TAYLOR CALVIN B BANKSHARES INC
Form 10-K
March 10, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2010
Commission File No. 000-50047

Calvin B. Taylor Bankshares, Inc.

(Exact name of registrant as specified in its Charter)

Maryland

(State of incorporation or organization)

52-1948274

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

24 North Main Street, Berlin, Maryland 21811

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (410) 641-1700

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $1.00 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes ____ No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes ____ No [X]

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 ____

Indicate by check mark whether the registrant has submitted electronically and posted on its Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post

such files). Yes ____ No ____ Not required [X]

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ____ Accelerated filer [X]
Non- accelerated filer ____ (Do not check if a smaller reporting company) Smaller reporting company ____

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

The aggregate market value of the Common Stock, all of which has voting rights, held by non-affiliates of the registrant on December 31, 2010, was $71,940,793. This calculation is based upon the last price known to the registrant at which its Common Stock was sold as of the last business day of the registrant's most recently completed second fiscal quarter. As of June 30, 2010, the last known sale price was $29.00 per share. There is not an active trading market for the Common Stock and it is not possible to identify precisely the market value of the Common Stock.

On February 28, 2011, 3,000,508 shares of the registrant's common stock were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

The Company's Proxy Statement for Annual Meeting of Stockholders to be held on May 11, 2011, is incorporated by reference in this Form 10-K in Part III, Item 10, Item 11, Item 12, Item 13, and Item 14. The Company's Annual Report to Stockholders for the year ended December 31, 2010, pages 1 through 26, are incorporated by reference in this Form 10-K in Part II, Item 8. Financial Statements and Supplementary Data.

This Report contains statements which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Securities Exchange Act of 1934. These statements appear in a number of places in this Report and include all statements regarding the intent, belief or current expectations of the Company, its directors, or its officers with respect to, among other things: (i) the Company's financing plans; (ii) trends affecting the Company's financial condition or results of operations; (iii) the Company's growth strategy and operating strategy; and (iv) the declaration and payment of dividends. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors discussed herein and those factors discussed in detail in the Company's filings with the Securities and Exchange Commission.

PART I

Item 1. Business

General

Calvin B. Taylor Bankshares, Inc. (Company) was incorporated as a Maryland corporation on October 31, 1995. The Company owns all of the stock of Calvin B. Taylor Banking Company of Berlin, Maryland (Bank). The Bank, which commenced operation in 1890, is a commercial bank incorporated under the laws of the State of Maryland on December 17, 1907, with a main office located in Berlin, Maryland.

Location and Service Area

The Company, through the Bank, is engaged in a general commercial and retail banking business serving individuals, small- to medium-sized businesses, professional organizations, and governmental units. The Bank operates nine branches located throughout Worcester County, Maryland and one branch located in Sussex County, Delaware. The Bank draws most of its customer deposits and conducts most of its lending transactions within the communities in which these branches are located.

Much of the Bank’s service area is located along the shores of the Atlantic Ocean and has grown as both a resort and a retirement community. The principal components of the economy are tourism and agriculture. Berlin has a strong component of health-care related businesses. The tourist businesses of Ocean City, Maryland and Bethany, Delaware and the health-care facilities in Berlin, Maryland (including Berlin Nursing Home and Atlantic General Hospital) are among the largest employers in the counties.

Banking Products and Services

The Bank offers a full range of deposit services including checking, NOW, Money Market, and savings accounts, and time deposits including certificates of deposit. The transaction, savings, and certificate of deposit accounts are tailored to the Bank’s principal market areas at rates competitive to those offered in the area. The Bank also offers Individual Retirement Accounts (IRA), Health Savings Accounts, and Education Savings Accounts. All deposits are insured by the Federal Deposit Insurance Corporation (FDIC) up to the maximum amount allowed by law. The Bank solicits these accounts from individuals, businesses, associations and organizations, and governmental authorities. The Bank offers individual customers up to $50 million in FDIC insured deposits through the Certificate of Deposit Account Registry Services® (CDARS).

The Bank also offers a full range of short- to medium-term commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans include secured and unsecured loans for financing automobiles, home improvements, education, and personal investments. The Bank originates commercial and residential mortgage loans and real estate construction and acquisition loans. These lending activities are subject to a variety of lending limits imposed by state and federal law. The Bank lends to directors and officers of the Company and the Bank under terms comparable to those offered to other borrowers entering into similar loan transactions. The Board of Directors approves all loans to officers and directors and reviews these loans every six months.

Other bank services include cash management services, 24-hour ATM’s, debit cards, safe deposit boxes, travelers’ checks, direct deposit of payroll and social security funds, and automatic drafts for various accounts. The Bank offers bank-by-phone and Internet banking services, including electronic bill-payment, as well as electronic statement delivery to both commercial and retail customers. The Bank’s commercial customers can subscribe to a remote capture service that enables them to electronically capture check images and make on-line deposits. The Bank also offers non-deposit products including retail repurchase agreements.

Competition

The Company and the Bank face strong competition in all areas of operations. The competition comes from entities operating in Worcester County, Maryland and Sussex County, Delaware and neighboring counties and includes branches of some of the largest banks in Maryland, Delaware, and Virginia. Its most direct competition for deposits historically has come from other commercial banks, savings banks, savings and loan associations, and credit unions operating in its service areas. The Bank also competes for deposits with money market mutual funds and corporate and government securities. The Bank competes for loans with the same banking entities, as well as mortgage banking companies and other institutional lenders. The competition for loans varies from time to time depending on certain factors. These factors include, among others, the general availability of lendable funds and credit, general and local economic conditions, current interest rate levels, conditions in the mortgage market, and other factors which are not readily predictable.

The Bank employs traditional marketing media including local newspapers and radio, to attract new customers. Bank officers, directors, and employees are active in numerous community organizations and participate in community-based events. These activities and referrals by satisfied customers result in new business.

Employees

As of December 31, 2010, the Bank employed 89 full-time equivalent employees. The Company's operations are conducted through the Bank. Consequently, the Company does not have separate employees. None of the employees of the Bank are represented by any collective bargaining unit. The Bank considers its relations with its employees to be good.

SUPERVISION AND REGULATION

The Company and the Bank are subject to state and federal banking laws and regulations which impose specific requirements or restrictions on, and provide for general regulatory oversight with respect to, virtually all aspects of operations. These laws and regulations are generally intended to protect depositors, not stockholders. The following is a summary of certain significant laws and regulations affecting the Company and the Bank. To the extent that the following summary describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory and regulatory provisions.

Proposed legislative changes and the policies of various regulatory authorities may affect the operations of the Company and the Bank and those effects may be material. The Company is unable to predict the nature or the extent of the effect on its business and earnings that fiscal or monetary policies, economic controls, or new federal or state legislation may have in the future.

Recent Economic and Legislative Developments

The wave of bank and thrift failures that began in late 2008 has continued throughout 2009 and 2010. Securitization of subprime, adjustable rate mortgage loans originated in the United States has been cited as contributing to a global economic recession. Other contributory factors include a pool of investors willing to tolerate the risks attached to high yield mortgage backed securities, complex investment products that were not understood by investors or auditors/examiners, and inadequate oversight. Although neither the Company nor the Bank originated or invested in subprime loans, the economic downturn has affected their ability to invest profitably and the ability of some customers to repay their loans.

The Federal Reserve Open Market Committee reduced the federal funds rate from 4.25% at the beginning of 2008 to a range of 0.00% to 0.25% at the end of 2008. This low rate has remained through 2010. Other short-term investments have experienced similar declines. The impact on the Company is reduced interest revenues and yields on federal funds sold, debt securities, and certificates of deposit in other banks. This generally low rate environment has also driven down yields on loans.

In the most stable economic times, the Company cannot reliably predict the effect of changing government policies on earnings, or loan and deposit levels. The impact on future results of operation of the Company and the Bank due to turbulent economic times are uncertain. Management expects this pattern of lower net interest income and higher fees associated with loan collection to continue through 2011.

-

The Dodd-Frank Act

On July 21, 2010, financial regulatory reform legislation entitled The "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the "Dodd-Frank Act") was signed into law in July 2010. It implements changes in financial institution regulations that include:

.. Creation of the Consumer Financial Protection Bureau with responsibility for implementing, examining and enforcing compliance with federal consumer financial laws.

.. Changes to the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, elimination of the cap on the size of the Deposit Insurance Fund ("DIF") and an increase to the lowest level permissible for the DIF.

.. Provision of unlimited federal deposit insurance for non-interest bearing demand transaction accounts in insured depository institutions until December 31, 2012.

.. Repeal the federal regulations prohibiting the payment of interest on demand deposit accounts of businesses depositors.

.. Amendment of the Electronic Fund Transfer Act ("EFTA") to authorize the Federal Reserve to issue rules governing interchange fees charged for debit card transactions for card issuers having assets over $10 billion, and giving Federal Reserve enforcement power over a new requirement that these fees be reasonable and proportional to the actual cost of the transaction to the issuer.

The full impact of the Dodd-Frank Act to the Company and the Bank is not known at this time. Due to the complexity of this legislation, various provisions will be effective over the coming years. Management does anticipate that revenues will be adversely impacted by the limitation of interchange fees. Although the Bank does not have assets over $10 billion, it is anticipated that smaller community banks will be forced to match the fee reductions of larger institutions with which they compete.

The Company

Bank Holding Company Act of 1956

The Company is a bank holding company within the meaning of the federal Bank Holding Company Act of 1956 (BHCA). Under the BHCA, the Company is subject to periodic examination by the Federal Reserve and is required to file periodic reports of its operations and such additional information as the Federal Reserve may require. The Company's and the Bank’s activities are limited to banking, managing or controlling banks, furnishing services to or performing services for its Subsidiary, or engaging in any other activity that the Federal Reserve determines to be so closely related to banking or managing and controlling banks as to be a proper incident thereto.

Investments, Control, and Activities. With certain limited exceptions, the BHCA requires a bank holding company to obtain the prior approval of the Federal Reserve before (i) acquiring substantially all the assets of any bank, (ii) acquiring direct or indirect ownership or control of any voting shares of any bank if after such acquisition it would own or control more than 5% of the voting shares of such bank (unless it already owns or controls the majority of such shares), or (iii) merging or consolidating with another bank holding company.

In addition, and subject to certain exceptions, the BHCA and the Change in Bank Control Act, together with regulations thereunder, require Federal Reserve approval (or, depending on the circumstances, no notice of disapproval) prior to any person or company acquiring "control" of a bank holding company, such as the Company. Control is conclusively presumed to exist if an individual or company acquires 25% or more of any class of voting securities of the bank holding company. Because the Company's Common Stock is registered under the Securities Exchange Act of 1934, under Federal Reserve regulations, control will be rebuttably presumed to exist if a person acquires at least 10% of the outstanding shares of any class of voting securities of the Company. The regulations provide a procedure for challenge of the rebuttable control presumption.

Under the BHCA, the Company is generally prohibited from engaging in, or acquiring direct or indirect control of more than 5% of the voting shares of any company engaged in non-banking activities, unless the Federal Reserve, by order or regulation, has found those activities to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

Source of Strength; Cross-Guarantee. Under Federal Reserve policy, the Company is expected to act as a source of financial strength to the Bank and to commit resources to support the Bank in circumstances in which the Company might not otherwise do so. The Federal Reserve may require a bank holding company to terminate an activity or relinquish control of a nonbank subsidiary if the Federal Reserve determines that such activity or control poses serious risk to the financial soundness or stability of a subsidiary bank. Further, federal bank regulatory authorities have discretion to require a bank holding company to divest itself of any bank or nonbank subsidiary if the agency determines that divestiture may aid the depository institution's financial condition. The Bank may be required to indemnify, or cross-guarantee, the FDIC against losses it incurs with respect to any other bank controlled by the Company, which in effect makes the Company's equity investments in healthy bank subsidiaries available to the FDIC to assist any failing or failed bank subsidiary of the Company.

