MERIDIAN INTERSTATE BANCORP INC
Form 10-K
March 15, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Fiscal Year Ended December 31, 2012

OR

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission file number 001-33898

Meridian Interstate Bancorp, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts	**20-4652200**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
10 Meridian Street, East Boston, Massachusetts	**02128**
(Address of Principal Executive Offices)	*Zip Code*

(617) 567-1500

(Registrant s telephone number, including area code)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, no par value	**The NASDAQ Stock Market, LLC**

Securities Registered Pursuant to Section 12(g) of the Act:

None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this form 10-K. þ

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

Large Accelerated Filer	¨	Accelerated Filer	þ	Non-Accelerated Filer	¨	Smaller Reporting Company	¨

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

The aggregate market value of the common stock held by non-affiliates of the Registrant, computed by reference to the closing price of such stock on June 30, 2012 was approximately $108,314,541. As of March 1, 2013, there were 22,138,805 outstanding shares of the Registrant s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2013 Annual Meeting of Stockholders of the Registrant are incorporated by reference in Part III of this Form 10-K.

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MERIDIAN INTERSTATE BANCORP, INC.

2012 FORM 10-K ANNUAL REPORT

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PART I

Forward Looking Statements

This report contains certain forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek and similar expressions. These forward looking statements include:

- statements of our goals, intentions and expectations;
- statements regarding our business plans, prospects, growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

These forward-looking statements are subject to significant risks and uncertainties. Actual results may differ materially from those contemplated by the forward-looking statements due to, among others, the following factors:

- general economic conditions, either nationally or in our market area, that are worse than expected;
- inflation and changes in the interest rate environment that reduce our interest margins or reduce the fair value of financial instruments;
- increased competitive pressures among financial services companies;
- changes in consumer spending, borrowing and savings habits;
- our ability to enter new markets successfully and take advantage of growth opportunities, and the possible dilutive effect of potential acquisitions or *de novo* branches, if any;
- legislative or regulatory changes that adversely affect our business;
- adverse changes in the securities markets;
- changes in accounting policies and practices, as may be adopted by the bank regulatory agencies, the Financial Accounting Standards Board or the Securities and Exchange Commission;
- inability of third-party providers to perform their obligations to us; and

changes in our organization, compensation and benefit plans.

Any of the forward-looking statements that we make in this report and in other public statements we make may later prove incorrect because of inaccurate assumptions we might make, the factors illustrated above or other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from the results indicated by these forward-looking statements and you should not rely on such statements. In addition, please see Item 1A. Risk Factors. Except as may be required by law, we disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1. ***BUSINESS***

Meridian Interstate Bancorp, Inc.

Meridian Interstate Bancorp, Inc. (the Company) is a Massachusetts mid-tier stock holding company that was formed in 2006 by East Boston Savings Bank to be its holding company. The Company owns all of East Boston Savings Bank s capital stock and directs, plans and coordinates East Boston Savings Bank s business activities. The Company previously owned 43% of the capital stock of Hampshire First Bank, a New Hampshire chartered bank, organized in 2006 and headquartered in Manchester, New Hampshire. On November 16, 2011, Hampshire First Bank entered into an Agreement and Plan of Merger with NBT Bancorp, Inc. (NBTB) and NBT Bank, N.A. which was completed on June 8, 2012. For more information about this transaction, see Item 1 Business Subsidiaries and Affiliates. At December 31, 2012, the Company had total assets of $2.279 billion, deposits of $1.865 billion and stockholders equity of $233.9 million.

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Meridian Financial Services, Incorporated

Meridian Financial Services, Incorporated (Meridian) is the Company s Massachusetts-chartered mutual holding company parent. As a mutual holding company, Meridian is a non-stock company. Meridian owns 59.5% of the Company s common stock. So long as Meridian exists, it will own a majority of the voting stock of the Company and, through its Board of Trustees, will be able to exercise voting control over most matters put to a vote of stockholders. Of the 12 directors of the Company, 10 are also members of the Board of Trustees of Meridian, which is composed of 30 members. Meridian does not currently intend to engage in any business activity other than those relating to owning a majority of the common stock of the Company.

East Boston Savings Bank

East Boston Savings Bank (the Bank) is a Massachusetts-chartered stock savings bank that operates from 26 full-service locations and three loan centers in the greater Boston metropolitan area. The Bank operates nine of its full-service locations and a loan center under the name Mt. Washington Bank, a Division of East Boston Savings Bank. The Bank was originally founded in 1848. We offer a variety of deposit and loan products to individuals and businesses located in our primary market, which consists of Suffolk, Middlesex and Essex Counties, Massachusetts.

We operate as a community-oriented financial institution offering financial services to consumers and businesses in our market area. We attract deposits from the general public and use those funds to originate one-to four-family real estate, multi-family and commercial real estate, construction, commercial business and consumer loans which we primarily hold for investment. Our lending business also involves the purchase and sale of loan participation interests. We also offer non-deposit financial products through a third-party network arrangement. On January 4, 2010, the Bank completed its acquisition of Mt. Washington Co-operative Bank (Mt. Washington). Refer to Item 8 *Financial Statements and Supplementary Data*, Note 2 to the consolidated financial statements for information regarding the transaction.

Available Information

The Company is a public company and files interim, quarterly and annual reports with the Securities and Exchange Commission. These respective reports are on file and a matter of public record with the Securities and Exchange Commission and may be read and copied at the Securities and Exchange Commission s Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC (http://www.sec.gov).

Our website address is www.ebsb.com. Information on our website should not be considered a part of this report.

Market Area

We consider the greater Boston metropolitan area to be our primary market area. While our primary deposit-gathering area is concentrated in the greater Boston metropolitan area, our lending area encompasses a broader market that includes most of eastern Massachusetts east of Route 93, including Cape Cod, and portions of south-eastern New Hampshire and Maine. We conduct our operations through our 26 full-service offices and three loan centers located in the following counties, all of which are located in the greater Boston metropolitan area: Essex (five offices and two loan centers), Middlesex (six offices) and Suffolk (15 offices and one loan center). The greater Boston metropolitan area is the 10th largest metropolitan area in the United States. Located adjacent to major transportation corridors, the Boston metropolitan area provides a highly diversified economic base, with major employment sectors ranging from services, manufacturing and wholesale retail trade, to finance, technology and medical care. Based on data from the Federal Reserve Bank of Boston, the unemployment rate for Massachusetts decreased to 6.7% for December 2012 from 6.9% from December 2011. Home prices in Massachusetts rose at an annual rate of 2.6% in the third quarter of 2012 compared to 2.6% for the third quarter of 2011.

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Competition

We face significant competition for the attraction of deposits and origination of loans. Our most direct competition for deposits has historically come from the many financial institutions operating in our market area and, to a lesser extent, from other financial service companies such as brokerage firms and insurance companies. Several large holding companies operate banks in our market area. These institutions are significantly larger than us and, therefore, have greater resources. We also face competition for investors funds from money market funds, mutual funds and other corporate and government securities. Based on data from the Federal Deposit Insurance Corporation (the FDIC) as of June 30, 2012, the Bank had 0.73% of the deposit market share within the Boston-Cambridge-Quincy, Massachusetts New Hampshire metropolitan statistical area.

Our competition for loans comes from financial institutions in our market area and from other financial service providers, such as mortgage companies and mortgage brokers. Competition for loans also comes from the increasing number of non-depository financial service companies entering the mortgage market, such as insurance companies, securities companies and specialty finance companies.

We expect competition to remain intense in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. Technological advances, for example, have lowered barriers to entry, allowed banks to expand their geographic reach by providing services over the internet and made it possible for non-depository institutions to offer products and services that traditionally have been provided by banks. Changes in federal law permit affiliation among banks, securities firms and insurance companies, which promotes a competitive environment in the financial services industry.

Lending Activities

Commercial Real Estate Loans

At December 31, 2012, commercial real estate loans were $795.6 million, or 44.0%, of our total loan portfolio. The commercial real estate loan portfolio consisted of $167.9 million of fixed-rate loans and $627.7 million of adjustable-rate loans at December 31, 2012. We currently target new individual commercial real estate loan originations to small- and mid-size owner occupants and investors in our market area and can, by policy, originate loans to one borrower up to $25.0 million, with exceptions greater than $25.0 million as approved by the Bank s Executive Committee of the Board of Directors. Our commercial real estate loans are generally secured by properties used for business purposes such as office buildings, industrial facilities and retail facilities. We intend to continue to grow our commercial real estate loan portfolio while maintaining prudent underwriting standards. In addition to originating these loans, we also participate in loans with other financial institutions.

We originate a variety of fixed- and adjustable-rate commercial real estate loans for terms up to 30 years. Interest rates and payments on our adjustable-rate loans adjust every three or five years and generally are adjusted to a rate equal to a percentage above the corresponding U.S. Treasury rate or Federal Home Loan Bank borrowing rate. Most of our adjustable-rate commercial real estate loans adjust every five years and amortize over terms of 20 to 25 years. The maximum amount by which the interest rate may be increased or decreased is generally 2.5% per adjustment period, with a lifetime interest rate cap of 5% over the initial interest rate of the loan. Loan amounts generally do not exceed 75% to 80% of the property s appraised value at the time the loan is originated.

At December 31, 2012, loan participations purchased totaled $57.9 million. The properties securing these loans are located primarily in eastern Massachusetts and southern New Hampshire. Our underwriting practices with respect to loan participations generally do not differ from loans that we originate.

One-to Four-Family Residential Loans

Our one-to four-family residential loan portfolio consists of mortgage loans that enable borrowers to purchase or refinance existing homes, most of which serve as the primary residence of the owner. At December 31, 2012, one-to four-family residential loans were $443.2 million, or 24.5% of our total loan portfolio, consisting of $134.1 million and $309.1 million of fixed-rate and adjustable-rate loans, respectively. We generally offer fixed-rate loans with terms up to 30 years and adjustable-rate loans with terms up to 40 years.

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Generally, our fixed-rate loans conform to Fannie Mae and Freddie Mac underwriting guidelines and those with longer terms (more than 15 years) are originated with the intention to sell. Our adjustable-rate mortgage loans generally adjust annually or every three years after an initial fixed period that ranges from three to seven years. Management has the intent and ability to hold the remaining fixed-rate bi-weekly loans in the Company s loan portfolio for the foreseeable future or until maturity or pay-off. Interest rates and payments on our adjustable-rate loans generally are adjusted to a rate equal to a percentage above the one or three year U.S. Treasury index. Depending on the loan type, the maximum amount by which the interest rate may be increased or decreased is generally 2% per adjustment period and the lifetime interest rate caps range from 2% to 4% over the initial interest rate of the loan. Our residential loans generally do not have prepayment penalties.

Borrower demand for adjustable-rate compared to fixed-rate loans is a function of the level of interest rates, the expectations of changes in the level of interest rates, and the difference between the interest rates and loan fees offered for fixed-rate mortgage loans as compared to the interest rates and loan fees for adjustable-rate loans. The relative amount of fixed-rate and adjustable-rate mortgage loans that can be originated at any time is largely determined by the demand for each in a competitive environment. The loan fees, interest rates and other provisions of mortgage loans are determined by us on the basis of our own pricing criteria and competitive market conditions.

While one-to four-family residential real estate loans are normally originated with up to 30-year terms, such loans typically remain outstanding for substantially shorter periods because borrowers often prepay their loans in full either upon sale of the property pledged as security or upon refinancing the original loan. Therefore, average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans. We do not offer loans with negative amortization and generally do not offer interest-only one-to four-family residential real estate loans. Additionally, our current practice is generally (1) to sell to the secondary market newly originated longer term (more than 15 year terms) fixed-rate one-to four-family residential real estate loans, and (2) to hold in our portfolio shorter-term fixed-rate loans, bi-weekly amortization loans and adjustable-rate loans. We sell residential real estate loans in the secondary market, primarily with servicing released. We also sell loans to Fannie Mae, the Federal Home Loan Bank Mortgage Partnership Finance Program and other investors with servicing retained.

We will make loans with loan-to-value ratios up to 95% (100% for first time home buyers) with such value measured at origination; however, we generally require private mortgage insurance for loans with a loan-to-value ratio over 80%. We require all properties securing mortgage loans to be appraised by a licensed real estate appraiser. We generally require title insurance on all first mortgage loans. Borrowers must obtain hazard insurance, and flood insurance is required for loans on properties located in a flood zone.

In an effort to provide financing for first-time buyers, we offer five-year adjustable-rate and fixed-rate 30-year residential real estate loans through the Massachusetts Housing Finance Agency First Time Home Buyer Program. We offer mortgage loans through this program to qualified individuals and originate the loans using modified underwriting guidelines, reduced interest rates and loan conditions.

We also offer loans secured by one-to four-family properties that are not owner-occupied. These loans consist primarily of bi-weekly fixed-rate loans with terms up to 30 years and adjustable-rate loans which adjust annually after an initial fixed period of three years or adjust every three years after an initial fixed period of five years. Non-owner-occupied one-to four-family residential loans generally can be made with a loan-to-value ratio of up to 80% with such value measured at origination. At December 31, 2012, these loans totaled $62.2 million.

To a lesser extent we also originate land loans primarily to local contractors and developers for making improvements on approved one-to four-family building lots. Such loans are generally written with a maximum 75% loan-to-value ratio based upon the appraised value or purchase price, whichever is less, for a term of up to three years. Interest rates on our land loans are fixed for three years. At December 31, 2012, land loans totaled $1.2 million.

Multi-Family Real Estate Loans

At December 31, 2012, multi-family real estate loans were $178.9 million, or 9.9%, of our total loan portfolio. The multi-family loan portfolio consisted of $6.7 million of fixed-rate loans and $172.2 million of adjustable-rate loans at December 31, 2012. We currently target new individual multi-family real estate loan originations to small- and mid-size owners and investors in our market area and can, by policy, originate loans to one borrower up to $25.0 million, with exceptions greater than $25.0 million as approved by the Bank s Executive Committee of the Board of Directors. Our multi-family real estate loans are generally secured by apartment buildings. We intend to continue to grow our multi-family loan portfolio, while maintaining prudent underwriting standards. In addition to originating these loans, we also participate in loans with other financial institutions.

We originate a variety of adjustable-rate multi-family real estate loans for terms up to 30 years. Interest rates and payments on our adjustable-rate loans adjust every three, five or seven years and generally are adjusted to a rate equal to a percentage above the corresponding U.S. Treasury rate or Federal Home Loan Bank borrowing rate. Most of our adjustable-rate multi-family real estate loans adjust every five years and amortize over terms of 20 to 25 years. The maximum amount by which the interest rate may be increased or decreased is generally 2.5% per adjustment period. Loan amounts generally do not exceed 75% to 80% of the property s appraised value at the time the loan is originated.

Construction Loans

At December 31, 2012, construction loans were $173.3 million, or 9.6% of our total loan portfolio. We expect to continue some level of construction lending, when appropriate, while maintaining a guarded, disciplined approach given the current decline in demand in the local real estate market. We remain focused on a strong credit culture and underwriting standards, as described below. In addition, we continue to carefully monitor the existing construction portfolio for performance and project completion, with a goal of moving completed commercial projects to the commercial real estate portfolio and reviewing sales based projects for tracking toward construction goals.

We primarily make construction loans for commercial development projects, including apartment buildings, small industrial buildings and retail and office buildings. We also originate adjustable loans to individuals and to builders to finance the construction of residential dwellings. Most of our construction loans are interest-only loans that provide for the payment of only interest during the construction phase, which is usually up to 12 to 24 months, although some construction loans are renewed, generally for one or two additional years. At the end of the construction phase, the loan may convert to a permanent mortgage loan or the loan may be paid in full. Loans generally can be made with a maximum loan-to-value ratio of 80% of the appraised market value upon completion of the project. As appropriate to the underwriting, a discounted cash flow analysis is utilized. Before making a commitment to fund a construction loan, we require an appraisal of the property by an independent licensed appraiser. We also will generally require an inspection of the property before disbursement of funds during the term of the construction loan.

We also originate construction and site development loans to contractors and builders to finance the construction of single-family homes and subdivisions. While we may originate these loans whether or not the collateral property underlying the loan is under contract for sale, we consider each project carefully in light of the current slow-down in the residential real estate market. Residential real estate construction loans include single-family tract construction loans for the construction of entry level residential homes. Loans to finance the construction of single-family homes and subdivisions are generally offered to experienced builders in our primary market areas. The maximum loan-to-value limit applicable to these loans is generally 75% to 80% of the appraised market value upon completion of the project. Development plans are required from builders prior to making the loan. Our loan officers are required to personally visit the proposed site of the development and the sites of competing developments. We require that builders maintain adequate insurance coverage. While maturity dates for residential construction loans are largely a function of the estimated construction period of the project, and generally do not exceed one year, land development loans generally are for 18 to 24 months. Substantially all of our residential construction loans have adjustable rates of interest based on U.S. Treasury rates, Federal Home

Loan Bank rates or *The Wall Street Journal* prime rate, and during the term of construction, the accumulated interest is added to the principal of the loan through an interest reserve. Construction loan proceeds are disbursed periodically in increments as construction progresses and as inspection by our approved inspectors warrant.

At December 31, 2012, we had $39.8 million in construction loans for one-to four-family residential properties that will convert to permanent loans. Also at that date, we had $133.5 million in construction loans on commercial and multi-family real estate consisting of mixed-use and non-residential loans.

Commercial Business Loans

We make commercial business loans primarily in our market area to a variety of professionals, sole proprietorships, nonprofit organizations and small businesses. At December 31, 2012, commercial business loans were $147.8 million, or 8.2% of our total loan portfolio, and we intend to increase the amount of commercial business loans that we originate. In the third quarter of 2011, we significantly expanded our commercial business lending capacity with the establishment of a new corporate banking division comprised of a veteran team of bankers that is expected to enhance our presence in all of our market areas and add strength to our business platform.

Commercial lending products include term loans and revolving lines of credit. Commercial loans and lines of credit are made with either variable or fixed rates of interest. Variable rates are based on the prime rate as published in *The Wall Street Journal*, plus a margin. Initial rates on fixed-rate business loans are generally based on a corresponding U.S. Treasury or Federal Home Loan Bank rate, plus a margin. Commercial business loans typically have shorter maturity terms and higher interest rates than commercial real estate loans, but may involve more credit risk because of the type and nature of the collateral. We are focusing our efforts on small- to medium-sized, privately-held companies with local or regional businesses that operate in our market area and can, by policy, originate loans to one borrower up to $25.0 million, with exceptions greater than $25.0 million as approved by the Bank s Executive Committee of the Board of Directors.

