

ARROW FINANCIAL CORP
Form 10-Q
August 09, 2012

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

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

For the Quarterly Period Ended June 30, 2012

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
(State or other jurisdiction of
incorporation or
organization)
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

22-2448962
(I.R.S. Employer
Identification No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes
 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). 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 Non-accelerated filer Smaller reporting company

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

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

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, 2012
Common Stock, par value \$1.00 per share	11,767,145

ARROW FINANCIAL CORPORATION
FORM 10-Q
TABLE OF CONTENTS

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>29</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>55</u>
<u>Item 4. Controls and Procedures</u>	<u>55</u>
<u>PART II - OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>56</u>
<u>Item 1.A. Risk Factors</u>	<u>56</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>56</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>56</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>56</u>
<u>Item 5. Other Information</u>	<u>56</u>
<u>Item 6. Exhibits</u>	<u>57</u>
<u>SIGNATURES</u>	<u>58</u>

PART I - Financial Information

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share and Per Share Amounts)

(Unaudited)

	June 30, 2012	December 31, 2011	June 30, 2011
ASSETS			
Cash and Due From Banks	\$31,391	\$29,598	\$33,202
Interest-Bearing Deposits at Banks	26,360	14,138	24,118
Investment Securities:			
Available-for-Sale	431,010	556,538	511,094
Held-to-Maturity (Approximate Fair Value of \$261,574 at June 30, 2012, \$159,059 at December 31, 2011 and \$143,327 at June 30, 2011)	252,902	150,688	138,334
Federal Home Loan Bank and Federal Reserve Bank Stock	4,479	6,722	7,019
Loans	1,146,641	1,131,457	1,120,096
Allowance for Loan Losses	(15,211)	(15,003)	(14,820)
Net Loans	1,131,430	1,116,454	1,105,276
Premises and Equipment, Net	24,823	22,629	19,490
Other Real Estate and Repossessed Assets, Net	837	516	31
Goodwill	22,003	22,003	20,823
Other Intangible Assets, Net	4,608	4,749	4,221
Accrued Interest Receivable	5,712	6,082	6,689
Other Assets	31,421	32,567	31,477
Total Assets	\$1,966,976	\$1,962,684	\$1,901,774
LIABILITIES			
Noninterest-Bearing Deposits	\$248,224	\$232,038	\$219,403
NOW Accounts	691,001	642,521	545,022
Savings Deposits	437,568	416,829	414,487
Time Deposits of \$100,000 or More	108,277	123,668	123,640
Other Time Deposits	219,813	228,990	239,307
Total Deposits	1,704,883	1,644,046	1,541,859
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	16,097	26,293	60,361
Other Short-Term Borrowings	—	—	2,211
Federal Home Loan Bank Overnight Advances	—	42,000	—
Federal Home Loan Bank Term Advances	30,000	40,000	90,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000
Accrued Interest Payable	898	1,147	1,549
Other Liabilities	23,158	22,813	22,205
Total Liabilities	1,795,036	1,796,299	1,738,185
STOCKHOLDERS' EQUITY			
Preferred Stock, \$5 Par Value; 1,000,000 Shares Authorized	—	—	—
Common Stock, \$1 Par Value; 20,000,000 Shares Authorized (16,094,277 Shares Issued at June 30, 2012 and at December 31, 2011,	16,094	16,094	15,626

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

and 15,625,512 Shares Issued at June 30, 2011)			
Additional Paid-in Capital	209,354	207,600	194,276
Retained Earnings	28,951	23,947	30,039
Unallocated ESOP Shares (105,211 Shares at June 30, 2012, 117,502 shares at December 31, 2011, and 118,292 Shares at June 30, 2011)	(2,250)	(2,500)	(2,600)
Accumulated Other Comprehensive Loss	(6,289)	(6,695)	(2,983)
Treasury Stock, at Cost (4,223,388 Shares at June 30, 2012, 4,213,470 shares at December 31, 2011, and 4,152,043 shares at June 30, 2011)	(73,920)	(72,061)	(70,769)
Total Stockholders' Equity	171,940	166,385	163,589
Total Liabilities and Stockholders' Equity	\$1,966,976	\$1,962,684	\$1,901,774

See Notes to Unaudited Interim Consolidated Financial Statements.