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act was signed into law in 1999. Among other things, the Act repeals the restriction, contained in the Glass-Steagall Act, on banks affiliating with securities firms. The Act permits bank holding companies to engage in a statutorily provided list of financial activities, including insurance and securities underwriting and agency activities, merchant banking, and insurance company portfolio investment activities. The Act also authorizes activities that are "complementary" to financial activities. The Act is intended to grant certain powers to community banks that larger institutions have accumulated on an ad hoc basis. While it is not possible to determine the full effect that the Act has had on the Company and the Bank, one possible consequence of the Act may be increased competition from larger institutions and other types of companies.

Securities Exchange Act of 1934

The Company’s common stock is registered with the Securities and Exchange Commission (SEC) under Section 12(g) of the Securities Exchange Act of 1934 (the Act). The Company is, therefore, subject to periodic and ad hoc information reporting, proxy solicitation rules, restrictions on insider trading, and other requirements of the Act.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act (SOX) of 2002 imposed additional disclosure requirements in the Company’s reports filed with the SEC. SOX defines new standards of independence for insiders, provides guidance for certain Board committees including the composition of those committees, and establishes corporate governance requirements.

The Bank

General. The Bank operates as a state nonmember banking association incorporated under the laws of the State of Maryland. It is subject to examination by the FDIC and the state department of banking regulation for each state in which it has a branch. The States and the FDIC regulate or monitor all areas of the Bank’s operations, including security devices and procedures, adequacy of capitalization and loss reserves, loans, investments, borrowings, deposits, mergers, issuances of securities, payment of dividends, interest rates payable on deposits, interest rates or fees on loans, establishment or closure of branches, corporate reorganizations, maintenance of books and records, and adequacy of staff training to carry on safe lending and deposit gathering practices. The FDIC requires the Bank to maintain certain capital ratios and imposes limitations on the Bank’s aggregate investment in real estate, bank premises, and furniture and fixtures. The Bank is required by the FDIC to prepare quarterly reports on the Bank’s financial condition.

Under provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), all insured institutions must undergo periodic on-site examination by the appropriate banking agency. The cost of examinations of insured depository institutions and any affiliates may be assessed by the agency against each institution or affiliate, as it deems necessary or appropriate. Insured institutions are required to submit annual reports to the FDIC and the appropriate agency (and state supervisor when applicable). FDICIA also directs the FDIC to develop with other appropriate agencies a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in any balance sheet, financial statement, report of condition, or other report of any insured depository institution. FDICIA also requires the federal banking regulatory agencies to prescribe, by regulation, standards for all insured depository institutions and depository institution holding companies relating, among other things, to: (i) internal controls, information systems, and audit systems; (ii) loan documentation; (iii) credit underwriting; (iv) interest rate risk exposure; and (v) asset quality.

Transactions With Affiliates and Insiders

The Bank is subject to Section 23A of the Federal Reserve Act, which places limits on the amount of loans or extensions of credit to, or investment in, or certain other transactions with, affiliates and on the amount of advances to third parties collateralized by the securities or obligations of affiliates. The aggregate of all covered transactions is limited in amount, as to any one affiliate, to 10% of the Bank’s capital and surplus and, as to all affiliates combined, to 20% of the Bank’s capital and surplus. In addition, each covered transaction must meet specific collateral requirements. The Bank is also subject to Section 23B of the Federal Reserve Act which, among other things, prohibits an institution from engaging in certain transactions with certain affiliates unless the transactions are on terms substantially the same, or at least as favorable to such institution or its subsidiaries, as those prevailing at the time for comparable transactions with nonaffiliated companies. The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, certain principal stockholders, and their related interests. Such extensions of credit (i) must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with third parties, and (ii) must not involve more than the normal risk of repayment or present other unfavorable features.

Community Reinvestment Act

The Community Reinvestment Act requires that the Bank shall be evaluated by its primary federal regulator with respect to its record in meeting the credit needs of its local community, including low and moderate income neighborhoods, consistent with safe and sound operations. These factors are also considered in evaluating mergers, acquisitions, and applications to open a branch or facility. The Bank received a satisfactory rating in its most recent evaluation.

The Bank Secrecy Act and USA Patriot Act

The Bank Secrecy Act of 1970 (BSA) requires financial institutions to assist federal agencies to detect and prevent money laundering by filing and/or maintaining reports of large cash transactions or other suspicious transactions involving cash. BSA is also referred to as anti-money laundering law as it is designed to detect money laundering, tax evasion, or other criminal activities.
In response to the terrorist attacks on September 11, 2001, Congress passed the Patriot Act. The Patriot Act requires that Banks prepare and retain additional records designed to assist the government in an effort to combat terrorism. The Act includes anti-money laundering and financial transparency provisions, and guidelines for verifying customer identification during account opening. The Act promotes cooperation between law enforcement, financial institutions, and financial regulators in identifying persons involved in illegal acts such as money laundering and terrorism.

Other Regulations

Interest and certain other charges collected or contracted for by the Bank are subject to state and federal laws concerning interest rates. The Bank’s loan operations are also subject to certain federal laws applicable to credit transactions, such as the federal Truth-In-Lending Act governing disclosures of credit terms to consumer borrowers, the Real Estate Settlement Procedures Act requiring lenders to provide disclosures to consumers at various times during an applicable transaction and which outlaws kickbacks that increase the cost of settlement services, the Home Mortgage Disclosure Act of 1975 requiring financial institutions in metropolitan statistical areas to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves, the Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed, or other prohibited bases in extending credit, the Fair Credit Reporting Act of 1978 governing the use and provision of information to credit reporting agencies, the Fair Debt Collection Act governing the manner in which consumer debts may be collected by collection agencies, and the rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws. The deposit operations of the Bank are subject to the Truth in Savings Act which governs disclosures of rate and fee information to consumer deposit customers, the Right to Financial Privacy Act which imposes a duty to maintain confidentiality of customers’ financial records and prescribes procedures for complying with administrative subpoenas of financial records, and the Electronic Fund Transfers Act as implemented by the Federal Reserve Board’s Regulation E which governs automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

Deposit Insurance

The FDIC establishes rates for the payment of deposit insurance premiums by federally insured banks and thrifts. The Deposit Insurance Fund (DIF) is maintained for commercial banks and thrifts, with insurance premiums from the industry used to offset losses from insurance payouts when banks and thrifts fail. Since 1993, insured depository institutions like the Bank have paid for deposit insurance under a risk-based premium system. The Federal Deposit Insurance Reform Act of 2005 creates a revised deposit insurance assessment rate structure, effective January 1, 2007. Under this system, assessment rates are based on Risk Categories as determined by a combination of CAMELS component ratings and financial ratios. In addition to the amount paid for deposit insurance, banks are assessed an additional amount to service the interest on the bond obligations of the Financial Corporation (FICO). Any increase in deposit insurance premiums for the Bank will increase the Bank’s operating expenses, and there can be no assurance that such costs can be passed on to the Bank’s customers.

During 2009, as a consequence of recent bank and thrift failures, the DIF fell below target levels. FDIC replenished the fund in mid-2009 by levying a special assessment on insured depository institutions. This special assessment was expensed in the second quarter of 2009. Late in 2009, additional DIF replenishment was achieved by FDIC collecting prepaid insurance premiums from insured depository institutions in an amount calculated to cover premiums for 2010 through 2012. The prepaid amount was paid in December 2009 and is being expensed in the periods to which it applies.

The Dodd-Frank Act changes the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, elimination of the cap on the size of the Deposit Insurance Fund ("DIF") and an increase to the lowest level permissible for the DIF. Management does not anticipate that the change of assessment base will have a material impact on earnings.

Dividends

The principal source of the Company's cash revenues comes from dividends received from the Bank. The amount of dividends that may be paid by the Bank to the Company depends on the Bank's earnings and capital position and is limited by federal and state laws, regulations, and policies. The Federal Reserve has stated that bank holding companies should refrain from or limit dividend increases or reduce or eliminate dividends under circumstances in which the bank holding company fails to meet minimum capital requirements or in which earnings are impaired.

The Company's ability to pay any cash dividends to its stockholders in the future will depend primarily on the Bank's ability to pay dividends to the Company. In order to pay dividends to the Company, the Bank must comply with the requirements of all applicable laws and regulations. Under Maryland law, the Bank must pay a cash dividend only from the following, after providing for due or accrued expenses, losses, interest, and taxes: (i) its undivided profits, or (ii) with the prior approval of the Department of Financial Regulation, its surplus in excess of 100% of its required capital stock. Under FDICIA, the Bank may not pay a dividend if, after paying the dividend, the Bank would be undercapitalized. See "Capital Regulations" below. See Item 5 for a discussion of dividends paid by the Company in the past three years.

In addition to the availability of funds from the Bank, the future dividend policy of the Company is subject to the discretion of the Board of Directors and will depend upon a number of factors, including future earnings, financial condition, cash needs, and general business conditions. The amount of dividends that might be declared in the future presently cannot be estimated and it cannot be known whether such dividends would continue for future periods.

Capital Regulations

The federal bank regulatory authorities have adopted risk-based capital guidelines for banks and bank holding companies that are designed to make regulatory capital requirements more sensitive to differences in risk profile among banks and bank holding companies, account for off-balance sheet exposure, and minimize disincentives for holding liquid assets. The resulting capital ratios represent qualifying capital as a percentage of total risk-weighted assets and off-balance sheet items. The guidelines are minimums, and the regulators have noted that banks and bank holding companies contemplating significant expansion programs should not allow expansion to diminish their capital ratios and should maintain ratios well in excess of the minimums.

Current guidelines require bank holding companies and federally regulated banks to maintain a minimum ratio of total risk-based capital to risk-weighted assets equal to 8%, of which at least 4% must be Tier 1 capital. Tier 1 capital includes common stockholders' equity before the unrealized gains and losses on securities available for sale, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, but excludes goodwill and most other intangibles, and excludes the allowance for loan losses. Tier 2 capital includes the excess of any preferred stock not included in Tier 1 capital, mandatory convertible securities, hybrid capital instruments, subordinated debt and intermediate term-preferred stock, and general reserves for loan losses up to 1.25% of risk-weighted assets. Total capital is the sum of Tier 1 plus Tier 2 capital. The federal bank regulatory authorities have also implemented a leverage ratio, which is Tier 1 capital as a percentage of average total assets less intangibles, to be used as a supplement to the risk-based guidelines. The principal objective of the leverage ratio is to place a constraint on the maximum degree to which a bank holding company may leverage its equity capital base. The minimum required leverage ratio for top-rated institutions is 4%, but most institutions are required to maintain an additional cushion of at least 100 to 200 basis points.

FDICIA established a new capital-based regulatory scheme designed to promote early intervention for troubled banks and requires the FDIC to choose the least expensive resolution of bank failures. The new capital-based regulatory framework contains five categories for compliance with regulatory capital requirements, including "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." To qualify as a "well capitalized" institution, a bank must have a leverage ratio of no less than 5%, a Tier 1 risk-based ratio of no less than 6%, and a total risk-based capital ratio of no less than 10%, and the bank must not be under any order or directive from the appropriate regulatory agency to meet and maintain a specific capital level. As of December 31, 2010, the Company and the Bank were qualified as "well capitalized." For further discussions, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation - Capital."

-

Item 1A. Risk Factors

The Company and the Bank are subject to various types of risk during the normal conduct of business. Investors should consider these risks and their possible consequences when making a decision to invest in the stock of the Company. Any of these risks could adversely affect the Company's results of operation and financial condition causing the market price of the Company's stock to decline.