When making commercial loans, we consider the financial statements of the borrower, our lending history with the borrower, the debt service capabilities of the borrower, the projected cash flows of the business and the value of the collateral, primarily real estate, accounts receivable, inventory and equipment. Depending on the collateral used to secure the loans, commercial loans are made in amounts of up to 80% of the value of the collateral securing the loan. All of these loans are secured by assets of the respective borrowers.

Home Equity Lines of Credit

We offer home equity lines of credit, which are secured by owner-occupied one-to four-family residences. At December 31, 2012, the outstanding balance owed on home equity lines of credit amounted to $60.9 million, or 3.4% of our total loan portfolio. Home equity lines of credit have adjustable rates of interest with ten-year draws amortized over 15 years that are indexed to the Prime Rate as published by *The Wall Street Journal* on the last business day of the month. Our home equity lines either have a monthly variable interest rate or an interest rate that is fixed for five years and that adjusts in years six and 11. We offer home equity lines of credit with cumulative loan-to-value ratios generally up to 80%, when taking into account both the balance of the home equity loans and first mortgage loan.

The procedures for underwriting home equity lines of credit include an assessment of the applicant s payment history on other debts and ability to meet existing obligations and payments on the proposed loan. Although the applicant s creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral to the proposed loan amount. The procedures for underwriting one-to four-family residential real estate loans apply equally to home equity loans.

Consumer Loans

We offer automobile loans, loans secured by passbook or certificate accounts and overdraft loans. At December 31, 2012, consumer loans were $7.1 million, or 0.4% of total loans. The procedures for underwriting consumer loans include an assessment of the applicant s payment history on other debts and ability to meet

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existing obligations and payments on the proposed loan. Although the applicant s creditworthiness is a primary consideration, the underwriting process also includes a comparison of the value of the collateral, if any, to the proposed loan amount.

Loan Underwriting Risks

Adjustable-Rate Loans

While we anticipate that adjustable-rate loans will better offset the adverse effects of an increase in interest rates as compared to fixed-rate mortgages, an increased monthly mortgage payment required of adjustable-rate loan borrowers in a rising interest rate environment could cause an increase in delinquencies and defaults. The marketability of the underlying property also may be adversely affected in a high interest rate environment. In addition, although adjustable-rate mortgage loans make our asset base more responsive to changes in interest rates, the extent of this interest sensitivity is limited by the annual and lifetime interest rate adjustment limits on residential loans.

Commercial and Multi-Family Real Estate Loans

Loans secured by commercial and multi-family real estate generally have larger balances and involve a greater degree of risk than one-to four-family residential mortgage loans. Of primary concern in commercial and multi-family real estate lending is the borrower s creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans, to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, we require borrowers and loan guarantors, if any, to provide annual financial statements on commercial and multi-family real estate loans. In reaching a decision on whether to make a commercial or multi-family real estate loan, we consider and review a global cash flow analysis of the borrower and consider the net operating income of the property, the borrower s expertise, credit history and profitability and the value of the underlying property. We have generally required that the properties securing these real estate loans have debt service coverage ratios (the ratio of earnings before debt service to debt service) of at least 1.20x. An environmental phase one report is obtained when the possibility exists that hazardous materials may have existed on the site, or the site may have been impacted by adjoining properties that handled hazardous materials. Land loans secured by improved lots generally involve greater risks than residential mortgage lending because land loans are more difficult to evaluate. If the estimate of value proves to be inaccurate, in the event of default and foreclosure, we may be confronted with a property the value of which is insufficient to assure full payment.

Construction Loans

Our construction loans are based upon estimates of costs and values associated with the completed project. Construction lending involves additional risks when compared with permanent residential lending because funds are advanced upon the security of the project, which is of uncertain value prior to its completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. This type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. In addition, generally during the term of a construction loan, interest may be funded by the borrower or disbursed from an interest reserve set aside from the construction loan budget. These loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. A discounted cash flow analysis is utilized for determining the value of any construction project of five or more units. Our ability to continue to originate a significant amount of construction loans is dependent on the strength of the housing market in our market areas.

Commercial Business Loans

Unlike residential mortgage loans, which generally are made on the basis of the borrower s ability to make repayment from his or her employment or other income, and which are secured by real property whose value tends to be more easily ascertainable, commercial business loans are of higher risk and typically are made on the basis of the borrower s ability to make repayment from the cash flow of the borrower s business and the collateral securing these loans may fluctuate in value. Our commercial business loans are originated primarily based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Most often, this collateral consists of real estate, accounts receivable, inventory or equipment. Credit support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any. As a result, the availability of funds for the repayment of commercial business loans may depend substantially on the success of the business itself. Further, any collateral securing such loans may depreciate over time, may be difficult to appraise and may fluctuate in value.

Consumer Loans

Consumer loans may entail greater risk than residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly, such as motor vehicles. Repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment for the outstanding loan and a small remaining deficiency often does not warrant further substantial collection efforts against the borrower. Consumer loan collections depend on the borrower s continuing financial stability, and therefore are likely to be adversely affected by various factors, including job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on such loans.

Loan Originations, Purchase and Sales

Loan originations come from a variety of sources. The primary sources of loan originations are current customers, walk-in traffic, our website, advertising and referrals from customers as well as our directors, trustees and corporates. We advertise in newspapers that are widely circulated throughout our market area and on local radio. We also participate in loans with others to supplement our origination efforts. We generally do not purchase whole loans.

We generally originate loans for our portfolio; however, we generally agree to sell to the secondary market newly originated conforming fixed-rate, 16- to 30-year one-to four-family residential real estate loans. Our decision to sell loans is based on prevailing market interest rate conditions and interest rate risk management. We sell residential real estate loans in the secondary market, primarily with servicing released. We also sell loans to Fannie Mae, the Federal Home Loan Bank Mortgage Partnership Finance Program and other investors with servicing retained. In addition, we sell participation interests in commercial real estate loans to local financial institutions, primarily on the portion of loans exceeding our borrowing limits, or as is prudent in concert with recognition of credit risk. For the years ended December 31, 2012 and December 31, 2011, we originated $191.6 million and $97.6 million of residential real estate loans for sale, respectively, and sold $183.0 million and $106.4 million of loans, respectively. At December 31, 2012, we were servicing $174.3 million of residential real estate loans for others.

Loan Approval Procedures and Authority

Our lending activities follow written, non-discriminatory, underwriting standards and loan origination procedures established by the Bank s Board of Directors and management. The Bank s Board of Directors has granted loan approval authority to certain officers up to prescribed limits, depending on the officer s experience, the type of loan and whether the loan is secured or unsecured. Loans below $1.0 million require approval by members of senior management. Loans from $1.0 million up to $2.0 million require approval by management s loan committee. Loans in excess of $2.0 million generally must be authorized by the Bank s Executive Committee of the Board of Directors.

Loans-to-One Borrower Limit and Loan Category Concentration

The maximum amount that we may lend to one borrower and the borrower s related entities is generally limited, by statute, to 20% of our capital, which is defined under Massachusetts law as the sum of our capital stock, surplus account and undivided profits. At December 31, 2012, our regulatory limit on loans-to-one borrower was $40.1 million. At that date, our largest lending relationship consisted of one loan for $25.2 million and was secured by commercial real estate. This loan was performing in accordance with its original repayment terms at December 31, 2012.

Loan Commitments

We issue commitments for fixed- and adjustable-rate mortgage loans conditioned upon the occurrence of certain events. Commitments to originate mortgage loans are legally binding agreements to lend to our customers. Generally, our loan commitments expire after 60 days.

Investment Activities

We have legal authority to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various government-sponsored enterprises, residential mortgage-backed securities and municipal governments, deposits at the Federal Home Loan Bank of Boston, certificates of deposit of federally insured institutions, investment grade corporate bonds and investment grade marketable equity securities, including common stock and money market mutual funds. Our equity securities generally pay dividends. We also are required to maintain an investment in Federal Home Loan Bank of Boston stock, which investment is based on the level of our FHLB borrowings. While we have the authority under applicable law to invest in derivative securities, we had no investments in derivative securities at December 31, 2012.

At December 31, 2012, our investment portfolio consisted primarily of corporate bonds, municipal bonds, investment-grade marketable equity securities, money market mutual fund investments, short-term obligations of government-sponsored enterprises and mortgage-backed securities.

Our investment objectives are to provide and maintain liquidity, to establish an acceptable level of interest rate and credit risk, to provide a use of funds when demand for loans is weak and to generate a favorable return. Our Board of Directors has the overall responsibility for the investment portfolio, including approval of our investment policy. The Executive Committee of the Board of Directors and management are responsible for implementation of the investment policy and monitoring our investment performance. Our Executive Committee reviews the status of our investment portfolio monthly.

Each reporting period, the Company evaluates all securities with a decline in fair value below the amortized cost of the investment to determine whether or not the impairment is deemed to be other-than-temporary (OTTI). OTTI is required to be recognized if (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. Marketable equity securities are evaluated for OTTI based on the severity and duration of the impairment and, if deemed to be other than temporary, the declines in fair value are reflected in earnings as realized losses. For impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. For all other impaired debt securities, credit-related OTTI is recognized through earnings and non-credit related OTTI is recognized in other comprehensive income/loss, net of applicable taxes.

Deposit Activities and Other Sources of Funds

General

Deposits, borrowings and loan repayments are the major sources of our funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general interest rates and market conditions.

Deposit Accounts

The substantial majority of our depositors reside in our market area. Deposits are attracted by advertising and through our website, primarily from within our market area through the offering of a broad selection of deposit instruments, including non-interest-bearing demand deposits (such as checking accounts), interest-bearing demand accounts (such as NOW and money market accounts), savings accounts and certificates of deposit. In addition to accounts for individuals, we also offer several commercial checking accounts designed for the businesses operating in our market area.

Deposit account terms vary according to the minimum balance required, the time period that funds must remain on deposit, and the interest rate, among other factors. In determining the terms of our deposit accounts, we consider the rates offered by our competition, our liquidity needs, profitability, and customer preferences and concerns. We generally review our deposit mix and pricing on a weekly basis. Our deposit pricing strategy has generally been to offer competitive rates and to periodically offer special rates in order to attract deposits of a specific type or term.

Borrowings

We may utilize advances from the Federal Home Loan Bank of Boston to supplement our supply of investable funds. The Federal Home Loan Bank functions as a central reserve bank providing credit for its member financial institutions. As a member, we are required to own capital stock in the Federal Home Loan Bank and are authorized to apply for advances on the security of such stock and certain of our whole first mortgage loans and other assets (principally securities which are obligations of, or guaranteed by, the United States), provided certain standards related to creditworthiness have been met. Advances are made under several different programs, each having its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based either on a fixed percentage of an institution s net worth or on the Federal Home Loan Bank s assessment of the institution s creditworthiness. As of December 31, 2012, we had $69.3 million of available borrowing capacity with the Federal Home Loan Bank of Boston, including an available line of credit of $9.4 million at an interest rate that adjusts daily. All of our borrowings from the Federal Home Loan Bank are secured by a blanket lien on qualified collateral, including certain investment securities and first mortgage loans on owner-occupied residential property held in the Bank s portfolio.

Financial Services

We offer customers a range of non-deposit products, including mutual funds, annuities, stocks and bonds which are offered and cleared by a third-party broker-dealer. We receive a portion of the commissions generated by our sales to our customers. We also offer customers long-term care insurance through a third-party insurance company which generates commissions for us. Our non-deposit products generated $432,000, $198,000 and $302,000 of non-interest income during the years ended December 31, 2012, 2011 and 2010, respectively.

Personnel

As of December 31, 2012, we had 348 full-time and 85 part-time employees, none of whom is represented by a collective bargaining unit. We believe our working relationship with our employees is excellent.

Subsidiaries and Affiliates

In addition to the Bank, the Company has another wholly-owned subsidiary, Meridian Interstate Funding Corporation, a Massachusetts corporation established in 2008 to loan funds to the Company s Employee Stock Ownership Plan (ESOP) to purchase stock in our initial public offering. At December 31, 2012, Meridian Interstate Funding Corporation had total assets of $10.0 million and total equity of $9.8 million.

The Company previously owned a 43% share in Hampshire First Bank, a New Hampshire chartered bank, organized and headquartered in Manchester, New Hampshire, which was accounted for using the equity method. On November 16, 2011, Hampshire First Bank entered into an Agreement and Plan of Merger with NBTB and NBT Bank, N.A. which was completed on June 8, 2012, with the Company recognizing a pre-tax gain of

$4.8 million and receiving $6.6 million of cash and 547,481 NBTB shares totaling $11.1 million as proceeds from the sale.

The Bank s subsidiaries include Prospect, Inc., which engages in securities transactions on its own behalf, EBOSCO, LLC and Berkeley Riverbend Estates, LLC, both of which hold foreclosed real estate; and East Boston Investment Services, Inc. which is authorized for third-party investment sales and is currently inactive.

Regulation and Supervision

General

The Bank is currently a Massachusetts-charted stock savings bank, and is the wholly-owned subsidiary of the Company, a Massachusetts corporation and registered bank holding company, which is a 59.5% owned subsidiary of Meridian, a Massachusetts mutual holding company and registered bank holding company. The Bank s deposits are insured up to applicable limits by the FDIC and by the Depositors Insurance Fund for amounts in excess of the FDIC insurance limits. The Bank is subject to extensive regulation by the Massachusetts Commissioner of Banks, as its chartering agency, and by the FDIC, as its deposit insurer. The Bank is required to file reports with, and is periodically examined by, the FDIC and the Massachusetts Commissioner of Banks concerning its activities and financial condition and must obtain regulatory approvals prior to entering into certain transactions, including, but not limited to, mergers with or acquisitions of other financial institutions. The Bank is a member of the Federal Home Loan Bank of Boston. The Company and Meridian are regulated as bank holding companies by the Federal Reserve Board and the Massachusetts Commissioner of Banks.

The regulation and supervision of the Bank establish a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of depositors and borrowers and, for purposes of the FDIC, the protection of the insurance fund. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies, whether by the applicable state legislature, the FDIC or Congress, could have a material adverse impact on Meridian, the Company or the Bank and their operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) made extensive changes in the regulation of depository institutions and their holding companies. Certain provisions of the Dodd-Frank Act have had a near term impact on the Bank and the Company. For example, the Dodd-Frank Act created a new Consumer Financial Protection Bureau as an independent bureau of the Federal Reserve Board. On July 21, 2011, the Consumer Financial Protection Bureau assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations, a function currently assigned to prudential regulators, and will have authority to impose new requirements. However, institutions of less than $10 billion in assets, such as the Bank, will continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the enforcement authority of, their prudential regulator, although the Consumer Financial Protection Bureau will have back-up authority to examine and enforce consumer protection laws against all institutions, including institutions with less than $10 billion in assets.

In addition to creating the Consumer Financial Protection Bureau, the Dodd-Frank Act, among other things, directs changes in the way that institutions are assessed for deposit insurance, mandates the imposition of tougher consolidated capital requirements on holding companies, requires the issuance of regulations requiring originators of securitized loans to retain a percentage of the risk for the transferred loans, imposes regulatory rate-setting for certain debit card interchange fees, repealed restrictions on the payment of interest on commercial demand deposits and contained a number of reforms related to mortgage originations. Many of the provisions of the Dodd-Frank Act are subject to delayed effective dates and/or require the issuance of implementing regulations. Their impact on operations cannot yet be fully assessed. However, there is significant possibility that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden, compliance costs and interest expense for the Bank and the Company.

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Certain regulatory requirements applicable to the Bank, the Company and Meridian are referred to below or elsewhere herein. The description of statutory provisions and regulations applicable to savings banks and their holding companies set forth below and elsewhere in this document does not purport to be a complete description of such statutes and regulations and their effects on the Bank, the Company and Meridian and is qualified in its entirety by reference to the actual laws and regulations involved.

Massachusetts Banking Laws and Supervision

The Bank, as a Massachusetts savings bank, is regulated and supervised by the Massachusetts Commissioner of Banks. The Massachusetts Commissioner of Banks is required to regularly examine each state-chartered bank. The approval of the Massachusetts Commissioner of Banks is required to establish or close branches, to merge with another bank, to form a holding company, to issue stock or to undertake many other activities. Any Massachusetts bank that does not operate in accordance with the regulations, policies and directives of the Massachusetts Commissioner of Banks may be sanctioned. The Massachusetts Commissioner of Banks may suspend or remove directors or officers of a bank who have violated the law, conducted a bank s business in a manner that is unsafe, unsound or contrary to the depositors interests, or been negligent in the performance of their duties. In addition, the Massachusetts Commissioner of Banks has the authority to appoint a receiver or conservator if it is determined that the bank is conducting its business in an unsafe or unauthorized manner, and under certain other circumstances.

The powers that Massachusetts-chartered savings banks can exercise under these laws are summarized as follows:

Lending Activities

A Massachusetts-chartered savings bank may make a wide variety of mortgage loans including fixed-rate loans, adjustable-rate loans, variable-rate loans, participation loans, graduated payment loans, construction and development loans, condominium and co-operative loans, second mortgage loans and other types of loans that may be made in accordance with applicable regulations. Commercial loans may be made to corporations and other commercial enterprises with or without security. Consumer and personal loans may also be made with or without security.

Insurance Sales

Massachusetts banks may engage in insurance sales activities if the Massachusetts Commissioner of Banks has approved a plan of operation for insurance activities and the bank obtains a license from the Massachusetts Division of Insurance. A bank may be licensed directly or indirectly through an affiliate or a subsidiary corporation established for this purpose. Customers of the Bank are offered certain insurance products through a third party. The Bank has not been approved for insurance sales activities.

Investment Activities

In general, Massachusetts-chartered savings banks may invest in preferred and common stock of any corporation organized under the laws of the United States or any state provided such investments do not involve control of any corporation and do not, in the aggregate, exceed 4.0% of the bank s deposits. Massachusetts-chartered savings banks may in addition invest an amount equal to 1.0% of their deposits in stocks of Massachusetts corporations or companies with substantial employment in the Commonwealth which have pledged to the Massachusetts Commissioner of Banks that such monies will be used for further development within the Commonwealth. At the present time, the Bank has the authority to invest in equity securities. However, such investment authority is constrained by federal law. See Federal Bank Regulation Investment Activities for such federal restrictions.