3

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,	
	2012	2011	2012	2011
INTEREST AND DIVIDEND INCOME				
Interest and Fees on Loans	\$13,628	\$14,714	\$27,586	\$29,729
Interest on Deposits at Banks	36	22	57	44
Interest and Dividends on Investment Securities:				
Fully Taxable	2,480	3,323	5,118	6,673
Exempt from Federal Taxes	1,389	1,497	2,710	3,001
Total Interest and Dividend Income	17,533	19,556	35,471	39,447
INTEREST EXPENSE				
NOW Accounts	976	1,361	2,035	2,692
Savings Deposits	329	503	686	1,006
Time Deposits of \$100,000 or More	569	664	1,177	1,331
Other Time Deposits	1,074	1,292	2,220	2,644
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	5	23	11	47
Federal Home Loan Bank Advances	172	986	369	2,302
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	154	146	313	290
Total Interest Expense	3,279	4,975	6,811	10,312
NET INTEREST INCOME	14,254	14,581	28,660	29,135
Provision for Loan Losses	240	170	520	390
NET INTEREST INCOME AFTER PROVISION FOR	14,014	14,411	28,140	28,745
LOAN LOSSES				
NONINTEREST INCOME				
Income From Fiduciary Activities	1,601	1,526	3,223	3,072
Fees for Other Services to Customers	2,054	2,058	4,014	3,973
Insurance Commissions	2,107	1,815	3,996	3,281
Gain on Securities Transactions	143	482	645	1,024
Net Gain on Sales of Loans	537	167	894	218
Other Operating Income	366	180	595	280
Total Noninterest Income	6,808	6,228	13,367	11,848
NONINTEREST EXPENSE				
Salaries and Employee Benefits	7,794	7,233	15,697	14,435
Occupancy Expenses, Net	1,970	1,894	3,994	3,812
FDIC Assessments	256	267	511	780
Other Operating Expense	2,631	2,777	5,595	5,463
Total Noninterest Expense	12,651	12,171	25,797	24,490
INCOME BEFORE PROVISION FOR INCOME TAXES	8,171	8,468	15,710	16,103
Provision for Income Taxes	2,577	2,619	4,828	4,973
NET INCOME	\$5,594	\$5,849	\$10,882	\$11,130
Average Shares Outstanding:				

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

Basic	11,759	11,729	11,765	11,702
Diluted	11,773	11,741	11,784	11,719
Per Common Share:				
Basic Earnings	\$0.48	\$0.50	\$0.92	\$0.95
Diluted Earnings	0.48	0.50	0.92	0.95

Share and Per Share Amounts have been restated for the September 2011 3% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

4

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net Income	\$5,594	\$5,849	\$10,882	\$11,130
Other Comprehensive Income (Loss), Net of Tax:				
Net Unrealized Securities Holding Gains Arising During the Period	445	2,611	347	3,787
Reclassification Adjustment for Securities Gains Included in Net Income	(86)	(291)	(389)	(618)
Amortization of Net Retirement Plan Actuarial Loss	229	155	457	309
Accretion of Net Retirement Plan Prior Service Credit	(5)	(19)	(9)	(38)
Other Comprehensive (Loss) Income	583	2,456	406	3,440
Comprehensive Income	\$6,177	\$8,305	\$11,288	\$14,570

See Notes to Unaudited Interim Consolidated Financial Statements.

5

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, 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, \$.50 per Share	—	—	(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
Balance at December 31, 2010	\$ 15,626	\$ 191,068	\$ 24,577	\$ (2,876)	\$ (6,423)	\$ (69,713)	\$ 152,259
Net Income	—	—	11,130	—	—	—	11,130
Other Comprehensive (Loss) Income	—	—	—	—	3,440	—	3,440
Cash Dividends Paid, \$.49 per Share ¹	—	—	(5,668)	—	—	—	(5,668)
Stock Options Exercised (14,717 Shares)	—	183	—	—	—	130	313

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

Shares Issued Under the Directors' Stock Plan (3,634 Shares)	—	55	—	—	—	33	88
Shares Issued Under the Employee Stock Purchase Plan (10,263 Shares)	—	154	—	—	—	92	246
Shares Issued for Dividend Reinvestment Plans (37,689 Shares)	—	541	—	—	—	348	889
Stock-Based Compensation Expense	—	174	—	—	—	—	174
Tax Benefit for Disposition of Stock Options	—	2	—	—	—	—	2
Purchase of Treasury Stock (113,415 Shares)	—	—	—	—	—	(2,759)	(2,759)
Acquisition of Subsidiaries (132,504 Shares)	—	2,034	—	—	—	1,100	3,134
Allocation of ESOP Stock (14,004 Shares)	—	65	—	276	—	—	341
Balance at June 30, 2011	\$15,626	\$194,276	\$30,039	\$ (2,600)	\$ (2,983)	\$(70,769)	\$163,589

¹ Cash dividends paid per share have been adjusted for the September 2011 3% stock dividend.

See Notes to Unaudited Interim Consolidated Financial Statements.

