

BERKSHIRE HILLS BANCORP INC
Form 10-Q
May 10, 2013
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: March 31, 2013

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

For the transition period from to

Commission File Number: 000-51584

BERKSHIRE HILLS BANCORP, INC.

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

04-3510455

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

24 North Street, Pittsfield, Massachusetts

(Address of principal executive offices)

01201

(Zip Code)

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

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

Yes No

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

Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes No

The Registrant had 25,078,040 shares of common stock, par value \$0.01 per share, outstanding as of May 7, 2013.

Table of Contents

BERKSHIRE HILLS BANCORP, INC.

FORM 10-Q

INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Consolidated Financial Statements (unaudited)</u>	
<u>Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012</u>	4
<u>Consolidated Statements of Income for the Three Months Ended March 31, 2013 and 2012</u>	5
<u>Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2013 and 2012</u>	6
<u>Consolidated Statements of Changes in Stockholders' Equity for the Three Months Ended March 31, 2013 and 2012</u>	7
<u>Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2013 and 2012</u>	8
Notes to Consolidated Financial Statements	10
<u>Note 1</u> <u>Basis of Presentation</u>	10
<u>Note 2</u> <u>Recent Accounting Pronouncements</u>	10
<u>Note 3</u> <u>Trading Account Security</u>	11
<u>Note 4</u> <u>Securities Available for Sale and Held to Maturity</u>	12
<u>Note 5</u> <u>Loans</u>	16
<u>Note 6</u> <u>Deposits</u>	31
<u>Note 7</u> <u>Borrowed Funds</u>	32
<u>Note 8</u> <u>Stockholders' Equity</u>	34
<u>Note 9</u> <u>Earnings per Share</u>	36
<u>Note 10</u> <u>Stock-Based Compensation Plans</u>	37
<u>Note 11</u> <u>Operating Segments</u>	37
<u>Note 12</u> <u>Derivative Financial Instruments and Hedging Activities</u>	38
<u>Note 13</u> <u>Fair Value Measurements</u>	46
<u>Note 14</u> <u>Net Interest Income after Provision for Loan Losses</u>	54
<u>Note 15</u> <u>Subsequent Events</u>	54
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	54
<u>Selected Financial Data</u>	58
<u>Average Balances and Average Yields/Rates</u>	59
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	67
<u>Item 4. Controls and Procedures</u>	68
<u>PART II. OTHER INFORMATION</u>	

Table of Contents

<u>Item 1A.</u>	<u>Risk Factors</u>	70
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	70
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	71
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	71
<u>Item 5.</u>	<u>Other Information</u>	71
<u>Item 6.</u>	<u>Exhibits</u>	72
<u>Signatures</u>		73

Table of Contents**PART I****ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)****BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except share data)	March 31, 2013	December 31, 2012
Assets		
Cash and due from banks	\$ 53,683	\$ 63,382
Short-term investments	20,648	34,862
Total cash and cash equivalents	74,331	98,244
Trading security	16,485	16,893
Securities available for sale, at fair value	558,875	466,169
Securities held to maturity (fair values of \$51,634 and \$52,490)	50,472	51,024
Federal Home Loan Bank stock and other restricted securities	37,870	39,785
Total securities	663,702	573,871
Loans held for sale	72,348	85,368
Residential mortgages	1,234,616	1,324,251
Commercial mortgages	1,397,142	1,413,544
Commercial business loans	618,342	600,126
Consumer loans	638,972	650,733
Total loans	3,889,072	3,988,654
Less: Allowance for loan losses	(33,263)	(33,208)
Net loans	3,855,809	3,955,446
Premises and equipment, net	88,181	86,461
Other real estate owned	2,513	1,929
Goodwill	255,529	255,199
Other intangible assets	17,682	19,059
Cash surrender value of bank-owned life insurance policies	88,893	88,198
Deferred tax assets, net	56,581	57,729
Other assets	69,765	75,305
Total assets	\$ 5,245,334	\$ 5,296,809
Liabilities		
Demand deposits	\$ 656,706	\$ 673,921
NOW deposits	374,721	379,880
Money market deposits	1,504,092	1,439,632
Savings deposits	451,959	436,387
Time deposits	1,113,113	1,170,589
Total deposits	4,100,591	4,100,409
Short-term debt	114,390	163,150
Long-term Federal Home Loan Bank advances	195,208	195,321
Subordinated notes	89,632	89,617
Total borrowings	399,230	448,088

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Other liabilities	71,631	81,047
Total liabilities	4,571,452	4,629,544

Stockholders' equity

Common stock (\$.01 par value; 50,000,000 shares authorized and 26,525,466 shares issued and 25,254,448 shares outstanding in 2013; 26,525,466 shares issued and 25,148,522 shares outstanding in 2012)	265	265
Additional paid-in capital	585,452	585,360
Unearned compensation	(5,845)	(3,035)
Retained earnings	126,430	122,014
Accumulated other comprehensive loss	(1,671)	(2,979)
Treasury stock, at cost (1,271,018 shares in 2013 and 1,376,944 shares in 2012)	(30,749)	(34,360)
Total stockholders' equity	673,882	667,265
Total liabilities and stockholders' equity	\$ 5,245,334	\$ 5,296,809

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

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)	Three Months Ended	
	2013	March 31, 2012
Interest and dividend income		
Loans	\$ 47,081	\$ 35,051
Securities and other	3,800	3,621
Total interest and dividend income	50,881	38,672
Interest expense		
Deposits	5,363	5,502
Borrowings and junior subordinated notes	3,581	2,025
Total interest expense	8,944	7,527
Net interest income	41,937	31,145
Non-interest income		
Loan related fees	2,717	1,171
Deposit related fees	4,259	3,500
Mortgage banking fees	2,217	202
Insurance commissions and fees	2,997	2,746
Wealth management fees	2,264	1,900
Total fee income	14,454	9,519
Non-recurring gain		42
Other	344	241
Total non-interest income	14,798	9,802
Total net revenue	56,735	40,947
Provision for loan losses	2,400	2,000
Non-interest expense		
Compensation and benefits	17,741	13,589
Occupancy and equipment	5,768	4,395
Technology and communications	2,991	1,958
Marketing and promotion	638	351
Professional services	1,490	1,365
FDIC premiums and assessments	828	681
Other real estate owned and foreclosures	23	179
Amortization of intangible assets	1,377	1,311
Merger and conversion related expenses	5,064	4,223
Other	3,563	2,142
Total non-interest expense	39,483	30,194
Income from continuing operations before income taxes	14,852	8,753
Income tax expense	4,387	2,272
Net income from continuing operations	10,465	6,481
Loss from discontinued operations before income taxes (including gain on disposal of \$63 in 2012)		(261)
Income tax expense		376
Net loss from discontinued operations		(637)
Net income	\$ 10,465	\$ 5,844
Basic and diluted earnings per share:		
Continuing operations	\$ 0.42	\$ 0.31
Discontinued operations		(0.03)
Total basic and diluted earnings per share	\$ 0.42	\$ 0.28

Weighted average common shares outstanding:

Basic	24,948	20,955
Diluted	25,143	21,062

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

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)	Three Months Ended	
	2013	March 31, 2012
Net income	\$ 10,465	\$ 5,844
Other comprehensive income, before tax:		
Changes in unrealized gains and losses on securities available-for-sale	733	1,293
Changes in unrealized gains and losses on derivative hedges	1,442	284
Changes in unrealized gains and losses on terminated swaps	236	235
Income taxes related to other comprehensive income:		
Changes in unrealized gains and losses on securities available-for-sale	(320)	(515)
Changes in unrealized gains and losses on derivative hedges	(575)	(206)
Changes in unrealized gains and losses on terminated swaps	(208)	(98)
Total other comprehensive income	1,308	993
Total comprehensive income	\$ 11,773	\$ 6,837

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

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY**

(In thousands)	Common stock Shares	Common stock Amount	Additional paid-in capital	Unearned compen- sation	Retained earnings	Accumulated other comprehensive loss	Treasury stock	Total
Balance at December 31, 2011	21,148	\$ 229	\$ 494,304	\$ (2,790)	\$ 109,477	\$ (4,885)	\$ (42,970)	\$ 553,365
Comprehensive income:								
Net income					5,844			5,844
Other comprehensive income						993		993
Total comprehensive income								6,837
Cash dividends declared (\$0.17 per share)					(3,603)			(3,603)
Forfeited shares	(6)		11	119			(130)	
Exercise of stock options	1				(6)		22	16
Restricted stock grants	60		(134)	(1,380)			1,514	
Stock-based compensation				466				466
Net tax benefit related to stock-based compensation			18					18
Other, net	(11)						(265)	(265)
Balance at March 31, 2012	21,192	\$ 229	\$ 494,199	\$ (3,585)	\$ 111,712	\$ (3,892)	\$ (41,829)	\$ 556,834
Balance at December 31, 2012	25,148	\$ 265	\$ 585,360	\$ (3,035)	\$ 122,014	\$ (2,979)	\$ (34,360)	\$ 667,265
Comprehensive income:								
Net income					10,465			10,465
Other comprehensive income						1,308		1,308
Total comprehensive income								11,773
Cash dividends declared (\$0.18 per share)					(4,561)			(4,561)
Treasury stock purchased	(98)						(2,434)	(2,434)
Forfeited shares	(4)		8	90			(98)	
Exercise of stock options	118				(1,488)		3,315	1,827
Restricted stock grants	146		(691)	(3,485)			4,176	
Stock-based compensation			296	585				881
Net tax benefit related to stock-based compensation			479					479
Other, net	(56)						(1,348)	(1,348)

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Balance at March 31, 2013	25,254	\$	265	\$	585,452	\$	(5,845)	\$	126,430	\$	(1,671)	\$	(30,749)	\$	673,882
--------------------------------------	--------	----	-----	----	---------	----	---------	----	---------	----	---------	----	----------	----	---------

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

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)	Three months ended March 31,	
	2013	2012
Cash flows from operating activities:		
Net income	\$ 10,465	\$ 5,844
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,400	2,000
Net amortization of securities	354	488
Change in unamortized net loan costs and premiums	(511)	(135)
Premises and equipment depreciation and amortization expense	1,725	1,441
Stock-based compensation expense	881	466
Accretion of purchase accounting entries	(4,659)	(1,248)
Amortization of other intangibles	1,377	1,311
Excess tax loss from stock-based payment arrangements	(479)	(18)
Income from cash surrender value of bank-owned life insurance policies	(695)	(643)
Gain on sales of securities, net	(1)	(41)
Net (increase) decrease in loans held for sale	13,020	1,455
Loss on disposition of assets	1,596	1,527
(Gain) loss on sale of real estate	(115)	40
Net change in other	(3,072)	792
Net cash provided by operating activities	22,286	13,279
Cash flows from investing activities:		
Net decrease in trading security	128	120
Proceeds from sales of securities available for sale		3,040
Proceeds from maturities, calls and prepayments of securities available for sale	37,481	23,190
Purchases of securities available for sale	(129,806)	(29,208)
Proceeds from maturities, calls and prepayments of securities held to maturity	882	1,436
Purchases of securities held to maturity	(329)	(2,057)
Net change in loans	100,676	(83,636)
Net cash used for Divestiture		(48,890)
Proceeds from sale of Federal Home Loan Bank stock	1,915	1,836
Purchase of premises and equipment, net	(5,094)	(4,468)
Proceeds from sale of other real estate	449	1,671
Net cash provided by (used in) investing activities	6,302	(136,966)

*(continued)**The accompanying notes are an integral part of these consolidated financial statements.*

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (CONCLUDED)**

(In thousands)	Three months ended March 31,	
	2013	2012
Cash flows from financing activities:		
Net increase in deposits	1,049	82,475
Proceeds from Federal Home Loan Bank advances and other borrowings	90,015	44,360
Repayments of Federal Home Loan Bank advances and other borrowings	(138,873)	(30,058)
Net proceeds from reissuance of treasury stock		16
Purchase of treasury stock	(2,434)	
Exercise of stock options	1,827	
Excess tax loss from stock-based payment arrangements	479	18
Common stock cash dividends paid	(4,564)	(3,603)
Net cash (used in) provided by financing activities	(52,501)	93,208
Net change in cash and cash equivalents	(23,913)	(30,479)
Cash and cash equivalents at beginning of year	98,244	75,782
Cash and cash equivalents at end of year	\$ 74,331	\$ 45,303
Supplemental cash flow information:		
Interest paid on deposits	\$ 5,330	\$ 5,539
Interest paid on borrowed funds	3,440	2,025
Income taxes paid, net	638	1,233
Acquisition of non-cash assets and liabilities:		
Liabilities assumed	(330)	
Other non-cash changes:		
Other net comprehensive income	1,308	993
Real estate owned acquired in settlement of loans	918	250

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

Table of Contents

NOTE 1. BASIS OF PRESENTATION

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

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

The results for any interim period are not necessarily indicative of results for the full year. These consolidated financial statements should be read in conjunction with the audited financial statements and note disclosures for Berkshire Bancorp, Inc. (the Company) previously filed with the Securities and Exchange Commission in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

Reclassifications

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

Out of Period Adjustment

During the three months ended March 31, 2013, the Company recorded a correction of an immaterial error that increased net income by \$0.4 million. The amount represents a correction to tax-related over-accruals that occurred in the fourth quarter of 2012. After evaluating the quantitative and qualitative aspects of these adjustments, the Company concluded that its prior year financial statements were not materially misstated and, therefore, no restatement was required.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Offsetting Assets and Liabilities

In December 2011, the Financial Accounting Standards Board (the FASB) issued Accounting Standards Update (ASU) No. 2011-11, Disclosures About Offsetting Assets and Liabilities. This project began as an attempt to converge the offsetting requirements under U.S. GAAP and International Financial Reporting Standards (IFRS). However, as the FASB and International Accounting Standards Board were not able to

reach a converged solution with regards to offsetting requirements, they each developed convergent disclosure requirements to assist in reconciling differences in the offsetting requirements under U.S. GAAP and IFRS. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. ASU No. 2011-11 also requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. In January 2013, the FASB issued ASU No. 2013-01, Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities. The provisions of ASU No. 2013-01 limits the scope of the new balance sheet offsetting disclosures to the following financial instruments, to the extent they are offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the statement of financial position: (1) derivative financial instruments; (2) repurchase agreements and reverse repurchase agreements; and (3) securities borrowing and securities lending transactions. The Company adopted the provisions of ASU No. 2011-11 and ASU No. 2013-01 effective January 1, 2013. As the provisions of ASU No. 2011-11 and ASU No. 2013-01 only impacted the disclosure requirements related to the offsetting of assets and liabilities and information about instruments and transactions eligible for offset in the statement of financial position, the adoption had no impact on the Company's consolidated statements of income and condition. See Note 12 to the Consolidated Financial Statements for the disclosures required by ASU No. 2011-11 and ASU No. 2013-01.

Table of Contents

Reclassifications Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued ASU No. 2013-02, Reporting of Amounts Reclassified out of Accumulated Other Comprehensive Income, to improve the transparency of reporting these reclassifications. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 requires an entity to disaggregate the total change of each component of other comprehensive income and separately present reclassification adjustments and current period other comprehensive income. The provisions of ASU No. 2013-02 also require that entities present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line item affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, entities would instead cross reference to the related note to the financial statements for additional information. The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the Company provided these required disclosures in the notes to the Consolidated Financial Statements, the adoption of ASU No. 2013-02 had no impact on the Company's consolidated statements of income and condition. See Note 8 to the Consolidated Financial Statements for the disclosures required by ASU No. 2013-02.

NOTE 3. TRADING ACCOUNT SECURITY

The Company holds a tax advantaged economic development bond that is being accounted for at fair value. The security had an amortized cost of \$13.5 million and \$13.6 million, and a fair value of \$16.5 million and \$16.9 million, at March 31, 2013 and December 31, 2012, respectively. As discussed further in Note 12 - Derivative Financial Instruments and Hedging Activities, the Company has entered into a swap contract to swap-out the fixed rate of the security in exchange for a variable rate. The Company does not purchase securities with the intent of selling them in the near term, and there are no other securities in the trading portfolio at March 31, 2013.

