BERKSHIRE HILLS BANCORP INC
Form 10-Q
August 11, 2014
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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, 2014

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

For the transition period from to

Commission File Number: 001-15781

BERKSHIRE HILLS BANCORP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3510455**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
24 North Street, Pittsfield, Massachusetts	**01201**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(413) 443-5601**

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

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

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

Large Accelerated Filer o	Accelerated Filer x
Non-Accelerated Filer o	Smaller Reporting Company o

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

The Registrant had 25,167,129 shares of common stock, par value $0.01 per share, outstanding as of August 6, 2014.

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PART I

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)	June 30, 2014	December 31, 2013
Assets		
Cash and due from banks	$ 81,642	$ 56,841
Short-term investments	31,236	18,698
Total cash and cash equivalents	112,878	75,539
Trading security	14,971	14,840
Securities available for sale, at fair value	1,080,668	760,048
Securities held to maturity (fair values of $44,359 and $45,764)	43,178	44,921
Federal Home Loan Bank stock and other restricted securities	59,479	50,282
Total securities	1,198,296	870,091
Loans held for sale, at fair value	20,185	15,840
Residential mortgages	1,397,231	1,384,274
Commercial real estate	1,579,500	1,417,120
Commercial and industrial loans	727,959	687,293
Consumer loans	745,613	691,836
Total loans	4,450,303	4,180,523
Less: Allowance for loan losses	(34,353)	(33,323)
Net loans	4,415,950	4,147,200
Premises and equipment, net	86,936	84,459
Other real estate owned	2,445	2,758
Goodwill	264,770	256,871
Other intangible assets	13,761	13,791
Cash surrender value of bank-owned life insurance policies	102,988	101,530
Deferred tax assets, net	37,911	50,711
Other assets	55,254	54,009
Total assets	$ 6,311,374	$ 5,672,799
Liabilities		
Demand deposits	$ 794,574	$ 677,917
NOW deposits	416,879	353,612
Money market deposits	1,425,348	1,383,856
Savings deposits	478,770	431,496
Time deposits	1,362,992	1,001,648
Total deposits	4,478,563	3,848,529
Short-term debt	900,000	872,510
Long-term Federal Home Loan Bank advances	64,179	101,918

Subordinated borrowings	89,713	89,679
Total borrowings	1,053,892	1,064,107
Other liabilities	88,456	82,101
Total liabilities	5,620,911	4,994,737
Stockholders equity		
Common stock ($.01 par value; 50,000,000 shares authorized and 26,525,466 shares issued and 25,115,138 shares outstanding in 2014; 26,525,466 shares issued and 25,036,169 shares outstanding in 2013)	265	265
Additional paid-in capital	585,340	587,247
Unearned compensation	(6,888)	(5,563)
Retained earnings	142,249	141,958
Accumulated other comprehensive income (loss)	4,276	(9,057)
Treasury stock, at cost (1,410,328 shares in 2014 and 1,489,297 shares in 2013)	(34,779)	(36,788)
Total stockholders equity	690,463	678,062
Total liabilities and stockholders equity	$ 6,311,374	$ 5,672,799

The accompanying notes are an integral part of these consolidated financial statements.

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Interest and dividend income				
Loans	$ 42,309	$ 45,443	$ 84,803	$ 92,524
Securities and other	8,866	4,254	16,167	8,054
Total interest and dividend income	51,175	49,697	100,970	100,578
Interest expense				
Deposits	4,478	5,052	9,199	10,415
Borrowings	2,368	3,541	4,676	7,122
Total interest expense	6,846	8,593	13,875	17,537
Net interest income	44,329	41,104	87,095	83,041
Non-interest income				
Loan related income	1,846	2,644	3,094	5,361
Mortgage banking income	691	2,129	1,063	4,346
Deposit related fees	6,610	4,805	12,049	9,064
Insurance commissions and fees	2,460	2,407	5,509	5,404
Wealth management fees	2,294	2,070	4,843	4,334
Total fee income	13,901	14,055	26,558	28,509
Other	402	546	926	890
Gain on sale of securities, net	203	1,005	237	1,005
Loss on termination of hedges			(8,792)	
Total non-interest income	14,506	15,606	18,929	30,404
Total net revenue	58,835	56,710	106,024	113,445
Provision for loan losses	3,989	2,700	7,385	5,100
Non-interest expense				
Compensation and benefits	20,279	18,151	40,138	35,892
Occupancy and equipment	6,656	5,737	13,470	11,505
Technology and communications	3,800	3,480	7,578	6,471
Marketing and promotion	621	603	1,142	1,241
Professional services	1,024	1,764	2,176	3,254
FDIC premiums and assessments	1,029	890	2,038	1,718
Other real estate owned and foreclosures	33	284	556	307
Amortization of intangible assets	1,274	1,345	2,580	2,722
Acquisition, restructuring and conversion related expenses	190	775	6,491	5,839
Other	4,357	4,906	8,454	8,469
Total non-interest expense	39,263	37,935	84,623	77,418
Income before income taxes	15,583	16,075	14,016	30,927
Income tax expense	4,119	4,038	3,658	8,425
Net income	$ 11,464	$ 12,037	$ 10,358	$ 22,502
Earnings per share:				
Basic	$ 0.46	$ 0.49	$ 0.42	$ 0.91
Diluted	$ 0.46	$ 0.48	$ 0.42	$ 0.90
Weighted average common shares outstanding:				
Basic	24,715	24,779	24,707	24,863
Diluted	24,809	24,956	24,821	25,049

The accompanying notes are an integral part of these consolidated financial statements.

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net income	$ 11,464	$ 12,037	$ 10,358	$ 22,502
Other comprehensive income, before tax:				
Changes in unrealized gain (loss) on securities available-for-sale	11,113	(13,431)	17,133	(12,698)
Changes in unrealized (loss) gain on derivative hedges	(3,267)	6,155	1,266	7,598
Changes in unrealized gain on terminated swaps		236	3,237	471
Income taxes related to other comprehensive income:				
Changes in unrealized gain (loss) on securities available-for-sale	(4,261)	5,077	(6,481)	4,758
Changes in unrealized (loss) gain on derivative hedges	1,322	(2,481)	(510)	(3,057)
Changes in unrealized gain on terminated swaps		(95)	(1,312)	(303)
Total other comprehensive income (loss)	4,907	(4,539)	13,333	(3,231)
Total comprehensive income	$ 16,371	$ 7,498	$ 23,691	$ 19,271

The accompanying notes are an integral part of these consolidated financial statements.

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(In thousands)	**Common stock Shares**	**Common stock Amount**	**Additional paid-in capital**	**Unearned compensation**	**Retained earnings**	**Accumulated other comprehensive (loss) income**	**Treasury stock**	**Total**
Balance at December 31, 2012	25,148	$ 265	$ 585,360	$ (3,035)	$ 122,014	$ (2,979)	$ (34,360)	$ 667,265
Comprehensive income:								
Net income					22,502			22,502
Other comprehensive loss						(3,231)		(3,231)
Total comprehensive income								19,271
Cash dividends declared ($0.36 per share)					(9,068)			(9,068)
Treasury stock purchased	(348)						(8,868)	(8,868)
Forfeited shares	(6)		10	140			(150)	
Exercise of stock options	195				(2,518)		5,100	2,582
Restricted stock grants	155		(690)	(3,717)			4,407	
Stock-based compensation			585	1,227				1,812
Net tax benefit related to stock-based compensation			1,150					1,150
Other, net	(48)		(14)				(1,160)	(1,174)
Balance at June 30, 2013	25,096	$ 265	$ 586,401	$ (5,385)	$ 132,930	$ (6,210)	$ (35,031)	$ 672,970
Balance at December 31, 2013	25,036	$ 265	$ 587,247	$ (5,563)	$ 141,958	$ (9,057)	$ (36,788)	$ 678,062
Comprehensive income:								
Net income					10,358			10,358
Other comprehensive income						13,333		13,333
Total comprehensive income								23,691
Cash dividends declared ($0.18 per share)					(9,122)			(9,122)
Treasury stock purchased	(100)						(2,467)	(2,467)
Forfeited shares	(7)		(6)	156			(150)	
Exercise of stock options	72				(945)		1,793	848
Restricted stock grants	130		44	(3,264)			3,220	
Stock-based compensation			41	1,783				1,824
Net tax benefit related to stock-based compensation			(1,980)					(1,980)
Other, net	(16)		(6)				(387)	(393)
Balance at June 30, 2014	25,115	$ 265	$ 585,340	$ (6,888)	$ 142,249	$ 4,276	$ (34,779)	$ 690,463

The accompanying notes are an integral part of these consolidated financial statements.

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	**Six Months Ended June 30, 2014**	**2013**
Cash flows from operating activities:		
Net (loss) income	$ 10,358	$ 22,502
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	7,385	5,100
Net amortization of securities	1,008	739
Change in unamortized net loan costs and premiums	(1,008)	(2,890)
Premises and equipment depreciation and amortization expense	4,037	3,610
Stock-based compensation expense	1,824	1,812
Accretion of purchase accounting entries, net	(3,479)	(8,884)
Amortization of other intangibles	2,580	2,722
Write down of other real estate owned	160	
Excess tax loss from stock-based payment arrangements	(93)	(1,150)
Income from cash surrender value of bank-owned life insurance policies	(1,458)	(1,394)
Gain on sales of securities, net	(237)	(1,005)
Net (increase) decrease in loans held for sale	(4,345)	21,267
Loss on disposition of assets	715	1,596
Loss (gain) on sale of real estate	170	(67)
Loss on termination of hedges	3,237	
Net change in other	3,968	(938)
Net cash provided by operating activities	24,822	43,020
Cash flows from investing activities:		
Net decrease in trading security	268	253
Proceeds from sales of securities available for sale	79,550	4,591
Proceeds from maturities, calls and prepayments of securities available for sale	68,342	66,176
Purchases of securities available for sale	(447,063)	(185,300)
Proceeds from maturities, calls and prepayments of securities held to maturity	2,764	2,493
Purchases of securities held to maturity	(1,021)	(1,073)
Net change in loans	(268,616)	120,860
Proceeds from sale of Federal Home Loan Bank stock	379	2,118
Purchase of Federal Home Loan Bank stock	(9,576)	
Net investment in limited partnership tax credits	(2,884)	
Proceeds from the sale of premises and equipment	1,756	
Purchase of premises and equipment, net	(4,302)	(7,280)
Acquisitions, net of cash paid	423,416	
Proceeds from sale of other real estate	799	1,472
Net cash (used in) provided by in investing activities	(156,188)	4,310

(continued)

The accompanying notes are an integral part of these consolidated financial statements.

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BERKSHIRE HILLS BANCORP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONCLUDED)

(In thousands)	**Six Months Ended June 30, 2014**	**2013**
Cash flows from financing activities:		
Net increase (decrease) in deposits	189,568	(283,650)
Proceeds from Federal Home Loan Bank advances and other borrowings	2,935,035	491,360
Repayments of Federal Home Loan Bank advances and other borrowings	(2,945,250)	(258,975)
Purchase of treasury stock	(2,467)	(8,868)
Exercise of stock options	848	2,582
Excess tax loss from stock-based payment arrangements	93	1,150
Common stock cash dividends paid	(9,122)	(9,068)
Net cash provided by (used in) financing activities	168,705	(65,469)
Net change in cash and cash equivalents	37,339	(18,139)
Cash and cash equivalents at beginning of year	75,539	98,244
Cash and cash equivalents at end of year	$ 112,878	$ 80,105
Supplemental cash flow information:		
Interest paid on deposits	$ 9,177	$ 10,411
Interest paid on borrowed funds	5,533	7,018
Income taxes paid, net	71	978
Acquisition of non-cash assets and liabilities:		
Assets acquired	18,064	
Liabilities assumed	(441,550)	(919)
Other non-cash changes:		
Other net comprehensive income (loss)	10,096	(3,231)
Real estate owned acquired in settlement of loans	816	2,189

The accompanying notes are an integral part of these consolidated financial statements.

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NOTE 1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and contain all adjustments, consisting solely of normal, recurring adjustments, necessary for a fair presentation of results for such periods.