6

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

	Six Months Ended June 30,	
	2012	2011
Cash Flows from Operating Activities:		
Net Income	\$ 10,882	\$ 11,130
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	520	390
Depreciation and Amortization	4,363	2,945
Allocation of ESOP Stock	299	341
Gains on the Sale of Securities Available-for-Sale	(645)	(1,041)
Other-Than-Temporary Impairment	—	17
Loans Originated and Held-for-Sale	(27,593)	(18,066)
Proceeds from the Sale of Loans Held-for-Sale	27,680	28,317
Net Gains on the Sale of Loans	(894)	(218)
Net (Gains) Loss on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	(38)	2
Contributions to Pension Plans	(160)	(1,698)
Deferred Income Tax (Benefit) Expense	(311)	537
Shares Issued Under the Directors' Stock Plan	87	88
Stock-Based Compensation Expense	207	174
Net (Increase) Decrease in Other Assets	1,564	(2,439)
Net Increase (Decrease) in Other Liabilities	775	4,026
Net Cash Provided By (Used In) Operating Activities	16,736	24,505
Cash Flows from Investing Activities:		
Proceeds from the Sale of Securities Available-for-Sale	16,385	16,971
Proceeds from the Maturities and Calls of Securities Available-for-Sale	125,354	145,744
Purchases of Securities Available-for-Sale	(18,041)	(151,655)
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	22,454	24,205
Purchases of Securities Held-to-Maturity	(125,207)	(2,757)
Net (Increase) Decrease in Loans	(15,544)	14,892
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	583	252
Purchase of Premises and Equipment	(3,055)	(1,415)
Cash Paid for Subsidiaries	(75)	(3,487)
Net Decrease in Other Investments	2,243	1,583
Purchase of Bank Owned Life Insurance	—	(12,833)
Net Cash Provided By (Used In) Investing Activities	5,097	31,500
Cash Flows from Financing Activities:		
Net Increase in Deposits	60,837	7,855
Net Increase (Decrease) in Short-Term Borrowings	(52,196)	9,358
Federal Home Loan Bank Advances	—	10,000
Repayments of Federal Home Loan Bank Term Advances	(10,000)	(50,000)
Purchase of Treasury Stock	(2,954)	(2,759)
Stock Options Exercised	1,149	313
Shares Issued Under the Employee Stock Purchase Plan	242	246

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

Tax Benefit from Exercise of Stock Options	53	2
Shares Issued for Dividend Reinvestment Plans	929	889
Cash Dividends Paid	(5,878)	(5,668)
Net Cash Provided By (Used In) Financing Activities	(7,818)	(29,764)
Net Increase in Cash and Cash Equivalents	14,015	26,241
Cash and Cash Equivalents at Beginning of Period	43,736	31,079
Cash and Cash Equivalents at End of Period	\$57,751	\$57,320
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	\$7,059	\$10,706
Income Taxes	3,316	4,181
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	855	228
Acquisition of Subsidiary	133	3,134
Fair Value of Assets from Acquisition of Subsidiary	—	7,688
Fair Value of Liabilities from Acquisition of Subsidiary	—	1,067

See Notes to Unaudited Interim Consolidated Financial Statements.

7

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, 2012, December 31, 2011 and June 30, 2011; the results of operations for the three and six-month periods ended June 30, 2012 and 2011; the consolidated statements of comprehensive income for the three and six-month periods ended June 30, 2012 and 2011; the changes in stockholders' equity for the six-month periods ended June 30, 2012 and 2011; and the cash flows for the six-month periods ended June 30, 2012 and 2011. 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, 2011, included in Arrow's 2011 Form 10-K.

Note 2. LOANS (In Thousands)

Loan Categories and Past Due Loans

The following table presents loan balances outstanding as of June 30, 2012, December 31, 2011 and June 30, 2011 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 \$1,699, \$893 and \$261 as of June 30, 2012, December 31, 2011 and June 30, 2011, respectively, are included in the residential real estate loan balances.

