DONEGAL GROUP INC
Form 424B5
August 05, 2010

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Filed Pursuant to Rule 424(b)(5)
Registration No. 333-167774

MERGER PROPOSAL YOUR VOTE IS VERY IMPORTANT

To the Shareholders of Union National Financial Corporation:

On April 19, 2010, our board of directors unanimously approved an agreement that provides for our merger with Donegal Financial Services Corporation, or DFSC. The merger agreement, as amended on May 20, 2010, also provides for the merger of Union National Community Bank, or UNCB, which we currently own, with and into Province Bank FSB, or Province, which DFSC currently owns. DFSC is a savings and loan holding company that Donegal Mutual Insurance Company, or DMIC, and Donegal Group Inc., or DGI, jointly own.

We are sending this proxy statement/prospectus to you to ask you to vote on the adoption of our merger agreement with DFSC, DMIC, DGI and Donegal Acquisition, Inc., or DAI, and the transactions the merger agreement contemplates.

If our shareholders adopt the merger agreement, and we subsequently complete the merger, each outstanding share of our common stock, other than the 248,999 shares DMIC owns and shares as to which the holders perfect dissenters rights, will be converted into the right to receive $5.05 in cash and 0.2134 share of Class A common stock of DGI. The merger consideration of $5.05 in cash and 0.2134 share of Class A common stock of DGI is fixed, and will not change if our stock price or the price of DGI Class A common stock changes. On April 19, 2010, the last trading day before we announced the merger, the closing price of our common stock on the OTC Bulletin Board, or OTCBB, was $6.00. Based on the closing price of DGI Class A common stock on the NASDAQ Global Select Market, or NASDAQ, on April 19, 2010, 0.2134 share of DGI Class A common stock and $5.05 in cash represented approximately $8.18 in value for each share of our common stock.

Based on the closing price of DGI Class A common stock on July 29 2010, the last practicable trading day before the printing of this proxy statement/prospectus, 0.2134 share of DGI Class A common stock and $5.05 in cash represented approximately $7.56 in value for each share of our common stock.

You should obtain current stock price quotations for DGI Class A common stock which trades on NASDAQ under the symbol DGICA and our common stock which trades on the OTCBB under the symbol UNNF.OB.

OUR BOARD OF DIRECTORS HAS UNANIMOUSLY DETERMINED THAT THE MERGER AND THE MERGER AGREEMENT ARE ADVISABLE AND IN THE BEST INTERESTS OF UNNF AND ITS SHAREHOLDERS AND UNANIMOUSLY RECOMMENDS THAT YOU VOTE *FOR* ADOPTION OF THE MERGER AGREEMENT. We cannot complete the merger unless the holders of 80% of our issued and outstanding shares of common stock vote to adopt the merger agreement. Whether or not you plan to attend our special meeting of shareholders, please vote by completing the enclosed proxy card and returning it to us in the enclosed envelope. **If you sign, date and return your proxy card without indicating how you want to vote, we will count your proxy as a vote *FOR* adoption of the merger agreement. If you fail to vote, or you do not instruct your broker how to vote any shares you hold in street name, it will have the same effect as voting against adoption of the merger agreement. You may also vote by telephone or Internet by following the instructions accompanying the enclosed proxy card.**

The accompanying proxy statement/prospectus describes our special meeting, the merger agreement, the transactions the merger agreement contemplates, the documents related to the merger and related matters. **We recommend that you carefully read this proxy statement/prospectus, including the considerations discussed under Risk Factors beginning on page 67 and the appendices to this proxy statement/prospectus, which include the merger agreement.**

On behalf of our board of directors, I thank you for your prompt attention to this important matter.

Sincerely,

Mark D. Gainer
Chairman, President and Chief Executive Officer

August 5, 2010

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the DGI Class A common stock to be distributed under this proxy statement/prospectus or determined if this proxy statement/prospectus is accurate or adequate. Any representation to the contrary is a criminal offense.

Shares of DGI Class A common stock are not savings or deposit accounts or other obligations of any bank or savings association and they are not insured by the Federal Deposit Insurance Corporation or any other governmental agency.

The date of this proxy statement/prospectus is July 29, 2010, and we are first mailing or otherwise delivering it to our shareholders on or about August 5, 2010.

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570 Lausch Lane, Suite 300
Lancaster, Pennsylvania 17601

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS
TO BE HELD SEPTEMBER 16, 2010

WE HEREBY GIVE NOTICE that we will hold a special meeting of our shareholders at 10:00 a.m., prevailing time, on Thursday, September 16, 2010 at Enck s Banquet and Conference Center, 1461 Lancaster Road, Manheim, PA 17545, for the following purposes, all of which we describe in greater detail in the subsequent pages of this proxy statement/prospectus:

(1) to consider and vote upon a proposal to adopt the Agreement and Plan of Merger, dated as of April 19, 2010, and as amended as of May 20, 2010, among Donegal Acquisition Inc., Donegal Financial Services Corporation, Donegal Group Inc., and Donegal Mutual Insurance Company and us, and the consummation of the transactions the merger agreement contemplates as discussed in this proxy statement/prospectus.

(2) to consider and vote upon a proposal to approve the adjournment of our special meeting, if necessary, to permit the further solicitation of proxies if sufficient votes have not been cast at the time of our special meeting to adopt the merger agreement; and

(3) to transact any other business properly presented for action at our special meeting and any adjournment or postponement of our special meeting.

You should read this proxy statement/prospectus in its entirety before you vote. We have included a copy of the merger agreement as Appendix A to this proxy statement/prospectus. Only the holders of our outstanding common stock as of the close of business on July 29, 2010 are entitled to vote at our special meeting and any adjournment or postponement of our special meeting.

This notice also constitutes notice of your right to dissent from the merger and, upon compliance with the requirements of Subchapter D of Chapter 15 of the Pennsylvania Business Corporation Law of 1988, or PBCL, to receive the appraised fair value of your shares. We have included a copy of the relevant sections of the PBCL regarding dissenters rights as Appendix C to this proxy statement/prospectus.

Our board of directors has unanimously approved the merger agreement and recommends that you vote *FOR* adoption of the merger agreement and *FOR* the adjournment of our special meeting.

Whether or not you expect to attend our special meeting in person, we urge you to vote. Please sign, date and promptly return the enclosed proxy. We enclose a self-addressed envelope for your convenience; no postage is required if mailed in the United States. If you submit a signed and dated proxy card but do not indicate how you want to vote your shares, the persons named as proxies in the enclosed proxy will vote your shares ***FOR*** the adoption of the merger agreement and ***FOR*** the adjournment of our special meeting. Returning your proxy will not prevent you from attending our special meeting and voting in person if you wish to vote in person. You may also vote by telephone or Internet by following the instructions accompanying the proxy card. You may revoke your proxy and vote in person at any time before we vote your proxy.

Please do not send any stock certificates at this time. Thank you for your cooperation.

By order of our board of directors,

Mark D. Gainer
Chairman, President and Chief Executive Officer

Lancaster, Pennsylvania
August 5, 2010

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WHERE YOU CAN FIND MORE INFORMATION

In this proxy statement/prospectus, you refers to the shareholders of UNNF, we, us, our or UNNF refers to Unio National Financial Corporation, UNCB refers to Union National Community Bank, DAI refers to Donegal Acquisition Inc., DMIC refers to Donegal Mutual Insurance Company, DGI refers to Donegal Group Inc., DFSC refers to Donegal Financial Services Corporation, Province refers to Province Bank FSB and the Donegal parties refers to one or more of DAI, DMIC, DGI, DFSC and Province as the context requires. Also, we refer to the mergers between DAI and UNNF and between UNNF and DFSC as the merger, and the agreement and plan of merger dated as of April 19, 2010, and as amended as of May 20, 2010, among the Donegal parties and UNNF as the merger agreement.

Both UNNF and DGI file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission, or SEC, under the Securities Exchange Act of 1934 as amended, or the 1934 Act. You may obtain copies of these documents by mail from the public reference room of the SEC at 100 F Street, N.E., Room 1580, Washington, D.C. 20549, at prescribed rates. You may also call the SEC at (800) SEC-0330 for further information on the public reference room. In addition, UNNF s and DGI s SEC filings are also available to the public from commercial document retrieval services and at the website the SEC maintains at www.sec.gov.

This proxy statement/prospectus incorporates by reference important business and financial information and risk factors about DGI from documents that DGI has previously filed with the SEC. We are not required to include, and have not included, these documents as part of this proxy statement/prospectus. See Incorporation of Certain Documents by Reference on page 127. You may obtain these documents from DGI at DGI s address and telephone number listed below without charge upon written or oral request:

Donegal Group Inc.
1195 River Road
Marietta, Pennsylvania 17547
Attention: Jeffrey D. Miller
Telephone: (888) 877-0600

In order to ensure timely delivery of the documents, you must request the information no later than September 9, 2010.

DGI has filed a registration statement on Form S-4 to register with the SEC under the Securities Act of 1933, as amended, or the 1933 Act, relating to 600,000 shares of DGI Class A common stock. DFSC will distribute the 600,000 shares of DGI Class A common stock as merger consideration to our shareholders pursuant to the merger agreement. This proxy statement/prospectus is a part of that registration statement. As SEC rules permit, this proxy statement/prospectus does not contain all of the information included in the registration statement or in the exhibits or schedules to the registration statement. You may read and copy the registration statement, including any amendments, schedules or exhibits, at the addresses listed above. Statements contained in this proxy statement/prospectus are not necessarily complete. In each case, you should refer to the copy of the applicable document or contract filed as an exhibit to the registration statement.

DGI Class A common stock trades on the NASDAQ Global Select Market, or NASDAQ, under the symbol DGICA, and UNNF common stock trades on the OTC Bulletin Board, or OTCBB, under the symbol UNNF.OB.

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QUESTIONS AND ANSWERS ABOUT THE MERGER AND OUR SPECIAL MEETING

Q. *What items of business will we ask our shareholders to consider at our special meeting?*

A. At our special meeting, we will ask our shareholders to vote in favor of the adoption of the merger agreement. We sometimes refer to this proposal as the merger proposal in this proxy statement/prospectus. We will also ask our shareholders to vote in favor of any necessary adjournment of our special meeting to solicit additional proxies in favor of the adoption of the merger agreement if we have not received sufficient votes to adopt the merger agreement at the time of our special meeting. We sometimes refer to this proposal as the adjournment proposal in this proxy statement/prospectus.

Q. *What should I do now?*

A. You should first carefully read this proxy statement/prospectus, including the appendices and the documents DGI has incorporated by reference in this proxy statement/prospectus. After you have decided how you wish to vote your shares, please return your proxy using one of the methods we describe below so that your shares will be represented and voted at our special meeting.

Q. *What will I receive in exchange for my UNNF shares if the merger takes place?*

A. Upon consummation of the merger, you will have the right to receive in exchange for each share of our common stock:

0.2134 share of DGI Class A common stock; and

$5.05 in cash.

Q. *What does our board of directors recommend?*

A. Our board of directors has unanimously determined that the merger is fair to you and in your and our best interests and unanimously recommends that you vote ***FOR*** the merger proposal and the adjournment proposal.

In making this determination, our board of directors considered the opinion of Sandler O Neill & Partners, L.P., or Sandler O Neill, our independent financial advisor, as to the fairness to us and you from a financial point of view of the cash and DGICA shares you will receive pursuant to the merger agreement. Our board of directors also reviewed and evaluated the terms and conditions of the merger agreement and the merger with the assistance of our independent legal counsel.

Q. *What was the opinion of our financial advisor?*

A. Sandler O Neill presented an opinion to our board of directors to the effect that, as of April 19, 2010, and based upon the assumptions Sandler O Neill made, the matters it considered and the limitations on its review as set forth in its opinion, the merger consideration provided for in the merger agreement is fair to us and you from a financial point of view.

Q. *Why is my vote important?*

A. Pennsylvania law and our articles of incorporation require the affirmative vote of the holders of 80% of our outstanding shares of common stock to approve the merger proposal. Therefore, abstentions, broker non-votes and failures to vote will have the same effect as a vote against adoption of the merger agreement

Q. *How do I vote my shares?*

A. If you are a registered shareholder of UNNF (that is, if your stock is registered in your name), you may attend our special meeting and vote in person or you may vote by proxy. To vote by proxy, please mark, sign and date your proxy card and return it in the postage-paid envelope we have enclosed. To vote by telephone or the Internet, please follow the instructions accompanying the proxy card.

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Q. *What if I do not specify how I want to vote my shares on my proxy card?*

A. If you submit a signed and dated proxy card but do not indicate how you want to vote your shares, we will vote your shares:

FOR the adoption of the merger agreement; and

FOR approval of any necessary adjournment of our special meeting.

