FIDELITY D & D BANCORP INC
Form 10-Q
November 09, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from ______________to______________________

Commission file number: 333-90273

FIDELITY D & D BANCORP, INC.

STATE OF INCORPORATION:	IRS EMPLOYER IDENTIFICATION NO:
PENNSYLVANIA	23-3017653

Address of principal executive offices:
BLAKELY & DRINKER ST.
DUNMORE, PENNSYLVANIA 18512

TELEPHONE:
570-342-8281

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 subjected to such filing requirements for the past 90 days. x YES o 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).
o YES o 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller reporting company x

(Do not check if a smaller reporting company)

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

The number of outstanding shares of Common Stock of Fidelity D & D Bancorp, Inc. on October 31, 2010, the latest practicable date, was 2,162,063 shares.

FIDELITY D & D BANCORP, INC.

Form 10-Q September 30, 2010

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PART I – Financial Information
Item 1: Financial Statements

FIDELITY D & D BANCORP, INC. AND SUBSIDIARY
Consolidated Balance Sheets

(Unaudited)

		September 30, 2010		December 31, 2009
Assets:				
Cash and due from banks	$	10,489,922	$	8,173,199
Interest-bearing deposits with financial institutions		37,081,253		154,755
Total cash and cash equivalents		47,571,175		8,327,954
Available-for-sale securities		86,720,420		75,821,292
Held-to-maturity securities (fair value $585,337 in 2010; $765,195 in 2009)		535,261		708,706
Federal Home Loan Bank Stock		4,781,100		4,781,100
Loans and leases, net (allowance for loan losses of $7,484,253 in 2010; $7,573,603 in 2009)		414,185,347		423,124,054
Loans held-for-sale (fair value $1,037,337 in 2010; $1,233,345 in 2009)		1,019,000		1,221,365
Bank premises and equipment, net		14,649,763		15,361,810
Cash surrender value of bank owned life insurance		9,347,707		9,117,156
Accrued interest receivable		2,233,322		2,250,855
Foreclosed assets held-for-sale		1,350,692		887,397
Other assets		14,204,811		14,415,582
Total assets	$	596,598,598	$	556,017,271
Liabilities:				
Deposits:				
Interest-bearing	$	409,063,486	$	388,103,880
Non-interest-bearing		81,819,441		70,890,578
Total deposits		490,882,927		458,994,458
Accrued interest payable and other liabilities		3,235,939		2,815,159
Short-term borrowings		21,804,259		16,533,107
Long-term debt		32,000,000		32,000,000
Total liabilities		547,923,125		510,342,724
Shareholders' equity:				
Preferred stock authorized 5,000,000 shares with no par value; none issued		-		-
Capital stock, no par value (10,000,000 shares authorized; shares issued and outstanding; 2,163,618 in 2010; and 2,105,860 in 2009)		20,793,445		19,982,677
Retained earnings		34,919,228		34,886,265
Accumulated other comprehensive loss		(7,037,200)		(9,194,395)
Total shareholders' equity		48,675,473		45,674,547
Total liabilities and shareholders' equity	$	596,598,598	$	556,017,271

See notes to unaudited consolidated financial statements

FIDELITY D & D BANCORP, INC. AND SUBSIDIARY
Consolidated Statements of Income
(Unaudited)

	Three months ended		Nine months ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Interest income:				
Loans and leases:				
Taxable	$ 6,056,924	$ 6,435,487	$ 18,141,108	$ 19,353,099
Nontaxable	157,015	110,566	457,166	338,828
Interest-bearing deposits with financial institutions	21,970	89	38,288	537
Investment securities:				
U.S. government agency and corporations	401,070	534,629	1,360,080	1,852,457
States and political subdivisions (non-taxable)	261,005	318,299	770,415	787,208
Other securities	55,607	50,994	184,578	393,502
Federal funds sold	109	3,422	13,549	10,781
Total interest income	6,953,700	7,453,486	20,965,184	22,736,412
Interest expense:				
Deposits	1,244,438	1,949,402	3,958,215	6,279,307
Securities sold under repurchase agreements	6,464	5,872	76,654	22,427
Other short-term borrowings and other	130	1,446	763	27,991
Long-term debt	429,896	1,075,934	1,280,565	2,420,466
Total interest expense	1,680,928	3,032,654	5,316,197	8,750,191
Net interest income	5,272,772	4,420,832	15,648,987	13,986,221
Provision for loan losses	375,000	3,125,000	1,250,000	3,850,000
Net interest income after provision for loan losses	4,897,772	1,295,832	14,398,987	10,136,221
Other (loss) income:				
Service charges on deposit accounts	675,598	676,107	1,964,512	1,956,755
Fees and other service charges	602,570	428,049	1,620,579	1,407,538
Gain (loss) on sale or disposal of:				
Loans	211,019	139,451	439,735	957,777
Premises and equipment	(7,359)	(34,617)	(23,530)	(41,241)
Foreclosed assets held-for-sale	36,135	7,780	57,550	33,667
Write-down of foreclosed assets held-for-sale	(39,700)	(77,560)	(39,700)	(77,560)

Impairment losses on investment securities:				
Other-than-temporary impairment on investment securities	(2,166,122)	(6,468,236)	(4,431,359)	(6,794,331)
Non-credit related losses on investment securities not expected to be sold (recognized in other comprehensive income/(loss))	417,448	4,036,470	1,927,763	4,036,470
Net impairment losses on investment securities recognized in earnings	(1,748,674)	(2,431,766)	(2,503,596)	(2,757,861)
Total other (loss) income	(270,411)	(1,292,556)	1,515,550	1,479,075
Other expenses:				
Salaries and employee benefits	2,167,403	2,502,818	7,169,335	7,495,167
Premises and equipment	808,204	874,028	2,549,466	2,685,343
Advertising	110,292	117,897	418,095	396,290
Other	1,231,712	1,614,552	3,979,319	3,933,271
Total other expenses	4,317,611	5,109,295	14,116,215	14,510,071
Income (loss) before income taxes	309,750	(5,106,019)	1,798,322	(2,894,775)
(Credit) provision for income taxes	(45,193)	(1,895,339)	168,527	(1,421,306)
Net income (loss)	$ 354,943	$ (3,210,680)	$ 1,629,795	$ (1,473,469)
Per share data:				
Net income (loss) - basic	$ (0.44)	$ (1.55)	$ 0.16	$ (0.71)
Net income (loss) - diluted	$ (0.44)	$ (1.55)	$ 0.16	$ (0.71)
Dividends	$ 0.25	$ 0.25	$ 0.75	$ 0.75

See notes to unaudited consolidated financial statements

FIDELITY D & D BANCORP, INC. AND SUBSIDIARY
Consolidated Statements of Changes in Shareholders' Equity
For the nine months ended September 30, 2010 and 2009
(Unaudited)

	Capital stock		Treasury stock			Accumulated other comprehensive	
	Shares	Amount	Shares	Amount	Retained earnings	loss	Total
Balance, December 31, 2008	2,075,182	$ 19,410,306	(12,255)	$ (351,665)	$ 38,126,250	$ (8,224,240)	$ 48,960,651
Cumulative effect of change in accounting principle					350,720	(350,720)	-
Total comprehensive income:							
Net loss					(1,473,469)		(1,473,469)
Change in net unrealized holding losses on available-for-sale securities, net of reclassification adjustment and net of tax adjustments of $2,499,696						4,852,351	4,852,351
Non-credit related impairment losses on investment securities not expected to be sold, net of tax adjustments of $1,372,400						(2,664,070)	(2,664,070)
Change in cash flow hedge intrinsic value						(560,956)	(560,956)
Comprehensive income							153,856
Issuance of common stock through Employee Stock Purchase Plan	1,701	40,569					40,569
Purchase of treasury stock			(2,500)	(56,505)			(56,505)

Issuance of common stock through Dividend Reinvestment Plan	16,430	320,269	14,755	408,170	(112,329)		616,110
Stock-based compensation expense		4,508					4,508
Cash dividends declared					(1,554,842)		(1,554,842)
Balance, September 30, 2009	2,093,313	$ 19,775,652	-	$ -	$ 35,336,330	$ (6,947,635)	$ 48,164,347
Balance, December 31, 2009	2,105,860	$ 19,982,677	-	$ -	$ 34,886,265	$ (9,194,395)	$ 45,674,547
Total comprehensive income:							
Net income					1,629,795		1,629,795
Change in net unrealized holding losses on available-for-sale securities, net of reclassification adjustment and net of tax adjustments of $1,766,721						3,429,518	3,429,518
Non-credit related impairment losses on investment securities not expected to be sold, net of tax adjustments of $655,440						(1,272,323)	(1,272,323)
Comprehensive income							3,786,990
Issuance of common stock through Employee Stock Purchase Plan	4,754	67,367					67,367
Issuance of common stock through Dividend							

Reinvestment Plan	53,004	735,916					735,916
Stock-based compensation expense		7,485					7,485
Cash dividends declared					(1,596,832)		(1,596,832)
Balance, September 30, 2010	2,163,618	$ 20,793,445	-	$ -	$ 34,919,228	$ (7,037,200)	$ 48,675,473

See notes to unaudited consolidated financial statements

FIDELITY DEPOSIT & DISCOUNT BANCORP, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(Unaudited)

	Nine months ended September 30,	
	2010	2009
Cash flows from operating activities:		
Net income (loss)	$ 1,629,795	$ (1,473,469)
Adjustments to reconcile net income (loss) to cash flows from operating activities:		
Depreciation, amortization and accretion	1,484,101	1,130,120
Provision for loan losses	1,250,000	3,850,000
Deferred income tax benefit	(703,673)	(1,211,999)
Stock-based compensation expense	7,485	4,508
Loss from investment in limited partnership	-	40,961
Proceeds from sale of loans held-for-sale	37,806,323	90,195,545
Originations of loans held-for-sale	(33,780,457)	(79,702,670)
Write-down of foreclosed assets held-for-sale	39,700	77,560
Increase in cash surrender value of life insurance	(230,551)	(230,777)
Net gain from sales of loans	(439,735)	(957,777)
Net gain from sales of foreclosed assets held-for-sale	(57,550)	(33,667)
Loss from disposal of equipment	23,530	41,241
Other-than-temporary impairment on securities	2,503,596	2,757,861
Change in:		
Accrued interest receivable	(74,406)	(285,893)
Other assets	(67,783)	(1,262,594)
Accrued interest payable and other liabilities	457,725	22,564
Net cash provided by operating activities	9,848,100	12,961,514
Cash flows from investing activities:		
Held-to-maturity securities:		
Proceeds from maturities, calls and principal pay-downs	173,443	169,017
Available-for-sale securities:		
Proceeds from maturities, calls and principal pay-downs	29,266,139	30,396,495
Purchases	(39,288,074)	(28,383,313)
Net decrease (increase) in loans and leases	2,930,070	(85,653)
Acquisition of bank premises and equipment	(623,134)	(808,304)
Proceeds from sale of foreclosed assets held-for-sale	570,605	510,554
Net cash (used in) provided by investing activities	(6,970,951)	1,798,796
Cash flows from financing activities:		
Net increase in deposits	31,888,469	43,946,639
Net increase (decrease) in short-term borrowings	5,271,152	(32,891,247)
Repayments of long-term debt	-	(20,000,000)
Purchase of treasury stock	-	(56,505)
Proceeds from Employee Stock Purchase Plan participants	67,367	40,569
Dividends paid, net of dividends reinvested	(1,067,807)	(938,732)

Proceeds from Dividend Reinvestment Plan participants	206,891	-
Net cash provided by (used in) financing activities	36,366,072	(9,899,276)
Net increase in cash and cash equivalents	39,243,221	4,861,034
Cash and cash equivalents, beginning	8,327,954	12,771,147
Cash and cash equivalents, ending	$ 47,571,175	$ 17,632,181

See notes to unaudited consolidated financial statements

FIDELITY D & D BANCORP, INC.

Notes to Consolidated Financial Statements
(Unaudited)

1. Nature of operations and critical accounting policies

Nature of operations

Fidelity Deposit and Discount Bank (the Bank) is a commercial bank chartered in the Commonwealth of Pennsylvania and a wholly-owned subsidiary of Fidelity D & D Bancorp, Inc. (the Company or collectively, the Company). Having commenced operations in 1903, the Bank is committed to provide superior customer service, while offering a full range of banking products and financial and trust services to both our consumer and commercial customers from our main office located in Dunmore and other branches located throughout Lackawanna and Luzerne counties.

Principles of consolidation

The accompanying unaudited consolidated financial statements of the Company and the Bank have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to this Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and footnote disclosures required by GAAP for complete financial statements. In the opinion of management, all normal recurring adjustments necessary for a fair presentation of the financial condition and results of operations for the periods have been included. All significant inter-company balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates. For additional information and disclosures required under GAAP, refer to the Company’s Annual Report on Form 10-K for the year ended December 31, 2009.

Management is responsible for the fairness, integrity and objectivity of the unaudited financial statements included in this report. Management prepared the unaudited financial statements in accordance with GAAP. In meeting its responsibility for the financial statements, management depends on the Company's accounting systems and related internal controls. These systems and controls are designed to provide reasonable but not absolute assurance that the financial records accurately reflect the transactions of the Company, the Company’s assets are safeguarded and that the financial statements present fairly the financial condition and results of operations of the Company.

In the opinion of management, the consolidated balance sheets as of September 30, 2010 and December 31, 2009 and the related consolidated statements of income for the three- and nine-month periods ended September 30, 2010 and 2009 and changes in shareholders’ equity and cash flows for the nine months ended September 30, 2010 and 2009 present fairly the financial condition and results of operations of the Company. All material adjustments required for a fair presentation have been made. These adjustments are of a normal recurring nature.

This Quarterly Report on Form 10-Q should be read in conjunction with the Company’s audited financial statements for the year ended December 31, 2009, and the notes included therein, included within the Company’s Annual Report filed on Form 10-K.

Critical accounting policies

The presentation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect many of the reported amounts and disclosures. Actual results could differ from these estimates.

A material estimate that is particularly susceptible to significant change relates to the determination of the allowance for loan losses. Management believes that the allowance for loan losses at September 30, 2010 is adequate and reasonable. Given the subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make different assumptions, and could, therefore calculate a materially different allowance value. While management uses available information to recognize losses on loans, changes in economic conditions may necessitate revisions in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize adjustments to the allowance based on their judgment of information available to them at the time of their examination.

Another material estimate is the calculation of fair values of the Company's investment securities. Except for the Company's investment in corporate bonds, consisting of pooled trust preferred securities, fair values of the other investment securities are determined by prices provided by a third-party vendor who is a provider of financial market data, analytics and related services to financial institutions. For the pooled trust preferred securities, management is unable to obtain readily attainable and realistic pricing from market traders due to lack of active market participants and therefore management has determined the market for these securities to be inactive. In order to determine the fair value of the pooled trust preferred securities, management relied on the use of an income valuation approach (present value technique) that maximizes the use of observable inputs and minimizes the use of unobservable inputs, the results of which are more representative of fair value than the market approach valuation technique used for the other investment securities.

