(6,014)	—	—	—	(6,014)
Stock Options Exercised (23,685 Shares)	—	262	—	—	—	233	495
Shares Issued Under the Directors' Stock Plan (4,255 Shares)	—	64	—	—	—	42	106
Shares Issued Under the Employee Stock Purchase Plan (10,402 Shares)	—	141	—	—	—	103	244
Shares Issued for Dividend Reinvestment Plans (17,323 Shares)	—	260	—	—	—	170	430
Stock-Based Compensation Expense	—	189	—	—	—	—	189
Tax Benefit for Disposition of Stock Options	—	9	—	—	—	—	9
Purchase of Treasury Stock (54,231 Shares)	—	—	—	—	—	(1,329)	(1,329)
Acquisition of Subsidiaries (9,503 Shares)	—	139	—	—	—	94	233
Allocation of ESOP Stock (7,718 Shares)	—	58	—	250	—	—	308
Balance at June 30, 2013	$16,416	$219,772	$30,625	$(1,900)	$(11,739)	$(75,567)	$177,607
Balance at December 31, 2011	$16,094	$207,600	$23,947	$(2,500)	$(6,695)	$(72,061)	$166,385
Net Income	—	—	10,882	—	—	—	10,882
Other Comprehensive (Loss) Income	—	—	—	—	406	—	406
Cash Dividends Paid, $.49 per Share [1]	—	—	(5,878)	—	—	—	(5,878)
Stock Options Exercised (52,502 Shares)	—	627	—	—	—	522	1,149

Shares Issued Under the Directors' Stock Plan (3,667 Shares)	—	51	—	—	—	36	87
Shares Issued Under the Employee Stock Purchase Plan (10,377 Shares)	—	139	—	—	—	103	242
Shares Issued for Dividend Reinvestment Plans (38,227 Shares)	—	549	—	—	—	380	929
Stock-Based Compensation Expense	—	207	—	—	—	—	207
Tax Benefit for Disposition of Stock Options	—	53	—	—	—	—	53
Purchase of Treasury Stock (120,117 Shares)	—	—	—	—	—	(2,954)	(2,954)
Acquisition of Subsidiaries (5,426 Shares)	—	79	—	—	—	54	133
Allocation of ESOP Stock (12,291 Shares)	—	49	—	250	—	—	299
Balance at June 30, 2012	$16,094	$209,354	$28,951	$ (2,250)	$ (6,289)	$(73,920)	$171,940

[1] Cash dividends paid per share have been adjusted for the September 2012 2% stock dividend.

See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Six Months Ended June 30,	
Cash Flows from Operating Activities:	2013	2012
Net Income	$10,388	$10,882
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	200	520
Depreciation and Amortization	4,785	4,363
Allocation of ESOP Stock	308	299
Gains on the Sale of Securities Available-for-Sale	(527)	(645)
Gains on the Sale of Securities Held-to-Maturity	(18)	—
Losses on the Sale of Securities Held-to-Maturity	5	—
Loans Originated and Held-for-Sale	(32,465)	(27,593)
Proceeds from the Sale of Loans Held-for-Sale	35,868	27,680
Net Gains on the Sale of Loans	(1,105)	(894)
Net Losses (Gains) on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	106	(38)
Contributions to Pension Plans	(221)	(160)
Deferred Income Tax Benefit	(93)	(311)
Shares Issued Under the Directors’ Stock Plan	106	87
Stock-Based Compensation Expense	189	207
Net Decrease in Other Assets	3,760	1,564
Net (Decrease) Increase in Other Liabilities	(2,690)	775
Net Cash Provided By Operating Activities	18,596	16,736
Cash Flows from Investing Activities:		
Proceeds from the Sale of Securities Available-for-Sale	16,273	16,385
Proceeds from the Maturities and Calls of Securities Available-for-Sale	60,679	125,354
Purchases of Securities Available-for-Sale	(107,772)	(18,041)
Proceeds from the Sale of Securities Held-to-Maturity	1,181	—
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	17,905	22,454
Purchases of Securities Held-to-Maturity	(29,112)	(125,207)
Net Increase in Loans	(36,195)	(15,544)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	440	583
Purchase of Premises and Equipment	(1,453)	(3,055)
Cash Paid for Subsidiaries, Net	(75)	(75)
Net (Increase) Decrease in Other Investments	(344)	2,243
Net Cash (Used In) Provided By Investing Activities	(78,473)	5,097
Cash Flows from Financing Activities:		
Net Increase in Deposits	48,750	60,837
Net Decrease (Increase) Decrease in Short-Term Borrowings	13,060	(52,196)
Repayments of Federal Home Loan Bank Term Advances	—	(10,000)
Purchase of Treasury Stock	(1,329)	(2,954)
Stock Options Exercised	495	1,149
Shares Issued Under the Employee Stock Purchase Plan	244	242
Tax Benefit from Exercise of Stock Options	9	53
Shares Issued for Dividend Reinvestment Plans	430	929

Cash Dividends Paid	(6,014)	(5,878)
Net Cash Provided By (Used In) Financing Activities	55,645	(7,818)
Net (Decrease) Increase in Cash and Cash Equivalents	(4,232)	14,015
Cash and Cash Equivalents at Beginning of Period	48,832	43,736
Cash and Cash Equivalents at End of Period	$44,600	$57,751
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	$4,552	$7,059
Income Taxes	4,011	3,316
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	684	855
Acquisition of Subsidiaries	233	133

See Notes to Unaudited Interim Consolidated Financial Statements.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 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 June 30, 2013, December 31, 2012 and June 30, 2012; the results of operations for the three and six-month periods ended June 30, 2013 and 2012; the consolidated statements of comprehensive income for the three and six-month periods ended June 30, 2013 and 2012; the changes in stockholders' equity for the six-month periods ended June 30, 2013 and 2012; and the cash flows for the six-month periods ended June 30, 2013 and 2012. 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, 2012, included in Arrow's 2012 Form 10-K.

New Accounting Standards Updates (ASU): During 2013, through the date of this report, the FASB issued nine accounting standards updates. Eight did not apply to Arrow. ASU 2013-02 "Comprehensive Income" requires additional disclosures relating to reclassifications out of accumulated other comprehensive income. Since the ASU was effective for this Form 10-Q, the new disclosures are included in the Consolidating Statements of Income and Note 5 - Comprehensive Income.

Note 2. INVESTMENT SECURITIES (In Thousands)

The following table is the schedule of Available-For-Sale Securities at June 30, 2013, December 31, 2012 and June 30, 2012:

Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
June 30, 2013						
Available-For-Sale Securities, at Amortized Cost	$151,199	$131,154	$197,775	$17,219	$1,120	$498,467
Available-For-Sale Securities, at Fair Value	150,046	130,444	203,230	16,711	1,143	501,574
Gross Unrealized Gains	—	135	5,586	—	23	5,744
Gross Unrealized Losses	1,153	845	131	508	—	2,637
Available-For-Sale Securities, Pledged as Collateral						270,243
Maturities of Debt Securities, at Amortized Cost:						
Within One Year	—	47,464	19,226	—		66,690
From 1 - 5 Years	151,199	80,191	168,347	16,219		415,956
From 5 - 10 Years	—	2,819	10,202	—		13,021
Over 10 Years	—	680	—	1,000		1,680

Maturities of Debt Securities, at Fair Value:						
Within One Year	—	47,501	19,969	—		67,470
From 1 - 5 Years	150,046	79,434	172,421	15,911		417,812
From 5 - 10 Years	—	2,829	10,840	—		13,669
Over 10 Years	—	680	—	800		1,480
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$150,048	$80,443	$6,750	$15,910	$—	$253,151
12 Months or Longer	—	4,228	—	800	—	5,028
Total	$150,048	$84,671	$6,750	$16,710	$—	$258,179
Number of Securities in a Continuous Loss Position	47	347	3	22	—	419
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$1,153	$826	$131	$308	$—	$2,418

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Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
12 Months or Longer	—	19	—	200	—	219
Total	$1,153	$845	$131	$508	$—	$2,637
December 31, 2012						
Available-For-Sale Securities, at Amortized Cost	$122,297	$84,798	$252,480	$8,689	$1,120	$469,384
Available-For-Sale Securities, at Fair Value	122,457	84,838	261,804	8,451	1,148	478,698
Gross Unrealized Gains	204	206	9,405	—	28	9,843
Gross Unrealized Losses	44	166	81	238	—	529
Available-For-Sale Securities, Pledged as Collateral						260,292
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$72,531	$46,627	$10,230	$8,451	$—	$137,839
12 Months or Longer	—	2,149	4,968	—	—	7,117
Total	$72,531	$48,776	$15,198	$8,451	$—	$144,956
Number of Securities in a Continuous Loss Position	22	198	7	11	—	238
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$44	$160	$50	$238	$—	$492
12 Months or Longer	—	6	31	—	—	37
Total	$44	$166	$81	$238	$—	$529
June 30, 2012						
Available-For-Sale Securities, at Amortized Cost	$48,300	$54,746	$314,394	$1,001	$1,364	$419,805
Available-For-Sale Securities, at Fair Value	48,655	55,013	325,076	801	1,465	431,010
Gross Unrealized Gains	355	284	10,863	—	107	11,609
Gross Unrealized Losses	—	17	181	200	6	404
Available-For-Sale Securities, Pledged as Collateral						184,631
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$—	$8,637	$23,477	$800	$—	$32,914
12 Months or Longer	—	—	—	—	39	39
Total	$—	$8,637	$23,477	$800	$39	$32,953
Number of Securities in a Continuous Loss Position	—	29	9	1	1	40

Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$—	$17	$181	$200	$—	$398
12 Months or Longer	—	—	—	—	6	6
Total	$—	$17	$181	$200	$6	$404

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The following table is the schedule of Held-To-Maturity Securities at June 30, 2013, December 31, 2012 and June 30, 2012:

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
June 30, 2013				
Held-To-Maturity Securities, at Amortized Cost	$200,182	$47,732	$1,000	$248,914
Held-To-Maturity Securities, at Fair Value	204,153	47,538	1,000	252,691
Gross Unrealized Gains	4,833	8	—	4,841
Gross Unrealized Losses	862	202	—	1,064
Held-To-Maturity Securities, Pledged as Collateral				247,914
Maturities of Debt Securities, at Amortized Cost:				
Within One Year	53,463	—	—	53,463
From 1 - 5 Years	75,659	47,732	—	123,391
From 5 - 10 Years	67,248	—	—	67,248
Over 10 Years	3,812	—	1,000	4,812
Maturities of Debt Securities, at Fair Value:				
Within One Year	53,490	—	—	53,490
From 1 - 5 Years	76,624	47,538	—	124,162
From 5 - 10 Years	70,091	—	—	70,091
Over 10 Years	3,948	—	1,000	4,948
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$39,598	$42,813	$—	$82,411
12 Months or Longer	13,204	—	—	13,204
Total	$52,802	$42,813	$—	$95,615
Number of Securities in a Continuous Loss Position	172	27	—	199
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$712	$203	$—	$915
12 Months or Longer	149	—	—	149
Total	$861	$203	$—	$1,064

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
December 31, 2012				
Held-To-Maturity Securities, at Amortized Cost	$183,373	$55,430	$1,000	$239,803
Held-To-Maturity Securities, at Fair Value	191,196	56,056	1,000	248,252
Gross Unrealized Gains	7,886	626	—	8,512
Gross Unrealized Losses	63	—	—	63
Held-To-Maturity Securities, Pledged as Collateral				238,803
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$21,583	$—	$—	$21,583
12 Months or Longer	503	—	—	503
Total	$22,086	$—	$—	$22,086
Number of Securities in a Continuous Loss Position	61	—	—	61
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$62	$—	$—	$62
12 Months or Longer	1	—	—	1
Total	$63	$—	$—	$63
June 30, 2012				
Held-To-Maturity Securities, at Amortized Cost	$183,277	$68,625	$1,000	$252,902
Held-To-Maturity Securities, at Fair Value	191,297	69,277	1,000	261,574
Gross Unrealized Gains	8,055	652	—	8,707
Gross Unrealized Losses	35	—	—	35
Held-To-Maturity Securities, Pledged as Collateral				251,902
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$14,908	$—	$—	$14,908
12 Months or Longer	—	—	—	—
Total	$14,908	$—	$—	$14,908
Number of Securities in a Continuous Loss Position	34	—	—	34
Unrealized Losses on				

Securities in a Continuous Loss Position:				
Less than 12 Months	$35	$—	$—	$35
12 Months or Longer	—	—	—	—
Total	$35	$—	$—	$35

In the tables above, maturities of mortgage-backed-securities - residential are included 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.

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In the available-for-sale category at June 30, 2013, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $151.2 million and a fair value of $150.0 million. Mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of $34.1 million and a fair value of $35.1 million and GSE securities with an amortized cost of $163.7 million and a fair value of $168.1 million. In the held-to-maturity category at June 30, 2013, mortgage-backed securities-residential consisted of GSEs with an amortized cost of $47.7 million and a fair value of $47.5 million.

In the available-for-sale category at June 30, 2012, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $48.3 million and a fair value of $48.7 million. Mortgage-backed securities-residential consisted of US Government Agency securities with an amortized cost of $42.5 million and a fair value of $44.0 million and GSEs with an amortized cost of $271.9 million and a fair value of $281.1 million. In the held-to-maturity category at June 30, 2012, mortgage-backed securities-residential consisted of GSEs with an amortized cost of $68.6 million and a fair value of $69.3 million.

Securities in a continuous loss position, in the tables above for June 30, 2013, December 31, 2012 and June 30, 2012 do not reflect any deterioration of the credit worthiness of the issuing entities. U.S. Agency issues, including agency-backed collateralized mortgage obligations and mortgage-backed securities, are all rated at least Aaa by Moody's or AA+ by Standard and Poor's. The state and 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 is performed in-house based upon data that has been submitted by the issuers to the NY State Comptroller. That analysis shows no deterioration in the credit worthiness of the municipalities. Subsequent to June 30, 2013, 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.

Note 3.   LOANS (In Thousands)

Loan Categories and Past Due Loans

The following table presents loan balances outstanding as of June 30, 2013, December 31, 2012 and June 30, 2012 and an analysis of the recorded investment in loans that are past due at these dates. Generally, Arrow considers a loan past due 30 or more days if the borrower is two or more payments past due.   Loans held-for-sale of $503, $2,801 and $1,699 as of June 30, 2013, December 31, 2012 and June 30, 2012, respectively, are included in the residential real estate loan balances.

Past Due Loans

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
June 30, 2013							
Loans Past Due 30-59 Days	$765	$—	$262	$16	$2,346	$1,161	$4,550
Loans Past Due 60-89 Days	655	—	997	15	527	1,196	3,390
Loans Past Due 90 or more Days	220	—	1,875	4	114	1,402	3,615
Total Loans Past Due	1,640	—	3,134	35	2,987	3,759	11,555
Current Loans	85,909	30,980	256,665	7,421	372,073	440,131	1,193,179
Total Loans	$87,549	$30,980	$259,799	$7,456	$375,060	$443,890	$1,204,734
Loans 90 or More Days Past Due and Still Accruing Interest	$154	$—	$—	$—	$—	$606	$760
Nonaccrual Loans	$299	$—	$1,941	$7	$264	$3,080	$5,591
December 31, 2012							
Loans Past Due 30-59 Days	$1,045	$—	$534	$43	$2,427	$407	$4,456
Loans Past Due 60-89 Days	1,588	—	1,332	17	793	2,466	6,196
Loans Past Due 90 or more Days	494	—	1,871	—	185	1,462	4,012
Total Loans Past Due	3,127	—	3,737	60	3,405	4,335	14,664
Current Loans	102,409	29,149	241,440	6,624	345,695	432,360	1,157,677
Total Loans	$105,536	$29,149	$245,177	$6,684	$349,100	$436,695	$1,172,341
Loans 90 or More Days Past Due and Still Accruing Interest	$126	$—	$378	$—	$42	$374	$920
Nonaccrual Loans	$1,787	$—	$2,026	$1	$419	$2,400	$6,633
June 30, 2012							
Loans Past Due 30-59 Days	$441	$—	$371	$13	$2,225	$1,554	$4,604
Loans Past Due 60-89 Days	1,779	—	—	5	483	639	2,906
Loans Past Due 90 or more Days	—	—	692	—	124	1,818	2,634
Total Loans Past Due	2,220	—	1,063	18	2,832	4,011	10,144
Current Loans	99,074	17,628	234,798	6,525	331,266	447,206	1,136,497
Total Loans	$101,294	$17,628	$235,861	$6,543	$334,098	$451,217	$1,146,641
Loans 90 or More Days Past Due and Still Accruing Interest	$—	$—	$27	$—	$—	$477	$504
Nonaccrual Loans	$1,675	$—	$1,511	$1	$536	$3,099	$6,822

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Allowance for Loan Losses

The following table presents a roll-forward of the allowance for loan losses and other information pertaining to the allowance for loan losses:

Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total
Roll-forward of the Allowance for Loan Losses for the Quarterly Periods:								
March 31, 2013	$1,619	$612	$3,379	$308	$4,294	$3,392	$999	$14,603
Charge-offs	(15)	—	—	(5)	(72)	—	—	(92)
Recoveries	36	—	—	—	31	—	—	67
Provision	(88)	34	(86)	(4)	104	16	124	100
June 30, 2013	$1,552	$646	$3,293	$299	$4,357	$3,408	$1,123	$14,678
March 31, 2012	$1,834	$661	$3,297	$352	$4,530	$3,300	$1,079	$15,053
Charge-offs	(10)	—	—	(23)	(70)	(33)	—	(136)
Recoveries	1	—	—	3	50	—	—	54
Provision	273	(133)	(2)	23	61	184	(166)	240
June 30, 2012	$2,098	$528	$3,295	$355	$4,571	$3,451	$913	$15,211
Roll-forward of the Allowance for Loan Losses for the Year-to-Date Periods:								
December 31, 2012	$2,344	$601	$3,050	$304	$4,536	$3,405	$1,058	$15,298
Charge-offs	(788)	—	(11)	(13)	(170)	—	—	(982)
Recoveries	40	—	—	—	122	—	—	162
Provision	(44)	45	254	8	(131)	3	65	200
June 30, 2013	$1,552	$646	$3,293	$299	$4,357	$3,408	$1,123	$14,678
December 31, 2011	$1,927	$602	$3,136	$350	$4,496	$3,414	$1,078	$15,003
Charge-offs	(15)	—	(167)	(42)	(176)	(33)	—	(433)
Recoveries	3	—	—	9	109	—	—	121
Provision	183	(74)	326	38	142	70	(165)	520
June 30, 2012	$2,098	$528	$3,295	$355	$4,571	$3,451	$913	$15,211
June 30, 2013								
Allowance for loan losses - Loans Individually	$—	$—	$—	$—	$—	$—	$—	$—

Evaluated for Impairment								
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$1,552	$646	$3,293	$299	$4,357	$3,408	$1,123	$14,678
Ending Loan Balance - Individually Evaluated for Impairment	$33	$—	$1,481	$—	$184	$1,078	$—	$2,776
Ending Loan Balance - Collectively Evaluated for Impairment	$87,516	$30,980	$258,318	$7,456	$374,876	$442,812	$—	$1,201,958

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Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total
December 31, 2012								
Allowance for loan losses - Loans Individually Evaluated for Impairment	$ 853	$ —	$—	$—	$—	$—	$—	$853
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$ 1,491	$ 601	$3,050	$304	$4,536	$3,405	$1,058	$14,445
Ending Loan Balance - Individually Evaluated for Impairment	$ 1,432	$ —	$2,528	$—	$203	$1,090	$—	$5,253
Ending Loan Balance - Collectively Evaluated for Impairment	$ 104,104	$ 29,149	$242,649	$6,684	$348,897	$435,605	$—	$1,167,088
June 30, 2012								
Allowance for loan losses - Loans Individually Evaluated for Impairment	$ 765	$ —	$—	$—	$—	$—	$—	$765
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$ 1,333	$ 528	$3,295	$355	$4,571	$3,451	$913	$14,446
Ending Loan Balance - Individually Evaluated for Impairment	$ 1,699	$ —	$1,625	$—	$213	$1,490	$—	$5,027
Ending Loan Balance - Collectively	$ 99,595	$ 17,628	$234,236	$6,543	$333,885	$449,727	$—	$1,141,614

Evaluated for
Impairment

Through the provision for loan losses, an allowance is maintained that reflects our best estimate of losses related to specifically identified loans and the inherent risk of probable 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 nonaccrual loans over $250 thousand and all troubled debt restructured loans individually for impairment, while we evaluate the remainder of the portfolio on a pooled basis as described below.