Our board of directors does not currently intend to bring any other proposal before our special meeting. If other proposals requiring a vote of shareholders properly come before our special meeting in compliance with our by-laws, the persons named as proxies will vote your shares in accordance with their judgment.

Q. *What if I fail to instruct my broker?*

A. Your broker may not vote your shares without instructions from you. You should follow the instructions you will receive from your broker and instruct your broker how you want to vote your shares.

Q. *Can I attend the special meeting and vote my shares in person?*

A. Yes. We invite all shareholders to attend our special meeting. Holders of record can vote in person at our special meeting by executing a ballot we will make available at our special meeting. If a broker holds your shares in street name, you are not a holder of record and you must obtain a written proxy in your name from your broker in order to vote those shares at our special meeting.

Q. *May I change my vote after I have voted?*

A. Yes. If you have not voted through your broker, you may change your vote after you have returned your proxy by:

submitting written notice of revocation to our corporate secretary;

submitting a new proxy by mail, telephone or Internet; or

voting in person at our special meeting.

However, simply attending our special meeting without voting will not revoke any proxy you previously submitted.

If you have instructed your broker or other nominee to vote your shares, you should follow the instructions of your broker or other nominee regarding the revocation of proxies.

Q. *When do you expect to complete the merger?*

A. We anticipate that DFSC will obtain all necessary regulatory approvals to consummate the merger in the fourth quarter of 2010, assuming we and DFSC satisfy all of the other conditions to the completion of the merger. However, we cannot assure you when or if the merger will occur. We must first obtain the approval of the holders of 80% of our outstanding common stock at our special meeting and we and DFSC must obtain the requisite regulatory approvals to complete the merger.

Q. *Should I send my stock certificates now?*

A. No. Holders of our common stock should not submit their stock for exchange until they receive transmittal instructions from the exchange agent.

Q. *What rights do I have to dissent from the merger?*

A. If you do not vote in favor of the merger proposal and you comply precisely with the applicable procedural requirements, the Pennsylvania Business Corporation Law of 1988, or the PBCL, entitles you to request the appraised fair value of your shares. You must carefully and precisely follow the applicable procedures under the PBCL in order to exercise your dissenters rights. We have included a complete copy of the relevant sections of the PBCL as Appendix C to this proxy statement/prospectus. The fair value of your shares

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as determined in a dissenters rights proceeding may be more or less than the merger consideration you have the right to receive from DFSC under the merger agreement.

Q. *What will happen to the UNNF shares that DMIC owns?*

A. DMIC currently owns 248,999 shares, or approximately 8.4%, of our outstanding common stock. DMIC has advised us that DMIC will vote those shares in favor of the merger proposal and the adjournment proposal. The merger agreement provides that DMIC will contribute these shares to the capital of DFSC and that DFSC will surrender the shares for cancellation at the effective time of the merger.

Q. *Who can answer my questions?*

A. If you have questions about the merger, please call Mark D. Gainer, our Chairman, President and Chief Executive Officer, at (717) 519-8630 or Georgeson, Inc., the proxy solicitation firm we have retained, at (866) 821-2614.

SUMMARY

This summary highlights selected information included in this proxy statement/prospectus but the summary does not contain all of the information that may be important to you. We encourage you to read carefully this entire proxy statement/prospectus and its appendices and the other documents to which we refer before you decide how to vote on the merger proposal. In addition, we incorporate by reference into this proxy statement/prospectus important business and financial information about DGI. For a description of this information, see Incorporation of Certain Documents by Reference on page 127. You may obtain the information incorporated by reference in this proxy statement/prospectus by following the instructions in Where You Can Find More Information on page v. In this summary, we have included page references to direct you to a more detailed description of the matters described in this summary.

This proxy statement/prospectus and the documents DGI incorporates by reference in this proxy statement/prospectus contain forward-looking information within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to:

- statements of goals, intentions and expectations;
- statements regarding business plans, prospects, growth and operating strategies; and
- statements regarding estimates of risks and future costs and benefits.

You can identify forward-looking statements by their use of words such as expects, anticipates, intends, plans, believes, seeks, estimates or words of similar meaning. DGI has based its forward-looking statements on the current beliefs and expectations of DGI s management. Such statements are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the ability of DGI to control. In addition, these forward-looking statements make certain assumptions with respect to future business strategies and decisions that may change. Actual results may differ materially from the anticipated results DGI discusses in these forward-looking statements. See Cautionary Statement Regarding Forward-Looking Statements on page 71.

We have included the entire text of the merger agreement as Appendix A to this proxy statement/prospectus.

UNNF provided the information contained in this proxy statement/prospectus with respect to UNNF, and DGI provided the information in this proxy statement/prospectus with respect to the Donegal parties.

The Parties

The Donegal Parties (DMIC, DGI, DFSC, DAI and Province) (Page 75)

DMIC

DMIC commenced business as a mutual fire insurance company in Pennsylvania in 1889. Since 1986, when DMIC formed DGI and DGI formed an insurance company subsidiary, Atlantic States Insurance Company, or ASIC, DMIC and the insurance company subsidiaries of DGI have conducted business together as the Donegal Insurance Group. The Donegal Insurance Group writes personal and commercial lines of property and casualty insurance in 18 Mid-Atlantic, Southern and Midwestern states. During 2010, A.M. Best Company, a leading insurance rating firm, reported that the Donegal Insurance Group ranked 116th among property and casualty insurance companies in the United States based on net premiums written during 2009, and A.M. Best Company assigned the Donegal Insurance

Group an A.M. Best rating of A (Excellent). The Donegal Insurance Group has also received the Wards Top 50 award for each of the past five years.

In the mid-1980 s, DMIC recognized that, as a small mutual insurance company, it needed to develop additional sources of capital and surplus to remain competitive, have the capacity to expand its business and assure its long-term viability. As a strategic response, in 1986, DMIC formed DGI as a downstream insurance holding company, and DGI organized ASIC as its subsidiary. DMIC and ASIC then entered into a proportional reinsurance agreement, or pooling agreement. Under this pooling agreement, DMIC and ASIC pool

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substantially all of their respective premiums, loss and loss expenses. DMIC currently cedes 80% of the pooled business to ASIC because of its access to public sources of capital as a subsidiary of DGI.

The following summary financial information of DMIC is presented on the statutory basis of accounting required by the National Association of Insurance Commissioners and does not represent financial information prepared in accordance with generally accepted accounting principles. At March 31, 2010, DMIC had admitted assets of $325.2 million and policyholders surplus of $170.0 million. At March 31, 2010, DMIC had total liabilities of $155.2 million, including debt of $13.0 million, reserves for net losses and loss expenses of $46.8 million and unearned premiums of $29.3 million. DMIC s investment portfolio of $255.4 million at March 31, 2010 consisted primarily of investment-grade bonds of $18.0 million and its investment in DGI common stock. At March 31, 2010, DMIC owned 8,355,184 shares, or approximately 42%, of DGI s Class A common stock outstanding at that date, which DMIC carried on its books at March 31, 2010 at $111.2 million, and 4,180,234 shares, or approximately 75%, of DGI s Class B common stock outstanding at that date, which DMIC carried on its books at March 31, 2010 at $55.6 million.

DGI

DGI is a Delaware business corporation that DMIC formed in 1986 for the reasons described above. DGI currently has six insurance subsidiaries that offer personal and commercial lines of property and casualty coverages exclusively through a network of approximately 2,000 independent insurance agents. The personal lines products consist primarily of homeowners and private passenger automobile policies. The commercial lines products consist primarily of commercial automobile, commercial multi-peril and workers compensation policies. At March 31, 2010, DGI had assets of $936.0 million and shareholders equity of $385.4 million.

DFSC

DFSC is a Delaware business corporation formed in 2000 to own Province. DMIC owns 51.8% of DFSC and DGI owns 48.2% of DFSC. The Office of Thrift Supervision, or the OTS, is the primary federal regulator of Province and also regulates DMIC, DGI and DFSC as members of a unitary savings and loan holding company. DFSC does not currently conduct any business other than its ownership of the stock of Province.

DAI

DAI is a Delaware business corporation DFSC formed in April 2010 solely for the purpose of facilitating UNNF s merger with DFSC. DAI will conduct no business activities before or after the merger.

Province

Province is a federally chartered savings bank that DMIC and DGI formed in 2000. Province has three branch locations in western Lancaster County and focuses on providing community banking services, including residential and commercial real estate loans, small business loans and consumer loans. At March 31, 2010, Province had assets of $102.5 million, $84.5 million in deposits and shareholders equity of $17.5 million.

The location of the principal executive offices of the Donegal parties is 1195 River Road, Marietta, Pennsylvania, 17547. DGI s telephone number is (888) 877-0600 and DGI s website address is www.donegalgroup.com. The information on DGI s website is not a part of this proxy statement/prospectus.

UNNF (Page 76)

We are a Pennsylvania business corporation UNCB formed in 1986 to serve as a bank holding company. We commenced business on January 2, 1987. Our primary business is the ownership and management of UNCB.

The location of our principal executive offices is 570 Lausch Lane, Suite 300, Lancaster, Pennsylvania 17601. Our telephone number is (717) 492-2222 and our website address is www.uncb.com. The information on our website is not part of this proxy statement/prospectus.

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Our Special Meeting (Page 72)

This section contains information for our shareholders about the special meeting of shareholders we have called to consider the approval of the merger proposal and related matters.

General (Page 71)

We are furnishing this proxy statement/prospectus to you for use at our special meeting and any adjournment or postponement of our special meeting.

When and Where We Will Hold Our Special Meeting (Page 72)

We will hold our special meeting held on Thursday, September 16, 2010, at 10:00 a.m., prevailing time, at Enck s Banquet and Conference Center, 1461 Lancaster Road, Manheim, PA 17545, subject to any adjournment or postponement of our special meeting.

The Matters Our Shareholders Will Consider (Page 72)

The purpose of our special meeting is to consider and vote upon:

Proposal 1 A proposal to adopt the merger agreement;

Proposal 2 A proposal to grant discretionary authority to adjourn our special meeting if necessary to permit further solicitation of proxies because we have not received sufficient votes at the time of our special meeting to adopt the merger agreement; and

Any other business that properly comes before our special meeting and any adjournment or postponement of our special meeting.

Our shareholders must approve Proposal 1 for the merger to occur. If our shareholders fail to approve this proposal, the merger will not occur.

At this time, our board of directors is unaware of any other matters, other than as set forth above, that we will present for action at our special meeting. If a shareholder presents another matter in compliance with our by-laws, the persons named as proxies will vote in accordance with their judgment with respect to such matter.

Record Date; Shares Outstanding and Entitled to Vote (Page 73)

Our board of directors has fixed the close of business on July 29, 2010 as the record date for the determination of holders of our common stock entitled to notice of, and to vote at, our special meeting and any adjournment or postponement of our special meeting.

On the record date, we had 2,979,894 issued and outstanding shares of our common stock entitled to vote at our special meeting, held by approximately 900 holders of record. Each holder is entitled to cast one vote for each share of our common stock held on all matters that come before our shareholders at our special meeting in compliance with our by-laws.

Quorum (Page 73)

The presence, in person or by properly executed proxy, of the holders of at least a majority of our outstanding shares of common stock on the record date is necessary to constitute a quorum at our special meeting. We will count abstentions for the purpose of determining whether a quorum is present. A quorum must be present in order for the vote on the merger proposal and the adjournment proposal to occur.

Based on the number of shares of our common stock issued and outstanding as of the record date, 1,489,948 shares of our common stock must be present in person or represented by proxy at our special meeting to constitute a quorum.

Shareholder Vote Required (Page 73)

Adopt the Merger Agreement. The affirmative vote of the holders of 80% of our issued and outstanding common stock entitled to vote thereon is required to approve the adoption of the merger agreement. Accordingly, we urge you to complete, date and sign the accompanying proxy card and return it promptly in the enclosed postage-paid envelope.

When considering our board of directors recommendation that you vote in favor of the adoption of the merger agreement, you should be aware that certain of our executive officers and directors have interests in the merger that may be different from, or in addition to, your interests as a shareholder. See The Merger Interests of Our Directors and Executive Officers in the Merger beginning on page 95.

Discretionary Authority to Adjourn Our Special Meeting. The affirmative vote of the holders of a majority of the votes present, in person or by proxy, at our special meeting entitled to vote on the adjournment proposal is required to approve the proposal to grant discretionary authority to adjourn our special meeting if necessary to permit further solicitation of proxies for the merger proposal.