Dividends

A Massachusetts stock bank may declare from net profits cash dividends not more frequently than quarterly and non-cash dividends at any time. No dividends may be declared, credited or paid if the bank s capital stock is impaired. The approval of the Massachusetts Commissioner of Banks is required if the total of all dividends declared in any calendar year exceeds the total of its net profits for that year combined with its retained net profits of the preceding two years. Net profits for this purpose means the remainder of all earnings from current operations plus actual recoveries on loans and investments and other assets after deducting from the total thereof all current operating expenses, actual losses, accrued dividends on preferred stock, if any, and all federal and state taxes.

Protection of Personal Information

Massachusetts has adopted regulatory requirements intended to protect personal information. The requirements, which are similar to existing federal laws such as the Gramm-Leach-Bliley Act, discussed below under Federal Regulations Privacy Regulations , that require organizations to establish written information security programs to prevent identity theft. The Massachusetts regulation also contains technology system requirements, especially for the encryption of personal information sent over wireless or public networks or stored on portable devices.

Parity Regulation

A Massachusetts bank may engage in any activity or offer any product or service if the activity, product or service is engaged in or offered in accordance with regulations promulgated by the Massachusetts Commissioner of Banks and has been authorized for national banks, federal thrifts or state banks in a state other than Massachusetts; provided that the activity is permissible under applicable federal and Massachusetts law and subject to the same limitations and restrictions imposed on the national bank, federal thrift or out-of-state bank that had previously been granted the power.

Loans to One Borrower Limitations

Massachusetts banking law grants broad lending authority. However, with certain limited exceptions, total obligations of one borrower to a bank may not exceed 20.0% of the total of the bank s capital, which is defined under Massachusetts law as the sum of the bank s capital stock, surplus account and undivided profits.

Loans to a Bank s Insiders

The Massachusetts banking laws prohibit any executive officer, director or trustee from borrowing, otherwise becoming indebted, or becoming liable for a loan or other extension of credit by such bank to any other person, except for any of the following loans or extensions of credit: (i) loans or extension of credit, secured or unsecured, to an officer of the bank in an amount not exceeding $100,000; (ii) loans or extensions of credit intended or secured for educational purposes to an officer of the bank in an amount not exceeding $200,000; (iii) loans or extensions of credit secured by a mortgage on residential real estate to be occupied in whole or in part by the officer to whom the loan or extension of credit is made, in an amount not exceeding $750,000; and (iv) loans or extensions of credit to a director or trustee of the bank who is not also an officer of the bank in an amount permissible under the bank s loan to one borrower limit. Massachusetts banking laws also prohibit officers and directors from receiving a preferential interest rate or terms on loans or extensions of credit.

Loans to insiders as described above require approval of the majority of the members of the Bank s Board of Directors, excluding any member involved in the loan or extension of credit. No such loan or extension of credit may be granted with an interest rate or other terms that are preferential in comparison to loans granted to persons not affiliated with the savings bank.

Regulatory Enforcement Authority

Any Massachusetts bank that does not operate in accordance with the regulations, policies and directives of the Massachusetts Commissioner of Banks may be subject to sanctions for non-compliance, including seizure of the property and business of the bank and suspension or revocation of its charter. The Massachusetts Commissioner of Banks may, under certain circumstances, suspend or remove officers or directors who have violated the law, conducted the bank s business in a manner which is unsafe, unsound or contrary to the

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depositors interests or been negligent in the performance of their duties. In addition, upon finding that a bank has engaged in an unfair or deceptive act or practice, the Massachusetts Commissioner of Banks may issue an order to cease and desist and impose a fine on the bank concerned. Finally, Massachusetts consumer protection and civil rights statutes applicable to the Bank permit private individual and class action law suits and provide for the rescission of consumer transactions, including loans, and the recovery of statutory and punitive damage and attorney s fees in the case of certain violations of those statutes.

Depositors Insurance Fund

All Massachusetts-chartered savings banks are required to be members of the Depositors Insurance Fund, a corporation that insures savings bank deposits in excess of federal deposit insurance coverage. The Depositors Insurance Fund is authorized to charge savings banks a risk-based assessment on deposits balances in excess of the amounts insured by the FDIC.

Massachusetts has other statutes and regulations that are similar to the federal provisions discussed below.

Federal Bank Regulation

Capital Requirements

Under FDIC regulations, federally insured state-chartered banks that are not members of the Federal Reserve System (state non-member banks), such as the Bank, are required to comply with minimum leverage capital requirements. For an institution determined by the FDIC to not be anticipating or experiencing significant growth and to be, in general, a strong banking organization rated composite 1 under the Uniform Financial Institutions Ranking System established by the Federal Financial Institutions Examination Council, the minimum capital leverage requirement is a ratio of Tier 1 capital to total assets of 3.0%. For all other institutions, the minimum leverage capital ratio is not less than 4.0%. Tier 1 capital is the sum of common stockholders equity, noncumulative perpetual preferred stock (including any related surplus) and minority investments in certain subsidiaries, less intangible assets (except for certain servicing rights and credit card relationships) and certain other specified items.

The FDIC regulations require state non-member banks to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of regulatory capital to regulatory risk-weighted assets is referred to as a bank s risk-based capital ratio. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items (including recourse obligations, direct credit substitutes and residual interests) to risk-weighted categories ranging from 0.0% to 200.0%, with higher levels of capital being required for the categories perceived as representing greater risk.

State non-member banks must maintain a minimum ratio of total capital to risk-weighted assets of at least 8.0%, of which at least one-half must be Tier 1 capital. Total capital consists of Tier 1 capital plus Tier 2 or supplementary capital items, which include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets, cumulative preferred stock and certain other capital instruments, and a portion of the net unrealized gain on equity securities. The includable amount of Tier 2 capital cannot exceed the amount of the institution s Tier 1 capital. Banks that engage in specified levels of trading activities are subject to adjustments in their risk based capital calculation to ensure the maintenance of sufficient capital to support market risk.

On June 6, 2012, the FDIC and the other federal bank regulatory agencies issued a series of proposed rules that would revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. The proposed rules would apply to all depository institutions, top-tier bank holding companies with total consolidated assets of $500 million or more and top-tier savings and loan holding companies. Among other things, the proposed rules establish a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets) and a higher minimum Tier 1 capital to risk-based assets requirement (6% of risk-weighted assets) and assign higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The proposed rules also require unrealized gains and losses on certain securities holdings to be included for purposes of calculating regulatory capital requirements. The proposed rules limit a banking organization s capital distributions and certain discretionary bonus payments if the banking organization does not hold a capital conservation buffer consisting of a specified amount of common equity Tier 1 capital in addition to the amount necessary to meet its minimum risk-based capital requirements. The proposed rules indicated that the final rules would become effective on January 1, 2013, and the changes set forth in the final rules will be phased in from January 1, 2013 through January 1, 2019. However, the agencies have recently indicated that, due to the volume of public comments received, the final rule has been delayed past January 1, 2013.

The Federal Deposit Insurance Corporation Improvement Act (the FDICIA) required each federal banking agency to revise its risk-based capital standards for insured institutions to ensure that those standards take adequate account of interest-rate risk, concentration of credit risk, and the risk of nontraditional activities, as well as to reflect the actual performance and expected risk of loss on multi-family residential loans. The FDIC, along with the other federal banking agencies, has adopted a regulation providing that the agencies will take into account the exposure of a bank s capital and economic value to changes in interest rate risk in assessing a bank s capital adequacy. The FDIC also has authority to establish individual minimum capital requirements in appropriate cases upon determination that an institution s capital level is, or is likely to become, inadequate in light of the particular circumstances.

Standards for Safety and Soundness

As required by statute, the federal banking agencies adopted final regulations and Interagency Guidelines Establishing Standards for Safety and Soundness to implement safety and soundness standards. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. The guidelines address internal controls and information systems, internal audit system, credit underwriting, loan documentation, interest rate exposure, asset growth, asset quality, earnings and compensation, fees and benefits. Most recently, the agencies have established standards for safeguarding customer information. If the appropriate federal banking agency determines that an institution fails to meet any standard prescribed by the guidelines, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard.

Investment Activities

All state-chartered FDIC insured banks, including savings banks, are generally limited in their investment activities to principal and equity investments of the type and in the amount authorized for national banks, notwithstanding state law, subject to certain exceptions. For example, state chartered banks may, with FDIC approval, continue to exercise state authority to invest in common or preferred stocks listed on a national securities exchange or the NASDAQ Global Market and in the shares of an investment company registered under the Investment Company Act of 1940, as amended. The maximum permissible investment is 100.0% of Tier 1 Capital, as specified by the FDIC s regulations, or the maximum amount permitted by Massachusetts law, whichever is less. The Bank received approval from the FDIC to retain and acquire such equity instruments equal to the lesser of 100% of the Bank s Tier 1 capital or the maximum permissible amount specified by Massachusetts law. Any such grandfathered authority may be terminated upon the FDIC s determination that such investments pose a safety and soundness risk. In addition, the FDIC is authorized to permit such institutions to engage in state authorized activities or investments not permissible for national banks (other than non-subsidiary equity investments) if they meet all applicable capital requirements and it is determined that such activities or investments do not pose a significant risk to the Bank Insurance Fund. The FDIC has adopted procedures for institutions seeking approval to engage in such activities or investments. In addition, a nonmember bank may control a subsidiary that engages in activities as principal that would only be permitted for a national bank to conduct in a financial subsidiary if a bank meets specified conditions and deducts its investment in the subsidiary for regulatory capital purposes.

Interstate Banking and Branching

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, or the Interstate Banking Act, permits adequately capitalized bank holding companies to acquire banks in any state subject to specified concentration limits and other conditions. The Interstate Banking Act also authorizes the interstate merger of banks. In addition, among other things, the Interstate Banking Act, as amended by the Dodd-Frank Act, permits banks to establish new branches on an interstate basis provided that branching is authorized by the law of the host state for the banks chartered by that state.

Prompt Corrective Regulatory Action

Federal law requires, among other things, that federal bank regulatory authorities take prompt corrective action with respect to banks that do not meet minimum capital requirements. For these purposes, the law establishes five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized.

The FDIC has adopted regulations to implement the prompt corrective action legislation. An institution is deemed to be well capitalized if it has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater and a leverage ratio of 5.0% or greater. An institution is adequately capitalized if it has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, and generally a leverage ratio of 4.0% or greater. An institution is undercapitalized if it has a total risk-based capital ratio of less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0%, or generally a leverage ratio of less than 4.0%. An institution is deemed to be significantly undercapitalized if it has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0%, or a leverage ratio of less than 3.0%. An institution is considered to be critically undercapitalized if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2.0%. As of December 31, 2012, the Bank was classified as a well capitalized institution.

Undercapitalized banks must adhere to growth, capital distribution (including dividend) and other limitations and are required to submit a capital restoration plan. A bank s compliance with such a plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5.0% of the institution s total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized. If an undercapitalized bank fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. Significantly undercapitalized banks must comply with one or more of a number of additional restrictions, including but not limited to an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, cease receipt of deposits from correspondent banks or dismiss directors or officers, and restrictions on interest rates paid on deposits, compensation of executive officers and capital distributions by the parent holding company. Critically undercapitalized institutions are subject to additional measures including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

The recently proposed rules that would increase regulatory capital requirements would adjust the prompt corrective action categories accordingly.

Transaction with Affiliates and Regulation W of the Federal Reserve Regulations

Transactions between banks and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a bank is any company or entity that controls, is controlled by or is under common control with the bank. In a holding company context, the parent bank holding company and any companies which are controlled by such parent holding company are affiliates of the bank. Generally, Sections 23A and 23B of the Federal Reserve Act and Regulation W (i) limit the extent to which the bank or its subsidiaries may engage in covered transactions with any one affiliate to an amount equal to 10.0% of such institution s capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20.0% of such institution s capital stock and surplus and (ii) require that all such transactions be on terms substantially the same, or at least as favorable, to the institution or subsidiary as those provided to a non-affiliate. The term covered transaction includes the making of loans, purchase of assets, issuance of a guarantee and other similar transactions. In addition, loans or other extensions of credit by the financial institution to the affiliate are required to be collateralized in accordance with the requirements set forth in Section 23A of the Federal Reserve Act.

Financial subsidiaries of banks are treated as affiliates for purposes of Sections 23A and 23B of the Federal Reserve Act. However, the investment by the bank in the financial subsidiary does not include retained earnings in the financial subsidiary. Certain anti-evasion provisions have been included that relate to the relationship between any financial subsidiary of a bank and sister companies of the bank: (1) any purchase of, or investment in, the securities of a financial subsidiary by any affiliate of the parent bank is considered a purchase or investment by the bank; or (2) if the Federal Reserve Board determines that such treatment is necessary, any loan made by an affiliate of the parent bank to the financial subsidiary is to be considered a loan made by the parent bank.

In addition, Sections 22(h) and (g) of the Federal Reserve Act place restrictions on loans to executive officers, directors and principal stockholders. Under Section 22(h) of the Federal Reserve Act, loans to a director, an executive officer and to a greater than 10.0% stockholder of a financial institution, and certain affiliated interests of these, may not exceed, together with all other outstanding loans to such person and affiliated interests, the financial institution s loans to one borrower limit, generally equal to 15.0% of the institution s unimpaired capital and surplus. Section 22(h) of the Federal Reserve Act also requires that loans to directors, executive officers and principal stockholders be made on terms substantially the same as offered in comparable transactions to other persons and also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a financial institution to insiders cannot exceed the institution s unimpaired capital and surplus. Furthermore, Section 22(g) of the Federal Reserve Act places additional restrictions on loans to executive officers.

Enforcement

The FDIC has extensive enforcement authority over insured state savings banks, including the Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices. The FDIC has authority under federal law to appoint a conservator or receiver for an insured bank under limited circumstances. The FDIC is required, with certain exceptions, to appoint a receiver or conservator for an insured state non-member bank if that bank was critically undercapitalized on average during the calendar quarter beginning 270 days after the date on which the institution became critically undercapitalized. The FDIC may also appoint itself as conservator or receiver for an insured state non-member institution under specific circumstances on the basis of the institution s financial condition or upon the occurrence of other events, including: (1) insolvency; (2) substantial dissipation of assets or earnings through violations of law or unsafe or unsound practices; (3) existence of an unsafe or unsound condition to transact business; and (4) insufficient capital, or the incurring of losses that will deplete substantially all of the institution s capital with no reasonable prospect of replenishment without federal assistance.

Federal Insurance of Deposit Accounts

The Bank is a member of the Deposit Insurance Fund, which is administered by the FDIC. Deposit accounts in the Bank are insured up to a maximum of $250,000 for each separately insured depositor.

The FDIC imposes an assessment for deposit insurance on all depository institutions. Under the FDIC s risk-based assessment system, insured institutions are assigned to risk categories based on supervisory evaluations, regulatory capital levels and certain other factors. An institution s assessment rate depends upon the category to which it is assigned and certain adjustments specified by FDIC regulations, with less risky institutions paying lower rates. Assessment rates (inclusive of possible adjustments) currently range from $2\,^1/_2$ to 45 basis points of each institution s total assets less tangible capital. The FDIC may increase or decrease the scale uniformly, except that no adjustment can deviate more than two basis points from the base scale without notice and comment rulemaking. The FDIC s current system represents a change, required by the Dodd-Frank Act, from its prior practice of basing the assessment on an institution s volume of deposits.

The FDIC imposed on all insured institutions a special emergency assessment of five basis points of total assets minus Tier 1 capital, as of June 30, 2009, (capped at ten basis points of an institution s deposit assessment base), in order to cover losses to the Deposit Insurance fund. That special assessment was collected on September 30, 2009.

In lieu of further special assessments, however, the FDIC required insured institutions to prepay estimated quarterly risk-based assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The estimated assessments, which included an assumed annual assessment base increase of 5%, were recorded as a prepaid expense asset as of December 30, 2009. As of December 31, 2009, and each quarter thereafter through the fourth quarter of 2012, a charge to earnings was recorded for each regular assessment with an offsetting credit to the prepaid asset. The Bank s prepayment amounted to $5.1 million.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC and the FDIC has recently exercised that discretion by establishing a long range fund of 2%.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. We cannot predict what insurance assessment rates will be in the future.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule order or regulatory condition imposed in writing. We do not know of any practice, condition or violation that might lead to termination of deposit insurance.

In addition to the FDIC assessments, the Financing Corporation (FICO) is authorized to impose and collect, with the approval of the FDIC, assessments for anticipated payments, issuance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the former Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended December 31, 2012, the annualized FICO assessment was equal to 66 basis points of total assets less tangible capital.

Privacy Regulations

Pursuant to the Gramm-Leach-Bliley Financial Modernization Act of 1999, FDIC regulations generally require that the Bank disclose its privacy policy, including identifying with whom it shares a customer s non-public personal information, to customers at the time of establishing the customer relationship and annually thereafter. In addition, the Bank is required to provide its customers with the ability to opt-out of having their personal information shared with unaffiliated third parties and not to disclose account numbers or access codes to non-affiliated third parties for marketing purposes. The Bank currently has a privacy protection policy in place and believes that such policy is in compliance with the regulations. The privacy provisions of the Act affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Community Reinvestment Act

Under the Community Reinvestment Act, or CRA, as amended and as implemented by FDIC regulations, a bank has a continuing and affirmative obligation, consistent with its safe and sound operation, to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. The CRA does require the FDIC, in connection with its examination of a bank, to assess the institution s record of meeting the credit needs of its community and to take such record into account in its evaluation of certain applications by such institution, including applications to acquire branches and other financial institutions. The CRA requires the FDIC to provide a written evaluation of an institution s CRA performance utilizing a four-tiered descriptive rating system. The Banks latest FDIC CRA rating was Satisfactory.

Massachusetts has its own statutory counterpart to the CRA which is also applicable to the Bank. The Massachusetts version is generally similar to the CRA but utilizes a five-tiered descriptive rating system. Massachusetts law requires the Massachusetts Commissioner of Banks to consider, but not be limited to, a bank s record of performance under Massachusetts law in considering any application by the bank to establish a branch or other deposit-taking facility, to relocate an office or to merge or consolidate with or acquire the assets and assume the liabilities of any other banking institution. The Banks most recent rating under Massachusetts law was Satisfactory.