Based on experience, management is aware that estimated fair values of investment securities tend to vary among valuation services. Accordingly, when selling investment securities, price quotes from more than one source may be obtained. The majority of the Company's investment securities are classified as available-for-sale (AFS). AFS securities are carried at fair value on the consolidated balance sheet, with unrealized gains and losses, net of income tax, reported separately within shareholders' equity through accumulated other comprehensive income (loss).

The fair value of residential mortgage loans, classified as held-for-sale (HFS), is obtained from the Federal National Mortgage Association (FNMA) or the Federal Home Loan Bank (FHLB). Generally, the market to which the Company sells mortgages it originates for sale is restricted and price quotes from other sources are not typically obtained. On occasion, the Company may transfer loans from the loan and lease portfolio to loans HFS. Under these rare circumstances, pricing may be obtained from other entities and the loans are transferred at the lower of cost or market value and simultaneously sold. For a further discussion on the accounting treatment of loans HFS, see the section entitled "Loans held-for-sale," contained within management's discussion and analysis.

For purposes of reporting cash flows, cash and cash equivalents includes cash on hand, amounts due from banks and interest-bearing deposits with financial institutions. For the nine months ended September 30, 2010 and 2009, the Company paid interest of $5,365,000 and $9,140,000, respectively. The Company paid income taxes during the first nine months of 2010 of $575,000, and $675,000 for the nine months ended September 30, 2009. Transfers from loans to foreclosed assets held-for-sale amounted to $1,053,000 and $470,000 during the first nine months of 2010 and 2009, respectively. Transfers from loans to loans HFS amounted to $3,706,000 and $11,140,000 during the nine months ended 2010 and 2009, respectively. Expenditures for construction in process, a component of other assets in the consolidated balance sheets, are included in acquisition of bank premises and equipment.

2. New Accounting Pronouncements

During the first quarter of 2010, the Company adopted the new accounting guidance related to the transfers and servicing of financial assets. The standard eliminates the concept of qualifying special purpose entities, provides guidance as to when a portion of a transferred financial asset should be evaluated for sale accounting, provides additional guidance with regard to accounting for transfers of financial assets and requires additional disclosures. The adoption of the new accounting guidance did not have a material impact on the Company's consolidated financial statements.

During the first quarter of 2010, the Company adopted the amended accounting guidance related to fair value measurements which entails new disclosures and clarifies disclosure requirements about fair value measurement as set forth in previous guidance. The objective is to improve these disclosures and, thus, increase the transparency in financial reporting. Specifically, an entity is required to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers; and in the reconciliation for fair value measurements using significant unobservable inputs, a reporting entity should present separately information about purchases, sales, issuances, and settlements. The amended guidance also clarifies the requirements of the following disclosures: for purposes of reporting fair value measurement for each class of assets and liabilities, a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities; and a reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements. The new guidance became effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures will become effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years.

In July 2010, the FASB issued new guidance on disclosures about the credit quality of financing receivables and the allowance for credit losses. The new disclosure guidance will significantly expand the existing requirements for greater transparency into a company's exposure to credit losses from lending type arrangements. The objectives of the

expanded disclosures are to provide information that will enable readers of financial statements to understand the nature of credit risk in a company's financing receivables, how that risk is analyzed in determining the related allowance for credit losses and changes to the allowance during the reporting period. The new guidance applies to all companies. The extensive new disclosures of information as of the end of a reporting period will become effective for both interim and annual reporting periods ending after December 15, 2010 for public companies. Specific items regarding activity that occurred before the issuance of the new guidance, such as the allowance roll forward and modification disclosures will be required for periods beginning after December 15, 2010 for public companies.

3. Investment securities

The amortized cost and fair value of investment securities at September 30, 2010 and December 31, 2009 are summarized as follows (dollars in thousands):

	September 30, 2010			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Held-to-maturity securities:				
MBS - GSE residential	$ 535	$ 50	$ -	$ 585
Available-for-sale securities:				
Agency - GSE	$ 17,311	$ 193	$ 81	$ 17,423
Obligations of states and political subdivisions	23,248	1,167	-	24,415
Corporate bonds:				
Pooled trust preferred securities	16,360	-	12,634	3,726
MBS - GSE residential	40,142	680	105	40,717
Total debt securities	97,061	2,040	12,820	86,281
Equity securities - financial services	322	117	-	439
Total available-for-sale securities	$ 97,383	$ 2,157	$ 12,820	$ 86,720

	December 31, 2009			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Held-to-maturity securities:				
MBS - GSE residential	$ 709	$ 56	$ -	$ 765
Available-for-sale securities:				
Agency - GSE	$ 34,205	$ 4	$ 1,077	$ 33,132
Obligations of states and political subdivisions	23,013	394	137	23,270
Corporate bonds:				
Pooled trust preferred securities	18,794	-	13,552	5,242
MBS - GSE residential	13,418	401	71	13,748
Total debt securities	89,430	799	14,837	75,392
Equity securities - financial services	322	121	14	429
Total available-for-sale securities	$ 89,752	$ 920	$ 14,851	$ 75,821

The amortized cost and fair value of debt securities at September 30, 2010 by contractual maturity are summarized below (dollars in thousands):

	Amortized cost	Market value
Held-to-maturity securities:		
MBS - GSE residential	$ 535	$ 585
Available-for-sale securities:		
Debt securities:		
Due in one year or less	$ 6,239	$ 6,156
Due after one year through five years	1,000	1,001
Due after five years through ten years	4,151	4,228
Due after ten years	45,529	34,179
Total debt securities	56,919	45,564
MBS - GSE residential	40,142	40,717
Total available-for-sale debt securities	$ 97,061	$ 86,281

Expected maturities will differ from contractual maturities because issuers and borrowers may have the right to call or repay obligations with or without call or prepayment penalty. Federal agency and municipal securities are included based on their original stated maturity. Mortgage-backed securities, which are based on weighted-average lives and subject to monthly principal pay-downs, are listed in total.

The following tables present the fair value and gross unrealized losses of investment securities aggregated by investment type, the length of time and the number of securities that have been in a continuous unrealized loss position as of September 30, 2010 and December 31, 2009 (dollars in thousands):

	September 30, 2010					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Agency - GSE	$ -	$ -	$ 6,006	$ 81	$ 6,006	$ 81
Corporate bonds:						
Pooled trust preferred securities	-	-	3,726	12,634	3,726	12,634
MBS - GSE residential	19,884	105	-	-	19,884	105
Total temporarily impaired securities	$ 19,884	$ 105	$ 9,732	$ 12,715	$ 29,616	$ 12,820
Number of securities	9		14		23	

	December 31, 2009					
	Less than 12 months		More than 12 months		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
Agency - GSE	$ 21,090	$ 291	$ 5,038	$ 786	$ 26,128	$ 1,077
Obligations of states and political subdivisions	3,534	115	2,600	22	6,134	137
Corporate bonds:						

Pooled trust preferred securities		-		-		5,242		13,552		5,242		13,552
MBS - GSE residential		5,055		71		-		-		5,055		71
Total debt securities		29,679		477		12,880		14,360		42,559		14,837
Equity securities - financial services		114		10		46		4		160		14
Total temporarily impaired securities	$	29,793	$	487	$	12,926	$	14,364	$	42,719	$	14,851
Number of securities		23				17				40		

Management conducts a formal review of investment securities on a quarterly basis for the presence of other-than-temporary impairment (OTTI). The accounting guidance related to OTTI requires the Company to assess whether OTTI is present when the fair value of a debt security is less than its amortized cost as of the balance sheet date. Under these circumstances, OTTI is considered to have occurred if: (1) the entity has intent to sell the security; (2) more likely than not the entity will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost.

The accounting guidance requires that credit-related OTTI be recognized in earnings while non-credit-related OTTI on securities not expected to be sold be recognized in other comprehensive income (OCI). Non-credit-related OTTI is based on other factors effecting market conditions, including illiquidity. The presentation of OTTI is made in the consolidated statements of income on a gross basis with an offset for the amount of non-credit-related OTTI recognized in OCI.

The Company's OTTI evaluation process also follows the guidance set forth in topics related to debt and equity securities. The guidance set forth in these pronouncements requires the Company to take into consideration current market conditions, fair value in relationship to cost, extent and nature of changes in fair value, issuer rating changes and trends, volatility of earnings, current analysts' evaluations, all available information relevant to the collectability of debt securities, the ability and intent to hold investments until a recovery of fair value, which may be maturity, and other factors when evaluating for the existence of OTTI. This guidance also eliminates the requirement that a holder's best estimate of cash flows is based upon those that a market participant would use. Instead, the guidance requires that OTTI be recognized as a realized loss through earnings when there has been an adverse change in the holder's expected cash flows such that the full amount (principal and interest) will probably not be received. This requirement is consistent with the impairment model in the guidance for accounting for debt and equity securities.

For all security types discussed below, at September 30, 2010 the Company applied the criteria provided in the recognition and presentation of OTTI guidance. That is, management has no intent to sell the securities and no conditions were identified by management that more likely than not would require the Company to sell the securities before recovery of their amortized cost basis. The results indicated there was no presence of OTTI for the Company's portfolios of Agency – Government Sponsored Enterprise (GSE), Mortgage-backed securities (MBS) – GSE residential and Obligations of states and political subdivisions.

Agency - GSE and MBS - GSE residential
Agency – GSE and MBS – GSE residential securities consist of medium and long-term notes issued by Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Federal Home Loan Bank (FHLB) and Government National Mortgage Association (GNMA). These securities have interest rates that are largely fixed-rate issues, have varying mid- to long-term maturity dates and have contractual cash flows guaranteed by the U.S. government or agencies of the U.S. government.

Obligations of states and political subdivisions
The municipal securities are bank qualified, general obligation bonds rated as investment grade by various credit rating agencies and have fixed rates of interest with mid- to long-term maturities. Fair values of these securities are highly driven by interest rates. Management performs ongoing credit quality reviews on these issues.

In all of the above security types, the decline in fair value is attributable to changes in interest rates and not credit quality. Consequently, no OTTI is considered necessary for these securities at September 30, 2010.

Pooled trust preferred securities
A Pooled Trust Preferred Collateralized Debt Obligation (CDO) is a type of investment security collateralized by trust preferred securities (TPS) issued by banks, insurance companies and real estate investment trusts (REITs). The primary collateral type is a TPS issued by a bank. A TPS is a hybrid security with both debt and equity characteristics such as the ability to voluntarily defer interest payments for up to 20 consecutive quarters. A TPS is considered a junior security in the capital structure of the issuer.

There are various tranches or investment classes issued by the CDO with the most senior tranche having the lowest yield but the most protection from credit losses compared to other tranches that are subordinate. Losses are generally allocated from the lowest tranche with the equity component holding the most risk and then subordinate tranches in reverse order up to the senior tranche. The allocation of losses is defined in the indenture when the CDO

was formed.

Unrealized losses in the pooled trust preferred securities (PreTSLs) are caused mainly by the following factors: (1) collateral deterioration due to bank failures and credit concerns across the banking sector; (2) widening of credit spreads and (3) illiquidity in the market. The Company's review of these securities, in accordance with the previous discussion, determined that in 2010, credit-related OTTI be recorded on six holdings of these securities all of which are in the AFS securities portfolio.

The following table summarizes the amount of OTTI recognized in earnings, by security during the periods indicated (dollars in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Pooled trust preferred securities:				
PreTSL V, Mezzanine	$ 122	$ -	$ 122	$ -
PreTSL VII, Mezzanine	-	325	86	651
PreTSL IX, B1, B3	-	690	-	690
PreTSL XI, B3	-	-	60	-
PreTSL XV, B1	285	154	285	154
PreTSL XVI, C	681	756	1,290	756
PreTSL XVII, C	661	-	661	-
PreTSL XXV, C1	-	507	-	507
Total	$ 1,749	$ 2,432	$ 2,504	$ 2,758

The following table is a tabular roll-forward of the cumulative amount of credit-related OTTI recognized in earnings (dollars in thousands):

	Inception to September 30, 2010		
	HTM	AFS	Total
Balance of credit-related OTTI - December 31, 2009	$ -	$ (3,198)	$ (3,198)
Additions for credit-related OTTI not previously recognized	-	(843)	(843)
Additional credit-related OTTI previously recognized when there is no intent to sell before recovery of amortized cost basis	-	(1,661)	(1,661)
Ending balance of credit-related OTTI	$ -	$ (5,702)	$ (5,702)

To determine the ending balance of credit-related OTTI, the Company uses discounted present value cash flow analysis and compares the results with the bond's face value. The analysis considered the following assumptions: the discount rate which equated to the discount margin for each tranche (credit spread) at the time of purchase which was then added to the appropriate three-month Libor forward rate obtained from the forward Libor curve; historical average default rates obtained from the FDIC for U.S. Banks and Thrifts for the period spanning 1988 to 1991 increased by a factor of three and rolled forward to project a rate of default of approximately one-third; the default rate was reduced by the actual deferrals/defaults experienced in all preferred term securities from 2008 through 2009; the remaining estimated default rate was then stratified with higher default rates occurring in the beginning of 2010 regressing to normal in 2011, with an estimated 15% recovery by way of a two year lag; and no prepayments of principal.

Two of the Company's initial mezzanine holdings (PreTSLs IV and V) are now senior tranches and the remaining holdings are mezzanine tranches. As of September 30, 2010, none of the pooled trust preferred securities were investment grade. At the time of initial issue, the subordination in the Company's tranches ranged in size from approximately 8.0% to 25.9% of the total principal amount of the respective securities and no more than 5% of any pooled trust preferred security consisted of a security issued by any one bank and 4% for insurance companies. As of September 30, 2010, management estimates the subordination in the Company's tranches ranging from 0% to 19.2% of the current performing collateral. During the nine months of 2010, PreTSL IX with a book value of $2.8 million and

corresponding fair value of $1.1 million, and PreTSL XVII with a book value of $353,000 and no corresponding fair value were placed on non-accrual status.

The following table is the composition of the Company's non-accrual PreTSL securities as of the period indicated (dollars in thousands):

Deal	Class	September 30, 2010 Book value	September 30, 2010 Fair value	December 31, 2009 Book value	December 31, 2009 Fair value
PreTSL VII	Mezzanine	$ 332	$ 154	$ 432	$ 219
PreTSL IX	B-1,B-3	2,765	1,119	-	-
PreTSL XV	B-1	1,075	125	1,359	297
PreTSL XVI	C	-	-	1,290	65
PreTSL XVII	C	353	-	-	-
PreTSL XXV	C-1	507	-	507	2
		$ 5,032	$ 1,398	$ 3,588	$ 583

The securities included in the above table, have experienced impairment of principal, and interest was "paid-in-kind". On a quarterly basis, each of the other issues will be evaluated for the presence of these two conditions and placed on non-accrual status if necessary.