Director and Executive Officer Voting (Page 74)

As of the record date, our directors and executive officers and their affiliates beneficially owned 231,721 shares of our common stock, or approximately 7.8% of the issued and outstanding shares of our common stock entitled to vote at our special meeting.

Proxies (Page 74)

Voting. You should complete and return the proxy card accompanying this proxy statement/prospectus in order to ensure that your vote will be counted at our special meeting and at any adjournment or postponement of our special meeting, regardless of whether you plan to attend our special meeting. If you sign, date and return your proxy card and do not indicate how you want to vote, we will count your proxy card as a vote in favor of approval of the merger proposal and in favor of approval of the adjournment proposal.

If you hold your shares of our common stock in the name of a bank, broker, nominee or other holder of record, you will receive instructions from the bank, broker, nominee or other holder of record that you must follow in order for them to vote your shares of our common stock on your behalf.

Revocability. You may revoke your proxy at any time before we conduct the vote at our special meeting. If you have not voted through a bank, broker, nominee or other holder of record, you may revoke your proxy by:

- submitting written notice of revocation to our corporate secretary any time before we conduct the vote at our special meeting;
- submitting a properly executed proxy with a later date;
- submitting a new proxy by telephone or Internet; or
- voting in person at our special meeting.

However, simply attending our special meeting without voting will not revoke an earlier proxy.

You should address any written notice of revocation and other communications regarding the revocation of your proxy to:

Union National Financial Corporation
570 Lausch Lane, Suite 300
Lancaster, Pennsylvania 17601
Attention: Darwin A. Nissley, Secretary

If you hold your shares in the name of a bank, broker, nominee or other holder of record, you should follow the instructions of the bank, broker, nominee or other holder of record regarding the revocation of proxies.

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The death or incapacity of a shareholder who executes and returns a proxy will not revoke that shareholder s proxy unless our corporate secretary receives notice of the death or incapacity of that shareholder before the proxies vote the shares of our common stock represented by such proxy.

How We Count Proxies. We will vote all shares of our common stock represented by properly executed and dated proxies received before or at our special meeting, and not revoked, in accordance with the instructions indicated in the proxies.

We will count a properly executed and dated proxy marked ABSTAIN as present for purposes of determining the presence of a quorum.

Brokers may not vote shares of our common stock that they hold of record either for or against the approval of the merger proposal or the adjournment proposal without specific instructions from the person who beneficially owns those shares. Therefore, if a broker holds your shares, you must give your broker instructions on how to vote your shares.

Solicitation. We will pay for the costs of our special meeting and for the mailing of this proxy statement/prospectus to our shareholders, as well as all other costs we incur in connection with the solicitation of proxies from our shareholders. However, DFSC and we will share equally the cost of printing this proxy statement/prospectus and the filing fees paid to the SEC.

In addition to soliciting proxies by mail, our directors, officers and employees and directors of Province may solicit proxies by telephone, over the Internet or in person. We will not specially compensate our directors, officers and employees for these activities. We also intend to request that brokers, banks, nominees and other holders of record solicit proxies from their principals, and we will reimburse the brokers, banks, nominees and other holders of record for certain expenses they incur for those activities.

We have retained the firm of Georgeson, Inc. to assist us in the solicitation of proxies, and we have agreed to pay Georgeson, Inc. $9,000, plus reimbursable expenses, for its services.

Recommendation of Our Board of Directors (Page 75)

Our board of directors unanimously approved the merger agreement and the transactions the merger agreement contemplates. Based on our reasons for the merger we describe in this proxy statement/prospectus, our board of directors believes that the merger is advisable and in our and your best interests. Accordingly, our board of directors unanimously recommends that our shareholders vote ***FOR*** the merger proposal and ***FOR*** the adjournment proposal. See The Merger Our Board of Directors Reasons for the Merger; Recommendation beginning on page 83, for a more detailed discussion of our board of directors recommendation.

Attending Our Special Meeting (Page 75)

If you hold your shares in street name and you want to attend our special meeting, you must bring an account statement or letter from your holder of record showing that you were the beneficial owner of the shares on July 29, 2010, the record date for our special meeting.

The Merger

Certain Effects of the Merger (Pages 101 to 102)

Upon consummation of the merger:

Each share of our common stock, other than the shares DMIC owns and shares held by holders who perfect dissenters rights, will automatically convert into the right to receive, subject to the provisions of the merger agreement:

0.2134 share of DGI Class A common stock; and

$5.05 in cash.

We will cease to exist as a separate legal entity and DFSC and Province will conduct all of our operations. Province will conduct its banking business under a name that DFSC and we will select.

Stock Options (Page 102)

The merger agreement provides that we will use commercially reasonable efforts to obtain from each holder of an option to purchase our common stock such holder s consent to the surrender and cancellation of such option prior to the effective date of the merger.

Opinion of Our Financial Advisor in Connection with the Merger (Pages 85 to 93)

Sandler O Neill, our independent financial advisor in connection with the merger, delivered a written fairness opinion to our board of directors on April 19, 2010, the date we executed the merger agreement, that, as of April 19, 2010, and based upon and subject to the factors and assumptions set forth in Sandler O Neill s opinion, the merger consideration in the merger is fair, from a financial point of view, to the holders of shares of our common stock.

Appendix B to this proxy statement/prospectus sets forth the full text of the Sandler O Neill opinion and includes the assumptions Sandler O Neill made, the procedures Sandler O Neill followed, the matters Sandler O Neill considered and the limitations on the review Sandler O Neill undertook in connection with its opinion. **Sandler O Neill provided its opinion for the information and assistance of our board of directors in connection with its consideration of the merger. The Sandler O Neill opinion is not a recommendation as to how you should vote with respect to the merger or any related matter.** We encourage you to read the Sandler O Neill opinion in its entirety.

Interests of Our Directors and Executive Officers in the Merger (Page 95)

In considering the recommendation of our board of directors that you vote ***FOR*** the merger proposal and ***FOR*** the adjournment proposal, you should be aware that certain of our executive officers and directors have employment and other compensation agreements or plans that give them interests in the merger that are different from, or in addition to, your interests as a shareholder. These interests relate to or arise from, among other things:

- the continued indemnification of our current directors and executive officers under the merger agreement and providing these individuals with directors and officers insurance;

- the agreement of DFSC and Province to honor the existing employment and change of control agreements for eight of our officers, including our executive officers, unless and until such officers individually determine to execute a mutually acceptable employment agreement with DFSC and Province;

- the agreement of DFSC and Province to honor Mr. Gainer s existing employment agreement and amended and restated executive salary continuation agreement, or the salary agreement, unless and until Mr. Gainer, DFSC and Province execute a mutually acceptable employment agreement and a mutually acceptable amended and restated salary agreement;

- the appointment of Mark D. Gainer and two other current members of our board of directors to DFSC s board of directors and their receipt of directors fees in connection therewith; and

- the appointment of Mark D. Gainer and four other current members of UNCB s board of directors to the board of directors of Province and their receipt of directors fees in connection therewith.

Regulatory Approvals Required for the Merger (Page 96)

We cannot complete the merger without the prior approval of the Office of Thrift Supervision, or OTS, and notice to the Pennsylvania Department of Banking, or the Department. DFSC has supplied the pro forma financial information the OTS has requested prior to the submission of a formal application for approval of the merger and providing the requisite notice to the Department. While DFSC does not know of any reason why

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the OTS would not grant the necessary approval in a timely manner, we can give you no assurance that the OTS will approve the merger, at all or on a timely basis or that such approval would not be subject to one or more burdensome conditions that would entitle DFSC to terminate the merger agreement. DMIC will not be required to obtain any approval from the Pennsylvania Insurance Department in connection with the merger.

Conditions to the Merger (Page 107)

Currently, we expect to complete the merger in the third quarter of 2010. However, the completion of the merger depends on the satisfaction of a number of conditions or, where legally permissible, the waiver of those conditions. These conditions include, among others:

approval of the merger proposal by the holders of 80% of our outstanding shares of common stock entitled to vote at our special meeting;

subject to certain limited exceptions and except as otherwise previously disclosed to the other party, the representations and warranties of the parties to the merger agreement must be true and correct unless the failure of the representations and warranties to be true and correct would not have and would not reasonably be expected to have, individually or in the aggregate, a material adverse effect on the representing party;

the receipt of all regulatory approvals needed to complete the merger, including the approval of the OTS and the provision of specified notice to the Department, and the absence of the imposition of materially burdensome conditions by the OTS and any other regulatory agencies whose regulatory approval is necessary for the completion of the merger;

the absence of any law, statute, rule, regulation, order, decree or injunction that would effectively prohibit the merger or make completion of the merger illegal;

DGI s registration statement, of which this proxy statement/prospectus forms a part, shall have become effective and no stop order suspending its effectiveness shall have been issued and the SEC shall not have initiated or threatened any proceedings for that purpose;

UNCB shall not have delinquent loans, as defined in the merger agreement, that exceed $37.5 million as of the end of the month preceding the month in which the closing of the merger is scheduled to occur;

NASDAQ shall have approved for listing the shares of DGI Class A common stock that DFSC will distribute to our shareholders as part of the merger consideration;

DFSC shall have delivered the merger consideration to the exchange agent not later than the day prior to the closing date; and

DFSC and we shall have received all necessary third party consents.

Although we anticipate the closing of the merger will occur during the third quarter of 2010, because the satisfaction of certain conditions to the merger is beyond our control, neither DFSC nor we can be certain when, or if, DFSC and we can satisfy the conditions to the merger, or agree to waive such conditions or whether or not we will be able to complete the merger.

Non-Solicitation (Page 106)

Subject to certain exceptions, we have agreed not to initiate, solicit, induce or knowingly encourage any third party to make any inquiries or proposals to acquire us or enter into an agreement to acquire us with a third party. However, the merger agreement does permit us, under specified circumstances, to respond to an acquisition proposal we have not solicited or an inquiry from a third party, which our board of directors believes in good faith is or is reasonably likely to result in a merger proposal that is superior to the DFSC merger proposal. In those specified circumstances, we may furnish the third party with information about us and conduct negotiations with such third party.

Litigation Related to the Merger (Page 109)

Certain litigation is pending in connection with the Merger. See The Merger Litigation Related to the Merger.

Termination of the Merger Agreement (Page 108)

We and DFSC may mutually agree to terminate the merger agreement before completing the merger, even after our shareholders approve the merger proposal.

Either DFSC or we may terminate the merger agreement, even after our shareholders approve the merger proposal, if certain conditions have not been met, such as:

- failure to obtain the necessary regulatory approvals for the merger unless the failure is due to the terminating party s failure to perform or observe its covenants in the merger agreement;
- failure to complete the merger by December 31, 2010, unless the reason for the failure not to consummate the merger by that date is a failure by the terminating party to perform or observe its covenants and agreements in the merger agreement;
- the non-terminating party s breach of a representation, warranty, covenant, agreement or other obligation contained in the merger agreement that would make it impossible to satisfy the closing conditions, provided the terminating party is not then in material breach of any of its representations, warranties, covenants, agreements or other obligations in the merger agreement; or
- failure of the holders of 80% of our outstanding common stock to approve the merger proposal, provided we are not in material breach of our obligations to hold our special meeting and our board of directors is not in breach of its covenant to recommend such approval.

DFSC may terminate the merger agreement at any time prior to our special meeting if we have:

- breached our obligation not to initiate, solicit or encourage or take any action to facilitate another proposal to acquire us, participate in any discussions or negotiations relating to another proposal to acquire us or, except as permitted by and subject to certain terms of the merger agreement, approve, recommend or enter into any letter of intent, agreement or other commitment relating to another proposal to acquire us;
- failed to have our board of directors recommend approval of the merger proposal by our shareholders or our board of directors shall have changed its recommendation, except as permitted by the merger agreement with respect to a proposal to acquire us on terms and conditions superior to those in the merger agreement;
- recommended approval of another proposal to acquire us; or
- failed to call, give notice of, convene and hold our special meeting.

We may terminate the agreement at any time prior to the mailing date of this proxy statement/prospectus our special meeting in order to enter into an agreement relating to an acquisition proposal that has terms superior to those of the merger agreement from the perspective of our shareholders.

Except as provided below with respect to termination fees and expenses and the parties respective confidentiality obligations in the event DFSC or we terminate the merger agreement, neither of us will have any liability or obligation other than liabilities or damages incurred by either of us as a result of our willful breach of any of our respective representations, warranties, covenants or agreements contained in the merger agreement.