Consumer Protection and Fair Lending Regulations

Massachusetts savings banks are subject to a variety of federal and Massachusetts statutes and regulations that are intended to protect consumers and prohibit discrimination in the granting of credit. These statutes and regulations provide for a range of sanctions for non-compliance with their terms, including imposition of administrative fines and remedial orders, and referral to the Attorney General for prosecution of a civil action for actual and punitive damages and injunctive relief. Certain of these statutes authorize private individual and class action lawsuits and the award of actual, statutory and punitive damages and attorneys fees for certain types of violations.

USA Patriot Act

The Bank is subject to the USA PATRIOT Act, which gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. By way of amendments to the Bank Secrecy Act, Title III of the USA PATRIOT Act takes measures intended to encourage information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents, and parties registered under the Commodity Exchange Act.

Other Regulations

Interest and other charges collected or contracted for by the Bank are subject to state usury laws and federal laws concerning interest rates. Loan operations are also subject to state and federal laws applicable to credit transactions, such as the:

- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies;
- Massachusetts Debt Collection Regulations, establishing standards, by defining unfair or deceptive acts or practices, for the collection of debts from persons within the Commonwealth of Massachusetts and the General Laws of Massachusetts, Chapter 167E, which governs the Bank s lending powers; and
- Rules and regulations of the various federal and state agencies charged with the responsibility of implementing such federal and state laws.

The deposit operations of the Bank also are subject to, among others, the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;

Check Clearing for the 21st Century Act (also known as Check 21), which gives substitute checks, such as digital check images and copies made from that image, the same legal standing as the original paper check;

Electronic Funds Transfer Act and Regulation E promulgated thereunder, and, as to the Bank Chapter 167B of the General Laws of Massachusetts, which govern automatic deposits to and withdrawals from deposit accounts and customers rights and liabilities arising from the use of automated teller machines and other electronic banking services; and

General Laws of Massachusetts, Chapter 167D, which governs the Bank s deposit powers.

Federal Reserve System

The Federal Reserve Board regulations require depository institutions to maintain non-interest-earning reserves against their transaction accounts (primarily NOW and regular checking accounts). The Federal Reserve Board regulations generally require that reserves be maintained against aggregate transaction accounts as follows: for that portion of transaction accounts aggregating $79.5 million or less (which may be adjusted by the Federal Reserve Board) the reserve requirement is 3.0%; and the amounts greater than $79.5 million require a 10.0% reserve (which may be adjusted annually by the Federal Reserve Board between 8.0% and 14.0%). The first $12.4 million of otherwise reservable balances (which may be adjusted by the Federal Reserve Board) are exempted from the reserve requirements. The Bank is in compliance with these requirements.

Federal Home Loan Bank System

The Bank is a member of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The Federal Home Loan Bank provides a central credit facility primarily for member institutions. Members of the Federal Home Loan Bank are required to acquire and hold shares of capital stock in the Federal Home Loan Bank. The Bank was in compliance with this requirement at December 31, 2012. Based on redemption provisions of the FHLB-Boston, the stock has no quoted market value and is carried at cost. The Bank reviews for impairment based on the ultimate recoverability of the cost basis of the FHLB-Boston stock. As of December 31, 2012, no impairment has been recognized.

At its discretion, the FHLB-Boston may declare dividends on the stock. The Federal Home Loan Banks are required to provide funds for certain purposes including the resolution of insolvent thrifts in the late 1980s and to contributing funds for affordable housing programs. These requirements could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. As a result of losses incurred, the FHLB-Boston suspended and did not pay dividends in 2009 and 2010. However, the FHLB-Boston resumed payment of quarterly dividends in 2011 equal to an annual yield of 0.30% and continued to pay quarterly dividends in 2012 equal to an annual yield of 0.50%. There can be no assurance that such dividends will continue in the future. Further, there can be no assurance that the impact of recent or future legislation on the Federal Home Loan Banks also will not cause a decrease in the value of the FHLB-Boston stock held by the Bank.

Holding Company Regulation

The Company and Meridian are subject to examination, regulation, and periodic reporting under the Bank Holding Company Act of 1956, as amended, as administered by the Federal Reserve Board. The Company and Meridian are required to obtain the prior approval of the Federal Reserve Board to acquire all, or substantially all, of the assets of any bank or bank holding company. Prior Federal Reserve Board approval would be required for the Company or Meridian to acquire direct or indirect ownership or control of any voting securities of any bank or bank holding company if, after such acquisition, it would, directly or indirectly, own or control more than 5% of any class of voting shares of the bank or bank holding company. In addition to the approval of the Federal Reserve Board, prior approval may also be necessary from other agencies having supervisory jurisdiction over the bank to be acquired before any bank acquisition can be completed.

A bank holding company is generally prohibited from engaging in non-banking activities, or acquiring, direct or indirect control of more than 5% of the voting securities of any company engaged in non-banking activities. One of the principal exceptions to this prohibition is for activities found by the Federal Reserve Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Some of the principal activities that the Federal Reserve Board has determined by regulation to be so closely related to banking are: (i) making or servicing loans; (ii) performing certain data processing services; (iii) providing discount brokerage services; (iv) acting as fiduciary, investment or financial advisor; (v) leasing personal or real property; (vi) making investments in corporations or projects designed primarily to promote community welfare; and (vii) acquiring a savings and loan association whose direct and indirect activities are limited to those permitted for bank holding companies.

The Gramm-Leach-Bliley Act of 1999 authorizes a bank holding company that meets specified conditions, including being well capitalized and well managed, to opt to become a financial holding company and thereby engage in a broader array of financial activities than previously permitted. Such activities can include insurance underwriting and investment banking.

The Company and Meridian are subject to the Federal Reserve Board s capital adequacy guidelines for bank holding companies (on a consolidated basis) which are similar to, though less stringent than, those of the FDIC for the Bank. The Dodd-Frank Act, however, requires the Federal Reserve Board to promulgate consolidated capital requirements for depository institution holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to institutions themselves. Instruments such as cumulative preferred stock and trust preferred securities will no longer be includable as Tier 1 capital, as is currently the case with bank holding companies. Instruments issued by May 19, 2010 should be grandfathered for mutual holding companies. The Federal Reserve Board issued proposed rules that would implement this requirement but such rules had not been finalized as of December 31, 2012.

A bank holding company is generally required to give the Federal Reserve Board prior written notice of any purchase or redemption of then outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the company s consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption if it determines that the proposal would constitute an unsafe and unsound practice, or would violate any law, regulation, Federal Reserve Board order or directive, or any condition imposed by, or written agreement with, the Federal Reserve Board. The Federal Reserve Board has adopted an exception to this approval requirement for well-capitalized bank holding companies that meet certain other conditions.

The Federal Reserve Board has issued a policy statement regarding capital distributions, including dividends, by bank holding companies. In general, the Federal Reserve Board s policies provide that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the bank holding company appears consistent with the organization s capital needs, asset quality and overall financial condition. The Federal Reserve Board s policies also require that a bank holding company serve as a source of financial strength to its subsidiary banks by standing ready to use available resources to provide adequate capital funds to those banks during periods of financial stress or adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks where necessary. The Dodd-Frank Act codified the source of strength doctrine and required the issuance of implementing regulations. Under the prompt corrective action laws, the ability of a bank holding company to pay dividends may be restricted if a subsidiary bank becomes undercapitalized. These regulatory policies could affect the ability of the Company or Meridian to pay dividends or otherwise engage in capital distributions.

Under the Federal Deposit Insurance Act, depository institutions are liable to the FDIC for losses suffered or anticipated by the FDIC in connection with the default of a commonly controlled depository institution or any assistance provided by the FDIC to such an institution in danger of default.

The status of the Company and Meridian as registered bank holding companies under the Bank Holding Company Act does not exempt them from certain federal and state laws and regulations applicable to corporations generally, including, without limitation, certain provisions of the federal securities laws.

The Company, Meridian and the Bank will be affected by the monetary and fiscal policies of various agencies of the United States Government, including the Federal Reserve System. In view of changing conditions in the national economy and in the money markets, it is impossible for management to accurately predict future changes in monetary policy or the effect of such changes on the business or financial condition of the Company, Meridian and the Bank.

Massachusetts Holding Company Regulation

Under the Massachusetts banking laws, a company owning or controlling two or more banking institutions, including a savings bank, is regulated as a bank holding company. The term company is defined by the Massachusetts banking laws similarly to the definition of company under the Bank Holding Company Act. Each Massachusetts bank holding company: (i) must obtain the approval of the Massachusetts Board of Bank Incorporation before engaging in certain transactions, such as the acquisition of more than 5% of the voting stock of another banking institution; (ii) must register, and file reports, with the Division; and (iii) is subject to examination by the Division. In addition, a Massachusetts mutual holding company: (i) may invest in the stock of one or more banking institutions; (ii) may merge with or acquire a mutual banking institution; (iii) may merge with or acquire another bank holding company provided that any such holding company has a subsidiary banking institution; (iv) may invest in a corporation; (v) must register, and file reports, with the Division; (vi) may engage directly or indirectly only in activities permitted by law for a Massachusetts bank holding company; and (vii) may take any action with respect to any securities of any subsidiary banking institution which are held by such mutual holding company.

Federal Securities Laws

Our common stock is registered with the Securities and Exchange Commission under Section 12(b) of the Securities Exchange Act of 1934, as amended. We are subject to information, proxy solicitation, insider trading restrictions, and other requirements under the Exchange Act.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. As directed by the Sarbanes-Oxley Act of 2002, the Company s Chief Executive Officer and Chief Financial Officer each are required to certify that the Company s quarterly and Annual Reports do not contain any untrue statement of a material fact. The rules adopted by the Securities and Exchange Commission under the Sarbanes-Oxley Act of 2002 have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of our internal controls; they have made certain disclosures to our auditors and the audit committee of the Board of Directors about our internal controls; and they have included information in our quarterly and Annual Reports about their evaluation and whether there have been significant changes in our internal controls or in other factors that could significantly affect internal controls.

Federal Income Taxation

General

The Company reports its income on a calendar year basis using the accrual method of accounting. The federal income tax laws apply to the Company in the same manner as to other corporations with some exceptions, including the reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Company. The Company s federal income tax returns have been either audited or closed under the statute of limitations through December 31, 2008. For its 2012 tax year, the Bank s maximum federal income tax rate was 35%.

Bad Debt Reserves

For taxable years beginning before January 1, 1996, thrift institutions that qualified under certain definitional tests and other conditions of the Internal Revenue Code were permitted to use certain favorable provisions to calculate their deductions from taxable income for annual additions to their bad debt reserve. A reserve could be established for bad debts on qualifying real property loans, generally secured by interests in real property improved or to be improved, under the percentage of taxable income method or the experience method. The reserve for non-qualifying loans was computed using the experience method. Federal legislation enacted in 1996 repealed the reserve method of accounting for bad debts and the percentage of taxable income method for tax years beginning after 1995 and required savings institutions to recapture or take into income certain portions of their accumulated bad debt reserves. However, those bad debt reserves accumulated prior to 1988 (Base Year Reserves) were not required to be recaptured unless the savings institution failed certain tests. At December 31, 2012, $9.8 million of the Bank s accumulated bad debt reserves would not be recaptured into taxable income unless the Bank makes a non-dividend distribution to the Company as described below.

Distributions

If the Bank makes non-dividend distributions to the Company, the distributions will be considered to have been made from the Bank s un-recaptured tax bad debt reserves, including the balance of its Base Year Reserves as of December 31, 1987, to the extent of the non-dividend distributions, and then from the Bank s supplemental reserve for losses on loans, to the extent of those reserves, and an amount based on the amount distributed, but not more than the amount of those reserves, will be included in the Bank s taxable income. Non-dividend distributions include distributions in excess of the Bank s current and accumulated earnings and profits, as calculated for federal income tax purposes, distributions in redemption of stock and distributions in partial or complete liquidation. Dividends paid out of the Bank s current or accumulated earnings and profits will not be so included in the Company s taxable income.

The amount of additional taxable income triggered by a non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Therefore, if the Bank makes a non-dividend distribution to the Company, approximately one and one-half times the amount of the distribution not in excess of the amount of the reserves would be includable in income for federal income tax purposes, assuming a 35% federal corporate income tax rate. The Bank does not intend to pay dividends that would result in a recapture of any portion of its bad debt reserves.

State Taxation

Financial institutions in Massachusetts are required to file combined income tax returns beginning with the year ended December 31, 2009. Starting in 2010, decreasing over a three year period, the Massachusetts excise tax rate for savings banks changed from 10.5% to 9.0% of federal taxable income, adjusted for certain items. Taxable income includes gross income as defined under the Internal Revenue Code, plus interest from bonds, notes and evidences of indebtedness of any state, including Massachusetts, less deductions, but not the credits, allowable under the provisions of the Internal Revenue Code, except for those deductions relating to dividends received and income or franchise taxes imposed by a state or political subdivision. Carryforwards and carrybacks of net operating losses and capital losses are not allowed. The Company s state tax returns, as well as those of its subsidiaries, are not currently under audit.

A financial institution or business corporation is generally entitled to special tax treatment as a security corporation under Massachusetts law provided that: (a) its activities are limited to buying, selling, dealing in or holding securities on its own behalf and not as a broker; and (b) it has applied for, and received, classification as a security corporation by the Commissioner of the Massachusetts Department of Revenue. A security corporation that is also a bank holding company under the Internal Revenue Code must pay a tax equal to 0.33% of its gross income. A security corporation that is not a bank holding company under the Internal Revenue Code must pay a tax equal to 1.32% of its gross income. Prospect, Inc. is qualified as a security corporation. As such, it has received security corporation classification by the Massachusetts Department of Revenue; and does not conduct any activities deemed impermissible under the governing statutes and the various regulations, directives, letter rulings and administrative pronouncements issued by the Massachusetts Department of Revenue.

ITEM 1A. RISK FACTORS

Risks Related to Our Business

Financial reform legislation recently enacted will, among other things, tighten capital standards and result in new laws and regulations that are expected to increase our costs of operations.

The Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted in 2010. This new law is significantly changing the current bank regulatory structure and affects the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impacts of the Dodd-Frank Act may not be known for many months or years.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau with broad powers to supervise and enforce consumer protection laws. The Consumer Financial Protection Bureau has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit unfair, deceptive or abusive acts and practices. The Consumer Financial Protection Bureau has examination and enforcement authority over all banks with more than $10 billion in assets. Banks with $10 billion or less in assets will continue to be examined for compliance with the consumer laws by their primary bank regulators. The Dodd-Frank Act also weakened the federal preemption rules that have been applicable for national banks and federal savings associations, and gives state attorneys general the ability to enforce federal consumer protection laws.

The Dodd-Frank Act required minimum leverage (Tier 1) and risk based capital requirements for bank and savings and loan holding companies that are no less than those applicable to banks, which will exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities.

A provision of the Dodd-Frank Act eliminated, as of July 21, 2011, the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to existing law could have an adverse impact on our interest expense.

The Dodd-Frank Act also broadened the base for FDIC deposit insurance assessments. Assessments are now based on the average consolidated total assets less tangible equity capital of a financial institution, rather than deposits. The Dodd-Frank Act also permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor, retroactive to January 1, 2009, and non-interest bearing transaction accounts had unlimited deposit insurance through December 31, 2012. The legislation also increased the required minimum reserve ratio for the Deposit Insurance Fund, from 1.15% to 1.35% of insured deposits, and directs the FDIC to offset the effects of increased assessments on depository institutions with less than $10 billion in assets.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs and could increase our interest expense.

Government responses to economic conditions may adversely affect our operations, financial condition and earnings.

The Company is subject to extensive regulation, supervision and examination by the Massachusetts Commissioner of Banks, the FDIC and the Federal Reserve Board. Such regulation and supervision governs the activities in which an institution and its holding company may engage and are intended primarily for the protection of the insurance fund and the depositors and borrowers of the Bank rather than for holders of the Company s common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Newly enacted financial reform legislation has changed the bank regulatory framework, created an independent consumer protection bureau that has assumed the consumer protection responsibilities of the various federal banking agencies, and established more stringent capital standards for banks and bank holding companies. The legislation will also result in new regulations affecting the lending, funding, trading and investment activities of banks and bank holding companies. Bank regulatory agencies also have been responding aggressively to concerns and adverse trends identified in examinations. Ongoing uncertainty and adverse developments in the financial services industry and the domestic and international credit markets, and the effect of new legislation and regulatory actions in response to these conditions, may adversely affect our operations by restricting our business activities, including our ability to originate or sell loans, modify loan terms, or foreclose on property securing loans. These measures are likely to increase our costs of doing business and may have a significant adverse effect on our lending activities, financial performance and operating flexibility. In addition, these risks could affect the performance and value of our loan and investment securities portfolios, which also would negatively affect our financial performance.

Furthermore, the Board of Governors of the Federal Reserve System, in an attempt to help the overall economy, has, among other things, kept interest rates low through its targeted federal funds rate and the purchase of mortgage-backed securities. If the Federal Reserve Board increases the federal funds rate, overall interest rates will likely rise, which may negatively impact the housing markets and the U.S. economic recovery. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

In addition, there have been proposals made by members of Congress and others that would reduce the amount distressed borrowers are otherwise contractually obligated to pay under their mortgage loans and limit an institution s ability to foreclose on mortgage collateral. Were proposals such as these, or other proposals limiting our rights as a creditor, to be implemented, we could experience increased credit losses or increased expense in pursuing our remedies as a creditor.

We have been negatively affected by current market and economic conditions. A continuation or worsening of these conditions could adversely affect our operations, financial condition and earnings.

Recent economic conditions have resulted in continued uncertainty in the financial markets and continued expectations of slow improvement in general economic conditions. Unemployment remains at very high levels with improvement at a slow rate beginning in late 2011. Our lending business is tied, in large part, to the housing market and real estate markets in general. The continuing housing slump has resulted in reduced demand for the construction of new housing, declines in home prices, and could ultimately result in increased delinquencies on our residential, commercial, multi-family and construction mortgage loans. Further, the ongoing concern about the stability of the financial markets in general has caused many lenders to reduce or cease providing funding to borrowers. These conditions may also cause a further reduction in loan demand, and increases in our non-performing assets, net charge-offs and provisions for loan losses, as well as adversely affect our liquidity and the willingness of certain counterparties and customers to do business with us. Continued negative developments in the financial services industry and the domestic and international credit markets may significantly affect the markets in which we do business, the market for and value of our loans and investments, and our ongoing operations, costs and profitability. Moreover, declines in the stock market in general, or stock values of financial institutions and their holding companies specifically, could adversely affect our stock performance.