In addition, these interim financial statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X, and accordingly, certain information and footnote disclosures normally included in financial statements prepared according to U.S. GAAP have been omitted.

The results for any interim period are not necessarily indicative of results for the full year. These consolidated financial statements should be read in conjunction with the audited financial statements and note disclosures for Berkshire Hills Bancorp, Inc. (the Company) previously filed with the Securities and Exchange Commission in the Company s Annual Report on Form 10-K for the year ended December 31, 2013.

Reclassifications

Certain items in prior financial statements have been reclassified to conform to the current presentation.

Recently Adopted Accounting Principles

On January 1, 2014 we adopted Accounting Standards Update (ASU) ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists to eliminate diversity in practice. This ASU requires that companies net their unrecognized tax benefits against all same-jurisdiction net operating losses or tax credit carryforwards that would be used to settle the position with a tax authority. The adoption of this ASU did not have a material effect on our consolidated financial statements.

Future Application of Accounting Pronouncements

In June 2014, the FASB issued ASU No. 2014-11 related to repurchase-to-maturity transactions, repurchase financing and disclosures. The pronouncement changes the accounting for repurchase-to-maturity transactions and linked repurchase financings to secured borrowing accounting, which is consistent with the accounting for other repurchase agreements. The pronouncement also requires two new disclosures. The first disclosure requires an entity to disclose information on transfers accounted for as sales in transactions that are economically similar to repurchase agreements. The second disclosure provides increased transparency about the types of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The pronouncement is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. Early adoption is not permitted. The adoption of this pronouncement is not expected to have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09 related to the recognition of revenue from contracts with customers. The new revenue pronouncement creates a single source of revenue guidance for all companies in all industries and is more principles-based than current revenue guidance. The pronouncement provides a five-step model for a company to recognize revenue when it transfers control of goods or services to customers at an amount that reflects the consideration to which it expects to be entitled in exchange for those goods or services. The five steps are (1) identify the contract with the customer, (2) identify the separate performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the separate performance obligations and (5) recognize revenue when each performance obligation is satisfied. The pronouncement is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2016 using either a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach. Early adoption is not permitted. The Company is currently evaluating the impact of the adoption of this pronouncement on its Consolidated Financial Statements.

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NOTE 2. BRANCH ACQUISITION

New York Branch Acquisition

On January 17, 2014, Berkshire Bank purchased twenty branch banking offices located in central and eastern New York State, from Bank of America, National Association. Berkshire Bank received $423.1 million in cash, which was net of $17.4 million cash consideration paid and acquisition costs, and assumed certain related deposit liabilities associated with these branches (the branch acquisition). Consideration paid included a 2.25% premium on deposits received. The branch acquisition increased the Bank s customer base and lending opportunities, and enhanced the Bank s geographical market presence between Albany and Syracuse, New York. In addition, the acquired deposits augmented the Bank s sources of liquidity.

On the acquisition date, the acquired branches had assets with a carrying value of approximately $8.9 million, including loans outstanding with a carrying value of approximately $4.5 million, as well as deposits with a carrying value of approximately $440.5 million. The results from the acquired branch operations are included in the Company s Consolidated Statement of Income from the date of acquisition.

The assets and liabilities obtained and assumed in the branch acquisition were recorded at fair value based on management s best estimate using information available at the date of acquisition. Consideration paid, and fair values of the assets acquired and liabilities assumed are summarized in the following table:

(in thousands)		As Acquired		Fair Value Adjustments		As Recorded at Acquisition
Consideration paid:						
Cash consideration paid to Bank of Amercia					$	17,105
Recognized amounts of identifiable assets acquired and liabilities assumed, at fair value:						
Cash and short-term investments	$	440,521	$		$	440,521
Loans		4,541		(533)(a)		4,008
Premises and equipment		4,381		(710)(b)		3,671
Core deposit intangibles				2,550(c)		2,550
Other intangibles				(79)(d)		(79)
Deposits		(440,507)		(15)(e)		(440,522)
Other liabilities				(944)(f)		(944)
Total identifiable net assets	$	8,936	$	269	$	9,205
Goodwill					$	7,900

Explanation of Certain Fair Value Adjustments

(a) The adjustment represents the write down of the book value of loans to their estimated fair value based on current interest rates and expected cash flows, which includes an estimate of expected loan loss inherent in the portfolio. Loans that met the criteria and are being accounted for in accordance with ASC 310-30 had a carrying amount of $201 thousand. Non-impaired loans not accounted for under 310-30 had a carrying value of $4.3 million.

(b) The amount represents the adjustment of the book value of buildings, and furniture and equipment, to their estimated fair value based on appraisals and other methods. The adjustments will be depreciated over the estimated economic lives of the assets.

(c) The adjustment represents the value of the core deposit base assumed in the acquisition. The core deposit asset was recorded as an identifiable intangible asset and will be amortized over the estimated useful life of the deposit base.

(d) Represents an intangible liability related to assumed leases, which was recorded as an identifiable intangible and will be amortized over the remaining life of the leases.

(e) The adjustment is necessary because the weighted average interest rate of deposits exceeded the cost of similar funding at the time of acquisition.

(f) Represents an establishment of a reserve on certain acquired lines of credit, which were determined to have specific credit risk at the time of acquisition.

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

Information about the acquired loan portfolio subject to ASC 310-30 as of January 17, 2014 is as follows (in thousands):

		ASC 310-30 Loans
Contractually required principal and interest at acquisition	$	201
Contractual cash flows not expected to be collected (nonaccretable discount)		(100)
Expected cash flows at acquisition		101
Interest component of expected cash flows (accretable premium)		20
Fair value of acquired loans	$	121

The core deposit intangible asset recognized is being amortized over its estimated useful life of approximately nine years utilizing a straight-line method. Other intangibles consist of leasehold intangible liability, which is amortized over the remaining life of three years using a straight-line method.

The goodwill, which is not amortized for book purposes, was assigned to our banking segment and is not deductible for tax purposes.

The fair value of savings and transaction deposit accounts acquired in the branch acquisition was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. The fair value of time deposits was estimated by discounting the contractual future cash flows using market rates offered for time deposits of similar remaining maturities.

Direct acquisition and integration costs of the branch acquisition were expensed as incurred, and totaled $3.7 million during the six months ending June 30, 2014, and none during the same period of 2013.

The following table presents selected unaudited pro forma financial information reflecting the branch acquisition assuming it was completed as of January 1, 2013. The unaudited pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the combined financial results of the Company and acquired branches had the transaction actually been completed at the beginning of the periods presented, nor does it indicate future results for any other interim or full-year period. Pro forma basic and diluted earnings per common share were calculated using Berkshire s actual weighted-average shares outstanding for the periods presented. The unaudited pro forma information is based on the actual financial statements of Berkshire for the periods shown, and on the calculated results of the acquired branches for the 2013 period shown and in 2014 until the date of acquisition, at which time their operations became included in Berkshire s financial statements.

The unaudited pro forma information, for the six months ended June 30, 2014 and 2013, set forth below reflects adjustments related to (a) purchase accounting fair value adjustments; (b) amortization of core deposit and other intangibles; and (c) adjustments to interest income and expense due to additional investments and borrowing reductions as a result of the branch acquisition. Direct acquisition and integration-related costs incurred by the Company during 2014 are reversed; as those expenses are assumed to have occurred prior to 2013. Furthermore, the unaudited pro forma information does not reflect management s estimate of any revenue-enhancing opportunities beyond investment of cash received from deposits, or anticipated cost-savings.

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Information in the following table is shown in thousands, except earnings per share:

	Pro Forma (unaudited) Six months ended June 30, 2014	2013
Net interest income	$ 88,221	$ 86,428
Non-interest income	19,138	32,914
Net income	12,982	22,030
Pro forma earnings per share:		
Basic	$ 0.53	$ 0.89
Diluted	$ 0.52	$ 0.88

NOTE 3. TRADING SECURITY

The Company holds a tax advantaged economic development bond that is being accounted for at fair value. The security had an amortized cost of $12.8 million and $13.1 million, and a fair value of $14.9 million and $14.8 million, at June 30, 2014 and December 31, 2013, respectively. As discussed further in Note 13 - Derivative Financial Instruments and Hedging Activities, the Company has entered into a swap contract to swap-out the fixed rate of the security in exchange for a variable rate. The Company does not purchase securities with the intent of selling them in the near term, and there are no other securities in the trading portfolio at June 30, 2014.

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NOTE 4. SECURITIES AVAILABLE FOR SALE AND HELD TO MATURITY

The following is a summary of securities available for sale and held to maturity:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2014				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	$ 133,188	$ 4,739	$ (513)	$ 137,414
Government-guaranteed residential mortgage-backed securities	79,095	787	(159)	79,723
Government-sponsored residential mortgage-backed securities	796,407	5,956	(5,272)	797,091
Trust preferred securities	15,763	1,170	(1,276)	15,657
Other bonds and obligations	3,237	1	(73)	3,165
Total debt securities	1,027,690	12,653	(7,293)	1,033,050
Marketable equity securities	45,139	3,194	(715)	47,618
Total securities available for sale	1,072,829	15,847	(8,008)	1,080,668
Securities held to maturity				
Municipal bonds and obligations	4,259			4,259
Government-sponsored residential mortgage-backed securities	71	3		74
Tax advantaged economic development bonds	38,509	1,377	(199)	39,687
Other bonds and obligations	339			339
Total securities held to maturity	43,178	1,380	(199)	44,359
Total	$ 1,116,007	$ 17,227	$ (8,207)	$ 1,125,027
December 31, 2013				
Securities available for sale				
Debt securities:				
Municipal bonds and obligations	$ 77,852	$ 1,789	$ (1,970)	$ 77,671
Government-guaranteed residential mortgage-backed securities	78,885	544	(658)	78,771
Government-sponsored residential mortgage-backed securities	531,441	2,000	(10,783)	522,658
Corporate bonds	40,945	157	(1,822)	39,280
Trust preferred securities	16,927	1,249	(1,565)	16,611
Other bonds and obligations	3,250		(166)	3,084
Total debt securities	749,300	5,739	(16,964)	738,075
Marketable equity securities	20,042	2,266	(335)	21,973
Total securities available for sale	769,342	8,005	(17,299)	760,048
Securities held to maturity				
Municipal bonds and obligations	4,244			4,244
Government-sponsored residential mortgage-backed securities	73	2		75
Tax advantaged economic development bonds	40,260	1,255	(414)	41,101
Other bonds and obligations	344			344

Total securities held to maturity		44,921		1,257		(414)		45,764
Total	$	814,263	$	9,262	$	(17,713)	$	805,812

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The amortized cost and estimated fair value of available for sale (AFS) and held to maturity (HTM) securities, segregated by contractual maturity at June 30, 2014 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable. Equity securities have no maturity and are also shown in total.