Expenses; Termination Fee (Page 109)

The merger agreement provides that we will pay DFSC a termination fee of $800,000 if:

- we terminate the merger agreement in order to enter into an agreement relating to an acquisition proposal that has terms superior to those of the merger agreement from the perspective of our shareholders;

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DFSC terminates the merger agreement prior to our special meeting because we have breached our obligation not to encourage or solicit acquisition proposals, we have failed to hold our special meeting or our board of directors has not recommended approval of the merger proposal or has changed its recommendation or has recommended approval of another proposal to acquire us or we fail to hold our special meeting;

a third party makes a tender or exchange offer for 25% or more of our common stock and our board of directors fails to send a statement to our shareholders recommending rejection of that offer within 10 days after the making of the offer; or

the occurrence of any of the following events within 18 months after the termination of the merger agreement, provided that a third party makes a proposal to acquire us after April 19, 2010 and does not withdraw its proposal prior to termination of the merger agreement:

we enter into an agreement to merge with or be acquired by that third party;

that third party acquires substantially all of our assets; or

that third party acquires more than 50% of our common stock.

The merger agreement also provides that upon termination:

by us because DFSC breached its representations, warranties, covenants, agreements or other obligations in the merger agreement, which breach could reasonably be expected to result in a material adverse effect and which breach cannot be or is not cured, assuming we are also not in material breach of our obligations under the merger agreement, DFSC will pay our out-of-pocket expenses in connection with the merger, including fees and expenses of legal counsel, financial advisors and accountants, up to a maximum of $500,000; and

by DFSC because we breached our representations, warranties, covenants, agreements or other obligations in the merger agreement which breach could reasonably be expected to result in a material adverse effect and which breach cannot be or is not cured, assuming DFSC is also not in material breach of its obligations under the merger agreement, we will pay DFSC s out-of-pocket expenses in connection with the merger, including fees and expenses of legal counsel, financial advisors and accountants, up to a maximum of $500,000, provided, however, that we do not have to pay DFSC s expenses if we have paid the break-up fee to DFSC.

Material U.S. Federal Income Tax Consequences of the Merger (Pages 110 to 112)

The merger will be a taxable transaction to our shareholders for U.S. federal income tax purposes. Each shareholder will generally recognize gain or loss equal to the difference between the amount of cash plus the fair market value, determined at the effective time of the merger, of the DGI Class A common stock such shareholder receives and the holder s tax basis in our common stock surrendered in the merger. The tax consequences of the merger may vary depending on the particular holder s circumstances. We urge each of you to consult your own tax advisor with respect to the tax consequences of the merger.

Dividends (Page 124)

DGI paid cash dividends on its Class A common stock totaling $0.45 per share for 2009. Based on the exchange ratio and DGI s current Class A annual dividend rate of $0.46 per share, holders of our common stock can anticipate receiving a dividend at an annual rate of $.098 per share. We have not paid any dividends on our common stock since

2007. Although DGI has no current plan or intention to change its Class A dividend rate, DGI s board of directors may, subject to applicable law, change its dividend rate in the future. DGI s ability to pay dividends on its common stock is subject to various legal and regulatory limitations.

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Certain Differences in Rights of Shareholders (Pages 113 to 124)

When we and DFSC complete the merger, Delaware law and DGI s certificate of incorporation and by-laws will govern the rights of our shareholders rather than Pennsylvania law and our articles of incorporation and by-laws.

Comparative Market Prices and Dividends (Page 124)

DGI s Class A common stock trades on the NASDAQ Global Select Market under the symbol DGICA. Our common stock trades on the OTCBB, under the symbol UNNF.OB. The table on page 123 lists the quarterly price range of DGI Class A common stock and our common stock since January 1, 2008 as well as the quarterly cash dividends DGI has paid on its Class A common stock and we have paid on our common stock since that date. The following table shows the closing price of DGI Class A common stock and our common stock as reported on April 19, 2010, the last trading day before DFSC and we announced the merger, and on July 29, 2010, the last practicable trading day before the printing of this proxy statement/prospectus. This table also shows the pro forma equivalent value of the merger consideration for each share of our common stock, assuming the conversion of all shares of our preferred stock into common stock, which we calculated by multiplying the closing price of DGI Class A common stock on those dates by 0.2134, the exchange ratio for the stock portion of the merger consideration, and adding $5.05 in cash.

	DGI Class A Common Stock	Our Common Stock	Pro Forma Equivalent Value of One Share of Our Common Stock
April 19, 2010	$ 14.68	$ 6.00	$ 8.18
July 29, 2010	11.78	7.45	7.56

The market price of DGI Class A common stock may change at any time. Consequently, the total dollar value of the DGI Class A common stock that you will be entitled to receive as a portion of the merger consideration may be higher or lower than its current value. We urge you to obtain a current market quotation for DGI Class A common stock. We make no representation as to the future price of DGI Class A common stock.

Dissenters Rights (Page 99)

Our shareholders have dissenters rights under the PBCL and, if a shareholder does not vote in favor of the merger proposal, that shareholder can seek the appraised fair value of his or her shares in a judicial proceeding.

Recent Developments

On July 15, 2010, DGI entered into an agreement and plan of merger relating to DGI s acquisition of Michigan Insurance Company, or MICO, which is an 83.6%-owned subsidiary of West Bend Mutual Insurance Company. MICO is a property and casualty insurance company that conducts business exclusively in Michigan. For the years ended December 31, 2009 and 2008, MICO had total revenues of $30.3 million and $28.6 million, respectively, and net income of $2.7 million and $2.3 million, respectively. Initially, DGI will follow MICO s practice of reinsuring approximately 75% of MICO s business, but over time will have the ability increase the percentage of MICO s business it retains. The transaction is subject to approval by the shareholders of MICO and by the Michigan Department of Insurance. DGI anticipates that it will be able to consummate the MICO acquisition before December 31, 2010.

For the six months ended June 30, 2010, DGI had total revenues of $199.4 million and net income of $2.0 million, or $.08 per Class A share, compared to total revenues of $190.3 million and net income of $4.6 million, or $.18 per Class A share, for the six months ended June 30, 2009. DGI s results for the six months ended June 30, 2010 were adversely affected by a number of severe winter storms and wind and hail events in DGI s Mid-Atlantic and Midwestern regions and are not necessarily reflective of DGI s results of operations for the remainder of 2010.

Questions and Additional Information (Page 75)

If you have questions about the merger or how to submit your proxy card, or if you need additional copies of this proxy statement/prospectus or the enclosed proxy card, please call Mark D. Gainer, our Chairman, President and Chief Executive Officer, at (717) 519-8630 or Georgeson, Inc., the proxy soliciting firm we have retained, at (866) 821-2614.

SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA OF DGI

Set forth below are highlights from DGI s consolidated financial data as of and for the years ended December 31, 2005 through 2009 and DGI s unaudited consolidated financial data as of and for the three months ended March 31, 2009 and 2010. DGI s results of operations for the three months ended March 31, 2010 are not necessarily indicative of DGI s results of operations for the full year of 2010. DGI management prepared the unaudited information on the same basis as it prepared DGI s audited consolidated financial statements. In the opinion of DGI s management, this information reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of this data for these periods. You should read this information in conjunction with DGI s consolidated financial statements and related notes included in DGI s Annual Report on Form 10-K for the year ended December 31, 2009 and DGI s Quarterly Report on Form 10-Q for the three months ended March 31, 2010 which we incorporate by reference in this proxy statement/prospectus and from which we derived this information. See Where You Can Find More Information on page v.

Selected Consolidated Historical Financial Data of DGI

	Three Months Ended March 31,		Year Ended December 31,				
	2010	2009	2009	2008	2007	2006	2005
	(Dollars in thousands, except per share amounts)						
Income Statement Data							
Premiums earned	$ 91,372	$ 88,350	$ 355,025	$ 346,575	$ 310,072	$ 301,478	$ 294,498
Investment income, net	4,930	5,358	20,631	22,756	22,785	21,320	18,472
Realized investment gains (losses)	22	259	4,480	(2,971)	2,051	1,830	1,803
Total revenues	97,915	95,502	386,733	372,424	340,618	329,967	319,847
Income before income taxes	276	212	20,677	32,092	52,849	56,622	52,345
Income taxes	41	42	1,847	6,550	14,569	16,408	15,396
Net income	235	170	18,830	25,542	38,280	40,215	36,949
Basic earnings per share Class A	0.01	0.01	0.76	1.03	1.55	1.65	1.57
Diluted earnings per share Class A	0.01	0.01	0.76	1.02	1.53	1.60	1.51
Cash dividends per share Class A			0.45	0.42	0.36	0.33	0.30
Basic earnings per share Class B	0.01	0.01	0.68	0.92	1.39	1.48	1.41
Diluted earnings per share Class B	0.01	0.01	0.68	0.92	1.39	1.48	1.41
Cash dividends per share Class B			0.40	0.37	0.31	0.28	0.26

Balance Sheet Data at End of Period							
Total investments	657,735	639,618	666,835	632,136	605,870	591,338	547,746
Total assets	936,025	890,379	935,602	880,109	834,096	831,698	781,422
Debt obligations	15,465	15,465	15,465	15,465	30,929	30,929	30,929
Stockholders equity	385,428	368,350	385,506	363,584	352,690	320,802	277,896
Book value per share	15.11	14.47	15.12	14.29	13.92	12.70	11.30

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SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA OF UNNF

Set forth below are highlights from UNNF s consolidated financial data as of and for the years ended December 31, 2005 through December 31, 2009 and UNNF s unaudited consolidated financial data as of and for the three months ended March 31, 2009 and 2010. The results of operations for the three months ended March 31, 2010 are not necessarily indicative of the results of operations of UNNF for the full year of 2010. UNNF management prepared the unaudited information on the same basis as it prepared UNNF s audited consolidated financial statements. In the opinion of UNNF s management, this information reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of this data for these periods. You should read this information in conjunction with UNNF s consolidated financial statements and related notes included elsewhere in this proxy statement/prospectus and from which we derived this information. See Where You Can Find More Information on page v and the Index to the UNNF Consolidated Financial Statements on page F-1.

Selected Consolidated Historical Financial Data of UNNF

	Three Months Ended March 31,		Year Ended December 31,				
	2010	2009	2009	2008	2007	2006	2005
	(Dollars in thousands, except per share amounts)						
ummary of Operations Data:							
nterest income	$ 5,522	$ 6,049	$ 23,758	$ 28,173	$ 31,373	$ 30,290	$ 23,978
nterest expense	2,263	3,178	11,286	13,579	16,009	15,626	9,662
let interest income	3,259	2,871	12,472	14,594	15,634	14,664	14,316
rovision for credit osses	496	313	2,627	1,027	1,237	672	681
let interest income fter provision for redit losses	2,763	2,558	9,845	13,567	14,127	13,992	13,635
Ion-interest income	1,180	619	5,375	3,807	6,509	8,262	6,011
Ion-interest expense	4,022	4,014	16,737	17,118	20,745	19,711	15,627
Loss) income before ncome taxes (benefit)	(79)	(837)	(1,517)	256	(109)	2,543	4,019
Benefit from) rovision for income axes	(82)	(328)	(802)	(188)	(421)	99	666
let (loss) income	3	(509)	(715)	444	312	2,444	3,353
referred stock ividends	18						
let (loss) income vailable to common hareholders	(15)	(509)	(715)	444	312	2,444	3,353
er Share Data:							
Loss) earnings per ommon share	$ (0.01)	$ (0.19)	$ (0.26)	$ 0.17	$ 0.12	$ 0.96	$ 1.31

ividends paid					0.28	0.62	0.63
ook value per share at eriod end	11.11	11.37	10.97	11.32	11.31	11.31	10.84
verage number of hares outstanding asic and diluted (in housands)	2,742	2,721	2,730	2,643	2,544	2,537	2,556
tatement of Condition Data (at nd of period):							
ssets	$499,931	$ 510,922	$ 489,644	$ 485,109	$ 501,776	$ 517,597	$ 462,178
et loans and leases	327,033	351,970	333,416	353,922	360,662	338,043	297,538
eposits	416,925	407,889	404,765	383,577	376,311	340,075	296,610
hort-term borrowings					6,629	10,544	18,305
ong-term debt	30,834	50,334	33,334	50,334	68,816	117,571	105,815
unior subordinated ebentures	17,341	17,341	17,341	17,341	17,341	17,341	11,341
otal stockholders quity	31,278	30,929	31,336	30,794	28,800	28,548	27,225
inancial Ratios:	(Annualized)						
eturn on average ssets	0.00%	(0.41)%	(0.14)%	0.09%	0.06%	0.50%	0.79%
eturn on average quity	0.04	(6.47)	(2.26)	1.48	1.07	8.81	12.59
atio of average equity o average assets	6.53	6.31	6.29	6.15	6.05	5.67	6.25

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MANAGEMENT S DISCUSSION AND ANALYSIS OF UNNF S FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion provides management s analysis of UNNF S financial condition and results of operations for the three-month periods ended March 31, 2009 and 2010 and for the years ended December 31, 2007, 2008 and 2009. The UNNF financial statements and accompanying notes included elsewhere in this proxy statement/prospectus are an integral part of this discussion and should be read in conjunction with it.