Historically low interest rates may adversely affect our net interest income and profitability.

During the past four years it has been the policy of the Federal Reserve Board to maintain interest rates at historically low levels through its targeted federal funds rate and the purchase of mortgage-backed securities. As a result, market rates on the loans we have originated and the yields on securities we have purchased have been at lower levels than available prior to 2008. As a general matter, our interest-bearing liabilities reprice or mature more quickly than our interest-earning assets, which has been one factor contributing to the increase in our interest rate spread as interest rates decreased. However, our ability to lower our interest expense will be limited at these interest rate levels while the average yield on our interest-earning assets may continue to decrease. The Federal Reserve Board has recently indicated its intention to maintain low interest rates until the unemployment rate is 6.5% or lower. Accordingly, our net interest income may be adversely affected and may even decrease, which may have an adverse effect on our profitability.

Actions to recapitalize the Deposit Insurance Fund could hurt our profits.

The Dodd-Frank Act increased the minimum target Deposit Insurance Fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of $10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.5% maximum fund ratio, instead leaving it to the discretion of the FDIC and the FDIC has recently exercised that discretion by establishing a long range fund ratio of 2%. The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on our operating expenses and results of operations. We cannot predict what insurance assessment rates will be in the future.

Our emphasis on commercial real estate, multi-family, commercial business and construction lending involves risks.

In recent years, the Company has focused on shifting its asset mix from increases in the one-to four-family residential loan portfolio to increases in commercial real estate, multi-family, commercial business and construction loans. As of December 31, 2012, our commercial real estate, multi-family, commercial business and construction loans totaled $1.296 billion, or 71.7% of our loan portfolio. As a result, our credit risk profile is higher than traditional savings institutions that have higher concentrations of one-to four-family residential loans. Also, these types of commercial lending activities, while potentially more profitable than one-to four-family residential lending, are generally more sensitive to regional and local economic conditions, making loss levels more difficult to predict. Collateral evaluation and financial statement analysis in these types of loans requires a more detailed analysis at the time of loan underwriting and on an ongoing basis. A further decline in real estate values would reduce the value of the real estate collateral securing our loans and increase the risk that we would incur losses if borrowers defaulted on their loans. In addition, the repayment of commercial real estate and multi-family loans generally is dependent, in large part, on the successful operation of the property securing the loan or the business conducted on the property securing the loan. In addition, loan balances for commercial real estate, multi-family and construction loans are typically larger than those for permanent single-family and consumer loans. Accordingly, when there are defaults and losses on these types of loans, they are often larger on a per loan basis than those for permanent one-to four-family residential and consumer loans. Commercial business loans expose us to additional risks since they typically are made on the basis of the borrower s ability to make repayments from the cash flow of the borrower s business and are secured by non-real estate collateral that may depreciate over time. A secondary market for most types of commercial real estate, multi-family, commercial business and construction loans is not readily liquid, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these loans.

Our construction loans are based upon estimates of costs and values associated with the completed project. These estimates may be inaccurate. Construction lending involves additional risks when compared with permanent residential lending because funds are advanced upon the security of the project, which is of uncertain value prior to its completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. This type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. In addition, generally during the term of a construction loan, interest may be funded by the borrower or disbursed from an interest reserve set aside from the construction loan budget. These loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. A discounted cash flow analysis is utilized for determining the value of any construction project of five or more units. Our ability to continue to originate a significant amount of construction loans is dependent on the recovery of the strength of the housing market in our market areas.

The credit risk related to commercial real estate and multi-family loans is considered to be greater than the risk related to one-to four-family residential or consumer loans because the repayment of commercial real estate loans and multi-family typically is dependent on the income stream of the real estate securing the loan as collateral and the successful operation of the borrower s business, which can be significantly affected by conditions in the real estate markets or in the economy. For example, if the cash flow from the borrower s project is reduced as a result of leases not being obtained or renewed, the borrower s ability to repay the loan may be impaired. In addition, some of our commercial real estate loans are not fully amortizing and contain large balloon payments upon maturity. These balloon payments may require the borrower to either sell or refinance the underlying property in order to make the balloon payment.

Further, if we foreclose on a commercial real estate and multi-family or construction loan, our holding period for the collateral may be longer than for one-to four-family residential mortgage loans because there are fewer potential purchasers of the collateral. These loans also generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, if we make any errors in judgment in the collectibility of our commercial real estate loans, any resulting charge-offs may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios.

The Company s recent business acquisition could have an impact on our earnings and results of operations that may negatively impact the value of the Company s stock.

The Company completed its acquisition of Mt. Washington on January 4, 2010 and successfully integrated Mt. Washington s operations and converted Mt. Washington s accounts to the Company s data servicing during 2010. The acquisition materially increased the size and complexity of our operations. Although the acquisition did not have an adverse effect upon the Company s operating results during 2010 and 2011, the acquired operations may not achieve levels of profitability comparable to those achieved by the Company s existing operations, or otherwise perform as expected. Such adverse effects on the Company s earnings and results of operations may have a negative impact on the value of the Company s stock.

Legislative or regulatory actions responding to financial and market weakness could affect us adversely. There can be no assurance that actions of the U.S. government, Federal Reserve and other governmental and regulatory bodies for the purpose of stabilizing the financial markets will achieve the intended effect.

The potential exists for additional federal or state laws and regulations regarding lending and funding practices and liquidity standards, and bank regulatory agencies are expected to be active in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. Actions taken to date, as well as potential actions, may not have the beneficial effects that are intended, particularly with respect to the extreme levels of volatility and limited credit availability currently being experienced. In addition, new laws, regulations, and other regulatory changes will increase our costs of regulatory compliance and of doing business, and otherwise affect our operations. Our FDIC insurance premiums may increase because market developments have significantly depleted the insurance fund of the FDIC and reduced the ratio of reserves to insured deposits. New laws, regulations, and other regulatory changes, along with negative developments in the financial services industry and the credit markets, may significantly affect the markets in which we do business, the markets for and value of our loans and investments, and our ongoing operations, costs and profitability.

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Our business strategy includes the continuation of significant growth plans, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We expect to continue to experience growth in the amount of our assets, the level of our deposits and the scale of our operations. Achieving our growth targets requires us to attract customers that currently bank at other financial institutions in our market, thereby increasing our share of the market. Our ability to successfully grow will depend on a variety of factors, including our ability to attract and retain experienced bankers, the continued availability of desirable business opportunities, the competitive responses from other financial institutions in our market areas and our ability to manage our growth. While we believe we have the management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or that we will successfully manage our growth. If we do not manage our growth effectively, we may not be able to achieve our business plan, and our business could be harmed.

A continued downturn in the local economy or a decline in local real estate values could hurt our profits.

Unlike larger financial institutions that are more geographically diversified, our profitability depends on the general economic conditions in the Boston metropolitan area. Local economic conditions have a significant impact on our commercial real estate and construction and consumer loans, the ability of the borrowers to repay these loans and the value of the collateral securing these loans. Almost all of our loans are to borrowers or secured by collateral located in Massachusetts. As a result of this concentration, the downturn in the local economy has resulted in an increase in non-performing loans, which can result in higher levels of loan loss provision expense. Moreover, a significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, an outbreak of hostilities or other international or domestic calamities, unemployment or other factors beyond our control could further impact these local economic conditions and could further negatively affect the financial results of our banking operations. A decline in real estate values in our market area may have caused some of our mortgage loans to become inadequately collateralized, which would expose us to a greater risk of loss on defaulted loans which would negatively impact our net income. The Company s non-performing assets declined in 2012 compared to 2011 and 2010, while its provision for loan losses increased primarily due to increases in the commercial real estate, construction and commercial business loan categories. Refer to *Management s Discussion and Analysis of Results of Operations and Financial Condition Asset Quality*.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could decrease.

The Company maintains an allowance for loan losses, which is established through a provision for loan losses that represents management s best estimate of probable losses within the existing portfolio of loans. The Company makes various assumptions and judgments about the collectibility of its loan portfolio, including the creditworthiness of borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. In determining the adequacy of the allowance for loan losses, the Company relies on its experience and its evaluation of economic conditions. If its assumptions prove to be incorrect, its current allowance for loan losses may not be sufficient to cover losses inherent in its loan portfolio and adjustment may be necessary to allow for different economic conditions or adverse developments in its loan portfolio. Consequently, a problem with one or more loans could require the Company to significantly increase the level of its provision for loan losses. In addition, federal and state regulators periodically review the Company s allowance for loan losses and may require it to increase its provision for loan losses or recognize further loan charge-offs. Material additions to the allowance would materially decrease the Company s net income.

Changes in interest rates could hurt our profits.

Our profitability, like most financial institutions, depends to a large extent upon our net interest income, which is the difference between our interest income on interest-earning assets, such as loans and securities, and our interest expense on interest-bearing liabilities, such as deposits and borrowed funds. Accordingly, our results of operations depend largely on movements in market interest rates and our ability to manage our interest-rate-sensitive assets and liabilities in response to these movements. Factors such as inflation, recession and instability in financial markets, among other factors beyond the Company s control, may affect interest rates.

If interest rates rise, and if rates on our deposits reprice upwards faster than the rates on our long-term loans and investments, we would experience compression of our interest rate spread, which would have a negative effect on our profitability. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce their borrowing costs. Under these circumstances, we are subject to reinvestment risk as we may have to redeploy such loan or securities proceeds into lower-yielding assets, which might also negatively impact our income.

While the Company pursues an asset/liability strategy designed to mitigate its risk from changes in interest rates, changes in interest rates can still have a material adverse effect on the Company s financial condition and results of operations. Changes in the level of interest rates also may negatively affect our ability to originate real estate loans, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately affect our earnings. For further discussion of how changes in interest rates could impact us, see *Management s Discussion and Analysis of Results of Operations and Financial Condition Risk Management Interest Rate Risk Management*.

The financial services sector represents a significant concentration within our investment portfolio.

Within the investment portfolio, the Company has a significant amount of marketable equity securities and corporate debt securities, including mortgage-backed securities, issued by companies in the financial services sector. Given the current market conditions, this sector has an enhanced level of credit risk.

Changes in the valuation of our securities portfolio could hurt our profits.

Management evaluates securities for other-than-temporary impairment on a monthly basis, with more frequent evaluation for selected issues. In analyzing a debt issuer s financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, industry analysts reports and, to a lesser extent given the relatively insignificant levels of depreciation in the Company s debt portfolio, spread differentials between the effective rates on instruments in the portfolio compared to risk-free rates. In analyzing an equity issuer s financial condition, management considers industry analysts reports, financial performance and projected target prices of investment analysts within a one-year time frame. Market valuation levels of the securities portfolio have increased as of December 31, 2012 following a decline as of December 31, 2011 compared to December 31, 2010. A decline in the market for the securities portfolio could result in impairment charges on some issues. Refer to *Management s Discussion and Analysis of Results of Operations and Financial Condition Securities Portfolio*.

The expiration of unlimited Federal Deposit Insurance Corporation insurance on certain non-interest-bearing transaction accounts may increase our costs and reduce our liquidity levels.

On December 31, 2012, unlimited FDIC insurance on certain non-interest-bearing transaction accounts expired. Unlimited insurance coverage did not apply to money market deposit accounts or negotiable order of withdrawal accounts. The reduction in FDIC insurance on other types of accounts to the standard $250,000 maximum amount may cause depositors to place such funds in fully insured interest-bearing accounts, which would increase our costs of funds and negatively affect our results of operations, or may cause depositors to withdraw their deposits and invest uninsured funds in investments perceived as being more secure, such as securities issued by the United States Treasury. This may reduce our liquidity, or require us to pay higher interest rates to maintain our liquidity by retaining deposits.

Impairment of goodwill could require charges to earnings, which could result in a negative impact on our results of operations.

Goodwill arises when a business is purchased for an amount greater than the net fair value of its assets. The Company recognized goodwill as an asset on the balance sheet in connection with its acquisition of Mt. Washington. The Company evaluates goodwill for impairment at least annually. Although the Company determined that goodwill and was not impaired during 2012, a significant and sustained decline in our stock price

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and market capitalization, a significant decline in our expected future cash flows, a significant adverse change in the business climate, slower growth rates or other factors could result in impairment of goodwill. If the Company were to conclude that a future write-down of the goodwill was necessary, then the Company would record the appropriate charge to earnings, which could be materially adverse to the results of operations and financial position. For further discussion of the Company s methodology of evaluating and impairing goodwill, refer to *Management s Discussion and Analysis of Results of Operations and Financial Condition Critical Accounting Policies Evaluation of Goodwill and Analysis for Impairment*.

The suspension of dividends by the Federal Home Loan Bank of Boston will negatively affect our earnings.

After suspending dividends in the fourth quarter of 2008, the Federal Home Loan Bank of Boston resumed payment of dividends in 2011 equal to an annual yield of 0.30% and continued to pay dividends in 2012 equal to an annual yield of 0.50%. We did not receive any such dividends in 2009 and 2010. The inconsistency in the Federal Home Loan Bank of Boston s ability to pay dividends could reduce our earnings during such periods of nonpayment.

If our investment in stock of the Federal Home Loan Bank of Boston is classified as other-than-temporarily impaired, our earnings and stockholders equity would decrease.

We own common stock of the Federal Home Loan Bank of Boston. We hold this stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the Federal Home Loan Bank of Boston s advance program. The aggregate cost and fair value of our Federal Home Loan Bank of Boston common stock as of December 31, 2012 was $12.1 million based on its par value. There is no market for our Federal Home Loan Bank of Boston common stock. Recent published reports indicate that certain member banks of the Federal Home Loan Bank System may be subject to accounting rules and asset quality risks that could result in materially lower regulatory capital levels. In an extreme situation, it is possible that the capitalization of a Federal Home Loan Bank, including the Federal Home Loan Bank of Boston, could be substantially diminished. Consequently, we believe that there is a risk that our investment in Federal Home Loan Bank of Boston common stock could be impaired at some time in the future. If this occurs, it would cause our earnings and stockholders equity to decrease by the after-tax amount of the impairment charge.

The building of market share through de novo branching and expansion of our residential, commercial real estate and commercial business lending capacity could cause our expenses to increase faster than revenues.

We intend to continue to build market share in the greater Boston metropolitan area through de novo branching and expansion of our residential, commercial real estate and commercial business lending capacity. Since 2002, we have opened 13 de novo branches including the most recent branch opened in February 2013. In the third quarter of 2011, we significantly expanded our commercial business lending capacity with the establishment of a new corporate banking division comprised of a veteran team of bankers that is expected to enhance our presence in all of our market areas and add strength to our business platform. There are considerable costs involved in opening branches and expansion of lending capacity that generally require a period of time to generate the necessary revenues to offset their costs, especially in areas in which we do not have an established presence. Accordingly, any such business expansion can be expected to negatively impact our earnings for some period of time until certain economies of scale are reached. Our expenses could be further increased if we encounter delays in the opening of any of our new branches. Finally, we have no assurance our business expansion will be successful after establishment.

Recent health care legislation could increase our expenses or require us to pass further costs on to our employees, which could adversely affect our operations, financial condition and earnings.

Legislation enacted in 2010 requires companies to provide expanded health care coverage to their employees, such as affordable coverage to part-time employees and coverage to dependent adult children of employees. Companies will also be required to enroll new employees automatically into one of their health plans. Compliance with these and other new requirements of the health care legislation will increase our employee benefits expense, and may require us to pass these costs on to our employees, which could give us a competitive disadvantage in hiring and retaining qualified employees.

Changes in the structure of Fannie Mae and Freddie Mac (GSEs) and the relationship among the GSEs, the federal government and the private markets, or the conversion of the current conservatorship of the GSEs into receivership, could result in significant changes to our securities portfolio.

The GSEs are currently in conservatorship, with its primary regulator, the Federal Housing Finance Agency, acting as conservator. We cannot predict if, when or how the conservatorships will end, or any associated changes to the GSEs business structure that could result. We also cannot predict whether the conservatorships will end in receivership. There are several proposed approaches to reform the GSEs which, if enacted, could change the structure of the GSEs and the relationship among the GSEs, the government and the private markets, including the trading markets for agency conforming mortgage loans and markets for mortgage-related securities in which we participate. We cannot predict the prospects for the enactment, timing or content of legislative or rulemaking proposals regarding the future status of the GSEs. Accordingly, there continues to be uncertainty regarding the future of the GSEs, including whether they will continue to exist in their current form. GSE reform, if enacted, could result in a significant change and adversely impact our business operations.

Our funding sources may prove insufficient to replace deposits at maturity and support our future growth.

We must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. As we continue to grow, we are likely to become more dependent on these sources, which include Federal Home Loan Bank advances, proceeds from the sale of loans; federal funds purchased and brokered certificates of deposit. Adverse operating results or changes in industry conditions could lead to difficulty or an inability to access these additional funding sources. Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our operating margins and profitability would be adversely affected.

Strong competition within our market area could hurt our profits and slow growth.

We face intense competition in making loans and attracting deposits. Price competition for loans and deposits sometimes results in us charging lower interest rates on our loans and paying higher interest rates on our deposits and may reduce our net interest income. Competition also makes it more difficult and costly to attract and retain qualified employees. Many of the institutions with which we compete have substantially greater resources and lending limits than we have and may offer services that we do not provide. We expect competition to increase in the future as a result of legislative, regulatory and technological changes and the continuing trend of consolidation in the financial services industry. If we are not able to effectively compete in our market area, our profitability may be negatively affected, potentially limiting our ability to pay dividends. The greater resources and broader offering of deposit and loan products of some of our competitors may also limit our ability to increase our interest-earning assets. For more information about our market area and the competition we face, see Item 1 Business Market Area and Item 1 Business Competition.

The success of the Company is dependent on hiring and retaining certain key personnel.