	Available for sale		Held to maturity	
(In thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Within 1 year	$	$	$ 1,423	$ 1,423
Over 1 year to 5 years	1,258	1,278	17,241	18,131
Over 5 years to 10 years	17,922	18,245	11,558	11,546
Over 10 years	133,008	136,713	12,885	13,185
Total bonds and obligations	152,188	156,236	43,107	44,285
Marketable equity securities	45,139	47,618		
Residential mortgage-backed securities	875,502	876,814	71	74
Total	$ 1,072,829	$ 1,080,668	$ 43,178	$ 44,359

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Securities with unrealized losses, segregated by the duration of their continuous unrealized loss positions, are summarized as follows:

(In thousands)	Less Than Twelve Months Gross Unrealized Losses	Less Than Twelve Months Fair Value	Over Twelve Months Gross Unrealized Losses	Over Twelve Months Fair Value	Total Gross Unrealized Losses	Total Fair Value
June 30, 2014						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	$ 2	$ 401	$ 511	$ 12,503	$ 513	$ 12,904
Government-guaranteed residential mortgage-backed securities	43	11,313	116	4,437	159	15,750
Government-sponsored residential mortgage-backed securities	1,022	151,880	4,250	160,445	5,272	312,325
Trust preferred securities			1,276	2,288	1,276	2,288
Other bonds and obligations	1	53	72	2,937	73	2,990
Total debt securities	1,068	163,647	6,225	182,610	7,293	346,257
Marketable equity securities	472	17,514	243	2,757	715	20,271
Total securities available for sale	1,540	181,161	6,468	185,367	8,008	366,528
Securities held to maturity						
Tax advantaged economic development bonds			199	7,932	199	7,932
Total securities held to maturity			199	7,932	199	7,932
Total	$ 1,540	$ 181,161	$ 6,667	$ 193,299	$ 8,207	$ 374,460
December 31, 2013						
Securities available for sale						
Debt securities:						
Municipal bonds and obligations	$ 1,657	$ 17,776	$ 313	$ 1,854	$ 1,970	$ 19,630
Government guaranteed residential mortgage-backed securities	658	35,631			658	35,631
Government-sponsored residential mortgage-backed securities	10,783	423,203			10,783	423,203
Corporate bonds	1,822	29,124			1,822	29,124
Trust preferred securities			1,565	2,039	1,565	2,039
Other bonds and obligations	166	3,082			166	3,082
Total debt securities	15,086	508,816	1,878	3,893	16,964	512,709
Marketable equity securities	117	1,653	218	1,782	335	3,435
Total securities available for sale	15,203	510,469	2,096	5,675	17,299	516,144
Securities held to maturity						
Tax advantaged economic development bonds	57	9,429	357	7,901	414	17,330
Total securities held to maturity	57	9,429	357	7,901	414	17,330
Total	$ 15,260	$ 519,898	$ 2,453	$ 13,576	$ 17,713	$ 533,474

Debt Securities

The Company expects to recover its amortized cost basis on all debt securities in its AFS and HTM portfolios. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of June 30, 2014, prior to this recovery. The Company s ability and intent to hold these securities until recovery is supported by the Company s strong capital and liquidity positions as well as its historically low portfolio turnover. The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company s AFS and HTM portfolios were not other-than-temporarily impaired at June 30, 2014:

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AFS municipal bonds and obligations

At June 30, 2014, 19 of the total 193 securities in the Company s portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 3.8% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during the second quarter of 2014. All securities are performing.

AFS residential mortgage-backed securities

At June 30, 2014, 55 out of the total 240 securities in the Company s portfolios of AFS residential mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 1.6% of the amortized cost of securities in unrealized loss positions within the AFS portfolio. The Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) guarantee the contractual cash flows of all of the Company s residential mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the past quarter. All securities are performing.

AFS trust preferred securities

At June 30, 2014, 2 out of the total 5 securities in the Company s portfolio of AFS trust preferred securities were in unrealized loss positions. Aggregate unrealized losses represented 35.8% of the amortized cost of securities in unrealized loss positions. The Company s evaluation of the present value of expected cash flows on these securities supports its conclusions about the recoverability of the securities amortized cost basis. Of the 2 securities, 1 security is investment grade rated. The Company reviews the financial strength of all of the single issue trust issuers and has concluded that the amortized cost remains supported by the market value of these securities and they are performing.

At June 30, 2014, $1.1 million of the total unrealized losses was attributable to a $2.8 million investment in a Mezzanine Class B tranche of a $360 million pooled trust preferred security collateralized by banking and insurance entities. The Company evaluated the security, with a Level 3 fair value of $1.4 million, for potential other-than-temporary-impairment (OTTI) at June 30, 2014 and determined that OTTI was not evident based on both the Company s ability and intent to hold the security until the recovery of its remaining amortized cost and the protection from credit loss afforded by $44 million in excess subordination above current and projected losses. The security is performing.

AFS other bonds and obligations

At June 30, 2014, 4 of the total 8 securities in the Company s portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 2.4% of the amortized cost of securities in unrealized loss positions. The securities are investment grade rated and there were no material underlying credit downgrades during the second quarter of 2014. All securities are performing.

HTM tax advantaged economic development bonds

At June 30, 2014, 1 of the total 7 securities in the Company s portfolio of tax advantaged economic development bonds was in an unrealized loss position. Aggregate unrealized losses represented 2.5% of the amortized cost of securities in unrealized loss positions. The Company has the intent of maintaining these bonds to recovery. These securities are performing. The Company expects to receive all future cash flows associated with these securities.

Marketable Equity Securities

In evaluating its marketable equity securities portfolio for OTTI, the Company considers its ability to more likely than not hold an equity security to recovery. The Company additionally considers other various factors including

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the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI is recognized immediately through earnings.

At June 30, 2014, 9 out of the total 29 securities in the Company s portfolio of marketable equity securities were in an unrealized loss position. The unrealized loss represented 3.4% of the amortized cost of the securities. The Company has the ability and intent to hold the securities until a recovery of their cost basis and does not consider the securities other-than-temporarily impaired at June 30, 2014. As new information becomes available in future periods, changes to the Company s assumptions may be warranted and could lead to a different conclusion regarding the OTTI of these securities.

NOTE 5. LOANS

The Company s loan portfolio is segregated into the following segments: residential mortgage, commercial real estate, commercial and industrial, and consumer. Residential mortgage loans include classes for 1- 4 family owner occupied and construction loans. Commercial real estate loans include construction, single and multi-family, and other commercial real estate classes. Commercial and industrial loans include asset based lending loans, lease financing and other commercial business loan classes. Consumer loans include home equity, direct and indirect auto and other. These portfolio segments each have unique risk characteristics that are considered when determining the appropriate level for the allowance for loan losses.

A substantial portion of the loan portfolio is secured by real estate in western Massachusetts, southern Vermont, northeastern New York, and in the Bank s other New England lending areas. The ability of many of the Bank s borrowers to honor their contracts is dependent, among other things, on the specific economy and real estate markets of these areas.

Total loans include business activity loans and acquired loans. Acquired loans are those loans acquired from the acquisitions of the 20 acquired branches, Beacon Federal Bancorp, Inc., The Connecticut Bank and Trust Company, Legacy Bancorp, Inc., and Rome Bancorp, Inc. The following is a summary of total loans:

	June 30, 2014			December 31, 2013		
(In thousands)	**Business Activities Loans**	**Acquired Loans**	**Total**	**Business Activities Loans**	**Acquired Loans**	**Total**
Residential mortgages:						
1-4 family	$ 1,073,431	$ 305,595	$ 1,379,026	$ 1,027,737	$ 333,367	$ 1,361,104
Construction	17,162	1,043	18,205	18,158	5,012	23,170
Total residential mortgages	1,090,593	306,638	1,397,231	1,045,895	338,379	1,384,274
Commercial real estate:						
Construction	165,276	6,824	172,100	125,247	13,770	139,017
Single and multi-family	89,684	61,420	151,104	63,493	64,827	128,320
Other commercial real estate	1,007,268	249,028	1,256,296	871,271	278,512	1,149,783
	1,262,228	317,272	1,579,500	1,060,011	357,109	1,417,120

Total commercial real estate						
Commercial and industrial loans:						
Asset based lending	328,681		328,681	294,241	3,130	297,371
Other commercial and industrial loans	337,801	61,477	399,278	323,196	66,726	389,922
Total commercial and industrial loans	666,482	61,477	727,959	617,437	69,856	687,293
Total commercial loans	1,928,710	378,749	2,307,459	1,677,448	426,965	2,104,413
Consumer loans:						
Home equity	240,301	69,708	310,009	232,677	74,154	306,831
Auto and other	297,010	138,594	435,604	213,171	171,834	385,005
Total consumer loans	537,311	208,302	745,613	445,848	245,988	691,836
Total loans	$ 3,556,614	$ 893,689	$ 4,450,303	$ 3,169,191	$ 1,011,332	$ 4,180,523

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The carrying amount of the acquired loans at June 30, 2014 totaled $894 million. These loans consisted of loans determined to be impaired at the time of acquisition, which are accounted for in accordance with ASC Topic 310-30, with a carrying amount of $23 million (and a note balance of $41 million) and loans that were considered not impaired at the acquisition date with a carrying amount of $871 million.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer.*

	Three Months Ended June 30,	
(In thousands)	**2014**	**2013**
Balance at beginning of period	$ 3,154	$ 5,666
Sales		(301)
Reclassification from nonaccretable difference for loans with improved cash flows	39	
Changes in expected cash flows that do not affect nonaccretable difference	(149)	
Accretion	(604)	(2,037)
Balance at end of period	$ 2,440	$ 3,328

	Six months ended June 30,	
(In thousands)	**2014**	**2013**
Balance at beginning of period	$ 2,559	$ 8,247
Acquisitions		
Sales		(301)
Reclassification from nonaccretable difference for loans with improved cash flows	1,579	
Changes in expected cash flows that do not affect nonaccretable difference	(149)	
Accretion	(1,549)	(4,618)
Balance at end of period	$ 2,440	$ 3,328

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The following is a summary of past due loans at June 30, 2014 and December 31, 2013:

Business Activities Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
June 30, 2014							
Residential mortgages:							
1-4 family	$ 2,785	$ 169	$ 4,885	$ 7,839	$ 1,065,592	$ 1,073,431	$ 1,533
Construction					17,162	17,162	
Total	2,785	169	4,885	7,839	1,082,754	1,090,593	1,533
Commercial real estate:							
Construction			1,370	1,370	163,906	165,276	
Single and multi-family	293	73	832	1,198	88,486	89,684	216
Other commercial real estate	2,567	1,486	9,204	13,257	994,011	1,007,268	1,721
Total	2,860	1,559	11,406	15,825	1,246,403	1,262,228	1,937
Commercial and industrial loans:							
Asset based lending					328,681	328,681	
Other commercial and industrial loans	271	41	3,730	4,042	333,759	337,801	123
Total	271	41	3,730	4,042	662,440	666,482	123
Consumer loans:							
Home equity	490		1,284	1,774	238,527	240,301	303
Auto and other	700	35	344	1,079	295,931	297,010	14
Total	1,190	35	1,628	2,853	534,458	537,311	317
Total	$ 7,106	$ 1,804	$ 21,649	$ 30,559	$ 3,526,055	$ 3,556,614	$ 3,910

Business Activities Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2013							
Residential mortgages:							
1-4 family	$ 2,500	$ 623	$ 7,382	$ 10,505	$ 1,017,232	$ 1,027,737	$ 1,451
Construction			41	41	18,117	18,158	
Total	2,500	623	7,423	10,546	1,035,349	1,045,895	1,451
Commercial real estate:							
Construction	174		3,176	3,350	121,897	125,247	
Single and multi-family	139	654	679	1,472	62,021	63,493	168
Other commercial real estate	622	4,801	6,912	12,335	858,936	871,271	865
Total	935	5,455	10,767	17,157	1,042,854	1,060,011	1,033
Commercial and industrial loans:							
Asset based lending					294,241	294,241	
Other commercial and industrial loans	1,136	386	1,477	2,999	320,197	323,196	42
Total	1,136	386	1,477	2,999	614,438	617,437	42
Consumer loans:							

Home equity	732	54	1,655	2,441	230,236	232,677	572
Auto and other	524	231	390	1,145	212,026	213,171	142
Total	1,256	285	2,045	3,586	442,262	445,848	714
Total	$ 5,827	$ 6,749	$ 21,712	$ 34,288	$ 3,134,903	$ 3,169,191	$ 3,240

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Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
June 30, 2014							
Residential mortgages:							
1-4 family	$ 1,319	$ 801	$ 2,612	$ 4,732	$ 300,863	$ 305,595	$ 669
Construction					1,043	1,043	
Total	1,319	801	2,612	4,732	301,906	306,638	669
Commercial real estate:							
Construction		179	805	984	5,840	6,824	805
Single and multi-family	409	189	1,205	1,803	59,617	61,420	508
Other commercial real estate	782		4,578	5,360	243,668	249,028	2,161
Total	1,191	368	6,588	8,147	309,125	317,272	3,474
Commercial and industrial loans:							
Asset based lending							
Other commercial and industrial loans	544	116	1,820	2,480	58,997	61,477	606
Total	544	116	1,820	2,480	58,997	61,477	606
Consumer loans:							
Home equity	386	20	898	1,304	68,404	69,708	496
Auto and other	1,605	151	1,674	3,430	135,164	138,594	28
Total	1,991	171	2,572	4,734	203,568	208,302	524
Total	$ 5,045	$ 1,456	$ 13,592	$ 20,093	$ 873,596	$ 893,689	$ 5,273

Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2013							
Residential mortgages:							
1-4 family	$ 1,891	$ 437	$ 2,577	$ 4,905	$ 328,462	$ 333,367	$ 805
Construction	134	32	625	791	4,221	5,012	501
Total	2,025	469	3,202	5,696	332,683	338,379	1,306
Commercial real estate:							
Construction			805	805	12,965	13,770	805
Single and multi-family	350	188	1,335	1,873	62,954	64,827	512
Other commercial real estate	537	518	6,108	7,163	271,349	278,512	2,925
Total	887	706	8,248	9,841	347,268	357,109	4,242
Commercial and industrial loans:							
Asset based lending					3,130	3,130	
Other commercial and industrial loans	440	135	1,239	1,814	64,912	66,726	318
Total	440	135	1,239	1,814	68,042	69,856	318
Consumer loans:							
Home equity	425	545	636	1,606	72,548	74,154	35
Auto and other	2,606	641	1,641	4,888	166,946	171,834	82
Total	3,031	1,186	2,277	6,494	239,494	245,988	117
Total	$ 6,383	$ 2,496	$ 14,966	$ 23,845	$ 987,487	$ 1,011,332	$ 5,983

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The following is summary information pertaining to non-accrual loans at June 30, 2014 and December 31, 2013:

(In thousands)	June 30, 2014 Business Activities Loans	June 30, 2014 Acquired Loans	June 30, 2014 Total	December 31, 2013 Business Activities Loans	December 31, 2013 Acquired Loans	December 31, 2013 Total
Residential mortgages:						
1-4 family	$ 3,352	$ 1,943	$ 5,295	$ 5,931	$ 1,772	$ 7,703
Construction				41	123	164
Total	3,352	1,943	5,295	5,972	1,895	7,867
Commercial real estate:						
Construction	1,370		1,370	3,176		3,176
Single and multi-family	616	697	1,313	511	823	1,334
Other commercial real estate	7,483	2,417	9,900	6,047	3,183	9,230
Total	9,469	3,114	12,583	9,734	4,006	13,740
Commercial and industrial loans:						
Other commercial and industrial loans	3,607	1,214	4,821	1,434	921	2,355
Total	3,607	1,214	4,821	1,434	921	2,355
Consumer loans:						
Home equity	981	402	1,383	1,083	602	1,685
Auto and other	330	1,646	1,976	249	1,559	1,808
Total	1,311	2,048	3,359	1,332	2,161	3,493
Total non-accrual loans	$ 17,739	$ 8,319	$ 26,058	$ 18,472	$ 8,983	$ 27,455

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Loans evaluated for impairment as of June 30, 2014 and December 31, 2013 were as follows:

Business Activities Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Total
June 30, 2014					
Loans receivable:					
Balance at end of period					
Individually evaluated for impairment	$ 3,872	$ 21,572	$ 3,505	$ 304	$ 29,253
Collectively evaluated	1,086,721	1,240,656	662,977	537,007	3,527,361
Total	$ 1,090,593	$ 1,262,228	$ 666,482	$ 537,311	$ 3,556,614

Business Activities Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Total
December 31, 2013					
Loans receivable:					
Balance at end of year					
Individually evaluated for impairment	$ 6,237	$ 22,429	$ 1,380	$ 515	$ 30,561
Collectively evaluated for impairment	1,039,658	1,037,582	616,057	445,333	3,138,630
Total	$ 1,045,895	$ 1,060,011	$ 617,437	$ 445,848	$ 3,169,191

Acquired Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Total
June 30, 2014					
Loans receivable:					
Balance at end of Period					
Individually evaluated for impairment	$ 1,054	$ 5,315	$ 485	$	$ 6,854
Collectively evaluated	305,584	311,957	60,992	208,302	886,835
Total	$ 306,638	$ 317,272	$ 61,477	$ 208,302	$ 893,689

Acquired Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Total
December 31, 2013					
Loans receivable:					

Balance at end of year										
Individually evaluated for impairment	$	1,568	$	6,295	$	367	$	154	$	8,384
Collectively evaluated for impairment		336,811		350,814		69,489		245,834		1,002,948
Total	$	338,379	$	357,109	$	69,856	$	245,988	$	1,011,332

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The following is a summary of impaired loans at June 30, 2014:

Business Activities Loans

	At June 30, 2014		
(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	$ 3,338	$ 3,338	$
Other commercial real estate loans	17,341	17,341	
Commercial real esate - construction	1,370	1,370	
Other commercial and industrial loans	566	566	
Consumer - home equity	183	183	
Consumer - other	121	121	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 477	$ 534	$ 57
Other commercial real estate loans	2,149	2,861	712
Other commercial and industrial loans	2,464	2,939	475
Total			
Residential mortgages	$ 3,815	$ 3,872	$ 57
Commercial real estate	20,860	21,572	712
Commercial and industrial loans	3,030	3,505	475
Consumer	304	304	
Total impaired loans	$ 28,009	$ 29,253	$ 1,244

Acquired Loans

	At June 30, 2014		
(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance:			
Residential mortgages - 1-4 family	$ 604	$ 604	$
Other commercial real estate loans	3,919	3,919	
Other commercial and industrial loans	419	419	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 390	$ 450	$ 60
Other commercial real estate loans	1,090	1,396	306
Other commercial and industrial loans	46	66	20
Total			
Residential mortgages	$ 994	$ 1,054	$ 60
Commercial real estate	5,009	5,315	306
Commercial and industrial loans	465	485	20
Total impaired loans	$ 6,468	$ 6,854	$ 386

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The following is a summary of impaired loans at December 31, 2013:

Business Activities Loans

	At December 31, 2013		
(In thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
With no related allowance:			
Residential mortgages - 1-4 family	$ 3,406	$ 3,406	$
Commercial real estate - construction	3,176	3,176	
Commercial real estate - single and multifamily			
Other commercial real estate loans	18,909	18,909	
Other commercial and industrial loans	811	811	
Consumer - home equity	270	270	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 1,926	$ 2,831	$ 905
Commercial real estate - construction			
Commercial real estate - single and multifamily			
Other commercial real estate loans	125	344	219
Other commercial and industrial loans	514	569	55
Consumer - home equity	142	245	103
Total			
Residential mortgages	$ 5,332	$ 6,237	$ 905
Commercial real estate	22,210	22,429	219
Commercial and industrial loans	1,325	1,380	55
Consumer	412	515	103
Total impaired loans	$ 29,279	$ 30,561	$ 1,282

Acquired Loans

	At December 31, 2013		
(In thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**
With no related allowance:			
Residential mortgages - 1-4 family	$ 381	$ 381	$
Other commercial real estate loans	3,853	3,853	
Other commercial and industrial loans	367	367	
With an allowance recorded:			
Residential mortgages - 1-4 family	$ 957	$ 1,187	$ 230
Other commercial real estate loans	1,954	2,442	488
Consumer - home equity	115	154	39
Total			
Residential mortgages	$ 1,338	$ 1,568	$ 230
Other commercial real estate loans	5,807	6,295	488

Other commercial and industrial loans		367		367		
Consumer - home equity		115		154		39
Total impaired loans	$	7,627	$	8,384	$	757

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The following is a summary of the average recorded investment and interest income recognized on impaired loans as of June 30, 2014 and June 30, 2013:

Business Activities Loans

	Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
(in thousands)	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Residential mortgages - 1-4 family	$ 4,661	$ 99	$ 3,911	$ 52
Commercial real estate - construction			2,494	
Commercial real estate - single and multifamily	17,308	312		
Other commercial real estate loans	2,397		16,934	447
Commercial and industrial loans	583	14	539	11
Consumer - home equity	300	3	530	9
Consumer - other	123	2		
With an allowance recorded:				
Residential mortgages - 1-4 family	$ 482	$ 3	$ 2,731	$ 26
Commercial real estate - construction			1,938	
Commercial real estate - single and multifamily	2,858			
Other commercial real estate loans			8,062	91
Commercial and industrial loans	2,055	44	1,554	17
Consumer - home equity			931	1
Total				
Residential mortgages	$ 5,143	$ 102	$ 6,642	$ 78
Commercial real estate	22,563	312	29,428	538
Commercial and industrial loans	2,638	58	2,093	28
Consumer loans	423	5	1,461	10
Total impaired loans	$ 30,767	$ 477	$ 39,624	$ 654

Acquired Loans

	Six Months Ended June 30, 2014		Six Months Ended June 30, 2013	
(in thousands)	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Residential mortgages - 1-4 family	$ 930	$ 5	$ 132	$ 1
Other commercial real estate loans	4,392	51	1,445	54
Commercial and industrial loans	537	8		
Consumer - home equity	51			
With an allowance recorded:				
Residential mortgages - 1-4 family	$ 363	$ 1	$ 708	$ 4
Other commercial real estate loans	1,489	55	1,399	2
Commercial and industrial loans	68	3	181	

Total				
Residential mortgages	$ 1,293	$ 6	$ 840	$ 5
Other commercial real estate loans	5,881	106	2,844	56
Commercial and industrial loans	605	11	181	
Consumer loans	51			
Total impaired loans	$ 7,830	$ 123	$ 3,865	$ 61

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Troubled Debt Restructuring Loans

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

The following tables include the recorded investment and number of modifications identified during the six months ended June 30, 2014 and for the six months ended June 30, 2013, respectively. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. The modifications for the six months ending June 30, 2014 were attributable to concessions granted as ordered by bankruptcy court, interest rate concessions and maturity date extensions. The modifications for the six months ending June 30, 2013 were attributable to interest rate concessions and maturity date extensions.

	Modifications by Class Six months ending June 30, 2014		
(Dollars in thousands)	**Number of Modifications**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Troubled Debt Restructurings			
Residential - 1-4 Family	3	$ 369	$ 366
Commercial - Single and multifamily	1	623	623
Commercial - Other	6	4,804	4,804
	10	$ 5,796	$ 5,793

	Modifications by Class Six months ending June 30, 2013		
(Dollars in thousands)	**Number of Modifications**	**Pre-Modification Outstanding Recorded Investment**	**Post-Modification Outstanding Recorded Investment**
Troubled Debt Restructurings			
Residential - 1-4 Family	5	$ 941	$ 941
Residential - Construction	1	320	320
Commercial - Single and multifamily	2	2,366	2,406
Commercial - Other	10	3,882	3,450
Commercial business - Other	4	100	100
	22	$ 7,609	$ 7,217

The following table discloses the recorded investment and number of modifications for TDRs within the last six months where a concession has been made, that then defaulted in the current reporting period.

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	Modifications that Subsequently Defaulted Six months ending June 30, 2014	
	Number of Contracts	Recorded Investment
Troubled Debt Restructurings		
Commercial and industrial - Other	2	$ 158

	Modifications that Subsequently Defaulted Six months ending June 30, 2013	
	Number of Contracts	Recorded Investment
Troubled Debt Restructurings		
Commercial - Single and multifamily	4	$ 224

The following table presents the Company s TDR activity for the six months ended June 30, 2014 and June 30, 2013:

	Six months ending June 30,	
(In thousands)	**2014**	**2013**
Balance at beginning of the period	$ 10,822	$ 4,626
Principal Payments	(960)	(37)
TDR Status Change (1)	(641)	(1,164)
Other Reductions (2)	99	(482)
Newly Identified TDRs	5,793	7,217
Balance at end of the period	$ 15,113	$ 10,160

(1) TDR Status change classification represents TDR loans with a specified interest rate equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk and the loan was on current payment status and not impaired based on the terms specified by the restructuring agreement.

(2) Other Reductions classification consists of transfer to other real estate owned and charge-offs and advances to loans.

The evaluation of certain loans individually for specific impairment includes loans that were previously classified as TDRs or continue to be classified as TDRs.