Overview

Management s discussion and analysis represents an overview of the financial condition and results of operations, and highlights the significant changes in the financial condition and results of operations, as presented in the accompanying consolidated financial statements for UNNF, a bank holding company, and its wholly owned subsidiary, UNCB. UNNF s consolidated financial condition and results of operations consist primarily of UNCB s financial condition and results of operations. UNNF s trust subsidiaries, Union National Capital Trust I and Union National Capital Trust II, were established for the purpose of issuing $11,000,000 of trust capital securities during 2003 and 2004.

Forward Looking Statements

These financial statements contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Actual results and trends of UNNF and UNCB could differ materially from those set forth in such statements due to various risks, uncertainties and other factors. Such risks, uncertainties and other factors that could cause actual results and experience to differ include, but are not limited to, the following:

strategic initiatives and business plans, including prospective business combinations, may not be satisfactorily completed or executed, if at all;

increased demand or prices for UNCB s financial services and products may not occur;

changing economic and competitive conditions;

technological developments;

the effectiveness of UNNF s business strategy due to changes in current or future market conditions;

actions of the U.S. government, the FRB, the OCC and other governmental and regulatory bodies for the purpose of stabilizing the financial markets; enforcement actions with bank regulatory agencies restricting certain transactions of UNNF and UNCB;

effects of deterioration of economic conditions on customers, specifically the effect on the ability of loan customers to repay loans;

UNNF s inability to raise or achieve desired or required levels of regulatory capital; paying significantly higher FDIC premiums in the future;

the effects of competition, and of changes in laws and regulations, including industry consolidation and development of competing financial products and services;

interest rate movements;

relationships with customers and employees;

challenges in establishing and maintaining operations;

volatilities in the securities markets and related potential impairments of investment securities;

deteriorating economic conditions and declines in housing prices and real estate values; and

other risks and uncertainties, including those described in UNNF s filings with the SEC.

When we use words such as believes , expects , anticipates , or similar expressions, we are making forward-looking statements. UNNF undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances that arise after the date of this report.

Readers should carefully review the risk factors described in the Annual Report and other documents that we periodically file with the SEC, including our Form 10-K for the year ended December 31, 2009, our Forms 8-K, and other reports, that we have filed during 2010 with the SEC.

Three Months Ended March 31, 2010 to Three Months Ended March 31, 2009

Critical Accounting Policies

We prepare our consolidated financial statements based upon the application of U.S. generally accepted accounting principles, or GAAP. The reporting of our financial condition and results of operations is impacted by the application of accounting policies by management, some of which are particularly sensitive and require significant judgments, estimates and assumptions to be made in matters that are inherently uncertain. These accounting policies, along with the disclosures presented in other financial statement notes and in this financial review, provide information on how significant assets and liabilities are valued in the financial statements and how those values are determined. Management views critical accounting policies to be those which are highly dependent on subjective or complex judgments, estimates and assumptions, and where changes in those estimates and assumptions could have a significant impact on the consolidated financial statements. Management currently views the determination of the allowance for credit losses, the fair value of investment securities and the fair value of other real estate owned to be critical accounting policies.

Determination of the Allowance for Credit Losses

The provision for credit losses and the level of the allowance for credit losses involve significant estimates by management. In evaluating the adequacy of the allowance for credit losses, management considers the specific collectability of impaired and nonperforming loans, past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect borrowers ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant qualitative factors. While we use available information to make such evaluations, future adjustments to the allowance for credit losses and the provision for credit losses may be necessary if economic conditions, loan credit quality, or collateral issues differ substantially from the factors and assumptions used in making the evaluation.

Fair Value of Investment Securities

Investments are carried at fair value with any unrealized gains and losses, considered to be temporary, reported net of tax as an adjustment to stockholders equity. In order to determine whether unrealized losses in the fair value of investment securities reflect other-than-temporary impairment, or OTTI, management regularly reviews the entire portfolio of investment securities for possible impairment, analyzing factors including, but not limited to, the underlying creditworthiness of the issuing organization, the length of time for which the fair value of the investment securities may be less than cost, and independent analysts opinions about circumstances that could affect the performance of the investment securities. In assessing potential OTTI for debt securities with fair values less than cost, other considerations include (i) whether management intends to sell the security, or (ii) if it is more likely than not that management will be required to sell the security before recovery, or (iii) if management does not expect to recover the entire amortized cost basis. In assessing potential OTTI for equity securities with fair values less than cost, consideration is given to management s intention and ability to hold the securities until recovery of any unrealized losses. After considering such factors, it is a matter of judgment on the part of management to make the determination of whether or not the decline in market value is other-than-temporary.

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Fair Value of Other Real Estate Owned

Other Real Estate Owned, or OREO, includes property acquired through foreclosure, deed in-lieu of foreclosure, and an in-substance foreclosure. OREO is held for sale. The carrying value of the property is recorded at the fair value of the property as determined based upon an independent appraisal, less estimated costs to sell at the time of acquisition. Any excess of the loan balance over the carrying value of the property at the time of transfer from loans to OREO is charged to the allowance for credit losses. Subsequent to the transfer to OREO, if the sales price of the property less actual costs to sell is less than the carrying value of the property, the deficiency is charged against income as a loss on sale. Due to changing market conditions, there are inherent uncertainties upon liquidation with respect to determining the fair value of OREO. Therefore, the amount ultimately realized upon liquidation may differ from the carrying value reflected in the accompanying consolidated financial statements.

Financial Condition

Total assets increased by $10,287,000 or 2% to $499,931,000 at March 31, 2010, from $489,644,000 at December 31, 2009. The increase was primarily the result of strong retail deposit generation, which further strengthened our liquidity position. Total deposits grew by $12,160,000 or 3% to $416,925,000 at March 31, 2010 from $404,765,000 at December 31, 2009.

Investment Securities

Investment securities were $60,757,000 at March 31, 2010, compared to $60,546,000 at December 31, 2009. All of our investment securities were classified as available for sale at March 31, 2010 and December 31, 2009. Investment securities classified as available for sale are marketable equity securities, and those debt securities that we intend to hold for an undefined period of time, but not necessarily to maturity. In addition to the investment portfolio generating interest income, it serves other primary financial management functions such as a reliable source of liquidity and a tool to manage interest rate risk. In order to support these functions, the entire investment securities portfolio has been designated as being available for sale. Any decision to sell an available-for-sale investment security would be based on various factors, including significant movements in interest rates, changes in maturity mix of assets and liabilities, liquidity needs, regulatory capital considerations, reasonable gain realization, changes in the creditworthiness of the issuing entity, changes in investment strategy and portfolio mix, and other similar factors. Changes in unrealized gains or losses on available-for-sale investment securities, net of taxes, are recorded as other comprehensive (loss) income, a component of stockholders equity.

Certain types of mortgage-backed and asset-backed securities are purchased to better position the investment securities portfolio for a subsequent increase or decrease in interest rates, as aligned with our interest rate risk position. These investment securities may be purchased at premiums or discounts, with short, mid, or long-term average expected lives or maturities. Overall yields on these investment securities will increase or decrease based on changes in prepayment speeds and subsequent cash flow reinvestments.

Investment security purchases and sales generally occur to manage UNCB s liquidity requirements, pledging requirements, interest rate risk, and to enhance net interest margin and capital management. The investment securities portfolio is evaluated regularly for possible opportunities to increase earnings through potential sales or portfolio repositioning. In the first three months of 2010, proceeds of $16,479,000 were received on sales, and $77,000 was recognized in net gains, while $18,644,000 of investment securities were purchased. Investment securities of $57,793,000 and $57,209,000 were pledged to secure public, trust, and government deposits and for other purposes at March 31, 2010 and December 31, 2009, respectively.

In addition to the credit risk present in the loan portfolio, we also have credit risk associated with our investment security holdings. Based on recent national economic trends and other factors, the private issuer mortgage-backed securities and corporate debt securities credit ratings as published by national statistical rating organizations are being monitored closely.

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Investment securities consisted of the following at of March 31, 2010 and December 31, 2009, (in thousands):

	March 31, 2010	December 31, 2009
Market Value of Debt Securities	$ 60,690	$ 60,478
Market Value of Equity Securities	67	68
Total Market Value of Investment Securities	$ 60,757	$ 60,546

Debt securities include mortgage-backed securities, obligations of state and political subdivisions, obligations of U.S. government agencies, structured notes and corporate securities. At March 31, 2010, there were fifteen debt securities with unrealized losses of $153,000 that amounted to 0.4% of their amortized cost, compared to December 31, 2009, when there were twenty-seven debt securities with unrealized losses of $585,000 that amounted to 1.3% of their amortized cost. Management believes that the unrealized losses reflect temporary declines primarily due to changes in interest rates subsequent to the acquisition of specific securities. These temporary declines have been provided for in other comprehensive income (loss). All of the obligations of state and political subdivisions outstanding at December 31, 2009, were sold in 2010, and as a result of positive market movements, no losses were recognized on the sale of these securities.

Equity securities held are comprised primarily of common stock holdings in other financial institutions. There were nine and ten equity securities with unrealized losses of $11,000, at both March 31, 2010 and December 31, 2009, respectively. We have the ability and intent to hold these investments for a reasonable period of time sufficient for the fair value of each equity security to increase to our cost. Management does not consider the equity securities to be other-than-temporarily impaired at March 31, 2010.

As of March 31, 2010, $12,000 of the fair value of the total investment securities portfolio was measured using Level 1 inputs as defined by fair value measurement and disclosure guidance, $57,848,000 or 95% of the fair value of total investment securities was measured using Level 2 inputs, and $2,897,000 or 5% of the fair value of total investment securities was measured using Level 3 inputs. For additional information, refer to Note 12 Fair Value Measurement of Assets and Liabilities and Fair Value of Financial Instruments to the consolidated financial statements included elsewhere in this proxy statement/prospectus.

The fair value of Level 3 investment securities decreased to $2,897,000 at March 31, 2010, compared to $3,269,000 at December 31, 2009. Of the decrease in value, $272,000 was related to net proceeds received on the sale of an impaired security, $172,000 was related to principal and interest payments received and fully applied to principal, offset by $72,000 of net unrealized gains (with a corresponding after-tax increase to stockholders equity of $48,000 recorded as other comprehensive income).

In order to determine whether unrealized losses in the fair value of investment securities are OTTI, management regularly reviews the entire portfolio of investment securities for possible impairment, analyzing factors including but not limited to the underlying creditworthiness of the issuing organization, the length of time for which the fair value of the investment securities has been less than cost, and independent analysts opinions about circumstances that could affect the performance of the investment securities. In assessing potential OTTI for debt securities, other considerations include (i) whether management intends to sell the security, or (ii) if it is more likely than not that management will be required to sell the security before recovery, or (iii) if management does not expect to recover the entire amortized cost basis. In assessing potential OTTI for equity securities, consideration is given to management s intention and ability to hold the securities until recovery of any unrealized losses.

As of March 31, 2010, our recorded investment balances include three securities with previously recorded impairments. The fair value of these impaired investments was $2,897,000 at March 31, 2010, compared to an original amortized cost of $6,950,000. All principal and interest payments received on impaired investment securities are fully applied to principal.

Accounting Standards Codification, or ASC, Topic 320, Investments Debt and Equity Securities provides a list of factors that a reporting entity should evaluate to determine whether there has been a

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significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value in accordance with fair value measurement and disclosure guidance. Further, fair value measurement and disclosure guidance clarifies that when there has been a significant decrease in the volume and level of activity for the asset or liability, some transactions may not be orderly, and we must evaluate the weight of evidence to determine whether the transactions are orderly. The guidance provides a list of circumstances that may indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

As discussed more thoroughly in Note 12 Fair Value of Assets and Liabilities and Fair Value of Financial Instruments to the consolidated financial statements included elsewhere in this proxy statement/prospectus, the fair value of these investment securities was determined by calculating the net present value of the expected future cash flows of each security, with qualitative risk-adjusted discounting for potential credit risks and nonperformance in the underlying issuers, and market sector illiquidity concerns. In accordance with ASC Topic 820, when an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, and include appropriate risk premiums, is acceptable. Management s judgment was that, as of March 31, 2010 and December 31, 2009, the facts and circumstances indicated significant illiquidity and an inactive market for these types of investments when other relevant observable inputs were not available; therefore, expected cash flows were used as a reasonable basis in determining the fair value of the corporate investment securities.