8

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

Past Due Loans

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
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							
Nonaccrual Loans	\$—	\$—	\$27	\$—	\$—	\$477	\$504
	\$1,675	\$—	\$1,511	\$1	\$536	\$3,099	\$6,822
December 31, 2011							
Loans Past Due 30-59 Days	\$538	\$—	\$284	\$75	\$3,512	\$1,544	\$5,953
Loans Past Due 60-89 Days	197	—	—	12	670	226	1,105
Loans Past Due 90 or more Days	17	—	1,825	6	314	3,056	5,218
Total Loans Past Due	752	—	2,109	93	4,496	4,826	12,276
Current Loans	99,039	11,083	230,040	6,225	317,879	454,915	1,119,181
Total Loans	\$99,791	\$11,083	\$232,149	\$6,318	\$322,375	\$459,741	\$1,131,457
Loans 90 or More Days Past Due and Still Accruing Interest							
Nonaccrual Loans	\$17	\$—	\$684	\$—	\$56	\$905	\$1,662
	\$6	\$—	\$1,503	\$6	\$431	\$2,582	\$4,528
June 30, 2011							
Loans Past Due 30-59 Days	\$268	\$—	\$76	\$58	\$2,853	\$314	\$3,569
Loans Past Due 60-89 Days	251	—	1,106	4	843	1,565	3,769
Loans Past Due 90 or more Days	250	—	169	—	220	2,269	2,908
Total Loans Past Due	769	—	1,351	62	3,916	4,148	10,246
Current Loans	96,432	6,907	227,191	5,919	312,776	460,625	1,109,850
Total Loans	\$97,201	\$6,907	\$228,542	\$5,981	\$316,692	\$464,773	\$1,120,096
Loans 90 or More Days Past Due and Still Accruing Interest							
	\$—	\$—	\$110	\$—	\$23	\$422	\$555

Nonaccrual Loans	\$319	\$—	\$1,173	\$—	\$489	\$3,009	\$4,990
------------------	-------	-----	---------	-----	-------	---------	---------

9

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	Other					
	Commercial	Construction	Real Estate	Consumer	Automobile	Residential	Unallocated	Total
Roll-forward of the Allowance for Loan Losses for the Quarterly Periods:								
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
March 31, 2011	\$ 1,476	\$ 134	\$ 4,314	\$ 314	\$ 4,486	\$ 2,902	\$ 1,119	\$ 14,745
Charge-offs	—	—	—	(45)	(104)	(1)	—	(150)
Recoveries	2	—	—	17	36	—	—	55
Provision	(402)	509	(700)	18	178	143	424	170
June 30, 2011	\$ 1,076	\$ 643	\$ 3,614	\$ 304	\$ 4,596	\$ 3,044	\$ 1,543	\$ 14,820
Roll-forward of the Allowance for Loan Losses for the Year-to-Date Periods:								
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
December 31, 2010	\$ 2,037	\$ 135	\$ 2,993	\$ 328	\$ 4,760	\$ 3,163	\$ 1,273	\$ 14,689
Charge-offs	(50)	—	—	(49)	(288)	(1)	—	(388)
Recoveries	3	—	—	22	104	—	—	129
Provision	(914)	508	621	3	20	(118)	270	390
June 30, 2011	\$ 1,076	\$ 643	\$ 3,614	\$ 304	\$ 4,596	\$ 3,044	\$ 1,543	\$ 14,820
June 30, 2012	\$ 765	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 765
Allowance for loan losses - Loans Individually								

Evaluated for Impairment Allowance for loan losses - Loans Collectively	\$ 1,333	\$ 528	\$ 3,295	\$ 355	\$ 4,571	\$ 3,451	\$ 13,533
Evaluated for Impairment Ending Loan Balance - Individually	\$ 1,699	\$—	\$ 1,625	\$—	\$ 213	\$ 1,490	\$ 5,027
Evaluated for Impairment Ending Loan Balance - Collectively	\$ 99,595	\$ 17,628	\$ 234,236	\$ 6,543	\$ 333,885	\$ 449,727	\$ 1,141,614
Evaluated for Impairment							

10

Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total
December 31, 2011								
Allowance for loan losses - Loans Collectively Evaluated for Impairment Ending Loan Balance -								
Individually Evaluated for Impairment Ending Loan Balance -								
Collectively Evaluated for Impairment								
June 30, 2011								
Allowance for loan losses - Loans Collectively Evaluated for Impairment Ending Loan Balance -								
Individually Evaluated for Impairment Ending Loan Balance -								
Collectively 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 past five years we have had little charge-off activity on loans secured by residential real estate. Indirect consumer

lending (principally automobile loans) represents a significant component of our total loan portfolio and contains the majority of our total loan charge-offs. We have had only two small losses on commercial real estate loans in the past five years. Losses on commercial loans (other than those secured by real estate) are also historically low, but can vary widely from year-to-year; this is the most complex category of loans in our loss analysis. Our net charge-offs for the past five years have been at or near historical lows for our Company. Annualized net charge-offs for the entire loan portfolio has ranged from .04% to .09% of average loans during this period.