Following are descriptions of the significant categories of risk most relevant to the Company. The risks described below are not the only ones that apply to the Company. Management may not be aware of some risks and may judge others to be unlikely to have a material effect on the Company or the Bank. In the opinion of management, there has been no material increase in any level of risk incurred by the Company or the Bank during the period covered by this report.

The Company may be adversely affected by conditions in the economy and financial markets.

The Company's asset quality and earnings are affected by general economic conditions. The Company relies on loan demand to generate earning assets that are the source of most of its revenues. While the regional and national economic recession which deepened throughout 2008 appears to have bottomed in 2009, the banking industry continues to endure adverse consequences. Borrowing customers have experienced both loss of income and declines in the value of their homes and businesses. As borrowers experience hardships that affect their ability to repay loans, the Bank experiences atypically high delinquencies, loan charge-offs, collateral repossessions, and mortgage foreclosures.

Management expects unfavorable market conditions to continue to depress earnings for at least another year resulting in slower than usual growth in capital.

The Company is exposed to lending risks including those related to asset quality and regulatory compliance.

The primary source of revenue for the Company and the Bank is lending. During the ongoing economic downturn which began in 2008, the Company has suffered historically high levels of delinquencies, troubled debt restructuring, and loan losses. Management expects high levels of delinquencies and loan losses to continue through 2011. For further discussion, see the section of Management's Discussion and Analysis of Financial Condition and Results of Operation titled Composition of the Loan Portfolio.

The banking regulations governing disclosures on loan originations, collections, and foreclosures are complex and change frequently. Failure to comply with applicable laws and regulations could result in penalties or other enforcement actions against the Company.

The Company's allowance for loan losses may be underestimated.

The Company's earnings may suffer from the failure of borrowers to fulfill their contractual commitment to the Bank. This risk encompasses the potential loss on a particular loan as well as the potential for loss from a group of related loans. The Bank provides for loan losses through an allowance for loan loss, which represents management's estimate of inherent and specifically identified losses in the Bank's loan portfolio. If the allowance for loan losses is not adequate, loan losses will reduce earnings and capital. For further discussion, see the section of Management's Discussion and Analysis of Financial Condition and Results of Operation titled Loan Quality and the Allowance for Loan Losses.

The Company may have reduced earnings due to interest-rate risk caused by market conditions.

The primary source of income for the Company is net interest income, which is the difference between revenue on interest-earning assets, such as investment securities and loans, and interest expense incurred on interest-bearing sources of funds, such as deposits and borrowings. Monetary policy and actions of the Board of Governors of the Federal Reserve System exert strong influence over the rates the Company can earn on loans or investment securities. Competitive pressures also factor into the rates the company pays on deposits or other borrowings. If the rates on interest-bearing deposits and other borrowings increase faster than the rates on loans and investments, the result could be a decline in earnings. The same result could occur if rates on loans and investments fell faster than rates on deposits and other borrowings. For further discussion, see the Net Interest Income section of Management's Discussion and Analysis of Financial Condition and Results of Operation.

-

The Company’s internal controls or transactional procedures may fail or be circumvented.

Management maintains a system of policies, procedures, checks and balances known as "internal controls." Internal controls are designed to ensure the likelihood of meeting corporate goals of accuracy, efficiency and legal compliance. A failure of internal controls could have an adverse effect on the Company’s reputation, results of operations, and financial condition.

The Company’s procedures for completion of various transactions and operating processes include system automation, employee training and integrity, and procedural instructions. Problems with service or product delivery may adversely impact the Company’s reputation, results of operations, and financial condition.

The Company and the Bank could fail to comply with complex laws, regulations, and supervisory guidance.

Compliance risk is the risk to earnings or capital from noncompliance with federal and state laws, rules, and regulations. Compliance risk is often the greatest risk a bank faces regardless of its size or products. Compliance is subject to examination by federal and state bank regulators. A significant failure of compliance could result in monetary fines or penalties, restriction of banking or corporate activities, and damage to the Company’s reputation.

The Company’s reputation could be damaged.

As a community bank, community and customer relations are critical to the Bank’s success. Anything that would impair that reputation poses a significant risk and could have an adverse effect on earnings as well as the ability to generate business.

The Company’s failure to make sound business decisions or to plan for future events could impair earnings or capital.

The Company’s Strategic Plan is general in nature, emphasizing customer service and profitability as its mission and profitability as its primary objective. The Plan mentions basic loan underwriting criteria as a foundation for asset quality. It includes sections on management succession and community involvement. If the plan is wrong or improperly implemented, the Company’s earnings or capital may be adversely affected.

-

-

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The Company has ten branch locations, all of which are owned by the Company or the Bank. The Bank leases the land on which the East Berlin branch is located. The locations are described as follows:

Office	Location	Square Footage
Main Office, Berlin	24 North Main Street, Berlin, Maryland 21811	24,229
East Berlin Office	10524 Old Ocean City Boulevard, Berlin, Maryland 21811	1,500
20th Street Office	100 20th Street, Ocean City, Maryland 21842	3,100
Ocean Pines Office	11103 Cathell Road, Berlin, Maryland 21811	2,420
Mid-Ocean City Office	9105 Coastal Highway, Ocean City, Maryland 21842	1,984
North Ocean City Office	14200 Coastal Highway, Ocean City, Maryland 21842	2,545
West Ocean City Office	9923 Golf Course Road, Ocean City, Maryland 21842	2,496
Pocomoke Office	2140 Old Snow Hill Road, Pocomoke, Maryland 21851	2,624
Snow Hill Office	108 West Market Street, Snow Hill, Maryland 21863	3,773
Ocean View, Delaware Office	50 Atlantic Avenue, Ocean View, Delaware 19970	4,900

The Berlin office is the centralized location for the Company and the Bank. Executive offices, loan processing, proof, bookkeeping, and the computer department are housed there. Most branches have a manager who also serves as a loan officer. All offices participate in normal day-to-day banking operations. The Company operates automated teller machines in all branches and at one non-branch location in a local hospital.

Item 3. Legal Proceedings

(a) There are no material pending legal proceedings to which the Company or the Bank or any of their properties are subject.
(b) No proceedings were terminated during the fourth quarter of the fiscal year covered by this report.

Item 4. (Removed and Reserved).

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's Articles of Incorporation, as amended, authorize it to issue up to 10,000,000 shares of common stock.

As of February 28, 2011 there were approximately 1,025 stockholders of record and 3,000,508 shares of Common Stock issued and outstanding. All outstanding shares of common stock of the Company are entitled to share equally in dividends from funds legally available, when, as, and if declared by the Board of Directors. The Company paid or declared dividends of $.91 per share in 2010, $.90 per share in 2009, and $2.15 per share in 2008. Included in 2008 was a special cash dividend of $1.30 per share which is not expected to be an annual event.

The following table presents high and low bid information obtained from the Over the Counter Bulletin Board and from other trades known to management of the Company. Because transactions in the Company's common stock are infrequent and are often negotiated privately between the persons involved in those transactions, actual prices may be higher or lower than those included in this table. Additionally, the number of shares traded at high or low prices may vary significantly. There is no established public trading market in the stock, and there is no likelihood that a trading market will develop in the near future.

	2010		2009	
Sales price per share	High	Low	High	Low
First quarter	$ 36.00	$ 32.00	$ 39.00	$ 35.50
Second quarter	$ 42.00	$ 29.00	$ 42.00	$ 32.25
Third quarter	$ 42.00	$ 29.00	$ 36.00	$ 32.00
Fourth quarter	$ 40.00	$ 26.00	$ 36.00	$ 32.00

The Company publicly announced on August 14, 2003, that it would repurchase up to 10% of its outstanding equity stock at that time. As of January 1, 2005, and again on May 18, 2007, this plan was renewed by public announcement, making up to 10% of the Company's outstanding equity stock available for repurchase at the time of each renewal. On January 13, 2010, as part of its capital planning, the Board of Directors voted to temporarily suspend the stock buy-back program. On February 9, 2011, the Board of Directors voted to suspend this program indefinitely.

There is no set expiration date for this program. No other stock repurchase plan or program existed or exists simultaneously, nor has any other plan or program expired during the period covered by this table. Common shares repurchased under this plan are retired. From its inception through December 31, 2009, 239,492 shares were retired under this program. No shares were retired during 2010.

-

Item 6. Selected Financial Data

The following table presents selected financial data for the five years ended December 31, 2010.

	2010	2009	2008	2007	2006
	(Dollars in thousands, except for per share data)				
At Year End					
Total assets	$406,148	$393,528	$372,603	$369,146	$369,512
Total deposits	$326,778	$312,648	$292,459	$288,944	$290,325
Total loans, net of unearned income and allowance for loan losses	$237,001	$240,062	$241,431	$238,076	$233,231
Total stockholders' equity	$74,195	$72,278	$72,283	$74,476	$71,381
Common shares issued and outstanding	3,000,508	3,000,508	3,048,397	3,102,510	3,149,356
For the Year					
Average total assets	$401,060	$386,038	$366,900	$372,006	$377,211
Average stockholders' equity	$73,733	$71,898	$73,726	$72,569	$69,268
Net interest income	$15,377	$15,360	$15,978	$17,032	$16,963
Net income	$5,197	$5,110	$6,059	$7,297	$7,400
Cash dividend	$2,730	$2,704	$6,566	$2,485	$2,368
Per share data					
Book value	$24.73	$24.09	$23.71	$24.01	$22.67
Net income	$1.73	$1.69	$1.97	$2.33	$2.33
Cash dividends declared	$0.91	$0.90	$2.15	$0.80	$0.75
Other ratios					
Return on average assets	1.30%	1.32%	1.65%	1.96%	1.96%
Return on average equity	7.05%	7.11%	8.22%	10.05%	10.68%
Dividend payout ratio	52.60%	53.25%	109.14%	34.33%	32.19%
Average equity to average assets ratio	18.38%	18.62%	20.09%	19.51%	18.36%

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

The following discussion of the Company's financial condition and results of operations should be read in conjunction with the Company's financial statements and related notes and other statistical information included in this report.

Critical Accounting Policies

The Company's financial condition and results of operations are sensitive to accounting measurements and estimates of inherently uncertain matters. When applying accounting policies in areas that are subjective in nature, management uses its best judgment to arrive at the carrying value of certain assets. One of the most critical accounting policies applied is related to the valuation of the loan portfolio.

The allowance for loan losses (ALLL) represents management's best estimate of inherent probable losses in the loan portfolio as of the balance sheet date. It is one of the most difficult and subjective judgments. The adequacy of the allowance for loan losses is evaluated no less than quarterly. The determination of the balance of the allowance for loan losses is based on management's judgments about the credit quality of the loan portfolio as of the review date. It should be sufficient to absorb losses in the loan portfolio as determined by management's consideration of factors including an analysis of historical losses, specific reserves for non-performing or past due loans, delinquency trends, portfolio composition (including segment growth or shifting of balances between segments, products and processes, and concentrations of credit, both regional and by relationship), lending staff experience and changes, critical documentation and policy exceptions, risk rating analysis, interest rates and the competitive environment, economic conditions in the Bank's service area, and results of independent reviews, including audits and regulatory examinations.

Overview

Consolidated income of the Company is derived primarily from operations of the Bank. Net income for 2010 was $5,196,779 compared to $5,109,609 for 2009, and $6,059,217 for 2008. The Company had a return on average equity of 7.05% and return on average assets of 1.30% for 2010, compared to returns on average equity of 7.11% and 8.22%, and returns on average assets of 1.32% and 1.65%, for 2009 and 2008, respectively.