Table of Contents**NOTE 4. SECURITIES AVAILABLE FOR SALE AND HELD TO MATURITY**

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

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2013				
Securities available for sale				
<i>Debt securities:</i>				
Municipal bonds and obligations	\$ 80,897	\$ 4,784	\$ (222)	\$ 85,459
Government guaranteed residential mortgage-backed securities	42,968	707	(35)	43,640
Government-sponsored residential mortgage-backed securities	336,894	2,666	(255)	339,305
Corporate bonds	36,042	248	(74)	36,216
Trust preferred securities	18,713	1,537	(1,873)	18,377
Other bonds and obligations	3,374	9	(1)	3,382
Total debt securities	518,888	9,951	(2,460)	526,379
<i>Equity securities:</i>				
Marketable equity securities	28,536	4,120	(160)	32,496
Total securities available for sale	547,424	14,071	(2,620)	558,875
Securities held to maturity				
Municipal bonds and obligations	8,289			8,289
Government-sponsored residential mortgage-backed securities	75	7		82
Tax advantaged economic development bonds	41,331	1,615	(460)	42,486
Other bonds and obligations	777			777
Total securities held to maturity	50,472	1,622	(460)	51,634
Total	\$ 597,896	\$ 15,693	\$ (3,080)	\$ 610,509
December 31, 2012				
Securities available for sale				
<i>Debt securities:</i>				
Municipal bonds and obligations	\$ 79,498	\$ 5,359	\$ (100)	\$ 84,757
Government guaranteed residential mortgage-backed securities	42,305	805	(18)	43,092
Government-sponsored residential mortgage-backed securities	275,940	2,732	(79)	278,593
Corporate bonds	9,998	117	(108)	10,007
Trust preferred securities	21,784	1,089	(1,916)	20,957
Other bonds and obligations	3,459	17	(4)	3,472
Total debt securities	432,984	10,119	(2,225)	440,878
Marketable equity securities	22,467	3,187	(363)	25,291
Total securities available for sale	455,451	13,306	(2,588)	466,169
Securities held to maturity				
Municipal bonds and obligations	8,295			8,295
	76	7		83

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Government-sponsored residential
mortgage-backed securities

Tax advantaged economic development bonds	41,678	1,837	(378)	43,137
Other bonds and obligations	975			975
Total securities held to maturity	51,024	1,844	(378)	52,490
Total	\$ 506,475	\$ 15,150	\$ (2,966)	\$ 518,659

Table of Contents

The amortized cost and estimated fair value of available for sale (AFS) and held to maturity (HTM) securities, segregated by contractual maturity at March 31, 2013 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable. Equity securities have no maturity and are also shown in total.

(In thousands)	Available for sale		Held to maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	\$ 100	\$ 100	\$ 4,500	\$ 4,500
Over 1 year to 5 years	9,922	10,048	4,208	4,259
Over 5 years to 10 years	46,876	47,729	25,382	26,252
Over 10 years	82,128	85,557	16,307	16,541
Total bonds and obligations	139,026	143,434	50,397	51,552
Marketable equity securities	28,536	32,496		
Residential mortgage-backed securities	379,862	382,945	75	82
Total	\$ 547,424	\$ 558,875	\$ 50,472	\$ 51,634

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Table of Contents

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

(In thousands)	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
March 31, 2013						
Securities available for sale						
<i>Debt securities:</i>						
Municipal bonds and obligations	\$ 222	\$ 9,308	\$	\$	\$ 222	\$ 9,308
Government-guaranteed residential mortgage-backed securities	35	5,355			35	5,355
Government-sponsored residential mortgage-backed securities	255	91,375			255	91,375
Corporate bonds	73	15,859	1	5,000	74	20,859
Trust preferred securities	1	1,545	1,872	1,728	1,873	3,273
Other bonds and obligations	1	1,986			1	1,986
Total debt securities	587	125,428	1,873	6,728	2,460	132,156
Marketable equity securities	18	1,713	142	1,858	160	3,571
Total securities available for sale	605	127,141	2,015	8,586	2,620	135,727
Securities held to maturity						
Tax advantaged economic development bonds	460	7,987			460	7,987
Total securities held to maturity	460	7,987			460	7,987
Total	\$ 1,065	\$ 135,128	\$ 2,015	\$ 8,586	\$ 3,080	\$ 143,714
December 31, 2012						
Securities available for sale						
<i>Debt securities:</i>						
Municipal bonds and obligations	\$ 100	\$ 4,140	\$	\$	\$ 100	\$ 4,140
Government guaranteed residential mortgage-backed securities	18	5,108			18	5,108
Government-sponsored residential mortgage-backed securities	69	31,433	10	5,366	79	36,799
Corporate bonds			108	6,892	108	6,892
Trust preferred securities	1	2,754	1,915	1,686	1,916	4,440
Other bonds and obligations	4	2,055			4	2,055
Total debt securities	192	45,490	2,033	13,944	2,225	59,434
Marketable equity securities	90	1,410	273	1,727	363	3,137
Total securities available for sale	\$ 282	\$ 46,900	\$ 2,306	\$ 15,671	\$ 2,588	\$ 62,571
Securities held to maturity						
Tax advantaged economic development bonds	378	8,129			378	8,129
Total securities held to maturity	378	8,129			378	8,129
Total	\$ 660	\$ 55,029	\$ 2,306	\$ 15,671	\$ 2,966	\$ 70,700

Debt Securities

The Company expects to recover its amortized cost basis on all debt securities in its AFS and HTM portfolios. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of March 31, 2013, prior to this recovery. The Company's ability and intent to hold these securities until recovery is supported by the Company's strong capital and liquidity positions as well as its historically low portfolio turnover. The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company's AFS and HTM portfolios were not other-than-temporarily impaired at March 31, 2013:

Table of Contents

AFS municipal bonds and obligations

At March 31, 2013, 12 of the total 140 securities in the Company's portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 2.3% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to the market. At this time, the Company feels the bonds in this portfolio carry minimal risk of default and we are appropriately compensated for that risk. There were no material underlying credit downgrades during the first quarter of 2013. All securities are performing.

AFS residential mortgage-backed securities

At March 31, 2013, 18 out of the total 186 securities in the Company's portfolios of AFS residential mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented less than 1% of the amortized cost of securities in unrealized loss positions within the AFS portfolio. The Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) guarantee the contractual cash flows of all of the Company's residential mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during the past quarter. All securities are considered performing.

AFS corporate bonds

At March 31, 2013, 5 out of the total 8 securities in the Company's portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represented less than 1% of the amortized cost of the securities. All 5 securities remain investment grade rated and the market value of the securities supports the Company's amortized value. The securities are considered performing.

AFS trust preferred securities

At March 31, 2013, 3 out of the total 7 securities in the Company's portfolio of AFS trust preferred securities were in unrealized loss positions. Aggregate unrealized losses represented 36.4% of the amortized cost of securities in unrealized loss positions. The Company's evaluation of the present value of expected cash flows on these securities supports its conclusions about the recoverability of the securities' amortized cost basis. 5 of the 7 securities contain at least one below investment grade ratings. The Company reviews the financial strength of all of the single issue trust issuers and has concluded that the amortized cost remains supported by the market value of these securities and they are considered performing.

At March 31, 2013, \$1.7 million of the total unrealized losses was attributable to a \$2.6 million investment in a Mezzanine Class B tranche of a \$360 million pooled trust preferred security issued by banking and insurance entities. The Company evaluated the security, with a Level 3 fair value of \$0.9 million, for potential other-than-temporary-impairment (OTTI) at March 31, 2013 and determined that OTTI was not evident based on both the Company's ability and intent to hold the security until the recovery of its remaining amortized cost and the protection from credit loss afforded by \$51 million in excess subordination above current and projected losses. The security is considered performing.

HTM tax advantaged economic development bonds

At March 31, 2013, 1 of the total 8 securities in the Company's portfolio of tax advantaged economic development bonds were in an unrealized loss position. Aggregate unrealized losses represented 5.5% of the amortized cost of securities in unrealized loss positions. The Company has the intent of maintaining these bonds to recovery. All securities are considered performing.

AFS other bonds and obligations

At March 31, 2013, 1 of the total 10 securities in the Company's portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented less than 1% of the amortized cost of securities

Table of Contents

in unrealized loss positions. The securities are investment grade rated and there were no material underlying credit downgrades during the first quarter of 2013. All securities are performing.

Marketable Equity Securities

In evaluating its marketable equity securities portfolio for OTTI, the Company considers its ability to more likely than not hold an equity security to recovery. The Company additionally considers other various factors, including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI is recognized immediately through earnings.

At March 31, 2013, 3 out of the total 26 securities in the Company's portfolio of marketable equity securities were in an unrealized loss position. The unrealized loss represented 4.3% of the amortized cost of the securities. The Company has the ability and intent to hold the securities until a recovery of their cost basis and does not consider the securities other-than-temporarily impaired at March 31, 2013. As new information becomes available in future periods, changes to the Company's assumptions may be warranted and could lead to a different conclusion regarding the OTTI of these securities.

NOTE 5. LOANS

The Company's loan portfolio includes residential mortgage, commercial mortgage, commercial business, and consumer loan segments to customers. Residential mortgage loans include classes for 1-4 family owner occupied and construction loans. Commercial mortgage loans include construction, single and multi-family, and commercial real estate classes. Commercial business loans include asset based lending loans and other commercial business loan classes. Consumer loans include home equity, direct and indirect auto and other. A substantial portion of the loan portfolio is secured by real estate in western Massachusetts, southern Vermont, northeastern New York, and in the Bank's New England lending areas. The ability of many of the Bank's debtors to honor their contracts is dependent, among other things, on the economies and real estate markets in these areas.

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

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Table of Contents

(In thousands)	Business Loans		March 31, 2013 Acquired Loans		Total
Residential mortgages					
1-4 family	\$	813,150	\$	396,899	\$ 1,210,049
Construction		18,516		6,051	24,567
Total residential mortgages		831,666		402,950	1,234,616
Commercial mortgages:					
Construction		149,599		19,461	169,060
Single and multi-family		65,203		78,003	143,206
Commercial real estate		754,411		330,465	1,084,876
Total commercial mortgages		969,213		427,929	1,397,142
Commercial business loans:					
Asset based lending		274,632		3,978	278,610
Other commercial business loans		243,057		96,675	339,732
Total commercial business loans		517,689		100,653	618,342
Total commercial loans		1,486,902		528,582	2,015,484
Consumer loans:					
Home equity		199,101		118,062	317,163
Other		98,489		223,320	321,809
Total consumer loans		297,590		341,382	638,972
Total loans	\$	2,616,158	\$	1,272,914	\$ 3,889,072

(In thousands)	Business Loans		December 31, 2012 Acquired Loans		Total
Residential mortgages:					
1-4 family	\$	870,322	\$	427,210	\$ 1,297,532
Construction		20,344		6,375	26,719
Total residential mortgages		890,666		433,585	1,324,251
Commercial mortgages:					
Construction		150,694		17,131	167,825
Single and multi-family		43,332		80,488	123,820
Commercial real estate		768,867		353,032	1,121,899
Total commercial mortgages		962,893		450,651	1,413,544
Commercial business loans:					
Asset based lending		255,265		2,830	258,095
Other commercial business loans		234,662		107,369	342,031
Total commercial business loans		489,927		110,199	600,126
Total commercial loans		1,452,820		560,850	2,013,670
Consumer loans:					
Home equity		205,892		119,509	325,401
Other		76,258		249,074	325,332
Total consumer loans		282,150		368,583	650,733

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Total loans	\$	2,625,636	\$	1,363,018	\$	3,988,654
-------------	----	-----------	----	-----------	----	-----------

Table of Contents

The carrying amount of the acquired loans at March 31, 2013 totaled \$1.27 billion. These loans consisted of loans determined to be impaired at the time of acquisition, which are accounted for in accordance with ASC Topic 310-30, with a carrying amount of \$69.8 million and loans that were considered not impaired at the acquisition date with a carrying amount of \$1.20 billion.

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

(In thousands)	Three months ended March 31,			
	2013		2012	
Balance at beginning of period	\$	8,247	\$	1,277
Acquisitions				
Sales				
Reclassification from nonaccretable difference for loans with improved cash flows				
Changes in expected cash flows that do not affect nonaccretable difference				
Accretion		(2,581)		(609)
Balance at end of period	\$	5,666	\$	668

Table of Contents

The following is a summary of past due loans at March 31, 2013 and December 31, 2012:

Business Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
March 31, 2013							
Residential mortgages:							
1-4 family	\$ 3,633	\$ 996	\$ 8,738	\$ 13,367	\$ 799,783	\$ 813,150	\$ 1,896
Construction	553	111	89	753	17,763	18,516	89
Total	4,186	1,107	8,827	14,120	817,546	831,666	1,985
Commercial mortgages:							
Construction		225	4,318	4,543	145,056	149,599	
Single and multi-family	214	140	474	828	64,375	65,203	330
Commercial real estate	3,962	548	6,248	10,758	743,653	754,411	
Total	4,176	913	11,040	16,129	953,084	969,213	330
Commercial business loans:							
Asset based lending					274,632	274,632	
Other commercial business loans	396	124	2,885	3,405	239,652	243,057	230
Total	396	124	2,885	3,405	514,284	517,689	230
Consumer loans:							
Home equity	1,663	186	2,553	4,402	194,699	199,101	1,001
Other	361	118	362	841	97,648	98,489	142
Total	2,024	304	2,915	5,243	292,347	297,590	1,143
Total	\$ 10,782	\$ 2,448	\$ 25,667	\$ 38,897	\$ 2,577,261	\$ 2,616,158	\$ 3,688

Business Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2012							
Residential mortgages:							
1-4 family	\$ 4,105	\$ 1,291	\$ 8,061	\$ 13,457	\$ 856,865	\$ 870,322	\$ 1,563
Construction		210	48	258	20,086	20,344	48
Total	4,105	1,501	8,109	13,715	876,951	890,666	1,611
Commercial mortgages:							
Construction			4,668	4,668	146,026	150,694	
Single and multi-family	616		27	643	42,689	43,332	
Commercial real estate	1,183	1,727	8,231	11,141	757,726	768,867	1,195
Total	1,799	1,727	12,926	16,452	946,441	962,893	1,195
Commercial business loans							
Asset based lending					255,265	255,265	

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Other commercial business loans	745	372	3,427	4,544	230,118	234,662	159
Total	745	372	3,427	4,544	485,383	489,927	159
Consumer loans:							
Home equity	828	300	1,856	2,984	202,908	205,892	424
Other	546	55	248	849	75,409	76,258	69
Total	1,374	355	2,104	3,833	278,317	282,150	493
Total	\$ 8,023	\$ 3,955	\$ 26,566	\$ 38,544	\$ 2,587,092	\$ 2,625,636	\$ 3,458

Table of Contents**Acquired Loans**

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
March 31, 2013							
Residential mortgages:							
1-4 family	\$ 862	\$ 648	\$ 2,819	\$ 4,329	\$ 392,570	\$ 396,899	\$ 843
Construction					6,051	6,051	
Total	862	648	2,819	4,329	398,621	402,950	843
Commercial mortgages:							
Construction			1,080	1,080	18,381	19,461	1,080
Single and multi-family	230	3,424	1,243	4,897	73,106	78,003	1,165
Commercial real estate	284		11,576	11,860	318,605	330,465	9,968
Total	514	3,424	13,899	17,837	410,092	427,929	12,213
Commercial business loans:							
Asset based lending					3,978	3,978	
Other commercial business loans	320	187	2,286	2,793	93,882	96,675	1,422
Total	320	187	2,286	2,793	97,860	100,653	1,422
Consumer loans:							
Home equity	544	495	279	1,318	116,744	118,062	64
Other	3,037	450	383	3,870	219,450	223,320	45
Total	3,581	945	662	5,188	336,194	341,382	109
Total	\$ 5,277	\$ 5,204	\$ 19,666	\$ 30,147	\$ 1,242,767	\$ 1,272,914	\$ 14,587

Acquired Loans

(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
December 31, 2012							
Residential mortgages:							
1-4 family	\$ 1,817	\$ 585	\$ 2,523	\$ 4,925	\$ 422,285	\$ 427,210	\$ 1,555
Construction					6,375	6,375	
Total	1,817	585	2,523	4,925	428,660	433,585	1,555
Commercial mortgages:							
Construction			1,056	1,056	16,075	17,131	1,056
Single and multi-family	194	1,328	746	2,268	78,220	80,488	746
Commercial real estate	1,532	2,024	11,062	14,618	338,414	353,032	10,176
Total	1,726	3,352	12,864	17,942	432,709	450,651	11,978
Commercial business loans:							
Asset based lending					2,830	2,830	
Other commercial business loans	422	577	2,177	3,176	104,193	107,369	1,764

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Total	422	577	2,177	3,176	107,023	110,199	1,764
Consumer loans:							
Home equity	1,689	169	89	1,947	117,562	119,509	52
Other	2,624	365	271	3,260	245,814	249,074	171
Total	4,313	534	360	5,207	363,376	368,583	223
Total	\$ 8,278	\$ 5,048	\$ 17,924	\$ 31,250	\$ 1,331,768	\$ 1,363,018	\$ 15,520

Table of Contents

The following is summary information pertaining to non-accrual loans at March 31, 2013 and December 31, 2012:

(In thousands)	March 31, 2013		Total
	Business Loans	Acquired Loans	
Residential mortgages:			
1-4 family	\$ 6,842	\$ 1,976	\$ 8,818
Total	6,842	1,976	8,818
Commercial mortgages:			
Construction	4,318		4,318
Single and multi-family	144	78	222
Other	6,248	1,608	7,856
Total	10,710	1,686	12,396
Commercial business loans:			
Other commercial business loans	2,655	864	3,519
Total	2,655	864	3,519
Consumer loans:			
Home equity	1,552	215	1,767
Other	220	338	558
Total	1,772	553	2,325
Total non-accrual loans	\$ 21,979	\$ 5,079	\$ 27,058