During 2009, four of UNCB s five private issuer securities were downgraded to below investment grade (one private issuer mortgage-backed security was downgraded to below investment grade in 2008). Accordingly, UNCB recorded $1,504,000 of other-than-temporary impairment charges in 2009 including (i) $859,000 related to three corporate securities supported primarily by obligations from other financial industry entities, and (ii) $645,000 related to two private issuer mortgage-backed securities not guaranteed by the U.S. government. During 2008, we recorded $1,290,000 of other-than-temporary investment impairment charges related to two securities, including the private-issuer security that was downgraded to below-investment-grade in 2008, and a corporate security. Management determined that, due to severe illiquidity and distress in the financial markets, the unrealized declines in the value of these investments were other-than-temporary and credit related, requiring the write-down and related impairment charge to earnings. For the securities with impairment charges recorded, interest income payments received subsequent to impairment are fully applied to principal further reducing the amortized cost of these investments.

During 2009, one of the previously impaired corporate securities (USCap Funding V) was fully impaired, completely written-off and declared as a worthless asset for tax purposes. This impaired corporate security had a cumulative credit related OTTI of $936,000 at December 31, 2009. During 2010, another one of the previously impaired corporate securities (InCaps Funding II Senior Note) was sold for $277,000, leaving UNCB with a total of three impaired investment securities remaining at March 31, 2010. At the time of the sale, the InCaps Funding II Senior Note security had $631,000 of previously recorded impairments and an adjusted amortized cost of $272,000, which resulted in a $5,000 gain that was recorded on the sale.

Management determined that further impairments as of March 31, 2010 were not warranted on the three remaining impaired investment securities based upon the following considerations:

All three impaired investment securities were current, as of March 31, 2010, for scheduled investment payments. Based upon the information reviewed by management in preparing the financial statements, the financial condition and near-term prospects of the issuers do not reflect any specific events which may have influenced the operations of the issuers, such as changes in technology or a discontinuance of a business segment that may have further impaired the earnings potential of the investments.

The securities experienced very limited trading activity during the last 12 months being in a market sector with a high degree of illiquidity and dislocation; therefore, determining fair value based upon discounted cash flows is considered reasonable.

Management does not intend to sell the securities, and it is not likely that management will be required to sell the securities before recovery to their adjusted amortized cost, and though management does not expect to recover the original amortized cost of the securities, management expects to hold the securities until a reasonable recovery towards the current carrying value.

Loans and Leases, Credit Quality and Credit Risk

Loans and leases at March 31, 2010 were $333,028,000 compared to $339,274,000 at December 31, 2009. Outstanding loans decreased by $6,246,000 from December 31, 2009 to March 31, 2010, primarily due to reduced loan demand from creditworthy borrowers and the impact of certain loans at December 31, 2009, that subsequently involved collateral foreclosure and were classified as OREO at March 31, 2010, in the Consolidated Statements of Financial Condition (for additional information, refer to the discussion on Non-Performing Assets on page 21). We continue to focus lending on creditworthy consumers and businesses, with necessary consideration given to increased credit risks posed by the weak economy and the housing market. The economy and housing market, and increased unemployment, could affect some of UNCB s borrowers, and may result in increased nonperforming loans and credit losses.

At March 31, 2010, UNCB had $68,708,000 of loans specifically pledged to the Federal Home Loan Bank of Pittsburgh, or FHLB, for providing collateral on FHLB long-term debt, compared to $72,287,000 of pledged loans at December 31, 2009.

Allowance for Credit Losses

In accordance with GAAP, the allowance for credit losses is maintained at a level believed by management to be adequate to absorb estimated probable loan and lease principal losses. The allowance for credit losses is established through provisions charged against net interest income. The uncollectible principal portion of impaired loans and leases is charged against the allowance for credit losses, and subsequent principal recoveries are credited to the allowance for credit losses.

Management s evaluation of the adequacy of the allowance is based on UNCB s past loan and lease loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower s ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant qualitative factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans and leases that may be susceptible to significant change.

The allowance for credit losses is evaluated based on an assessment of the losses inherent in the loan and lease portfolio. This assessment results in an allowance that consists of specific, general and unallocated components. The specific component relates to loans and leases that are classified as impaired. For such loans and leases, an allowance is established when (i) the discounted cash flows, or (ii) collateral value, or (iii) observable market price of the impaired loan or lease is lower than the carrying value. The general component covers all other loans and leases, including criticized loans that are not impaired, and is based on historical loss experience adjusted for relevant qualitative factors. Separate qualitative adjustments are made for higher-risk criticized loans that are not impaired. An unallocated component is maintained to cover uncertainties that could affect our estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the loan and lease portfolio.

UNCB continues to monitor closely the loan portfolio, and the underlying borrower financial performance and collateral values, identifying credit concerns and risks, including those resulting from the uncertain and weakened economy. Future adjustments may be necessary to the allowance for credit losses, and consequently the provision for credit losses, if economic conditions or loan credit quality differ substantially from the assumptions management used in the evaluation of the level of the allowance compared to the balance of outstanding loans and leases.

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The allowance for credit losses was $5,995,000 at March 31, 2010, compared to $5,858,000 at December 31, 2009. A provision for credit losses of $496,000 was made for the three months ended March 31, 2010, compared to $313,000 for the same period in 2009. The provision for credit losses for the three months ended March 31, 2010, was significantly higher than the provision for credit losses for the three months ended March 31, 2009 (for additional information, refer to the related discussion on Provision for Credit Losses on page 25) given the increased credit risks in the loan portfolio, including those resulting from the current weak economy and real estate market. With the higher provision exceeding net loan charge-offs of $359,000 as well as the decrease to the loan and lease portfolio in the first quarter of 2010, the allowance for credit losses increased to 1.80% of loans at March 31, 2010 compared to 1.73% of loans at December 31, 2009. Management believes, based on information then currently available, that the allowance for credit losses as of March 31, 2010, was adequate to meet probable credit losses at that date.

The following table summarizes the changes in the allowance for credit losses for the three months ended March 31, 2010 and 2009 (dollars in thousands):

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Allowance for Credit Losses, Beginning of Period	$ 5,858	$ 4,358
Charge-Offs	(360)	(363)
Recoveries	1	11
Net Charge-Offs	(359)	(352)
Addition to Provision for Credit Losses	496	313
Allowance for Credit Losses, End of Period	$ 5,995	$ 4,319
Loans and Leases Average	$ 338,341	$ 356,118
Gross Loans and Leases Actual	$ 333,028	$ 356,289
Ratio of Gross Loans and Leases Charged Off to Average Loans and Leases (Annualized)	0.43%	0.41%
Ratio of The Allowance for Credit Losses to Gross Loans and Leases	1.80%	1.21%

Impaired Loans

Other than as described herein, management does not believe there are any significant trends, events or uncertainties that are reasonably expected to have a material impact on our loan and lease portfolio to affect future results of operations, liquidity or capital resources. However, based on known information, management believes that the effects of current and past economic conditions and other unfavorable business conditions may impact certain borrowers abilities to comply with their repayment terms and therefore may have an adverse effect on future results of operations, liquidity, or capital resources. Management continues to closely monitor economic and business conditions and the impact on borrowers financial strength. For certain loans and leases, management has determined that it is probable that all principal and interest payments due according to the contractual terms of the loan agreements will not be collected. These loans are considered to be impaired as defined by GAAP.

The balance of loans and leases that were considered to be impaired under GAAP was $6,174,000 and $8,715,000, which consisted of eight and ten separate loan and lease relationships to unrelated borrowers, at March 31, 2010 and December 31, 2009, respectively. At March 31, 2010, three of the relationships represented 84% of the total impaired loans and leases of $6,174,000. The decrease in impaired loans and leases from December 31, 2009 to March 31, 2010, primarily resulted from several loans, with a related allowance, that were foreclosed on and transferred into other real estate owned at March 31, 2010 (for additional information, refer to the discussion on Non-Performing Assets on page 21). Management continues to diligently monitor and evaluate the impaired loan portfolio, and identify new credit concerns and collectability risks, including those resulting from the current uncertain and weakened economy. The measure

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of impairment is based primarily on the fair value of collateral securing these loans, which is primarily real estate and equipment.

Impaired Loans With a Related Allowance

We had $3,498,000 and $5,916,000 of impaired loans and leases with a related allowance for credit losses at March 31, 2010 and December 31, 2009, respectively. These consisted of four and five separate loan and lease relationships to unrelated borrowers, with a related allowance for credit losses of $1,199,000 and $1,458,000 at March 31, 2010 and December 31, 2009, respectively. This group of impaired loans and leases has a related allowance due to the probability of the borrower not being able to continue to make principal and interest payments due under the contractual terms of the loan or lease. These loans and leases appear to have insufficient collateral and UNNF s principal may be at risk; as a result, a related allowance is necessary to cover future probable losses.

Impaired Loans without a Related Allowance

We had $2,676,000 and $2,799,000 of impaired loans and leases without a related allowance at March 31, 2010 and December 31, 2009, respectively. These consisted of four and five separate loan and lease relationships at March 31, 2010 and December 31, 2009, respectively. This group of impaired loans and leases is considered impaired due to the likelihood of the borrower not being able to continue to make principal and interest payments due under the contractual terms of the loan or lease. However, these loans and leases appear to have sufficient collateral and our principal does not appear to be at risk of probable principal losses; as a result, our management believes a related allowance is not necessary.

Substandard Loans and Leases

Under UNCB s current internal risk rating system, loans and leases with a rating of substandard that were performing, and not determined to be impaired, amounted to $30,885,000 and $32,410,000 at March 31, 2010 and December 31, 2009, respectively. Despite these credits not being impaired, management believes these substandard credits reflect increased risks to the loan portfolio, including risks resulting from the current weak economy and real estate markets. Management considered such increased risks in determining the provision for credit losses (refer to the related discussion on Provision for Credit Losses on page 25). Management continues to closely monitor the loan portfolio, and the underlying borrower financial performance and collateral values, identifying credit concerns and risks, including those resulting from the current weak economy. Management considers both impaired and these substandard loans to be potential problem loans, and believes that the current persisting and weakened economic conditions may result in additional loans being classified or nonperforming in future periods.

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Nonperforming Assets

Nonperforming assets consist of nonperforming loans and leases, OREO, and repossessed assets. The following table provides a summary of nonperforming assets at March 31, 2010 and December 31, 2009 (dollars in thousands):

	March 31, 2010	December 31, 2009
Nonaccruing Loans	$ 5,255	$ 8,034
Accruing Loans 90 days or more past due	1,236	506
Total Nonperforming Loans and Leases	6,491	8,540
Other Real Estate Owned	8,170	5,383
Repossessed Assets	190	436
Total Nonperforming Assets	$ 14,851	$ 14,359
Gross Loans and Leases	$ 333,028	$ 339,274
Allowance for Credit Losses	$ 5,995	$ 5,858
Nonperforming Loans and Leases as a % of Gross Loans and Leases	1.9%	2.5%
Nonperforming Assets as a % of Total Assets	3.0%	2.9%
Allowance for Credit Losses as a % of Nonperforming Loans and Leases	92%	69%

Nonperforming loans and leases consist of loans and leases that are nonaccruing, and those that are 90 days or more past due. Nonaccruing loans and leases are no longer accruing interest income because of apparent financial difficulties of the borrower. Interest received on nonaccruing loans and leases is recorded as income only after the past due principal is brought current and deemed collectible in full. Total nonperforming loans and leases decreased to $6,491,000, or 1.9%, of gross loans and leases at March 31, 2010, compared to $8,540,000, or 2.5% of gross loans and leases, at December 31, 2009. The decrease in nonperforming loans and leases primarily resulted from several loans being foreclosed on in 2010 and are reported as OREO in the Consolidated Statements of Financial Condition at March 31, 2010. Historically, the percentage of nonperforming loans to gross loans for the five year-end periods ended December 31, 2009, was an average of 1.2%.

OREO includes assets acquired through foreclosure, deed in-lieu of foreclosure, and loans identified as in-substance foreclosures. A loan is classified as an in-substance foreclosure when effective control of the collateral has been taken prior to completion of formal foreclosure proceedings. OREO is held for sale and is recorded at fair value less estimated costs to sell. Costs to maintain OREO and subsequent gains and losses attributable to OREO liquidation are included in the Consolidated Statements of Operations in other income and other expense as realized. No depreciation or amortization expense is recognized. OREO was $8,170,000 and $5,383,000 at March 31, 2010 and December 31, 2009, respectively. The increase was primarily the result of foreclosing on two commercial mortgages in 2010. At March 31, 2010, $7,375,000, or 90% of the total OREO balance, consisted of two commercial properties in Lancaster, Pennsylvania. The remaining $795,000, or 10% of the total OREO balance, was comprised of five smaller commercial and residential properties.