Results of Operations

The Company's net income of $5,196,779, or $1.73 per share, for the year ended December 31, 2010, was an increase of $87,170 (1.71%) from net income of $5,109,609, or $1.69 per share, for the year ended December 31, 2009. Contributing to this increase was increased noninterest revenue of $88,827 and a $231,698 reduction of noninterest expense, partially offset by an increase of $162,000 in the provision for loan losses. These factors are discussed further in the following pages.

The Company's net income of $5,109,609, or $1.69 per share, for the year ended December 31, 2009, was a decrease of $949,608 (15.67%) from net income of $6,059,217, or $1.97 per share, for the year ended December 31, 2008. Contributing to this decrease was a $618,834 (3.87%) decrease in net interest income, a $232,474 (37.65%) increase in the provision for loan losses, a $48,564 (2.38%) decrease in noninterest revenue, and a $561,304 (7.06%) increase in noninterest expense, offset by a $511,568 (15.11%) reduction in income tax expense. These factors are discussed further in the following pages.

The Company's net income of $958,654 or $.32 per share, for the quarter ended December 31, 2010, decreased by $149,440 (13.49%) from the net income of $1,108,094 or $.37 per share, for the quarter ended December 31, 2009. The primary reason for the decrease was lower net interest income, which decreased $127,323 from fourth quarter 2009 to 2010.

The Company's net income of $1,108,094 or $.37 per share, for the quarter ended December 31, 2009, was a modest increase of $20,155 (1.85%) from the net income of $1,087,939 or $.36 per share, for the quarter ended December 31, 2008. A lower quarterly provision for loan loss, the primary reason for the decrease, resulted from management's assessment of the quality of the loan portfolio at the reporting date. See "Loan Quality and the Allowance for Loan Losses" for additional related disclosure and discussion.

Net Interest Income

The primary source of income for the Company is net interest income, which is the difference between revenue on interest-earning assets, such as investment securities and loans, and interest expense incurred on interest-bearing sources of funds, such as deposits and borrowings. The level of net interest income is determined primarily by the average balances of interest-earning assets and the Company's funding sources, such as deposits and securities sold under agreements to repurchase, and the rate spreads between interest-earning assets and funding sources. Changes in net interest income from period to period result from increases or decreases in the volume of interest-earning assets and interest-bearing liabilities, and increases or decreases in the average rates earned and paid on such assets and liabilities. The volume of interest-earning assets and interest-bearing liabilities is affected by the ability to manage the earning-asset portfolio, which includes loans, and the availability of particular sources of funds, such as noninterest-bearing deposits.

The key performance measure for net interest income is the "net margin on interest-earning assets," or net interest income divided by average interest-earning assets. The Company's net interest margin for 2010 on a non-GAAP tax-equivalent basis was 4.26%, compared to 4.38% and 4.77% for 2009 and 2008, respectively. Because most of the Bank's loans are written with a demand feature, the income of the Bank should not change dramatically as interest rates change. Management of the Company expects to maintain the net margin on interest-earning assets. The net margin may decline, however, if competition increases, loan demand decreases, the volume of nonaccruing loans increases, or the cost of funds rises faster than the return on loans and securities. Although such expectations are based on management's judgment, actual results will depend on a number of factors that cannot be predicted with certainty, and fulfillment of management's expectations cannot be assured. In recent years, nonaccruing loan volume has increased as the Bank feels the consequences of a prolonged economic downturn during which many borrowers have experienced financial distress.

The following tables present information including average balances of interest-earning assets and interest-bearing liabilities, the amount of related interest income and interest expense, and the resulting yields by category of interest-earning asset and interest-bearing liability. In these tables, dividends and interest on tax-exempt securities and loans are reported on a fully taxable equivalent basis, which is a non-GAAP measure as defined in SEC Regulation G and Item 10 of SEC Regulation S-K. Management believes that these measures provide better yield comparability as a tool for managing net interest income.

Average Balances, Interest, and Yields
(Dollars stated in thousands)

	For the Year Ended December 31, 2010			For the Year Ended December 31, 2009			For the Year Ended December 31, 2008		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets									
Federal funds sold	$ 35,853	$ 66	0.18%	$ 33,355	$ 67	0.20%	$ 36,328	$ 732	2.02%
Interest-bearing deposits	9,582	49	0.52%	12,227	158	1.30%	9,659	325	3.37%
Investment securities:									
U. S. Treasury	63,485	1,134	1.80%	56,949	1,498	2.63%	44,359	1,902	4.29%
U. S. Government Agency	8,497	100	1.18%	9,926	199	2.00%	10,330	468	4.53%
State and municipal	4,425	81	1.83%	2,541	72	2.83%	1,359	65	4.82%
Other	1,934	66	3.40%	1,934	92	4.77%	1,934	109	5.64%
Total investment securities	78,341	1,381	1.76%	71,350	1,861	2.61%	57,982	2,544	4.39%
Loans:									
Commercial	18,241	1,208	6.62%	21,104	1,338	6.34%	24,272	1,628	6.71%
Mortgage	223,980	14,719	6.57%	218,800	14,617	6.68%	212,104	14,917	7.03%
Consumer	1,968	161	8.16%	2,191	181	8.24%	2,497	206	8.23%
Total loans	244,189	16,088	6.59%	242,095	16,136	6.67%	238,873	16,751	7.01%
Allowance for loan losses	739			725			237		
Total loans, net of allowance	243,450	16,088	6.61%	241,370	16,136	6.69%	238,636	16,751	7.02%
Total interest-earning assets	367,226	17,584	4.79%	358,302	18,222	5.09%	342,605	20,352	5.94%
Noninterest-bearing cash	18,157			13,634			10,906		
Premises and equipment	6,421			6,546			6,391		
Other assets	9,256			7,556			6,998		
Total assets	$401,060			$386,038			$366,900		
Interest-bearing deposits									
NOW	$ 57,230	223	0.39%	$ 50,932	138	0.27%	$ 48,624	201	0.41%
Money market	38,434	191	0.50%	34,946	189	0.54%	32,070	305	0.95%
Savings	48,178	219	0.45%	44,648	221	0.50%	41,667	309	0.74%
Other time	99,531	1,277	1.28%	99,614	1,958	1.97%	90,596	3,149	3.48%
Total interest-bearing deposits	243,373	1,910	0.78%	230,140	2,506	1.09%	212,957	3,964	1.86%
Securities sold under agreements to repurchase	6,256	31	0.50%	6,527	32	0.50%	4,792	53	1.11%
Borrowed funds	34	2	6.71%	60	4	6.21%	85	5	6.14%
Total interest-bearing liabilities	249,663	1,943	0.78%	236,727	2,542	1.07%	217,834	4,022	1.85%
Noninterest-bearing deposits	77,085	-		76,666	-		74,262	-	
	326,748	1,943	0.59%	313,393	2,542	0.81%	292,096	4,022	1.38%
Other liabilities	579			747			1,078		
Stockholders' equity	73,733			71,898			73,726		
Total liabilities and stockholders' equity	$401,060			$386,038			$366,900		
Net interest spread			4.01%			4.01%			4.09%
Net interest income		$ 15,641			$ 15,680			$ 16,330	
Net margin on interest-earning assets			4.26%			4.38%			4.77%

Tax equivalent adjustment included in:

Investment income	$ 116	$ 147	$ 183
Loan income	$ 158	$ 173	$ 169

Average Balances, Interest, and Yields
(Dollars stated in thousands)

	For the Year Ended December 31, 2007			For the Year Ended December 31, 2006		
	Average Balance	Interest	Yield	Average Balance	Interest	Yield
Assets						
Federal funds sold	$ 37,826	$ 1,919	5.07%	$ 22,547	$ 1,137	5.04%
Interest-bearing deposits	3,494	168	4.82%	2,173	79	3.62%
Investment securities:						
U. S. Treasury	55,061	2,636	4.79%	71,441	2,614	3.66%
U. S. Government Agency	6,568	310	4.73%	13,378	398	2.98%
State and municipal	2,397	95	3.97%	7,443	219	2.94%
Other	1,927	101	5.27%	1,900	102	5.38%
Total investment securities	65,953	3,142	4.77%	94,162	3,333	3.54%
Loans:						
Commercial	23,812	1,691	7.10%	23,804	1,711	7.19%
Mortgage	208,936	14,870	7.12%	200,588	14,020	6.99%
Consumer	2,465	206	8.37%	2,491	206	8.28%
Total loans	235,213	16,767	7.13%	226,883	15,937	7.02%
Allowance for loan losses	199			211		
Total loans, net of allowance	235,014	16,767	7.13%	226,672	15,937	7.03%
Total interest-earning assets	342,287	21,996	6.43%	345,554	20,486	5.93%
Noninterest-bearing cash	16,179			17,694		
Premises and equipment	6,548			6,605		
Other assets	6,992			7,358		
Total assets	$372,006			$377,211		
Interest-bearing deposits						
NOW	$ 51,297	183	0.36%	$ 57,052	141	0.25%
Money market	33,590	317	0.94%	41,810	335	0.80%
Savings	44,137	327	0.74%	47,812	285	0.60%
Other time	84,867	3,789	4.46%	68,359	2,414	3.53%
Total interest-bearing deposits	213,891	4,616	2.16%	215,033	3,175	1.48%
Securities sold under agreements to repurchase	4,248	29	0.69%	5,878	40	0.68%
Borrowed funds	109	7	6.10%	145	8	5.73%
Total interest-bearing liabilities	218,248	4,652	2.13%	221,056	3,223	1.46%
Noninterest-bearing deposits	79,807	-		84,380	-	
	298,055	4,652	1.56%	305,436	3,223	1.06%
Other liabilities	1,382			2,507		
Stockholders' equity	72,569			69,268		
Total liabilities and stockholders' equity	$372,006			$377,211		
Net interest spread			4.30%			4.47%
Net interest income		$ 17,344			$ 17,263	
Net margin on interest-earning assets			5.07%			5.00%

Tax equivalent adjustment included in:

Investment income	$ 191	$ 231
Loan income	$ 121	$ 69

Analysis of Changes in Net Interest Income
(Dollars stated in thousands)

	Year ended December 31, 2010 compared with 2009 variance due to			Year ended December 31, 2009 compared with 2008 variance due to		
	Total	Rate	Volume	Total	Rate	Volume
Interest-earning assets						
Federal funds sold	(1)	(6)	5	(665)	(605)	(60)
Interest-bearing deposits	(109)	(75)	(34)	(167)	(254)	87
Investment securities:						
U. S. Treasury	(364)	(536)	172	(404)	(944)	540
U. S. Government Agency	(99)	(70)	(29)	(269)	(251)	(18)
State and municipals	9	(44)	53	7	(50)	57
Other	(26)	(26)	-	(17)	(17)	-
Loans:						
Commercial	(130)	52	(182)	(290)	(77)	(213)
Mortgage	102	(244)	346	(300)	(771)	471
Consumer	(20)	(2)	(18)	(25)	-	(25)
Total interest revenue	(638)	(951)	313	(2,130)	(2,969)	839
Interest-bearing liabilities						
NOW	85	68	17	(63)	(73)	10
Money market	2	(17)	19	(116)	(143)	27
Savings	(2)	(19)	17	(88)	(110)	22
Other time deposits	(681)	(679)	(2)	(1,191)	(1,504)	313
Other borrowed funds	(3)	-	(3)	(22)	(39)	17
Total interest expense	(599)	(647)	48	(1,480)	(1,869)	389
Net interest income	(39)	(304)	265	(650)	(1,100)	450

In the preceding table, the variance that is both rate and volume related is reported with the rate variance.