(In thousands)	December 31, 2012		Total
	Business Loans	Acquired Loans	
Residential mortgages:			
1-4 family	\$ 6,498	\$ 968	\$ 7,466
Construction			
Total	6,498	968	7,466
Commercial mortgages:			
Construction	4,668		4,668
Single and multi-family	27		27
Other	7,036	886	7,922
Total	11,731	886	12,617
Commercial business loans:			
Other commercial business loans	3,268	413	3,681
Total	3,268	413	3,681
Consumer loans:			
Home equity	1,432	37	1,469
Other	179	100	279
Total	1,611	137	1,748
Total non-accrual loans	\$ 23,108	\$ 2,404	\$ 25,512

Activity in the allowance for loan losses for the three months ended March 31, 2013 and the period ended December 31, 2012 was as follows:

Table of Contents**Business Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
March 31, 2013						
Balance at beginning of year	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891
Charged-off loans	190	720	679	250		1,839
Recoveries on charged-off loans	16	3	71	36		126
Provision for loan losses	244	402	194	874	148	1,862
Balance at end of period	\$ 5,998	\$ 18,548	\$ 5,191	\$ 2,126	\$ 177	\$ 32,040
Individually evaluated for impairment	765	1,374	824	272		3,235
Collectively evaluated	5,233	17,174	4,367	1,854	177	28,805
Total	\$ 5,998	\$ 18,548	\$ 5,191	\$ 2,126	\$ 177	\$ 32,040

Loans receivable:

Balance at end of period						
Individually evaluated for impairment	7,625	30,024	1,900	1,510		41,059
Collectively evaluated	824,041	939,189	515,789	296,080		2,575,099
Total	\$ 831,666	\$ 969,213	\$ 517,689	\$ 297,590		\$ 2,616,158

Business Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
December 31, 2012						
Balance at beginning of year	\$ 3,150	\$ 22,095	\$ 4,540	\$ 2,203	\$ (90)	\$ 31,898
Charged-off loans	2,604	4,229	697	1,537		9,067
Recoveries on charged-off loans	103	52	96	165		416
Provision for loan losses	5,279	945	1,666	635	119	8,644
Balance at end of year	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891
Individually evaluated for impairment	342	1,444	1,205	273		3,264
Collectively evaluated for impairment	5,586	17,419	4,400	1,193	29	28,627
Total	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891

Loans receivable:

Balance at end of year						
Individually evaluated for impairment	6,362	30,287	2,821	1,218		40,688
Collectively evaluated for impairment	884,304	932,606	487,106	280,932		2,584,948
Total	\$ 890,666	\$ 962,893	\$ 489,927	\$ 282,150		\$ 2,625,636

Table of Contents**Acquired Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
March 31, 2013						
Balance at beginning of year	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317
Charged-off loans	86	235	25	316		662
Recoveries on charged-off loans			2	28		30
Provision for loan losses	95	265	27	307	(156)	538
Balance at end of period	\$ 518	\$ 420	\$ 100	\$ 333	\$ (148)	\$ 1,223
Individually evaluated for impairment	113					113
Collectively evaluated	405	420	100	333	(148)	1,110
Total	\$ 518	\$ 420	\$ 100	\$ 333	\$ (148)	\$ 1,223

Loans receivable:

Balance at end of Period						
Individually evaluated for impairment	954	2,374	181			3,509
Collectively evaluated	401,996	425,555	100,472	341,382		1,269,405
Total	\$ 402,950	\$ 427,929	\$ 100,653	\$ 341,382		\$ 1,272,914

Acquired Loans

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
December 31, 2012						
Balance at beginning of year	\$ 281	\$ 158	\$ 38	\$ 87	\$ (18)	\$ 546
Charged-off loans	43			340		383
Recoveries on charged-off loans				208		208
Provision for loan losses	271	232	58	359	26	946
Balance at end of year	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317
Individually evaluated for impairment	55					55
Collectively evaluated for impairment	454	390	96	314	8	1,262
Total	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317

Loans receivable:

Balance at end of year						
Individually evaluated for impairment	371	886				1,257
Collectively evaluated for impairment	433,214	449,765	110,199	368,583		1,361,761
Total	\$ 433,585	\$ 450,651	\$ 110,199	\$ 368,583		\$ 1,363,018

Table of Contents

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

Business Loans

(In thousands)	Recorded Investment	At March 31, 2013 Unpaid Principal Balance		Related Allowance
With no related allowance:				
Residential mortgages - 1-4 family	\$ 2,476	\$ 2,476		\$
Commercial mortgages - single and multifamily	2,380	2,380		
Commercial mortgages - real estate	3,289	3,289		
Other commercial business loans	70	70		
Consumer - home equity	556	556		
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 1,933	\$ 2,698		\$ 765
Commercial mortgages - construction	1,408	1,938		530
Commercial mortgages - real estate	1,755	2,599		844
Other commercial business loans	565	1,389		824
Consumer - home equity	456	728		272
Total				
Residential mortgages	\$ 4,409	\$ 5,174		\$ 765
Commercial mortgages	8,832	10,206		1,374
Commercial business	635	1,459		824
Consumer	1,012	1,284		272
Total impaired loans	\$ 14,888	\$ 18,123		\$ 3,235

Acquired Loans

(In thousands)	Recorded Investment	At March 31, 2013 Unpaid Principal Balance		Related Allowance
With no related allowance:				
Commercial mortgages - real estate	\$ 1,608	\$ 1,608		\$
Other commercial business loans	180	180		
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 747	\$ 860		\$ 113
Total				
Residential mortgages	\$ 747	\$ 860		\$ 113
Commercial mortgages	1,608	1,608		
Commercial business	180	180		
Total impaired loans	\$ 2,535	\$ 2,648		\$ 113

Table of Contents

The following is a summary of impaired loans at December 31, 2012:

Business Loans

(In thousands)	Recorded Investment	At December 31, 2012		Related Allowance
		Unpaid Principal		
		Balance		
With no related allowance:				
Residential mortgages - 1-4 family	\$ 3,408	\$ 3,408		\$
Commercial mortgages - construction	2,730	2,730		
Commercial mortgages - single and multifamily				
Commercial mortgages - real estate	3,450	3,450		
Other commercial business loans	31	31		
Consumer - home equity	602	602		
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 1,056	\$ 1,343		\$ 287
Commercial mortgages - construction	1,584	1,938		354
Commercial mortgages - single and multifamily				
Commercial mortgages - real estate	2,019	3,109		1,090
Other commercial business loans	1,135	2,340		1,205
Consumer - home equity	209	482		273
Total				
Residential mortgages	\$ 4,464	\$ 4,751		\$ 287
Commercial mortgages	9,783	11,227		1,444
Commercial business	1,166	2,371		1,205
Consumer	811	1,084		273
Total impaired loans	\$ 16,224	\$ 19,433		\$ 3,209

Acquired Loans

(In thousands)	Recorded Investment	At December 31, 2012		Related Allowance
		Unpaid Principal		
		Balance		
With no related allowance:				
Residential mortgages - 1-4 family	\$ 215	\$ 215		
Commercial mortgages - real estate	886	886		
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 101	\$ 156		\$ 55
Total				
Residential mortgages	\$ 316	\$ 371		\$ 55
Residential mortgages - 1-4 family	886	886		
Total impaired loans	\$ 1,202	\$ 1,257		\$ 55

Table of Contents

The following is a summary of the average recorded investment and interest income recognized on impaired loans as of March 31, 2013 and March 31, 2012:

Business Loans

(in thousands)	Three Months Ended March 31, 2013		Three Months Ended March 31, 2012	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Residential mortgages - 1-4 family	\$ 2,141	\$ 20	\$ 583	\$ 15
Commercial-construction	2,380			
Commercial mortgages - single and multifamily			81	
Commercial mortgages - real estate	3,295	10	677	15
Commercial business loans	70			
Consumer-home equity	455	4	35	1
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 2,234	\$ 1	\$ 914	\$ 14
Commercial-construction	1,938		34	2
Commercial mortgages - single and multifamily			1,926	
Commercial mortgages - real estate	2,765		6	
Commercial business loans	1,721	14	526	9
Consumer-home equity	558		211	
Total				
Residential mortgages	\$ 4,375	\$ 21	\$ 1,497	\$ 29
Commercial mortgages	10,378	10	3,216	24
Commercial business loans	1,791	14	34	2
Consumer loans	1,013	4	246	1
Total impaired loans	\$ 17,557	\$ 49	\$ 4,993	\$ 56

Acquired Loans

(in thousands)	Three Months Ended March 31, 2013		Three Months Ended March 31, 2012	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
With no related allowance:				
Commercial mortgages - real estate	\$ 803	\$ 2	\$	\$
Commercial business loans	181			
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 861	\$	\$	\$
Total				
Residential mortgages	\$ 861	\$	\$	\$
Commercial mortgages	803	2		
Commercial business loans	181			

Total impaired loans	\$	1,845	\$	2	\$	\$
-----------------------------	----	-------	----	---	----	----

Table of Contents

Credit Quality Information

The Bank utilizes an eleven grade internal loan rating system for each of its commercial real estate, construction and commercial loans as follows:

1 **Substantially Risk Free**

Borrowers in this category are of unquestioned credit standing and are at the pinnacle of credit quality. Credits in this category are generally cash secured with strong management depth and experience and exhibit a superior track record.

2 **Minimal Risk**

A relationship which provides an adequate return on investment to the Company, has been stable during the last three years and has a superior financial condition as determined by a comparison with the industry. In addition, management must be of unquestionable character and have strong abilities as measured by its long-term financial performance.

3 **Moderate Risk**

A relationship which does not appear to possess more than the normal degree of credit risk. Overall, the borrower's financial statements compare favorably with the industry. A strong secondary repayment source exists and the loan is performing as agreed.

4 **Better than Average Risk**

A relationship which possesses most of the characteristics found in the Moderate Risk category and ranges from definitely sound to those with minor risk characteristics. Operates in a reasonably stable industry that may be moderately affected by the business cycle and moderately open to changes. Has a satisfactory track record and the loan is performing as agreed.

5 **Average Risk**

A relationship which possesses most of the characteristics found in the Better than Average Risk category but may have recently experienced a loss year often as a result of its operation in a cyclical industry. The relationship has smaller margins of debt service coverage with some elements of reduced strength. Good secondary repayment source exists and the loan is performing as agreed. Start-up businesses and construction loans will generally be assigned to this category as well.

6 **Acceptable Risk**

Borrowers in this category may be more highly leveraged than their industry peers and experience moderate losses relative to net worth. Trends and performance, e.g. sales and earnings, leverage, among other factors may be negative. Management's ability may be questionable, or perhaps untested. The industry may be experiencing either temporary or long term pressures. Collateral values are seen as more important in assessing risk than in higher quality loans. Failure to meet required line clean-up periods or other terms and conditions, including some slow payments may also predicate this grade.

7 **Special Mention**

A classification assigned to all relationships for credits with potential weaknesses which present a higher than normal credit risk, but not to the point of requiring a Substandard loan classification. No loss of principal or interest is anticipated. However, these credits are followed closely, and if necessary, remedial plans to reduce the Company's risk exposure are established.

Table of Contents

8 **Substandard Performing**

A classification assigned to a credit that is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Substandard loans will be evaluated on at least a quarterly basis to determine if an additional allocation of the Company's allowance for loan loss is warranted.

9 **Substandard Non-Performing**

A classification given to Substandard credits which have deteriorated to the point that management has placed the accounts on non-accrual status due to delinquency exceeding 90 days or where the Company has determined that collection of principal and interest in full is unlikely.

10 **Doubtful**

Loans classified as doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, highly questionable and improbable. Collection in excess of 50% of the balance owed is not expected.

11 **Loss**

Loans classified Loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be possible in the future.

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

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

Acquired Loans Credit Quality Analysis

Upon acquiring a loan portfolio, our Internal Loan Review function undertakes the same process of assigning risk ratings as historical loans, which may differ from the risk rating policy of the predecessor company. Loans which are rated Substandard or worse according to the rating process outlined below are deemed to be credit impaired loans accounted for under ASC 310-30, regardless of whether they are classified as performing or non-performing.

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

Table of Contents

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

A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time for ASC 310-30 loans. At March 31, 2013, there had not been such a decrease and therefore there was no allowance for losses on acquired loans under Subtopic ASC 310-30.

The Company presented several tables within this footnote of historical loans and acquired loans in order to distinguish the credit performance of the acquired loans.

The following table presents the Company's loans by risk rating at March 31, 2013 and December 31, 2012:

Business Loans**Residential Mortgages**

Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 803,416	\$ 860,970	\$ 18,316	\$ 20,085	\$ 821,732	\$ 881,055
Special mention	996	1,291	111	210	1,107	1,501
Substandard	8,738	8,061	89	49	8,827	8,110
Total	\$ 813,150	\$ 870,322	\$ 18,516	\$ 20,344	\$ 831,666	\$ 890,666

Commercial Mortgages

Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family		Real estate		Total commercial mortgages	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:								

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Pass	\$ 141,218	\$ 142,946	\$ 61,679	\$ 40,690	\$ 693,588	\$ 707,867	\$ 896,485	\$ 891,503
Special mention			88	\$ 420	7,958	5,965	8,046	6,385
Substandard	8,381	7,748	3,436	2,222	52,865	54,930	64,682	64,900
Doubtful						105		105
Total	\$ 149,599	\$ 150,694	\$ 65,203	\$ 43,332	\$ 754,411	\$ 768,867	\$ 969,213	\$ 962,893

Commercial Business Loans

Credit Risk Profile by Creditworthiness Category

(In thousands)	Asset based lending		Other		Total commercial business loans	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 274,632	\$ 255,265	\$ 228,583	\$ 219,172	\$ 503,215	\$ 474,437
Special mention			8,386	5,857	8,386	5,857
Substandard			5,513	9,541	5,513	9,541
Doubtful			575	92	575	92
Total	\$ 274,632	\$ 255,265	\$ 243,057	\$ 234,662	\$ 517,689	\$ 489,927

Consumer Loans

Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Other		Total consumer loans	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Performing	\$ 197,549	\$ 204,460	\$ 98,269	\$ 76,079	\$ 295,818	\$ 280,539
Nonperforming	1,552	1,432	220	179	1,772	1,611
Total	\$ 199,101	\$ 205,892	\$ 98,489	\$ 76,258	\$ 297,590	\$ 282,150

Table of Contents**Acquired Loans****Residential Mortgages**

Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 393,432	\$ 424,102	\$ 6,051	\$ 6,375	\$ 399,483	\$ 430,477
Special mention	648	585			648	585
Substandard	2,819	2,523			2,819	2,523
Total	\$ 396,899	\$ 427,210	\$ 6,051	\$ 6,375	\$ 402,950	\$ 433,585

Commercial Mortgages

Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family		Real estate		Total commercial mortgages	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:								
Pass	\$ 11,569	\$ 10,142	\$ 58,052	\$ 57,305	\$ 297,964	\$ 318,809	\$ 367,585	\$ 386,256
Special mention	1,061	1,057	6,105	10,383	4,543	6,790	11,709	18,230
Substandard	6,831	5,932	13,846	12,800	27,958	27,433	48,635	46,165
Total	\$ 19,461	\$ 17,131	\$ 78,003	\$ 80,488	\$ 330,465	\$ 353,032	\$ 427,929	\$ 450,651

Commercial Business Loans

Credit Risk Profile by Creditworthiness Category

(In thousands)	Asset based lending		Other		Total commercial business loans	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Grade:						
Pass	\$ 3,978	\$ 2,830	\$ 79,581	\$ 87,325	\$ 83,559	\$ 90,155
Special mention			5,496	7,444	5,496	7,444
Substandard			11,598	12,600	11,598	12,600
Total	\$ 3,978	\$ 2,830	\$ 96,675	\$ 107,369	\$ 100,653	\$ 110,199

Consumer Loans

Credit Risk Profile Based on Payment Activity

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

(In thousands)	Home equity		Other		Total consumer loans	
	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012	Mar. 31, 2013	Dec. 31, 2012
Performing	\$ 117,847	\$ 119,472	\$ 222,982	\$ 248,974	\$ 340,829	\$ 368,446
Nonperforming	215	37	338	100	553	137
Total	\$ 118,062	\$ 119,509	\$ 223,320	\$ 249,074	\$ 341,382	\$ 368,583

The following table summarizes information about total loans rated Special Mention or lower.

(In thousands)	March 31, 2013			December 31, 2012		
	Business Loans	Acquired Loans	Total	Business Loans	Acquired Loans	Total
Non-Accrual	\$ 21,979	\$ 5,079	\$ 27,058	\$ 23,108	\$ 2,405	\$ 25,513
Substandard Accruing	60,533	58,634	119,167	61,745	59,243	120,988
Total Classified	82,512	63,713	146,225	84,853	61,648	146,501
Special Mention	17,843	18,799	36,642	14,097	26,793	40,890
Total Criticized	\$ 100,355	\$ 82,512	\$ 182,867	\$ 98,950	\$ 88,441	\$ 187,391

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

Table of Contents

The following tables include the recorded investment and number of modifications identified during the three months ended March 31, 2013. The Company reports the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured.

(Dollars in thousands)	Number of Modifications	Modifications by Class	
		Three months ending March 31, 2013	Post-Modification
		Pre-Modification Outstanding Recorded Investment	Outstanding Recorded Investment
Troubled Debt Restructurings			
Residential- 1-4 Family	5	\$ 941	\$ 941
Commercial - Single and multifamily	1		40
Commercial - Other	5	2,022	1,589
	11	\$ 2,963	\$ 2,570

As of March 31, 2013, there were no loans that were restructured within the last twelve months that have subsequently defaulted.