The Company s performance is largely dependent on the talents and efforts of highly skilled individuals. The Company relies on key personnel to manage and operate its business, including major revenue generating functions such as loan and deposit generation. The loss of key staff may adversely affect the Company s ability to maintain and manage these functions effectively, which could negatively affect the Company s revenues. In addition, loss of key personnel could result in increased recruiting and hiring expenses, which could cause a decrease in the Company s net income. The Company s continued ability to compete effectively depends on its ability to attract new employees and to retain and motivate its existing employees. In July 2011, we hired a new

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Executive Vice President of Corporate Banking and a veteran team of bankers for the Company s new corporate banking division.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by hackers. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins, phishing and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. Although we, with the help of third-party service providers, intend to continue to implement security technology and establish operational procedures to prevent such damage, our security measures may not be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures could have a material adverse effect on our financial condition and results of operations.

It is possible that significant amount of time and money may be spent to rectify the harm caused by a breach or hack. While we have general liability insurance and cyber liability insurance, there are limitations on coverage as well as dollar amount. Furthermore, cyber incidents carry a greater risk of injury to our reputation. Finally, depending on the type of incident, banking regulators can impose restrictions on our business and consumer laws may require reimbursement of customer loss.

Our risk management framework may not be effective in mitigating risk and reducing the potential for significant losses.

Our risk management framework is designed to minimize risk and loss to us. We seek to identify, measure, monitor, report and control our exposure to risk, including strategic, market, liquidity, compliance and operational risks. While we use a broad and diversified set of risk monitoring and mitigation techniques, these techniques are inherently limited because they cannot anticipate the existence or future development of currently unanticipated or unknown risks. Recent economic conditions and heightened legislative and regulatory scrutiny of the financial services industry, among other developments, have increased our level of risk. Accordingly, we could suffer losses as a result of our failure to properly anticipate and manage these risks.

ITEM 1B. ***UNRESOLVED STAFF COMMENTS***

Not applicable.

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ITEM 2. *PROPERTIES*

At December 31, 2012, we conducted business through our 24 full service offices and three loan centers located in Boston, Cambridge, Danvers, East Boston, Revere, South Boston, Dorchester, Jamaica Plain, West Roxbury, Everett, Medford, Melrose, Wakefield, Winthrop, Lynn, Peabody and Saugus, Massachusetts. In January and February 2013, we opened two full service offices located in Allston and Belmont, Massachusetts. During the second quarter of 2013, we are planning to open our 27th full service office in Somerville, Massachusetts and are scheduled to open a loan operation center located in Malden, Massachusetts. We own 18 and lease 14 of our offices. At December 31, 2012, the total net book value of our land, buildings, furniture, fixtures and equipment was $38.7 million.

Location	Size (Square Feet)	Owned or Leased	Lease Expiration Date
Offices:			
Suffolk County:			
10 Meridian Street, East Boston, MA 02128	6,900	Owned	Not Applicable
1 Bennington Street, East Boston, MA 02128	3,285	Owned	Not Applicable
856 Bennington Street, East Boston, MA 02128	6,900	Owned	Not Applicable
575 Broadway, Revere, MA 02151	4,400	Owned	Not Applicable
126 Squire Road, Revere, MA 02151	2,500	Owned	Not Applicable
430 West Broadway, South Boston, MA 02127	6,100	Owned	Not Applicable
455 West Broadway, South Boston, MA 02127	13,474	Owned	Not Applicable
708 East Broadway, South Boston, MA 02127	3,542	Owned	Not Applicable
501 Southampton Street, South Boston, MA 02127	3,100	Leased	01/31/2031
489 Gallivan Boulevard, Dorchester, MA 02124	3,000	Leased	08/31/2023
305 Talbot Avenue, Dorchester, MA 02124	4,478	Owned	Not Applicable
515 Centre Street, Jamaica Plain, MA 02130	3,061	Owned	Not Applicable
1985 Centre Street, West Roxbury, MA 02132	2,420	Leased	07/31/2030
15 Barlett Road, Winthrop, MA 02152	2,600	Owned	Not Applicable
1134 Washington Street, Boston, MA 02118	2,507	Leased	05/31/2021
181 Brighton Avenue, Allston, MA 02134	2,760	Leased	01/31/2028
Middelesex County:			
1755 Revere Beach Parkway, Everett, MA 02149	8,800	Owned	Not Applicable
410 Riverside Avenue, Medford, MA 02155	3,200	Leased	06/01/2018
108 Main Street, Melrose, MA 02176	6,052	Owned	Not Applicable
381 Main Street, Wakefield, MA 01880	2,200	Leased	03/01/2018
2172 Massachusetts Avenue, Cambridge, MA 02140	2,268	Leased	04/30/2016
70 Concord Avenue, Belmont, MA 02478	3,892	Leased	01/31/2023
Essex County:			
335 Broadway, Lynn, MA 01904	6,000	Owned	Not Applicable
220 Broadway, Suite 401, Lynnfield, MA 01940	1,760	Owned	Not Applicable
67 Prospect Street, Peabody, MA 01960	108,000	Owned	Not Applicable
320 Central Street, Saugus, MA 01906	14,860	Owned	Not Applicable
317 Main Street, Saugus, MA 01906	3,870	Leased	01/31/2017
8 Essex Center Drive, Peabody, MA 01960	4,250	Leased	11/30/2018
10 Elm Street, Danvers, MA 01923	7,200	Leased	05/31/2016
51 High Street, Danvers, MA 01923	2,428	Owned	Not Applicable
Planned Offices:			
37 Union Square, Somerville, MA 02143	3,351	Leased	05/31/2023
350 Main Street, Malden, MA 02148	12,217	Leased	04/30/2019

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ITEM 3. ***LEGAL PROCEEDINGS***

Periodically, there have been various claims and lawsuits against us, such as claims to enforce liens, condemnation proceedings on properties in which we hold security interests, claims involving the making and servicing of real property loans and other issues incident to our business. We are not a party to any pending legal proceedings that we believe would have a material adverse effect on our financial condition, results of operations or cash flows.

ITEM 4. ***MINE SAFETY DISCLOSURES***

Not Applicable.

PART II

ITEM 5. ***MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

Market Information and Holders

The Company s shares of common stock are traded on the NASDAQ Global Select Market under the symbol EBSB . The approximate number of shareholders of record of the Company s common stock as of March 1, 2013 was 937. Certain shares of the Company are held in nominee or street name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

The following table sets forth for each quarter of 2012 and 2011 the intra-day high and low sales prices per share of common stock as reported by Nasdaq. No cash dividends were declared in either year. On March 1, 2013, the closing market price of the Company s common stock was $18.12.

2012	**High**	**Low**	**Dividends Declared**
Fourth quarter	$ 17.98	$ 15.65	$
Third quarter	17.35	13.38	
Second quarter	13.92	12.51	
First quarter	13.60	12.39	

2011	**High**	**Low**	**Dividends Declared**
Fourth quarter	$ 13.68	$ 10.76	$
Third quarter	13.95	10.68	
Second quarter	14.30	12.02	
First quarter	14.05	11.82	

Dividends

The Board of Directors may declare and pay periodic special cash dividends in addition to, or in lieu of, regular cash dividends. In determining whether to declare or pay any dividends, whether regular or special, the Board of Directors will take into account our financial condition and results of operations, tax considerations, capital requirements, industry standards and economic conditions. The regulatory restrictions that affect the payment of dividends by the Bank to the Company discussed below also will be considered. We cannot guarantee that we will pay dividends or that, if paid, we will not reduce or eliminate dividends in the future.

If the Company pays dividends to its stockholders, it will be required to pay dividends to Meridian. The Federal Reserve Board s current policy prohibits the waiver of dividends by mutual holding companies with subsidiary bank holding companies. In addition, Massachusetts banking regulations prohibit Meridian from waiving dividends declared and paid by the Company unless the Massachusetts Commissioner of Banks does not object to the waiver and provided the waiver is not detrimental to the safe and sound operation of the Bank. Accordingly, we do not currently anticipate that Meridian will be permitted to waive dividends paid by the Company.

The Company is subject to Massachusetts law, which prohibits distributions to stockholders if, after giving effect to the distribution, the Company would not be able to pay its debts as they become due in the usual course of business or the Company s total assets would be less than the sum of its total liabilities plus the amount that would be needed, if the Company were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of stockholders whose preferential rights are superior to those receiving the distribution. In addition, the Company is subject to the Federal Reserve Board s policy that dividends should be paid only out of current earnings and only if the prospective rate of earnings retention by the Company appears consistent with its capital needs, asset quality and overall financial condition. See *Regulation and Supervision Holding Company Regulation.*

Dividends from the Company may depend, in part, upon receipt of dividends from the Bank because the Company has no source of income other than dividends from the Bank and earnings from investment of net proceeds from the offering retained by the Company. Massachusetts banking law and FDIC regulations limit distributions from the Bank to the Company. For example, the Bank could not pay dividends if it were not in compliance with applicable regulatory capital requirements. See *Regulation and Supervision State Bank Regulation Dividends* and *Federal Bank Regulation Prompt Corrective Regulatory Action.*

Any payment of dividends by the Bank to the Company that would be deemed to be drawn out of the Bank s bad debt reserves would require the Bank to pay federal income taxes at the then-current income tax rate on the amount deemed distributed. See *Federal and State Taxation Federal Income Taxation* and Note 10, *Income Taxes* in the Notes to Consolidated Financial Statements included in Item 8, *Financial Statements and Supplementary Data* within this report. The Company does not contemplate any distribution by the Bank that would result in this type of tax liability.

Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities

Not Applicable.

Securities Authorized for Issuance under Equity Compensation Plans

Information regarding stock-based compensation awards outstanding and available for future grants as of December 31, 2012, represents stock-based compensation plans approved by stockholders. Other than our Employee Stock Ownership Plan, there are no plans that have not been approved by stockholders. Additional information is presented in Note 12, *Employee Benefits,* in the Notes to Consolidated Financial Statements included in Item 8, *Financial Statements and Supplementary Data,* within this report. Additional information regarding the Company s equity compensation plans is included in Part III, Item 12(d) of this Form 10-K.

Purchases of Equity Securities by the Issuer and Affiliated Purchases

The following table sets forth information with respect to any purchase made by or on behalf of the Company during the indicated periods:

Period	(a) Total Number of Shares (or Units) Purchased	(b) Average Price Paid Per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (1)	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
October 1 - 31, 2012		$		708,858
November 1 - 30, 2012	1,200	15.84	1,200	707,658
December 1 - 31, 2012				707,658
Total	1,200	$ 15.84	1,200	707,658

(1) In August 2011, the Company s Board of Directors voted to adopt a fourth stock repurchase program of up to 10% of its outstanding common stock not held by its mutual holding company parent, or 904,224 shares of its common stock.

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Performance Graph

The Company s shares of common stock began trading on the NASDAQ Global Select Market on January 23, 2008. Accordingly, no comparative stock performance information is available for periods ending prior to this date. The performance graph below compares the Company s cumulative shareholder return on its common stock since the inception of trading on January 23, 2008 to the cumulative total return of the NASDAQ Composite and the SNL Bank and Thrift Composite. Total shareholder return is measured by dividing total dividends (assuming dividend reinvestment) for the measurement period plus share price change for the period from the share price at the beginning of the measurement period. The return is based on an initial investment of $100.00.

Meridian Interstate Bancorp, Inc.

	Period Ending					
Index	**01/22/08**	**12/31/08**	**12/31/09**	**12/31/10**	**12/31/11**	**12/31/12**
Meridian Interstate Bancorp, Inc.	100.00	92.50	87.00	117.90	124.50	167.80
SNL Bank and Thrift	100.00	63.90	63.04	70.38	54.73	73.49
NASDAQ Composite	100.00	69.43	100.93	119.24	118.29	139.29

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ITEM 6. ***SELECTED FINANCIAL DATA***

The following table sets forth selected financial data for the Company.

	At or For the Years Ended December 31,				
(Dollars in thousands, except per share amounts)	**2012**	**2011**	**2010**	**2009**	**2008**
Financial Condition Data					
Total assets	$ 2,278,771	$ 1,974,380	$ 1,835,830	$ 1,211,386	$ 1,065,352
Securities available for sale	262,785	335,230	360,602	293,367	252,529
Loans, net	1,786,339	1,341,301	1,173,562	813,300	704,104
Deposits	1,865,433	1,604,488	1,459,729	922,475	796,852
Borrowings	161,254	131,450	148,683	75,410	65,486
Total stockholders equity	233,943	219,944	215,611	200,415	189,840
Operating Data					
Interest and dividend income	$ 84,969	$ 78,812	$ 82,059	$ 56,667	$ 52,897
Interest expense	18,945	20,972	21,040	20,392	27,044
Net interest income	66,024	57,840	61,019	36,275	25,853
Provision for loan losses	8,581	3,663	3,181	4,082	5,638
Net interest income, after provision for loan losses	57,443	54,177	57,838	32,193	20,215
Non-interest income	21,261	15,388	11,721	5,295	8,373
Non-interest expenses	59,948	50,994	48,804	31,566	31,966
Income (loss) before income taxes	18,756	18,571	20,755	5,922	(3,378)
Provision (benefit) for income taxes	6,330	6,601	7,381	2,159	(1,270)
Net income (loss)	$ 12,426	$ 11,970	$ 13,374	$ 3,763	$ (2,108)
Key Performance Ratios					
Return (loss) on average assets	0.59%	0.63%	0.77%	0.32%	(0.20)%
Return (loss) on average equity	5.42	5.45	6.38	1.94	(1.09)
Interest rate spread(1)	3.16	3.06	3.62	2.95	2.01
Net interest margin(2)	3.33	3.24	3.80	3.34	2.61
Non-interest expense to average assets	2.84	2.66	2.81	2.71	2.99
Efficiency ratio(3)	77.96	74.16	65.00	74.88	107.29
Average interest-earning assets to average interest-bearing liabilities	117.32	114.97	114.06	120.76	122.16
Capital Ratios					
Average equity to average assets	10.87%	11.47%	12.05%	16.65%	18.17%
Total capital to risk weighted assets(4)	10.23	11.36	11.37	14.17	15.26
Tier I capital to risk weighted assets(4)	9.10	10.41	10.49	13.17	14.50
Tier I capital to average assets(4)	8.15	8.52	8.50	11.20	12.82
Asset Quality Ratios					
Allowance for loan losses/total loans	1.13%	0.96%	0.86%	1.12%	0.97%
Allowance for loan losses/non-accrual loans	51.81	24.31	23.54	42.59	48.57
Net charge-offs/average loans outstanding	0.07	0.06	0.19	0.23	0.38
Non-accrual loans/total loans	2.19	3.97	3.64	2.63	2.00
Non-performing assets/total assets	1.85	2.91	2.57	2.03	1.58
Per Share Data					
Basic earnings per share	$ 0.57	$ 0.55	$ 0.61	$ 0.17	N/A
Diluted earnings per share	0.57	0.55	0.61	0.17	N/A
Book value per share	10.57	9.93	9.59	9.07	8.34
Tangible book value per share	9.95	9.31	8.98	9.07	8.34
Market value per share	16.78	12.45	11.79	8.70	9.25

Number of shares outstanding at end of period	22,135,855	22,149,409	22,480,877	22,098,565	22,750,000
Other data: Number of offices	24	23	19	13	12

(1) Represents the difference between the weighted average yield on average interest-earning assets and the weighted average cost of interest-bearing liabilities.

(2) Represents net interest income as a percent of average interest-earning assets.

(3) Represents non-interest expense excluding data processing contract termination costs, divided by the sum of net interest income and non-interest income excluding gains or losses on securities and gain on sale of investment in affiliate bank.

(4) Ratios are for East Boston Savings Bank only.

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The objective of this section is to help readers understand our views on our results of operations and financial condition. You should read this discussion in conjunction with the consolidated financial statements and notes to the consolidated financial statements that appear elsewhere in this Annual Report.

Critical Accounting Policies

The Company s summary of significant accounting policies are described in Note 1 to the Consolidated Financial Statements included in this Annual Report on Form 10-K for the year ended December 31, 2012. Critical accounting estimates are necessary in the application of certain accounting policies and procedures and are particularly susceptible to significant change. Critical accounting policies are defined as those involving significant judgments and assumptions by management that could have a material impact on the carrying value of certain assets or on income under different assumptions or conditions. Management believes that the most critical accounting policies, which involve the most complex or subjective decisions or assessments, are as follows:

Allowance for Loan Losses

The determination of the allowance for loan losses is considered critical due to the high degree of judgment involved, the subjectivity of the underlying assumptions used, and the potential for changes in the economic environment that could result in material changes in the amount of the allowance for loan losses considered necessary. The allowance for loan losses is utilized to absorb losses inherent in the loan portfolio. The allowance represents management s estimate of losses as of the date of the financial statements. The allowance includes an allocated component for impaired loans and a general component for pools of non-impaired loans.

The adequacy of the allowance for loan losses is evaluated on a regular basis by management and is based upon management s periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

While management believes that it uses the best information available to establish the allowance for loan losses, future adjustments to the allowance may be necessary and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making its determinations. Because the estimation of inherent losses cannot be made with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loan deteriorate as a result of the factors noted above. Any material increase in the allowance for loan losses may adversely affect the financial condition and results of operations and will be recorded in the period in which the circumstances become known.

Valuation of Goodwill and Analysis for Impairment

The Company s goodwill resulted from the acquisition of another financial institution accounted for under the acquisition method of accounting. The amount of goodwill recorded at acquisition is impacted by the recorded fair value of the assets acquired and liabilities assumed, which is an estimate determined by the use of internal or other valuation techniques.

Goodwill is subject to an annual review by management that first assesses qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. The Company would not be required to calculate the fair value of the Company or the reporting unit unless management determines, based on the qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. If the two-step quantitative goodwill impairment test is necessary, step one compares the book value of the Company or the reporting unit to the fair value of the Company, or to the fair value of the reporting unit. If test one is failed, a more detailed analysis is performed, which involves measuring the excess of the fair value of the reporting unit, as determined in step one, over the aggregate fair value of the individual assets, liabilities, and identifiable intangibles by utilizing a comparable analysis of relevant price multiples in recent market transactions. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

Other-than-temporary Impairment of Securities

In analyzing a debt issuer s financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, industry analysts reports and, to a lesser extent given the relatively insignificant levels of depreciation in the Company s debt portfolio, spread differentials between the effective rates on instruments in the portfolio compared to risk-free rates. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation.