The following table provides additional information with respect to the Company's pooled trust preferred securities as of September 30, 2010 (dollars in thousands):

Deal	Class	Book value	Fair value	Unrealized loss	Moody's / Fitch ratings	Current number of banks / insurance companies	Actual deferrals and defaults	Actual deferrals and defaults as a % of current collateral	Excess subordination	Excess subordination* as a % of current performing collateral	Effective subordination** as a % of current performing collateral
PreTSL IV	Mezzanine	$ 610	$ 421	$ (189)	Ca / CCC	6 / -	18,000	27.1	9,889	19.2	35.0
PreTSL V	Mezzanine	151	151	-	Ba3 / D	3 / -	28,950	100.0	None	N/A	N/A
PreTSL VII	Mezzanine	332	154	(178)	Ca / C	19 / -	160,000	70.5	None	N/A	N/A
PreTSL IX	B-1,B-3	2,766	1,118	(1,648)	Ca / C	49 / -	131,510	29.2	None	N/A	N/A
PreTSL XI	B-3	2,341	769	(1,572)	Ca / C	65 / -	142,780	23.7	None	N/A	6.9
PreTSL XV	B-1	1,075	125	(950)	Ca / C	63 / 9	209,450	35.0	None	N/A	N/A
PreTSL XVI	C	-	-	-	Ca / C	49 / 7	251,190	43.6	None	N/A	N/A
PreTSL XVII	C	353	-	(353)	Ca / C	51 / 6	187,670	39.6	None	N/A	N/A
PreTSL XVIII	C	1,017	64	(953)	Ca / C	66 / 14	158,140	23.4	None	N/A	4.8
PreTSL XIX	C	2,566	180	(2,386)	C / C	60 / 14	172,400	24.6	None	N/A	5.1
	B-1	2,245	194	(2,051)			374,800	35.7	None	N/A	10.0

PreTSL XXIV					Caa3 / CC	80 / 13					
PreTSL XXV	C-1	507	-	(507)	C / C	64 / 9	285,600	32.6	None	N/A	0.3
PreTSL XXVII	B	2,397	550	(1,847)	Ca / CC	42 / 7	95,800	29.4	None	N/A	19.9
		$ 16,360	$ 3,726	$ (12,634)							

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* Excess subordination represents the excess (if any) of the amount of performing collateral over the given class of bonds.

** Effective subordination represents the estimated percentage of the performing collateral that would need to defer or default at the next payment in order to trigger a loss of principal or interest. This differs from excess subordination in that it considers the effect of excess interest earned on the performing collateral.

For a further discussion on the fair value determination of the Company's investment in pooled trust preferred securities, see "Investment securities" under the caption "Comparison of financial condition at September 30, 2010 and December 31, 2009" of Part 1, Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations"; below.

4. Earnings (loss) per share

Basic earnings (loss) per share (EPS) is computed by dividing income available to common shareholders by the weighted-average number of common stock outstanding for the period. Diluted EPS is computed in the same manner as basic EPS but reflects the potential dilution that could occur if stock options to issue additional common stock were exercised, which would then result in additional stock outstanding to share in or dilute the earnings of the Company. The Company maintains two share-based compensation plans that may generate additional potential dilutive common shares. Generally, dilution would occur if Company-issued stock options were exercised and converted into common stock.

In the computation of diluted EPS, the Company uses the treasury stock method to determine the dilutive effect of its granted but unexercised stock options. Under the treasury stock method, the assumed proceeds received from shares issued, in a hypothetical stock option exercise, are assumed to be used to purchase treasury stock. There were no potentially dilutive shares outstanding in either period because the average share market price of the Company's common stock during the nine months ended September 30, 2010 and 2009 was below the strike prices of all options granted. For a further discussion on the Company's stock option plans, see Note 5, "Stock plans," below.

The following table illustrates the data used in computing basic EPS and a reconciliation to derive at the components of diluted EPS for the periods indicated:

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Basic EPS:				
Net income (loss) available to common shareholders	$ 354,943	$ (3,210,680)	$ 1,629,795	$ (1,473,469)
Weighted-average common shares outstanding	2,151,880	2,085,089	2,132,974	2,075,181
Basic EPS	$ 0.16	$ (1.55)	$ 0.76	$ (0.71)
Diluted EPS:				
Net income (loss) available to common shareholders	$ 354,943	$ (3,210,680)	$ 1,629,795	$ (1,473,469)
Weighted-average common shares outstanding	2,151,880	2,085,089	2,132,974	2,075,181
Potentially dilutive common shares	-	-	-	-
Weighted-average common shares and dilutive potential shares	2,151,880	2,085,089	2,132,974	2,075,181
Diluted EPS	$ 0.16	$ (1.55)	$ 0.76	$ (0.71)

5. Stock plans

The Company has two stock-based compensation plans (the stock option plans) and applies the fair value method of accounting for stock-based compensation provided under the current accounting guidance. The guidelines require the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. The stock option plans were shareholder-approved and permit the grant of share-based compensation awards to its directors, key officers and certain other employees. The Company believes that the stock option plans better align the interest of its directors, key officers and employees with the interest of its shareholders. The Company further believes that the granting of share-based awards is necessary to retain the knowledge base, continuity and expertise of its directors, key officers and employees. In the stock option plans, directors, key officers and certain other employees are eligible to be awarded stock options to purchase the Company's common stock at the fair market value on the date of grant.

The Company established the 2000 Independent Directors Stock Option Plan and has reserved 55,000 shares of its un-issued capital stock for issuance under the plan. No stock options were awarded during the nine months ended September 30, 2010 and 2009. As of September 30, 2010, there were 21,050 unexercised stock options outstanding under this plan.

The Company also established the 2000 Stock Incentive Plan and has reserved 55,000 shares of its un-issued capital stock for issuance under the plan. There were no options awarded during the nine months ended September 30, 2010 and 2009. As of September 30, 2010, there were 6,810 unexercised stock options outstanding under this plan.

Since no awards were vested in either of the stock option plans during the nine months ended September 30, 2010 and 2009, there was no stock-based compensation expense recognized related to either of the stock option plans.

In addition to the two stock option plans, the Company established the 2002 Employee Stock Purchase Plan (the ESPP) and reserved 110,000 shares of its un-issued capital stock for issuance. The plan was designed to promote broad-based employee ownership of the Company's stock and to motivate employees to improve job performance and enhance the financial results of the Company. Under the ESPP, employees use automatic payroll withholdings to purchase the Company's capital stock at a discounted price based on the fair market value of the capital stock as measured on either the commencement date or termination date. As of September 30, 2010, 17,025 shares have been

issued under the ESPP. The ESPP is considered a compensatory plan and as such, is required to comply with the provisions of authoritative accounting guidance. The Company recognizes compensation expense on its ESPP on the date the shares are purchased. For the nine months ended September 30, 2010 and 2009, compensation expense related to the ESPP approximated $7,000 and $5,000, respectively, and is included as a component of salaries and employee benefits in the consolidated statements of income.

6. Fair value measurements

The accounting guidelines established a framework for measuring fair value and enhancing disclosures about fair value measurements. The guidelines of fair value reporting instituted a valuation hierarchy for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 inputs are quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 inputs are unobservable inputs based on our own assumptions to measure assets and liabilities at fair value. Level 3 pricing for securities may also include unobservable inputs based upon broker-traded transactions. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

The Company uses fair value to measure certain assets and, if necessary, liabilities on a recurring basis when fair value is the primary measure for accounting. Thus, the Company uses fair value for AFS securities. Fair value is used on a non-recurring basis to measure certain assets when adjusting carrying values to market values, such as impaired loans.

The following table illustrates the financial instruments measured at fair value on a recurring basis segregated by hierarchy fair value levels as of September 30, 2010 and December 31, 2009 (dollars in thousands):

		Fair value measurements at September 30, 2010:		
Assets:	Total carrying value at September 30, 2010	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	$ 17,423	$ -	$ 17,423	$ -
Obligations of states and political subdivisions	24,415	-	24,415	-
Corporate bonds:				
Pooled trust preferred securities	3,726	-	-	3,726
MBS - GSE residential	40,717	-	40,717	-
Equity securities - financial services	439	439	-	-
Total available-for-sale securities	$ 86,720	$ 439	$ 82,555	$ 3,726

		Fair value measurements at December 31, 2009:		
Assets:	Total carrying value at December 31, 2009	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Available-for-sale securities:				
Agency - GSE	$ 33,132	$ -	$ 33,132	$ -
Obligations of states and political subdivisions	23,270	-	23,270	-
Corporate bonds:				
Pooled trust preferred securities	5,242	-	-	5,242
MBS - GSE residential	13,748	-	13,748	-
Equity securities - financial services	429	429	-	-
Total available-for-sale securities	$ 75,821	$ 429	$ 70,150	$ 5,242

Equity securities in the AFS portfolio are measured at fair value using quoted market prices for identical assets and are classified within Level 1 of the valuation hierarchy. Other than the Company's investment in corporate bonds, consisting of pooled trust preferred securities, all other debt securities in the AFS portfolio are measured at fair value using prices provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. Assets classified as Level 2 use valuation techniques that are common to bond valuations. That is, in active markets whereby bonds of similar characteristics frequently trade, quotes for similar assets are obtained. For the nine months ended September 30, 2010, there were no transfers to and from Level 1 and Level 2 fair value measurements for financial assets measured on a recurring basis.

The Company's pooled trust preferred securities include both observable and unobservable inputs to determine fair value and, therefore, are classified as Level 3 inputs. For a discussion on the fair value determination of the Company's investment in pooled trust preferred securities, see "Investment securities" under the caption "Comparison of Financial Condition at September 30, 2010 and December 31, 2009" in "Management's Discussion and Analysis of Financial Condition and Results of Operations," below.

The following table illustrates the changes in Level 3 financial instruments, consisting of the Company's investment in pooled trust preferred securities, measured at fair value on a recurring basis for the periods indicated (dollars in thousands):

	As of and for the nine months ended September 30, 2010	As of and for the nine months ended September 30, 2009
Assets:		
Balance at beginning of period	$ 5,242	$ 10,260
Realized / unrealized (losses) gains:		
in earnings	(2,504)	(2,758)
in comprehensive income (loss)	988	(306)
Purchases, sales, issuances and settlements, amortization and accretion, net	-	643
Balance at end of period	$ 3,726	$ 7,839

The following table illustrates the financial instruments measured at fair value on a non-recurring basis segregated by hierarchy fair value levels as of September 30, 2010 and December 31, 2009 (dollars in thousands):

		Fair value measurements at September 30, 2010 using:		
Assets:	Total carrying value at September 30, 2010	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired loans	$ 4,141	$ -	$ 4,039	$ 102

		Fair value measurements at December 31, 2009 using:		
Assets:	Total carrying value at December 31, 2009	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Impaired loans	$ 4,842	$ 15	$ 4,447	$ 380

Impaired loans that are collateral dependent are written down to fair value through the establishment of specific reserves. Techniques used to value the collateral that secures the impaired loan include: quoted market prices for identical assets classified as Level 1 inputs; for Level 2, observable inputs, employed by certified appraisers for similar assets are utilized if the loan is collateral dependent and then discounted based upon the type and/or age of the appraisal, the costs to sell and maintain the underlying collateral. If the loan is not considered to be collateral dependent, any impairment may be determined based upon the present value of the reported cash flows discounted at the loan's effective interest rate. In cases where valuation techniques included inputs that are unobservable, the valuations are based on commonly used and generally accepted industry liquidation advance rates or estimates and assumptions developed by management, with significant adjustments applied to the best information available under each circumstance. These asset valuations are classified as Level 3 inputs. A net reduction or transfer out of the impaired loans with Level 2 inputs occurred during the nine month period ended September 30, 2010 based upon payments received. There were no significant transfers during the quarter in the Level 1 and Level 3 impaired loans.

A summary of the carrying amounts and estimated fair values of certain financial instruments follows as of the periods indicated (dollars in thousands):

	September 30, 2010		December 31, 2009	
	Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
Financial assets:				
Cash and cash equivalents	$ 47,571	$ 47,571	$ 8,328	$ 8,328
Held-to-maturity securities	535	585	709	765
Available-for-sale securities	86,720	86,720	75,821	75,821
FHLB stock	4,781	4,781	4,781	4,781
Loans and leases	414,185	412,054	423,124	420,908
Loans held-for-sale	1,019	1,037	1,221	1,233
Accrued interest	2,233	2,233	2,251	2,251
Financial liabilities:				
Deposit liabilities	490,883	491,438	458,994	453,264
Short-term borrowings	21,804	21,804	16,533	16,533
Long-term debt	32,000	35,774	32,000	35,017
Accrued interest	616	616	665	665

The following summarizes the methodology used to determine estimated fair values in the above table:

The carrying value of short-term financial instruments, as listed below, approximates their fair value. These instruments generally have limited credit exposure, no stated or short-term maturities and carry interest rates that approximate market.

- Cash and cash equivalents
- Non-interest bearing deposit accounts
- Savings, NOW and money market accounts
- Short-term borrowings
- Accrued interest

Securities: Except for corporate bonds consisting of preferred term securities, fair values on the other investment securities are determined by prices provided by a third-party vendor, who is a provider of financial market data, analytics and related services to financial institutions. The fair values of pooled trust preferred securities is determined based on a present value technique (income valuation) as described under the caption “Investment securities” of the comparison of financial condition at September 30, 2010 and December 31, 2009, below.

FHLB stock, or restricted regulatory equity, is carried at cost, which approximates fair value.

Loans and leases: The fair value of all loans is estimated by the net present value of the future expected cash flows discounted at current market rates.

Loans held-for-sale (HFS): For loans HFS, the fair value is estimated using rates currently offered for similar loans and are obtained from the FNMA or the FHLB.

Certificates of deposit: The fair values of certificate of deposit accounts are based on discounted cash flows using rates which approximate market rates of deposits with similar maturities.

Long-term debt: The fair value is estimated using market rates currently offered for similar borrowings.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of the significant changes in the consolidated financial condition of the Company as of September 30, 2010 compared to December 31, 2009 and a comparison of the results of operations for the three- and nine-months ended September 30, 2010 and 2009. Current performance may not be indicative of future results. This discussion should be read in conjunction with the Company's 2009 Annual Report filed on Form 10-K.

Forward-looking statements

Certain of the matters discussed in this Quarterly Report on Form 10-Q may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, and as such may involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. The words "expect," "anticipate," "intend," "plan," "believe," "estimate," and similar expressions are intended to identify such forward-looking statements.

The Company’s actual results may differ materially from the results anticipated in these forward-looking statements due to a variety of factors, including, without limitation:

- the effects of economic deterioration on current customers, specifically the effect of the economy on loan customers’ ability to repay loans;
- the costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- governmental monetary and fiscal policies, as well as legislative and regulatory changes, in particular the effects of the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;
- the risks of changes in interest rates on the level and composition of deposits, loan demand, and the values of loan collateral, securities and interest rate protection agreements, as well as interest rate risks;
- the effects of competition from other commercial banks, thrifts, mortgage banking firms, consumer finance companies, credit unions, securities brokerage firms, insurance companies, money market and other mutual funds and other financial institutions operating in our market area and elsewhere, including institutions operating locally, regionally, nationally and internationally, together with such competitors offering banking products and services by mail, telephone, computer and the internet;
- technological changes;
- acquisitions and integration of acquired businesses;
- the failure of assumptions underlying the establishment of reserves for loan and lease losses and estimations of values of collateral and various financial assets and liabilities;
- volatilities in the securities markets;
- deteriorating economic conditions;
- acts of war or terrorism; and
- disruption of credit and equity markets.