Composition of the Loan Portfolio

Because loans are expected to produce higher yields than investment securities and other interest-earning assets (assuming that loan losses are not excessive), the absolute volume of loans and the volume as a percentage of total earning assets is an important determinant of net interest margin. Average loans, net of the allowance for loan losses, were $243,450,000, $241,370,000, and $238,636,000, during 2010, 2009, and 2008, respectively, which constituted 66.29%, 67.36%, and 69.65% of average interest-earning assets for the periods. The Company's ratio of net loans to deposits was 72.53, 76.78%, 82.55%, at December 31, 2010, 2009, and 2008, respectively. Average net loans to average deposits were 75.97%, 78.67%, and 83.09%, for 2010, 2009, and 2008. The decrease in the average loan to deposit ratio from 2009 to 2010 is attributable to continued deposit growth which is relatively greater than loan growth in the same period. The decrease in the average loan to deposit ratio from 2008 to 2009 is attributable to 1.15% growth in the average loan portfolio relative to 6.82% growth in average deposits during 2009.

The average balance table above reveals a 5-year pattern of growth in loan balances. Despite the challenges posed by general economic conditions since 2008, the Bank has continued to fund loans in a manner consistent with the Company's philosophy of safe and sound practice. The Bank does not engage in risky lending practices such as subprime mortgages, high loan-to-value lending, or teaser rate lending.

The Bank extends loans primarily to customers located in and near Worcester County, Maryland and Sussex County, Delaware. Although the portfolio is diversified, its performance may be influenced by regional economic conditions. The Company has a substantial portion of its loans in real estate and performance will be influenced by the real estate market in the region. Additionally, the coastal geography is subject to catastrophic storms. The local agricultural and fishing community is subject to adverse weather conditions throughout their productive seasons. There is no adverse weather condition at the time of the valuation.

As of December 31, 2010, the Bank had approximately $43.9 million in secured and unsecured loans and unfunded lines to borrowers in the hospitality industry, including hotels, motels, and other rentals. Ocean City MD, the state's only ocean resort, is located in the Bank's market area. During summer months, Ocean City becomes Maryland's second largest city through a seasonal population growth averaging 250,000. If tourism in the resort area falls off due to the current recession, this industry may encounter cash flow challenges. Management closely monitors this situation and works with customers to assure timely repayment of seasonal working capital lines. As of December 31, 2010, none of the 51 accounts comprising this concentration are past due 30 days or more.

Since mid-2007, general economic conditions have caused a widespread decline in real estate values and an increase in time to market many properties. Conservative underwriting practices have somewhat insulated the Bank from the adverse consequences such as loan losses and foreclosures. Management monitors fluctuations in the value of real estate held as collateral and, if deemed necessary, obtains additional collateral to limit the Bank's loss exposure; still the adverse effects on many of the Bank's customers have become apparent in increased loan delinquencies. The Bank experienced higher than usual loan losses and nonaccrual classifications of loans from 2008 through 2010. Management believes that loan delinquency and losses are trailing indicators of economic weakness and expects 2011 to bring continued challenges to borrowers resulting in delinquencies and losses to the Bank.

The following table sets forth the composition of the Company's loan portfolio for each of the five most recent year ends.

Composition of the Loan Portfolio Stated in Dollars and Percentages

	2010	2009	2008	2007	2006
Real estate mortgages					
Construction, land development, and land	$ 21,792,060	$ 21,952,873	$ 30,330,261	$ 38,230,033	$ 37,331,256
Residential 1 to 4 family	92,592,277	94,757,873	95,203,258	87,327,448	88,599,071
Second mortgages	1,660,805	2,460,550	2,952,418	3,287,734	2,395,178
Commercial properties	104,560,765	102,476,713	89,302,549	84,568,665	79,484,039
Commercial	15,662,957	16,915,476	21,990,067	22,283,007	23,264,997
Consumer	1,715,533	2,136,145	2,359,513	2,574,916	2,352,660
Total loans	237,984,397	240,699,630	242,138,066	238,271,803	233,427,201
Less allowance for loan losses	983,178	637,761	707,152	195,525	196,083
Loans, net	$ 237,001,219	$ 240,061,869	$ 241,430,914	$ 238,076,278	$ 233,231,118
Real estate mortgages					
Construction, land development, and land	9.16%	9.12%	12.53%	16.04%	15.99%
Residential 1 to 4 family	38.91%	39.37%	39.32%	36.66%	37.95%
Second mortgages	0.70%	1.02%	1.22%	1.38%	1.03%
Commercial properties	43.93%	42.57%	36.88%	35.49%	34.05%
Commercial	6.58%	7.03%	9.08%	9.35%	9.97%
Consumer	0.72%	0.89%	0.97%	1.08%	1.01%
Total loans	100.00%	100.00%	100.00%	100.00%	100.00%

The following table sets forth the maturity distribution, classified according to sensitivity to changes in interest rates, for selected components of the Company's loan portfolio as of December 31, 2010.

Loan Maturity Schedule and Sensitivity to Changes in Interest Rates
December 31, 2010

	One year or less	Over one through five years	Over five years	Total
Real estate mortgages				
Construction, land development, and land	$ 21,792,060	$ -	$ -	$ 21,792,060
Residential 1 to 4 family	92,635,944	-	-	92,635,944
Second mortgages	1,660,805	-	-	1,660,805
Commercial properties	102,578,171	-	-	102,578,171
Commercial	14,968,956	1,614,971	1,012,524	17,596,451
Consumer	724,887	785,211	210,868	1,720,966
	$ 234,360,823	$ 2,400,182	$ 1,223,392	$ 237,984,397
Fixed interest rate	$ 5,067,729	$ 2,400,182	$ 1,223,392	$ 8,691,303
Variable interest rate (or demand)	229,293,094	-	-	229,293,094
Total	$ 234,360,823	$ 2,400,182	$ 1,223,392	$ 237,984,397

As of December 31, 2010, $229,293,094 or 96.35% of total loans were either variable rate loans or loans written on demand.

The Company has the following commitments, lines of credit, and letters of credit outstanding as of December 31, 2010, 2009, and 2008, respectively.

	2010	2009	2008
Construction and land development loans	$ 8,569,169	$ 10,231,711	$ 15,218,812
Other loan commitments	21,164,229	19,038,506	22,245,089
Standby letters of credit	1,590,367	1,907,736	1,921,878
Total	$ 31,323,765	$ 31,177,953	$ 39,385,779

Loan commitments are agreements to lend to customers as long as there is no violation of any conditions to the contracts. Loan commitments generally have interest at current market rates, fixed expiration dates, and may require the payment of a fee. Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Company's exposure to loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment.

Loan Quality and the Allowance for Loan Losses

The allowance for loan losses represents an amount which management believes to be adequate to absorb identified and inherent losses in the loan portfolio as of the balance sheet date. Valuation of the allowance is completed no less than quarterly. The determination of the allowance is

inherently subjective as it relies on estimates of potential loss related to specific loans, the effects of portfolio trends, and other internal and external factors.

The ALLL consists of (i) formula-based reserves comprised of potential losses in the balance of the loan portfolio segmented into homogeneous pools, (ii) specific reserves comprised of potential losses on loans that management has identified as impaired and (iii) unallocated reserves. Unallocated reserves are not associated with a specific portfolio segment or a specific loan, but may be appropriate if properly supported and in accordance with GAAP. Management anticipates having low levels of unallocated reserves in future years, as discussed in conjunction with the table titled Allocation of the Allowance for Loan Losses, below.

The Company evaluates loan portfolio risk for the purpose of establishing an adequate allowance for loan losses. In determining an adequate level for the formula-based portion of the ALLL, management considers historical loss experience for major types of loans. Homogenous categories of loans were evaluated based on loss experience in recent years, applied to the current portfolio. This formulation gives weight to portfolio size and loss experience for categories of real-estate secured loans (i.e. real estate – construction and real estate – mortgage), other loans to commercial borrowers, and other consumer loans. However, historical data may not be an accurate predictor of loss potential in the current loan portfolio.

Management also evaluates trends in delinquencies, the composition of the portfolio, concentrations of credit, and changes in lending products, processes, or staffing. Management further considers external factors such as the interest rate environment, competition, current local and national economic trends, and the results of recent independent reviews by auditors and banking regulators. The protracted slow-down in the real-estate market has affected both the price and time to market residential and commercial properties. Management closely monitors such trends and the potential effect on the Company. The impact of the current adverse economic conditions is reflected in historically high losses and provisions for loan loss in 2008, 2009 and 2010.

Management has also adopted a risk rating system which gives weight to collateral status (secured vs. unsecured), and to the absence or improper execution of critical contract or collateral documents. Unsecured loans and those loans with critical documentation exceptions, as defined by management, are considered to have greater loss exposure. Management incorporates these factors in the formula-based portion of the ALLL. Additionally, consideration is given to those segments of the loan portfolio which management deems to pose the greatest likelihood of loss. In an economic downturn, such as the region has experienced since late 2007, management believes there is increased likelihood of loss in unsecured loans - commercial and consumer, and in secured consumer loans. Reserves for these segments of the portfolio are included in the formula-based portion of the ALLL.

As the real estate market continues to languish, management continually evaluates the adequacy of collateral on loans where it appears the borrower is having difficulty servicing their debt, taking additional available collateral if prudent. The Bank foreclosed on mortgages during 2009 and 2010, and expects more foreclosures in 2011. Foreclosure may result in loan losses, costs to hold real estate acquired in foreclosure, and losses on the sale of real estate acquired in foreclosure. Management is unable to estimate the financial consequence of future foreclosure activity.

In determining an adequate level for the specific reserve portion of the ALLL, management reviews the current portfolio giving particular consideration to problem loans. The allowance may include reserves for specific loans identified as impaired during management's loan review or the Company’s independent loan review or internal audit functions. For significant problem loans, management's review consists of evaluation of the financial strengths of the borrowers and guarantors, the related collateral, and the effects of economic conditions. Management prepares a Watch List of troubled loans for review by the Board of Directors at their monthly meeting.

The provision for loan losses is a charge to earnings in the current period to replenish the allowance and maintain it at a level management has determined to be adequate. The allowance is increased by current period provisions and by recoveries of amounts previously charged-off. The allowance is decreased when loans are charged-off as losses, which occurs when they are deemed to be uncollectible. Adjustments are made to bring the balance in the allowance to the level established by application of management’s allowance methodology, and may result in an increase or decrease to expense. Provisions for loan losses of $1,012,000, $850,000, and $617,526 were recorded in 2010, 2009, and 2008, respectively. No provision for loan losses was made in 2007 or 2006.

Management considers the December 31, 2010 allowance appropriate and adequate to absorb identified and inherent losses in the loan portfolio. As of December 31, 2010, management had not identified any loans which were anticipated to be fully charged-off within the next 12 months. There can be no assurance that charge-offs in future periods will not exceed the allowance for loan loss or that additional increases in the loan loss allowance will not be required.

The following is a schedule of transactions in the allowance for loan losses for each of the five most recent years ended December 31. The Bank experienced a low level of charge-offs in 2006 and 2007, which was consistent with its historical performance. Increased losses in 2008 and years thereafter and the increased level of the ALLL as a percentage of the gross loan portfolio, reflect the impact of recessionary conditions on the Bank’s borrowers, who are troubled by job losses, higher energy prices, and lower real estate values.