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NOTE 6. LOAN LOSS ALLOWANCE

Activity in the allowance for loan losses for the six months ended June 30, 2014 and 2013 was as follows:

Business Activities Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Unallocated	Total
June 30, 2014						
Balance at beginning of period	$ 6,937	$ 13,705	$ 5,173	$ 3,644	$ 68	$ 29,527
Charged-off loans	1,159	1,645	1,426	571		4,801
Recoveries on charged-off loans	64	6	22	177		269
Provision for loan losses	(299)	2,389	1,396	1,597	143	5,226
Balance at end of period	$ 5,543	$ 14,455	$ 5,165	$ 4,847	$ 211	$ 30,221
Individually evaluated for impairment	57	712	475			1,244
Collectively evaluated	5,486	13,743	4,690	4,847	211	28,977
Total	$ 5,543	$ 14,455	$ 5,165	$ 4,847	$ 211	$ 30,221

Business Activities Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Unallocated	Total
June 30, 2013						
Balance at beginning of period	$ 5,928	$ 18,863	$ 5,605	$ 1,466	$ 29	$ 31,891
Charged-off loans	836	2,015	694	600		4,145
Recoveries on charged-off loans	150	451	81	113		795
Provision for loan losses	389	777	376	1,919	117	3,578
Balance at end of period	$ 5,631	$ 18,076	$ 5,368	$ 2,898	$ 146	$ 32,119
Individually evaluated for impairment	302	1,812	903	295		3,312
Collectively evaluated	5,329	16,264	4,465	2,603	146	28,807
Total	$ 5,631	$ 18,076	$ 5,368	$ 2,898	$ 146	$ 32,119

Acquired Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Unallocated	Total
June 30, 2014						
Balance at beginning of period	$ 625	$ 2,339	$ 597	$ 235	$	$ 3,796
Charged-off loans	723	495	176	638		2,032
Recoveries on charged-off loans	161	1	24	23		209

Provision for loan losses	599	246	624	690		2,159
Balance at end of period	$ 662	$ 2,091	$ 1,069	$ 310	$	$ 4,132
Individually evaluated for impairment	60	306	20			386
Collectively evaluated	602	1,785	1,049	310		3,746
Total	$ 662	$ 2,091	$ 1,069	$ 310	$	$ 4,132

Acquired Loans

(In thousands)	Residential mortgages	Commercial real estate	Commercial and industrial loans	Consumer	Unallocated	Total
June 30, 2013						
Balance at beginning of period	$ 509	$ 390	$ 96	$ 314	$ 8	$ 1,317
Charged-off loans	422	682	134	574		1,812
Recoveries on charged-off loans	(4)	11	23	72		102
Provision for loan losses	435	706	112	519	(250)	1,522
Balance at end of period	$ 518	$ 425	$ 97	$ 331	$ (242)	$ 1,129
Individually evaluated for impairment	70	29				99
Collectively evaluated	448	396	97	331	(242)	1,030
Total	518	425	97	331	(242)	1,129

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Credit Quality Information

Business Activities Loans Credit Quality Analysis

The Company monitors the credit quality of its portfolio by using internal risk ratings that are based on regulatory guidance. Loans that are given a Pass rating are not considered a problem credit. Loans that are classified as Special Mention loans are considered to have potential credit problems and are evaluated closely by management. Substandard and non-accruing loans are loans for which a definitive weakness has been identified and which may make full collection of contractual cash flows questionable. Doubtful loans are those with identified weaknesses that make full collection of contractual cash flows, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The Company assigns an internal risk rating at origination and reviews the rating annually, semiannually or quarterly depending on the risk rating. The rating is also reassessed at any point in time when management becomes aware of information that may affect the borrower s ability to fulfill their obligations.

The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Loans that are current within 59 days are rated Pass. Residential mortgages that are 60-89 days delinquent are rated Special Mention. Loans delinquent for 90 days or greater are rated Substandard and generally placed on non-accrual status. Home equity loans are risk rated based on the same rating system as the Company s residential mortgages.

Ratings for other consumer loans, including auto loans, are based on a two rating system. Loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Other consumer loans are placed on non-accrual at such time as they become Non-performing.

Acquired Loans Credit Quality Analysis

Upon acquiring a loan portfolio, our internal loan review function assigns risk ratings to the acquired loans, utilizing the same methodology as it does with business activities loans. This may differ from the risk rating policy of the predecessor bank. Loans which are rated Substandard or worse according to the rating process outlined below are deemed to be credit impaired loans accounted for under ASC 310-30, regardless of whether they are classified as performing or non-performing.

The Bank utilizes an eleven grade internal loan rating system for each of its acquired commercial real estate, construction and commercial loans as outlined in the Credit Quality Information section of this Note. The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Residential mortgages that are current within 59 days are rated Pass. Residential mortgages that are 60 89 days delinquent are rated Special Mention. Residential mortgages delinquent for 90 days or greater are rated Substandard. Home equity loans are risk rated based on the same rating system as the Company s residential mortgages. Other consumer loans are rated based on a two rating system. Other consumer loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Non-performing other consumer loans are deemed to be credit impaired loans accounted for under ASC 310-30.

The Company subjects loans that do not meet the ASC 310-30 criteria to ASC 450-20 by collectively evaluating these loans for an allowance for loan loss. The Company applies a methodology similar to the methodology prescribed for business activities loans, which includes the application of environmental factors to each category of loans. The methodology to collectively evaluate the acquired loans outside the scope of ASC 310-30 includes the application of a number of environmental factors that reflect management s best estimate of the level of incremental credit losses that might be recognized given current conditions. This is reviewed as part of the allowance for loan loss adequacy analysis. As the loan portfolio matures and environmental factors change, the loan portfolio will be reassessed each quarter to determine an appropriate reserve allowance.

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A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time for ASC 310-30 loans. At June 30, 2014, the allowance for loan losses related to acquired loans was $4.1 million using the above mentioned criteria.

The Company presented several tables within this footnote separately for business activity loans and acquired loans in order to distinguish the credit performance of the acquired loans from the business activity loans.

The following table presents the Company s loans by risk rating at June 30, 2014 and December 31, 2013:

Business Activities Loans

Residential Mortgages

Credit Risk Profile by Internally Assigned Grade

	1-4 family		Construction		Total residential mortgages	
(In thousands)	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013
Grade:						
Pass	$ 1,068,377	$ 1,019,732	$ 17,162	$ 18,117	$ 1,085,539	$ 1,037,849
Special mention	169	623			169	623
Substandard	4,885	7,382		41	4,885	7,423
Total	$ 1,073,431	$ 1,027,737	$ 17,162	$ 18,158	$ 1,090,593	$ 1,045,895

Commercial Real Estate

Credit Risk Profile by Creditworthiness Category

	Construction		Single and multi-family		Other		Total commercial real estate	
(In thousands)	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013
Grade:								
Pass	$ 161,733	$ 120,071	$ 86,250	$ 59,636	$ 940,577	$ 800,672	$ 1,188,560	$ 980,379
Special mention			137	140	5,015	8,150	5,152	8,290
Substandard	3,543	5,176	3,297	3,717	61,603	61,807	68,443	70,700
Doubtful					73	642	73	642
Total	$ 165,276	$ 125,247	$ 89,684	$ 63,493	$ 1,007,268	$ 871,271	$ 1,262,228	$ 1,060,011

Commercial and Industrial Loans

Credit Risk Profile by Creditworthiness Category

(In thousands)	Asset based lending June 30, 2014	Asset based lending Dec. 31, 2013	Other June 30, 2014	Other Dec. 31, 2013	Total comm. and industrial loans June 30, 2014	Total comm. and industrial loans Dec. 31, 2013
Grade:						
Pass	$ 328,681	$ 294,241	$ 326,244	$ 313,984	$ 654,925	$ 608,225
Special mention			1,266	884	1,266	884
Substandard			10,291	7,725	10,291	7,725
Doubtful				603		603
Total	$ 328,681	$ 294,241	$ 337,801	$ 323,196	$ 666,482	$ 617,437

Consumer Loans

Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity June 30, 2014	Home equity Dec. 31, 2013	Auto and other June 30, 2014	Auto and other Dec. 31, 2013	Total consumer loans June 30, 2014	Total consumer loans Dec. 31, 2013
Performing	$ 239,017	$ 231,594	$ 296,630	$ 212,922	$ 535,647	$ 444,516
Nonperforming	1,284	1,083	380	249	1,664	1,332
Total	$ 240,301	$ 232,677	$ 297,010	$ 213,171	$ 537,311	$ 445,848

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Acquired Loans

Residential Mortgages

Credit Risk Profile by Internally Assigned Grade

	1-4 family		Construction		Total residential mortgages	
(In thousands)	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013
Grade:						
Pass	$ 302,182	$ 330,353	$ 1,043	$ 1,081	$ 303,225	$ 331,434
Special mention	801	437			801	437
Substandard	2,612	2,577		3,931	2,612	6,508
Total	$ 305,595	$ 333,367	$ 1,043	$ 5,012	$ 306,638	$ 338,379

Commercial Real Estate

Credit Risk Profile by Creditworthiness Category

	Construction		Single and multi-family		Other		Total commercial real estate	
(In thousands)	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013
Grade:								
Pass	$ 4,211	$ 7,154	$ 48,043	$ 46,961	$ 227,566	$ 254,787	$ 279,820	$ 308,902
Special mention	342		827	4,799	6,796	9,034	7,965	13,833
Substandard	2,271	6,616	12,550	13,067	14,666	14,691	29,487	34,374
Total	$ 6,824	$ 13,770	$ 61,420	$ 64,827	$ 249,028	$ 278,512	$ 317,272	$ 357,109

Commercial and Industrial Loans

Credit Risk Profile by Creditworthiness Category

	Asset based lending		Other		Total comm. and industrial loans	
(In thousands)	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013
Grade:						
Pass	$	$ 3,130	$ 54,037	$ 59,615	$ 54,037	$ 62,745
Special mention			3,156	2,396	3,156	2,396
Substandard			4,284	4,715	4,284	4,715
Total	$	$ 3,130	$ 61,477	$ 66,726	$ 61,477	$ 69,856

Consumer Loans

Credit Risk Profile Based on Payment Activity

	Home equity		Auto and other		Total consumer loans	
(In thousands)	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013	June 30, 2014	Dec. 31, 2013
Performing	$ 68,791	$ 73,552	$ 136,769	$ 170,275	$ 205,560	$ 243,827
Nonperforming	917	602	1,825	1,559	2,742	2,161
Total	$ 69,708	$ 74,154	$ 138,594	$ 171,834	$ 208,302	$ 245,988

The following table summarizes information about total loans rated Special Mention or lower as of June 30, 2014 and December 31, 2013. The table below includes consumer loans that are special mention and substandard accruing that are classified in the above table as performing based on payment activity.

	June 30, 2014			December 31, 2013		
(In thousands)	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
Non-Accrual	$ 17,739	$ 8,319	$ 26,058	$ 18,472	$ 8,983	$ 27,455
Substandard Accruing	67,583	30,635	98,218	70,667	38,891	109,558
Total Classified	85,322	38,954	124,276	89,139	47,874	137,013
Special Mention	6,621	12,094	18,715	10,081	17,853	27,934
Total Criticized	$ 91,943	$ 51,048	$ 142,991	$ 99,220	$ 65,727	$ 164,947

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NOTE 7. DEPOSITS

A summary of time deposits is as follows:

(In thousands)	June 30, 2014	December 31, 2013
Time less than $100,000	$ 525,297	$ 490,902
Time $100,000 or more	837,695	510,746
Total time deposits	$ 1,362,992	$ 1,001,648

Included in time deposits are brokered deposits of $286.0 million and $23.4 million at June 30, 2014 and December 31, 2013, respectively. Also included are certificates of deposit through the Certificate of Deposit Account Registry Service (CDARS) network of $30.5 million at June 30, 2014. There were no CDARS deposits at December 31, 2013.

NOTE 8. BORROWED FUNDS

Borrowed funds at June 30, 2014 and December 31, 2013 are summarized, as follows:

	June 30, 2014		December 31, 2013	
(dollars in thousands)	Principal	Weighted Average Rate	Principal	Weighted Average Rate
Short-term borrowings:				
Advances from the FHLBB	$ 900,000	0.21%	$ 862,510	0.22%
Other Borrowings			10,000	1.92
Total short-term borrowings:	900,000	0.21	872,510	0.24
Long-term borrowings:				
Advances from the FHLBB	64,179	0.94	101,918	1.23
Subordinated borrowings	74,249	7.00	74,215	7.00
Junior subordinated borrowings	15,464	2.08	15,464	2.09
Total long-term borrowings:	153,892	3.98	191,597	3.53
Total	$ 1,053,892	0.76%	$ 1,064,107	0.83%

The Bank also maintains a $3.0 million secured line of credit with the FHLBB that bears a daily adjustable rate calculated by the FHLBB. There was no outstanding balance on the FHLBB line of credit for the periods ended June 30, 2014 and December 31, 2013.