Qualitative Analysis: While historical loss experience provides a reasonable starting point for our analysis, historical losses, or even recent trends in losses, do not by themselves form a sufficient basis to determine the appropriate level for the allowance. Therefore, we 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, 2012, December 31, 2011 and June 30, 2011:

Loan Credit Quality Indicators

	Commercial	Commercial	Other				
	Commercial	Construction	Real Estate	Consumer	Automobile	Residential	Total
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
December 31, 2011							
Credit Risk Profile by							
Creditworthiness Category:							
Satisfactory	91,555	9,195	213,413				314,163
Special Mention	3,975	—	458				4,433
Substandard	4,261	1,888	18,278				24,427
Doubtful	—	—	—				—
Credit Risk Profile Based on							
Payment Activity:							
Performing				6,312	321,888	456,254	784,454
Nonperforming				6	487	3,487	3,980
June 30, 2011							
Credit Risk Profile by							
Creditworthiness Category:							
Satisfactory	90,354	4,967	206,900				302,221
Special Mention	4,222	263	1,048				5,533
Substandard	2,625	1,677	20,594				24,896

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

Doubtful	\$—	\$—	\$—	—	
Credit Risk Profile Based on Payment Activity:					
Performing		5,981	316,198	461,342	783,521
Nonperforming		\$—	\$512	\$3,431	\$3,943

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)

12

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.

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	Other				
	Commercial	Commercial	Other	Automobile	Residential	Total	
	Construction	Real Estate	Consumer				
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
December 31, 2011							
Recorded Investment:							
With No Related Allowance	\$66	\$—	\$1,953	\$—	\$268	\$2,108	\$4,395
Unpaid Principal Balance:							
With No Related Allowance	66	—	1,953	—	268	2,108	4,395
June 30, 2011							
Recorded Investment:							
With No Related Allowance	\$—	\$—	\$994	\$—	\$—	\$1,812	\$2,806
Unpaid Principal Balance:							
With No Related Allowance	—	—	994	—	—	1,812	2,806
For the Quarter Ended:							
June 30, 2012							
Average Recorded Balance:							
With No Related Allowance	\$60	\$—	\$1,707	\$—	\$227	\$1,645	\$3,639

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

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	—	—	—	—	—	—	—
June 30, 2011							
Average Recorded Balance:							
With No Related Allowance	\$—	\$—	\$995	\$—	\$—	\$1,803	\$2,798
Interest Income Recognized:							
With No Related Allowance	—	—	—	—	—	—	—
Cash Basis Income:							
With No Related Allowance	—	—	—	—	—	—	—

13

Impaired Loans

	Commercial Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
For the Year-To-Date Period Ended:							
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	—	—	—	—	—	—	—
June 30, 2011							
Average Recorded Balance:							
With No Related Allowance	\$—	\$—	\$996	\$—	\$—	\$1,793	\$2,789
Interest Income Recognized:							
With No Related Allowance	—	—	—	—	—	23	23
Cash Basis Income:							
With No Related Allowance	—	—	—	—	—	—	—

At June 30, 2012, December 31, 2011 and June 30 2011, 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 December 31, 2011 and June 30, 2011. 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.

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	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
For the Quarter Ended:							
June 30, 2012							
Number of Loans Pre-Modification	—	—	—	—	2	—	2
Outstanding Recorded Investment	\$—	\$—	\$—	\$—	\$16	\$—	\$16
Post-Modification Outstanding Recorded Investment	\$—	\$—	\$—	\$—	\$16	\$—	\$16
June 30, 2011							
Number of Loans Pre-Modification	1	—	—	—	3	—	4
Outstanding Recorded Investment	\$62	\$—	\$—	\$—	\$31	\$—	\$93
Post-Modification Outstanding Recorded Investment	\$62	\$—	\$—	\$—	\$31	\$—	\$93
For the Year-To-Date Period Ended:							
June 30, 2012							
Number of Loans Pre-Modification	—	—	—	—	7	—	7
Outstanding Recorded Investment	\$—	\$—	\$—	\$—	\$60	\$—	\$60
Post-Modification Outstanding Recorded Investment	\$—	\$—	\$—	\$—	\$60	\$—	\$60
June 30, 2011							
Number of Loans Pre-Modification	1	—	—	—	9	—	10
Outstanding Recorded Investment	\$62	\$—	\$—	\$—	\$88	\$—	\$150
Post-Modification Outstanding Recorded Investment	\$62	\$—	\$—	\$—	\$88	\$—	\$150

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, 2012.