Allowance for Loan Losses

	2010	2009	2008	2007	2006
Balance at beginning of year	$ 637,761	$ 707,152	$ 195,525	$ 196,083	$ 211,374
Loans charged-off:					
Real estate - construction and land	100,000	75,000	-	-	-
Real estate - mortgage	190,093	656,191	-	-	-
Commercial	354,854	200,357	76,383	-	5,357
Consumer	52,935	47,321	34,532	6,263	10,029
Total loan losses	697,882	978,869	110,915	6,263	15,386
Recoveries on loans previously charged off:					
Real estate - construction and land	-	-	-	-	-
Real estate - mortgage	1,100	669	-	-	-
Commercial	1,073	40,364	3,785	-	-
Consumer	29,126	18,445	1,231	5,705	95
Total loan recoveries	31,299	59,478	5,016	5,705	95
Net loan charge-offs (recoveries)	666,583	919,391	105,899	558	15,291
Provision for loan losses charged to expense	1,012,000	850,000	617,526	-	-
Balance at end of year	$ 983,178	$ 637,761	$ 707,152	$ 195,525	$ 196,083
Gross loans outstanding at year end	$ 237,984,397	$ 240,699,630	$ 242,138,066	$ 238,271,803	$ 233,427,201
Allowance for loan losses to loans					
outstanding at end of year	0.41%	0.26%	0.29%	0.08%	0.08%
Average gross loans	$ 244,189,000	$ 242,095,000	$ 238,873,000	$ 235,213,000	$ 226,883,000
Net charge-offs to average gross loans	0.27%	0.38%	0.04%	0.00%	0.01%

The following table details the allocation of the allowance for loan losses to major categories of loans and the percentage of loans in each category relative to total loans at the five most recent year-ends. The loan portfolio is divided into homogeneous categories of loans for the purpose of calculating formula-based reserves. The categories of real estate – construction and real estate – mortgage loans share similar risks of potential collateral deterioration or devaluation. However, these loans tend to be more adequately secured than those commercial and consumer loans that are not real estate secured. Prior to 2009, the Bank had not incurred a mortgage loan loss since 1997, and therefore no reserves were allocated to the real estate secured portions of the loan portfolio in determining the ALLL for 2007, or 2006. During 2010, 2009, and 2008, the Company made provisions for loss on real estate secured loans of $734,538, $450,911, and $475,099, respectively. Non-real estate secured loans, commercial and consumer, generally pose a greater risk of loss due to erosion of the borrower's ability to repay the loan in a timely manner. Collateral on these loans is generally, although not always, less reliable than real estate as a source of recovery if default occurs. The Bank's loan losses in 2008, 2007, and 2006 were consumer and commercial loans which were unsecured or secured with collateral other than real estate. In 2010, $290,093 or 41.57% of total loan losses were real estate secured. In 2009, $731,191 or 74.70% of total loan losses were real estate secured. Management attributes the high level of real estate secured loan loss in 2010 and 2009 to the current economic downturn and an accompanying erosion of real estate values. Management expects additional losses on real estate secured loans in 2011, and those losses may be

significant.

Allocation of Allowance for Loan Losses

	December 31, 2010			December 31, 2009			December 31, 2008		
	Amount	% of Loans		Amount	% of Loans		Amount	% of Loans	
Real estate - construction and land									
Formula-based	$ 233,438			$ 15,400			$ -		
Specific reserves	-			35,262			370,000		
Total real estate - construction and land	233,438	9.16	%	50,662	9.12	%	370,000	12.53	%
Real estate - mortgage									
Formula-based	76,836			134,600			125		
Specific reserves	330,759			-			104,973		
Total real estate - mortgage	407,595	83.54	%	134,600	82.96	%	105,098	77.42	%
Commercial									
Formula-based	196,946			156,554			73,694		
Specific reserves	-			223,607			128,521		
Total commercial	196,946	6.58	%	380,161	7.03	%	202,215	9.08	%
Consumer									
Formula-based	119,228			53,638			27,929		
Specific reserves	-			-			1,910		
Total consumer	119,228	0.72		53,638	0.89		29,839	0.97	
Subtotal	957,207	100.00	%	619,061	100.00	%	707,152	100.00	%
Unallocated	25,971			18,700			-		
Total	$ 983,178			$ 637,761			$ 707,152		

	December 31, 2007		December 31, 2006	
	Amount	% of Loans	Amount	% of Loans
Real estate - construction and land				
Total real estate - construction and land	$ -	16.85	$ -	15.99
Real estate - mortgage				
Total real estate - mortgage	-	73.52	-	73.03

Commercial				
Formula-based	34,952		10,556	
Specific reserves	109,200		-	
Total commercial	144,152	8.55 %	10,556	9.97 %
Consumer				
Formula-based	21,636		24,347	
Specific reserves	29,314		-	
Total consumer	50,950	1.08	24,347	1.01
Subtotal	195,102	100.00 %	34,903	100.00 %
Unallocated	423		161,180	
Total	$ 195,525		$ 196,083	

Unallocated reserves are not associated with a specific portfolio segment or a specific loan, but may be appropriate if properly supported and in accordance with GAAP. Because no portion of the ALLL is calculated on a total loan portfolio basis, management anticipates having low levels of unallocated reserves in future periods. The unallocated portion in the preceding table appears higher prior to 2007, the year in which management adopted a revised methodology. Management believes that the ALLL reflected in this table prior to 2007 does not materially differ from the balance that would have been calculated as of December 31, 2006 had current methodology been applied then.

The accrual of interest on a loan is discontinued when principal or interest is ninety days past due or when the loan is determined to be impaired, unless collateral is sufficient to discharge the debt in full and the loan is in process of collection. When a loan is placed in nonaccruing status, any interest previously accrued but unpaid, is reversed from interest income. Interest payments received on nonaccrual loans may be recorded as cash basis income, or as a reduction of principal, depending on management's judgment on a loan by loan basis. Accrual of interest may be restored when all principal and interest are current and management believes that future payments will be received in accordance with the loan agreement.

Nonperforming loans are loans past due 90 or more days and still accruing plus nonaccrual loans. Nonperforming assets are comprised of nonperforming loans combined with other real estate owned, which is real estate acquired in foreclosure and held for sale. The composition of nonperforming assets is presented in following table.

	2010	2009	2008	2007	2006
Loans 90 days or more past due and still accruing	$ 684,422	$ 787,580	$ 4,647,792	$ 9,100	$ 239,620
Nonaccruing loans					
Current	1,185,435	423,227	-	-	-
Past due 30 days or more	2,921,086	599,856	199,724	40,916	-
	4,106,521	1,023,083	199,724	-	-
Total nonperforming loans	684,422	787,580	4,647,792	9,100	239,620
Other real estate owned	779,500	1,433,000	-	-	-
Total nonperforming assets	$ 1,463,922	$ 2,220,580	$ 4,647,792	$ 9,100	$ 239,620

Included in amounts past due 90 days or more and still accruing at December 31, 2008, was a loan with a principal balance of $4,500,000. Late in 2008, the Bank was notified that there was a lien on the property securing this loan that was superior to the Bank's liens, and which the settlement agent did not discover during the title examination process. As of December 31, 2010, the Bank has been restored to first lien position and interest is current. Management anticipates that the property securing the loan will be sold during 2011 with no loss to the Bank.

Loans are considered impaired when, based on current information, management considers it unlikely that collection of principal and interest payments will be made according to contractual terms. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued, although management may categorize a performing loan as impaired based on knowledge of the borrower's financial condition, devaluation of collateral, or other circumstances that are deemed relevant to loan collection. Impaired loans may have specific reserves, or valuation allowances, allocated to them in the ALLL. Estimates of loss reserves on impaired loans are determined based on one of two measurement methods: (1) the loan's observable fair price, or (2) the fair value of collateral, if repayment of the loan is expected to be provided by underlying collateral. Loans determined to be impaired, but for which no specific valuation allowance is made because management believes the loan is secured with adequate collateral or the Bank will not take a loss on such loan, are grouped with other homogeneous loans for evaluation under formula-based criteria described previously.

The following table sets forth principal balances of impaired loans and the related valuation allowances as of December 31, 2010, 2009, 2008, and 2007. Management had identified no impaired loans as of December 31, 2006.

	2010	2009	2008	2007
Impaired loans with valuation allowances,				
including nonaccruing loans	$ 2,478,049	$ 799,834	$ 4,328,618	$ 595,774
Valuation allowances on impaired loans	$ 330,759	$ 258,869	$ 605,405	$ 138,514
Impaired loans with no valuation allowances	$ 1,628,472	$ 2,102,025	$ 4,559,582	$ -

Liquidity and Interest Rate Sensitivity

The primary objective of asset/liability management is to ensure the steady growth of the Company's primary source of earnings, net interest income. Net interest income can fluctuate with significant interest rate movements. To lessen the impact of these margin swings, the balance sheet should be structured so that repricing opportunities exist for both assets and liabilities in roughly equivalent amounts at approximately the same time intervals. Imbalances in these repricing opportunities at any point in time constitute interest rate sensitivity.

Liquidity represents the ability to provide steady sources of funds for loan commitments and investment activities, as well as to provide sufficient funds to cover deposit withdrawals and payment of debt and operating obligations. These funds can be obtained by converting assets to cash or by attracting new deposits. Average liquid assets (cash and amounts due from banks, interest-bearing deposits in other banks, federal funds sold, and investment securities) were 44.29% of average deposits for 2010, compared to 42.56 and 40.00% for 2009 and 2008, respectively.

Average net loans to average deposits were 75.97%, 78.67%, and 83.09% for 2010, 2009, and 2008. The decrease in the loan to deposit ratio from 2009 to 2010 is attributable to $2,080,000 (.86%) growth in the average net loan portfolio offset by $13,652,000 (4.45%) growth in average deposits during 2010. The decrease in the loan to deposit ratio from 2008 to 2009 is attributable to $2,734,000 (1.35%) growth in the average loan portfolio offset by $19,587,000 (6.82%) growth in average deposits during 2009. Funding for loan growth in 2009 and 2010 was provided by increased deposit balances. This shift has a positive effect on earnings as loan rate exceed rates paid on deposits. The increase in loans does not negatively impact the Company’s ability to meet liquidity demands.

As of December 31, 2010, $41,851,103 (46.62%) of total debt securities mature in one year or less, of which, $35,292,775 is classified as "available-for-sale." Federal funds sold provide additional liquidity. Other sources of liquidity include letters of credit, overnight federal funds, and reverse repurchase agreements available from correspondent banks. The total lines and letters of credit available from correspondent banks were $28,000,000 as of December 31, 2010 and 2009, and $27,000,000 as of December 31, 2008.

The following table shows a distribution of investment securities by their contractual maturities and their yields for the various maturity timeframes. In this schedule, investment securities classified as available for sale are presented at fair value and investments classified as held to maturity are presented at amortized cost.

Investment Securities Maturity Distribution and Yields

	December 31, 2010		December 31, 2009		December 31, 2008	
	Amount	Yield	Amount	Yield	Amount	Yield
U. S. Treasury						
One year or less	$ 37,720,874	0.89%	$ 27,022,810	2.02%	$ 28,997,415	3.03%
Over one through five years	36,174,343	1.15%	35,034,605	1.66%	22,278,930	3.30%
Over ten years	2,691,562	7.28%	2,589,375	7.28%	2,961,875	7.28%
Total U.S. Treasury securities	76,586,779	1.24%	64,646,790	2.04%	54,238,220	3.37%
U.S. Government Agencies						
One year or less	2,002,278	0.93%	3,000,000	1.10%	1,000,000	3.00%
Over one through five years	5,000,170	0.78%	7,000,000	2.04%	5,999,443	3.13%
Total U. S. Government Agencies	7,002,448	0.82%	10,000,000	1.76%	6,999,443	3.11%
State, county, and municipal						
One year or less	2,127,951	0.84%	1,155,730	1.27%	970,355	2.71%
Over one through five years	4,051,980	1.07%	2,343,944	1.50%	537,026	3.34%
Total state, county, and municipal	6,179,931	0.99%	3,499,674	1.42%	1,507,381	2.93%
Total debt securities						
One year or less	41,851,103	0.89%	31,178,540	1.91%	30,967,770	3.02%
Over one through five years	45,226,493	1.11%	44,378,549	1.71%	28,815,399	3.27%
Over ten years	2,691,562	7.28%	2,589,375	7.28%	2,961,875	7.28%
Total debt securities	89,769,158	1.19%	78,146,464	1.97%	62,745,044	3.33%
Equity securities	2,336,334	2.33%	3,219,056	3.28%	3,852,024	3.87%
Total securities	$ 92,105,492	1.22%	$ 81,365,520	2.03%	$ 66,597,068	3.36%

Interest rate sensitivity refers to the responsiveness of interest-bearing assets and liabilities to changes in market interest rates. The rate-sensitive position, or gap, is the difference in the volume of rate-sensitive assets and liabilities at a given time interval. The general objective of gap management is to actively manage rate-sensitive assets and liabilities to reduce the impact of interest rate fluctuations on the net interest margin. Management generally attempts to maintain a balance between rate-sensitive assets and liabilities as the exposure period is lengthened to minimize the overall interest rate risk to the Company.