The Bank is approved to borrow on a short-term basis from the Federal Reserve Bank of Boston as a non-member bank. The Bank has pledged certain loans and securities to the Federal Reserve Bank to support this arrangement. No borrowings with the Federal Reserve Bank of Boston took place for the periods ended June 30, 2014 and December 31, 2013.

Long-term FHLBB advances consist of advances with an original maturity of more than one year. The advances outstanding at June 30, 2014 include callable advances totaling $5.0 million, and amortizing advances totaling $5.4 million. The advances outstanding at December 31, 2013 include callable advances totaling $5.0 million, and amortizing advances totaling $5.5 million. All FHLBB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.

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A summary of maturities of FHLBB advances as of June 30, 2014 and December 31, 2013 is as follows:

	June 30, 2014		December 31, 2013	
(in thousands, except rates)	**Principal**	**Weighted Average Rate**	**Principal**	**Weighted Average Rate**
Fixed rate advances maturing:				
2014	$ 902,388	0.21%	$ 882,525	0.28%
2015	50,000	0.29		
2016	1,551	0.85	1,583	0.79
2017	5,000	4.33	5,000	4.33
2018 and beyond	5,240	3.84	5,320	3.83
Total fixed rate advances	$ 964,179	0.26%	$ 894,428	0.35%
Variable rate advances maturing:				
2014	$	%	$ 10,000	0.32%
2015			20,000	0.30
2016			10,000	0.30
2017				
2018 and beyond			30,000	0.30
Total variable rate advances	$	%	$ 70,000	0.30%
Total FHLBB advances	$ 964,179	0.26%	$ 964,428	0.32%

In September 2012, the Company issued fifteen year subordinated notes in the amount of $75.0 million at a discount of 1.15%. The interest rate is fixed at 6.875% for the first ten years. After ten years, the notes become callable and convert to an interest rate of three-month LIBOR rate plus 511.3 basis points.

The Company holds 100% of the common stock of Berkshire Hills Capital Trust I (Trust I) which is included in other assets with a cost of $0.5 million. The sole asset of Trust I is $15.5 million of the Company s junior subordinated debentures due in 2035. These debentures bear interest at a variable rate equal to LIBOR plus 1.85% and had a rate of 2.08% and 2.09% at June 30, 2014 and December 31, 2013, respectively. The Company has the right to defer payments of interest for up to five years on the debentures at any time, or from time to time, with certain limitations, including a restriction on the payment of dividends to stockholders while such interest payments on the debentures have been deferred. The Company has not exercised this right to defer payments. The Company has the right to redeem the debentures at par value. Trust I is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, Trust I is not consolidated into the Company s financial statements.

NOTE 9. STOCKHOLDERS EQUITY

The Bank s actual and required capital ratios were as follows:

	June 30, 2014	December 31, 2013	FDIC Minimum to be Well Capitalized

Total capital to risk weighted assets	11.0%	11.6%	10.0%
Tier 1 capital to risk weighted assets	9.5	10.0	6.0
Tier 1 capital to average assets	7.3	8.0	5.0

At each date shown, Berkshire Bank met the conditions to be classified as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table above.

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Accumulated other comprehensive income (loss)

Components of accumulated other comprehensive income (loss) are as follows:

(In thousands)	June 30, 2014	December 31, 2013
Other accumulated comprehensive income (loss), before tax:		
Net unrealized holding gain (loss) on AFS securities	$ 7,839	$ (9,294)
Net loss on effective cash flow hedging derivatives	(1,023)	(2,289)
Net loss on terminated swap		(3,237)
Net unrealized holding gain on pension plans	17	17
Income taxes related to items of accumulated other comprehensive income (loss):		
Net unrealized holding gain (loss) on AFS securities	(2,963)	3,518
Net loss on effective cash flow hedging derivatives	413	923
Net loss on terminated swap		1,312
Net unrealized holding gain on pension plans	(7)	(7)
Accumulated other comprehensive income (loss)	$ 4,276	$ (9,057)

The following table presents the components of other comprehensive income (loss) for the three and six months ended June 30, 2014 and June 30, 2013:

(In thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended June 30, 2014			
Net unrealized holding gain on AFS securities:			
Net unrealized gain arising during the period	$ 11,316	$ (4,344)	$ 6,972
Less: reclassification adjustment for (gains) realized in net income	(203)	83	(120)
Net unrealized holding gain on AFS securities	11,113	(4,261)	6,852
Net loss on cash flow hedging derivatives:			
Net unrealized (losses) arising during the period	(3,267)	1,322	(1,945)
Less: reclassification adjustment for losses realized in net income			
Net gain on cash flow hedging derivatives	(3,267)	1,322	(1,945)
Other Comprehensive Income	$ 7,846	$ (2,939)	$ 4,907
Three Months Ended June 30, 2013			
Net unrealized holding loss on AFS securities:			
Net unrealized (loss) arising during the period	$ (12,427)	$ 4,672	$ (7,755)
Less: reclassification adjustment for losses realized in net income	(1,004)	405	(599)
Net unrealized holding loss on AFS securities	(13,431)	5,077	(8,354)
Net gain on cash flow hedging derivatives:			
Net unrealized gain arising during the period	5,256	(2,118)	3,138
Less: reclassification adjustment for losses realized in net income	899	(363)	536
Net gain on cash flow hedging derivatives	6,155	(2,481)	3,674
Net gain on terminated swap:			
Net unrealized loss arising during the period			

Less: reclassification adjustment for losses realized in net income		236		(95)		141
Net gain on terminated swap		236		(95)		141
Other Comprehensive Loss	$	(7,040)	$	2,501	$	(4,539)

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(In thousands)	Before Tax	Tax Effect	Net of Tax
Six Months Ended June 30, 2014			
Net unrealized holding gain on AFS securities:			
Net unrealized gain arising during the period	$ 17,370	$ (6,576)	$ 10,794
Less: reclassification adjustment for (gains) realized in net income	(237)	95	(142)
Net unrealized holding gain on AFS securities	17,133	(6,481)	10,652
Net loss on cash flow hedging derivatives:			
Net unrealized (loss) arising during the period	(4,127)	1,691	$ (2,436)
Less: reclassification adjustment for losses realized in net income	5,393	(2,201)	3,192
Net gain on cash flow hedging derivatives	1,266	(510)	756
Net loss on terminated swap:			
Net unrealized loss arising during the period			
Less: reclassification adjustment for losses realized in net income	3,237	(1,312)	1,925
Net loss on terminated swap	3,237	(1,312)	1,925
Other Comprehensive Income	$ 21,636	$ (8,303)	$ 13,333
Six Months Ended June 30, 2013			
Net unrealized holding loss on AFS securities:			
Net unrealized (loss) arising during the period	$ (11,694)	$ 4,353	$ (7,341)
Less: reclassification adjustment for (gains) realized in net income	(1,004)	405	(599)
Net unrealized holding loss on AFS securities	(12,698)	4,758	(7,940)
Net gain on cash flow hedging derivatives:			
Net unrealized gain arising during the period	5,687	(2,285)	3,402
Less: reclassification adjustment for losses realized in net income	1,911	(772)	1,139
Net gain on cash flow hedging derivatives	7,598	(3,057)	4,541
Net gain on terminated swap:			
Net unrealized loss arising during the period			
Less: reclassification adjustment for losses realized in net income	471	(303)	168
Net gain on terminated swap	471	(303)	168
Other Comprehensive Loss	$ (4,629)	$ 1,398	$ (3,231)

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The following table presents the changes in each component of accumulated other comprehensive income (loss), for the three and six months ended June 30, 2014 and June 30, 2013:

(in thousands)	Net unrealized holding (loss) gain on AFS Securities	Net loss on effective cash flow hedging derivatives	Net loss on terminated swap	Net unrealized holding loss on pension plans	Total
Three Months Ended June 30, 2014					
Balance at Beginning of Period	$ (1,976)	$ 1,335	$	$ 10	$ (631)
Other Comprehensive Loss Before reclassifications	6,972	(1,945)			5,027
Amounts Reclassified from Accumulated other comprehensive income	(120)				(120)
Total Other Comprehensive Income	6,852	(1,945)			4,907
Balance at End of Period	$ 4,876	$ (610)	$	$ 10	$ 4,276
Three Months Ended June 30, 2013					
Balance at Beginning of Period	$ 7,124	$ (5,690)	$ (2,350)	$ (755)	$ (1,671)
Other Comprehensive Loss Before reclassifications	(7,755)	3,138			(4,617)
Amounts Reclassified from Accumulated other comprehensive income	(599)	536	141		78
Total Other Comprehensive Income	(8,354)	3,674	141		(4,539)
Balance at End of Period	$ (1,230)	$ (2,016)	$ (2,209)	$ (755)	$ (6,210)
Six Months Ended June 30, 2014					
Balance at Beginning of Period	$ (5,776)	$ (1,366)	$ (1,925)	$ 10	$ (9,057)
Other Comprehensive Loss Before reclassifications	10,794	(2,436)			8,358
Amounts Reclassified from Accumulated other comprehensive income	(142)	3,192	1,925		4,975
Total Other Comprehensive Income	10,652	756	1,925		13,333
Balance at End of Period	$ 4,876	$ (610)	$	$ 10	$ 4,276
Six Months Ended June 30, 2013					
Balance at Beginning of Period	$ 6,710	$ (6,557)	$ (2,377)	$ (755)	$ (2,979)
Other Comprehensive Loss Before reclassifications	(7,341)	3,402			(3,939)
Amounts Reclassified from Accumulated other comprehensive income	(599)	1,139	168		708
Total Other Comprehensive Income	(7,940)	4,541	168		(3,231)
Balance at End of Period	$ (1,230)	$ (2,016)	$ (2,209)	$ (755)	$ (6,210)

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The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three and six months ended June 30, 2014 and June 30, 2013:

(in thousands)	Three Months Ended June 30, 2014	2013	Affected Line Item in the Statement where Net Income is Presented
Realized (gains) on AFS securities:			
	$ (203)	$ (1,004)	Non-interest income
	83	405	Tax expense
	(120)	(599)	Net of tax
Realized losses on cash flow hedging derivatives:			
		899	Non-interest income
		(363)	Tax expense
		536	Net of tax
Amortization of realized gains on terminated swap:			
		236	Non-interest income
		(95)	Tax expense
		141	Net of tax
Total reclassifications for the period	$ (120)	$ 78	Net of tax

(in thousands)	Six Months Ended June 30, 2014	2013	Affected Line Item in the Statement Where Net Income Is Presented
Realized (gains) on AFS securities:			
	$ (237)	$ (1,004)	Non-interest income
	95	405	Tax expense
	(142)	(599)	Net of tax
Realized losses on cash flow hedging derivatives:			
	5,393	1,911	Interest income
	(2,201)	(772)	Tax expense
	3,192	1,139	Net of tax
Amortization of realized gains on terminated swap:			
	3,237	471	Interest income
	(1,312)	(303)	Tax expense
	1,925	168	Net of tax
Total reclassifications for the period	$ 4,975	$ 708	Net of tax

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NOTE 10. EARNINGS PER SHARE

Earnings per share have been computed based on the following (average diluted shares outstanding are calculated using the treasury stock method):

(In thousands, except per share data)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Net income	$ 11,464	$ 12,037	$ 10,358	$ 22,502
Average number of common shares issued	26,525	26,525	26,525	26,525
Less: average number of treasury shares	1,417	1,427	1,421	1,344
Less: average number of unvested stock award shares	393	319	397	318
Average number of basic common shares outstanding	24,715	24,779	24,707	24,863
Plus: dilutive effect of unvested stock award shares	44	59	55	68
Plus: dilutive effect of stock options outstanding	50	118	59	118
Average number of diluted common shares outstanding	24,809	24,956	24,821	25,049
Earnings per share:				
Basic	$ 0.46	$ 0.49	$ 0.42	$ 0.91
Diluted	$ 0.46	$ 0.48	$ 0.42	$ 0.90

For the six months ended June 30, 2014, 342 thousand shares of restricted stock and 305 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the six months ended June 30, 2013, 252 thousand shares of restricted stock and 365 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations.