Repossessed assets consist of (i) vehicles and other equipment acquired from lessees, who defaulted on their contractual lease obligation, and (ii) mobile homes where UNCB does not own the underlying real estate. Repossessed assets were $190,000 and $436,000 at March 31, 2010 and December 31, 2009, respectively. The decrease resulted primarily from the write-down of certain repossessed leased assets to fair market value, which amounted to $144,000.

Stockholders Equity

Stockholders equity increased by $392,000 to $31,728,000 at March 31, 2010, compared to $31,336,000 at December 31, 2009. The increase in stockholders equity was primarily the result of other comprehensive income during the period, proceeds received through the Dividend Reinvestment Plan, or DRIP, and increases to retained earnings resulting from year-to-date net income, which was offset by scheduled dividends paid to preferred stockholders.

Our regulatory capital position at March 31, 2010 exceeded the current regulatory required minimums as disclosed below.

Regulatory Capital

Bank regulatory authorities in the United States issue risk-based capital standards. These capital standards relate a bank s capital to the risk profile of its assets and provide the basis by which all banks are evaluated in terms of its capital adequacy. We and UNCB are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on our consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, We and UNCB 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.

Quantitative measures established by regulation to ensure capital adequacy require UNCB and us to maintain minimum amounts and ratios of Tier 1 capital to average assets and of total capital (as defined in the regulations) to risk-weighted assets.

As of March 31, 2010 and December 31, 2009, we and UNCB exceeded the current regulatory requirements to be considered a quantitatively well capitalized financial institution, i.e. a leverage ratio exceeding 5%, Tier 1 risk-based capital exceeding 6%, and total risk-based capital exceeding 10%.

In addition to the above regulatory capital standards, effective September 30, 2009, the OCC established individual minimum capital requirements for UNCB. For additional information, refer to Note 9 Enforcement Actions with Bank Regulatory Agencies to the consolidated financial statements included elsewhere in this proxy statement/prospectus. The specific capital requirements established for UNCB were 8% for Tier 1 capital to average total assets, 9.5% for Tier 1 capital to risk-based assets, and 12% for total capital to risk-based assets. At March 31, 2010, UNCB s measure of Tier I capital to average Total assets was 8.34%, Tier 1 capital to risk-based assets of 10.00% and total capital to risk-based assets of 12.72%. At March 31, 2010, all three ratios exceeded the respective individual minimum capital requirements established by the OCC.

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UNNF and UNCB s regulatory capital levels as of March 31, 2010 and December 31, 2009 were as follows (dollars in thousands):

	Actual		Minimum Required for Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio(1)	Amount	Ratio
Union National Financial Corporation						
March 31, 2010:						
Tier 1 (leverage) capital	$ 42,024	8.52%	$ 19,733	4.00%	N/A	N/A
Tier 1 risk-based capital	42,024	10.22	16,449	4.00	N/A	N/A
Total risk-based capital	53,669	13.05	32,898	8.00	N/A	N/A
December 31, 2009:						
Tier 1 (leverage) capital	$ 42,036	8.52%	$ 19,744	4.00%	N/A	N/A
Tier 1 risk-based capital	42,036	9.93	16,929	4.00	N/A	N/A
Total risk-based capital	53,825	12.72	33,858	8.00	N/A	N/A
Union National Community Bank						
March 31, 2010:						
Tier 1 (leverage) capital	$ 41,004	8.34%	$ 19,671	4.00%	$ 24,589	5.00%
Tier 1 risk-based capital	41,004	10.00	16,400	4.00	24,599	6.00
Total risk-based capital	52,141	12.72	32,799	8.00	40,999	10.00
December 31, 2009:						
Tier 1 (leverage) capital	$ 40,910	8.31%	$ 19,686	4.00%	$ 24,608	5.00%
Tier 1 risk-based capital	40,910	9.69	16,881	4.00	25,322	6.00
Total risk-based capital	52,194	12.37	33,762	8.00	42,203	10.00

(1) The OCC requires UNCB to meet higher individual minimum capital ratios effective September 30, 2009. For additional information, refer to Note 9 Enforcement Actions with Bank Regulatory Agencies included elsewhere in this proxy statement/prospectus.

Included in Tier 1 regulatory capital of UNNF is $10,507,000 of trust capital securities issued through our UNCT I and UNCT II subsidiaries. The balance of these trust capital securities, $493,000, is included in our Tier 2 regulatory capital. In addition, included in Tier 2 regulatory capital of UNCB and UNNF is $6,000,000 of junior subordinated debentures issued by UNCB. These securities would become callable if the FRB makes a determination that trust capital securities can no longer be considered in regulatory capital.

Regulatory capital requirements may be increased in the future. We will closely monitor and evaluate its capital position as the regulatory capital environment changes, and if regulatory capital requirements are changed.

Restrictions

Banking regulations limit the amount of investments, loans, extensions of credit and advances UNCB can make to us at any time to 10% of UNCB s total regulatory capital. At March 31, 2010, this limitation amounted to approximately $5,214,000. These regulations also require any such investment, loan, extension of credit or advance to be secured by securities having a market value in excess of the amount thereof.

UNCB is subject to certain restrictions in connection with the payment of dividends. National banking laws require the approval of the OCC if the total of all dividends declared by a national bank in any calendar year exceeds the net profits of UNCB for that year (as defined) combined with UNCB s retained net operating results for the preceding two calendar years. Under this formula, UNCB s retained net operating results for the preceding two calendar years was ($189,000). As a result, in 2010, UNCB may declare dividends to UNNF in

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an amount equal to the net profits of UNCB in 2010 less $189,000, up to the date of any such dividend declaration. UNCB s net income for the three months ended March 31, 2010 was $94,000, restricting UNCB from declaring or making any dividend payment to us at March 31, 2010.

On January 28, 2010, we entered into an informal Memorandum of Understanding, or MOU, with the Federal Reserve Bank of Philadelphia, or the Philadelphia FRB. The MOU, which is not a written agreement for purposes of Section 8 of the Federal Deposit Insurance Act, requires, among other things, us to seek prior approval by the Philadelphia FRB before we (i) declare or pay dividends to shareholders, (ii) distribute interest, principal or other sums on UNCT I and UNCT II junior subordinated debentures, and (iii) incur, increase or guarantee any additional debt. Subsequent to March 31, 2010, the Philadelphia FRB did approve the quarterly interest payments for the second quarter of 2010 on the UNCT I and UNCT II junior subordinated debentures and the preferred stock dividend payments.

Results of Operations For The Three Months Ended March 31, 2010 and 2009

Overview

We reported a net loss available to common stockholders of ($15,000) or a basic and diluted loss per share of ($0.01) for the first quarter of 2010, compared to a net loss available to common stockholders of ($509,000) or a basic and diluted loss per share of ($0.19) for the same period in 2009. The year-over-year first quarter results improved primarily due to an increased net interest margin for the first quarter of 2010, compared to the same period in 2009, and the first quarter of 2010 not having any impairment charges on investment securities similar to those that occurred in the first quarter 2009.

Our net interest income as adjusted for tax-exempt financial instruments increased $363,000, or 12%, to $3,296,000 for the first quarter of 2010, compared to $2,933,000 for the same period in 2009. The cost of interest-bearing deposits decreased to 1.92% for the first quarter of 2010, compared to 2.65% for same period in 2009, which significantly improved the taxable-equivalent net interest margin percentage to 2.96% for the first quarter of 2010, compared to 2.58% for same period in 2009.

The operating results for the first quarter of 2009 reflected $839,000 in other-than-temporary investment impairment charges related to three pooled trust preferred debt securities that were downgraded to below-investment-grade in 2009. These other-than-temporary investment impairment charges were offset by $411,000 of realized net gains on the sale of investment securities during the first quarter of 2009, resulting in $428,000 of net investment losses. For the first quarter of 2010, gains of $77,000 were realized on the sale of investment securities and UNCB incurred no additional other-than-temporary impairment charges.

The discussion that follows further explains the changes in the components of the operating results when comparing the three months ended March 31, 2010 to the same period in 2009.

Net Interest Income

Net interest income, our primary source of revenue, is the amount by which interest income on loans and investments exceeds interest incurred on deposits and borrowings. The amount of net interest income is affected by changes in interest rates and by changes in the volume and mix of interest-sensitive assets and liabilities. Net interest income and corresponding yields are presented in the discussion and analysis below on a taxable-equivalent basis. Income from tax-exempt assets, primarily loans to or securities issued by state and local governments, is adjusted by an amount equivalent to the federal income taxes which would have been paid if the income received on these assets was taxable at the statutory rate of 34%.

Although the effective interest rate impact on earning assets and funding sources can be reasonably estimated at current interest rate levels, the options selected by customers, and the future mix of the loan, investment and deposit products in UNCB s portfolios, may significantly change the estimates used in the simulation models. In addition, our net interest income may be impacted by further interest rate actions of the FRB and movements in the London Interbank Offered Rate, or LIBOR, upon which certain variable rate loans are priced.

Net interest income as adjusted for tax-exempt financial instruments was $3,296,000 for the three months ended March 31, 2010, compared to $2,933,000 for the same period in 2009. The yield on interest-earning assets decreased by 39 basis points to 4.99% for the first quarter of 2010, compared to 5.38% for the same period in 2009. The interest rate paid on average interest-bearing liabilities decreased by 80 basis points to 2.27% for the first quarter of 2010, compared to 3.07% for the same period in 2009. The decrease in the interest rate paid on average interest-bearing liabilities more than offset the decrease in the yield on interest-earning assets, which resulted in a higher net interest margin for the first quarter of 2010, compared to the same period in 2009. The taxable-equivalent net interest margin percentage for the first quarter of 2010 was 2.96%, compared to 2.58% for the same period in 2009.

Interest and fees on loans and leases on a taxable-equivalent basis decreased by $385,000, or 7%, to $5,047,000 for the three months ended March 31, 2010, compared to $5,432,000 for the same period in 2009. The average yield decreased by 14 basis points to 6.05% for the first quarter of 2010, compared to 6.19% for the same period in 2009. The variable rate structure of many of UNNF s loans reduced the overall yield due to the persistent low market interest rates. The average balance of loans and leases decreased by $17,777,000 for the first quarter of 2010, compared to the same period in 2009 due to reduced loan demand from creditworthy borrowers, the impact of nearly $10 million of loan participations sold for capital and risk management purposes in the third quarter of 2009, and the impact of approximately $8 million of loans that were foreclosed on and transferred to OREO since December 2009. The decrease in interest and fees on loans and leases primarily resulted from the decrease in loans outstanding.

Interest and dividends earned on investment securities on a taxable-equivalent basis decreased by $191,000, or 30%, to $438,000 for the three months ended March 31, 2010, compared to $629,000 for the same period in 2009. The decrease in interest and dividends earned on investment securities primarily resulted from a decrease in the average balance of investment securities, which decreased by $10,638,000 for the first quarter of 2010, compared to the same period in 2009. A lack of income from impaired and non-accruing investments, and reduced yields on re-invested proceeds from investment maturities and sales, also contributed to lower investment interest income for the first quarter of 2010. As a result, the average yield decreased by 66 basis points to 3.12% for the first quarter of 2010, compared to 3.78% for the same period in 2009.

Interest expense on deposits decreased by $621,000, or 27%, to $1,681,000 for the three months ended March 31, 2010, compared to $2,302,000 for the same period in 2009. The decrease in interest expense on deposits was primarily driven by a decrease of 73 basis points in average rate paid on deposits. The average rate paid on deposits was 1.92% for the first quarter of 2010, compared to 2.65% for the same period in 2009.

Interest expense on long-term debt decreased by $252,000, or 39%, to $393,000 for the three months ended March 31, 2010, compared to $645,000 for the same period in 2009. We continued to take measures to reduce our cost of borrowings, prepaying $2,500,000 and $17,000,000 of higher-cost long-term debt in the first quarter of 2010 and for the full year of 2009, respectively, which resulted in a $18,917,000 decrease in the average balance of long-term debt for the first quarter of 2010, compared to the same period in 2009.