Quantitative Analysis: Quantitatively, we determine the historical loss rate for each homogeneous loan pool. During the previous 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 historically contains the majority of our total loan charge-offs. We have had only two small losses on commercial real estate loans in the previous five years. Prior to the first quarter of 2013, losses on commercial loans (other than those secured by real estate) were also historically low, but can vary widely from year-to-year; this is the most complex category of loans in our loss analysis. For the whole portfolio, our net charge-offs for the previous five years have been at or near historical lows for our Company. Annualized net charge-offs for the entire loan portfolio has ranged from .04% to .09% of average loans during this period, although we may exceed that range for all of 2013, due to one large commercial charge-off in the first quarter of 2013.

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 also consider and adjust historical loss factors for qualitative and environmental factors that are likely to impact the inherent risk of loss 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 net 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 on a quarterly basis.

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 economic conditions within our market area.

Credit Quality Indicators

The following table presents the credit quality indicators by loan category at June 30, 2013, December 31, 2012 and June 30, 2012:

Loan Credit Quality Indicators

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
June 30, 2013							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	$81,067	$29,816	$238,702				$349,585
Special Mention	262	—	1,349				1,611
Substandard	6,220	1,164	19,748				27,132
Doubtful	—	—	—				—
Credit Risk Profile Based on Payment Activity:							
Performing				$7,449	$374,796	$440,203	822,448
Nonperforming				7	264	3,687	3,958
December 31, 2012							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	97,085	27,913	225,312				350,310
Special Mention	192	—	1,419				1,611
Substandard	6,872	1,236	18,446				26,554
Doubtful	1,387	—	—				1,387
Credit Risk Profile Based on Payment Activity:							
Performing				6,683	348,676	433,922	789,281
Nonperforming				1	424	2,773	3,198
June 30, 2012							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	93,621	15,826	213,937				323,384
Special Mention	2,393	—	2,433				4,826
Substandard	5,280	1,802	19,491				26,573
Doubtful	—	—	—				—
Credit Risk Profile Based on Payment Activity:							
Performing				6,542	333,562	447,641	787,745
Nonperforming				1	536	3,576	4,113

We use an internally developed system of five credit quality indicators to rate the credit worthiness of each commercial loan 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 and loans with potential for problems due to weakening economic or market conditions; 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. “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. Commercial loans are evaluated on an annual basis, unless the credit quality indicator falls to a level of "substandard" or below, when the loan is evaluated quarterly. The credit quality indicator is one of the factors used to determine any loss, as further described in this footnote.
For the purposes of the table above, nonperforming consumer loans are those loans on nonaccrual status or are 90 days or more past due and still accruing interest.

Impaired Loans

The following table presents information on impaired loans based on whether the impaired loan has a recorded related allowance or has no recorded related allowance:
Impaired Loans

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
June 30, 2013							
Recorded Investment:							
With No Related Allowance	$33	$—	$1,481	$—	$184	$1,078	$2,776
With a Related Allowance	—	—	—	—	—	—	—
Unpaid Principal Balance:							
With No Related Allowance	33	—	1,481	—	184	1,078	2,776
With a Related Allowance	—	—	—	—	—	—	—
December 31, 2012							
Recorded Investment:							
With No Related Allowance	$45	$—	$2,528	$—	$203	$1,090	$3,866
With a Related Allowance	1,387	—	—	—	—	—	1,387
Unpaid Principal Balance:							
With No Related Allowance	45	—	2,695	—	203	1,090	4,033
With a Related Allowance	1,387	—	—	—	—	—	1,387
June 30, 2012							
Recorded Investment:							
With No Related Allowance	$58	$—	$1,625	$—	$213	$1,490	$3,386
With a Related Allowance	1,641	—	—	—	—	—	1,641
Unpaid Principal Balance:							
With No Related Allowance	58	—	1,458	—	213	1,490	$3,219
With a Related Allowance	1,641	—	—	—	—	—	1,641
For the Quarter Ended:							
June 30, 2013							
Average Recorded Balance:							
With No Related Allowance	$35	$—	$1,493	$—	$183	$1,082	$2,793
With a Related Allowance	—	—	—	—	—	—	—
Interest Income Recognized:							
With No Related Allowance	1	—	—	—	3	—	4
With a Related Allowance	—	—	—	—	—	—	—
Cash Basis Income:							
With No Related Allowance	—	—	—	—	—	—	—
With a Related Allowance	—	—	—	—	—	—	—

June 30, 2012							
Average Recorded Balance:							
With No Related Allowance	$60	$—	$1,707	$—	$227	$1,645	$3,639
With a Related Allowance	559	—	—	—	—	—	559
Interest Income Recognized:							
With No Related Allowance	1	—	6	—	3	3	13
With a Related Allowance	—	—	—	—	—	—	—
Cash Basis Income:							
With No Related Allowance	—	—	6	—	—	—	6
With a Related Allowance	—	—	—	—	—	—	—

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Impaired Loans

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
For the Year-To-Date Period Ended:							
June 30, 2013							
Average Recorded Balance:							
With No Related Allowance	$39	$—	$2,005	$—	$194	$1,084	$3,322
With a Related Allowance	345	—	—	—	—	—	345
Interest Income Recognized:							
With No Related Allowance	2	—	—	—	5	4	11
With a Related Allowance	72	—	—	—	—	—	72
Cash Basis Income:							
With No Related Allowance	—	—	—	—	—	—	—
With a Related Allowance	72	—	—	—	—	—	72
June 30, 2012							
Average Recorded Balance:							
With No Related Allowance	$62	$—	$1,789	$—	$241	$1,799	$3,891
With a Related Allowance	280	—	—	—	—	—	280
Interest Income Recognized:							
With No Related Allowance	3	—	44	—	5	4	56
With a Related Allowance	—	—	—	—	—	—	—
Cash Basis Income:							
With No Related Allowance	—	—	44	—	—	—	44
With a Related Allowance	—	—	—	—	—	—	—

At June 30, 2013, December 31, 2012 and June 30, 2012, all impaired loans were considered to be collateral dependent and were therefore evaluated for impairment based on the fair value of collateral less estimated cost to sell. There was no allowance for loan losses allocated to impaired loans at June 30, 2013 and June 30, 2012. Interest income recognized in the table above, represents income earned after the loans became impaired and includes restructured loans in compliance with their modified terms and nonaccrual loans where we have recognized interest income on a cash basis.

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Loans Modified in Trouble Debt Restructurings

The following table presents information on loans modified in trouble debt restructurings during the periods indicated:

Loans Modified in Trouble Debt Restructurings During the Period

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
For the Quarter Ended:							
June 30, 2013							
Number of Loans	—	—	—	—	3	—	3
Pre-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$30	$—	$30
Post-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$30	$—	$30
June 30, 2012							
Number of Loans	—	—	—	—	2	—	2
Pre-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$16	$—	$16
Post-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$16	$—	$16
For the Year-To-Date Period Ended:							
June 30, 2013							
Number of Loans	—	—	—	—	5	—	5
Pre-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$41	$—	$41
Post-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$41	$—	$41
June 30, 2012							
Number of Loans	—	—	—	—	7	—	7
Pre-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$60	$—	$60
Post-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$60	$—	$60

In general, loans requiring modification are restructured to accommodate the projected cash-flows of the borrower. As indicated in the table above, no loans modified during the preceding twelve months subsequently defaulted as of June 30, 2013.

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Note 4.   GUARANTEES (In Thousands)

The following table presents the balance for standby letters of credit for the periods ended June 30, 2013, December 31, 2012 and June 30, 2012:

Loan Commitments and Letters of Credit

	06/30/2013	12/31/2012	06/30/2012
Notional Amount:			
Commitments to Extend Credit	$219,622	$198,405	$211,117
Standby Letters of Credit	3,439	10,929	11,389
Fair Value:			
Commitments to Extend Credit	$—	$—	$—
Standby Letters of Credit	56	118	100

Arrow is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit include home equity lines of credit, commitments for residential and commercial construction loans and other personal and commercial lines of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of the involvement Arrow has in particular classes of financial instruments.

Arrow's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. Arrow uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Arrow evaluates each customer's creditworthiness on a case-by-case basis. Home equity lines of credit are secured by residential real estate. Construction lines of credit are secured by underlying real estate. For other lines of credit, the amount of collateral obtained, if deemed necessary by Arrow upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. Most of the commitments are variable rate instruments.

Arrow has issued conditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit at June 30, 2013, December 31, 2012 and June 30, 2012 represent the maximum potential future payments Arrow could be required to make. Typically, these instruments have terms of 12 months or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance sheet instruments. Company policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios will generally range from 50% for movable assets, such as inventory, to 100% for liquid assets, such as bank CD's. Fees for standby letters of credit range from 1% to 3% of the notional amount. Fees are collected upfront and amortized over the life of the commitment. The fair values of Arrow's standby letters of credit at June 30, 2013, December 31, 2012 and June 30, 2012, in the table above, were the same as the carrying amounts. The fair value of standby letters of credit is based on the fees currently charged for similar agreements or the cost to terminate the arrangement with the counterparties.

The fair value of commitments to extend credit is determined by estimating the fees to enter into similar agreements, taking into account the remaining terms and present creditworthiness of the counterparties, and for fixed rate loan commitments, the difference between the current and committed interest rates. Arrow provides several types of commercial lines of credit and standby letters of credit to its commercial customers. The pricing of these services is not isolated as Arrow considers the customer's complete deposit and borrowing relationship in pricing individual products and services. The commitments to extend credit also include commitments under home equity lines of credit, for which Arrow charges no fee. The carrying value and fair value of commitments to extend credit are not material and Arrow does not expect to incur any material loss as a result of these commitments.