From time to time, management s intent to hold depreciated debt securities to recovery or maturity may change as a result of prudent portfolio management. If management s intent changes, unrealized losses are recognized either as impairment charges to the consolidated income statement or as realized losses if a sale has been executed. In most instances, management sells the securities at the time their intent changes.

In analyzing an equity issuer s financial condition, management considers industry analysts reports, financial performance and projected target prices of investment analysts within a one-year time frame. A decline of 10% or more in the value of an acquired equity security is generally the triggering event for management to review individual securities for liquidation and/or classification as other-than-temporarily impaired. Impairment losses are recognized when management concludes that declines in the value of equity securities are other than temporary, or when they can no longer assert that they have the intent and ability to hold depreciated equity securities for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses on marketable equity securities that are in excess of 25% of cost and that have been sustained for more than twelve months are generally considered-other-than temporary and charged to earnings as impairment losses, or realized through sale of the security.

Income Taxes

The Company reduces deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is not more likely than not that some portion or all of the deferred tax assets will be realized. The Company assesses the realizability of its deferred tax assets by assessing the likelihood of the Company generating federal and state tax income, as applicable, in future periods in amounts sufficient to offset the deferred tax charges in the periods they are expected to reverse. Based on this assessment, management concluded that a valuation allowance was not required as of December 31, 2012, 2011 and 2010.

Operating Strategies

Our mission is to operate and grow a profitable community-oriented financial institution. We plan to achieve this by executing our strategies of:

1. Managing credit risk to maintain a low level of nonperforming assets, and interest rate risk to optimize our net interest margin;

2. Growing our franchise through the opening of additional branch offices, expanding lending capacity and the possible acquisition of existing financial service companies or their assets;

3. Increasing core deposits through aggressive marketing and offering new deposit products; and

4. Continuing to grow and diversify our sources of non-interest income.

Managing credit risk to maintain a low level of nonperforming assets, and interest rate risk to optimize our net interest margin

Managing risk is an essential part of successfully managing a financial institution. Credit risk and interest rate risk are two prominent risk exposures that we face. Credit risk is the risk of not collecting the interest and/or the principal balance of a loan or investment when it is due. Our strategy for credit risk management focuses on having well-defined credit policies and uniform underwriting criteria and providing prompt attention to potential problem loans. We believe that strong asset quality is a key to long-term financial success. We have sought to grow and diversify the loan portfolio, while maintaining a strong asset quality and moderate credit risk, using underwriting standards that we believe are conservative, as well as diligent monitoring of the portfolio and loans in non-accrual status and on-going collection efforts. Although we will continue to originate commercial real estate, commercial business and construction loans, we intend to continue our philosophy of managing large loan exposures through our experienced, risk-based approach to lending. In addition, we intend to remain focused on lending within the Bank s immediate market area, with a specific focus on commercial customers disaffected by their relationships with larger banks as a result of turmoil in the industry.

We continually monitor the investment portfolio for credit risk, with a monthly formal review by the Company s Executive Committee of any issuers that have heightened credit risk factors such as rating agency and analyst downgrades and declines in market valuation. In addition, the Executive Committee reviews new investments for credit-worthiness before purchase. The Company generally purchases marketable equity securities in lots over time, while debt securities are purchased individually. We intend to replace maturing investments in 2013 as determined to be appropriate in accordance with our risk management policies and our funding needs. The Company also invests in money market mutual fund accounts which it utilizes as an alternative to investing excess cash in federal funds.

Interest rate risk is the potential reduction of net interest income as a result of changes in interest rates. Our earnings and the market value of our assets and liabilities are subject to fluctuations caused by changes in the level of interest rates. We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: originating loans with adjustable interest rates; selling the residential real estate fixed-rate loans with terms greater than 10 years that we originate; promoting core deposit products; and gradually extending the maturity of funding sources, as borrowing and term deposit rates are historically low.

In order to improve our risk management, we utilize a Risk Management Officer to oversee the bank-wide risk management process. These responsibilities include the implementation of an overall risk program and strategy, determining risks and implementing risk mitigation strategies in the following areas: interest rates, operational/compliance, liquidity, strategic, reputation, credit and legal/regulatory. This position provides counsel to members of our senior management team on all issues that affect our risk positions.

Expanding our franchise through the opening of additional branch offices, additions to lending capacity and the possible acquisition of existing financial service companies or their assets

We are always looking to expand our franchise in the greater Boston metropolitan area. Since 2002, we have opened 13 de novo branches, the most recent in February 2013. In the third quarter of 2011, we significantly expanded our commercial business lending capacity with the establishment of a new corporate banking division comprised of a veteran team of bankers that is expected to enhance our presence in all of our market areas and add strength to our business platform. We intend to continue our geographic expansion in the greater Boston metropolitan area by opening de novo branches in communities contiguous to those currently served by the Bank, as opportunities present themselves in favorable locations. There are considerable costs involved in opening branches and expansion of lending capacity that generally require a period of time to generate the necessary revenues to offset their costs, especially in areas in which we do not have an established presence. Accordingly, any such business expansion can be expected to negatively impact our earnings for some period of time until certain economies of scale are reached.

On January 4, 2010, the Company completed its acquisition of Mt. Washington Co-operative Bank (Mt. Washington). The combination of Mt. Washington and the Bank resulted in a community bank with 19 full service branch offices located throughout the Boston metropolitan area. The transaction increased the Company s deposits from $922.5 million to $1.3 billion as of January 4, 2010. We hope to continue to increase our franchise by pursuing expansion through the acquisition of existing financial service companies or their assets, although we currently have no specific plans or agreements regarding any acquisitions.

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In addition to branching, lending expansion and acquisitions, we are focusing on upgrading existing facilities in an effort to better serve our customers. The new facilities and the renovations to our existing facilities are expected to be funded by cash generated by our business. Consequently, we do not currently expect to borrow funds specifically for these expansion projects.

Increasing core deposits through aggressive marketing and the offering of new deposit products

Retail deposits are our primary source of funds for investing and lending. Core deposits, which include all deposit account types except certificates of deposit, comprised 66.3% of our total deposits at December 31, 2012, up from 59.7% of total deposits at December 31, 2011. We value our core deposits because they represent a lower cost of funding and are generally less sensitive to withdrawal when interest rates fluctuate as compared to certificate of deposit accounts. We market core deposits through the internet, in-branch and local mail, print and television advertising, as well as programs that link various accounts and services together, minimizing service fees. We will continue to customize existing deposit products and introduce new products to meet the needs of our customers.

Continuing to grow and diversify our sources of non-interest income

Our profits rely heavily on the spread between the interest earned on loans and securities and interest paid on deposits and borrowings. In order to decrease our reliance on interest rate spread income, we have pursued initiatives to increase non-interest income. We generated income from customer service fees of $6.6 million, $5.9 million and $5.8 million in 2012, 2011 and 2010, respectively. We offer reverse mortgages, which generated $105,000, $161,000 and $135,000 of loan fee income in 2012, 2011 and 2010, respectively. We also offer non-deposit investment products, including mutual funds, annuities, stocks, bonds, life insurance and long-term care. Our non-deposit financial products generated $432,000, $198,000 and $302,000 of non-interest income during the years ended December 31, 2012, 2011 and 2010, respectively.

Balance Sheet Analysis

Assets

Our total assets increased $304.4 million, or 15.4%, to $2.279 billion at December 31, 2012 from $1.974 billion at December 31, 2011. Net loans increased $445.0 million, or 33.2%, to $1.786 billion at December 31, 2012 from $1.341 billion at December 31, 2011. Cash and cash equivalents decreased $63.5 million, or 40.5%, to $93.2 million at December 31, 2012 from $156.7 million at December 31, 2011. Securities available for sale decreased $72.4 million, or 21.6%, to $262.8 million at December 31, 2012 from $335.2 million at December 31, 2011.

Loans

At December 31, 2012, net loans were $1.786 billion, or 78.4% of total assets. During the year ended December 31, 2012, total loans increased $445.0 million, or 33.2%. The net increase in loans for the year ended December 31, 2012 was primarily due to increases of $267.1 million in commercial real estate loans, $80.1 million in construction loans, $76.3 million in commercial business loans and $25.3 million in one-to four-family residential loans.

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Loan Portfolio Analysis

Our loan portfolio consists primarily of residential real estate, commercial real estate, construction, commercial and consumer segments. The residential real estate loans include classes for one-to four-family, multi-family and home equity lines of credit. There are no foreign loans outstanding. Interest rates charged on loans are affected principally by the demand for such loans, the supply of money available for lending purposes and the rates offered by our competitors. Loan detail by category was as follows:

	At December 31,								
	2012		2011		2010		2009		20(
ds)	Amount	%	Amount	%	Amount	%	Amount	%	Amount
te:									
	$ 443,228	24.5%	$ 417,889	30.9%	$ 402,887	34.0%	$ 276,122	33.5%	$ 274,716
	178,948	9.9	176,668	13.0	135,290	11.4	53,402	6.5	31,212
f									
	60,907	3.4	60,989	4.5	62,750	5.3	29,979	3.6	28,253
ate	795,642	44.0	528,585	39.0	433,504	36.6	350,648	42.6	269,454
	173,255	9.6	93,158	6.9	113,142	9.6	94,102	11.4	91,652
ns	1,651,980	91.4	1,277,289	94.3	1,147,573	96.9	804,253	97.6	695,287
s									
	147,814	8.2	71,544	5.3	30,189	2.6	18,029	2.2	15,355
	7,143	0.4	5,195	0.4	6,043	0.5	1,205	0.2	1,379
	1,806,937	100.0%	1,354,028	100.0%	1,183,805	100.0%	823,487	100.0%	712,021
	(20,504)		(13,053)		(10,155)		(9,242)		(6,912)
es)	(94)		326		(88)		(945)		(1,005)
	$ 1,786,339		$ 1,341,301		$ 1,173,562		$ 813,300		$ 704,104

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Loan Maturity

The following table sets forth certain information at December 31, 2012 regarding the dollar amount of loan principal repayments becoming due during the period indicated. The table does not include any estimate of prepayments which significantly shorten the average life of all loans and may cause our actual repayment experience to differ from that shown below. Demand loans having no stated schedule of repayments and no stated maturity are reported as due in one year or less. The amounts shown below exclude net deferred loan origination fees. Our adjustable-rate mortgage loans generally do not provide for downward adjustments below the initial discounted contract rate, other than declines due to a decline in the index rate.

	December 31, 2012			
(In thousands)	**Real Estate**	**Commercial Business**	**Consumer**	**Total**
Amounts due in:				
One year or less	$ 246,003	$ 33,807	$ 478	$ 280,288
More than one to five years	894,282	56,963	6,661	957,906
More than five to ten years	255,096	48,656		303,752
More than ten years	256,599	8,388	4	264,991
Total	$ 1,651,980	$ 147,814	$ 7,143	$ 1,806,937
Interest rate terms on amounts due after one year:				
Fixed-rate loans	$ 341,469	$ 28,011	$ 6,665	$ 376,145
Adjustable-rate loans	1,064,508	85,996		1,150,504
Total	$ 1,405,977	$ 114,007	$ 6,665	$ 1,526,649

At December 31, 2012, our loan portfolio consisted of $419.8 million of fixed-rate loans and $1.387 billion of adjustable-rate loans.

Asset Quality

Credit Risk Management

Our strategy for credit risk management focuses on having well-defined credit policies and uniform underwriting criteria and providing prompt attention to potential problem loans.

When a borrower fails to make a required loan payment, we take a number of steps to have the borrower cure the delinquency and restore the loan to current status, including contacting the borrower by letter and phone at regular intervals. When the borrower is in default, we may commence collection proceedings. If a foreclosure action is instituted and the loan is not brought current, paid in full, or refinanced before the foreclosure sale, the real property securing the loan generally is sold at foreclosure. Management informs the Executive Committee monthly of the amount of loans delinquent more than 30 days. Management provides detailed information to the Board of Directors on loans 60 or more days past due and all loans in foreclosure and repossessed property that we own.

Delinquencies

Total past due loans decreased $16.7 million, or 34.3%, to $32.0 million at December 31, 2012 from $48.7 million at December 31, 2011, reflecting decreases of $7.1 million in loans 90 days or more past due and $9.6 million in loans 30 to 89 days past due. Delinquent loans at December 31, 2012 included $15.7 million of loans acquired in the Mt. Washington merger, including $3.5 million that were 30 to 59 days past due, $1.9 million that were 60 to 89 days past due and $10.3 million that were 90 days or more past due. At December 31, 2012, non-accrual loans exceeded loans 90 days or more past due primarily due to loans which were placed on non-accrual status based on a determination that the ultimate collection of all principal and interest due was not expected and certain loans that remain on non-accrual status until they attain a sustained payment history of six months.

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Non-performing Assets

Non-performing assets include loans that are 90 or more days past due or on non-accrual status and real estate and other loan collateral acquired through foreclosure and repossession. Loans 90 days or more past due may remain on an accrual basis if adequately collateralized and in the process of collection. At December 31, 2012, we did not have any accruing loans past due 90 days or more. For non-accrual loans, interest previously accrued but not collected is reversed and charged against income at the time a loan is placed on non-accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Real estate that we acquire as a result of foreclosure or by deed-in-lieu of foreclosure is classified as foreclosed real estate until it is sold. When property is acquired, it is initially recorded at the fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Holding costs and declines in fair value after acquisition of the property result in charges against income. The following table provides information with respect to our non-performing assets at the dates indicated.

	At December 31,				
(Dollars in thousands)	**2012**	**2011**	**2010**	**2009**	**2008**
Loans accounted for on a non-accrual basis:					
Real estate loans:					
Residential real estate:					
One-to four-family	$ 18,870	$ 15,795	$ 11,529	$ 4,098	$ 3,962
Multi-family	976	1,605	2,246	850	
Home equity lines of credit	2,674	1,765	2,408		
Commercial real estate	8,844	11,588	11,290	7,388	883
Construction	7,785	22,434	15,326	9,224	9,387
Total real estate loans	39,149	53,187	42,799	21,560	14,232
Commercial business loans	424	508	335		
Consumer				138	
Total non-accrual loans(1)	39,573	53,695	43,134	21,698	14,232
Foreclosed assets	2,604	3,853	4,080	2,869	2,604
Total non-performing assets	$ 42,177	$ 57,548	$ 47,214	$ 24,567	$ 16,836
Non-accrual loans to total loans	2.19%	3.97%	3.64%	2.63%	2.00%
Non-accrual loans to total assets	1.74%	2.72%	2.35%	1.79%	1.34%
Non-performing assets to total assets	1.85%	2.91%	2.57%	2.03%	1.58%

(1) TDRs on accrual status not included above totaled $6.8 million at December 31, 2012, $1.3 million at December 31, 2011, $1.3 million at December 31, 2010, $189,000 at December 31, 2009 and $0 at December 31, 2008.

Non-accrual loans declined $14.1 million to $39.6 million, or 2.19% of total loans outstanding at December 31, 2012, from $53.7 million, or 3.97% of total loans outstanding at December 31, 2011, primarily due to decreases of $14.6 million in non-accrual construction loans, $2.7 million in non-accrual commercial real estate loans and $629,000 in non-accrual multi-family loans, partially offset by increases of $3.1 million in non-accrual one-to four-family loans and $909,000 in non-accrual home equity lines of credit. Foreclosed real estate decreased $1.2 million, or 32.4%, to $2.6 million at December 31, 2012 from $3.9 million at December 31, 2011. Non-performing assets declined $15.4 million to $42.2 million, or 1.85% of total assets, at December 31, 2012, from $57.5 million, or 2.91% of total assets, at December 31, 2011. Non-performing assets at December 31, 2012 included $19.5 million of assets acquired in the Mt. Washington merger, comprised of $18.5 million of non-accrual loans and $1.0 million of foreclosed real estate. Interest income that would have been recorded for the

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year ended December 31, 2012 had non-accruing loans been current according to their original terms amounted to $1.1 million.

Troubled Debt Restructurings

In the course of resolving non-accrual loans, the Bank may choose to restructure the contractual terms of certain loans, with terms modified to fit the ability of the borrower to repay in line with its current financial status. A loan is considered a troubled debt restructure if, for reasons related to the debtor s financial difficulties, a concession is granted to the debtor that would not otherwise be considered.

The following table summarizes the Company s troubled debt restructurings (TDRs) at the dates indicated.

	At December 31,		
(In thousands)	**2012**	**2011**	**2010**
TDRs on accrual status:			
One-to four-family	$ 1,992	$ 1,269	$ 1,289
Multi-family	110		
Home equity lines of credit	22		
Commercial real estate	1,393		
Construction	3,319		
Total TDRs on accrual status	6,836	1,269	1,289
TDRs on non-accrual status:			
One-to four-family	2,493	2,052	288
Commercial real estate	4,466	4,663	4,797
Construction	3,838	7,715	3,487
Total TDRs on non-accrual status	10,797	14,430	8,572
Total TDRs	$ 17,633	$ 15,699	$ 9,861

Construction TDRs on accrual status were the result of a two loan relationship that was returned to accrual status during the year ended December 31, 2012. The increases in commercial real estate and multi-family TDRs on accrual status were due to a loan restructured into two loans during the year ended December 31, 2012. The commercial real estate TDR reflects a 30 year note with a variable interest rate tied to the 5 year FHLB classic advance rate plus 300 basis points with a rate at the time of origination of 3.75% (rate was previously fixed at 8.25%). The multi-family TDR reflects a one year interest-only balloon with variable interest rate tied to Prime plus 100 basis points with a rate at the time of origination of 4.25%.

The increase in one-to-four family TDRs was due to one residential loan modification completed for the year ended December 31, 2012 and two one-to-four family TDRs that were returned to accrual status. The increase in one-to-four family non-accrual TDRs was due to six residential loan modifications completed for the year ended December 31, 2012 and two one-to-four family TDRs that were returned to accrual status. Modifications of one-to-four family TDRs consist of rate reductions, loan term extensions or provisions for interest-only payments for specified periods up to 12 months. The Company has generally been successful with the concessions it has offered to borrowers to date. The Company generally returns TDRs to accrual status when they have sustained payments for six months based on the restructured terms. Interest income that would have been recorded for the year ended December 31, 2012 had TDRs been current according to their original terms amounted to $474,000.