Management of the Company cautions readers not to place undue reliance on forward-looking statements, which reflect analyses only as of the date of this document. We have no obligation to update any forward-looking statements to reflect events or circumstances after the date of this document.

Readers should review the risk factors described in other documents that we file or furnish, from time to time, with the Securities and Exchange Commission, including Annual Reports to Shareholders, Annual Reports filed on Form 10-K and other current reports filed or furnished on Form 8-K.

General

The Company’s results of operations depend primarily on net interest income. Net interest income is the difference between interest income and interest expense. Interest income is generated from yields on interest-earning assets,

which consist principally of loans and investment securities. Interest expense is incurred from rates paid on interest-bearing liabilities, which consist of deposits and borrowings. Net interest income is determined by the Company’s interest rate spread (the difference between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities. Interest rate spread is significantly impacted by: changes in interest rates and market yield curves and their related impact on cash flows; the composition and characteristics of interest-earning assets and interest-bearing liabilities; differences in the maturity and re-pricing characteristics of assets compared to the maturity and re-pricing characteristics of the liabilities that fund them and by the competition in our marketplace.

The Company’s profitability is also affected by the level of its non-interest income and expenses, provision for loan losses and provision for income taxes. Non-interest income consists of service charges on the Bank’s loan and deposit products, trust and asset management service fees, increases in the cash surrender value of the bank owned life insurance (BOLI), net gains or losses from sales of loans, securities and foreclosed assets held-for-sale and from credit-related other-than-temporary impairment (OTTI) charges on investment securities. Non-interest expense consists of compensation and related employee benefit expenses, occupancy, equipment, data processing, advertising, marketing, professional fees, insurance and other operating overhead.

The Company’s profitability is significantly affected by general economic and competitive conditions, changes in market interest rates, government policies and actions of regulatory authorities. The Company’s loan portfolio is comprised principally of commercial and commercial real estate loans. The properties underlying the Company’s mortgages are concentrated in Northeastern Pennsylvania. Credit risk, which represents the possibility of the Company not recovering amounts due from its borrowers, is significantly related to local economic conditions in the areas the properties are located as well as the Company’s underwriting standards. Economic conditions affect the market value of the underlying collateral as well as the levels of adequate cash flow and revenue generation from income-producing commercial properties.

Comparison of the results of operations
Three and nine months ended September 30, 2010 and 2009

Overview

Net income for the third quarter of 2010 was $355,000, or $0.16 per diluted share, compared to a net loss of $3,211,000, or $1.55, recorded in the same quarter of 2009. For the nine months ended September 30, 2010, net income was $1,630,000, or $0.76 per diluted share, compared to a net loss $1,473,000, or $0.71, recorded for the nine months ended September 30, 2009. The improvement in net earnings in the quarter and year-to-date comparisons was due to: a decline in non-cash, other-than-temporary impairment (OTTI) charges related to the Company's investment portfolio, lower provisions for loan losses, higher levels of net interest income, more collected fees and service charges and lower operating expenses. In addition, gains from mortgage banking services improved by $72,000 in the quarter-to-quarter comparison and declined $518,000 in the year-to-date comparative periods.

Return on average assets (ROA) and return on average shareholders' equity (ROE) were 0.24% and 2.87%, respectively, for the three months ended September 30, 2010 compared to -2.25% and -25.75%, respectively, for the three months ended September 30, 2009. For the nine months ended September 30, 2010, ROA and ROE were 0.37% and 4.58%, respectively, compared to -0.35% and -4.07% for the same period in 2009. The improvements in both ROA and ROE are attributable to net earnings recorded in both the current quarter and year.

Net interest income and interest sensitive assets / liabilities

Net interest income increased $852,000, or 19%, to $5,273,000 in the third quarter of 2010, from $4,421,000 recorded in the same quarter of 2009. The improvement was principally from lower interest expense of $1,352,000 due to a 126 basis point reduction in rates paid on interest-bearing liabilities, where a 76 basis point reduction in deposit rates more than offset the effect of a $14,636,000 increase in average balances. Conversely, though average interest-earning assets increased $16,200,000, interest income was negatively impacted by a 52 basis point decline in yields earned resulting in a net decline in interest income of $500,000 in the third quarter of 2010 compared to the third quarter of 2009.

During the third quarter of 2010, the Company's tax-equivalent margin and spread were 3.93% and 3.68%, compared to 3.43% and 2.95%, respectively, during the third quarter of 2009. The improvement in spread was caused by a greater reduction in rates paid on interest-bearing liabilities than the lower yields earned on interest-earning assets. The improvement in margin was from higher net interest income.

For the nine months ended September 30, 2010, net interest income improved 12%, or $1,663,000, compared to the nine months ended September 30, 2009. Similar to the third quarter comparison, the improvement was principally from lower interest expense of $3,434,000 due to a 108 basis point reduction in rates paid on interest-bearing liabilities including an 87 basis point reduction in rates paid on deposits. The decrease in interest income of $1,771,000 was from lower yields on earning assets.

The Company's tax-equivalent margin and spread improved to 3.92% and 3.66%, respectively, for the nine months ended September 30, 2010 from 3.62% and 3.17% during the same period of 2009. The improvements stem from deposit rates declining more rapidly than yields from earning assets resulting in higher net interest income.

The low interest rate environment has dominated the economy for several quarters and the probability of a near-term change is unlikely. As the Company continues to operate in this environment, earning assets will continue to re-price to lower levels causing additional downward pressure on yields. However, the Company's Asset Liability Management (ALM) team will, if and when deemed necessary, adjust interest rates on deposits and repurchase agreements in order to maintain acceptable interest rate margins. At this time, the Company's deposit offering rates

are at historical low levels and whether the Company can grow and retain its deposit base will largely depend on customers' desire to maintain relatively low-earning deposits. Nonetheless, the Company's ALM team will continue to proactively address interest rate issues in this difficult financial environment and is poised to create and offer products that are fair for its customers yet equitable for the Company.

The table that follows sets forth a comparison of average balances and their corresponding fully tax-equivalent (FTE) interest income and expense and annualized tax-equivalent yield and cost for the periods indicated (dollars in thousands):

	Three months ended:					
	September 30, 2010			September 30, 2009		
Assets	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets:						
Loans and leases	$ 424,053	$ 6,295	5.89%	$ 431,024	$ 6,603	6.08%
Investments	94,448	845	3.55	99,922	1,065	4.23
Federal funds sold	169	-	0.26	5,335	3	0.25
Interest-bearing deposits	34,424	22	0.25	622	-	0.06
Total interest-earning assets	553,094	7,162	5.14	536,903	7,671	5.67
Non-interest-earning assets	32,848			29,089		
Total assets	$ 585,942			$ 565,992		
Liabilities and shareholders' equity						
Interest-bearing liabilities:						
Other interest-bearing deposits	$ 259,678	$ 407	0.63%	$ 228,308	$ 579	1.01%
Certificates of deposit	146,952	838	2.29	163,683	1,370	3.32
Borrowed funds	42,274	430	4.04	42,746	1,077	10.00
Repurchase agreements	8,685	6	0.30	7,266	6	0.32
Total interest-bearing liabilities	457,589	1,681	1.46	442,003	3,032	2.72
Non-interest-bearing deposits	75,831			70,412		
Other non-interest-bearing liabilities	3,509			4,102		
Shareholders' equity	49,013			49,475		
Total liabilities and shareholders' equity	$ 585,942			$ 565,992		
Net interest income / interest rate spread		$ 5,481	3.68%		$ 4,639	2.95%
Net interest margin			3.93%			3.43%

	Nine months ended:					
	September 30, 2010			September 30, 2009		
Assets	Average balance	Interest	Yield / rate	Average balance	Interest	Yield / rate
Interest-earning assets:						
Loans and leases	$ 431,108	$ 18,834	5.84%	$ 432,607	$ 19,866	6.14%
Investments	95,686	2,693	3.76	98,971	3,436	4.64
Federal funds sold	7,708	14	0.24	5,872	11	0.25
Interest-bearing deposits	20,181	38	0.25	722	-	0.10
Total interest-earning assets	554,683	21,579	5.20	538,172	23,313	5.79
Non-interest-earning assets	31,892			29,048		
Total assets	$ 586,575			$ 567,220		
Liabilities and shareholders' equity						

Interest-bearing liabilities:								
Other interest-bearing deposits	$	260,211	$	1,386	1.07%	$	217,674	$	1,698	1.04%
Certificates of deposit		145,586		2,572	3.56		169,808		4,581	3.61
Borrowed funds		42,111		1,281	4.07		49,138		2,448	6.66
Repurchase agreements		12,634		77	0.81		9,144		22	0.33
Total interest-bearing liabilities		460,542		5,316	1.54		445,764		8,749	2.62
Non-interest-bearing deposits		74,917					69,143			
Other non-interest-bearing liabilities		3,502					3,950			
Shareholders' equity		47,614					48,363			
Total liabilities and shareholders' equity	$	586,575				$	567,220			
Net interest income / interest rate spread			$	16,263	3.66%			$	14,564	3.17%
Net interest margin					3.92%					3.62%

In the preceding table, interest income was adjusted to a tax-equivalent basis, using the corporate federal tax rate of 34%, to recognize the income from tax-exempt interest-earning assets as if the interest was taxable. This treatment allows a uniform comparison between yields on interest-earning assets. Loans include loans HFS and non-accrual loans but exclude the allowance for loan losses. Securities include non-accrual securities. Average balances are based on amortized cost and do not reflect net unrealized gains or losses. Net interest margin is calculated by dividing net interest income by total average interest-earning assets.

Provision for loan losses

The provision for loan losses represents the necessary amount to charge against current earnings, the purpose of which is to increase the allowance for loan losses to a level that represents management's best estimate of known and inherent losses in the Company's loan portfolio. Loans and leases determined to be uncollectible are charged off against the allowance for loan losses. The required amount of the provision for loan losses, based upon the adequate level of the allowance for loan losses, is subject to ongoing analysis of the loan portfolio. The Company's Special Assets Committee meets periodically to review problem loans and leases. The committee is comprised of management, including the senior loan officer, the chief risk officer, loan officers, loan workout officers and collection personnel. The committee reports quarterly to the Credit Administration Committee of the Board of Directors.

Management continuously reviews the risks inherent in the loan and lease portfolio. Specific factors used to evaluate the adequacy of the loan loss provision during the formal process include:

- specific loans that could have loss potential;
- levels of and trends in delinquencies and non-accrual loans;
- levels of and trends in charge-offs and recoveries;
- trends in volume and terms of loans;
- changes in risk selection and underwriting standards;
- changes in lending policies, procedures and practices;
- experience, ability and depth of lending management;
- national and local economic trends and conditions; and
- changes in credit concentrations.

The provision for loan losses was $375,000 for the three months ending September 30, 2010 and was $3,125,000 for the three month period ending September 30, 2009. Total provisions for the nine months ended September 30, 2010 were $1,250,000 and $3,850,000 for the same nine months of 2009. The $375,000 provision for the current quarter was recorded to provide increased allocations for commercial loans, residential mortgages and consumer loans resulting from the continued locally weakened economic conditions and to reserve for a decline in real estate values. For a further discussion on non-performing loans, see "Non-performing assets" under the caption "Comparison of financial condition at September 30, 2010 and December 31, 2009", below.

The allowance for loan losses was $7,484,000 at September 30, 2010 compared to $7,574,000 at December 31, 2009. For a further discussion on the allowance for loan losses, see "Allowance for loan losses" under the caption "Comparison of financial condition at September 30, 2010 and December 31, 2009" below.

Other income (loss)

In the third quarter of 2010, other (non-interest) income/loss improved $1,022,000, or 79%, from a net loss of 1,292,000 recorded in the third quarter of 2009 to a net loss of $270,000 recorded in the third quarter of 2010. The improvement was primarily from $683,000 lower non-cash OTTI charges recorded in the current year quarter. The OTTI is related to credit impairment in the Company's investments in pooled trust preferred securities that is discussed

more fully in Note 3, "Investment securities". Non-interest income was bolstered by a $175,000, or 41%, increase in fees and other service charges emanating mostly from lending activities. In addition, the prolonged low interest rate environment has again spiked mortgage loan origination and refinancing activities. As such, mortgage banking services recognized $72,000 in additional gains in the current year third quarter compared to the third quarter of 2009.

For the nine months ended September 30, 2010, other income improved $36,000 compared to the nine months ended September 30, 2009. In the current year, the Company recognized OTTI credit-related charges of $2,504,000 compared to $2,758,000 in 2009, an improvement of approximately $254,000. In addition, other fees and service charges improved $213,000 on the strength of lending and trust services activities. Partially offsetting these positive factors for the nine months ended September 30, 2010, the Company recorded $440,000 in gains from mortgage banking services compared to $958,000 recognized during the first nine months of 2009, or a decline of $518,000. The 2009 gain included sales of $10,838,000 of loans transferred from the loan and lease portfolio to loans HFS and simultaneously sold.

Other operating expenses

For the quarter ended September 30, 2010, other (non-interest) expenses declined $792,000, or 15%, compared to the quarter ended September 30, 2009. Salary and employee benefits decreased $335,000, or 13%, due to employee downsizing in conjunction with the planned reorganization of the Company during the latter part of 2009 and first quarter of 2010. The number of full-time equivalent employees (FTE) amounted to 159 at September 30, 2010 compared to 185 at September 30, 2009. The $66,000, or 8%, savings in premises and equipment is principally from lower rental expense. The Company recently entered into a new lease agreement with a new owner-landlord of the Company's Eynon branch. As a result, the company was required to reverse previously accrued and unpaid future rental obligations expensed in accordance with current accounting guidance. In conjunction with the new ownership, the previous lease agreement with the previous owner-landlord terminated. The other category of other operating expense declined $383,000, or 24%. Professional services declined $226,000, or 32%, due in part to the one-time $162,000 consulting agreement expense paid to the Company's former chief executive officer in the third quarter of 2009 and to a lesser degree, the permanent exemption of smaller reporting companies from the Sarbanes-Oxley internal control audit requirement as a result of the signing into law, the Dodd-Frank Wall Street Reform and Consumer Protection Act. This enactment eliminated the need to accrue expenses for this effort. Finally, in the 2010 third quarter, credit-collection related costs were approximately half of the amount recognized in the third quarter of 2009 due to the recovery of some previously recognized expenses incurred on larger problem credits.