Note 5. COMPREHENSIVE INCOME (In Thousands)

The following table presents the components of other comprehensive income for the three and six months ended June 30, 2013 and 2012 :

Schedule of Comprehensive Income

	Three Months Ended June 30,			Six Months Ended June 30,		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
2013						
Net Unrealized Securities Holding Gains Arising During the Period	$(6,034)	$2,391	$(3,643)	$(5,667)	$2,244	$(3,423)
Reclassification Adjustment for Securities Gains Included in Net Income	(13)	5	(8)	(540)	214	(326)
Amortization of Net Retirement Plan Actuarial Loss	392	(156)	236	783	(311)	472
Other Comprehensive Income	$(5,655)	$2,240	$(3,415)	$(5,424)	$2,147	$(3,277)
2012						
Net Unrealized Securities Holding Gains Arising During the Period	$739	$(294)	$445	$577	$(230)	$347
Reclassification Adjustment for Securities Gains Included in Net Income	(143)	57	(86)	(645)	256	(389)
Amortization of Net Retirement Plan Actuarial Loss	379	(150)	229	757	(300)	457
Accretion of Net Retirement Plan Prior Service Credit	(8)	3	(5)	(15)	6	(9)
Other Comprehensive Income	$967	$(384)	$583	$674	$(268)	$406

The following table presents the changes in accumulated other comprehensive income by component:

Changes in Accumulated Other Comprehensive Income by Component (1)

	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Plan Items		
		Net Gain (Loss)	Net Prior Service (Cost) Credit	Total
For the Quarter-To-Date periods ended:				
March 31, 2013	$5,527	$(13,800)	$(51)	$(8,324)
Other comprehensive income before reclassifications	(3,643)	—	—	(3,643)
Amounts reclassified from accumulated other comprehensive income	(8)	236	—	228
Net current-period other comprehensive income	(3,651)	236	—	(3,415)
June 30, 2013	$1,876	$(13,564)	$(51)	$(11,739)
March 31, 2012	$6,407	$(13,481)	$202	$(6,872)
Other comprehensive income before reclassifications	445	—	—	445
Amounts reclassified from accumulated other comprehensive income	(86)	229	(5)	138
Net current-period other comprehensive income	359	229	(5)	583
June 30, 2012	$6,766	$(13,252)	$197	$(6,289)
For the Year-To-Date periods ended:				
December 31, 2012	$5,625	$(14,036)	$(51)	$(8,462)
Other comprehensive income before reclassifications	(3,423)	—	—	(3,423)
Amounts reclassified from accumulated other comprehensive income	(326)	472	—	146
Net current-period other comprehensive income	(3,749)	472	—	(3,277)
June 30, 2013	$1,876	$(13,564)	$(51)	$(11,739)
December 31, 2011	$6,808	$(13,709)	$206	$(6,695)
Other comprehensive income before reclassifications	347	—	—	347
Amounts reclassified from accumulated other comprehensive income	(389)	457	(9)	59
Net current-period other comprehensive income	(42)	457	(9)	406
June 30, 2012	$6,766	$(13,252)	$197	$(6,289)

(1) All amounts are net of tax. Amounts in parentheses indicate debits.

The following table presents the reclassifications out of accumulated other comprehensive income:

Reclassifications Out of Accumulated Other Comprehensive Income [1]

Details about Accumulated Other Comprehensive Income Components	Amounts Reclassified from Accumulated Other Comprehensive Income		Affected Line Item in the Statement Where Net Income Is Presented
For the Quarter-to-date periods ended:			
June 30, 2013			
Unrealized gains and losses on available-for-sale securities			
	$13		Gain on Securities Transactions
	13		Total before tax
	(5	)	Provision for Income Taxes
	$8		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	$—	[2]	Salaries and Employee Benefits
Actuarial gains/(losses)	(392	) [2]	Salaries and Employee Benefits
	(392	)	Total before tax
	156		Provision for Income Taxes
	$(236	)	Net of tax
Total reclassifications for the period	$(228	)	Net of tax
June 30, 2012			
Unrealized gains and losses on available-for-sale securities			
	$143		Gain on Securities Transactions
	143		Total before tax
	(57	)	Provision for Income Taxes
	$86		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	$8	[2]	Salaries and Employee Benefits
Actuarial gains/(losses)	(379	) [2]	Salaries and Employee Benefits
	(371	)	Total before tax
	147		Provision for Income Taxes
	$(224	)	Net of tax
Total reclassifications for the period	$(138	)	Net of tax

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For the Year-to-date periods ended:

June 30, 2013			
Unrealized gains and losses on available-for-sale securities			
	$540		Gain on Securities Transactions
	540		Total before tax
	(214	)	Provision for Income Taxes
	$326		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	$—	(2)	Salaries and Employee Benefits
Actuarial gains/(losses)	(783	) (2)	Salaries and Employee Benefits
	(783	)	Total before tax
	311		Provision for Income Taxes
	$(472	)	Net of tax
Total reclassifications for the period	$(146	)	Net of tax
June 30, 2012			
Unrealized gains and losses on available-for-sale securities			
	$645		Gain on Securities Transactions
	645		Total before tax
	(256	)	Provision for Income Taxes
	$389		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	15	(2)	Salaries and Employee Benefits
Actuarial gains/(losses)	$(757	) (2)	Salaries and Employee Benefits
	(742	)	Total before tax
	294		Provision for Income Taxes
	$(448	)	Net of tax
Total reclassifications for the period	$(59	)	Net of tax

(1) Amounts in parentheses indicate debits to profit/loss.
(2) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see pension footnote for additional details.).

Note 6. STOCK BASED COMPENSATION PLANS

Under our 2008 Long-Term Incentive Plan, we granted options in the first quarter of 2013 to purchase shares of our common stock. The fair values of the options were estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of our grants is expensed over the four year vesting period. Share and per share amounts have been restated for the September 2012 2% stock dividend.

The following table presents a roll-forward of our stock option plans and grants issued during 2013:
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Schedule of Share-based Compensation Arrangements

	Stock Option Plans	
Roll-Forward of Shares Outstanding:		
Outstanding at January 1, 2013	442,385	
Granted	10,000	
Exercised	(23,685	)
Forfeited	(6,520	)
Outstanding at June 30, 2013	422,180	
Exercisable at Period End	302,574	
Vested and Expected to Vest	422,180	
Roll-Forward of Shares Outstanding - Weighted Average Exercise Price:		
Outstanding at January 1, 2013	$23.03	
Granted	24.28	
Exercised	20.93	
Forfeited	25.77	
Outstanding at June 30, 2013	23.14	
Exercisable at Period End	22.67	
Vested and Expected to Vest	23.14	
Grants Issued During 2013 - Weighted Average Information:		
Fair Value	5.57	
Fair Value Assumptions:		
Dividend Yield	4.20	%
Expected Volatility	36.57	%
Risk Free Interest Rate	1.31	%
Expected Lives (in years)	6.71	

The following table presents information on the amounts expensed and remaining amounts to be expensed for the periods ended June 30, 2013 and 2012:
Share-Based Compensation Expense

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
Share-Based Compensation Expense	$92	$108	$189	$207

Arrow also sponsors an Employee Stock Purchase Plan under which employees purchase Arrow's common stock at a 5% discount below market price. Under current accounting guidance, a stock purchase plan with a discount of 5% or less is not considered a compensatory plan.

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Note 7. RETIREMENT PLANS (Dollars in Thousands)

The following tables provide the components of net periodic benefit costs for the three and six-month periods ended June 30:

	Employees' Pension Plan	Select Executive Retirement Plan	Postretirement Benefit Plans
Net Periodic Benefit Cost			
For the Three Months Ended June 30, 2013:			
Service Cost	$367	$5	$51
Interest Cost	276	10	69
Expected Return on Plan Assets	(716)	—	—
Amortization of Prior Service Cost (Credit)	9	20	(29)
Amortization of Net Loss	312	38	42
Net Periodic Benefit Cost	$248	$73	$133
Plan Contributions During the Period	—	110	94
For the Three Months Ended June 30, 2012:			
Service Cost	$339	$19	$45
Interest Cost	534	51	93
Expected Return on Plan Assets	(755)	—	—
Amortization of Prior Service (Credit) Cost	10	11	(29)
Amortization of Net Loss	311	35	33
Net Periodic Benefit Cost	$439	$116	$142
Plan Contributions During the Period	$—	$80	$158
Net Periodic Benefit Cost			
For the Six Months Ended June 30, 2013:			
Service Cost	$734	$27	$102
Interest Cost	629	48	150
Expected Return on Plan Assets	(1,432)	—	—
Amortization of Prior Service Cost (Credit)	18	40	(58)
Amortization of Net Loss	624	76	83
Net Periodic Benefit Cost	$573	$191	$277
Plan Contributions During the Period	$—	$221	$175
Estimated Future Contributions in the Current Fiscal Year	$—	$221	$175
For the Six Months Ended June 30, 2012:			
Service Cost	$679	$38	$90
Interest Cost	938	102	181
Expected Return on Plan Assets	(1,510)	—	—

Amortization of Prior Service (Credit) Cost	20	22	(57)
Amortization of Net Loss	621	70	66
Net Periodic Benefit Cost	$748	$232	$280
Plan Contributions During the Period	$—	$160	$231

We are not required to make a contribution to our qualified pension plan in 2013, and currently, we do not expect to make a contribution in 2013. Arrow makes contributions to its other post-retirement benefit plans in an amount equal to actual expenses for the year.

Note 8. EARNINGS PER COMMON 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 periods ended June 30, 2013 and 2012. All share and per share amounts have been adjusted for the September 2012 2% stock dividend.

Earnings Per Share

	Quarterly Period Ended:		Year-to-Date Period Ended:	
	6/30/2013	6/30/2012	6/30/2013	6/30/2012
Earnings Per Share - Basic:				
Net Income	$5,207	$5,594	$10,388	$10,882
Weighted Average Shares - Basic	12,021	11,994	12,026	12,000
Earnings Per Share - Basic	$0.43	$0.47	$0.86	$0.91
Earnings Per Share - Diluted:				
Net Income	$5,207	$5,594	$10,388	$10,882
Weighted Average Shares - Basic	12,021	11,994	12,026	12,000
Dilutive Average Shares Attributable to Stock Options	17	15	18	19
Weighted Average Shares - Diluted	12,038	12,009	12,044	12,019
Earnings Per Share - Diluted	$0.43	$0.47	$0.86	$0.91
Antidilutive Shares Excluded from the Calculation of Earnings Per Share	124	209	126	209

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Note 9. FAIR VALUE OF FINANCIAL INSTRUMENTS (In Thousands)

FASB ASC Subtopic 820-10 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and requires certain disclosures about fair value measurements. We do not have any nonfinancial assets or liabilities measured at fair value on a recurring basis. The only assets or liabilities that Arrow measured at fair value on a recurring basis at June 30, 2013, December 31, 2012 and June 30, 2012 were securities available-for-sale. Arrow held no securities or liabilities for trading on such date.