15

Note 3. INVESTMENT SECURITIES (In Thousands)

The following table is the schedule of Available-For-Sale Securities at June 30, 2012, December 31, 2011 and June 30, 2011:

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, 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						183,631
Maturities of Debt Securities, at Amortized Cost:						
Within One Year	24,290	14,009	14,474	—		52,773
From 1 - 5 Years	24,010	37,707	271,696	1		333,414
From 5 - 10 Years	—	1,344	28,224	—		29,568
Over 10 Years	—	1,686	—	1,000		2,686
Maturities of Debt Securities, at Fair Value:						
Within One Year	24,320	14,051	14,706	—		53,077
From 1 - 5 Years	24,335	37,881	280,416	1		342,633
From 5 - 10 Years	—	1,395	29,954	—		31,349
Over 10 Years	—	1,686	—	800		2,486
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

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
December 31, 2011						
Available-For-Sale Securities, at Amortized Cost	\$ 116,055	\$ 44,712	\$ 382,118	\$ 1,015	\$ 1,365	\$ 545,265
Available-For-Sale Securities, at Fair Value	116,393	44,999	392,712	1,015	1,419	556,538
Gross Unrealized Gains	342	305	10,813	—	69	11,529
Gross Unrealized Losses	4	18	219	—	15	256
Available-For-Sale Securities, Pledged as Collateral						264,854

Securities in a Continuous
Loss Position, at Fair Value:

Less than 12 Months	\$ 25,956	\$ 4,505	\$ 9,857	\$ —	\$ —	\$ 40,318
12 Months or Longer	—	—	5,715	—	78	5,793
Total	\$ 25,956	\$ 4,505	\$ 15,572	\$ —	\$ 78	\$ 46,111
Number of Securities in a Continuous Loss Position	7	12	5	—	2	26

Unrealized Losses on
Securities in a Continuous
Loss Position:

Less than 12 Months	\$ 4	\$ 18	\$ 204	\$ —	\$ —	\$ 226
12 Months or Longer	—	—	15	—	15	30
Total	\$ 4	\$ 18	\$ 219	\$ —	\$ 15	\$ 256

June 30, 2011

Available-For-Sale Securities, at Amortized Cost	\$ 49,312	\$ 90,451	\$ 357,194	\$ 1,357	\$ 1,314	\$ 499,628
Available-For-Sale Securities, at Fair Value	49,551	90,700	368,029	1,345	1,469	511,094
Gross Unrealized Gains	239	251	11,126	—	165	11,781
Gross Unrealized Losses	—	2	291	12	10	315
Available-For-Sale Securities, Pledged as Collateral						233,074

Securities in a Continuous
Loss Position, at Fair Value:

Less than 12 Months	\$ —	\$ 3,359	\$ 65,391	\$ —	\$ 28	\$ 68,778
12 Months or Longer	—	—	146	317	46	509
Total	\$ —	\$ 3,359	\$ 65,537	\$ 317	\$ 74	\$ 69,287
Number of Securities in a Continuous Loss Position	—	3	24	1	2	30

Unrealized Losses on

Securities in a Continuous

Loss Position:

Less than 12 Months	\$—	\$2	\$291	\$—	\$8	\$301
12 Months or Longer	—	—	—	12	2	14
Total	\$—	\$2	\$291	\$12	\$10	\$315

17

The following table is the schedule of Held-To-Maturity Securities at June 30, 2012, December 31, 2011 and June 30, 2011:

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To- Maturity Securities
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				252,902
Maturities of Debt Securities, at Amortized Cost:				
Within One Year	35,450	—	—	35,450
From 1 - 5 Years	83,611	68,625	—	152,236
From 5 - 10 Years	59,047	—	—	59,047
Over 10 Years	5,169	—	1,000	6,169
Maturities of Debt Securities, at Fair Value:				
Within One Year	35,563	—	—	35,563
From 1 - 5 Years	85,763	69,277	—	155,040
From 5 - 10 Years	64,429	—	—	64,429
Over 10 Years	5,542	—	1,000	6,542
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

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To- Maturity Securities
December 31, 2011				
Held-To-Maturity Securities, at Amortized Cost	\$ 149,688	\$—	\$ 1,000	\$ 150,688
Held-To-Maturity Securities, at Fair Value	158,059	—	1,000	159,059
Gross Unrealized Gains	8,378	—	—	8,378
Gross Unrealized Losses	7	—	—	7
Held-To-Maturity Securities, Pledged as Collateral				150,688

Securities in a Continuous
Loss Position, at Fair Value:

Less than 12 Months	\$ 510	\$—	\$—	\$ 510
12 Months or Longer	—	—	—	—
Total	\$ 510	\$—	\$—	\$ 510
Number of Securities in a Continuous Loss Position	1	—	—	1

Unrealized Losses on
Securities in a Continuous
Loss Position:

Less than 12 Months	\$ 7	\$—	\$—	\$ 7
12 Months or Longer	—	—	—	—
Total	\$ 7	\$—	\$—	\$ 7