Interest rate sensitivity may be controlled on either side of the balance sheet. On the asset side, management exercises some control over maturities. Also, loans are written to provide repricing opportunities on fixed rate notes. The Company's investment portfolio, including federal funds sold, provides the most flexible and fastest control over rate sensitivity since it can generally be restructured more quickly than the loan portfolio.

On the liability side, deposit products are structured to offer incentives to attain the maturity distribution desired. Competitive factors sometimes make control over deposits more difficult and, therefore, less effective as an interest rate sensitivity management tool.

The asset mix of the balance sheet is continually evaluated in terms of several variables: yield, credit quality, appropriate funding sources, and liquidity. Management of the liability mix of the balance sheet focuses on expanding the various funding sources.

As of December 31, 2010, the Company was cumulatively asset-sensitive for all time horizons. For asset-sensitive institutions, if interest rates should decrease, the net interest margins should decline. Since all interest rates and yields do not adjust at the same velocity, the gap is only a general indicator of rate sensitivity.

Interest Sensitivity Analysis

December 31, 2010

	Within three months	After three but within twelve months	After one but within five years	After five years	Total
Assets					
Earning assets					
Federal funds sold	$ 36,081,862	$ -	$ -	$ -	$ 36,081,862
Interest-bearing deposits	7,297,405	4,353,444	-	-	11,650,849
Investment debt securities	23,648,086	20,403,228	43,026,280	2,691,563	89,769,157
Loans	233,514,965	845,859	2,400,182	1,223,392	237,984,398
Total earning assets	$ 300,542,318	$ 25,602,531	$ 45,426,462	$ 3,914,955	$ 375,486,266
Liabilities					
Interest-bearing deposits					
NOW	$ 59,410,096	$ -	$ -	$ -	$ 59,410,096
Money market	43,030,285	-	-	-	43,030,285
Savings	48,417,028	-	-	-	48,417,028
Certificates $100,000 and over	19,885,556	19,975,640	4,528,464	-	44,389,660
Certificates under $100,000	21,223,186	25,998,576	7,069,115	-	54,290,877
Securities sold under agreements to repurchase	4,490,512	-	-	-	4,490,512
Total interest-bearing liabilities	$ 196,456,663	$ 45,974,216	$ 11,597,579	$ -	$ 254,028,458
Period gap	$ 104,085,655	$ (20,371,685)	$ 33,828,883	$ 3,914,955	$ 121,457,808

Cumulative gap	$ 104,085,655	$ 83,713,970	$ 117,542,853	$ 121,457,808
Ratio of cumulative gap to total earning assets	27.72%	22.29%	31.30%	32.35%

Deposits and Other Interest-Bearing Liabilities

Average interest-bearing liabilities increased $12,936,000 (5.46%) to $249,663,000 in 2010, from $236,727,000 in 2009. Management deployed those additional funds into investment securities on which yields have been decreasing during the past two years. In order to maintain a reasonable net interest spread, management has lowered rates on deposits to offset reductions of interest revenue. Average interest-bearing deposits increased $13,233,000 (5.75%) to $243,373,000 in 2010 from $230,140,000 in 2009, while average noninterest-bearing demand deposits increased by a modest $419,000 (.55%) to $77,085,000 in 2010 from $76,666,000 in 2009.

At December 31, 2010, total deposits were $326,777,754, compared to $312,647,619 at December 31, 2009, an increase of $14,130,135 (4.52%). Management believes that this multi-year period with high levels of deposit growth relates to investors' loss of confidence in the stock market, coupled with higher deposit insurance limits. Management expects deposit levels to stabilize as investors regain confidence in stocks as an investment.

Average interest-bearing liabilities increased $18,893,000 (8.67%) to $236,727,000 in 2009, from $217,834,000 in 2008. Average interest-bearing deposits increased $17,183,000 (8.07%) to $230,140,000 in 2009 from $212,957,000 in 2008, while average noninterest-bearing demand deposits increased $2,404,000 (3.24%) to $76,666,000 in 2009 from $74,262,000 in 2008.

At December 31, 2009, total deposits were $312,647,619, compared to $292,459,213 at December 31, 2008, an increase of $20,188,406 (6.90%). Throughout 2009, deposit levels exceeded those of the previous two years during comparable periods. Management attributes this deposit influx to a flight of investors from the troubled stock market to the safety of insured bank deposits, similar to the events of late 2001 through 2004. Higher levels of deposit insurance and the reputation of the Company and the Bank for safe and sound operation are key factors in the deposit increases during 2009.

The following table sets forth the deposits of the Company by category as of December 31, 2010, 2009, and 2008, respectively.

	December 31,					
	2010		2009		2008	
	Amount	Percent of deposits	Amount	Percent of deposits	Amount	Percent of deposits
Non-interest bearing	$ 76,763,686	23.48%	$ 72,431,731	23.16%	$ 70,652,032	24.15%
NOW	59,410,096	18.18%	58,328,093	18.66%	48,043,193	16.43%
Money market	43,030,285	13.17%	36,559,471	11.69%	32,039,678	10.96%
Savings	48,417,028	14.82%	46,958,194	15.02%	43,064,214	14.72%
Time deposits less than $100,000	55,243,123	16.91%	56,511,968	18.08%	61,284,880	20.96%
Core deposits	282,864,218		270,789,457		255,083,997	
Time deposits of $100,000 or more	43,913,536	13.44%	41,858,162	13.39%	37,375,216	12.78%
Total deposits	$ 326,777,754	100.00%	$ 312,647,619	100.00%	$ 292,459,213	100.00%

Core deposits, which exclude certificates of deposit of $100,000 or more, provide a relatively stable funding source for the Company's loan portfolio and other earning assets. The Company's core deposits increased $12,074,761 during 2010 and $15,705,460 during 2009. Deposits, and particularly core deposits, have been the Company's primary source of funding and have enabled the Company to meet both its short-term and long-term liquidity needs. Management anticipates that while such deposits will continue to be the Company's primary source of funding in the future, continued reductions in deposit levels, if coupled with growth in the Company's loan portfolio, could require periodic borrowing of funds. In this event, it is likely that Management would liquidate investment securities from the available for sale portfolio or purchase overnight federal funds as needed.

The maturity distribution of the Company's time deposits of $100,000 or more at December 31, 2010, is shown in the following table.

	Within three Months	After three through six months	After six through twelve months	After twelve months	Total
Time deposits of $100,000 or more	$ 19,885,555	$ 7,218,824	$ 12,280,693	$ 4,528,464	$ 43,913,536

Customers who invest in large certificates of deposit tend to be highly sensitive to interest rate levels, making these deposits less reliable sources of funding for liquidity planning purposes than core deposits. Some financial institutions partially fund their balance sheets using large certificates of deposit obtained through brokers. These brokered deposits are generally expensive and are unreliable as long-term funding sources. Accordingly, the Company does not accept brokered deposits under these conditions. Since 2007, the Bank has been a member of the Certificate of Deposit Account Registry Service (CDARS). This service allows the Bank to offer depositors up to $50 million in FDIC insurance through a network of member banks. While CDARS deposits are considered to be brokered deposits for regulatory reporting, they are not considered volatile as they typically remain in the program until maturity. At December 31, 2010, there were no time deposits issued to customers of other CDARS member banks under the reciprocal program.

Noninterest revenue

Noninterest revenue for 2010 increased $88,827 (4.47%) from the previous year. The most significant contributions to this increase are a gain of $195,939 on the sale of collectible coin and a gain of $55,050 from the sale of real property to the Department of Transportation in Delaware for a road improvement project. Additionally, proceeds from the grant of a right of way related to the road improvement project resulted in an increase in miscellaneous revenue of $45,000. These revenue increases are offset in part by losses totaling $200,904 from the sale and revaluation of other real estate owned.

Service charges on deposit accounts decreased by $37,792 (3.83%). This decrease results from a banking regulation, effective in August 2010, which prohibits banks from collecting a fee for processing consumer non-recurring debit card charges which present against insufficient funds. Management expects further loss of service charge revenue in 2011 as a result of this regulation. The Bank prevents authorization of debit card transactions against insufficient funds, but a combination of customers' inattention to their account balances and outstanding transactions, and merchants' failure to process card transactions in a manner that assures that adequate funds are in the deposit account, result in point of sale transactions posting to accounts that do not have sufficient funds. ATM and debit card revenue increased $36,560 (6.85%) due to increased card usage.

Noninterest revenue for 2009 decreased $48,564 (2.38%) from the previous year. Service charges on deposit accounts decreased by $105,730 (9.67%) due to lower volume of fees for items presented against insufficient funds. ATM and debit card revenue increased $14,963 (2.88%) due to increased card usage. In 2009, the Bank had a gain of $33,410 on the sale of collectible coins.

The following table presents the principal components of noninterest revenue for the years ended December 31, 2010, 2009, and 2008, respectively.

Noninterest revenue	2010	2009	2008
Service charges on deposit accounts	$ 949,377	$ 987,169	$ 1,092,899
ATM and debit card revenue	570,382	533,822	518,859
Increase in cash surrender value of bank owned life insurance	171,261	174,468	194,040
Gain (loss) on sale of assets	252,703	38,403	(4,671)
Loss on other real estate owned	(200,904)	(490)	-
Miscellaneous revenue	334,634	255,254	236,063
	$ 2,077,453	$ 1,988,626	$ 2,037,190

Total noninterest revenue			
Noninterest revenue as a percentage of average total assets	0.52%	0.52%	0.56%

Noninterest Expense

Noninterest expense decreased $231,698 (2.72%) from 2009 to 2010. A reduction in deposit insurance premiums of $199,288 comprises most of the variance. Expense related to ATM and debit card activities decreased $73,968 due to a contract renegotiation with the Bank's service provider which took effect in late 2009. Professional fees continued at a high level due to loan collection expense.

Noninterest expense increased $561,304 (7.06%) from 2008 to 2009. A deposit insurance increase of $452,220 resulted from a special assessment to replenish the Deposit Insurance Funds, depleted by bank failures, plus an increase in insured deposit levels and the expiration of a credit which benefited the Bank in recent years. Expense related to ATM and debit card activities decreased $48,887 based on a contract renegotiation with the Bank's service provider. Professional fees increased $77,020 as the Bank engaged legal representation for loan collection.

The following table presents the principal components of noninterest expense for the years ended December 31, 2010, 2009, 2008, respectively.