The table below presents the financial instrument's fair value and the amounts within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement:

Fair Value of Assets and Liabilities Measured on a Recurring and Nonrecurring Basis

		Fair Value Measurements at Reporting Date Using:		
	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair Value of Assets and Liabilities Measured on a Recurring Basis:				
June 30, 2013				
Securities Available-for Sale:				
U.S. Agency Obligations	$150,046	$—	$150,046	$—
State and Municipal Obligations	130,444	—	130,444	—
Mortgage-Backed Securities - Residential	203,230	—	203,230	—
Corporate and Other Debt Securities	16,711	—	16,711	—
Mutual Funds and Equity Securities	1,143	—	1,143	—
Total Securities Available-for-Sale	$501,574	$—	$501,574	$—
December 31, 2012				
Securities Available-for Sale:				
U.S. Agency Obligations	$122,457	$—	$122,457	$—
State and Municipal Obligations	84,838	—	84,838	—
Mortgage-Backed Securities - Residential	261,804	—	261,804	—
Corporate and Other Debt Securities	8,451	—	8,451	—
Mutual Funds and Equity Securities	1,148	—	1,148	—
Total Securities Available-for Sale	$478,698	$—	$478,698	$—
June 30, 2012				
Securities Available-for Sale:				
U.S. Agency Obligations	$48,655	$—	$48,655	$—
State and Municipal Obligations	55,013	—	55,013	—
Mortgage-Backed Securities - Residential	325,076	—	325,076	—
Corporate and Other Debt Securities	801	—	801	—
Mutual Funds and Equity Securities	1,465	249	1,216	—
Total Securities Available-for Sale	$431,010	$249	$430,761	$—

Fair Value of Assets and Liabilities Measured on a Nonrecurring Basis:

June 30, 2013

Collateral Dependent Impaired Loans	$—	$—	$—	$—
Other Real Estate Owned and Repossessed Assets, Net	$1,175	$—	$—	$1,175
December 31, 2012				
Collateral Dependent Impaired Loans	$1,020	$—	$—	$1,020
Other Real Estate Owned and Repossessed Assets, Net	$1,034	$—	$—	$1,034
June 30, 2012				
Collateral Dependent Impaired Loans	$486	$—	$—	$486
Other Real Estate Owned and Repossessed Assets, Net	$837	$—	$—	$837

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We determine the fair value of financial instruments under the following hierarchy:

- 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 for identical or similar assets or liabilities 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).

Fair Value Methodology for Assets and Liabilities Measured on a Recurring Basis

The fair value of level 1 securities available-for-sale are based on unadjusted, quoted market prices from exchanges in active markets. The fair value of level 2 securities available-for-sale are based on an independent bond and equity pricing service for identical assets or significantly similar securities and an independent equity pricing service for equity securities not actively traded. The pricing services use a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Fair Value Methodology for Assets and Liabilities Measured on a Nonrecurring Basis

The fair value of collateral dependent impaired loans was based on third-party appraisals of the collateral.

The fair value of other real estate owned was based on third-party appraisals.

Other assets which might have been included in this table include mortgage servicing rights, goodwill and other intangible assets. Arrow evaluates each of these assets for impairment on an annual basis, with no impairment recognized for these assets at June 30, 2013, December 31, 2012 and June 30, 2012.

Fair Value by Balance Sheet Grouping

The following table presents a summary of the carrying amount, the fair value or an amount approximating fair value and the fair value hierarchy of Arrow's financial instruments:

Schedule of Fair Values by Balance Sheet Grouping

			Fair Value Hierarchy		
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
June 30, 2013					
Cash and Cash Equivalents	$44,600	$44,600	$44,600	$—	$—
Securities Available-for-Sale	501,574	501,574	—	501,574	—
Securities Held-to-Maturity	248,914	252,691	—	252,691	—
Federal Home Loan Bank and Federal Reserve Bank Stock	6,136	6,136	6,136	—	—
Net Loans	1,190,056	1,198,430	—	—	1,198,430
Accrued Interest Receivable	5,708	5,708	5,708	—	—
Deposits	1,779,905	1,776,590	1,510,867	265,723	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	14,738	14,738	14,738	—	—
Federal Home Loan Bank Term Advances	70,000	70,267	40,000	30,267	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	493	493	493	—	—
December 31, 2012					
Cash and Cash Equivalents	$48,832	$48,832	$48,832	$—	$—
Securities Available-for-Sale	478,698	478,698	—	478,698	—
Securities Held-to-Maturity	239,803	248,252	—	248,252	—
Federal Home Loan Bank and Federal Reserve Bank Stock	5,792	5,792	5,792	—	—
Net Loans	1,157,043	1,192,628	—	—	1,192,628
Accrued Interest Receivable	5,486	5,486	5,486	—	—
Deposits	1,731,155	1,732,894	1,447,882	285,012	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	12,678	12,678	12,678	—	—
Federal Home Loan Bank Term Advances	59,000	60,312	29,000	31,312	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	584	584	584	—	—
June 30, 2012					
Cash and Cash Equivalents	$57,751	$57,751	$57,751	$—	$—
Securities Available-for-Sale	431,010	431,010	249	430,761	—
Securities Held-to-Maturity	252,902	261,574	—	261,574	—
Federal Home Loan Bank and Federal Reserve Bank Stock	4,479	4,479	4,479	—	—

Net Loans	1,131,430	1,156,811	—	—	1,156,811
Accrued Interest Receivable	5,712	5,712	5,712	—	—
Deposits	1,704,883	1,708,994	1,380,904	328,090	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	16,097	16,097	16,097	—	—
Federal Home Loan Bank Term Advances	30,000	31,269	—	31,269	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	898	898	898	—	—

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Fair Value Methodology for Financial Instruments Not Measured on a Recurring or Nonrecurring Basis

Securities held-to-maturity are fair valued utilizing an independent bond pricing service for identical assets or significantly similar securities. The pricing service uses a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Fair values for loans are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial real estate, residential mortgage, indirect and other consumer loans. Each loan category is further segmented into fixed and adjustable interest rate terms and by performing and nonperforming categories. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions.   Fair value for nonperforming loans is generally based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discount rates are judgmentally determined using available market information and specific borrower information.

The fair value of time deposits is based on the discounted value of contractual cash flows, except that the fair value is limited to the extent that the customer could redeem the certificate after imposition of a premature withdrawal penalty. The discount rates are estimated using the FHLBNY yield curve, which is considered representative of Arrow’s time deposit rates. The fair value of all other deposits is equal to the carrying value.

The fair value of FHLBNY advances is estimated based on the discounted value of contractual cash flows. The discount rate is estimated using current rates on FHLBNY advances with similar maturities and call features.

Based on Arrow’s capital adequacy, the book value of the outstanding trust preferred securities (Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts) are considered to approximate fair value since the interest rates are variable (indexed to LIBOR) and Arrow is well-capitalized.

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders
Arrow Financial Corporation:

We have reviewed the consolidated balance sheets of Arrow Financial Corporation and subsidiaries (the Company) as of June 30, 2013 and 2012, and the related consolidated statements of income and comprehensive income for the three and six-month periods ended June 30, 2013 and 2012, and the related consolidated statements of changes in stockholders' equity and cash flows for the six-month periods ended June 30, 2013 and 2012. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Arrow Financial Corporation and subsidiaries as of December 31, 2012, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 15, 2013, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2012, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP
Albany, New York
August 7, 2013

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
June 30, 2013

Note on Terminology - In this Quarterly Report on Form 10-Q, the terms “Arrow,” “the registrant,” “the company,” “we,” “us, and “our” generally refer to Arrow Financial Corporation and its subsidiaries as a group, except where the context indicates otherwise.

The Company and Its Subsidiaries - Arrow is a two-bank holding company headquartered in Glens Falls, New York. Our banking subsidiaries are Glens Falls National Bank and Trust Company (Glens Falls National) whose main office is located in Glens Falls, New York, and Saratoga National Bank and Trust Company (Saratoga National) whose main office is located in Saratoga Springs, New York. Our non-bank subsidiaries include Capital Financial Group, Inc. (an insurance agency specializing in selling and servicing group health care policies); three property and casualty insurance agencies: Loomis & LaPann, Inc., Upstate Agency LLC, and McPhillips Agency which is a division of Glens Falls National Insurance Agencies LLC; North Country Investment Advisers, Inc. (a registered investment adviser that provides investment advice to our proprietary mutual funds); Glens Falls National Community Development Corporation (which invests in qualifying community development projects); and Arrow Properties, Inc. (a real estate investment trust, or REIT). All of these are wholly owned or majority owned subsidiaries of Glens Falls National.

Our Peer Group - At certain points in this Report, our performance is compared with that of our “peer group” of financial institutions. Unless otherwise specifically stated, this peer group is comprised of the group of 351 domestic bank holding companies with \$1 to \$3 billion in total consolidated assets as identified in the Federal Reserve Board’s “Bank Holding Company Performance Report” for March 31, 2013 (the most recent such Report currently available), and peer group data has been derived from such Report.

Forward Looking Statements - The information contained in this Quarterly Report on Form 10-Q contains statements that are not historical in nature but rather are based on our beliefs, assumptions, expectations, estimates and projections about the future. These statements are “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and involve a degree of uncertainty and attendant risk. Words such as “expects,” “believes,” “anticipates,” “estimates” and variations of such words and similar expressions are intended to identify such forward-looking statements. Some of these statements, such as those included in the interest rate sensitivity analysis in Part I, Item 3, entitled “Quantitative and Qualitative Disclosures About Market Risk,” are merely presentations of what future performance or changes in future performance would look like based on hypothetical assumptions and on simulation models. Other forward-looking statements are based on our general perceptions of market conditions and trends in business activity, both our own and in the banking industry generally, as well as current management strategies for future operations and development.