The following table presents the Company's TDR activity for the three months ended March 31, 2013 and 2012:

(In thousands)	2013	March 31,	2012
Balance at beginning of the period	\$ 4,626	\$	1,263
Principal Payments	(22)		(2)
TDR Status Change (1)			(522)
Other Reductions (2)	(485)		
Newly Identified TDRs	2,571		
Balance at end of the period	\$ 6,690	\$	739

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

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

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

NOTE 6. DEPOSITS

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

A summary of time deposits is as follows:

(In thousands)	March 31, 2013		December 31, 2012	
Time less than \$100,000	\$	517,880	\$	548,895
Time \$100,000 or more		595,233		621,694
Total time deposits	\$	1,113,113	\$	1,170,589

Table of Contents**NOTE 7. BORROWED FUNDS**

Borrowed funds at March 31, 2013 and December 31, 2012 are summarized, as follows:

(in thousands, except rates)	March 31, 2013		December 31, 2012	
	Principal	Weighted Average Rate	Principal	Weighted Average Rate
Short-term borrowings:				
Advances from the FHLBB	\$ 114,390	0.32%	\$ 153,150	0.28%
Other Borrowings			10,000	1.96
Total short-term borrowings:	114,390	0.32	163,150	0.38
Long-term borrowings:				
Advances from the FHLBB	195,208	1.14	195,321	1.18
Junior subordinated notes	74,168	7.00	74,153	7.00
Other junior subordinated notes	15,464	2.14	15,464	2.16
Total long-term borrowings:	284,840	1.96	284,938	2.76
Total	\$ 399,230	2.04%	\$ 448,088	1.89%

Short-term debt includes Federal Home Loan Bank of Boston (FHLBB) advances with an original maturity of less than one year. Total short-term debt was \$114.4 million with a weighted average interest rate of 0.32% and \$163.2 million with a weighted average interest rate of 0.38% at March 31, 2013 and December 31, 2012, respectively. The Bank also maintains a \$3.0 million secured line of credit with the FHLBB that bears a daily adjustable rate calculated by the FHLBB. There was no outstanding balance on the FHLBB line of credit for the period ended March 31, 2013 and December 31, 2012.

The Bank is approved to borrow on a short-term basis from the Federal Reserve Bank of Boston as a non-member bank. The Bank has pledged certain loans and securities to the Federal Reserve Bank to support this arrangement. No borrowings with the Federal Reserve Bank of Boston took place for the period ended March 31, 2013 and December 31, 2012.

Long-term FHLBB advances consist of advances with an original maturity of more than one year. The advances outstanding at March 31, 2013 include callable advances totaling \$5.0 million, and amortizing advances totaling \$5.6 million. The advances outstanding at December 31, 2012 include callable advances totaling \$5.0 million, and amortizing advances totaling \$5.6 million. All FHLBB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.

Table of Contents

A summary of FHLBB advances as of March 31, 2013 and December 31, 2012 is as follows:

(in thousands, except rates)	March 31, 2013		December 31, 2012	
	Principal	Weighted Average Rate	Principal	Weighted Average Rate
Fixed rate advances maturing:				
2013	\$ 147,582	0.36%	\$ 186,448	0.32%
2014	20,215	3.01	20,280	3.04
2015				
2016	1,630	0.79	1,645	0.80
2017 and beyond	5,437	3.81	5,478	3.87
Total fixed rate advances	\$ 174,864	0.77%	\$ 213,851	0.67%
Variable rate advances maturing:				
2013	\$ 59,734	1.30%	\$ 59,620	1.33%
2014	10,000	0.36	10,000	0.39
2015	20,000	0.36	20,000	0.41
2016	10,000	0.36	10,000	0.41
2017 and beyond	35,000	0.93	35,000	0.97
Total variable rate advances	\$ 134,734	0.92%	\$ 134,620	0.96%
Total FHLBB advances	\$ 309,598	0.84%	\$ 348,471	0.78%

On September 28, 2012, the Company issued \$75.0 million principal amount of 6.875% fixed to floating rate subordinated notes (the "notes") through a private placement at a discount of 1.15%. The Company will pay interest on the subordinated notes each March 28 and September 28 through September 28, 2022, and thereafter on each March 28, June 28, September 28 and December 28. The maturity date of the notes is September 28, 2027, although the Company may redeem some or all of the subordinated notes beginning on the interest payment date of September 28, 2022 and on any interest payment date thereafter. From and including September 28, 2012 to but excluding September 28, 2022, the notes will bear interest at the rate of 6.875% per year and will be payable semi-annually in arrears on March 28 and September 28 of each year. From and including September 28, 2022, the notes will bear an interest rate per annum equal to the three-month LIBOR rate plus 511.3 basis points, payable quarterly on each March 28, June 28, September 28 and December 28, commencing on December 28, 2022, through the maturity date or the early redemption date of the notes.

The Company holds 100% of the common stock of Berkshire Hills Capital Trust I ("Trust I") which is included in other assets with a cost of \$0.5 million. The sole asset of Trust I is \$15.5 million of the Company's junior subordinated debentures due in 2035. These debentures bear interest at a variable rate equal to LIBOR plus 1.85% and had a rate of 2.14% and 2.16% at March 31, 2013 and December 31, 2012, respectively. The Company has the right to defer payments of interest for up to five years on the debentures at any time, or from time to time, with certain limitations, including a restriction on the payment of dividends to stockholders while such interest payments on the debentures have been deferred. The Company has not exercised this right to defer payments. The Company has the right to redeem the debentures at par value. Trust I is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, Trust I is not consolidated into the Company's financial statements.

Table of Contents**NOTE 8. STOCKHOLDERS EQUITY**

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

	March 31, 2013	December 31, 2012	FDIC Minimum to be Well Capitalized
Total capital to risk weighted assets	12.2%	11.8%	10.0%
Tier 1 capital to risk weighted assets	10.4	10.0	6.0
Tier 1 capital to average assets	8.2	7.5	5.0

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

Accumulated other comprehensive income

Components of accumulated other comprehensive loss are as follows:

(In thousands)	March 31, 2013	December 31, 2012
Other accumulated comprehensive income/(loss), before tax:		
Net unrealized holding gain on AFS securities	\$ 11,451	\$ 10,719
Net loss on effective cash flow hedging derivatives	(9,512)	(10,955)
Net loss on terminated swap	(3,944)	(4,179)
Net unrealized holding loss on pension plans	(1,265)	(1,265)
Income taxes related to items of accumulated other comprehensive (loss)/income:		
Net unrealized holding loss on AFS securities	(4,327)	(4,007)
Net loss on effective cash flow hedging derivatives	3,822	4,397
Net loss on terminated swap	1,594	1,801
Net unrealized holding gain on pension plans	510	510
Accumulated other comprehensive loss	\$ (1,671)	\$ (2,979)

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Table of Contents

The following table presents the components of other comprehensive loss for the three months ended March 31, 2013 and 2012:

(In thousands)	Before Tax	Tax Effect	Net of Tax
Three Months Ended March 31, 2013			
Net unrealized holding gain on AFS securities:			
Net unrealized gain arising during the period	\$ 732	\$ (320)	\$ 412
Less: reclassification adjustment for gains realized in net income			
Net unrealized holding gain on AFS securities	732	(320)	412
Net loss on effective cash flow hedging derivatives:			
Net unrealized loss arising during the period	305	(116)	189
Less: reclassification adjustment for losses realized in net income	1,138	(459)	679
Net loss on effective cash flow hedging derivatives	1,443	(575)	868
Net loss on terminated swap:			
Net unrealized loss arising during the period			
Less: reclassification adjustment for losses realized in net income	236	(208)	28
Net loss on terminated swap	236	(208)	28
Other Comprehensive Income	\$ 2,411	\$ (1,103)	\$ 1,308
Three Months Ended March 31, 2012			
Net unrealized holding gain on AFS securities:			
Net unrealized gain arising during the period	\$ 1,333	\$ (531)	\$ 802
Less: reclassification adjustment for losses realized in net income	(41)	17	(24)
Net unrealized holding gain (loss) on AFS securities	1,292	(514)	778
Net loss on effective cash flow hedging derivatives:			
Net unrealized gain arising during the period	(697)	188	(509)
Less: reclassification adjustment for losses realized in net income	982	(395)	587
Net loss on effective cash flow hedging derivatives	285	(207)	78
Net loss on terminated swap:			
Net unrealized loss arising during the period			
Less: reclassification adjustment for losses realized in net income	235	(98)	137
Net loss on terminated swap	235	(98)	137
Other Comprehensive Income	\$ 1,812	\$ (819)	\$ 993

The following table presents the changes in each component of accumulated other comprehensive income, for the three months ended March 31, 2013:

(in thousands)	Net unrealized holding gain on AFS Securities	Net loss on effective cash flow hedging derivatives	Net loss on terminated swap	Net unrealized holding loss on pension plans	Total
Balance, December 31, 2012	\$ 10,719	\$ (10,955)	\$ (4,179)	\$ (1,265)	\$ (5,680)
Other Comprehensive Loss Before reclassifications	732	305			1,037
Amounts Reclassified from Accumulated other comprehensive income		1,138	236		1,374
Other Comprehensive Income	732	1,443	236		2,411
Balance, March 31, 2013	\$ 11,451	\$ (9,512)	\$ (3,943)	\$ (1,265)	\$ (3,269)

Table of Contents

The following table presents the amounts reclassified out of each component of accumulated other comprehensive income for the three months ended March 31, 2013:

(in thousands)	Amount Reclassified From Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income Is Presented
Realized losses on effective cash flow hedging derivatives		
	1,138	Borrowings and junior subordinated notes
	(459)	Tax expense
	679	Net of tax
Amortization of realized losses on terminated swap		
	236	Borrowings and junior subordinated notes
	(208)	Tax expense
	28	Net of tax
Total reclassifications for the period	\$ 707	Net of tax

NOTE 9. EARNINGS PER SHARE

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

(In thousands, except per share data)	Three Months Ended March 31,	
	2013	2012
Net income from continuing operations	\$ 10,465	\$ 6,481
Loss from discontinued operations before income taxes (including gain on disposal of \$63)		(261)
Income tax expense		376
Net loss from discontinued operations		(637)
Net income	\$ 10,465	\$ 5,844
Average number of common shares issued	26,525	22,860
Less: average number of treasury shares	1,260	1,685
Less: average number of unvested stock award shares	317	220
Average number of basic common shares outstanding	24,948	20,955
Plus: dilutive effect of unvested stock award shares	73	62
Plus: dilutive effect of stock options outstanding	122	45
Average number of diluted common shares outstanding	25,143	21,062
Basic and diluted earnings per share:		
Continuing operations	\$ 0.42	\$ 0.31

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Discontinued operations				(0.03)
Total basic and diluted earnings per share	\$	0.42	\$	0.28

For the quarter ended March 31, 2013, 251 thousand shares of restricted stock and 499 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the quarter ended March 31, 2012, 159 thousand shares of restricted stock and 357 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations.

Table of Contents**NOTE 10. STOCK-BASED COMPENSATION PLANS**

A combined summary of activity in the Company's stock award and stock option plans for the three months ended March 31, 2013 is presented in the following table:

(Shares in thousands)	Non-vested Stock Awards Outstanding		Stock Options Outstanding	
	Number of Shares	Weighted-Average Grant Date Fair Value	Number of Shares	Weighted-Average Exercise Price
Balance, December 31, 2012	244	\$ 21.69	688	\$ 18.13
Granted	146	23.90		
Stock options exercised			(118)	15.51
Stock awards vested	(69)	18.99		
Forfeited	(4)	22.40	(8)	18.24
Expired			(8)	21.82
Balance, March 31, 2013	317	\$ 23.29	554	\$ 18.64
Exercisable options, March 31, 2013			497	\$ 11.78

During the three months ended March 31, 2013 and 2012, proceeds from stock option exercises totaled \$1.8 million and \$16 thousand, respectively. During the three months ended March 31, 2013, there were 69 thousand shares issued in connection with vested stock awards. During the three months ended March 31, 2012, there were 46 thousand shares issued in connection with vested stock awards. All of these shares were issued from available treasury stock. Stock-based compensation expense totaled \$881 thousand and \$466 thousand during the three months ended March 31, 2013 and 2012, respectively. Stock-based compensation expense is recognized ratably over the requisite service period for all awards.

NOTE 11. OPERATING SEGMENTS

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

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

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Table of Contents

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

(In thousands)	Banking	Insurance	Parent	Eliminations	Total Consolidated
Three months ended March 31, 2013					
Net interest income (expense)	\$ 42,901	\$	\$ 6,036	\$ (7,000)	\$ 41,937
Provision for loan losses	2,400				2,400
Non-interest income	11,818	2,980	4,463	(4,463)	14,798
Non-interest expense	36,687	2,134	662		39,483
Income (loss) before income taxes	15,632	846	9,837	(11,463)	14,852
Income tax expense (benefit)	4,705	310	(628)		4,387
Net income	\$ 10,927	\$ 536	\$ 10,465	\$ (11,463)	\$ 10,465
Average assets (in millions)	\$ 5,203	\$ 27	\$ 755	\$ (745)	\$ 5,240
Three months ended March 31, 2012					
Net interest income (expense)	\$ 31,352	\$	\$ (207)	\$	\$ 31,145
Provision for loan losses	2,000				2,000
Non-interest income	7,056	2,746	6,284	(6,284)	9,802
Non-interest expense	27,617	2,214	363		30,194
Income (loss) before income taxes	8,791	532	5,714	(6,284)	8,753
Income tax expense (benefit)	2,188	214	(130)		2,272
Net income from continuing operations	6,603	318	5,844	(6,284)	6,481
Income from discontinued operations before income taxes (including gain on disposal of \$63)	(261)				(261)
Income tax expense	376				376
Net loss from discontinued operations	(637)				(637)
Net income	\$ 5,966	\$ 318	\$ 5,844	\$ (6,284)	\$ 5,844
Average assets (in millions)	\$ 3,954	\$ 30	\$ 494	\$ (481)	\$ 3,997

NOTE 12. DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

As of March 31, 2013, the Company held derivatives with a total notional amount of \$1.1 billion. That amount included \$330.0 million in interest rate swap derivatives that were designated as cash flow hedges for accounting purposes. The Company also had economic hedges and non-hedging derivatives totaling \$640.0 million and \$150.8 million, respectively, which are not designated as accounting hedges. Economic hedges included interest rate swaps totaling \$433.3 million, and \$206.7 million in forward commitment contracts.

As part of the Company's risk management strategy, the Company enters into interest rate swap agreements to mitigate the interest rate risk inherent in certain of the Company's assets and liabilities. Interest rate swap agreements involve the risk of dealing with both Bank customers and institutional derivative counterparties and their ability to meet contractual terms. The agreements are entered into with counterparties that meet established credit standards and contain master netting and collateral provisions protecting the at-risk party. The derivatives program is overseen by the Risk Management Committee of the Company's Board of Directors. Based on adherence to the Company's credit standards and the presence of the netting and collateral provisions, the Company believes that the credit risk inherent in these contracts was not significant at March 31, 2013.

The Company pledged collateral to derivative counterparties in the form of cash totaling \$5.8 million and securities with an amortized cost of \$34.1 million and a fair value of \$35.0 million as of March 31, 2013. The Company does not typically require its Commercial customers to post cash or securities as collateral on its program of back-to-back economic hedges. However certain language is written into the ISDA and loan documents where, in default situations, the Bank is allowed to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Company may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions.

Table of Contents

Information about interest rate swap agreements and non-hedging derivative assets and liabilities at March 31, 2013, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Rate Paid	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLBB borrowings	\$ 135,000	1.7	0.30%	3.28%	\$ (4,909)
Forward-starting interest rate swaps on FHLBB borrowings	180,000	5.3		2.05%	(4,203)
Interest rate swaps on junior subordinated notes	15,000	1.1	2.14%	5.54%	(578)
Total cash flow hedges	330,000				(9,690)
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	13,481	16.7	0.57%	5.09%	(3,214)
Interest rate swaps on loans with commercial loan customers	209,926	5.0	2.49%	5.22%	(13,658)
Reverse interest rate swaps on loans with commercial loan customers	209,926	5.0	2.49%	5.22%	13,269
Forward commitments	206,677	0.2			(550)
Total economic hedges	640,010				(4,153)
Non-hedging derivatives:					
Interest rate lock commitments	150,799	0.2			2,758
Total non-hedging derivatives	150,799				2,758
Total	\$ 1,120,809				\$ (11,085)

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Table of Contents

Information about interest rate swap agreements and non-hedging derivative assets and liabilities at December 31, 2012, follows:

	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Rate Paid	Estimated Fair Value Asset (Liability) (In thousands)
Cash flow hedges:					
Interest rate swaps on FHLBB borrowings	\$ 115,000	1.6	0.35%	3.47%	\$ (4,608)
Forward-starting interest rate swaps on FHLBB borrowings	140,000	5.4		2.37%	(5,810)
Interest rate swaps on junior subordinated notes	15,000	1.4	2.16%	5.54%	(704)
Total cash flow hedges	270,000				(11,122)
Economic hedges:					
Interest rate swap on tax advantaged economic development bond	13,609	16.9	0.58%	5.09%	(3,473)
Interest rate swaps on loans with commercial loan customers	205,319	5.1	2.54%	5.28%	(15,219)
Reverse interest rate swaps on loans with commercial loan customers	205,319	5.1	5.28%	0.11%	14,746
Forward commitments	335,548	0.1			(1,336)
Total economic hedges	759,795				(5,282)
Non-hedging derivatives:					
Interest rate lock commitments	282,752	0.2			6,258
Total non-hedging derivatives	282,752				6,258
Total	\$ 1,312,547				\$ (10,146)

Cash flow hedges

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

The Company has entered into several interest rate swaps with an aggregate notional amount of \$135.0 million to convert the LIBOR based floating interest rates on a \$135.0 million portfolio of FHLBB advances to fixed rates, with the objective of fixing the Company's monthly interest expense on these borrowings.