Provision for Credit Losses

The provision for credit losses is an expense charged against net interest income to provide for estimated losses attributable to uncollectible loans and leases. The provision is based on management s analysis of the adequacy of the allowance for credit losses. The provision for credit losses was $496,000 for the three months ended March 31, 2010, compared to $313,000 for the same period in 2009. The increased provision was the result of increased credit risk related to the loan portfolio at March 31, 2010, compared to March 31, 2009 (refer to the related discussions on the Allowance for Credit Losses on page 18 and Substandard Loans and Leases on page 20). Management continues to closely monitor the loan portfolio and the adequacy of the allowance for credit loss reserve considering underlying borrower financial performance and collateral values, and increasing credit risks. Future adjustments may be necessary to the provision for credit losses, and consequently the allowance for credit losses, if economic conditions or loan credit quality differ substantially from the assumptions we used in making our evaluation of the level of the allowance for credit losses compared to the balance of outstanding loans and leases.

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Non-Interest Income

Non-interest income increased by $561,000, or 91%, to $1,180,000 for the three months ended March 31, 2010, compared to $619,000 for the same period in 2009. Increases (decreases) in the components of non-interest income when comparing the three months ended March 31, 2010 to the same period in 2009, are as follows (in thousands):

Non-Interest Income	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Increase (Decrease)
Service Charges on Deposit Accounts	$ 458	$ 473	$ (15)
Other Service Charges, Commissions, Fees	288	267	21
Alternative Investment Sales Commissions	167	110	57
Income from Fiduciary Activities	47	46	1
Earnings from Bank-Owned Life Insurance	102	108	(6)
Other Income	41	43	(2)
Net Gain on Sale of Investment Securities	77	411	(334)
Other-than-temporary Impairments (OTTI) of Securities		(839)	839
Portion of OTTI Recognized in Other Comprehensive Income			
Net OTTI Losses on Securities		(839)	839
Total Non-Interest Income	$ 1,180	$ 619	$ 561

A significant portion of the $561,000 increase in non-interest income was related to investment securities activities. The operating results for the first quarter of 2009 reflected $839,000 in other-than-temporary investment impairment charges related to three pooled trust preferred debt securities that were downgraded to below-investment-grade in 2009. These other-than-temporary investment impairment charges were offset by $411,000 of realized net gains on the sale of investment securities during the first quarter of 2009, resulting in $428,000 of net investment losses. For the first quarter of 2010, gains of $77,000 were realized on the sale of investment securities and UNCB incurred no additional other-than-temporary impairment charges.

Non-Interest Expense

Non-interest expense was $4,022,000 for the three months ended March 31, 2010, compared to $4,014,000 for the same period in 2009. Increases (decreases) in the components of non-interest expense when comparing the three months ended March 31, 2010, to the same period in 2009, are as follows (in thousands):

Non-Interest Expense	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009	Increase (Decrease)
Salaries, Wages, and Employee Benefits	$ 1,798	$ 1,946	$ (148)
Net Occupancy	462	478	(16)
Data and ATM Processing	406	404	2
Professional Fees and Regulatory Assessments	206	257	(51)

Furniture and Equipment	218	246	(28)
FDIC Insurance	228	120	108
Pennsylvania Shares Tax	95	89	6
Advertising and Marketing	38	67	(29)
Supplies and Postage	60	74	(14)
Other Expense	511	333	178
Total Non-Interest Expense	$ 4,022	$ 4,014	$ 8

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The discussion that follows explains the significant changes in the components of non-interest expense when comparing the three months ended March 31, 2010 to the same period in 2009.

Salaries, wages and employee benefits decreased by $148,000 for the three months ended March 31, 2010, compared to the same period in 2009. The decrease was related to positions that were eliminated in the first quarter of 2009, savings in health care costs due to UNCB s beneficial participation in a healthcare consortium and savings from the suspension of our 401-K match which began during the second quarter of 2009 and remained suspended through March 31, 2010.

Due to recent changes in deposit premium assessments by the FDIC, FDIC insurance assessments amounted to $228,000 for the three months ended March 31, 2010, representing a $108,000 or 90% increase over the three months ended March 31, 2009. The increase in FDIC insurance premiums was primarily the result of increased base assessment rates, as determined by the FDIC.

The increase in other expense was primarily the result of several repossessed assets being written-down by $144,000 to fair market value. These repossessed assets consisted of vehicles acquired from lessees, who defaulted on their contractual lease obligations, and the write-downs reflect recent significant market devaluations for the types of assets held as repossessed by UNCB. In addition, during the three months ended March 31, 2010, UNCB prepaid $2,500,000 of FHLB advances to further de-leverage UNCB and reduce current and future borrowing costs. In conjunction with the prepayments, UNCB incurred $89,000 of prepayment penalties, which also contributed to the increase in other expense for the three months ended March 31, 2010. UNCB did not prepay any FHLB advances in the first quarter of 2009, and therefore, did not incur any prepayment penalties for the three months ended March 31, 2009.

Income Taxes

An income tax benefit of $82,000 and $328,000 was recorded for the three months ended March 31, 2010 and 2009, respectively. For both of these periods, the benefit resulted from tax-exempt earnings as well as from a pre-tax loss. Generally, our effective tax rate is below the statutory rate due to tax-exempt earnings on loans, investments, and bank-owned life insurance, and the impact of tax credits. The realization of deferred tax assets is dependent upon future earnings. Management anticipates that future earnings will be adequate to fully utilize deferred tax assets.

Liquidity

Our objective is to maintain adequate liquidity to meet funding needs at a reasonable cost and to provide contingency plans to meet unanticipated funding needs or a loss of funding sources, while minimizing interest rate risk. Adequate liquidity provides resources for credit needs of borrowers, for depositor withdrawals and for funding corporate operations. Sources of liquidity are as follows:

- A growing core retail deposit base;
- Proceeds from the sale or maturity of investment securities;
- Payments received on loans and mortgage-backed securities; and,
- Overnight correspondent bank borrowings credit lines, and borrowing capacity available from the FRB.

Management believes that UNCB s core deposits remain fairly stable. Liquidity and funds management is governed by policies and measured on a daily basis, with supplementary weekly and monthly analyses. These measurements indicate that liquidity generally remains stable and exceeds our minimum defined levels of adequacy. Other than the trends of continued competitive pressures and volatile interest rates, there are no known demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in, liquidity increasing or decreasing in any material way.

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Off-Balance Sheet Commitments

In the normal course of business, we are party to financial instruments with off-balance sheet risk to meet the financing needs of our customers. These financial instruments include commitments to extend credit and standby letters of credit. Total commitments to extend credit amounted to $106,597,000 at March 31, 2010 compared to $110,791,000 at December 31, 2009. Total standby letters of credit amounted to $5,725,000 at March 31, 2010 compared to $6,199,000 at December 31, 2009.

In addition, in the normal course of business operations, we routinely enter into contracts for services. These contracts may require payment for services to be provided in the future and may also contain penalty clauses for the early termination of the contracts. In January 2007, the contract with our core data processor was renegotiated, resulting in a new maturity date of November 2013. Any early termination will require the payment of a substantial penalty. For the three months ended March 31, 2010, there has been no material change in contracts for services since this contract was renegotiated.

Regulatory Matters

From time to time, various types of federal and state legislation have been proposed that could result in additional regulation of, and restrictions on, our and UNCB s business. As a consequence of the extensive regulation of commercial banking activities in the United States, our and UNCB s business is particularly susceptible to being affected by federal and state legislation and regulations that may increase the cost of doing business. Also, we are susceptible to changes in tax law that may increase the cost of doing business or impact our ability to realize the value of deferred tax assets. Further, our business is affected by the state of the financial services industry in general. Please refer to Note 9 Enforcement Actions with Bank Regulatory Agencies to the consolidated financial statements included elsewhere in this proxy statement/prospectus for a discussion on specific regulatory matters impacting us.

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

Overview

Management s discussion and analysis represents an overview of the financial condition and results of operations, and highlights the significant changes in the financial condition and results of operations, as presented in our accompanying consolidated financial statements. Our consolidated financial condition and results of operations consist primarily of UNCB s financial condition and results of operations. We established our trust subsidiaries, UNNF Capital Trust I, or UNCT I, and UNNF Capital Trust II, or UNCT II, for the purpose of issuing $11.0 million of trust capital securities during 2003 and 2004. Refer to Note 16 Residential Mortgage Business Venture to the consolidated financial statements included elsewhere in this proxy statement/prospectus for information about our former subsidiaries Home Team Financial, LLC and TA of Lancaster, LLC.

Financial Condition

Total assets increased by $4,535,000 or 1% to $489,644,000 at December 31, 2009 from $485,109,000 at December 31, 2008. The increase was primarily the result of strong retail deposit generation, which further strengthened UNNF s liquidity position. The proceeds received from the deposit growth were used to pay down high cost long-term debt and to purchase short-term investments. Total deposits grew by $21,188,000 or 6% to $404,765,000 at December 31, 2009 from $383,577,000 at December 31, 2008.

Investment Securities

Investment securities were $60,546,000 at December 31, 2009 compared to $64,289,000 at December 31, 2008. All of our investment securities were classified as available for sale at December 31, 2009 and 2008. Investment securities classified as available for sale are marketable equity securities, and those debt securities that we intend to hold for an undefined period of time, but not necessarily to maturity. In addition to the investment portfolio generating interest income, it serves other primary financial management functions such

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as an ultimate source of liquidity and a tool to manage interest rate risk. In order to support these functions, the entire investment securities portfolio has been designated as being available for sale. Any decision to sell an available-for-sale investment security would be based on various factors, including significant movements in interest rates, changes in maturity mix of assets and liabilities, liquidity needs, regulatory capital considerations, changes in the creditworthiness of the issuing entity, changes in investment strategy and portfolio mix, and other similar factors. Changes in unrealized gains or losses on available-for-sale investment securities, net of taxes, are recorded as other comprehensive (loss) income, a component of stockholders equity.

At December 31, 2009, there were no significant concentrations of investments (greater than 10% of stockholders equity) in any individual investment security issue. The investment securities portfolio included $53,394,000 or 88% of U.S. agency mortgage-backed securities at December 31, 2009.

The following is a summary of available-for-sale investment securities recorded at fair value as of December 31, 2009, 2008 and 2007 (in thousands):

	At December 31,		
	2009	**2008**	**2007**
U.S. Agency Mortgage-Backed Securities	$ 53,394	$ 56,250	$ 19,572
Private Issuer Mortgage-Backed Securities	2,638	3,219	6,658
Obligations of U.S. Government Agencies		3,396	43,086
Obligations of State and Political Subdivisions	3,815		
Corporate Debt Securities	631	1,218	4,413
Equity Securities	68	206	447
Total	$ 60,546	$ 64,289	$ 74,176

The following table presents the stated maturities of investment securities at fair value and the weighted-average yields as of December 31, 2009. Yields are shown on a taxable-equivalent basis, assuming a 34% federal income tax rate (dollars in thousands).

	Within 1 Year	**1-5 Years**	**5-10 Years**	**After 10 Years**	**No Stated Maturity**	**Total**	**Yield**
U.S. Agency Mortgage-Backed Securities(1)	$	$	$	$ 53,394	$	$ 53,394	4.31%
Private Issuer Mortgage-Backed Securities				2,638		2,638	
Obligations of State and Political Subdivisions				3,815		3,815	5.89
Corporate Debt Securities				631		631	
Equity Securities(2)					68	68	2.67
Total Securities	$	$	$	$ 60,478	$ 68	$ 60,546	4.18%

Yield	%	%	%	4.18%	2.67%(2)	4.18%

(1) It is anticipated that the mortgage-backed securities will be repaid prior to their contractual maturity dates. The yield for these securities is impacted by normal amortization and estimated prepayments based on current market interest rates.

(2) The yield on the equity securities assumes the same dividend payout ratio as in 2009.

The realized rate of return on average investment securities, including net investment securities gains (losses) and OTTI charges was 3.39% and 3.12% for the years ended December 31, 2009 and 2008,

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respectively. The following table presents the realized rate of return on average investment securities by investment category for the years ended December 31, 2009 and 2008 (dollars in thousands).

	Year Ended December 31, 2009					
	Average Balance	Tax-Equivalent Interest and Dividends	Net Realized Gain on Sale	OTTI Charge	Total Return	Yield
U.S. Agency and Treasury Holdings	$ 58,661	$ 1,551	$ 1,749	$	$ 3,300	5.63%
Private Issuer MBS and Corporate Securities	3,834	131		(1,504)	(1,373)	(35.81)
All Other Securities	5,766	294	92		386	6.69
Total	$ 68,261	$ 1,976	$ 1,841	$ (1,504)	$ 2,313	3.39%

	Year Ended December 31, 2008					
	Average Balance	Tax-Equivalent Interest and Dividends	Net Realized Gain (Loss) on Sale	OTTI Charge	Total Return	Yield
U.S. Agency and Treasury Holdings	$ 62,675	$ 2,904	$ 256	$	$	