Examples of Forward-Looking Statements:

Topic	Page	Location
Impact of Heath Care Reform	40	"Health care reform"
Impact of market rate structure on net interest margin, loan yields and deposit rates	44	2nd paragraph under "Recent Pressure on Our Net Interest Margin"
	44	"Potential Inflation; Effect on Interest Rates and Margin"
	47	Last paragraph under "Quarterly Taxable Equivalent Yield on Loans"
Provision for loan losses	50	1st paragraph in section
Future level of nonperforming assets	51	Last 3 paragraphs under "Risk Elements"

Future level of residential real estate loans	46	"Maintenance of High Quality in the Loan Portfolio"
Future level of indirect consumer loans	47	Last paragraph under "Automobile Loans"
Future level of commercial loans	47	3rd paragraph under "Commercial, Commercial Real Estate and Construction and Land Development Loans"
Impact of changing capital standards and legislative developments	40	"Dodd-Frank Act"
	51	"Important Proposed Changes to Regulatory Capital Standards"
Liquidity	54	6th paragraph
Fees for other services to customers	56	3rd paragraph under "Noninterest Income"
	58	3rd paragraph under "Noninterest Income"

These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to quantify or, in some cases, to identify. In the case of all forward-looking statements, actual outcomes and results may differ materially from what the statements predict or forecast. Factors that could cause or contribute to such differences include, but are not limited to:

a. rapid and dramatic changes in economic and market conditions, such as the U.S. economy experienced in the early stages of the "financial crisis" particularly, 2008-2009;
b. sharp fluctuations in interest rates, economic activity, and consumer spending patterns;
c. sudden changes in the market for products we provide, such as real estate loans;
d. significant new banking laws and regulations, including the wide array of new banking regulations still to be issued under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2011 (the Dodd-Frank Act or Dodd-Frank);
e. unexpected or enhanced competition from new or unforeseen sources; and
f. similar uncertainties inherent in banking operations or business generally.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We undertake no obligation to revise or update these forward-looking statements to reflect the occurrence of unanticipated events. This Quarterly Report should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012.

USE OF NON-GAAP FINANCIAL MEASURES

The Securities and Exchange Commission (SEC) has adopted Regulation G, which applies to all public disclosures, including earnings releases, made by registered companies that contain “non-GAAP financial measures.” GAAP is generally accepted accounting principles in the United States of America. Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure and a statement of the Company’s reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. The SEC has exempted from the definition of “non-GAAP financial measures” certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. The following measures used in this Report, which are commonly utilized by financial institutions, have not been specifically exempted by the SEC and may constitute "non-GAAP financial measures" within the meaning of the SEC's new rules, although we are unable to state with certainty that the SEC would so regard them.

Tax-Equivalent Net Interest Income and Net Interest Margin: Net interest income, as a component of the tabular presentation by financial institutions of Selected Financial Information regarding their recently completed operations, is commonly presented on a tax-equivalent basis. That is, to the extent that some component of the institution's net interest income, which is presented on a before-tax basis, is exempt from taxation (e.g., is received by the institution as a result of its holdings of state or municipal obligations), an amount equal to the tax benefit derived from that component is added to the actual before-tax net interest income total. This adjustment is considered helpful in comparing one financial institution's net interest income to that of other institutions or in analyzing any institution’s net interest income trend line over time, to correct any analytical distortion that might otherwise arise from the fact that financial institutions vary widely in the proportions of their portfolios that are invested in tax-exempt securities, and that even a single institution may significantly alter over time the proportion of its own portfolio that is invested in tax-exempt obligations. Moreover, net interest income is itself a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, tax-equivalent net interest income is generally used by financial institutions, as opposed to actual net interest income, again to provide a better basis of comparison from institution to institution and to better demonstrate a single institution’s performance over time. We follow these practices.

The Efficiency Ratio: Financial institutions often use an "efficiency ratio" as a measure of expense control. The efficiency ratio typically is defined as the ratio of noninterest expense to net interest income and noninterest income. Net interest income as utilized in calculating the efficiency ratio is, once again, typically expressed on a tax-equivalent basis (see preceding paragraph). Moreover, most financial institutions, in calculating the efficiency ratio, also adjust both noninterest expense and noninterest income to exclude from these items (as calculated under GAAP) certain recurring component elements of income and expense, such as intangible asset amortization (deducted from noninterest expense) and securities gains or losses (excluded from noninterest income). We follow these practices.

Tangible Book Value per Share: Tangible equity is total stockholders' equity less intangible assets. Tangible book value per share is tangible equity divided by total shares issued and outstanding. Tangible book value per share is often regarded as a more meaningful comparative ratio than book value per share as calculated under GAAP, that is, total stockholders' equity including intangible assets divided by total shares issued and outstanding. Intangible assets includes many items, but essentially represents goodwill for Arrow.

Adjustments for Certain Items of Income or Expense: In addition to our disclosures of certain GAAP financial measures, including net income, earnings per share (i.e. EPS), return on average assets (i.e. ROA), return on average equity (i.e. ROE), we may also provide comparative disclosures that adjust these GAAP financial measures for a particular period by removing from the calculation thereof the impact of certain transactions or other material items of income or expense occurring during the period, including certain nonrecurring items. We believe that the resulting non-GAAP financial measures may improve an understanding of our results of operations by separating out any such transactions or items that may have had a disproportionate positive or negative impact during the particular period in question. Additionally, we believe that in certain cases such adjustments may provide a better comparison from period to period in our results of operations with respect to our fundamental lines of business including the commercial banking business. In our presentation of any such non-GAAP (adjusted) financial measures not specifically discussed in the preceding paragraphs, we supply the supplemental financial information and explanations required under Regulation G.

We believe that the non-GAAP financial measures disclosed by us from time-to-time are useful in evaluating our performance and that such information should be considered as supplemental in nature and not as a substitute for or superior to the related financial information prepared in accordance with GAAP. Our non-GAAP financial measures may differ from similar measures presented by other companies.

Selected Quarterly Information - Unaudited (dollars in thousands)

Quarter Ended	06/30/2013	03/31/2013	12/31/2012	09/30/2012	06/30/2012
Net Income	$5,207	$5,181	$5,549	$5,748	$5,594
Transactions Recorded in Net Income (Net of Tax):					
Net Gain on Securities Transactions	8	318	94	39	86
Net Gain on Sales of Loans	301	367	476	362	324
Reversal of the VISA Litigation Reserve	—	—	—	—	178
Share and Per Share Data:[1]					
Period End Shares Outstanding	12,043	12,010	12,025	12,034	12,001
Basic Average Shares Outstanding	12,021	12,031	12,014	12,012	11,994
Diluted Average Shares Outstanding	12,038	12,049	12,032	12,032	12,009
Basic Earnings Per Share	$0.43	$0.43	$0.46	$0.48	$0.47
Diluted Earnings Per Share	0.43	0.43	0.46	0.48	0.47
Cash Dividend Per Share	0.25	0.25	0.25	0.25	0.25
Selected Quarterly Average Balances:					
Interest-Bearing Deposits at Banks	$26,632	$41,145	$40,065	$33,332	$55,023
Investment Securities	771,018	711,848	745,150	670,328	682,589
Loans	1,185,041	1,169,870	1,160,226	1,148,771	1,143,666
Deposits	1,801,346	1,773,126	1,781,778	1,701,599	1,733,320
Other Borrowed Funds	94,596	64,622	80,357	68,667	66,022
Shareholders’ Equity	178,867	176,874	176,514	174,069	170,199
Total Assets	2,099,138	2,039,314	2,064,602	1,971,215	1,994,883
Return on Average Assets	0.99 %	1.03 %	1.07 %	1.16 %	1.13 %
Return on Average Equity	11.68 %	11.88 %	12.51 %	13.14 %	13.22 %
Return on Tangible Equity[2]	13.70 %	13.97 %	14.72 %	15.50 %	15.67 %
Average Earning Assets	$1,982,691	$1,922,863	$1,945,441	$1,852,431	$1,881,278
Average Interest-Bearing Liabilities	1,641,300	1,590,401	1,612,959	1,511,634	1,565,692
Interest Income, Tax-Equivalent	16,989	17,059	17,787	18,168	18,508
Interest Expense	2,223	2,239	2,503	2,643	3,279
Net Interest Income, Tax-Equivalent	14,766	14,820	15,284	15,525	15,229
Tax-Equivalent Adjustment	1,180	1,063	1,047	1,000	975
Net Interest Margin [3]	2.99 %	3.13 %	3.13 %	3.33 %	3.26 %
Efficiency Ratio Calculation:					
Noninterest Expense	$13,274	$13,411	$13,117	$12,922	$12,651
Less: Intangible Asset Amortization	(112)	(124)	(126)	(126)	(127)
Net Noninterest Expense	$13,162	$13,287	$12,991	$12,796	$12,524
Net Interest Income, Tax-Equivalent	$14,766	$14,820	$15,284	$15,525	$15,229
Noninterest Income	7,071	7,174	6,897	6,835	6,808
Less: Net Securities Gains	(13)	(527)	(156)	(64)	(143)
Net Gross Income	$21,824	$21,467	$22,025	$22,296	$21,894
Efficiency Ratio	60.31 %	61.90 %	58.98 %	57.39 %	57.20 %
Period-End Capital Information:					
Total Stockholders’ Equity (i.e. Book Value)	$177,607	$177,803	$175,825	$176,314	$171,940
Book Value per Share	14.75	14.80	14.62	14.65	14.33
Intangible Assets	26,387	26,460	26,495	26,546	26,611
Tangible Book Value per Share [2]	12.56	12.60	12.42	12.45	12.11
Capital Ratios:					
Tier 1 Leverage Ratio	9.19 %	9.30 %	9.10 %	9.41 %	9.09 %

Tier 1 Risk-Based Capital Ratio	14.82 %	15.15 %	15.02 %	15.20 %	15.08 %
Total Risk-Based Capital Ratio	15.96 %	16.34 %	16.26 %	16.45 %	16.34 %
Assets Under Trust Administration and Investment Management	$1,073,523	$1,094,708	$1,045,972	$1,051,176	$1,019,702

[1]Share and Per Share Data have been restated for the September 27, 2012 2% stock dividend.
[2]Tangible Book Value and Tangible Equity exclude intangible assets from total equity. These are non-GAAP financial measures which we believe provide investors with information that is useful in understanding our financial performance (see page 35).
[3]Net Interest Margin is the ratio of our annualized tax-equivalent net interest income to average earning assets. This is also a non-GAAP financial measure which we believe provides investors with information that is useful in understanding our financial performance (see page 35).