The Company has also entered into fourteen forward-starting interest rate swaps with a combined notional value of \$180.0 million. Two of these swaps will become effective by the close of the second quarter, each with a duration of one year. In 2014, nine of the remaining twelve forward starting swaps will become effective; of these, two have a duration of three years, four have durations of four years, and the final three have durations of five years. The last three forward starting swaps will become effective in 2015, two of which have a duration of four years and the

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

other which has a duration of seven years. This hedge strategy converts the LIBOR based rate of interest on certain FHLB advances to fixed interest rates, thereby protecting the Company from floating interest rate variability.

The Company has entered into an interest rate swap with a notional value of \$15.0 million to convert the floating rate of interest on its junior subordinated debentures to a fixed rate of interest. The purpose of the hedge was to protect the Company from the risk of variability arising from the floating rate interest on the debentures.

Amounts included in the Consolidated Statements of Income and in the other comprehensive income section of the Consolidated Statements of Changes in Stockholders' Equity related to interest rate derivatives designated as hedges of cash flows, were as follows:

Table of Contents

(In thousands)	Three Months Ended March 31,	
	2013	2012
Interest rate swaps on FHLBB borrowings:		
Unrealized gain (loss) recognized in accumulated other comprehensive loss	\$ 306	\$ (635)
Reclassification of unrealized loss from accumulated other comprehensive loss to interest expense	1,011	861
Reclassification of unrealized loss from accumulated other comprehensive loss to other non-interest expense for termination of swaps	236	235
Reclassification of unrealized deferred tax benefit from accumulated other comprehensive loss to tax expense for terminated swaps	(208)	(98)
Net tax benefit on items recognized in accumulated other comprehensive loss	(522)	(164)
Interest rate swaps on junior subordinated debentures:		
Unrealized loss recognized in accumulated other comprehensive loss	(1)	(62)
Reclassification of unrealized loss from accumulated other comprehensive loss to interest expense	127	121
Net tax benefit on items recognized in accumulated other comprehensive loss	(54)	(43)
Other comprehensive income recorded in accumulated other comprehensive loss, net of reclassification adjustments and tax effects	\$ 895	\$ 215
Net interest expense recognized in interest expense on hedged FHLBB borrowings	\$ 1,243	\$ 1,083
Net interest expense recognized in interest expense on junior subordinated notes	\$ 127	\$ 118

Table of Contents

Hedge ineffectiveness on interest rate swaps designated as cash flow hedges was immaterial to the Company's financial statements during the three months ended March 31, 2013 and 2012. The Company does not anticipate material events or transactions within the next twelve months that are likely to result in a reclassification of unrealized gains or losses from accumulated other comprehensive loss to earnings.

Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate liabilities. During the next twelve months, the Company estimates that \$4.8 million will be reclassified as an increase to interest expense.

Economic hedges

The Company has an interest rate swap with a \$13.5 million notional amount to swap out the fixed rate of interest on an economic development bond bearing a fixed rate of 5.09%, currently within the Company's trading portfolio under the fair value option, in exchange for a LIBOR-based floating rate. The intent of the economic hedge is to improve the Company's asset sensitivity to changing interest rates in anticipation of favorable average floating rates of interest over the 21-year life of the bond. The fair value changes of the economic development bond are mostly offset by fair value changes of the related interest rate swap.

The Company also offers certain derivative products directly to qualified commercial borrowers. The Company economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third-party financial institutions. The transaction allows the Company's customer to convert a variable-rate loan to a fixed rate loan. Because the Company acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts mostly offset each other in earnings. Credit valuation adjustments arising from the difference in credit worthiness of the commercial loan and financial

Table of Contents

institution counterparties totaled \$359 thousand as of March 31, 2013. The interest income and expense on these mirror image swaps exactly offset each other.

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

The company uses the following types of forward commitments contracts:

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

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

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

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

Non-hedging derivatives

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

Table of Contents

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

(In thousands)	Three Months Ended March 31,	
	2013	2012
Economic hedges		
<i>Interest rate swap on industrial revenue bond:</i>		
Unrealized gain recognized in other non-interest income	\$ 107	\$ 440
<i>Interest rate swaps on loans with commercial loan customers:</i>		
Unrealized gain recognized in other non-interest income	1,554	1,111
<i>Reverse interest rate swaps on loans with commercial loan customers:</i>		
Unrealized loss recognized in other non-interest income	(1,554)	(1,111)
Favorable change in credit valuation adjustment recognized in other non-interest income	78	122
<i>Forward Commitments:</i>		
Unrealized loss recognized in other non-interest income	(550)	
Realized gain in other non-interest income	1,055	
Non-hedging derivatives		
<i>Interest rate lock commitments</i>		
Unrealized gain recognized in other non-interest income	2,758	
Realized gain in other non-interest income	1,240	

Table of Contents

Assets and Liabilities Subject to Enforceable Master Netting Arrangements

Interest Rate Swap Agreements (Swap Agreements)

The Company enters into swap agreements to facilitate the risk management strategies for commercial banking customers. The Company mitigates this risk by entering into equal and offsetting swap agreements with highly rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated statements of condition. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral generally in the form of marketable securities is received or posted by the counterparty with net liability positions, respectively, in accordance with contract thresholds. The Company had net asset positions with its financial institution counterparties totaling \$13.3 million and \$14.7 million as of March 31, 2013 and December 31, 2012, respectively. The Company had net liability positions with its financial institution counterparties totaling \$26.5 million and \$29.8 million as of March 31, 2013 and December 31, 2012, respectively. The collateral posted by the Company for the net liability positions was \$26.5 million and \$29.8 million as of March 31, 2013 and December 31, 2012, respectively.

The following table presents the assets and liabilities subject to an enforceable master netting arrangement as of March 31, 2013 and December 31, 2012:

Table of Contents

Offsetting of Financial Assets and Derivative Assets

(in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition	Financial Instruments	Cash Collateral Received	Net Amount
As of March 31, 2013							
Interest Rate Swap							
Agreements:							
Institutional counterparties	\$	\$	\$	\$		\$	\$
Commercial counterparties	13,269		13,269				13,269
Total	\$ 13,269	\$	\$ 13,269	\$		\$	\$ 13,269

Offsetting of Financial Liabilities and Derivative Liabilities

(in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition	Financial Instruments	Cash Collateral Pledged	Net Amount
As of March 31, 2013							
Interest Rate Swap							
Agreements:							
Institutional counterparties	\$ (26,562)	\$	\$ (26,562)	\$ 22,132		\$ 4,430	\$
Commercial counterparties							
Total	\$ (26,562)	\$	\$ (26,562)	\$ 22,132		\$ 4,430	\$

Offsetting of Financial Assets and Derivative Assets

(in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition	Financial Instruments	Cash Collateral Received	Net Amount
As of December 31, 2012							
Interest Rate Swap							
Agreements:							
Institutional counterparties	\$	\$	\$			\$	\$
Commercial counterparties	14,746		14,746				14,746
Total	\$ 14,746	\$	\$ 14,746	\$		\$	\$ 14,746

Offsetting of Financial Liabilities and Derivative Liabilities

Gross Amounts of	Gross Amounts Offset in the	Net Amounts of Liabilities Presented in the	Gross Amounts Not Offset in the Statements of Condition
---------------------	--------------------------------	---	--

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

(in thousands)	Recognized Liabilities	Statements of Condition	Statements of Condition	Financial Instruments	Cash Collateral Pledged	Net Amount
As of December 31, 2012						
Interest Rate Swap Agreements:						
Institutional counterparties	\$ (29,814)	\$	\$ (29,814)	\$ 25,384	\$ 4,430	\$
Commercial counterparties						
Total	\$ (29,814)	\$	\$ (29,814)	\$ 25,384	\$ 4,430	\$

NOTE 13. FAIR VALUE MEASUREMENTS

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

Recurring fair value measurements

The following table summarizes assets and financial liabilities measured at fair value on a recurring basis as of March 31, 2013 and December 31, 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value. There were no transfers between levels during the three months ended March 31, 2013.

Table of Contents

(In thousands)	March 31, 2013			Total Fair Value
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Trading account security	\$	\$	\$ 16,485	\$ 16,485
Available-for-sale securities:				
Municipal bonds and obligations		85,459		85,459
Government-guaranteed residential mortgage-backed securities		43,640		43,640
Government-sponsored residential mortgage-backed securities		339,305		339,305
Corporate bonds		36,216		36,216
Trust preferred securities		17,479	898	18,377
Other bonds and obligations		3,382		3,382
Marketable equity securities	31,130	596	770	32,496
Loans held for sale		72,348		72,348
Derivative assets (1)		13,269	2,758	16,027
Derivative liabilities (2)	33	26,562	517	27,112

(In thousands)	December 31, 2012			Total Fair Value
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	
Trading account security	\$	\$	\$ 16,893	\$ 16,893
Available-for-sale securities:				
Municipal bonds and obligations		84,757		84,757
Government-guaranteed residential mortgage-backed securities		43,091		43,091
Government-sponsored residential mortgage-backed securities		278,593		278,593
Corporate bonds		10,007		10,007
Trust preferred securities		20,072	885	20,957
Other bonds and obligations		3,472		3,472
Marketable equity securities	25,291			25,291
Loans Held for Sale		85,368		85,368
Derivative assets (1)		14,746	6,258	21,004
Derivative liabilities (2)	282	29,818	1,055	31,155

(1) Total fair value excludes \$0.5 million and 1.3 million of unrealized losses as of March 31, 2013 and December 31, 2012, respectively, on forward commitments presented under other assets on the consolidated balance sheet.

(2) Total fair value includes \$0.5 million and 1.3 million of unrealized losses as of March 31, 2013 and December 31, 2012, respectively, on forward commitments presented under other assets on the consolidated balance sheet.

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

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

Table of Contents

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

March 31, 2013 (In thousands)	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
Loans Held for Sale	\$ 72,348	\$ 70,577	\$ 1,771

December 31, 2012 (In thousands)	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
Loans Held for Sale	\$ 85,368	\$ 82,560	\$ 2,808

Derivative Assets and Liabilities.

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

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

Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of March 31, 2013, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

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

Forward Commitments. The Company utilizes forward commitments as economic hedges against potential changes in the values of the IRLCs and loans held for sale. To be announced (TBA) mortgage-backed securities forward commitment sales are classified as Level 1, and consist of publicly-traded debt securities for which identical fair values can be obtained through quoted market prices in active exchange markets. The fair

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

values of the Company's best efforts and mandatory delivery loan sale commitments are determined similarly to the IRLCs using quoted prices in the market place that are observable, however; costs to originate and closing ratios included in the calculation are internally generated and are based on management's judgment and prior experience, which are considered factors that are not observable. As such, best efforts and mandatory forward commitments are classified as Level 3 measurements.

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Table of Contents

The table below presents the changes in Level 3 assets that were measured at fair value on a recurring basis at March 31, 2013 and 2012.

(In thousands)	Trading Account Security	Assets Securities Available for Sale	Interest Rate Lock Commitments	Liabilities Forward Commitments
Balance as of December 31, 2012	\$ 16,893	\$ 885	\$ 6,258	\$ (1,055)
Purchase of Marketable Equity Security		770		
Unrealized (loss) gain recognized in other non-interest income	(280)		3,998	538
Unrealized gain included in accumulated other comprehensive loss		13		
Paydown of trading account security	(128)			
Cash settlements				
Transfers to held for sale loans			(7,498)	
Balance as of March 31, 2013	\$ 16,485	\$ 1,668	\$ 2,758	\$ (517)
Unrealized gains (losses) relating to instruments still held at March 31, 2013	\$ 3,004	\$ (1,704)	\$ 2,758	\$ (517)

(In thousands)	Trading Account Security	Assets Securities Available for Sale	Interest Rate Lock Commitments	Liabilities Forward Commitments
Balance as of December 31, 2011	\$ 17,395	\$ 544	\$	\$
Unrealized gain recognized in other non-interest income	(428)			
Unrealized loss included in accumulated other comprehensive loss				
Paydown of trading account security	(120)			
Balance as of March 31, 2012	\$ 16,847	\$ 544	\$	\$
Unrealized gains (losses) relating to instruments still held at March 31, 2012	\$ 2,871	\$ (2,055)	\$	\$

Table of Contents

Quantitative information about the significant unobservable inputs within Level 3 recurring assets is as follows:

(In thousands)	Fair Value March 31, 2013	Valuation Techniques	Unobservable Inputs	Significant Unobservable Input Value
Assets				
Trading Account Security	\$ 16,485	Discounted Cash Flow	Discount Rate	2.46%
Interest Rate Lock Commitment	2,758	Historical Trend Pricing Model	Closing Ratio Origination Costs	91.98% 2,500
Total	\$ 19,243			

(In thousands)	Fair Value December 31, 2012	Valuation Techniques	Unobservable Inputs	Significant Unobservable Input Value
Assets				
Trading Account Security	\$ 16,893	Discounted Cash Flow	Discount Rate	2.08%
Interest Rate Lock Commitment	6,258	Historical Trend Pricing Model	Closing Ratio Origination Costs	93.04% 2,500
Total	\$ 23,151			

Non-recurring fair value measurements

The Company is required, on a non-recurring basis, to adjust the carrying value or provide valuation allowances for certain assets using fair value measurements in accordance with GAAP. The following is a summary of applicable non-recurring fair value measurements. There are no liabilities measured at fair value on a non-recurring basis.

(In thousands)	March 31, 2013 Level 3 Inputs	December 31, 2012 Level 3 Inputs	Three months ended March 31, 2013 Total Gains (Losses)
Assets			
Impaired loans	\$ 6,864	\$ 6,104	\$ (760)
Capitalized mortgage servicing rights	3,617	3,198	324
Other real estate owned	2,513	1,929	115
Total	\$ 12,994	\$ 11,231	\$ (321)

Quantitative information about the significant unobservable inputs within Level 3 non-recurring assets is as follows:

(in thousands)	Fair Value March 31, 2013	Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
Assets				

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Impaired loans	\$	6,864	Fair value of collateral	Loss severity	9.18% to 50.0% (25.57%)
				Appraised value	\$130.0 to \$1,950.0 (\$887.0)
Capitaized mortgage servicing rights		3,617	Discounted cash flow	Constant prepayment rate (CPR)	11.49% to 20.42% (15.09%)
				Discount rate	11.00% to 15.50% (11.23%)
Other real estate owned		2,513	Fair value of collateral	Appraised value	\$0 to \$1,000.0 (\$414.1)
Total	\$	12,994			

(in thousands)	Fair Value		Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
	December 31, 2012				
Assets					
Impaired loans	\$	6,104	Fair value of collateral	Loss severity	5.24% to 100.0% (42.79%)
				Appraised value	\$15.7 to \$1,584.0 (\$863.8)
Capitaized mortgage servicing rights		3,198	Discounted cash flow	Constant prepayment rate (CPR)	13.25% to 26.02% (18.41%)
				Discount rate	11.00% to 15.50% (11.14%)
Other real estate owned		1,929	Fair value of collateral	Appraised value	\$0 to \$1,000.0 (\$457.1)
Total	\$	11,231			

(a) Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective assets in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.

There were no Level 1 or Level 2 nonrecurring fair value measurements for the periods ended March 31, 2013 and December 31, 2012.

Table of Contents

Impaired Loans. Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records non-recurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Non-recurring adjustments can also include certain impairment amounts for collateral-dependent loans calculated when establishing the allowance for credit losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated valuation amount does not necessarily represent the fair value of the loan. Real estate collateral is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. However, the choice of observable data is subject to significant judgment, and there are often adjustments based on judgment in order to make observable data comparable and to consider the impact of time, the condition of properties, interest rates, and other market factors on current values. Additionally, commercial real estate appraisals frequently involve discounting of projected cash flows, which relies inherently on unobservable data. Therefore, real estate collateral related nonrecurring fair value measurement adjustments have generally been classified as Level 3. Estimates of fair value for other collateral that supports commercial loans are generally based on assumptions not observable in the marketplace and therefore such valuations have been classified as Level 3.