June 30, 2011

Held-To-Maturity Securities, at Amortized Cost	\$ 137,334	\$—	\$ 1,000	\$ 138,334
Held-To-Maturity Securities, at Fair Value	142,327	—	1,000	143,327
Gross Unrealized Gains	5,008	—	—	5,008
Gross Unrealized Losses	15	—	—	15
Held-To-Maturity Securities, Pledged as Collateral				138,334

Securities in a Continuous
Loss Position, at Fair Value:

Less than 12 Months	\$—	\$—	\$—	\$—
12 Months or Longer	1,561	—	—	1,561
Total	\$ 1,561	\$—	\$—	\$ 1,561
Number of Securities in a Continuous Loss Position	5	—	—	5

Unrealized Losses on

Securities in a Continuous

Loss Position:

Less than 12 Months	\$—	\$—	\$—	\$—
12 Months or Longer	15	—	—	15
Total	\$15	\$—	\$—	\$15

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.

19

Securities in a continuous loss position, in the tables above for June 30, 2012, December 31, 2011 and June 30, 2011 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 Aaa by Moody's and 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, 2012, 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 we would be required to sell the securities prior to recovery, the impairment is considered temporary.

Note 4. FINANCIAL INSTRUMENTS WITH OFF-BALANCE SHEET RISK AND CONTINGENT LIABILITIES

(In Thousands)

The following table presents the balance for standby letters of credit for the periods ended June 30, 2012, December 31, 2011 and June 30, 2011:

Outstanding Guarantees Under Letters of Credit

	06/30/2012	12/31/2011	06/30/2011
Standby Letters of Credit	\$ 11,389	\$ 11,641	\$ 8,301

Arrow does not issue any guarantees that would require liability-recognition or disclosure, other than its standby letters of credit. Standby and other letters of credit are conditional commitments issued by Arrow to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including bond financing and similar transactions. The credit risk involved in issuing standby letters of credit is essentially the same as that involved in extending loan facilities to customers. Typically, these instruments have terms of twelve months or less. Some expire unused, and therefore, the total amounts do not necessarily represent future cash requirements. Some have automatic renewal provisions.

For letters of credit, the amount of the collateral obtained, if any, is based on management's credit evaluation of the counter-party, most of which will expire within one year and some of which were not collateralized. All standby letters of credit were for private borrowing arrangements. The fair value of Arrow's standby letters of credit at June 30, 2012, December 31, 2011 and June 30, 2011 was insignificant.

Note 5. COMPREHENSIVE INCOME (In Thousands)

The following table presents the components of other comprehensive income for the three months ended June 30, 2012 and 2011 :

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
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 Loss	\$967	\$(384)	\$583	\$674	\$(268)	\$406
2011						
Net Unrealized Securities Holding Gains Arising During the Period	\$4,324	\$(1,713)	\$2,611	\$6,272	\$(2,485)	\$3,787
Reclassification Adjustment for Securities Gains Included in Net Income	(482)	191	(291)	(1,024)	406	(618)
Amortization of Net Retirement Plan Actuarial Loss	257	(102)	155	512	(203)	309
Accretion of Net Retirement Plan Prior Service Credit	(32)	13	(19)	(63)	25	(38)
Other Comprehensive Income	\$4,067	\$(1,611)	\$2,456	\$5,697	\$(2,257)	\$3,440

The following table presents the components, net of tax, of accumulated other comprehensive income (loss) as of:

Schedule of Accumulated Other Comprehensive Income (Loss)

	June 30, 2012	December 31, 2011	June 30, 2011
Retirement Plan Net Loss	\$(13,252)	\$(13,709)	\$(10,648)
Retirement Plan Prior Service Credit	197	206	741
Net Unrealized Securities Holding Gains	6,766	6,808	6,924
Total Accumulated Other Comprehensive Loss	\$(6,289)	\$(6,695)	\$(2,983)

Note 6. STOCK BASED COMPENSATION PLANS

Under our 2008 Long-Term Incentive Plan, we granted options in both the first quarter of 2012 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.

The following table presents a roll-forward of our stock option plans and grants issued during 2012:

Schedule of Share-based Compensation Arrangements

	Stock Option Plans	
Roll-Forward of Shares Outstanding:		
Outstanding at January 1, 2012	473,435	
Granted	74,300	
Exercised	(52,502))
Forfeited	(8,354))
Outstanding at June 30, 2012	486,879	
Exercisable at Period End	300,532	
Vested and Expected to Vest	486,879	
Roll-Forward of Shares Outstanding - Weighted Average Exercise Price:		
Outstanding at December 31, 2011	\$22.91	
Granted	25.42	
Exercised	21.89	
Forfeited	24.43	
Outstanding at June 30, 2012	23.38	
Exercisable at Period End	22.80	
Vested and Expected to Vest	\$23.38	
Grants Issued During 2012 - Weighted Average Information:		
Fair Value	6.13	
Fair Value Assumptions:		
Dividend Yield	3.93	%
Expected Volatility	37.43	%
Risk Free Interest Rate	1.22	%
Expected Lives (in years)	6.46	

The following table presents information on the amounts expensed and remaining amounts to be expensed for the periods ended June 30, 2012 and 2011:

Share-Based Compensation Expense	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Share-Based Compensation Expense	\$108	\$92	\$207	\$174

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.