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Selected Six-Month Period Information
(Dollars In Thousands, Except Per Share Amounts)

Year-to-Date Period Ended	06/30/2013	06/30/2012
Net Income	10,388	$10,882
Transactions Recorded in Net Income (Net of Tax):		
Net Securities Gains	326	389
Net Gain on Sales of Loans	667	540
Reversal of the VISA Litigation Reserve	—	178
Period-End Shares Outstanding	12,043	12,001
Basic Average Shares Outstanding	12,026	12,000
Diluted Average Shares Outstanding	12,044	12,019
Basic Earnings Per Share	$0.86	$0.91
Diluted Earnings Per Share	0.86	0.91
Cash Dividends Per Share	0.50	0.49
Average Assets	$2,069,391	$1,977,312
Average Equity	177,876	169,024
Return on Average Assets	1.01 %	1.11 %
Return on Average Equity	11.78 %	12.95 %
Average Earning Assets	$1,952,943	$1,863,428
Average Interest-Bearing Liabilities	1,615,991	1,555,394
Interest Income, Tax-equivalent [1]	34,048	37,318
Interest Expense	4,462	6,811
Net Interest Income, Tax-equivalent [1]	29,586	30,507
Tax-equivalent Adjustment	2,243	1,847
Net Interest Margin [1]	3.05 %	3.29 %
Efficiency Ratio Calculation [1]		
Noninterest Expense	$26,685	$25,797
Less: Intangible Asset Amortization	(236)	(265)
Net Noninterest Expense	$26,449	$25,532
Net Interest Income, Tax-equivalent [1]	$29,586	$30,507
Noninterest Income	14,245	13,367
Less: Net Securities Gains	(540)	(645)
Net Gross Income, Adjusted	$43,291	$43,229
Efficiency Ratio [1]	61.10 %	59.06 %
Period-End Capital Information:		
Tier 1 Leverage Ratio	9.24 %	9.23 %
Total Stockholders' Equity (i.e. Book Value)	$177,607	$171,940
Book Value per Share	14.75	14.33
Intangible Assets	26,387	26,611
Tangible Book Value per Share [1]	12.56	12.11
Asset Quality Information:		
Net Loans Charged-off as a Percentage of Average Loans, Annualized	0.14 %	0.06 %
Provision for Loan Losses as a Percentage of Average Loans, Annualized	0.03 %	0.09 %
Allowance for Loan Losses as a	1.22 %	1.33 %

Percentage of Period-end Loans				
Allowance for Loan Losses as a Percentage of Nonperforming Loans	215.47	%	194.12	%
Nonperforming Loans as a Percentage of Period-end Loans	0.57	%	0.68	%
Nonperforming Assets as a Percentage of Period-end Total Assets	0.38	%	0.44	%

[1] See “Use of Non-GAAP Financial Measures” on page 35.

Average Consolidated Balance Sheets and Net Interest Income Analysis
(see “Use of Non-GAAP Financial Measures” on page 35)
(Fully Taxable Basis using a marginal tax rate of 35%)
(Dollars In Thousands)

Quarter Ended June 30:	2013			2012		
	Average Balance	Interest Income/ Expense	Rate Earned/ Paid	Average Balance	Interest Income/ Expense	Rate Earned/ Paid
Interest-Bearing Deposits at Banks	$26,632	$19	0.29 %	$55,023	$36	0.26 %
Investment Securities:						
Fully Taxable	437,318	1,644	1.51	457,354	2,485	2.19
Exempt from Federal Taxes	333,700	2,612	3.14	225,235	2,285	4.08
Loans	1,185,041	12,714	4.30	1,143,666	13,702	4.82
Total Earning Assets	1,982,691	16,989	3.44	1,881,278	18,508	3.96
Allowance for Loan Losses	(14,606)			(15,135)		
Cash and Due From Banks	29,965			29,981		
Other Assets	101,088			98,759		
Total Assets	$2,099,138			$1,994,883		
Deposits:						
NOW Accounts	$796,330	786	0.40	$733,600	976	0.54
Savings Deposits	479,480	277	0.23	431,896	329	0.31
Time Deposits of $100,000 or More	87,059	305	1.41	111,766	569	2.05
Other Time Deposits	183,835	505	1.10	222,408	1,074	1.94
Total Interest-Bearing Deposits	1,546,704	1,873	0.49	1,499,670	2,948	0.79
Short-Term Borrowings	44,596	33	0.30	16,022	5	0.13
FHLBNY Term Advances and Other Long-Term Debt	50,000	317	2.54	50,000	326	2.62
Total Interest-Bearing Liabilities	1,641,300	2,223	0.54	1,565,692	3,279	0.84
Demand Deposits	254,642			233,650		
Other Liabilities	24,329			25,342		
Total Liabilities	1,920,271			1,824,684		
Stockholders’ Equity	178,867			170,199		
Total Liabilities and Stockholders’ Equity	$2,099,138			$1,994,883		
Net Interest Income (Tax-equivalent Basis)		14,766			15,229	
Reversal of Tax Equivalent Adjustment		(1,180)	0.24 %		(975)	0.21 %
Net Interest Income		$13,586			$14,254	
Net Interest Spread			2.90 %			3.12 %
Net Interest Margin			2.99 %			3.26 %

Average Consolidated Balance Sheets and Net Interest Income Analysis
(see "Use of Non-GAAP Financial Measures" on page 35)
(Fully Taxable Basis using a marginal tax rate of 35%)
(Dollars In Thousands)

Six-Month Period Ended June 30:	2013			2012		
	Average Balance	Interest Income/ Expense	Rate Earned/ Paid	Average Balance	Interest Income/ Expense	Rate Earned/ Paid
Interest-Bearing Deposits at Banks	$33,848	$46	0.27 %	$42,902	$57	0.27 %
Investment Securities:						
Fully Taxable	439,980	3,444	1.58	469,889	5,128	2.19
Exempt from Federal Taxes	301,617	4,993	3.34	210,642	4,399	4.20
Loans	1,177,498	25,565	4.38	1,139,995	27,734	4.89
Total Earning Assets	1,952,943	34,048	3.52	1,863,428	37,318	4.03
Allowance for Loan Losses	(14,955)			(15,072)		
Cash and Due From Banks	30,298			29,876		
Other Assets	101,105			99,080		
Total Assets	$2,069,391			$1,977,312		
Deposits:						
NOW Accounts	$794,012	1,564	0.40	$711,291	2,035	0.58
Savings Deposits	467,462	545	0.24	428,571	686	0.32
Time Deposits of $100,000 or More	89,179	624	1.41	116,439	1,177	2.03
Other Time Deposits	185,646	1,059	1.15	224,555	2,220	1.99
Total Interest-Bearing Deposits	1,536,299	3,792	0.50	1,480,856	6,118	0.83
Short-Term Borrowings	29,692	36	0.24	23,934	11	0.09
FHLBNY Term Advances and Other Long-Term Debt	50,000	634	2.56	50,604	682	2.71
Total Interest-Bearing Liabilities	1,615,991	4,462	0.56	1,555,394	6,811	0.88
Demand Deposits	251,015			227,694		
Other Liabilities	24,509			25,200		
Total Liabilities	1,891,515			1,808,288		
Stockholders' Equity	177,876			169,024		
Total Liabilities and Stockholders' Equity	$2,069,391			$1,977,312		
Net Interest Income (Tax-equivalent Basis)		29,586			30,507	
Reversal of Tax Equivalent Adjustment		(2,243)	0.23 %		(1,847)	0.20 %
Net Interest Income		$27,343			$28,660	
Net Interest Spread			2.96 %			3.15 %
Net Interest Margin			3.05 %			3.29 %

OVERVIEW

We reported net income for the second quarter of 2013 of $5.2 million, representing diluted earnings per share (EPS) of $0.43. This was a decrease of four cents, or 8.5%, from the EPS of 0.47 reported for the second quarter of 2012. Return on average equity (ROE) for the 2013 quarter continued to be strong at 11.68%, although a decrease from the ROE of 13.22% for the quarter ended June 30, 2012. Return on average assets (ROA) for the 2013 quarter also continued to be strong at 0.99%, a decrease from ROA of 1.13% for the quarter ended June 30, 2012. The decrease in our 2013 results was primarily attributable to a decrease in net interest income, which itself was a direct result of the narrowing of our net interest margin between the two periods. Net interest income was $14,766 thousand on a tax-equivalent basis, a decrease of $463 thousand, or 3.0%, from net interest income of $15,229 thousand for the quarter ended June 30, 2012. Total assets were $2.083 billion at June 30, 2013, which represented an increase of $60.4 million, or 3.0%, above the level at December 31, 2012, and an increase of $116.2 million, or 5.9%, from the June 30, 2012 level.

The changes in net income, net interest income and net interest margin between the three and six-month periods are more fully described under the heading "RESULTS OF OPERATIONS," beginning on page 55. See also, "CHANGE IN FINANCIAL CONDITIONS - Impact of Interest Rate Changes," on page 44.

Stockholders' equity was $177.6 million at June 30, 2013, an increase of $5.7 million, or 3.3%, from the year earlier level. Stockholders' equity was also up $1.8 million, or 1.0%, from the December 31, 2012 level of $175.8 million. The components of the change in stockholders' equity since year-end 2012 are presented in the Consolidated Statement of Changes in Stockholders' Equity on page 6, and are discussed in more detail in the last section of this Overview on page 41 entitled, "Increase in Stockholder Equity."

Regulatory capital: At period-end, we continued to exceed all current regulatory minimum capital requirements at both the holding company and bank levels, by a substantial amount. As of June 30, 2013 both of our banks, as well as our holding company, qualified as "well-capitalized" under federal bank regulatory guidelines. Our regulatory capital levels have consistently remained well in excess of required minimums during recent years, despite the economic downturn, because of our continued profitability and strong asset quality. Even under the new enhanced bank capital requirements, recently adopted by all U.S. federal bank regulators, which will become effective for community banks like ours on January 1, 2015, Arrow and its banks would be deemed well-capitalized. See the discussions of "Current Capital Standards" under the “CURRENT REGULATORY CAPITAL STANDARDS" section beginning on page 52, and “Important Future Changes to Regulatory Capital Standards” under the "CAPITAL RESOURCES" section beginning on page 51.

Economic recession and loan quality: During the early stages of the financial crisis in late 2008 and early 2009, our market area of northeastern New York State was relatively sheltered from the widespread collapse in real estate values and general surge in unemployment. This may have been due, in part, to the fact that our market area was less affected by the preceding real estate “bubble” than other areas of the U.S. As the recession became stronger and deeper through late 2009, even northeastern New York began to feel the impact of the worsening national economy including a slow-down in regional real estate sales and increasing unemployment rates. From year-end 2009 and through most of 2010, we experienced a very modest decline in the credit quality of our loan portfolio, although by standard measures our portfolio continued to be significantly stronger than the average for our peer group of U.S. bank holding companies with $1 billion to $3 billion in total assets (see page 34 for peer group information).