For the nine months ended September 30, 2010, non-interest related expenses decreased $394,000, or 3%, from $14,510,000 recorded in 2009 compared to $14,116,000 in 2010. Salary and employee benefits decreased $326,000, or 4%, despite approximately $400,000 of one-time severance and voluntary termination payouts from the previously mentioned planned, structured reorganization of the Company. Savings in property insurance, facility maintenance and the aforementioned termination of the old and simultaneous signing of the new branch lease agreement helped reduce premises and equipment expenses by $136,000, or 5%. Advertising expenses increased $22,000, or 6%, due to costs for the development of a new Company website, the implementation of a Company branding campaign and the expenses associated with customer notification of federal regulatory changes. The other category of non-interest expenses increased by $46,000, or 1% in 2010, compared to 2009, due to a sundry of offsetting components consisting of: higher collection expense caused by higher levels of non-performing loans; less deferral of mortgage-related origination costs on less origination activity; the establishment of a loss contingency reserve associated with potential off-balance sheet loan commitment losses and an increase in promotion related expenses for sales campaigns designed to bolster services for deposit customers. Partially offsetting these items were lower: professional services from the non-recurrence of the consulting payments, ORE costs, travel related expenses and sold loan charges on lower origination and sales volumes.

(Credit) provision for income taxes

For the nine months ended September 30, 2010 and 2009 the Company recorded a provision for income taxes of $169,000 and an income tax benefit of $1,421,000, respectively. This is a result of the Company incurring pre-tax losses during the first nine months of 2009 as compared to generating pre-tax income for the first nine months of 2010. Though the Company generated pre-tax income during the third quarter of 2010, the tax benefit was caused by a higher level net non-taxable permanent differences recognized during the same period.

Comparison of financial condition at
September 30, 2010 and December 31, 2009

Overview

Consolidated assets increased $40,581,000 to $596,598,000 or 7%, as of September 30, 2010 from $556,017,000 at December 31, 2009. The increase was primarily from $31,888,000 growth in deposits, an increase in short-term borrowings of $5,271,000 and a $3,001,000 increase in shareholders' equity.

Investment securities

At the time of purchase, management classifies investment securities into one of three categories: trading, available-for-sale (AFS) or held-to-maturity (HTM). To date, management has not purchased any securities for trading purposes. Most of the securities purchased are classified as AFS even though there is no immediate intent to sell them. The AFS designation affords management the flexibility to sell securities and position the balance sheet in response to capital levels, liquidity needs or changes in market conditions. Securities AFS are carried at fair value in the consolidated balance sheet with an adjustment to shareholders' equity, net of tax, presented under the caption "Accumulated other comprehensive income (loss)." Securities designated as HTM are carried at amortized cost and represent debt securities that the Company has the ability and intent to hold until maturity.

As of September 30, 2010, the carrying value of investment securities amounted to $87,255,000, or 15% of total assets, compared to $76,530,000, or 14% of total assets, at December 31, 2009. At September 30, 2010, approximately 47% of the carrying value of the investment portfolio was comprised of mortgage-backed securities that amortize and provide monthly cash flow.

As of September 30, 2010, investment securities were comprised of HTM and AFS securities with carrying values of $535,000 and $86,720,000, respectively. The AFS debt securities were recorded with a net unrealized loss in the amount of $10,780,000 and equity securities were recorded with an unrealized net gain of $117,000. During the nine months ended September 30, 2010, the carrying value of total investments increased $10,725,000. The increase includes $3,268,000 in net market value appreciation in the AFS portfolio. The Company used cash flow generated from mortgage-backed securities, bond calls and pay downs as well as excess cash reserves to diversify the securities portfolio weighted heavier in mortgage-backed securities with relatively short durations and which provide a regular source of cash flow.

A comparison of investment securities at September 30, 2010 and December 31, 2009 is as follows (dollars in thousands):

	September 30, 2010		December 31, 2009	
	Amount	%	Amount	%
Agency - GSE	$ 17,423	20.0	$ 33,132	43.3
MBS - GSE residential	41,252	47.3	14,457	18.9
State & municipal subdivisions	24,415	28.0	23,270	30.4
Pooled trust preferred securities	3,726	4.2	5,242	6.8
Equity securities - financial services	439	0.5	429	0.6
Total investments	$ 87,255	100.0	$ 76,530	100.0

Quarterly, management performs a review of the investment portfolio to determine the cause of declines in the fair value of each security. The Company uses inputs provided by independent third parties to determine the fair value of its investment securities portfolio. The inputs provided are reviewed and corroborated by management. Evaluations of the causes of the unrealized losses are performed to determine whether impairment is temporary or other-than-temporary. Considerations such as the Company's intent to sell the security, whether the Company will more likely than not be required to sell the security before recovery of its amortized cost basis, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis, recoverability of the invested amounts over the intended holding period, the length of time and the severity in pricing decline below cost, the interest rate environment, receipts of amounts contractually due and whether or not there is an active market for the security, for example, are applied, along with the financial condition of the issuer for management to make a realistic judgment of the probability that the Company will be unable to collect all amounts (principal and interest) due in determining whether a security is other-than-temporarily impaired. If a decline in value is deemed to be other-than-temporary, the amortized cost of the security is reduced by the credit impairment amount and a corresponding charge to earnings is recognized. If at the time of sale, call or maturity the proceeds exceed the security's amortized cost, the impairment charge may be fully or partially recovered.

Under these circumstances, OTTI is considered to have occurred if: (1) the entity has intent to sell the security; (2) more likely than not the entity will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost.

The uncertainty in the financial markets continues to promote volatility in fair value estimates for the securities in the Company's investment portfolio. Fair values of the Company's AFS investment securities have improved since year-end 2009, but remain well below their amortized cost - $10.7 million, or 11% as of September 30, 2010 and $13.9 million, or 16% as of December 31, 2009. Management believes fair values and their changes are due mainly to a combination of the interest rate environment, instability in the capital markets, limited trading activity and illiquid conditions in certain financial markets, not deterioration in the creditworthiness of the issuers. Nearly all of the securities in the portfolio have fixed rates or have predetermined scheduled rate changes, and many have call features that allow the issuer to call the security at par before its stated maturity without penalty. The most significant component of the $10.7 million net unrealized loss in the AFS securities portfolio, as of September 30, 2010, was $12.6 million from the Company's investments in corporate bonds consisting of collateralized debt obligation (CDO) securities that are backed by pooled trust preferred securities issued by banks, thrifts and insurance companies.

Management has been unable to obtain readily attainable and realistic pricing from market traders for the pooled trust preferred securities portfolio because there continues to be a lack of active market participants who deal in these securities.

As of September 30, 2010, the Company owned 13 tranches of pooled trust preferred securities (PreTSLs). Management has determined the market for these securities and other issues of PreTSLs at September 30,

2010 is inactive. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which PreTSLs trade, then by a significant decrease in the volume of trades relative to historical levels and the lack of a new-issue market since 2007. There are currently very few market participants who are willing and/or able to transact for these securities. Given the conditions in the debt markets today and the absence of observable transactions in the secondary and new issue markets, management has made the following observations and has determined:

- The few observable transactions and market quotations that were available were not reliable for purposes of determining fair value at September 30, 2010,

- An income valuation approach (present value technique) that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs is equally or more representative of fair value than the market approach valuation technique, and

- The PreTSL securities are classified within "Level 3" in the fair value hierarchy (as defined in current accounting guidance and explained in Note 6, "Fair Value Measurements" of the consolidated financial statements) because significant adjustments are required to determine fair value at the measurement date. The valuations of the Company's PreTSLs were prepared by an independent third party and corroborated by management. The approach to determine fair value involved the following:
  - Data about the issue structure as defined in the indenture and the underlying collateral were collected,
    - The credit quality of the collateral is estimated using issuer-specific probability of default values,
- The default probabilities also considered the potential for 50% correlation among issuers within the same industry (e.g. banks with other banks) and 30% correlation between industries (e.g. banks vs. insurance),
- The loss given default, or amount of cash lost to the investor when a debt asset defaults, was assumed to be 100% (no recovery). This replicates the historically high default loss levels on trust preferred instruments,
- The cash flows were forecast for the underlying collateral and applied to each tranche to determine the resulting distribution among the securities. This ascertains which investors are paid and which investors incur losses. Thus, these cash flow projections capture the credit risk,
- The expected cash flows utilize no prepayments and were discounted utilizing three-month LIBOR as the risk-free rate for the base case and then added a 300bp liquidity premium as the discount rate to calculate the present value of the security,
- The effective discount rates on an overall basis range from 8.9% to 76.4% and are highly dependent upon the credit quality of the collateral, the relative position of the tranche within the capital structure of the security and the prepayment assumptions, and
  - The calculations were modeled in several thousand scenarios using a Monte Carlo engine to establish a distribution of intrinsic values and the average was used for valuation purposes.

Based on the technique described, the Company determined that as of September 30, 2010, the fair value of eight PreTSL securities: V, VII, IX, XI, XV, XVI, XVII and XXV had declined $7,710,000 in total below their amortized cost basis and since the present value of the security's expected cash flows were insufficient to recover the entire amortized cost basis, the securities are deemed to have experienced credit-related other-than-temporary impairment in the amount of $2,504,000 which was charged to current earnings as a component of other income in the consolidated statement of income for the nine months ended September 30, 2010. This compares to $2,758,000 of credit-related impairment charges recorded during the nine months ended September 30, 2009. The Company closely monitors the pooled trust preferred securities market and performs collateral sufficiency and cash flow analyses on a quarterly basis. Future analyses could yield results that may indicate further impairment has occurred and would therefore require additional write-downs and corresponding other-than-temporary impairment charges to current earnings.

Federal Home Loan Bank Stock

In order to gain access to the low-cost products and services offered by the FHLB, investment in FHLB stock is required for membership in the organization and is carried at cost since there is no market value available. The amount the Company is required to invest is dependent upon the relative size of outstanding borrowings the Company has with the FHLB. Excess stock is typically repurchased from the Company at par if the level of borrowings declines to a predetermined level. In addition, the Company normally earns a return or dividend on the amount invested. In order to preserve its capital level, in December 2008 the FHLB announced that it had suspended the payment of

dividends and excess capital stock repurchasing and as of September 30, 2010, that position has not changed. That decision was based on the FHLB's analysis and consideration of certain negative market trends and the impact those trends will have on their financial condition. Based on the financial results of the FHLB for the nine months ended September 30, 2010 and for the year-ended December 31, 2009, management believes that the suspension of both the dividend payments and excess capital stock repurchase is temporary in nature. Management further believes that the FHLB will continue to be a primary source of wholesale liquidity for both short- and long-term funding and has concluded that its investment in FHLB stock is not other-than-temporarily impaired. There can be no assurance, however, that future negative changes to the financial condition of the FHLB may not require the Company to recognize an impairment charge with respect to such holdings. The Company will continue to monitor the financial condition of the FHLB and assess its future ability to resume normal dividend payments and stock redemption activities.

Loans held-for-sale (HFS)

Generally, upon origination, certain residential mortgages are classified as HFS. In the event of market rate increases, fixed-rate loans and loans not immediately scheduled to re-price would no longer produce yields consistent with the current market. In a declining interest rate environment, the Company would be exposed to prepayment risk and, as rates decrease, interest income could be negatively affected. Consideration is given to the Company's current liquidity position and projected future liquidity needs. To better manage prepayment and interest rate risk, loans that meet these conditions may be classified as HFS. The carrying value of loans HFS is at the lower of cost or estimated fair value. If the fair values of these loans fall below their original cost, the difference is written down and charged to current earnings. Subsequent appreciation in the portfolio is credited to current earnings but only to the extent of previous write-downs.

Loans HFS at September 30, 2010 amounted to $1,019,000 with a corresponding fair value of approximately $1,037,000, compared to $1,221,000 and $1,233,000, respectively, at December 31, 2009. During the nine months ended September 30, 2010, residential mortgage loans with principal balances of $37,690,000 were sold into the secondary market with net gains of approximately $440,000 recognized, compared to $90,045,000 and $958,000, respectively, during the nine months ended September 30, 2009. Included in the 2009 sales was $10,838,000 of residential mortgage loans transferred from the loan and lease portfolio during the first quarter of 2009. The Company expects loan originations and the related sales to decline in 2010, though volumes have increased somewhat during the third quarter of 2010.

Loans and leases

The Company originates commercial and industrial (C&I) and commercial real estate (CRE) loans, collectively, commercial loans, residential mortgages, consumer, home equity and construction loans. The relative volume of originations is dependent upon customer demand, current interest rates and the perception and duration of future interest rate levels. As part of the overall strategy to serve the business community in which it operates, the Company is focused on developing and implementing products and services to the broad spectrum of businesses that operate in our marketplace. The Company's goals center on building relationships by providing credit and non-credit products and services, continuing to diversify its loan portfolio and utilizing participations to reduce risk in larger credit transactions. Especially in the current economic climate, the Company, in providing credit to existing and new customers, has implemented policies and procedures to reduce the associated risk. The risks associated with interest rates are being managed by utilizing floating versus long-term fixed rates and exploring programs where we can match our cost of funds.

The majority of the Company's loan portfolio is collateralized, at least in part, by real estate primarily located in Lackawanna and Luzerne Counties of Pennsylvania. Commercial lending activities may involve a greater degree of risk than consumer lending because typically they have larger balances and are likely more affected by adverse conditions in the economy. Because payments on commercial loans depend upon the successful operation and management of the properties and the businesses which operate from within them, repayment of such loans may be affected by factors outside the borrower's control. Such factors may include adverse conditions in the real estate market, the economy, the industry or changes in government regulations. As such, commercial loans require more ongoing evaluation and monitoring which occurs with the Bank's credit administration and outsourced loan review functions.

The composition of the loan portfolio at September 30, 2010 and December 31, 2009, is summarized as follows (dollars in thousands):

	September 30, 2010		December 31, 2009	
	Amount	%	Amount	%

Real estate:				
Commercial	$ 173,754	41.1	$ 186,727	43.3
Residential	65,554	15.6	71,001	16.5
Construction	10,754	2.6	10,125	2.4
Commercial and industrial	84,287	20.0	76,788	17.8
Consumer	87,015	20.6	85,690	19.9
Direct financing leases	305	0.1	367	0.1
Gross loans	421,669	100.0	430,698	100.0
Allowance for loan losses	(7,484)		(7,574)	
Net loans	$ 414,185		$ 423,124	

The $9.0 million net decline in gross loans during the first half of 2010 was predominantly from the payoff of some sizeable CRE credits that the Company aggressively sought for settlement. The growth in C&I is attributable to a short-term, match funded loan with a municipal customer. This loan matures during the fourth quarter of 2010.

Allowance for loan losses

Management continually evaluates the credit quality of the Company's loan portfolio and performs a formal review of the adequacy of the allowance for loan losses (the allowance) on a quarterly basis. The allowance reflects management's best estimate of the amount of credit losses in the loan portfolio. Management's judgment is based on the evaluation of individual loans, past experience, the assessment of current economic conditions and other relevant factors including the amounts and timing of cash flows expected to be received on impaired loans. Those estimates may be susceptible to significant change. The provision for loan losses represents the amount necessary to maintain an appropriate allowance. Loan losses are charged directly against the allowance when loans are deemed to be uncollectible. Recoveries from previously charged-off loans are added to the allowance when received.