Capitalized mortgage loan servicing rights. A loan servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans exceed adequate compensation for performing the servicing. The fair value of servicing rights is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Adjustments are only recorded when the discounted cash flows derived from the valuation model are less than the carrying value of the asset. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation hierarchy.

Other real estate owned (OREO). OREO results from the foreclosure process on residential or commercial loans issued by the Bank. Upon assuming the real estate, the Company records the property at the fair value of the asset less the estimated sales costs. Thereafter, OREO properties are recorded at the lower of cost or fair value less the estimated sales costs. OREO fair values are primarily determined based on Level 3 data including sales comparables and appraisals.

Summary of estimated fair values of financial instruments

The estimated fair values, and related carrying amounts, of the Company's financial instruments follow. Certain financial instruments and all non-financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein may not necessarily represent the underlying fair value of the Company.

Table of Contents

(In thousands)	Carrying Amount	Fair Value	March 31, 2013		
			Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	\$ 53,683	\$ 53,683	\$ 53,683	\$	\$
Trading security	16,485	16,485			16,485
Securities available for sale	558,875	558,875	31,130	526,077	1,668
Securities held to maturity	50,472	51,634			51,634
Restricted equity securities	37,870	37,870		37,870	
Net loans	3,855,809	3,917,205			3,917,205
Loans held for sale	72,348	72,348		72,348	
Accrued interest receivable	12,368	12,368		12,368	
Cash surrender value of bank-owned life insurance policies	88,893	88,893		88,893	
Derivative assets (1)	16,027	16,027		13,269	2,758
Financial Liabilities					
Total deposits	\$ 4,100,591	\$ 4,110,772	\$	\$ 4,110,772	\$
Short-term debt	114,390	114,644		114,644	
Long-term Federal Home Loan Bank advances	195,208	198,591		198,591	
Subordinated notes	89,632	88,589		88,589	
Derivative liabilities (2)	27,112	27,112	33	26,562	517

Table of Contents

(In thousands)	Carrying Amount	Fair Value	December 31, 2012		
			Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	\$ 63,382	\$ 63,382	\$ 63,382	\$	\$
Trading security	16,893	16,893			16,893
Securities available for sale	466,169	466,169	25,291	439,993	885
Securities held to maturity	51,024	51,024			51,024
Restricted equity securities	39,785	39,785		39,785	
Net loans	3,955,446	4,004,259			4,044,259
Loans held for sale	85,368	85,368		85,368	
Accrued interest receivable	14,731	14,731		14,731	
Cash surrender value of bank-owned life insurance policies	88,198	88,198		88,198	
Derivative assets (1)	21,004	21,004		14,746	6,258
Financial Liabilities					
Total deposits	\$ 4,104,402	\$ 4,116,999	\$	\$ 4,116,999	\$
Short-term debt	163,150	163,150		163,150	
Long-term Federal Home Loan Bank advances	195,321	199,420		199,420	
Subordinated notes	89,617	73,967		73,967	
Derivative liabilities (2)	31,155	31,155	282	29,818	1,055

(1) Total fair value excludes \$0.5 million and 1.3 million of unrealized losses as of March 31, 2013 and December 31, 2012, respectively, on forward commitments presented under other assets on the consolidated balance sheet.

(2) Total fair value includes \$0.5 million and 1.3 million of unrealized losses as of March 31, 2013 and December 31, 2012, respectively, on forward commitments presented under other assets on the consolidated balance sheet.

Other than as discussed above, the following methods and assumptions were used by management to estimate the fair value of significant classes of financial instruments for which it is practicable to estimate that value.

Cash and cash equivalents. Carrying value is assumed to represent fair value for cash and cash equivalents that have original maturities of ninety days or less.

Restricted equity securities. Carrying value approximates fair value based on the redemption provisions of the issuers.

Cash surrender value of life insurance policies. Carrying value approximates fair value.

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Loans, net. The carrying value of the loans in the loan portfolio is based on the cash flows of the loans discounted over their respective loan origination rates. The origination rates are adjusted for substandard and special mention loans to factor the impact of declines in the loan's credit standing. The fair value of the loans is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality.

Accrued interest receivable. Carrying value approximates fair value.

Deposits. The fair value of demand, non-interest bearing checking, savings and money market deposits is determined as the amount payable on demand at the reporting date. The fair value of time deposits is estimated by

Table of Contents

discounting the estimated future cash flows using market rates offered for deposits of similar remaining maturities.

Borrowed funds. The fair value of borrowed funds is estimated by discounting the future cash flows using market rates for similar borrowings. Such funds include all categories of debt and debentures in the table above.

Subordinated notes. The Company utilizes a pricing service along with internal models to estimate the valuation of its junior subordinated debentures. The junior subordinated debentures re-price every ninety days.

Off-balance-sheet financial instruments. Off-balance-sheet financial instruments include standby letters of credit and other financial guarantees and commitments considered immaterial to the Company's financial statements.

NOTE 14. NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES

Presented below is net interest income after provision for loan losses for the three and nine months ended March 31, 2013 and 2012, respectively.

(In thousands)	Three Months Ended			
	March 31,		2012	
	2013		2012	
Net interest income	\$	41,937	\$	31,145
Provision for loan losses		2,400		2,000
Net interest income after provision for loan losses	\$	39,537	\$	29,145

NOTE 15. SUBSEQUENT EVENTS

The Company has evaluated subsequent events through May 10, 2013, the date the financial statements were issued, noting no events requiring disclosure.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**OVERVIEW**

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Management's discussion and analysis of financial condition and results of operations is intended to assist in understanding the financial condition and results of operations of the Company. The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and the notes thereto appearing in Part I, Item 1 of this document and with the Company's consolidated financial statements and the notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations included in the 2012 Annual Report on Form 10-K. In the following discussion, income statement comparisons are against the same period of the previous year and balance sheet comparisons are against the previous fiscal year-end, unless otherwise noted. Operating results discussed herein are not necessarily indicative of the results for the year 2013 or any future period. In management's discussion and analysis of financial condition and results of operations, certain reclassifications have been made to make prior periods comparable. Tax-equivalent adjustments are the result of increasing income from tax-advantaged securities by an amount equal to the taxes that would be paid if the income were fully taxable based on a 40.3% marginal effective income tax rate. In the discussion, references to earnings per share refer to diluted earnings per share unless otherwise specified.

Berkshire Hills Bancorp (Berkshire or the Company) is headquartered in Pittsfield, Massachusetts. Berkshire Hills Bancorp, Inc. is a Delaware corporation and the holding company for the Berkshire Bank (the Bank) and Berkshire Insurance Group. Established in 1846, the Bank is a state chartered Massachusetts savings bank. The Bank is one of Massachusetts' oldest and largest independent banks and is the largest banking institution based in Western Massachusetts. Berkshire Bank operates under the brand America's Most Exciting Bank®.

Table of Contents

On April 20, 2012, Berkshire completed the acquisition of CBT – The Connecticut Bank and Trust Company, headquartered in Hartford, Connecticut. On April 30, 2012, Berkshire acquired the net assets and operations of Greenpark Mortgage, headquartered in Needham, Massachusetts. On October 19, 2012, Berkshire completed the acquisition of Beacon Federal Bancorp, headquartered in East Syracuse, New York. Berkshire's operations in 2013 include all of these acquired operations. Berkshire's operations in the first quarter of 2012 did not include any of these acquired operations. Berkshire currently has \$5.2 billion in assets. It provides personal and business banking, insurance, and wealth management services through 73 full service branch offices in Western Massachusetts, Central and Eastern New York, North Central Connecticut, and Southern Vermont. Berkshire also operates 10 lending offices for commercial and residential mortgage originations in central and eastern Massachusetts. The Company also has two former Beacon branch offices in Tennessee. For more information, visit www.berkshirebank.com or call 800-773-5601.

Berkshire is a regional financial services company that seeks to distinguish itself based on the following attributes:

- Strong growth from organic, de novo, product and acquisition strategies
- Positive operating leverage elevating long term profitability
- Solid capital, core funding and risk management culture
- Experienced executive team focused on earnings and stockholder value
- Distinctive brand and culture as America's Most Exciting Bank®
- Diversified integrated financial service revenues
- Positioned to be regional consolidator in attractive markets

FORWARD-LOOKING STATEMENTS

Certain statements contained in this document that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the Securities Exchange Act), and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words may, will, should, could, would, plan, potential, estimate, project, believe, intend, anticipate, expect, target and similar expressions. These forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions, increased

Table of Contents

competitive pressures, changes in the interest rate environment, legislative and regulatory change, changes in the financial markets, and other risks and uncertainties disclosed from time to time in documents that Berkshire Hills Bancorp files with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and the Risk Factors in Item 1A of this report. Because of these and other uncertainties, Berkshire's actual results, performance or achievements, or industry results, may be materially different from the results indicated by these forward-looking statements. In addition, Berkshire's past results of operations do not necessarily indicate Berkshire's combined future results. You should not place undue reliance on any of the forward-looking statements, which speak only as of the dates on which they were made. Berkshire is not undertaking an obligation to update these forward-looking statements, even though its situation may change in the future, except as required under federal securities law. Berkshire qualifies all of its forward-looking statements by these cautionary statements.

GENERAL

This discussion is intended to assist in understanding the financial condition and results of operations of the Company. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes contained in this report.

APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES, AND RECENT ACCOUNTING PRONOUNCEMENTS

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements in this Form 10-Q and in the most recent Form 10-K. Please see those policies in conjunction with this discussion. The accounting and reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Please see those policies in conjunction with this discussion. Management believes that the following policies would be considered critical under the SEC's definition:

Allowance for Loan Losses. The allowance for loan losses represents probable credit losses that are inherent in the loan portfolio at the financial statement date and which may be estimated. Management uses historical information, as well as current economic data, to assess the adequacy of the allowance for loan losses as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. Although management believes that it uses appropriate available information to establish the allowance for loan losses, future additions to the allowance may be necessary if certain future events occur that cause actual results to differ from the assumptions used in making the evaluation. Conditions in the local economy and real estate values could require the Company to increase provisions for loan losses, which would negatively impact earnings.

Acquired Loans. Loans that the Company acquired in business combinations are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest. Going forward, the Company continues to evaluate reasonableness of expectations for the timing and the amount of cash to be collected. Subsequent decreases in expected cash flows may result in changes in the amortization or accretion of fair market value adjustments, and in some cases may result in the loan being considered impaired. For collateral dependent loans with deteriorated credit quality, the Company estimates the fair value of the underlying collateral of the loans. These values are discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral.

Table of Contents

Income Taxes. Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. The Company uses the asset and liability method of accounting for income taxes in which deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. The realization of the net deferred tax asset generally depends upon future levels of taxable income and the existence of prior years' taxable income, to which carry back refund claims could be made. A valuation allowance is maintained for deferred tax assets that management estimates are more likely than not to be unrealizable based on available evidence at the time the estimate is made. In determining the valuation allowance, the Company uses historical and forecasted future operating results, based upon approved business plans, including a review of the eligible carry-forward periods, tax planning opportunities and other relevant considerations. These underlying assumptions can change from period to period. For example, tax law changes or variances in future projected operating performance could result in a change in the valuation allowance. Should actual factors and conditions differ materially from those considered by management, the actual realization of the net deferred tax asset could differ materially from the amounts recorded in the financial statements. If the Company is not able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset valuation allowance would be charged to income tax expense in the period such determination is made.

Goodwill and Identifiable Intangible Assets. Goodwill and identifiable intangible assets are recorded as a result of business acquisitions and combinations. These assets are evaluated for impairment annually or whenever events or changes in circumstances indicate the carrying value of these assets may not be recoverable. When these assets are evaluated for impairment, if the carrying amount exceeds fair value, an impairment charge is recorded to income. The fair value is based on observable market prices, when practicable. Other valuation techniques may be used when market prices are unavailable, including estimated discounted cash flows and market multiples analyses. These types of analyses contain uncertainties because they require management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

Determination of Other-Than-Temporary Impairment of Securities. The Company evaluates debt and equity securities within the Company's available for sale and held to maturity portfolios for other-than-temporary impairment (OTTI), at least quarterly. If the fair value of a debt security is below the amortized cost basis of the security, OTTI is required to be recognized if any of the following are met: (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. For all impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. Credit-related OTTI for all other impaired debt securities is recognized through earnings. Noncredit related OTTI for such debt securities is recognized in other comprehensive income, net of applicable taxes. In evaluating its marketable equity securities portfolios for OTTI, the Company considers its intent and ability to hold an equity security to recovery of its cost basis in addition to various other factors, including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI on marketable equity securities is recognized immediately through earnings. Should actual factors and conditions differ materially from those expected by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

Fair Value of Financial Instruments. The Company uses fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Trading assets, securities available for sale, and derivative instruments are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, or to establish a loss allowance or write-down based on the fair value of impaired assets. Further, the notes to financial statements include information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. For financial instruments not recorded at fair value, the notes to financial statements disclose the estimate of their fair value. Due to the judgments and uncertainties involved in the estimation process, the estimates could result in materially different results under different assumptions and conditions.

Table of Contents**SELECTED FINANCIAL DATA**

The following summary data is based in part on the consolidated financial statements and accompanying notes, and other information appearing elsewhere in this Form 10-Q.

	At or for the Three Months Ended	
	2013	2012
March 31,		
PER COMMON SHARE DATA		
Net earnings, diluted	\$ 0.42	\$ 0.28
Total common book value	26.68	26.28
Dividends	0.18	0.17
Common stock price:		
High	26.01	24.49
Low	23.38	21.03
Close	25.54	22.92
PERFORMANCE RATIOS (1)		
Return on average assets	0.80%	0.59%
Return on average common equity	6.28	4.23
Net interest margin, fully taxable equivalent	3.73	3.62
Fee income/Net interest and fee income	25.63	23.44
ASSET QUALITY RATIOS		
Net charge-offs (current period annualized)/average loans	0.23%	0.24%
Allowance for loan losses/total loans	0.86	1.07
CAPITAL RATIO		
Stockholders' equity to total assets	12.85%	13.82%
FINANCIAL DATA: (In millions)		
Total assets	\$ 5,245	\$ 4,029
Total earning assets	4,646	3,585
Total loans	3,889	3,039
Allowance for loan losses	33	33
Total intangible assets	273	222
Total deposits	4,101	3,184
Total borrowings and notes	399	252
Total common stockholders' equity	674	557
FOR THE PERIOD: (In thousands)		
Net interest income	\$ 41,937	\$ 31,145
Non-interest income	14,798	9,802
Provision for loan losses	2,400	2,000
Non-interest expense	39,483	30,194
Net income	10,465	5,844

(1) All performance ratios are annualized and are based on average balance sheet amounts, where applicable.

(2) Ratio calculations related to loans and deposits of discontinued operations have not been reclassified on the above schedule.

- (3) Generally accepted accounting principles require that loans acquired in a business combination be recorded at fair value, whereas loans from business activities are recorded at cost. The fair value of loans acquired in a business combination includes expected loan losses, and there is no loan loss allowance recorded for these loans at the time of acquisition. Accordingly, the ratio of the loan loss allowance to total loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Similarly, net loan charge-offs are normally reduced for loans acquired in a business combination since these loans are recorded net of expected loan losses. Therefore, the ratio of net loan charge-offs to average loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Other institutions may have loans acquired in a business combination, and therefore there may be no direct comparability of these ratios between and among other institutions.

Table of Contents**AVERAGE BALANCES AND AVERAGE YIELDS/RATES**

The following table presents average balances and an analysis of average rates and yields on an annualized fully taxable equivalent basis for the periods included.

(\$ In millions)	2013		Three Months Ended March 31,		2012	
	Average Balance		Yield/Rate (FTE basis)		Average Balance	Yield/Rate (FTE basis)
Assets						
Loans:						
Residential mortgages	\$ 1,291		4.04%		\$ 1,058	4.63%
Commercial mortgages	1,407		5.45		1,154	5.01
Commercial business loans	601		4.40		412	4.76
Consumer loans	645		4.94		366	3.98
Total loans	3,944		4.75		2,990	4.72
Investment securities (2)	591		3.04		525	3.29
Short term investments and loans held for sale	98		1.83		15	0.07
Total interest-earning assets	4,633		4.51		3,530	4.48
Intangible assets	98				224	
Other non-interest earning assets	4,634				236	
Total assets	\$ 5,240				\$ 3,990	
Liabilities and stockholders equity						
Deposits:						
NOW	\$ 369		0.29%		\$ 272	0.26%
Money market	1,477		0.39		1,085	0.55
Savings	442		0.18		360	0.20
Time	1,148		1.23		984	1.51
Total interest-bearing deposits	3,436		0.63		2,701	0.82
Borrowings and notes	424		3.43		257	3.16
Total interest-bearing liabilities	3,860		0.94		2,958	1.02
Non-interest-bearing demand deposits	646				439	
Other non-interest earning liabilities	68				40	
Total liabilities	4,574				3,437	
Total stockholders equity	666				553	
Total liabilities and stockholders equity	\$ 5,240				\$ 3,990	
Net interest spread			3.57%			3.46%
Net interest margin			3.73			3.62
Cost of funds			0.81			0.89
Cost of deposits			0.53			0.71
Supplementary data						
Total deposits (In millions)	\$ 4,082				\$ 3,140	
Fully taxable equivalent income adj. (In thousands)	\$ 629				\$ 669	

(1) The average balances of loans include nonaccrual loans and deferred fees and costs.