By year-end 2010, our loan quality, to the limited extent it had declined at all, began to stabilize, a trend that continued through 2011 and 2012. During this period, although nonperforming loans increased slightly, net charge-offs decreased. However, in the first quarter of 2013, we charged-off one commercial loan for $753 thousand, which had been fully reserved at December 31, 2012. This charge-off led to an annualized charge-offs to average loans ratio for the first quarter of 0.28%. Otherwise, our ratio of net charge-offs to average loans (annualized) remained at very low levels throughout the 2011 and 2012 periods, as well as for the first six months of 2013. Our net charge-offs for the second quarter of 2013 were $25 thousand as compared to $82 thousand for the 2012 quarter. Our ratio of net charge-offs to average loans (annualized) for the second quarter of 2013 was 0.01% versus 0.03% for the second quarter of 2012. By contrast, our peer group's ratio of net charge-offs to average loans (annualized) for the first quarter of 2013 was 0.25% . At June 30, 2013, our allowance for loan losses was $14.7 million representing 1.22% of total loans, down eight basis points from the December 31, 2012 ratio.

Nonperforming loans were $6.8 million at June 30, 2013, representing 0.57% of period-end loans. By way of comparison, this ratio for our peer group was 2.01% at March 31, 2013, which was a significant improvement from the peer group's ratio of 3.60% at year-end 2010, but still very high when compared to the group's ratio of 1.09% at December 31, 2007.

Since the onset of the financial crisis in 2008, we have not experienced significant deterioration in any of our three major loan portfolio segments:

Commercial Loans: These loans comprise approximately 31% of our loan portfolio. Current unemployment rates in our region are higher than in the past few years and the total number of jobs has decreased, but these trends are largely attributable to a scaling back of local operations on the part of a few large corporations having operations in our service area. Commercial property values have not shown significant deterioration. We update the appraisals on our nonperforming and watched commercial loan properties as deemed necessary, usually when the loan is downgraded or when we perceive significant market deterioration since our last appraisal.

Residential Real Estate Loans: These loans, including home equity loans, make up approximately 37% of our portfolio. We have not experienced a notable increase in our foreclosure or loss rates on our residential real estate loans, primarily due to the fact that we never have originated or participated in underwriting high-risk mortgage loans, such as so called “Alt A,” “negative amortization,” “option ARM's” or “negative equity” loans. We originated all of the residential real estate loans currently held in our portfolio and apply conservative underwriting standards to our originations.

Automobile Loans (Primarily Through Indirect Lending): These loans comprise approximately 31% of our loan portfolio. Throughout 2010, 2011, 2012 and the first six months of 2013, we did not experience any significant change in our delinquency rate or level of charge-offs on these loans.

Recent legislative developments:

(i) Dodd-Frank Act: As a result of the 2008-2009 financial crisis, the U.S. Congress passed and the President signed into law the Dodd-Frank Act on July 21, 2010. While many of the Act's provisions have not had and likely will not have any direct impact on Arrow, other provisions have impacted or likely will impact our business operations and financial results in a significant way. These include the establishment of a new regulatory body known as the Bureau of Consumer Financial Protection. (See the discussion on p. 9 under "The Dodd-Frank Act" regarding the likely impact on Arrow of the Bureau of Consumer Financial Protection.) Dodd-Frank also directs the federal banking authorities to issue new capital requirements for banks and holding companies that must be at least as strict as the pre-existing capital requirements for depository institutions and may be much more onerous. The Federal Reserve Board and other federal bank authorities recently issued the final bank capital rules required to be issued by them under Dodd-Frank, which are scheduled to take effect in upcoming periods. See the discussion under "Important Future Changes to Regulatory Capital Standards" on page 51 of this Report. As part of Dodd-Frank's changes to bank capital requirements, the Act stipulated that any new issuances of trust preferred securities ("TRUPs") by bank holding companies having between $500 million and $15 billion in assets (such as Arrow) will no longer be able to qualify as Tier 1 capital, although TRUPs previously issued by such bank holding companies and outstanding on the Act's grandfathering date (May 19, 2010), including Arrow's $20 million of TRUPs that are currently outstanding, will continue to qualify as Tier 1 capital. Accordingly, TRUPs, which have been an important financing tool for community banks such as ours, can no longer be counted on as a viable source of new capital.

(ii) Health care reform: In March 2010, comprehensive healthcare reform legislation was passed under the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the "Health Reform Act"). Included among the major provisions of the Health Reform Act is a change in tax treatment of the federal drug subsidy paid with respect to eligible retirees. The statute also contains provisions that may impact the Company's accounting for some of its benefit plans in future periods. The exact extent of the Health Reform Act's impact, if any, cannot be determined until final regulations are promulgated and interpretations of the Health Reform Act become available.

Liquidity and access to credit markets: We have not experienced any liquidity problems or special concerns during 2013, nor did we during 2012 or 2011. The terms of our lines of credit with our correspondent banks, the FHLBNY and the Federal Reserve Bank have not changed. In general, we rely on asset-based liquidity (i.e., funds in overnight investments and cash flow from maturing investments and loans) with liability-based liquidity as a secondary source (our main liability-based sources are overnight borrowing arrangements with our correspondent banks, term credit arrangement advances from the FHLBNY and the Federal Reserve Bank discount window). During the recent financial crisis, many financial institutions, small and large, relied extensively on the Fed's discount window to support their liquidity positions, but we did not. We maintain, and periodically test, a contingent liquidity plan to ensure that we can generate an adequate amount of available funds to meet a wide variety of potential liquidity crises, including a severe crisis.

FDIC Shift From Deposit-Based to Asset-Based Insurance Premiums; Reduction in Our Premiums: The Dodd-Frank Act changed the basis on which insured banks would be assessed deposit insurance premiums, which has had a beneficial effect on the insurance rates community banks like us pay and our overall premiums. Beginning with the second quarter of 2011, the calculation of regular FDIC insurance premiums for insured institutions changed so as to be based on adjusted assets (as defined) rather than deposits. This had the effect of imposing FDIC insurance fees not only on deposits but on other sources of funding as well, including short-term borrowings and repurchase agreements (even though these other sources are not FDIC-insured). The rate, however, given the significantly larger base on which premiums would be assessed (total assets versus insured deposits), was set at a lower percentage than the rate applicable under the old formula. Because our banks, like most community banks, have a much higher ratio of deposits to total assets than the large banks maintain, the new substantially lower rate, even applied to a somewhat larger base of assets, has resulted in a significant decrease in our FDIC premiums, whereas the large banks, even with the lower rates, have such vastly greater asset totals than deposit totals that their premiums have generally increased.

VISA Transactions - Reversal of the Litigation Reserve: In July 2012, Visa and MasterCard entered into a Memorandum of Understanding ("MOU") with a class of plaintiffs to settle certain additional antitrust claims involving merchant discounts. Visa's share of this settlement also will be paid out of its escrow fund. In light of the current state of covered litigation at Visa, which is winding down, as well as the remaining dollar amounts in Visa's escrow fund, we determined in the second quarter 2012 to reverse the entire amount of our 2008 VISA litigation-related accrual, which was $294 thousand pre-tax. This reversal reduced our other operating expenses for the year ending December 31, 2012. We believed then, and continue to believe, that the multi-billion dollar balance that Visa maintains in its escrow fund is substantially sufficient to satisfy the Company's contingent liability for the remaining covered litigation. The Company continues not to recognize any economic value for its remaining shares of Visa Class B common stock.
Increase in Stockholders' Equity: At June 30, 2013, our tangible book value per share (calculated based on stockholders' equity reduced by goodwill and other intangible assets) amounted to $12.56, an increase of $0.14, or 1.1%, from December 31, 2012 and an increase of $0.45, or 3.7%, from the level as of June 30, 2012. Our total stockholders' equity at June 30, 2013 increased 3.3% over the year-earlier level, and our total book value per share increased by 2.9% over the year earlier level. The increase in stockholders' equity over the first six months of 2013 principally reflected the following factors: i) $10.4 million net income for the period; ii) issuance of $845 thousand of common stock through our employee benefit and dividend reinvestment plans; offset in part by iii) cash dividends of $6.0 million; (iv) repurchases of our own common stock of $1.3 million; and, (v) $3.3 million of unrealized net securities losses. As of June 30, 2013, our closing stock price was $24.75, representing a trading multiple of 1.97 to our tangible book value. From a regulatory capital standpoint, the Company and each of its subsidiary banks also continued to remain classified as “well-capitalized” at quarter end. The Board of Directors declared and the Company paid quarterly cash dividends of $.245 per share for the first three quarters of 2012, as adjusted for a 2% stock

dividend distributed September 27, 2012, and cash dividends of $.25 per share for the last quarter of 2012 and the first two quarters of 2013.

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CHANGE IN FINANCIAL CONDITION

Summary of Selected Consolidated Balance Sheet Data
(Dollars in Thousands)

	At Period-End			$ Change	$ Change	% Change	% Change
	6/30/2013	12/31/2012	6/30/2012	From Dec	From Jun	From Dec	From Jun
Interest-Bearing Bank Balances	$11,894	$11,756	$26,360	$138	$(14,466)	1.2 %	(54.9)%
Securities Available-for-Sale	501,574	478,698	431,010	22,876	70,564	4.8 %	16.4 %
Securities Held-to-Maturity	248,914	239,803	252,902	9,111	(3,988)	3.8 %	(1.6)%
Loans (1)	1,204,734	1,172,341	1,146,641	32,393	58,093	2.8 %	5.1 %
Allowance for Loan Losses	14,678	15,298	15,211	(620)	(533)	(4.1)%	(3.5)%
Earning Assets (1)	1,973,252	1,908,390	1,861,392	64,862	111,860	3.4 %	6.0 %
Total Assets	2,083,169	2,022,796	1,966,976	60,373	116,193	3.0 %	5.9 %
Demand Deposits	261,910	247,232	248,224	14,678	13,686	5.9 %	5.5 %
NOW Accounts	754,371	758,287	691,001	(3,916)	63,370	(0.5)%	9.2 %
Savings Deposits	494,586	442,363	437,568	52,223	57,018	11.8 %	13.0 %
Time Deposits of $100,000 or More	87,369	93,375	108,277	(6,006)	(20,908)	(6.4)%	(19.3)%
Other Time Deposits	181,669	189,898	219,813	(8,229)			