Management applies two primary components during the loan review process to determine proper allowance levels. The two components are a specific loan loss allocation for loans that are deemed impaired and a general loan loss allocation for those loans not specifically allocated. The methodology to analyze the adequacy of the allowance for loan losses is as follows:

- identification of specific impaired loans by loan category;
- calculation of specific allowances where required for the impaired loans based on collateral and other objective and quantifiable evidence;
- determination of homogenous pools by loan category and eliminating the impaired loans;
- application of historical loss percentages (two-/three-year average) to pools to determine the allowance allocation;
- application of qualitative factor adjustment percentages to historical losses for trends or changes in the loan portfolio, and /or current economic conditions.

Allocation of the allowance for different categories of loans is based on the methodology as explained above. A key element of the methodology to determine the allowance is the Company's credit risk evaluation process, which includes credit risk grading of individual commercial loans. Commercial loans are assigned credit risk grades based on the Company's assessment of conditions that affect the borrower's ability to meet its contractual obligations under the loan agreement. That process includes reviewing borrowers' current financial information, historical payment experience, credit documentation, public information and other information specific to each individual borrower. Upon review, the commercial loan credit risk grade is revised or reaffirmed. The credit risk grades may be changed at any time management feels an upgrade or downgrade may be warranted. The credit risk grades for the commercial loan portfolio are taken into account in the reserve methodology and loss factors are applied based upon the credit risk grades. The loss factors applied are based upon the Company's historical experience as well as what management believes to be best practices and within common industry standards. Historical experience reveals there is a direct correlation between the credit risk grades and loan charge-offs. The changes in allocations in the commercial loan portfolio from period-to-period are based upon the credit risk grading system and from periodic reviews of the loan and lease portfolios.

Each quarter, management performs an assessment of the allowance and the provision for loan losses. The Company's Special Assets Committee meets quarterly and the applicable lenders discuss each relationship under review and reach a consensus on the appropriate estimated loss amount based on current accounting guidelines. The Special Assets Committee's focus is on ensuring the pertinent facts are considered and the reserve amounts pursuant to the accounting principles are reasonable. The assessment process includes the review of all loans on a non-accruing basis as well as a review of certain loans to which the lenders or the Company's Credit Administration function have assigned a criticized or classified risk rating.

Total charge-offs net of recoveries for the nine months ending September 30, 2010, were $1,339,000, compared to $1,870,000 in the first nine months of 2009. The reduced level of charge-offs recorded in the current year is primarily attributable to lower charge-offs incurred on commercial and industrial as well as consumer loans. The commercial and industrial loan net charge-offs were $320,000 for the nine months ending September 30, 2010 compared to net charge-offs of $730,000 in the same period of 2009. Consumer loan net charge-offs of $166,000 were recorded during the nine months ending September 30, 2010 versus $289,000 at the September 30, 2009 like period end. On an aggregate basis the commercial and residential real estate net charge-offs were relatively level, totaling $853,000 at September 30, 2010 and $850,000 at September 30, 2009. Commercial real estate loan net charge-offs were $531,000 during the nine month period ending September 30, 2010 versus $841,000 at September 30, 2009. Residential real estate loan net charge-offs totaled $322,000 for the nine month period ending September 30, 2010, and were $9,000 in the like period of 2009 For a discussion on the provision for loan losses, see the “Provision for loan losses,” located in the results of operations section of management’s discussion and analysis contained herein.

The allowance for loan losses was $7,484,000 at September 30, 2010 and $7,574,000 at December 31, 2009. Management believes that the current balance in the allowance for loan losses of $7,484,000 is sufficient to withstand the identified potential credit quality issues that may arise and others unidentified but inherent to the portfolio as of this time. Potential problem loans are those where there is known information that leads management to believe repayment of principal and/or interest is in jeopardy and the loans are currently neither on non-accrual status or past due 90 days or more. Given continuing pressure on property values and the generally uncertain economic backdrop, there could be additional instances which become identified in future periods that may require additional charge-offs and/or increases to the allowance. The ratio of allowance for loan losses to total loans was 1.77% at September 30, 2010 compared to 1.75% at December 31, 2009.

The following tables set forth the activity in the allowance for loan losses and certain key ratios for the period indicated:

	As of and for the nine months ended September 30, 2010	As of and for the twelve months ended December 31, 2009	As of and for the nine months ended September 30, 2009
Balance at beginning of period	$ 7,573,603	$ 4,745,234	$ 4,745,234
Provision charged to operations	1,250,000	5,050,000	3,850,000
Charge-offs:			
Real estate:			
Commercial	534,260	843,527	843,526
Residential	322,433	9,158	9,158
Commercial and industrial	323,077	983,490	746,093
Consumer	195,096	432,951	299,041
Total	1,374,866	2,269,126	1,897,818
Recoveries:			
Real estate:			
Commercial	3,236	2,075	2,075
Residential	-	-	-
Commercial and industrial	3,149	34,735	16,018
Consumer	29,131	10,685	9,348
Total	35,516	47,495	27,441
Net charge-offs	1,339,350	2,221,631	1,870,377
Balance at end of period	$ 7,484,253	$ 7,573,603	$ 6,724,857
Total loans, end of period	$ 422,688,600	$ 431,919,023	$ 428,439,731

	As of and for the nine months ended September 30, 2010	As of and for the twelve months ended December 31, 2009	As of and for the nine months ended September 30, 2009
Net charge-offs to (annualized):			
Average loans	0.41%	0.51%	0.58%
Allowance for loan losses	23.86%	29.33%	37.08%
Provision for loan losses	1.07x	0.44x	0.49x
Allowance for loan losses to:			
Total loans	1.77%	1.75%	1.57%
Non-accrual loans	0.78x	0.61x	0.85x
Non-performing loans	0.77x	0.59x	0.76x
Net charge-offs (annualized)	4.19x	3.41x	2.70x

Loans 30-89 days past due and still accruing	$	2,869,909	$	5,173,394	$	3,077,722
Loans 90 days past due and accruing	$	119,566	$	554,806	$	1,002,720
Non-accrual loans	$	9,581,793	$	12,329,338	$	7,900,547
Allowance for loan losses to loans 90 days or more past due and accruing		62.60x		13.65x		6.71x

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Non-performing assets

The Company defines non-performing assets as accruing loans past due 90 days or more, non-accrual loans, restructured loans, other real estate owned (ORE), non-accrual securities and repossessed assets. As of September 30, 2010, non-performing assets represented 2.22% of total assets compared to 2.58% at December 31, 2009. The decline at September 30, 2010 was driven by reductions in both the loans past due more than 90 days as well as the reduced non-accrual levels.

In the review of loans for both delinquency and collateral sufficiency, management concluded that there were a number of loans that lacked the ability to repay in accordance with contractual terms. The decision to place loans or leases on a non-accrual status is made on an individual basis after considering factors pertaining to each specific loan. The commercial loans are placed on non-accrual status when management has determined that payment of all contractual principal and interest is in doubt or the loan is past due 90 days or more as to principal and interest, unless well-secured and in the process of collection. Consumer loans secured by real estate are placed on non-accrual status at 120 days past due as to principal and interest, and unsecured consumer loans are charged-off when the loan is 90 days or more past due as to principal and interest. Uncollected interest income accrued on all non-accrual loans is reversed and charged to interest income.

The majority of the non-performing assets for the period were comprised of non-accruing commercial business loans, non-accruing real estate loans, non-accrual securities and ORE. Most of the loans are collateralized, thereby mitigating the Company's potential for loss. During the first nine months of 2010, $1,398,000 of corporate bonds consisting of pooled trust preferred securities were on non-accrual status. There were no non-accrual securities prior to 2009. For a further discussion on the Company's securities portfolio, see Note 3, "Investments Securities", within the notes to the consolidated financial statements and the section entitled "Investments", contained within this management discussion and analysis section.

Non-performing loans were reduced from $12,884,000 on December 31, 2009 to $9,701,000 on September 30, 2010. At December 31, 2009, the over 90 day past due portion was comprised of nine loans ranging from $1,000 to $294,000, and the non-accrual loan portion numbered 58 loans ranging from $2,600 to $2,800,000. At September 30, 2010, there were five loans ranging from $2,000 to $94,000 in the over 90 days past due category, and 59 loans ranging from $2,600 to $1,300,000 in the non-accrual category. The reduction of $3,183,000 in non-performing loans from December 31, 2009 to September 30, 2010 resulted mainly from non-accrual commercial loan repayments and the transfer of $1,053,000 from non-accrual to ORE.

The Company, on a regular basis, reviews changes to loans to determine if they meet the definition of a troubled debt restructuring (TDR). TDR loans arise when a borrower experiences financial difficulty and the Company grants a concession that it would not otherwise make in order to maximize the Company's recovery. TDR loans were $786,000 at September 30, 2010 and consisted of $601,000 of accruing commercial real estate loans and $185,000 of accruing commercial and industrial loans. If applicable, a TDR loan classified as non-accrual would require a minimum of six months of payments before consideration for a return to accrual status. Concessions made to borrowers typically involve an extension of the loan's maturity date or a change in the loan's amortization period. The Company believes its concessions have been successful as the borrowers are generally current with respect to the restructured terms. The Company has not reduced interest rates, forgiven principal or entered into any forbearance or other actions with respect to these loans. If loans characterized as a TDR perform according to the restructured terms for a satisfactory period of time, the TDR designation may be removed in a new calendar year if the loan yields a market rate of interest. There were no TDR loans at December 31, 2009.

ORE at September 30, 2010 was $1,351,000 and consisted of five properties. At September 30, 2010, the non-accrual loans aggregated $9,582,000 as compared to $12,329,000 at December 31, 2009. The net reduction in the level of non-accrual loans at September 30, 2010 occurred as follows: Additions to the non-accrual loan component of the non-performing assets totaling $7,118,000 were made during the first nine months of the year. These were partially offset by reductions or payoffs of $7,333,000, charge-offs of $1,071,000, transfers to ORE of $1,053,000 and $408,000 of loans that returned to performing status. Loans past due 90 days or more and accruing were $120,000 at September 30, 2010 and $555,000, at December 31, 2009. Non-accrual securities were $1,398,000 at September 30, 2010 and $583,000 at December 31, 2009.

Non-performing loans to total loans were 2.30% at September 30, 2010, down from 2.98% at December 31, 2009. The percentage of non-performing assets to total assets was 2.22% at September 30, 2010, also down from 2.58% at December 31, 2009, primarily driven by the aforementioned decline in the non-accrual loans component.

The 30-89 day past due loans at September 30, 2010 were $2,870,000 reduced from $5,173,000 at December 31, 2009. The reduced level occurred as a result of the transfer of some loans to non-accrual, payments collected on others and the conversion / transfer of a loan to ORE status.

The following table sets forth non-performing assets data as of the period indicated:

	September 30, 2010	December 31, 2009	September 30, 2009
Loans past due 90 days or more and accruing	$ 119,566	$ 554,806	$ 1,002,720
Non-accrual loans	9,581,793	12,329,338	7,900,547
Total non-performing loans	9,701,359	12,884,144	8,903,267
Troubled debt restructurings	786,000	-	-
Other real estate owned	1,350,692	887,397	1,364,397
Non-accrual securities	1,397,514	583,390	-
Total non-performing assets	$ 13,235,565	$ 14,354,931	$ 10,267,664
Total loans including HFS	$ 422,688,600	$ 431,919,023	$ 415,204,347
Total assets	$ 596,598,598	$ 556,017,271	$ 565,999,434
Non-accrual loans to total loans	2.27%	2.85%	1.90%
Non-performing loans to total loans	2.30%	2.98%	2.14%
Non-performing assets to total assets	2.22%	2.58%	1.81%

The composition of gross loans and non-performing loans as of September 30, 2010 (dollars in thousands):

	Gross loan balances	Past due 90 days or more and still accruing	Non-accrual loans	Total non-performing loans	% of gross loans
Real estate:					
Commercial	$ 173,754	$ 3	$ 2,878	$ 2,881	1.66%
Residential (1-4 family)	66,573	95	3,993	4,088	6.14%
Construction	10,754	-	-	-	-
Commercial and industrial	84,287	20	2,150	2,170	2.57%

Consumer	87,015	2	561	563	0.65%
Direct financing leases	305	-	-	-	-
Total	$ 422,688	$ 120	$ 9,582	$ 9,702	2.30%

Bank premises and equipment, net

The Company entered into a new lease agreement with a new owner-landlord of its Eynon branch. Under the terms of the new operating lease, as defined in the accounting guidance, the terms contain an initial ten year period supplemented with four renewal options of five years each. The terms and minimum lease payments under the new lease agreement are not materially different than the terms and minimum rental payments of the original, terminated lease.

Foreclosed assets held-for-sale

Foreclosed assets held-for-sale, consisting of ORE, was $1,351,000 at September 30, 2010 comprised of five properties which are listed for sale with local realtors. The $464,000 rise in ORE from the December 31, 2009 balance of $887,000 occurred from the sale of one commercial property with a book balance of $550,000, an ORE fair value write-down of $39,000 and the transfer into ORE of three properties at an aggregate fair value of $1,053,000.

Other assets

Other assets at September 30, 2010 declined $211,000, or 1%, from December 31, 2010. A lower net deferred tax asset from the net appreciation in fair values in the securities portfolio partially offset increased credit-related OTTI charges in the Company's portfolio of pooled trust preferred securities. In addition, the period recognition and associated reduction of the pre-funded FDIC insurance premiums caused a $341,000 reduction in prepaid expenses. These decreases were partially offset by an increase in construction in process associated with leasehold improvements of the Peckville branch office and higher levels of other prepaid expenses.

Deposits

The Bank is a community-based commercial financial institution, member FDIC, which offers a variety of deposit products with varying ranges of interest rates and terms. Deposit products include savings, clubs, interest-bearing checking (NOW), money market, non-interest-bearing checking (DDAs) and certificates of deposit accounts. Certificates of deposit accounts, or CDs, are deposits with stated maturities which can range from seven days to ten years. The flow of deposits is significantly influenced by general economic conditions, changes in prevailing interest rates, pricing and competition. To determine deposit product interest rates, the Company considers local competition, spreads to earning-asset yields, liquidity position and rates charged for alternative sources of funding such as borrowings which include repurchase agreements. Though the Company tends to experience intense competition for deposits, the interest rate setting strategy also includes consideration of the Company's balance sheet structure and cost effective strategies that are mindful of the current economic climate.

Compared to December 31, 2009 total deposits grew $31,889,000, or 7%, during the nine months ended September 30, 2010. The growth in total deposits was due to increases in DDA, NOW and savings accounts of $10,929,000, or 15%, $19,130,000, or 31% and $16,336,000, or 19%, respectively, partially offset by lower CD and money market balances. Generally, deposits are obtained from consumers and businesses within the communities that surround the Company's 11 branch offices and all deposits are insured by the FDIC up to the full extent permitted by law. In an effort to grow and retain core deposits, the Company introduces innovative options to its variety of deposit products. The multi-tiered interest rate savings account developed in 2009 continued to grow, while NOW account balances have prospered from the seasonal influx of local municipal tax deposits and growth in the non-personal, business sector. The Company will continue to provide superb customer service and bring innovative ideas to the market in order to continue to grow and retain deposits.