NOTE 11. STOCK-BASED COMPENSATION PLANS

A combined summary of activity in the Company s stock award and stock option plans for the six months ended June 30, 2014 is presented in the following table:

	Non-vested Stock Awards Outstanding		Stock Options Outstanding	
(Shares in thousands)	Number of Shares	Weighted-Average Grant Date Fair Value	Number of Shares	Weighted-Average Exercise Price
Balance, December 31, 2013	334	$ 23.26	442	$ 20.41
Granted	130	25.05		
Stock options exercised			(72)	11.76
Stock awards vested	(66)	22.81		
Forfeited	(7)	23.48		
Expired			(69)	36.65
Balance, June 30, 2014	391	$ 24.33	301	$ 20.17

Exercisable options, June 30, 2014	301	$	20.20

During the six months ended June 30, 2014 and 2013, proceeds from stock option exercises totaled $848 thousand and totaled $2.6 million, respectively. During the six months ended June 30, 2014, there were 66 thousand shares issued in connection with vested stock awards. During the six months ended June 30, 2013, there were 74 thousand shares issued in connection with vested stock awards. All of these shares were issued from available

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treasury stock. Stock-based compensation expense totaled $1.8 million during the six months ended June 30, 2014 and the six months ended June 30, 2013. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

NOTE 12. OPERATING SEGMENTS

The Company has two reportable operating segments, Banking and Insurance, which are delineated by the consolidated subsidiaries of Berkshire Hills Bancorp, Inc. Banking includes the activities of the Bank and its subsidiaries, which provide retail and commercial banking, along with wealth management and investment services. Insurance includes the activities of Berkshire Insurance Group, Inc. (BIG), which provides retail and commercial insurance services. The only other consolidated financial activity of the Company is the Parent, which consists of the transactions of Berkshire Hills Bancorp, Inc. Management fees for corporate services provided by the Bank to BIG and the Parent are eliminated.

The accounting policies of each reportable segment are the same as those of the Company. The Insurance segment and the Parent reimburse the Bank for administrative services provided to them. Income tax expense for the individual segments is calculated based on the activity of the segments, and the Parent records the tax expense or benefit necessary to reconcile to the consolidated total. The Parent does not allocate capital costs. Average assets include securities available-for-sale based on amortized cost.

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A summary of the Company s operating segments was as follows:

(In thousands)	Banking	Insurance	Parent	Eliminations	Total Consolidated
Three months ended June 30, 2014					
Net interest income (expense)	$ 45,244	$	$ (915)	$	$ 44,329
Provision for loan losses	3,989				3,989
Non-interest income	12,046	2,460	12,272	(12,272)	14,506
Non-interest expense	36,970	1,887	406		39,263
Income before income taxes	16,331	573	10,951	(12,272)	15,583
Income tax expense (benefit)	4,409	223	(513)		4,119
Net income	$ 11,922	$ 350	$ 11,464	$ (12,272)	$ 11,464
Average assets (in millions)	$ 6,111	$ 27	$ 744	$ (736)	$ 6,146
Three months ended June 30, 2013					
Net interest income	$ 42,086	$	$ 7,018	$ (8,000)	$ 41,104
Provision for loan losses	2,700				2,700
Non-interest income	13,204	2,402	5,026	(5,026)	15,606
Non-interest expense	35,267	2,038	630		37,935
Income before income taxes	17,323	364	11,414	(13,026)	16,075
Income tax expense (benefit)	4,503	158	(623)		4,038
Net income	$ 12,820	$ 206	$ 12,037	$ (13,026)	$ 12,037
Average assets (in millions)	$ 5,175	$ 27	$ 746	$ (749)	$ 5,199
Six months ended June 30, 2014					
Net interest income	$ 88,954	$	$ (1,859)	$	$ 87,095
Provision for loan losses	7,385				7,385
Non-interest income	13,420	5,509	12,020	(12,020)	18,929
Non-interest expense	79,543	4,209	871		84,623
Income before income taxes	15,446	1,300	9,290	(12,020)	14,016
Income tax expense (benefit)	4,217	509	(1,068)		3,658
Net income	$ 11,229	$ 791	$ 10,358	$ (12,020)	$ 10,358
Average assets (in millions)	$ 5,971	$ 26	$ 733	$ (732)	$ 5,998
Six months ended June 30, 2013					
Net interest income (expense)	$ 84,989	$	$ 13,052	$ (15,000)	$ 83,041
Provision for loan losses	5,100				5,100
Non-interest income	25,022	5,382	9,490	(9,490)	30,404
Non-interest expense	71,956	4,171	1,291		77,418
Income before income taxes	32,955	1,211	21,251	(24,490)	30,927
Income tax expense (benefit)	9,208	468	(1,251)		8,425
Net income	$ 23,747	$ 743	$ 22,502	$ (24,490)	$ 22,502
Average assets (in millions)	$ 5,189	$ 27	$ 751	$ (758)	$ 5,208

NOTE 13. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

As of June 30, 2014, the Company held derivatives with a total notional amount of $911.9 million. That amount included $300.0 million in interest rate swap derivatives that were designated as cash flow hedges for accounting purposes. The Company also had economic hedges and non-hedging derivatives totaling $571.5 million and $40.4 million, respectively, which are not designated as hedges for accounting purposes and are therefore recorded at fair value. Economic hedges included interest rate swaps totaling $518.6 million, and $52.9 million in forward commitment contracts.

As part of the Company s risk management strategy, the Company enters into interest rate swap agreements to mitigate the interest rate risk inherent in certain of the Company s assets and liabilities. Interest rate swap agreements involve the risk of dealing with both Bank customers and institutional derivative counterparties and

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their ability to meet contractual terms. The agreements are entered into with counterparties that meet established credit standards and contain master netting and collateral provisions protecting the at-risk party. The derivatives program is overseen by the Risk Management Committee of the Company s Board of Directors. Based on adherence to the Company s credit standards and the presence of the netting and collateral provisions, the Company believes that the credit risk inherent in these contracts was not significant at June 30, 2014.

The Company pledged collateral to derivative counterparties in the form of cash totaling $1.8 million and securities with an amortized cost of $24.4 million and a fair value of $24.8 million as of June 30, 2014. The Company does not typically require its commercial customers to post cash or securities as collateral on its program of back-to-back economic hedges. However certain language is written into the International Swaps Dealers Association, Inc. (ISDA) and loan documents where, in default situations, the Bank is allowed to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Company may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions.

Information about derivative assets and liabilities at June 30, 2014, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Rate Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Forward-starting interest rate swaps on FHLBB borrowings	$ 300,000	4.8	0.00%	2.29%	$ (1,022)
Total cash flow hedges	300,000				(1,022)
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	12,827	15.4	0.52%	5.09%	(2,322)
Interest rate swaps on loans with commercial loan customers	252,874	5.9	2.34%	4.58%	(9,193)
Reverse interest rate swaps on loans with commercial loan customers	252,874	5.9	4.58%	2.34%	9,222
Forward sale commitments	52,922	0.2			(561)
Total economic hedges	571,497				(2,854)
Non-hedging derivatives:					
Interest rate lock commitments	40,391	0.2			660
Total non-hedging derivatives	40,391				660
Total	$ 911,888				$ (3,216)

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Information about derivative assets and liabilities at December 31, 2013, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLBB borrowings	$ 150,000	2.5	0.25%	2.61%	$ (3,102)
Forward-starting interest rate swaps on FHLBB borrowings	260,000	4.5		1.88%	1,015
Interest rate swaps on junior subordinated notes	15,000	0.4	2.09%	5.54%	(203)
Total cash flow hedges	425,000				(2,290)
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	13,095	15.9	0.54%	5.09%	(1,889)
Interest rate swaps on loans with commercial loan customers	206,933	5.4	2.44%	4.68%	(6,278)
Reverse interest rate swaps on loans with commercial loan customers	206,933	5.4	4.68%	2.44%	6,286
Forward sale commitments	32,911	0.2			261
Total economic hedges	459,872				(1,620)
Non-hedging derivatives:					
Interest rate lock commitments	20,199	0.2			258
Total non-hedging derivatives	20,199				258
Total	$ 905,071				$ (3,652)

Cash flow hedges

The effective portion of unrealized changes in the fair value of derivatives accounted for as cash flow hedges is reported in other comprehensive income and subsequently reclassified to earnings in the same period or periods during which the hedged transaction is forecasted to affect earnings. Each quarter, the Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or transaction. The ineffective portion of changes in the fair value of the derivatives is recognized directly in earnings.

The Company has entered into six forward-starting interest rate swap contracts with a combined notional value of $300.0 million as of June 30, 2014. The six forward starting swaps will become effective in 2016. All have durations of three years. This hedge strategy converts the one month rolling FHLBB borrowings based on the FHLBB s one month fixed interest rate to fixed interest rates, thereby protecting the Company from floating interest rate variability.

Amounts included in the Consolidated Statements of Income and in the other comprehensive income section of the Consolidated Statements of Comprehensive Income (related to interest rate derivatives designated as hedges of cash flows), were as follows:

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(In thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Interest rate swaps on FHLBB borrowings:				
Unrealized (loss) gain recognized in accumulated other comprehensive loss	$ (3,343)	$ 5,131	$ (4,127)	$ 5,437
Reclassification of unrealized (loss) gain from accumulated other comprehensive loss to interest expense		899		1,910
Reclassification of unrealized loss from accumulated other comprehensive loss to other non-interest income for termination of swaps		236	8,630	472
Reclassification of unrealized deferred tax benefit from accumulated other comprehensive loss to tax expense for terminated swaps		(95)	(3,611)	(303)
Net tax benefit (expense) on items recognized in accumulated other comprehensive loss	1,352	(2,433)	1,666	(2,955)
Interest rate swaps on junior subordinated debentures:				
Unrealized loss recognized in accumulated other comprehensive loss		(4)	(1)	(5)
Reclassification of unrealized loss from accumulated other comprehensive loss to interest expense	75	129	204	256
Net tax expense on items recognized in accumulated other comprehensive loss	(29)	(48)	(80)	(102)
Other comprehensive income recorded in accumulated other comprehensive loss, net of reclassification adjustments and tax effects	$ (1,945)	$ 3,815	$ 2,681	$ 4,710
Net interest expense recognized in interest expense on hedged FHLBB borrowings	$	$ 1,076	$	$ 2,319
Net interest expense recognized in interest expense on junior subordinated notes	$ 75	$ 129	$ 204	$ 256

Hedge ineffectiveness on interest rate swaps designated as cash flow hedges was immaterial to the Company s financial statements during the three and six months ended June 30, 2014 and 2013.

Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on the Company s variable-rate liabilities. During the next twelve months, the Company does not anticipate any such reclassifications.

As a result of the branch acquisition, in the first quarter of 2014, the Company initiated and subsequently terminated all of its interest rate swaps, with various institutions, associated with FHLB advances with 3-month LIBOR based floating interest rates with an aggregate notional amount of $30 million, all of its interest rate swaps associated with 90 day rolling FHLB advances issued using the FHLB s 3-month fixed interest rate with an aggregate notional amount of $145 million and all of its forward-starting interest rate swaps associated with 90 day rolling FHLB advances issued using the FHLB s 3-month fixed interest rate with an aggregate notional amount of $235 million. In the first quarter of 2014, the Company elected to extinguish $215 million of FHLB advances related to the terminated swaps. As a result the Company reclassified $8.6 million of losses from the effective portion of the unrealized changes in the fair value of the terminated derivatives from other comprehensive income to non-interest income as the forecasted transactions to the related FHLB advances will not occur.

Economic hedges

As of June 30, 2014, the Company has an interest rate swap with a $12.8 million notional amount to swap out the fixed rate of interest on an economic development bond bearing a fixed rate of 5.09%, currently within the Company s trading portfolio under the fair value option, in exchange for a LIBOR-based floating rate. The intent of the economic hedge is to improve the Company s asset sensitivity to changing interest rates in anticipation of favorable average floating rates of interest over the 21-year life of the bond. The fair value changes of the economic development bond are mostly offset by fair value changes of the related interest rate swap.