22

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:

Benefit Plans - Periodic Benefit Costs

	Pension Plans		Other Post-Retirement Benefit Plans	
	Periods Ended:		Periods Ended:	
	6/30/2012	6/30/2011	6/30/2012	6/30/2011
For the Quarterly Periods:				
Service Cost	\$358	\$395	\$45	\$40
Interest Cost	585	431	93	67
Expected Return on Plan Assets	(755)	(746)	—	—
Amortization (Accretion) of Prior Service Cost (Credit)	21	(3)	(29)	(29)
Amortization of Net Loss	346	233	33	24
Net Periodic Benefit Cost	\$555	\$310	\$142	\$102
Plan Contributions During the Period	\$80	\$1,599	\$158	\$86
For the Year-to-Date Periods:				
Service Cost	\$717	\$715	\$90	\$80
Interest Cost	1,040	910	181	182
Expected Return on Plan Assets	(1,510)	(1,390)	—	—
Amortization (Accretion) of Prior Service Cost (Credit)	42	(6)	(57)	(57)
Amortization of Net Loss	691	465	66	47
Net Periodic Benefit Cost	\$980	\$694	\$280	\$252
Plan Contributions During the Period	\$160	\$1,698	\$231	\$172
Estimated Future Contributions in the Current Fiscal Year	\$1,850		\$475	

Although we are not required to make a contribution to our qualified pension plan in 2012, we expect to make a contribution subject to changes in market conditions. 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, 2012 and 2011. All share and per share amounts have been adjusted for the 2011 3% stock dividend.

Earnings Per Share

	Quarterly Period Ended:		Year-to-Date Period Ended:	
	6/30/2012	6/30/2011	6/30/2012	6/30/2011
Earnings Per Share - Basic:				
Net Income	\$5,594	\$5,849	\$10,882	\$11,130
Weighted Average Shares - Basic	11,759	11,729	11,765	11,702
Earnings Per Share - Basic	\$0.48	\$0.50	\$0.92	\$0.95
Earnings Per Share - Diluted:				
Net Income	\$5,594	\$5,849	\$10,882	\$11,130

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

Weighted Average Shares - Basic	11,759	11,729	11,765	11,702
Dilutive Average Shares Attributable to Stock Options	14	12	19	17
Weighted Average Shares - Diluted	\$11,773	\$11,741	\$11,784	\$11,719
Earnings Per Share - Diluted	\$0.48	\$0.50	\$0.92	\$0.95
Antidilutive Shares Excluded from the Calculation of Earnings Per Share	205	132	205	132

23

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, 2012, December 31, 2011 and June 30, 2011 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	Fair Value Measurements at Reporting Date		
		Using:		
		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, 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	\$—
December 31, 2011				
Securities Available-for Sale:				
U.S. Agency Obligations	\$116,393	\$—	\$116,393	\$—
State and Municipal Obligations	44,999	—	44,999	—
Mortgage-Backed Securities - Residential	392,712	—	392,712	—
Corporate and Other Debt Securities	1,015	—	1,015	—
Mutual Funds and Equity Securities	1,419	257	1,162	—
Total Securities Available-for Sale	\$556,538	\$257	\$556,281	\$—
June 30, 2011				
Securities Available-for Sale:				
U.S. Agency Obligations	\$49,551	\$—	\$49,551	\$—
State and Municipal Obligations	90,700	—	90,700	—
Mortgage-Backed Securities - Residential	368,029	—	368,029	—
Corporate and Other Debt Securities	1,345	—	1,028	317
Mutual Funds and Equity Securities	1,469	215	1,254	—
Total Securities Available-for Sale	\$511,094	\$215	\$510,562	\$317

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

June 30, 2012

Edgar Filing: ARROW FINANCIAL CORP - Form 10-Q

Collateral Dependent Impaired Loans	\$486	\$—	\$486	\$—
Other Real Estate Owned and Repossessed Assets, Net	837	—	837	—
December 31, 2011:				
Other Real Estate Owned and Repossessed Assets, Net	\$516	\$—	\$516	\$—
June 30, 2011				