The following table represents the components of deposits as of the date indicated:

	September 30, 2010		December 31, 2009	
	Amount	%	Amount	%
Money market	$ 77,594	15.8	$ 91,488	19.9
NOW	81,161	16.5	62,031	13.5
Savings and club	102,671	20.9	86,335	18.8
Certificates of deposit	135,828	27.7	139,502	30.5
CDARS	11,810	2.4	8,748	1.9
Total interest-bearing	409,064	83.3	388,104	84.6
Non-interest-bearing	81,819	16.7	70,890	15.4
Total deposits	$ 490,883	100.0	$ 458,994	100.0

The Company uses the Certificate of Deposit Account Registry Service (CDARS) reciprocal program to obtain FDIC insurance protection for customers who have large deposits that at times may exceed the FDIC maximum amount of $250,000. In the CDARS program, deposits with varying terms and interest rates, originated in the Company's own markets, are exchanged for deposits of other financial institutions that are members in the CDARS network. By placing these deposits in other participating institutions, the deposits of our customers are fully insured by the FDIC. In return for deposits placed with network institutions, the Company receives from network institutions deposits that are approximately equal in amount and contain similar terms as those placed for our customers. Deposits the Company receives, or reciprocal deposits, from other institutions are considered brokered deposits by regulatory definitions.

Excluding CDARS, certificates of deposit accounts of $100,000 or more amounted to $53,143,000 and $54,941,000 at September 30, 2010 and December 31, 2009, respectively. Certificates of deposit of $250,000 or more amounted to $20,300,000 and $20,641,000 as of September 30, 2010 and December 31, 2009.

Including CDARS, approximately 13% and 46% of the CDs are scheduled to mature in 2010 and 2011, respectively. Renewing CDs may re-price to lower or higher market rates depending on the direction of interest rate movements, the shape of the yield curve, competition, the rate profile of the maturing accounts and depositor preference for alternative products. In this current low interest rate environment, a widespread preference has been for customers with maturing CDs to hold their deposits in readily available transaction products such as savings accounts. When interest rates begin to rise, the Company expects CDs to grow to more normal levels.

In July 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act, which, in part, permanently raises the current standard maximum deposit insurance amount to $250,000. The standard maximum insurance amount of $100,000 had been temporarily raised to $250,000 until December 31, 2013. In addition, non-interest bearing transaction accounts will be fully insured, for a two year extension period beginning January 1, 2011. The FDIC insurance coverage and limits apply per depositor, per insured depository institution for each account ownership category. Low interest-bearing consumer checking accounts and Interest on Lawyer Trust Accounts (IOLTA) will be ineligible for the unlimited guarantee during the extension period.

Borrowings

Borrowings are used as a complement to deposit generation as an alternative funding source whereby the Bank will borrow under customer repurchase agreements in the local market, advances from the Federal Home Loan Bank of Pittsburgh (FHLB) and other correspondent banks for asset growth and liquidity needs.

Repurchase agreements are non-insured interest-bearing liabilities that have a perfected security interest in qualified investments of the Company. The FDIC Depositor Protection Act of 2009 requires banks to provide a perfected security interest to the purchasers of uninsured repurchase agreements. Repurchase agreements are offered through a sweep product. A sweep account is designed to ensure that on a daily basis, an attached DDA is adequately funded and excess funds are transferred, or swept, into an interest-bearing overnight repurchase agreement account. Due to the constant flow of funds in to and out of the sweep product, their balances tend to be somewhat volatile mimicking the likes of a DDA. Customer liquidity is the typical cause for variances in repurchase agreements, which for the first nine months of 2010 increased $4,021,000 from December 31, 2009.

The components of borrowings as of September 30, 2010 and December 31, 2009 are as follows (dollars in thousands):

	September 30, 2010		December 31, 2009	
	Amount	%	Amount	%
Overnight borrowings	$ -	-	$ 8,573	17.7

Repurchase agreements		11,767	21.8		7,747	16.0
Demand note, U.S. Treasury		537	1.0		213	0.4
FHLB advances:						
Short-term		9,500	17.7		-	-
Long-term		32,000	59.5		32,000	65.9
Total borrowings	$	53,804	100.0	$	48,533	100.0

Total borrowings have increased $5,271,000 or 11%, during the nine months ended September 30, 2010. While growth in deposits has reduced the Company's frequency for overnight funding needs, the increase in total borrowings is from growth in repurchase agreements and the use of a short-term FHLB advance. The advance is a low-cost means to accommodate a short-term, match funded commercial loan with a municipal customer. The advance matures in the fourth quarter of 2010.

Recent Developments

Dodd-Frank Wall Street Reform and Consumer Protection Act. On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). The Act will result in sweeping financial regulatory reform aimed at strengthening the nation's financial services sector.

The Act's provisions that have received the most public attention generally have been those applying to larger institutions or institutions that engage in practices in which we do not engage. These provisions include growth restrictions, credit exposure limits, higher prudential standards, prohibitions on proprietary trading, and prohibitions on sponsoring and investing in hedge funds and private equity funds.

However, the Act contains numerous other provisions that likely will directly impact the Company. These include increased fees payable by banks to regulatory agencies, new capital guidelines for banks and bank holding companies, permanently increasing the FDIC insurance coverage from $100,000 to $250,000 per depositor, new mortgage lending provisions, new liquidation procedures for banks, new regulations affecting consumer financial products, new corporate governance disclosures and requirements and the increased cost of supervision and compliance more generally. Many aspects of the law are subject to rulemaking by various government agencies and will take effect over several years. This time table, combined with the Act's significant deference to future rulemaking by various regulatory agencies, makes it difficult for us to anticipate the Act's overall financial, competitive and regulatory impact on us, our customers, and the financial industry more generally.

Item 3. Quantitative and Qualitative Disclosure About Market Risk

Management of interest rate risk and market risk analysis

The Company is subject to the interest rate risks inherent in its lending, investing and financing activities. Fluctuations of interest rates will impact interest income and interest expense along with affecting market values of all interest-earning assets and interest-bearing liabilities, except for those assets or liabilities with a short term remaining to maturity. Interest rate risk management is an integral part of the asset/liability management process. The Company has instituted certain procedures and policy guidelines to manage the interest rate risk position. Those internal policies enable the Company to react to changes in market rates to protect net interest income from significant fluctuations. The primary objective in managing interest rate risk is to minimize the adverse impact of changes in interest rates on net interest income along with creating an asset/liability structure that maximizes earnings.

Asset/Liability Management. One major objective of the Company when managing the rate sensitivity of its assets and liabilities is to stabilize net interest income. The management of and authority to assume interest rate risk is the responsibility of the Company's Asset/Liability Committee (ALCO), which is comprised of senior management and members of the board of directors. ALCO meets quarterly to monitor the relationship of interest-sensitive assets to interest- sensitive liabilities. The process to review interest rate risk is a regular part of managing the Company. Consistent policies and practices of measuring and reporting interest rate risk exposure, particularly regarding the treatment of non-contractual assets and liabilities, are in effect. In addition, there is an annual process to review the interest rate risk policy with the board of directors which includes limits on the impact to earnings from shifts in interest rates.

Interest Rate Risk Measurement. Interest rate risk is monitored through the use of three complementary measures: static gap analysis, earnings at risk simulation and economic value at risk simulation. While each of the interest rate risk measurements has limitations, taken together they represent a reasonably comprehensive view of the magnitude of interest rate risk in the Company and the distribution of risk along the yield curve, the level of risk through time and the amount of exposure to changes in certain interest rate relationships.

Static Gap. The ratio between assets and liabilities re-pricing in specific time intervals is referred to as an interest rate sensitivity gap. Interest rate sensitivity gaps can be managed to take advantage of the slope of the yield curve as well as forecasted changes in the level of interest rate changes.

To manage this interest rate sensitivity gap position, an asset/liability model commonly known as cumulative gap analysis is used to monitor the difference in the volume of the Company's interest-sensitive assets and liabilities that mature or re-price within given time intervals. A positive gap (asset sensitive) indicates that more assets will mature or re-price during a given period compared to liabilities, while a negative gap (liability sensitive) has the opposite effect. The Company employs computerized net interest income simulation modeling to assist in quantifying interest rate risk exposure. This process measures and quantifies the impact on net interest income through varying interest rate changes and balance sheet compositions. The use of this model assists the ALCO to gauge the effects of the interest rate changes on interest-sensitive assets and liabilities in order to determine what impact these rate changes will have upon the net interest spread. As of September 30, 2010, the Bank maintained a one-year cumulative gap of positive $50.4 million, or 8.44%, of total assets. The effect of this positive gap position provided a mismatch of assets and liabilities which may expose the Bank to interest rate risk during periods of falling interest rates. Conversely, in an increasing interest rate environment, net interest income could be positively impacted because more assets than liabilities would re-price upward during the one-year period.

Certain shortcomings are inherent in the method of analysis discussed above and presented in the next table. Although certain assets and liabilities may have similar maturities or periods of re-pricing, they may react in different degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable-rate mortgages, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayment and early withdrawal levels may deviate significantly from those assumed in calculating the table. The ability of many borrowers to service their adjustable-rate debt may decrease in the event of an interest rate increase.

The following table illustrates the Company's interest sensitivity gap position at September 30, 2010 (dollars in thousands):

	Three months or less	Three to twelve months	One to three years	Over three years	Total
Cash and cash equivalents	$ 89	$ -	$ -	$ 47,482	$ 47,571
Investment securities (1)(2)	19,695	11,834	22,219	33,508	87,256
Loans (2)	135,184	73,005	120,095	86,920	415,204
Fixed and other assets	-	9,348	-	37,220	46,568
Total assets	$ 154,968	$ 94,187	$ 142,314	$ 205,130	$ 596,599
Total cumulative assets	$ 154,968	$ 249,155	$ 391,469	$ 596,599	
Non-interest bearing transaction deposits (3)	$ -	$ 8,182	$ 22,500	$ 51,137	$ 81,819
Interest-bearing transaction deposits (3)	80,775	-	68,842	111,809	261,426
Time deposits	19,477	57,554	56,327	14,280	147,638
Repurchase agreements	11,767	-	-	-	11,767
Short-term borrowings	10,037	-	-	-	10,037
Long-term debt	11,000	-	-	21,000	32,000
Other liabilities	-	-	-	3,236	3,236
Total liabilities	$ 133,056	$ 65,736	$ 147,669	$ 201,462	$ 547,923
Total cumulative liabilities	$ 133,056	$ 198,792	$ 346,461	$ 547,923	
Interest sensitivity gap	$ 21,912	$ 28,451	$ (5,355)	$ 3,668	
Cumulative gap	$ 21,912	$ 50,363	$ 45,008	$ 48,676	
Cumulative gap to total assets	3.67%	8.44%	7.54%	8.16%	

(1) Includes FHLB stock and the net unrealized gains/losses on securities AFS.

(2) Investments and loans are included in the earlier of the period in which interest rates were next scheduled to adjust or the period in which they are due. In addition, loans are included in the periods in which they are scheduled to be repaid based on scheduled amortization. For amortizing loans and MBS – GSE residential, annual prepayment rates are assumed reflecting historical experience as well as management's knowledge and experience of its loan products.

(3)

The Bank's demand and savings accounts are generally subject to immediate withdrawal. However, management considers a certain amount of such accounts to be core accounts having significantly longer effective maturities based on the retention experiences of such deposits in changing interest rate environments. The effective maturities presented are the recommended maturity distribution limits for non-maturing deposits based on historical deposit studies.

Earnings at Risk and Economic Value at Risk Simulations. The Company recognizes that more sophisticated tools exist for measuring the interest rate risk in the balance sheet that extend beyond static re-pricing gap analysis. Although it will continue to measure its re-pricing gap position, the Company utilizes additional modeling for identifying and measuring the interest rate risk in the overall balance sheet. The ALCO is responsible for focusing on "earnings at risk" and "economic value at risk", and how both relate to the risk-based capital position when analyzing the interest rate risk.

Earnings at Risk. Earnings at risk simulation measures the change in net interest income and net income should interest rates rise and fall. The simulation recognizes that not all assets and liabilities re-price one-for-one with market rates (e.g., savings rate). The ALCO looks at "earnings at risk" to determine income changes from a base case scenario under an increase and decrease of 200 basis points in interest rate simulation models.

Economic Value at Risk. Earnings at risk simulation measures the short-term risk in the balance sheet. Economic value (or portfolio equity) at risk measures the long-term risk by finding the net present value of the future cash flows from the Company's existing assets and liabilities. The ALCO examines this ratio quarterly utilizing an increase and decrease of 200 basis points in interest rate simulation models. The ALCO recognizes that, in some instances, this ratio may contradict the "earnings at risk" ratio.

The following table illustrates the simulated impact of 200 basis points upward or downward movement in interest rates on net interest income, net income and the change in the economic value (portfolio equity). This analysis assumes that interest-earning asset and interest-bearing liability levels at September 30, 2010 remain constant. The impact of the rate movements was developed by simulating the effect of rates changing over a twelve-month period from the September 30, 2010 levels:

Earnings at risk:	Rates +200	Rates -200
Percent change in:		
Net interest income	2.4%	(0.6) %
Net income	8.2	(2.3)
Economic value at risk:		
Percent change in:		
Economic value of equity	(23.3)	2.9
Economic value of equity as a percent of book assets	(1.6)	0.2

Economic value has the most meaning when viewed within the context of risk-based capital. Therefore, the economic value may normally change beyond the Company's policy guideline for a short period of time as long as the risk-based capital ratio (after adjusting for the excess equity exposure) is greater than 10%. As of September 30, 2010, the Company's risk-based capital ratio was 12.2%.

The table below summarizes estimated changes in net interest income over a twelve-month period beginning October 1, 2010, under alternate interest rate scenarios using the income simulation model described above (dollars in thousands):

Change in interest rates	Net interest income	$ variance	% variance
+200 basis points	$ 21,381	$ 499	2.4%
+100 basis points	21,064	182	0.9
Flat rate	20,882	-	-
-100 basis points	20,864	(18)	(0.1)
-200 basis points	20,759	(123)	(0.6)

Simulation models require assumptions about certain categories of assets and liabilities. The models schedule existing assets and liabilities by their contractual maturity, estimated likely call date or earliest re-pricing opportunity. MBS – GSE residential securities and amortizing loans are scheduled based on their anticipated cash flow including estimated prepayments. For investment securities, the Bank uses a third-party service to provide cash flow estimates in the various rate environments. Savings, money market and NOW accounts do not have a stated maturity or re-pricing term and can be withdrawn or re-priced at any time. This may impact the margin if more expensive alternative sources of deposits are required to fund loans or deposit runoff. Management projects the re-pricing characteristics of these accounts based on historical performance and assumptions that it believes reflect their rate sensitivity. The model reinvests all maturities, repayments and prepayments for each type of asset or liability into the same product for

a new like term at current product interest rates. As a result, the mix of interest-earning assets and interest bearing-liabilities is held constant.