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

- (2) The average balance for securities available for sale is based on amortized cost. The average balance of equity also reflects this adjustment.
- (3) The above schedule includes yields associated with discontinued operations, although the related income is excluded from income from continuing operations on the income statement. The above schedule includes balances associated with discontinued operations in loans and deposits.
- (4) Interest income on loans held for sale is included in loan interest income on the income statement.

Table of Contents

SUMMARY

During the first quarter of 2013, Berkshire posted record quarterly earnings totaling \$10.5 million, or \$0.42 per share. This was the first full quarter to include the combined operations resulting from business combinations in 2012. Results in the quarter included \$5.1 million (\$0.20 per share pre-tax) in merger and conversion related expenses.

During the quarter, Berkshire announced the expansion of its commercial banking operations in Eastern Massachusetts and Central New York as a result of recruitment. The company finalized its integration of the systems and operations of Beacon Federal, which completed the operational integrations related to 2012 business combinations, utilizing the new core systems that the Company converted to in last year's third quarter. The Company believes that it has substantially achieved the cost savings objectives that were announced with the 2012 business combinations and that the merger costs related to these combinations have been within the range of its original expectations. During the quarter, the Company continued to record double digit annualized growth in targeted areas, including commercial business lending and personal checking account balances. Measures of efficiency and profitability remained near the higher levels reached in the prior quarter subsequent to the completion of 2012 business combinations. The Company consolidated two branch offices during the quarter, while also continuing with its de novo expansion plans in the Eastern Massachusetts and Albany markets. First quarter financial highlights included:

- 39% increase in net revenue, compared to first quarter of 2012
- 12% annualized increase in commercial business loans during quarter
- 10% annualized increase in average deposit balances over prior quarter
- 3.73% net interest margin, increased from 3.67% in the prior quarter
- 0.56% non-performing assets/total assets
- 0.23% annualized net loan charge-offs/average loans

COMPARISON OF FINANCIAL CONDITION AT MARCH 31, 2013 AND DECEMBER 31, 2012

Summary: Total assets decreased by \$51 million (1%) to \$5.25 billion in the first quarter of 2013 as short term liquid assets were used to pay down overnight borrowings. Proceeds from a \$90 million decrease in residential mortgages were reinvested into shorter duration securities available for sale, reducing the medium term risk to income from possible future interest rate increases. An \$18 million increase in commercial business loans offset \$19 million in collections of acquired impaired and other lower rated commercial loan balances. Measures of asset quality, liquidity, and capital remained favorable and generally improved during the quarter. The ratio of loans/deposits was 95% and the ratio of equity/assets was 13% at quarter-end.

Securities: Total investment securities increased by \$90 million to \$664 million based on the reinvestment of funds from the reduction in residential mortgages. Government-sponsored residential mortgage-backed securities increased by \$61 million, including a \$41 million increase

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

in collateralized mortgage obligations and a \$20 million increase in pass-through securities. Additionally, corporate bonds increased by \$26 million. There was no significant change in the net unrealized gain on securities, which totaled \$13 million (2% of amortized cost) at quarter-end. The yield on the portfolio decreased to 3.04% in the first quarter of 2013 compared to 3.17% in the prior quarter and to 3.29% in the first quarter of 2012, reflecting the ongoing yield compression due to the continuing low interest rate environment. There were no significant changes in the analysis of securities impairment during the quarter..

Loans: The loan portfolio decreased by \$100 million (2%) to \$3.89 billion in the first quarter of 2013, due to a \$90 million (7%) decrease in the residential mortgage portfolio. This decrease included amortization and prepayments, together with the sale of \$35 million in existing seasoned mortgages. Proceeds from the decrease were reinvested in shorter duration investment securities consisting primarily of mortgage-backed securities, which reduced the risk to medium term income in the event that interest rates move higher in the future.

Table of Contents

Total commercial loans benefited from growth of \$18 million (3%) in commercial business loans during the first quarter. Berkshire is building business loan volume in its markets while it targets relationships with middle market customers who require a full range of products and services provided by a responsive local banking partner. The growth in commercial business loans included a \$21 million increase in asset based loans outstanding. Total originations of commercial loan commitments were up 23% from the prior quarter and 48% from the prior year first quarter. Collections of acquired impaired and other targeted commercial credit balances were approximately \$19 million, or 4% of total commercial loans on an annualized basis, as the Company continued to make progress with integrating acquired bank portfolios to contribute to its balanced portfolio growth objectives. In the most recent quarter, Berkshire expanded its commercial banking business, including an experienced new team in Eastern Massachusetts, a new commercial leader in its recently acquired Syracuse market, and team additions in the Hartford/Springfield region. These teams are expected to contribute to increased commercial loan originations in these regional markets where Berkshire increased its presence in 2012.

Based on its customer relationship and risk management strategies, the Company has not emphasized originations of commercial real estate and home equity loans. As a result, these portfolios decreased in the most recent quarter. The decrease in commercial real estate loans also reflected increased migration of loans into commercial mortgage backed securities structures under government sponsored agency financing programs, along with the impact of increased competition on commercial loan margins, tenors, and structures. The loan yield increased to 4.75% in the first quarter of 2013 from 4.73% in the prior quarter and compared to 4.72% in the first quarter of 2012. The year-over-year increase included the benefit of purchase loan accounting accretion related to the CBT and Beacon acquisitions. This benefit primarily was due to the higher effective yields assigned to acquired impaired loans. Total loans repricing over five years decreased to \$1.42 billion at March 31, 2013, compared to \$1.50 billion at the start of the year, including the impact of the reduction in the mortgage portfolio. Such loans totaled \$0.92 billion at the end of 2011, prior to the business combinations that Berkshire entered into in 2012.

Asset Quality. Acquired loans are recorded at fair value and are categorized as performing regardless of their payment status. Therefore, some overall portfolio measures of asset performance are not comparable between periods or among institutions as a result of recent business combinations.

The Company viewed its asset quality metrics as favorable and generally improving during the quarter. Quarter-end non-performing assets were 0.56% of total assets, and non-performing loans were 0.70% of total loans. Net loan charge-offs measured 0.23% of average loans, which was the lowest level in the last five quarters. Accruing delinquent loans declined slightly to 1.08% of total loans during the quarter. For loans from business activities (excluding loans acquired in business combinations), net charge-offs averaged 0.26% of average loans and the ratio of non-performing loans to total loans was 0.84% at quarter-end, compared to 0.88% at the start of the year. Foreclosed assets and troubled debt restructurings remained insignificant during the most recent quarter; a total of \$3.0 million in loans were newly classified as troubled debt restructurings during the quarter.

The Company views its potential problem loans as those loans from business activities which are rated as classified and continue to accrue interest. These loans have a possibility of loss if weaknesses are not corrected. Classified loans acquired in business combinations are recorded at fair value and are classified as performing at the time of acquisition and therefore are not generally viewed as potential problem loans. Potential problem loans totaled \$61 million at the end of the first quarter, compared to \$62 million at the start of the year. Information about the Company's analysis of its credit risk profile is presented in the loans note to the consolidated financial statements. Total criticized balances decreased to \$183 million from \$187 million during the quarter; the ending balance included \$100 million in loans from business activities and \$83 million in loans acquired from business combinations (which were recorded at fair market value at acquisition). The balance related to loans acquired from business combinations decreased by \$6 million, which was included in collections of targeted commercial credit balances which was previously addressed in the loans discussion. Collections of impaired acquired loans produced an additional \$2.3 million in recoveries of discounts which were recorded to net interest income and which are included in the later discussion of results of operations.

Table of Contents

Loan Loss Allowance. The determination of the allowance for loan losses is a critical accounting estimate. The Company considers the allowance for loan losses appropriate to cover probable losses which can be reasonably estimated in the loan portfolio as of the balance sheet date. Under accounting standards for business combinations, acquired loans are recorded at fair value with no loan loss allowance on the date of acquisition. A loan loss allowance is recorded by the Company for the emergence of new probable and estimable losses on acquired loans which were not impaired as of the acquisition date. Because of the accounting for acquired loans, some measures of the loan loss allowance are not comparable to periods prior to the acquisition date. The total amount of the loan loss allowance increased to \$33.3 million from \$33.2 million during the first quarter of 2013, increasing to 0.86% from 0.83% of total loans. The allowance related to loans from business activities increased to 1.22% from 1.21% of related loans during this period.

Deposits and Borrowings. Total deposits were unchanged at \$4.10 billion during the quarter. Ongoing deposit acquisition resulted in 10% annualized growth in total average deposits compared to the prior quarter, including 10% annualized growth in average transaction balances. Outstanding balances were affected by seasonal factors at the start and end of the period. Berkshire promotes lower cost transaction accounts as a focus of relationship based business development for retail and business accounts. Personal checking account balances increased at a 15% annualized rate during the quarter. First quarter results continued to show an ongoing shift from higher cost maturing time accounts (declining by \$57 million) into money market balances (increasing by \$64 million). This contributed to a decrease in the cost of deposits to 0.53% during the quarter, compared to 0.59% in the prior quarter. This cost decreased from 0.71% in the first quarter of 2012, reflecting the ongoing impact of the low interest rate environment. The cost of time deposits declined to 1.23% from 1.51% in the first quarter of 2013 compared to 2012. Total borrowings decreased by \$49 million during the quarter as overnight balances were reduced with excess cash and due to a seasonal decrease in residential mortgages held for sale, which are normally funded with overnight borrowings. The cost of borrowings increased to 3.43% in the most recent quarter from 2.80% in the prior quarter and from 3.16% in the first quarter of 2012. The increase compared to the prior quarter reflected the lower proportion of near-zero cost overnight money, while the increase from the prior year primarily reflected the impact of long term subordinated debt incurred in the third quarter of 2012 to finance the cash consideration of the Beacon acquisition.

Derivative Financial Instruments and Hedging Activities. The total notional value of derivatives decreased by \$192 million (15%) to \$1.12 billion due primarily to a seasonal decrease in mortgage banking activity, which resulted in a decrease in both interest rate lock commitments and forward commitments that hedge these interest rate locks. The total amount of these commitments decreased by \$261 million to \$357 million during the quarter. This decrease was partially offset by a \$60 million increase to \$330 million in cash flow hedges consisting principally of forward-starting interest rate swaps intended to provide medium term protection in the event of potential future interest rate increases. The estimated net fair value discount of total derivative financial instruments increased slightly to \$11 million from \$10 million during the quarter and was principally related to cash flow hedges.

Stockholders' Equity. Total stockholders' equity increased by \$7 million (4% annualized) to \$674 million during the most recent quarter, and measured 12.8% of period-end assets.

Equity benefited from the quarter's earnings and was net of \$5 million in cash dividends paid at \$0.18 per share, which resulted in a 44% dividend payout ratio. The dividend provided a 2.9% annualized yield based on the \$24.59 average closing price of Berkshire's common stock in the first quarter of 2013. During the quarter, shares outstanding increased by 106 thousand, including 146 thousand shares issued for stock-based compensation and 118 thousand shares issued for option exercises, less 98 thousand in open market stock repurchases. Near the end of the quarter, Berkshire announced that the board of directors authorized a program for the repurchase of an additional 500,000 shares, or approximately 2% of total outstanding shares. This program provides the capacity to offset the impact of stock option exercises, which have totaled 372 thousand shares since the beginning of 2012 primarily due to exercises of options acquired as part of the Beacon merger consideration.

Berkshire Bank's risk based capital ratio increased to 12.2% from 11.8% during the quarter due to the decline in assets and the increase in equity.

Table of Contents

COMPARISON OF OPERATING RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2013 AND 2012

Summary: Berkshire's results in 2013 include 2012 business combinations completed subsequent to the first quarter of 2012. As a result, most categories of revenue and expense increased due to these acquisitions. Earnings per share were affected by the issuance of additional Berkshire common shares related to these acquisitions. All references to revenue and expense in this discussion exclude discontinued operations of Legacy branches, which were divested in the first quarter of 2012.

Berkshire's first quarter operating results improved in 2013 compared to 2012. Berkshire has benefited from positive operating leverage with revenue growth exceeding expense growth. This has been due to the combination of business development, acquisitions, and improvements in efficiency. The positive operating leverage has also been reflected in profitability measures including return on assets and return on equity. The Company has maintained an asset sensitive net interest income profile, as management has chosen to sacrifice current yield to protect earnings in the event of future rate increases. The Company is also absorbing the costs of ongoing branch and business expansion in its cost of operations. Berkshire is balancing current period earnings growth with disciplines and investments intended to support future earnings results.

First quarter net income increased by \$4.6 million (79%) to \$10.5 million. Earnings per share increased by \$0.14 to \$0.42, which was a 50% increase over prior year first quarter results. The \$0.14 increase in earnings per share included the contribution from 2012 business combinations together with the benefit of positive operating leverage resulting from general business expansion.

During the most recent quarter, Berkshire's return on assets was 0.80% and its return on equity was 6.3%. These measures were improved from 0.59% and 4.2% in the prior year first quarter. These measures are net of merger and conversion related expenses, which totaled \$0.20 per share (before tax) in both periods. The Company also evaluates its profitability before the impact of these charges in assessing the level and trend of its operating profitability.

The Company believes that its expansion has provided it with a number of diversified levers that it can utilize to continue to generate growth in earnings and market share. In addition to the improvement compared to 2012, Berkshire's results in the most recent quarter represented an improvement over results in the final quarter of 2012, including a 12% increase in net income and an 11% increase in earnings per share.

Revenue. Total first quarter net revenue increased by \$15.8 million (39%) to \$56.7 million in 2013 compared to 2012. Annualized revenue per share increased by 16% to \$9.03 from \$7.78, demonstrating the top line accretive benefit of Berkshire's growth initiatives. Fee income increased to 25% of revenue from 23% including the benefit of acquired mortgage banking operations. Berkshire's goal is to increase fee income as a percentage of total revenue in order to diversify revenue sources and increase opportunities to improve wallet share with its customers and market share in its regions.

Net Interest Income. Growth in net interest income has included the benefit of growth from business development as well as the business combinations. Berkshire's goal is to generate ongoing growth in net interest income, driven by market share gains in loan volume. Together with accompanying growth in fee income, this is intended to produce growth in net income and profitability metrics.

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

First quarter net interest income increased by \$10.8 million (35%) to \$41.9 million in 2013 compared to 2012. This included the benefit of a 31% increase in average earning assets and an improvement in the net interest

Table of Contents

margin to 3.73% from 3.62%. Net interest income includes the net benefit from loan purchase accounting accretion, which totaled \$3.8 million and \$0.5 million in 2013 and 2012, respectively. This income contributed approximately 0.33% and 0.06% to the net interest margin in these years, respectively. The benefit in the most recent period included approximately \$2.3 million in benefit (0.20% to the net interest margin) from collections of discounted acquired impaired loans. Business combinations in the last two years have included the recordation of credit related discounts primarily on impaired and higher risk commercial loans. These include accretable discounts which are recorded to net interest income over the expected life of the loan and nonaccretable discounts which may give rise to recoveries that are recorded to income if the Company succeeds in collecting the loan for an amount which exceeds the permanent net loss originally attributed to the loan.

Excluding the benefit of loan purchase account accretion, the net interest margin decreased by approximately 0.16% from year-to-year, reflecting the ongoing yield compression on earning assets due to the persistent low interest rate environment. Berkshire maintains a close focus on its loan and deposit pricing disciplines to lessen the impact of market yield compression. Berkshire has also balanced its portfolio growth and funding sources to support the net interest margin and to support the ongoing organic growth in market share as it continues to pursue strategic growth in its regional markets. Berkshire maintains an asset sensitive interest rate risk profile so that any future rate increases from the current low rate environment are expected to benefit net interest income.

The balance of accretable yield remaining for acquired impaired loans stood at \$5.7 million at March 31, 2013 and most of this balance was expected to be recorded to net interest income over the next several quarters. Changes in loan prepayment speeds and recoveries of nonaccretable discount have introduced more volatility to the net interest margin over the last several periods. There was no significant change in net interest income in the most recent quarter compared to the final quarter of 2012. A slight increase in average earning assets related to a full quarter benefit from the Beacon acquisition was offset by a lower number of calendar days in which to generate net interest income.

Non-Interest Income. Total first quarter non-interest income increased by \$5.0 million (51%) to \$14.8 million in 2013 compared to 2012. This included the benefit of business development as well as business combinations. The increase included a \$2.0 million increase in mortgage banking fees as a result of the acquisition of the Eastern Massachusetts mortgage banking operations in the second quarter of 2012. Mortgage banking revenue is recorded when application rate locks are recorded. The increase in other loan related income included a \$0.4 million increase in income from the sale of seasoned residential mortgages in conjunction with the portfolio adjustment discussed previously. The ratio of deposit related fees to average deposits decreased to 0.42% annualized from 0.45% due to lower fee income in acquired business operations; this ratio was down seasonally from 0.44% in the final quarter of 2012. Insurance related income increased by 9% and wealth management income increased by 19% from year-to-year including the benefit of improved operating conditions in these business lines. Insurance revenues include a seasonal component in the first half of the year related to contingency income; this seasonality was reduced beginning in 2012 due to a restructuring of the revenue structure with insurance providers. Total wealth and investment assets under management increased during the most recent quarter to \$1.15 billion including the benefit of business development and improved securities market prices. Included in other non-interest income is a \$0.7 million credit for income on bank owned life insurance policies, which is partially offset by a \$0.4 million charge representing the loss on investment tax credit limited partnership interests. This loss is offset by a \$0.5 million credit to income tax expense representing the net tax benefit of these investments in renewable energy, low income housing, and other tax credit partnerships.