The Company also offers certain derivative products directly to qualified commercial borrowers. The Company economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third-party financial institutions. The transaction allows the Company s customer to convert a variable-rate loan to a fixed rate loan. Because the Company acts as an intermediary for its customer,

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changes in the fair value of the underlying derivative contracts mostly offset each other in earnings. Credit valuation adjustments arising from the difference in credit worthiness of the commercial loan and financial institution counterparties totaled $28.4 thousand as of June 30, 2014. The interest income and expense on these mirror image swaps exactly offset each other.

The Company utilizes forward sale commitments to hedge interest rate risk and the associated effects on the fair value of interest rate lock commitments and loans held for sale. The forward sale commitments are accounted for as derivatives with changes in fair value recorded in current period earnings.

The Company uses the following types of forward sale commitments contracts:

- Best efforts loan sales,
- Mandatory delivery loan sales, and
- To Be Announced (TBA) mortgage-backed securities sales.

A best efforts contract refers to a loan sale agreement where the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. The Company may enter into a best efforts contract once the price is known, which is shortly after the potential borrower s interest rate is locked.

A mandatory delivery contract is a loan sale agreement where the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. Generally, the Company may enter into mandatory delivery contracts shortly after the loan closes with a customer.

The Company may sell TBA mortgage-backed securities to hedge the changes in fair value of interest rate lock commitments and held for sale loans, which do not have corresponding best efforts or mandatory delivery contracts. These security sales transactions are closed once mandatory contracts are written. On the closing date the price of the security is locked-in, and the sale is paired-off with a purchase of the same security. Settlement of the security purchase/sale transaction is done with cash on a net-basis.

Non-hedging derivatives

The Company enters into interest rate lock commitments (IRLCs) for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance. Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. The IRLCs are free-standing derivatives which are carried at fair value with changes recorded in noninterest income in the Company s consolidated statements of income. Changes in the fair value of IRLCs subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time.

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Amounts included in the Consolidated Statements of Income related to economic hedges and non-hedging derivatives were as follows:

(In thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Economic hedges				
Interest rate swap on industrial revenue bond:				
Unrealized (loss) gain recognized in other non-interest income	$ (350)	$ 665	$ (731)	$ 772
Interest rate swaps on loans with commercial loan customers:				
Unrealized gain recognized in other non-interest income	(1,919)	4,996	(1,732)	6,550
Reverse interest rate swaps on loans with commercial loan customers:				
Unrealized loss recognized in other non-interest income	1,919	(4,996)	1,732	(6,550)
Favorable change in credit valuation adjustment recognized in other non-interest income	4	259	11	337
Forward Commitments:				
Unrealized loss recognized in other non-interest income	(561)	4,913	(669)	4,363
Realized loss in other non-interest income	(177)	517	(341)	1,572
Non-hedging derivatives				
Interest rate lock commitments				
Unrealized gain recognized in other non-interest income	660	(1,507)	1,037	1,251
Realized gain in other non-interest income	$ 769	$ 2,758	$ 1,035	$ 3,998

Assets and Liabilities Subject to Enforceable Master Netting Arrangements

Interest Rate Swap Agreements (Swap Agreements   )

The Company enters into swap agreements to facilitate the risk management strategies for commercial banking customers. The Company mitigates this risk by entering into equal and offsetting swap agreements with highly rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company   s consolidated statements of condition. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral generally in the form of marketable securities is received or posted by the counterparty with net liability positions, respectively, in accordance with contract thresholds. The Company had net asset positions with its commercial banking counterparties totaling $9.4 million and $7.8 million as of June 30, 2014 and December 31, 2013, respectively. The Company had net liability positions with its financial institution counterparties totaling $12.6 million and $11.2 million as of June 30, 2014 and December 31, 2013, respectively. At June 30, 2014, the Company also had a net liability position of $144 thousand with its commercial banking counterparties as compared to a $720 thousand liability at December 31, 2013. The collateral posted by the Company that covered liability positions was $12.6 million and $11.2 million as of June 30, 2014 and December 31, 2013, respectively.

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The following table presents the assets and liabilities subject to an enforceable master netting arrangement as of June 30, 2014 and December 31, 2013:

Offsetting of Financial Assets and Derivative Assets

(in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Gross Amounts Not Offset in the Statements of Condition: Cash Collateral Received	Net Amount
As of June 30, 2014						
Interest Rate Swap Agreements:						
Institutional counterparties	$	$	$	$	$	$
Commercial counterparties	9,368	(2)	9,366			9,366
Total	$ 9,368	$ (2)	$ 9,366	$	$	$ 9,366

Offsetting of Financial Liabilities and Derivative Liabilities

(in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Gross Amounts Not Offset in the Statements of Condition: Cash Collateral Pledged	Net Amount
As of June 30, 2014						
Interest Rate Swap Agreements:						
Institutional counterparties	$ (12,738)	$ 170	$ (12,568)	$ 10,868	$ 1,700	$
Commercial counterparties	(144)		(144)			(144)
Total	$ (12,882)	$ 170	$ (12,712)	$ 10,868	$ 1,700	$ (144)

Offsetting of Financial Assets and Derivative Assets

(in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Gross Amounts Not Offset in the Statements of Condition: Cash Collateral Received	Net Amount
As of December 31, 2013						
Interest Rate Swap Agreements:						
Institutional counterparties	$	$	$	$	$	$
Commercial counterparties	7,799		7,799			7,799
Total	$ 7,799	$	$ 7,799	$	$	$ 7,799

Offsetting of Financial Liabilities and Derivative Liabilities

(in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition: Financial Instruments	Gross Amounts Not Offset in the Statements of Condition: Cash Collateral Pledged	Net Amount
As of December 31, 2013						
Interest Rate Swap Agreements:						
Institutional counterparties	$ (13,157)	$ 1,913	$ (11,244)	$ 9,544	$ 1,700	$
Commercial counterparties	(720)		(720)			(720)
Total	$ (13,877)	$ 1,913	$ (11,964)	$ 9,544	$ 1,700	$ (720)

NOTE 14. FAIR VALUE MEASUREMENTS

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company s financial assets and financial liabilities that are carried at fair value.

Recurring fair value measurements

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

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(In thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
		June 30, 2014		
Trading security	$	$	$ 14,971	$ 14,971
Available-for-sale securities:				
Municipal bonds and obligations		137,414		137,414
Governmentguaranteed residential mortgage-backed securities		79,723		79,723
Government-sponsored residential mortgage-backed securities		797,091		797,091
Trust preferred securities		14,236	1,421	15,657
Other bonds and obligations		3,165		3,165
Marketable equity securities	46,465	357	796	47,618
Loans held for sale		20,185		20,185
Derivative assets		9,538	660	10,198
Derivative liabilities	398	12,917	163	13,478

(In thousands)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
		December 31, 2013		
Trading security	$	$	$ 14,840	$ 14,840
Available-for-sale securities:				
Municipal bonds and obligations		77,671		77,671
Government guaranteed residential mortgage-backed securities		78,771		78,771
Government-sponsored residential mortgage-backed securities		522,658		522,658
Corporate bonds		39,280		39,280
Trust preferred securities		15,372	1,239	16,611
Other bonds and obligations		3,084		3,084
Marketable equity securities	20,891	357	725	21,973
Loans Held for Sale		15,840		15,840
Derivative assets	242	7,799	277	8,318
Derivative liabilities		11,964		11,964

There were no transfers between levels during the six months ended June 30, 2014 or 2013.

Trading Security at Fair Value. The Company holds one security designated as a trading security. It is a tax advantaged economic development bond issued to the Company by a local nonprofit which provides wellness and health programs. The determination of the fair value for this security is determined based on a discounted cash flow methodology. Certain inputs to the fair value calculation are unobservable and there is little to no market activity in the security; therefore, the security meets the definition of a Level 3 security. The discount rate used in the valuation of the security is sensitive to movements in the 3-month LIBOR rate.

Securities Available for Sale. AFS securities classified as Level 1 consist of publicly-traded equity securities for which the fair values can be obtained through quoted market prices in active exchange markets. AFS securities classified as Level 2 include most of the Company s debt securities. The pricing on Level 2 was primarily sourced from third party pricing services, overseen by management, and is based on models that consider standard input factors such as dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond s terms and condition, among other things. The Company holds one pooled trust preferred security and one privately owned equity security. Both securities fair values are based on unobservable issuer-provided financial information and the pooled security also utilizes discounted cash flow models derived from the underlying structured pool and therefore both are classified as Level 3.

Loans held for sale. The Company elected the fair value option for all loans held for sale (HFS) originated on or after May 1, 2012. Loans HFS are classified as Level 2 as the fair value is based on input factors such as quoted prices for similar loans in active markets.

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June 30, 2014 (In thousands)	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
Loans Held for Sale	$ 20,185	$ 19,519	$ 666

December 31, 2013 (In thousands)	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
Loans Held for Sale	$ 15,840	$ 15,641	$ 199

The changes in fair value of loans held for sale for the three and six months ended June 30, 2014, were gains of $427 thousand and $467 thousand, respectively. The changes in fair value of loans held for sale were losses of $2.9 million and $3.9 million for the three and six months ended June 30, 2013. The changes in fair value are included in mortgage banking income in the Consolidated Statements of Income.

Derivative Assets and Liabilities.

Interest Rate Swap. The valuation of the Company s interest rate swaps is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty s nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings.

Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of June 30, 2014, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

Interest Rate Lock Commitments. The Company enters into IRLCs for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. The estimated fair value of commitments to originate residential mortgage loans for sale is based on quoted prices for similar loans in active markets. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close, and by the non-refundable costs of originating the loan. The closing ratio is derived from the Bank s internal data and is adjusted using significant management judgment. The costs to originate are primarily based on the Company s internal commission rates that are not observable. As such, IRLCs are classified as Level 3 measurements.

Forward Sale Commitments. The Company utilizes forward sale commitments as economic hedges against potential changes in the values of the IRLCs and loans held for sale. To Be Announced (TBA) mortgage-backed securities forward commitment sales are used as the hedging instrument, are classified as Level 1, and consist of publicly-traded debt securities for which identical fair values can be obtained through quoted market prices in active exchange markets. The fair values of the Company s best efforts and mandatory delivery loan sale commitments are determined similarly to the IRLCs using quoted prices in the market place that are observable. However, costs to originate and closing ratios included in the calculation are internally generated and are based on management s judgment and prior experience, which are considered factors that are not observable. As such, best efforts and mandatory forward commitments are classified as Level 3 measurements.

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The table below presents the changes in Level 3 assets and liabilities that were measured at fair value on a recurring basis for the three and six months ended June 30, 2014 and June 30, 2013.

	Assets (Liabilities)			
(In thousands)	**Trading Security**	**Securities Available for Sale**	**Interest Rate Lock Commitments**	**Forward Commitments**
Three Months Ended June 30, 2014				
Balance as of March 31, 2014	$ 14,923	$ 2,046	$ 377	$ (96)
Purchase of Marketable Equity Security				
Unrealized (loss) gain, net recognized in other non-interest income	181		1,075	(67)
Unrealized gain included in accumulated other comprehensive loss		171		
Paydown of trading security	(133)			
Transfers to held for sale loans			(792)	
Balance as of June 30, 2014	$ 14,971	$ 2,217	$ 660	$ (163)
Six Months Ended June 30, 2014				
Balance as of December 31, 2013	$ 14,840	$ 1,964	$ 258	$ 19
Purchase of Marketable Equity Security				
Unrealized (loss) gain, net recognized in other non-interest income	399		1,794	(182)
Unrealized gain included in accumulated other comprehensive loss		253		
Paydown of trading account security	(268)			
Transfers to held for sale loans			(1,392)	
Balance as of June 30, 2014	$ 14,971	$ 2,217	$ 660	$ (163)
Unrealized gains (losses) relating to instruments still held at June 30, 2014	$ 2,144	$ (1,118)	$ 660	$ (163)

	Assets (Liabilities)	
	Securities	**Interest Rate**