Liquidity

Liquidity management ensures that adequate funds will be available to meet customers' needs for borrowings, deposit withdrawals and maturities and normal operating expenses of the Company. Current sources of liquidity are cash and cash equivalents, asset maturities and pay-downs within one year, loans HFS and investments AFS, growth of core deposits, growth of repurchase agreements, increases of other borrowed funds from correspondent banks and issuance of capital stock. Although regularly scheduled investment and loan payments are a dependable source of daily funds, the sales of loans HFS and investments AFS, deposit activity and investment and loan prepayments are significantly influenced by general economic conditions and the interest rate environment. During low and declining interest rate environments, prepayments from interest-sensitive assets tend to accelerate and provide significant liquidity which can be used to invest in other interest-earning assets but at lower market rates. Conversely, during periods of high and rising interest rates, prepayments from interest-sensitive assets tend to decelerate causing cash flow from mortgage loans and the MBS–GSE residential securities portfolio to decrease. Rising interest rates may also cause deposit inflow to accelerate at higher market interest rates. The Company closely monitors activity in the capital markets and takes appropriate action to ensure that the liquidity levels are adequate for funding, investing and operating activities.

In 2010, the Company implemented a contingency funding plan (CFP) that sets a framework for handling liquidity issues in the event circumstances arise which the Company deems to be less than normal. To accomplish this, the Company established guidelines for identifying, measuring, monitoring and managing the resolution of potentially serious liquidity crises. The Company's CFP outlines required monitoring tools, acceptable alternative funding sources and required actions during various liquidity scenarios. Thus, the Company has implemented a proactive means for the measurement and resolution for dealing with potentially significant adverse liquidity issues. At least quarterly, the CFP monitoring tools, current liquidity position and monthly projected liquidity sources and uses are presented and reviewed by the Company's ALCO. As of September 30, 2010, the Company has not experienced any adverse liquidity issues that would give rise to its inability to raise liquidity in an emergency situation.

For the nine months ended September 30, 2010, the Company generated approximately $39.2 million of cash. During 2010, the Company's financing activities provided $36.4 million, primarily from $37.2 million in growth of deposits and repurchase agreements. During the same period, the Company's operations provided approximately $9.8 million principally from the sales of mortgages HFS, net of originations, and from increased pre-tax, pre-credit loss earnings. A portion of the cash generated from operations and financing activities was used to purchase investment securities and to fund capital investments.

As of September 30, 2010, the Company maintained $47.6 million in cash and cash equivalents and $87.7 million of investments AFS and loans HFS and also had approximately $125.8 million available to borrow from the FHLB, $21.0 million available from other correspondent banks, $22.9 million from the Discount Window of the Federal Reserve Bank and $28.9 million with CDARS. This combined total of $333.9 million represented 56% of total assets at September 30, 2010. Management believes this level of liquidity to be strong and adequate to support current operations.

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business in order to meet the financing needs of its customers and in connection with the overall interest rate management strategy. These instruments involve, to a varying degree, elements of credit, interest rate and liquidity risk. In accordance with GAAP, these instruments are not recorded in the consolidated financial statements. Such instruments primarily include lending commitments and lease obligations.

Lending commitments include commitments to originate loans and commitments to fund unused lines of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established by contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

In addition to lending commitments, the Company has contractual obligations related to operating lease commitments, certificates of deposit, FHLB advances and repurchase agreements. Operating lease commitments are obligations under various non-cancelable operating leases on buildings and land used for office space and other bank purposes. The Company's position with respect to lending commitments and significant contractual obligations, both on a short- and long-term basis has increased to $232.8 million in total at September 30, 2010 compared to $219.9 million as of December 31, 2010. The $12.9 million increase was caused by a short-term $9.5 million FHLB advance to match-fund a commercial loan, the proceeds of which are scheduled to be re-paid by 2010 year-end. The balance of the increase is from normal business activity, mostly from growth in repurchase agreements. The Company does not consider this increase to have a material effect on the Company's ability to fund its obligations.

During April 2010, the FHLB informed the Company of a 50% collateral maintenance requirement on outstanding obligations and restrictions on utilization above 35% of the amount available to borrow. During October 2010, the FHLB informed the Company that it has reduced the restrictions on utilization to above 50% of the amount available to borrow. The Company is formulating strategies to continue to improve its position and have the requirements

eventually lifted. The requirements only impose more stringent collateral delivery requirements and utilization subject to prior credit committee decision-making and does not minimize or reduce the amount the Company may borrow. Management does not consider this action to significantly effect the liquidity position of the Company.

Capital

During the nine months ended September 30, 2010, total shareholders' equity increased $3,001,000, or 7%. The improvement was caused by: net income of $1,630,000; a $2,157,000 (net of $1,272,000 in non-credit-related OTTI) after tax improvement in the market value of the AFS securities portfolio; $67,000 in proceeds from employees enrolled in the Company’s Employee Stock Purchase Plan; partially offset by $861,000 of dividends paid to shareholders, net of dividends reinvested and optional cash payments received from participants in the Company’s Dividend Reinvestment Plan.

As of September 30, 2010, the Company reported a net unrealized loss of $7,037,000, net of tax, from the securities AFS compared to a net unrealized loss of $9,194,000 as of December 31, 2009. While the unrealized loss position has improved, the prolonged economic downturn continues to assert uncertainty and in certain circumstances illiquidity in the financial and capital markets and has had a sizable negative impact on the fair value estimates on the securities in banks' investment portfolios. Management maintains these changes are due mainly to liquidity problems in the financial markets and to a lesser extent the deterioration in the creditworthiness of the issuers.

The Company (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Under these guidelines, assets and certain off-balance sheet items are assigned to broad risk categories, each with appropriate weights. The resulting capital ratios represent capital as a percentage of total risk-weighted assets and certain off-balance sheet items. The appropriate risk-weighting, pursuant to regulatory guidelines, requires an increase in the risk-weighting of securities that are rated below investment grade, thereby significantly inflating the total risk-weighted assets. The regulatory guidelines require all banks and bank holding companies to maintain a minimum ratio of total risk-based capital to total risk-weighted assets (Total Risk Adjusted Capital) of 8%, including Tier I capital to total risk-weighted assets (Tier I Capital) of 4% and Tier I capital to average total assets (Leverage Ratio) of at least 4%. As of September 30, 2010, the Company and the Bank met all capital adequacy requirements to which it was subject.

The Company continues to closely monitor and evaluate alternatives to enhance its capital ratios as the regulatory and economic environments change. The following table depicts the capital amounts and ratios of the Company and the Bank as of September 30, 2010:

	Actual		For capital adequacy purposes		To be well capitalized under prompt corrective action provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)						
Consolidated	$ 62,052,881	12.2 %	≥$ 40,696,324	≥ 8.0%	N/A	N/A
Bank	$ 61,681,557	12.1 %	≥$ 40,686,528	≥ 8.0 %	≥$50,858,160	≥ 10.0%
Tier I capital (to risk-weighted assets)						
Consolidated	$ 55,626,693	10.9 %	≥$20,348,162	≥ 4.0%	N/A	N/A
Bank	$ 55,309,537	10.9 %	≥$20,343,264	≥ 4.0 %	≥$30,514,896	≥ 6.0%
Tier I capital (to average assets)						
Consolidated	$ 55,626,693	9.5 %	≥$23,432,653	≥ 4.0%	N/A	N/A
Bank	$ 55,309,537	9.5 %	≥$23,415,435	≥ 4.0 %	≥$29,269,294	≥ 5.0%

Item 4T. Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Company's management, with the participation of its Interim President and Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934. Based on such evaluation, the Interim President and Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports the Company files or furnishes under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations, and are operating in an effective manner. The Company made no significant changes in its internal controls over financial reporting or in other factors that materially affected, or are reasonably likely to materially affect, these controls during the last fiscal quarter ended September 30, 2010.

In July 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, which in part, provides smaller companies and debt-only issuers with a permanent exemption from the Sarbanes-Oxley internal control audit requirements. Without this exemption, these companies would have been required to comply with the internal control audit requirements for fiscal years ended on or after June 15, 2010. The permanent exemption applies to entities that are commonly referred to as non-accelerated filers and smaller reporting companies, such as the Company. Generally speaking, a non-accelerated filer and a smaller reporting company have public float, or market capitalization of less than $75.0 million. The permanent exemption applies only to the Sarbanes-Oxley internal control audit requirements. Non-accelerated filers and smaller reporting companies are still required to disclose management's assessment of the effectiveness of internal control over financial reporting.

PART II - Other Information

Item 1. Legal Proceedings

The nature of the Company's business generates some litigation involving matters arising in the ordinary course of business. However, in the opinion of the Company after consultation with legal counsel, no legal proceedings are pending, which, if determined adversely to the Company or the Bank, would have a material effect on the Company's undivided profits or financial condition. No legal proceedings are pending other than ordinary routine litigation incidental to the business of the Company and the Bank. In addition, to management's knowledge, no governmental authorities have initiated or contemplated any material legal actions against the Company or the Bank.

Item 1A. Risk Factors

The following is an additional risk factor that should be read in conjunction with Item 1A, "Risk Factors" that were disclosed in the Company's December 31, 2009 Form 10-K filed with the Securities and Exchange Commission on March 8, 2010:

The Company has an Interim Chief Executive Officer while it searches for a permanent Chief Executive Officer.

During the third quarter of 2009, our President and Chief Executive Officer (CEO) resigned. As a result, the board of directors formed a CEO search committee and is currently conducting a search. The process has taken longer than we initially expected. While we expect to recruit a new CEO by year-end, we cannot assure you that the process will be concluded by then. Further, until we find a permanent CEO, we may be unable to successfully manage and grow the business; and, our business, financial condition and profitability may suffer. We believe each member of our senior management team is important to our success and the unexpected loss of any of theses persons could impair our day-to-day operations as well as our strategic direction.

Management of the Company does not believe there have been any other material changes in risk factors that were disclosed in the 2009 Form 10-K filed with the Securities and Exchange Commission on March 8, 2010.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Default Upon Senior Securities

None

Item 4. (Removed and Reserved)

None

Item 5. Other Information

None

Item 6. Exhibits

The following exhibits are filed herewith or incorporated by reference as a part of this Form 10-Q:

3(i) Amended and Restated Articles of Incorporation of Registrant. Incorporated by reference to Annex B of the Proxy Statement/Prospectus included in Registrant's Amendment 4 to its Registration Statement No. 333-90273 on Form S-4, filed with the SEC on April 6, 2000.

3(ii) Amended and Restated Bylaws of Registrant. Incorporated by reference to Exhibit 3(ii) to Registrant's Form 8-K filed with the SEC on November 21, 2007.

*10.1 1998 Independent Directors Stock Option Plan of The Fidelity Deposit and Discount Bank, as assumed by Registrant. Incorporated by reference to Exhibit 10.1 to Registrant's Registration Statement No. 333-90273 on Form S-4, filed with the SEC on November 3, 1999.

*10.2 1998 Stock Incentive Plan of The Fidelity Deposit and Discount Bank, as assumed by Registrant. Incorporated by reference to Exhibit 10.2 of Registrant's Registration Statement No. 333-90273 on Form S-4, filed with the SEC on November 3, 1999.

*10.3 Registrant's 2000 Dividend Reinvestment Plan. Incorporated by reference to Exhibit 4 to Registrant's Registration Statement No. 333-45668 on Form S-1, filed with the SEC on September 12, 2000 and as amended by Pre-Effective Amendment No. 1 on October 11, 2000, by Post-Effective Amendment No. 1 on May 30, 2001, by Post-Effective Amendment No. 2 on July 7, 2005, by Registration Statement No. 333-152806 on Form S-3 filed on August 6, 2008 and by Post-Effective Amendment No. 1 on January 25, 2010.

*10.4 Registrant's 2000 Independent Directors Stock Option Plan. Incorporated by reference to Exhibit 4.3 to Registrant's Registration Statement No. 333-64356 on Form S-8 filed with the SEC on July 2, 2001.

*10.5 Amendment, dated October 2, 2007, to the Registrant's 2000 Independent Directors Stock Option Plan. Incorporated by reference to Exhibit 10.2 to Registrant's Form 8-K filed with the SEC on October 4, 2007.

*10.6 Registrant's 2000 Stock Incentive Plan. Incorporated by reference to Exhibit 4.4 to Registrant's Registration Statement No. 333-64356 on Form S-8 filed with the SEC on July 2, 2001.

*10.7 Amendment, dated October 2, 2007, to the Registrant's 2000 Stock Incentive Plan. Incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed with the SEC on October 4, 2007.

*10.8 Registrant's 2002 Employee Stock Purchase Plan. Incorporated by reference to Exhibit 4.4 to Registrant's Registration Statement No. 333-113339 on Form S-8 filed with the SEC on March 5, 2004.

*10.9 Change of Control Agreements with Salvatore R. DeFrancesco, Registrant and The Fidelity Deposit and Discount Bank, dated March 21, 2006. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on March 27, 2006.

*10.10 Amended and Restated Executive Employment Agreement between Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank and Steven C. Ackmann, dated July 11, 2007. Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed with the SEC on July 13, 2007.

*10.11 Executive Employment Agreement between Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank and Timothy P. O'Brien, dated January 3, 2008. Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed with the SEC on January 10, 2008.

*10.12 Executive Employment Agreement between Fidelity D & D Bancorp, Inc., The Fidelity Deposit and Discount Bank and Daniel J. Santaniello, dated February 28, 2008. Incorporated by reference to Exhibit 10.1 to Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.

*10.13 Release Agreement between Steven C. Ackmann, Registrant and The Fidelity Deposit and Discount Bank, dated August 31, 2009. Incorporated by reference to Exhibit 99.1 to Registrant's Current Report on Form 8-K filed with the SEC on September 8, 2009.

*10.14 Consulting Agreement between Steven C. Ackmann, former President and Chief Executive Officer of the Registrant and The Fidelity Deposit and Discount Bank, and The Fidelity Deposit and Discount Bank, dated September 1, 2009. Incorporated by reference to Exhibit 99.2 to Registrant's Current Report on Form 8-K filed with the SEC on September 8, 2009.

11 Statement regarding computation of earnings per share. Included herein in Note No. 4, "Earnings (loss) per share," contained within the Notes to Consolidated Financial Statements, and incorporated herein by reference.

31.1 Rule 13a-14(a) Certification of Principal Executive Officer, filed herewith.

31.2 Rule 13a-14(a) Certification of Principal Financial Officer, filed herewith.

32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, filed herewith.

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* Management contract or compensatory plan or arrangement.

Signatures

FIDELITY D & D BANCORP, INC.

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.

	FIDELITY D & D BANCORP, INC.
Date: November 9, 2010	/s/ Patrick J. Dempsey Patrick J. Dempsey, Interim President and Chief Executive Officer
Date: November 9, 2010	/s/ Salvatore R. DeFrancesco, Jr. Salvatore R. DeFrancesco, Jr., Treasurer and Chief Financial Officer

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