Loan Loss Provision. The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company as an estimate of the probable and estimable loan losses in the portfolio as of period-end. The level of the allowance is a critical accounting estimate, which is subject to uncertainty. The level of the allowance was included in the discussion of financial condition. The first quarter loan loss provision increased to \$2.4 million in 2013 compared to \$2.0 million in 2012 due primarily to growth in loans from business activities. The provision exceeded the level of net loan charge-offs, resulting in an increase in the total allowance for loan losses.

Non-Interest Expense. First quarter non-interest expense increased from year-to-year primarily due to the impact of the 2012 business combinations, together with costs related to business development and expansion. Non-interest expense included merger and conversion related expenses in both years. First quarter non-interest expense increased by \$9.3 million (31%) to \$39.5 million in 2013 compared to 2012. Berkshire's goal is to

Table of Contents

generate positive operating leverage, with revenue growth exceeding expense growth. The 39% growth in first quarter revenue exceeded expense growth and contributed towards this objective for the subject periods of this report. Of note, non-interest expense also includes noncash charges for the amortization of intangible assets. Full time equivalent staff totaled 1,004 at March 31, 2013, compared to 1,012 at year-end 2012.

Net Income From Continuing Operations. First quarter earnings from continuing operations increased by \$4.0 million (61%) to \$10.5 million in 2013 compared to 2012. The effective income tax rate on continuing operations increased to 30% from 26%. The increase in rate is primarily due to the higher level of pretax income in 2013 and the lower proportionate benefit of tax advantaged income from investments and bank owned life insurance.

Net Loss From Discontinued Operations. The net loss from discontinued operations was \$0.6 million (\$0.3 per share) in the first quarter of 2012. Berkshire originally designated certain Legacy branches as held for sale and as discontinued operations in the third quarter of 2011, and Berkshire continued to operate these branches until sold. The loss in 2012 related to the sale of the final four branches in January 2012 and included the costs of completing the sale, and a \$0.4 million charge to income tax expense due to the non-deductibility of the goodwill associated with these branches.

Results of Segment and Parent Operations. Berkshire Hills Bancorp (the Parent) has two subsidiary operating segments banking and insurance. First quarter results in the banking segment generally followed the levels and trends of consolidated results, which have been previously discussed. In the insurance segment, revenues increased from year-to-year per the earlier discussion of non-interest income, and expenses decreased. As a result, first quarter insurance segment earnings increased to \$536 thousand from \$318 thousand. The Parent's income primarily reflected changes in the Bank's income. In 2013, the Bank paid a \$7 million dividend to the parent which was recorded in the Parent's net interest income. The Bank's retained earnings are recorded in the Parent's non-interest income. In 2012, the Bank did not pay a first quarter dividend to the Parent, and so none of its earnings were included in the Parent's net interest income. Most of the parent's revenues are non-taxable revenues from subsidiaries, and the Parent therefore receives a tax benefit related to the taxable loss generated by its expenses.

Total Comprehensive Income. Total comprehensive income includes net income together with other comprehensive income, which was \$1.3 million in the first quarter of 2013 and \$1.0 million in the first quarter of 2012. Other comprehensive income has generally reflected the benefit of lower interest rates. This benefit was primarily related to unrealized gains on derivative hedges in 2013 and to unrealized gains on available for sale securities in 2012. Including this income, total comprehensive income was \$11.8 million in the first quarter of 2013, compared to \$6.8 million in the first quarter of 2012.

Liquidity and Cash Flows. Net proceeds from reductions in residential mortgages were the primary source of funds in the first quarter of 2013, and reinvestments of these funds in securities available for sale were the primary use of funds. Additionally, liquid assets including cash and cash equivalents and loans held for sale decreased and these funds were used to pay down overnight borrowings. FHLBB borrowings will continue to be a significant source of liquidity for daily operations and borrowings targeted for specific asset/liability purposes. The Company also uses interest rate swaps in managing its funds sources and uses. At the end of the most recent quarter, the Company had approximately \$778 million in borrowing availability with the Federal Home Loan Bank.

Berkshire Hills Bancorp had a cash balance totaling \$31 million as of March 31, 2013, which was on deposit with Berkshire Bank. The primary long run routine sources of funds for the Parent are expected to be dividends from Berkshire Bank and Berkshire Insurance Group, as well as cash from the exercise of stock options. The Parent also has a \$10 million revolving line of credit provided by a correspondent bank. The primary long run routine uses of funds by the parent include the payment of cash dividends on common stock and debt service. The Parent's cash balance decreased by \$9 million from \$40 million at the start of the quarter due to the clean-up of

Table of Contents

\$10 million in short term line of credit borrowings which were outstanding at year-end. During the first quarter of 2013, Berkshire Bank paid a \$7 million cash dividend to the Parent which funded stockholder dividends and debt service. Stock option exercises provided \$1.8 million in cash and treasury stock repurchases utilized \$2.4 million in cash. The Company repurchased the remaining 98 thousand shares authorized in its existing stock buyback program and announced a new 500,000 share repurchase program for which no repurchases had been completed as of March 31, 2013. The Company expects to fund treasury stock repurchases with dividends from subsidiaries and from capital markets activities.

Capital Resources. Please see the Stockholders' Equity section of the Comparison of Financial Condition for a discussion of stockholders' equity together with the Stockholders' Equity note to the consolidated financial statements. At March 31, 2013, Berkshire Bank continued to be classified as Well Capitalized. Additional information about regulatory capital is contained in the notes to the consolidated financial statements and in the 2012 Form 10-K.

As discussed in the 2012 Form 10-K and in Item 1A of this Form, there are financial system reforms which became federal law in July 2010 and which constitute the most significant regulatory and systemic reform since the 1930s. It cannot be determined at this time what the full effects of the reforms will be. Some of the reforms are intended to increase required capital levels in the banking system.

Beginning with reports to be filed in April 2013, the Company will begin reporting consolidated holding company regulatory capital ratios with its regulator, the Federal Reserve Bank of Boston, as if it was chartered as a bank holding company. This represents a further step in the transition from its previous federal regulator, The Office of Thrift Supervision, which was phased out based on federal legislation in 2011. The Company continues to be chartered as a Savings and Loan Holding Company and, as such, is not required to meet regulatory capital requirements applicable to bank holding companies. The Company expects that at a future time, it will be required to meet the same requirements as bank holding companies and that prior to that time, the level and trend of these financial metrics will be considered by the Federal Reserve Bank in its supervision of the Company's activities.

Off-Balance Sheet Arrangements and Contractual Obligations. In the normal course of operations, Berkshire engages in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in the Company's financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. A further presentation of the Company's off-balance sheet arrangements is presented in the Company's 2012 Form 10-K and information relating to payments due under contractual obligations is presented in the 2012 Form 10-K. Information about derivative financial instruments and hedging activities is reported in the related footnote to the consolidated financial statements, and was included in management's discussion of changes in financial condition. There were no significant changes in off-balance sheet arrangements and contractual obligations during the first quarter of 2013.

Fair Value Measurements. The Company records fair value measurements of certain assets and liabilities, as described in the related note in the financial statements. There were no significant changes in the fair value measurement methodologies nor in the difference between carrying value and fair value of financial instruments at March 31, 2013 compared to December 31, 2012.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to the way that the Company measures market risk nor in the Company's net market risk position during the first three months of 2013. For further discussion about the Company's Quantitative and Qualitative Aspects of Market Risk, please review Item 7A of the Report 10-K filed for the fiscal year ended December 31, 2012.

As discussed in Item 2, Berkshire has a targeted position to maintain a moderately asset sensitive interest rate risk profile, as measured by the sensitivity of net interest income to market interest rate changes. The Company measures this sensitivity primarily by evaluating the impact of ramped interest rate changes in the 12 month and 24 month time horizons. Due to an uptick in interest rates in the first quarter (much of which reversed near to and

Table of Contents

subsequent to quarter-end), refinancing volumes in the lending markets decreased. This contributed to lower prepayment speeds and modestly less sensitivity of net interest income to further increases in interest rates. During the most recent quarter, the Company reduced the duration of its residential mortgage assets by shifting certain balances from residential mortgage loans to shorter duration mortgage backed securities. As previously discussed, this contributed to a reduction in the Company's exposure to fixed rate loans with repricing horizons over five years. Additionally, the Company increased its utilization of forward starting interest rate swaps, which were primarily targeted to forward start in 18-24 months. These activities collectively reduced the Company's exposure to interest rate risk in periods beyond 24 months but did not significantly change its interest rate risk measured in the next 24 months based on its interest sensitivity modeling. The Company had determined that its asset sensitive interest rate risk profile had decreased in 2012 as a result of operating activities, business combinations, and capital markets activities. Balance sheet growth in the two most recent quarters was below the Company's expectations and the generation of new variable rate earning assets was also below the Company's expectations. Balance sheet changes in the most recent quarter to provide additional medium term protection from rising interest rates were an alternate strategy to accomplish the Company's interest rate risk management objectives in light of lower than anticipated generation of variable rate earning assets.

Please see the additional discussion in Item 7A of the Report 10-K filed for the fiscal year ended December 31, 2012 regarding the Company's asset liability management strategies in the current and anticipated interest rate environment.

ITEM 4. CONTROLS AND PROCEDURES

- a) Disclosure controls and procedures.

The principal executive officers, including the principal financial officer, based on their evaluation of disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that the Company's disclosure controls and procedures are effective for ensuring that information required to be disclosed in the reports that it files or submits

Table of Contents

under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures, include, without limitation, controls and procedures designed to ensure that information required to be disclosed in filed or submitted reports is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer as appropriate, to allow timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting.

There were no changes in the Company's internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II****ITEM 1. LEGAL PROCEEDINGS**

As of March 31, 2013, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. Periodically, there have been various claims and lawsuits involving the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans and other issues incident to the Bank's business. However, neither the Company nor the Bank is a party to any pending legal proceedings that it believes, in the aggregate, would have a material adverse effect on the financial condition or operations of the Company.

ITEM 1A. RISK FACTORS

There have been no material additions to the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2012. In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I,

Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2012, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. During the most recent quarter, the Company completed the systems conversion related to the operations acquired from Beacon. The Company recruited a new commercial banking team in Eastern Massachusetts and new commercial banking leadership in Central New York. The Company has ongoing projects and processes related to its organization, operating methods, and integration of its newly acquired operations, newly recruited teams, and recently installed systems.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) No Company unregistered securities were sold during the quarter ended March 31, 2013.
- (b) Not applicable.
- (c) The following table provides certain information with regard to shares repurchased by the Company in the first quarter of 2013.

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
January 1-31, 2013 (1)	55,855	\$ 22.88		97,993
February 1-28, 2013				97,993
March 1-31, 2013	97,993	24.84	97,993	500,000

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

Total 153,848

(1) Shares represent common stock withheld by the Company to satisfy tax withholding requirements on the vesting of shares under the Company's benefit plans and shares used in a constructive exchange of stock options.

On December 14, 2007, the Company authorized the purchase of up to 300,000 additional shares, from time to time, subject to market conditions. The repurchase plan was completed during the first quarter of 2013.

On March 26, 2013, the Company announced that its Board of Directors authorized a new stock repurchase program, pursuant to which the Company may repurchase up to 500,000 shares of the Company's common stock, which represents approximately 2.0% of the Company's issued and outstanding shares. The timing of the purchases will depend on certain factors, including but not limited to, market conditions and prices, available

Table of Contents

funds, and alternative uses of capital. The stock repurchase program may be carried out through open-market purchases, block trades, negotiated private transactions and pursuant to a trading plan adopted in accordance with Rule 10b5-1 under the Securities Exchange Act of 1934. Any repurchased shares will be recorded as treasury shares. The program will continue until it is completed or terminated by the Board of Directors. The Company has no intentions to terminate this program or to cease any future potential purchases. As of March 31, 2013, there were no stock purchases which had been completed under this new stock repurchase program.

ITEM 3. _____ DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. _____ MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. _____ OTHER INFORMATION

None.

Table of Contents

ITEM 6. EXHIBITS

- 3.1 Certificate of Incorporation of Berkshire Hills Bancorp, Inc. (1)
- 3.2 Amended and Restated Bylaws of Berkshire Hills Bancorp, Inc.(2)
- 4.1 Form of Common Stock Certificate of Berkshire Hills Bancorp, Inc. (1)
- 4.2 Note Subscription Agreement by and among Berkshire Hills Bancorp, Inc. and certain subscribers dated September 20, 2012 (3)
- 10.1 Amended and Restated Employment Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Michael P. Daly (4)
- 10.2 Amended and Restated Three Year Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Kevin P. Riley (4)
- 10.3 Amended and Restated Three Year Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Sean A. Gray (5)
- 10.4 Amended and Restated Three Year Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Richard M. Marotta (6)
- 10.5 Amended and Restated Supplemental Executive Retirement Agreement between Berkshire Bank and Michael P. Daly (7)
- 10.6 Berkshire Hills Bancorp, Inc. 2011 Equity Incentive Plan (7)
- 10.7 Form of Berkshire Bank Employee Severance Compensation Plan (1)
- 10.8 Three Year Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Patrick J. Sullivan, dated as of December 21, 2010 (8)
- 10.9 Severance Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Patrick J. Sullivan, dated as of December 21, 2010 (8)
- 10.10 Non-Competition and Consulting Agreement by and among Berkshire Hills Bancorp, Inc., Berkshire Bank and J. Williar Dunlaevy, dated as of April 6, 2011 (8)
- 10.11 Legacy Bancorp, Inc. Amended and Restated 2006 Equity Incentive Plan (9)
- 10.12 Form of Split Dollar Agreement entered into with Michael P. Daly, Kevin P. Riley, Sean A. Gray, and Richard M. Marotta (10)
- 10.13 Endorsement Agreement by and among Berkshire Hills Bancorp, Inc. and Geno Auriemma dated as of May 14, 2012 (11)
- 10.14 Berkshire Hills Bancorp, Inc. 2013 Equity Incentive Plan (12)
- 31.1 Certification pursuant to Rule 13a-14(a)/15d-14(a)
- 31.2 Certification pursuant to Rule 13a-14(a)/15d-14(a)
- 32 Certifications pursuant to 18 U.S.C. 1350
- 101 The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, formatted in XBRL (Extensive Business Reporting Language): (i) the Consolidated Statements of Condition as of March 31, 2013 and December 31, 2012; (ii) Consolidated Statements of Income for the three months ended March 31, 2013 and 2012; (iii) Consolidated Statements of Comprehensive Income for the three months ended March 31, 2013 and 2012; (iv) Consolidated Statements of Changes in Stockholders' Equity for the three months ended March 31, 2013 and 2012; (v) Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012; and (vi) Notes to Consolidated Financial Statements. (13)

-
- (1) Incorporated herein by reference from the Exhibits to Form S-1, Registration Statement and amendments thereto, initially filed on March 10, 2000, Registration No. 333-32146.
 - (2) Incorporated herein by reference from the Exhibits to the Form 8-K as filed on December 18, 2012.
 - (3) Incorporated by reference from the Exhibits to the Form 8-K as filed on September 26, 2012.
 - (4) Incorporated herein by reference from the Exhibits to the Form 8-K as filed on January 6, 2009.
 - (5) Incorporated herein by reference from the Exhibits to the Form 10-K as filed on March 16, 2011.
 - (6) Incorporated herein by reference from the Exhibits to the Form 10-K as filed on March 16, 2010.
 - (7) Incorporated herein by reference from the Exhibits to Form 10-K as filed on March 16, 2009.
 - (8) Incorporated herein by reference from the Exhibits to the Registration Statement on Form S-4 as filed on April 20, 2011, Registration No. 333-173404.
 - (9) Incorporated herein by reference from the Exhibits to the Form 8-K filed by Legacy Bancorp, Inc. on December 22, 2010.
 - (10) Incorporated herein by reference from the Exhibit to the Form 8-K as filed on January 19, 2011.
 - (11) Incorporated herein by reference from the Exhibit 10.16 to the Form 10-Q as filed on August 16, 2012.
 - (12) Incorporated herein by reference from the Proxy Statement for the 2013 Annual Meeting of Shareholders filed on April 2, 2013
 - (13)

Edgar Filing: BERKSHIRE HILLS BANCORP INC - Form 10-Q

As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

Table of Contents

SIGNATURES

Pursuant to the requirements 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.

BERKSHIRE HILLS BANCORP, INC.

Dated: May 10, 2013

By: /s/ Michael P. Daly
Michael P. Daly
President and Chief Executive Officer

Dated: May 10, 2013

By: /s/ Kevin P. Riley
Kevin P. Riley
Executive Vice President and Chief Financial
Officer