Noninterest expense	2010	2009	2008
Salaries and employee benefits	$ 4,698,755	$ 4,670,997	$ 4,670,951
Occupancy expense	811,373	763,715	753,605
Furniture and equipment expense	441,459	476,518	464,559
Deposit insurance	296,118	495,406	43,186
Advertising	180,336	190,461	211,056
Armored car service	73,985	75,446	66,003
ATM and debit card	181,882	255,850	304,737
Business and product development	71,482	77,319	78,757
Computer software amortization	68,924	71,895	78,364
Computer software maintenance	159,797	151,927	148,098
Correspondent bank fees	65,488	79,677	60,666
Courier service	45,360	41,472	34,776
Director fees	183,350	147,650	151,900
Dues, donations, and subscriptions	74,337	81,634	84,872
Liability insurance	26,049	26,018	29,358
Postage	155,168	154,065	165,249
Professional fees	171,580	158,668	81,648
Stationery and supplies	58,628	76,896	95,945
Telephone	165,464	173,792	159,065
Miscellaneous	352,339	344,166	269,473
Total noninterest expense	$ 8,281,874	$ 8,513,572	$ 7,952,268

Noninterest expense as a percentage of average total assets	2.06%	2.21%	2.17%

Capital

Under capital guidelines adopted by the Federal Reserve Board and the FDIC, the Company and the Bank are currently required to maintain a minimum risk-based total capital ratio of 8%, with at least 4% being Tier 1 capital. Tier 1 capital consists of common stockholders' equity, qualifying perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less certain intangibles. In addition, the Company and the Bank must maintain a minimum Tier 1 leverage ratio (Tier 1 capital to total assets) of at least 4%, but this minimum ratio is increased by 100 to 200 basis points for other than the highest-rated institutions.

At December 31, 2010, 2009, and 2008, the Company and the Bank were well-capitalized, exceeding all minimum requirements, as set forth in the following table.

		Analysis of Capital		
	Consolidated Company	Bank	To be well capitalized	Required minimums
2010				
Total risk-based capital ratio	33.6%	32.1%	10.0%	8.0%
Tier 1 risk-based capital ratio	33.0%	31.7%	6.0%	4.0%
Tier 1 leverage ratio	17.5%	16.9%	5.0%	4.0%
2009				
Total risk-based capital ratio	32.1%	30.6%	10.0%	8.0%
Tier 1 risk-based capital ratio	31.6%	30.3%	6.0%	4.0%
Tier 1 leverage ratio	17.7%	16.9%	5.0%	4.0%
2008				
Total risk-based capital ratio	32.5%	30.8%	10.0%	8.0%
Tier 1 risk-based capital ratio	31.8%	30.4%	6.0%	4.0%
Tier 1 leverage ratio	18.7%	17.8%	5.0%	4.0%

Website Access to Securities and Exchange Commission Reports

The Bank maintains an Internet website at www.taylorbank.com. The Company's periodic SEC reports, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, are accessible through this website. Access to these filings is free of charge. The reports are available as soon as practicable after they are filed electronically with the SEC.

Accounting Rule Changes

On July 1, 2009, the Accounting Standards Codification (ASC) became the Financial Accounting Standards Board's (FASB) officially recognized source of authoritative U.S. generally accepted accounting principles applicable to all public and non-public non-governmental entities, superseding existing FASB, AICPA, EITF and related literature. Rules and interpretive releases of the SEC under the authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. All other accounting literature is considered non-authoritative. The switch to the ASC affects the way companies refer to U.S. GAAP in financial statements and accounting policies.

The following accounting guidance has been approved by the Financial Accounting Standards Board and would apply to the Company if the Company or the Bank entered into an applicable activity.

Accounting Standards Update (ASU) No. 2010-06, *"Fair Value Measurements and Disclosures (Topic 820)—Improving Disclosures About Fair Value Measurement."* requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3, and (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized. ASU 2010-06 further defines the detail in which classes of assets and liabilities (rather than major category) should be disclosed, and that companies should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities in Levels 2 and 3. All disclosure requirements and clarifications were effective January 1, 2010 and have not had a significant impact on the Company's financial statements.

ASU No.2009-16, "Transfers and Servicing (Topic 860) – Accounting for Transfers of financial Assets"t; enhances reporting about transfers of financial assets, including securitizations, and where companies have continuing exposure to the risks related to transferred financial assets. This new guidance eliminates the concept of a "qualifying special-purpose entity" and changes the requirements for derecognizing financial assets. It also requires additional disclosures about all continuing involvements with transferred financial assets including information about gains and losses resulting from transfers during the period. ASC Topic 860 was effective January 1, 2010 and has not had a significant impact on the Company's financial statements.

The accounting policies adopted by management are consistent with authoritative U.S. generally accepted accounting principles and are consistent with those followed by peer Banks.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Impact of Inflation

Unlike most industrial companies, the assets and liabilities of financial institutions such as the Company and the Bank are primarily monetary in nature. Therefore, interest rates have a more significant effect on the Company's performance than do the effects of changes in the general rate of inflation and change in prices. In addition, interest rates do not necessarily move in the same direction or in the same magnitude as the prices of goods and services. As discussed previously, management seeks to manage the relationships between interest sensitive assets and liabilities in order to protect against wide interest rate fluctuations, including those resulting from inflation. See "Liquidity and Interest Rate Sensitivity" above.

Item 8. Financial Statements and Supplementary Data

In response to this Item, the information included on pages 1 through 26 of the Company's Annual Report to Stockholders for the year ended December 31, 2010, is incorporated herein by reference.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

There have been no changes in or disagreements with accountants on accounting or financial disclosure during the fiscal year covered by this report.

-

Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures

Disclosure controls and procedures are designed and maintained by the Company to ensure that information required to be disclosed in the Company's publicly filed reports is recorded, processed, summarized and reported in a timely manner. Such information must be available to management, including the Chief Executive Officer (CEO) and Treasurer, to allow them to make timely decisions about required disclosures. Even a well-designed and maintained control system can provide only reasonable, not absolute, assurance that its objectives are achieved. Inherent limitations in any system of controls include flawed judgment, errors, omissions, or intentional circumvention of controls.

The Company's management, including the CEO and Treasurer, performed an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2010. Based on that evaluation, the Company's management, including the CEO and Treasurer, has concluded that the Company's disclosure controls and procedures are effective. The projection of an evaluation of controls to future periods is subject to the risk that procedures may become inadequate due to changes in conditions including the degree of compliance with procedures.

Internal Control Over Financial Reporting

Management Report on Internal Control over Financial Reporting

Calvin B. Taylor Bankshares, Inc. maintains a system of internal control over financial reporting, which is designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation of reliable published financial statements. The system includes an organizational structure and division of responsibility, established policies and procedures including a code of conduct to foster a strong ethical climate, and the careful selection, training and development of our staff. The system contains self-monitoring mechanisms, and an internal auditor monitors the operation of the internal control system and reports findings and recommendations to management and the board of directors. Corrective actions are taken to address control deficiencies and other opportunities for improving the system as they are identified. The board, operating through its audit committee, which is composed entirely of directors who are not officers or employees of the Company, provides oversight to the financial reporting process.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation. Furthermore, the effectiveness of an internal control system may vary over time and with circumstances.

The Company assessed its internal control system as of December 31, 2010 in relation to criteria for effective internal control over financial reporting as described in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its assessment, the Company believes that, as of December 31, 2010, its system of internal control over financial reporting met those criteria.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 9, 2011 By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

Date: March 9, 2011 By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins, Treasurer
Principal Accounting Officer
Principal Financial Officer

-

Attestation Report of the Independent Registered Public Accounting Firm

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Calvin B. Taylor Bankshares, Inc.
Berlin, Maryland

We have audited Calvin B. Taylor Bankshares, Inc. and Subsidiary's internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Calvin B. Taylor Bankshares, Inc. and Subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control –*

Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board in the United States of America, the balance sheets and the related statements of income, changes in stockholders' equity and cash flows of Calvin B. Taylor Bankshares, Inc. and Subsidiary, and our report dated March 5, 2010, expressed an unqualified opinion.

/s/ Rowles & Company, LLP

Baltimore, Maryland
March 9, 2011

-

Changes in Internal Controls

During the quarter ended on the date of this report, there were no significant changes in the Company's internal controls over financial reporting that have had or are reasonably likely to have a material effect on the Company's internal control over financial reporting. As of December 31, 2010, the Company's management, including the CEO and Treasurer, has concluded that the Company's internal controls over financial reporting are effective.

Audit Committee and Financial Expert

The Board of Directors has adopted a written Audit Policy, which serves as a charter for the Audit Committee. The Audit Committee is comprised of seven independent directors, including Chairman James R. Bergey, Jr., CPA who serves as the financial expert. The Audit Committee is scheduled to meet quarterly and held four meetings in 2010.

Item 9B. Other Information

There is no information required to be disclosed on Form 8-K which has not been reported.

PART III

Item 10. Directors and Executive Officers and Corporate Governance

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services

The information required by this item is included in the Company's Proxy Statement to be filed in connection with the 2010 Annual Meeting of Stockholders, and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Exhibits

(a)(1), (2) Annual Report to Stockholders for the year ended December 31, 2010

3.1 Articles of Incorporation of the Company, incorporated by reference to Exhibit 3.1 of Registration Statement Form S-4, File No. 33-99762.

3.2 Bylaws of the Company, incorporated by reference to Exhibit 3.2 of Registration Statement Form S-4, File No. 33-99762.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CALVIN B. TAYLOR BANKSHARES, INC.
((Registrant)

Date: March 9, 2011 By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

Date: March 9, 2011 By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins, Treasurer
Principal Accounting Officer / Principal Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March 9, 2011 By: /s/ James R. Bergey, Jr.
James R. Bergey, Jr., Director

Date: March 9, 2011 By: /s/ John H. Burbage, Jr.
John H. Burbage, Jr., Director

Date: March 9, 2011 By: /s/ Todd E. Burbage
Todd E. Burbage, Director

Date: March 9, 2011 By: /s/ Charlotte K. Cathell
Charlotte K. Cathell, Director

Date: March 9, 2011 By: /s/ Reese F. Cropper, Jr.
Reese F. Cropper, Jr.
Chairman of the Board of Directors

Date: March 9, 2011 By: /s/ Reese F. Cropper, III
Reese F. Cropper, III, Director

Date: March 9, 2011 By: /s/ Hale Harrison
Hale Harrison, Director

Date: March 9, 2011 By: /s/ Gerald T. Mason
Gerald T. Mason, Director

Date: March 9, 2011 By: /s/ William H. Mitchell
William H. Mitchell, Director
Vice President

Date: March 9, 2011 By: /s/ Joseph E. Moore
Joseph E. Moore, Director

Date: March 9, 2011 By: /s/ Michael L. Quillin, Sr.
Michael L. Quillin, Sr., Director

Date: March 9, 2011 By: /s/ Raymond M. Thompson
Raymond M. Thompson, Director
President and Chief Executive Officer

Certification - Pursuant to 18 U.S.C. 1350
Section 906 of the Sarbanes-Oxley Act of 2002

We, the undersigned, certify that to the best of our knowledge, based upon a review of the Annual Report on Form 10-K for the period ended December 31, 2010 of the Registrant (the "Report"):

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)t)

Date: March 9, 2011

By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

Date: March 9, 2011

By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins, Treasurer
Principal Accounting Officer
Principal Financial Officer

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Raymond M. Thompson, certify that:

I have reviewed this annual report on Form 10-K of Calvin B. Taylor Bankshares, Inc.;

Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)t)

Date: March 9, 2011

By: /s/ Raymond M. Thompson
Raymond M. Thompson
Chief Executive Officer

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Jennifer G. Hawkins, certify that:

I have reviewed this annual report on Form 10-K of Calvin B. Taylor Bankshares, Inc.;

Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and

d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

CALVIN B. TAYLOR BANKSHARES, INC.
(Registrant)

Date: March 9, 2011 By: /s/ Jennifer G. Hawkins
Jennifer G. Hawkins, Treasurer
Principal Accounting Officer
Principal Financial Officer