Potential Problem Loans

Certain loans are identified during the Company s loan review process that are currently performing in accordance with their contractual terms and we expect to receive payment in full of principal and interest, but it

is deemed probable that we will be unable to collect all the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. This may result from deteriorating conditions such as cash flows, collateral values or creditworthiness of the borrower. These loans are classified as impaired but are not accounted for on a non-accrual basis. There were no potential problem loans identified at December 31, 2012 other than those already classified as non-performing, impaired or troubled debt restructurings.

Allowance for Loan Losses

The allowance for loan losses is maintained at levels considered adequate by management to provide for probable loan losses inherent in the loan portfolio as of the consolidated balance sheet reporting dates. The allowance for loan losses is based on management s assessment of various factors affecting the loan portfolio, including portfolio composition, delinquent and non-accrual loans, national and local business conditions and loss experience and an overall evaluation of the quality of the underlying collateral.

Changes in the allowance for loan losses during the periods indicated were as follows:

	Years Ended December 31,				
(Dollars in thousands)	**2012**	**2011**	**2010**	**2009**	**2008**
Beginning balance	$ 13,053	$ 10,155	$ 9,242	$ 6,912	$ 3,637
Provision for loan losses	8,581	3,663	3,181	4,082	5,638
Charge offs:					
Real estate	1,840	1,334	2,719	1,938	2,265
Commercial business		72	93		98
Consumer	164	96	199	87	3
Total charge-offs	2,004	1,502	3,011	2,025	2,366
Recoveries:					
Real estate	823	690	646	250	
Commercial business	11		8		
Consumer	40	47	89	23	3
Total recoveries	874	737	743	273	3
Net charge-offs	(1,130)	(765)	(2,268)	(1,752)	(2,363)
Ending balance	$ 20,504	$ 13,053	$ 10,155	$ 9,242	$ 6,912
Allowance to non-accrual loans	51.81%	24.31%	23.54%	42.59%	48.57%
Allowance to total loans outstanding	1.13%	0.96%	0.86%	1.12%	0.97%
Net charge-offs to average loans outstanding	0.07%	0.06%	0.19%	0.23%	0.38%

The Company s provision for loan losses was $8.6 million for the year ended December 31, 2012 compared to $3.7 million for the year ended December 31, 2011. The increase in the provision for loan losses was primarily due to increases in the commercial real estate, construction and commercial business loan categories for the year ended December 31, 2012 compared to the year ended December 31, 2011, as such loans have higher inherent credit risk than loans in our residential real estate loan categories. The provision for loan losses was also based on management s assessment of loan portfolio growth and composition changes, an ongoing evaluation of credit quality and current economic conditions. The allowance for loan losses was $20.5 million or 1.13% of total loans outstanding at December 31, 2012, compared to $13.1 million or 0.96% of total loans outstanding at December 31, 2011. The Company continues to assess the adequacy of its allowance for loan losses in accordance with established policies.

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The following table sets forth the breakdown of the allowance for loan losses by loan category at the periods indicated:

	At December 31,								
	2012			2011			2010		
(Dollars in thousands)	Amount	% of Allowance to Total Allowance	% of Loans in Category of Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category of Total Loans	Amount	% of Allowance to Total Allowance	% of Loans in Category of Total Loans
Real estate loans:									
Residential real estate:									
One-to four-family	$ 2,507	12.2%	24.5%	$ 1,861	14.3%	30.9%	$ 1,130	11.1%	34.0%
Multi-family	1,431	7.0	9.9	1,361	10.4	13.0	1,038	10.2	11.4
Home equity lines of credit	226	1.1	3.4	245	1.9	4.5	227	2.2	5.3
Commercial real estate	10,405	50.8	44.0	6,980	53.4	39.0	5,238	51.7	36.6
Construction	3,656	17.8	9.6	1,430	11.0	6.9	2,042	20.1	9.6
Total real estate loans	18,225	88.9	91.4	11,877	91.0	94.3	9,675	95.3	96.9
Commercial business loans	2,174	10.6	8.2	1,061	8.1	5.3	448	4.4	2.6
Consumer	105	0.5	0.4	115	0.9	0.4	32	0.3	0.5
Total loans	$ 20,504	100.0%	100.0%	$ 13,053	100.0%	100.0%	$ 10,155	100.0%	100.0%

The allowance consists of general and allocated components. The general component relates to pools of non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The allocated component relates to loans that are classified as impaired, whereby an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan.

The Company had impaired loans totaling $41.2 million and $58.9 million as of December 31, 2012 and 2011, respectively. At December 31, 2012, impaired loans totaling $6.7 million had a valuation allowance of $649,000. Impaired loans totaling $9.1 million had a valuation allowance of $490,000 at December 31, 2011. The Company s average investment in impaired loans was $51.7 million and $49.7 million for the years ended December 31, 2012 and 2011, respectively.

A loan is considered impaired when, based on current information and events, it is probable that we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Impairment is measured on a loan by loan basis by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, we do not separately identify individual one-to four-family residential and consumer loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring. The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a TDR. All TDRs are initially classified as impaired.

We review residential and commercial loans for impairment based on the fair value of collateral, if collateral-dependent, or the present value of expected cash flows. Management has reviewed the collateral value for all impaired and non-accrual loans that were collateral-dependent as of December 31, 2012 and considered any probable loss in determining the allowance for loan losses.

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For residential loans measured for impairment based on the collateral value, we will do the following:

- When a loan becomes seriously delinquent, generally 60 days past due, internal valuations are completed by our in-house appraiser who is a Massachusetts certified residential appraiser. We obtain third party appraisals, which are generally the basis for charge-offs when a loss is indicated, prior to the foreclosure sale. We generally are able to complete the foreclosure process within nine to 12 months from receipt of the internal valuation.

- We make adjustments to appraisals based on updated economic information, if necessary, prior to the foreclosure sale. We review current market factors to determine whether, in management s opinion, downward adjustments to the most recent appraised values may be warranted. If so, we use our best estimate to apply an estimated discount rate to the appraised values to reflect current market factors.

- Appraisals we receive are based on comparable property sales.

For commercial loans measured for impairment based on the collateral value, we will do the following:

- We obtain a third party appraisal at the time a loan is deemed to be in a workout situation and there is no indication that the loan will return to performing status, generally when the loan is 90 days or more past due. One or more updated third party appraisals are obtained prior to foreclosure depending on the foreclosure timeline. In general we order new appraisals every 180 days on loans in the process of foreclosure.

- We make downward adjustments to appraisals when conditions warrant. Adjustments are made by applying a discount to the appraised value based on occupancy, recent changes in condition to the property and certain other factors. Adjustments are also made to appraisals for construction projects involving residential properties based on recent sales of units. Losses are recognized if the appraised value less estimated costs to sell is less than our carrying value of the loan.

- Appraisals we receive are generally based on a reconciliation of comparable property sales and income capitalization approaches. For loans on construction projects involving residential properties, appraisals are generally based on a discounted cash flow analysis assuming a bulk sale to a single buyer.

Loans that are partially charged off generally remain on non-accrual status until foreclosure or such time that they are performing in accordance with the terms of the loan and have a sustained payment history of at least six months. The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. Loan losses are charged against the allowance when we believe the uncollectability of a loan balance is confirmed, generally when appraised values (as adjusted values, if applicable) less estimated costs to sell, are less than the Company s carrying values.

Although we believe that we use the best information available to establish the allowance for loan losses, future adjustments to the allowance for loan losses may be necessary and our results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making the determinations. Furthermore, while we believe we have established our allowance for loan losses in conformity with generally accepted accounting principles in the United States of America, there can be no assurance that regulators, in reviewing our loan portfolio, will not require us to increase our allowance for loan losses. In addition, because future events affecting borrowers and collateral cannot be predicted with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loans deteriorate as a result of the factors discussed above. Any material increase in the allowance for loan losses may adversely affect our financial condition and results of operations.

Securities Portfolio

At December 31, 2012, the securities portfolio was $262.8 million, or 11.5% of total assets. At that date, 46.2% of the securities portfolio, or $121.4 million, was invested in corporate bonds. The amortized cost and fair value of corporate bonds in the financial services sector was $76.0

million, and $78.5 million, respectively. The remainder of the corporate bond portfolio includes companies from a variety of industries. Refer to Note 3 *Securities Available for Sale* in Notes to the Consolidated Financial Statements included in Item 8 *Financial Statements and Supplementary*

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Data within this report for more detail regarding industry concentrations in the Company s corporate bond portfolio. The portfolio also includes debt securities issued by government-sponsored enterprises, municipal bonds, mortgage-backed securities issued by government-sponsored enterprises and private companies and marketable equity securities. Included in marketable equity securities are money market mutual funds and common stocks. The following table sets forth the amortized cost and fair value of our securities, all of which at the dates indicated were available for sale.

	At December 31,					
	2012		2011		2010	
(In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Debt securities:						
Corporate bonds	$ 117,714	$ 121,420	$ 163,746	$ 165,704	$ 214,625	$ 222,038
Government-sponsored enterprises	53,084	53,149	82,898	83,195	36,062	35,900
Municipal bonds	7,236	7,461	7,401	7,574	6,583	6,493
Residential mortgage-backed securities:						
Government-sponsored enterprises	16,280	17,298	25,296	26,664	33,625	34,542
Private label	3,169	3,309	7,322	7,055	9,737	10,334
Other debt securities					641	641
Total debt securities	197,483	202,637	286,663	290,192	301,273	309,948
Marketable equity securities:						
Common stocks	42,406	46,334	31,820	36,007	31,344	36,765
Money market mutual funds	13,833	13,814	9,049	9,031	13,904	13,889
Total marketable equity securities	56,239	60,148	40,869	45,038	45,248	50,654
Total	$ 253,722	$ 262,785	$ 327,532	$ 335,230	$ 346,521	$ 360,602

At December 31, 2012, we had no investments in a single company or entity, other than Government-sponsored enterprises, that had an aggregate book value in excess of 10% of our equity.

The following table sets forth the stated maturities and weighted average yields of the securities at December 31, 2012.

	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
(Dollars in thousands)	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
Debt securities:										
Corporate bonds	$ 5,290	4.69%	$ 105,845	2.80%	$ 6,579	4.07%	$	%	$ 117,714	2.96%
Government-sponsored enterprises			97	4.06	52,987	1.30			53,084	1.30
Municipal bonds	1,460	2.18	4,377	2.98	1,399	3.61			7,236	2.94
Residential mortgage-backed securities:										
Government-sponsored enterprises			4	12.46	18	9.34	16,258	4.38	16,280	4.39
Private label					256	5.00	2,913	5.67	3,169	5.62
Total debt securities	$ 6,750	4.14%	$ 110,323	2.81%	$ 61,239	1.67%	$ 19,171	4.58%	$ 197,483	2.67%

The available-for-sale securities portfolio decreased $72.4 million, or 21.6% to $262.8 million at December 31, 2012 from $335.2 million at December 31, 2011. Money market mutual funds included in the marketable equity securities portfolio totaled $13.8 million and $9.0 million at December 31, 2012 and 2011, respectively.

Each reporting period, the Company evaluates all securities with a decline in fair value below the amortized cost of the investment to determine whether or not the impairment is deemed to be other-than-temporary. OTTI is required to be recognized if (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis.

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Marketable equity securities are evaluated for OTTI based on the severity and duration of the impairment and, if deemed to be other than temporary, the declines in fair value are reflected in earnings as realized losses. For impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. For all other impaired debt securities, credit-related OTTI is recognized through earnings and non-credit related OTTI is recognized in other comprehensive income/loss, net of applicable taxes. At December 31, 2012, unrealized losses in our debt portfolio ranged from 0% to 6.6%, and unrealized losses in our equity portfolio ranged from 0% to 23.5%.

As of December 31, 2012, the net unrealized gain on the total debt securities portfolio was $5.2 million. The Company has no indication that the issuer will be unable to continue to service the obligations, and management does intend not to sell, and more likely than not will not be required to sell, such bond before the earlier of recovery or maturity. As a result, management considers the decline in market value to be temporary. No other debt securities had a market decline greater than 5.0% of amortized cost.

As of December 31, 2012, the net unrealized gain on the total marketable equity securities portfolio was $3.9 million. Two equity securities had fair value declines of 15.0% or more, with net unrealized losses of $116,000. The most significant market valuation decrease related to any one equity security within the portfolio at December 31, 2012 is $72,000. Although the issuers have shown declines in earnings as a result of the weakened economy, no credit issues have been identified that cause management to believe the decline in market value is other than temporary, and the Company has the ability and intent to hold these investments until a recovery of fair value. In analyzing an equity issuer s financial condition, management considers industry analysts reports, financial performance and projected target prices of investment analysts within a one-year time frame.

Refer to Note 3 *Securities Available for Sale* in Notes to the Consolidated Financial Statements included in Item 8 *Financial Statements and Supplementary Data* within this report for more detail regarding the Company s assessment of other-than-temporary impairment.

Deposits

Deposits are a major source of our funds for lending and other investment purposes. Deposit inflows and outflows are significantly influenced by general interest rates and money market conditions. Our deposit base is comprised of demand, NOW, money market, regular savings and other deposits, and certificates of deposit. We consider demand, NOW, money market, and regular and other deposits to be core deposits. Total deposits increased $260.9 million, or 16.3%, to $1.865 billion at December 31, 2012 from $1.604 billion at December 31, 2011. Our continuing focus on the acquisition and expansion of core deposit relationships resulted in net growth in those non-term deposits of $279.1 million, or 29.1%, to $1.237 billion, or 66.3% of total deposits. The net deposit growth also reflects $156.3 million of new deposits from the five branches opened during the last two years.

The following table sets forth the average balances of deposits for the periods indicated.

	Years Ended December 31,								
	2012			2011			2010		
(Dollars in thousands)	Average Balance	Average Rate	Percent of Total Deposits	Average Balance	Average Rate	Percent of Total Deposits	Average Balance	Average Rate	Percent of Total Deposits
Demand deposits	$ 172,258	%	10.9%	$ 126,737	%	9.1%	$ 106,549	%	7.7%
NOW deposits	154,375	0.48	9.7	134,557	0.46	9.6	117,584	0.46	9.3
Money market deposits	523,133	0.86	32.5	376,546	0.93	27.8	308,756	1.12	22.2
Regular and other deposits	231,274	0.38	13.2	205,664	0.49	13.3	184,287	0.55	12.9
Certificates of deposit	630,349	1.53	33.7	692,638	1.82	40.2	644,181	1.93	47.9
Total	$ 1,711,389	0.92%	100.0%	$ 1,536,142	1.15%	100.0%	$ 1,361,357	1.28%	100.0%

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The following table indicates the amount of certificates of deposit of $100,000 or more by time remaining until maturity as of December 31, 2012.

(In thousands)		Certificates of Deposit
Maturity Period:		
Three months or less	$	36,992
Over three through six months		58,447
Over six through twelve months		84,077
Over twelve months		148,066
Total	$	327,582

Borrowings

We use borrowings from the Federal Home Loan Bank of Boston to supplement our supply of funds for loans and investments. In addition, we may also purchase federal funds from local banking institutions as an additional short-term funding source for the Bank. Total borrowings increased $29.8 million, or 22.7%, to $161.3 million at December 31, 2012 from $131.5 million at December 31, 2011, reflecting a $46.3 million increase in Federal Home Loan Bank of Boston advances partially offset by a $16.5 million decrease in short-term borrowings. The Bank entered into new advances with the Federal Home Loan Bank of Boston totaling $90.0 million with terms of five to seven years and fixed interest rates of 0.99% to 1.57% during the year ended December 31, 2012. At December 31, 2012 and 2011, Federal Home Loan Bank of Boston advances totaled $161.3 million and $114.9 million, respectively, with a weighted average rate of 2.05% and 2.61%, respectively. At December 31, 2012 and 2011, federal funds purchased totaled $0 and $16.5 million, respectively, with a weighted average rate of 0.15%. At December 31, 2012, we also had an available line of credit of $9.4 million with the Federal Home Loan Bank of Boston at an interest rate that adjusts daily, none of which was outstanding at that date.

Information relating to borrowings, including the federal funds purchased, is detailed in the following table.

	Years Ended December 31,					
(Dollars in thousands)		2012		2011		2010
Balance outstanding at end of year	$	161,254	$	131,450	$	148,683
Average amount outstanding during the year	$	152,730	$	143,346	$	154,123
Weighted average interest rate during the year		2.10%		2.26%		2.33%
Maximum outstanding at any month end	$	182,061	$	157,848	$	163,336
Weighted average interest rate at end of year		2.05%		2.29%		2.43%

Stockholders Equity

Total stockholders equity increased $14.0 million, or 6.4%, to $233.9 million at December 31, 2012, from $219.9 million at December 31, 2011. The increase for the year ended December 31, 2012 was due primarily to $12.4 million in net income and a $930,000 increase in accumulated other comprehensive income primarily reflecting an increase in the fair value of available for sale securities, net of tax, partially offset by a $1.0 million increase in treasury stock resulting from the Company s repurchase of 87,504 shares. Stockholders equity to assets was 10.27% at December 31, 2012, compared to 11.14% at December 31, 2011. Book value per share increased to $10.57 at December 31, 2012 from $9.93 at December 31, 2011. Tangible book value per share increased to $9.95 at December 31, 2012 from $9.31 at December 31, 2011. Market price per share increased $4.33, or 34.8%, to $16.78 at December 31, 2012 from $12.45 at December 31, 2011. At December 31, 2012, the Company and the Bank continued to exceed all regulatory capital requirements.

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Average Balance Sheets and Related Yields and Rates

The following table presents information regarding average balances of assets and liabilities, the total dollar amounts of interest income and dividends from average interest-earning assets, the total dollar amounts of interest expense on average interest-bearing liabilities and the resulting annualized average yields and costs. The yields and costs for the periods indicated are derived by dividing income or expense by the average balances of assets or liabilities, respectively, for the periods presented. For purposes of this table, average balances have been calculated using daily average balances, and non-accrual loans are included in average balances but are not deemed material. Loan fees are included in interest income on loans but are not material.

	Years Ended December 31,								
	2012			2011			2010		
n thousands)	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yield/ Cost	Average Balance	Interest	Yie Co
rning assets:									
	$ 1,550,707	$ 76,050	4.90%	$ 1,230,294	$ 66,157	5.38%	$ 1,184,816	$ 67,459	
and of deposits	298,918	8,587	2.87	364,199	12,153	3.34	350,038	14,432	
est-earning	135,183	332	0.25	190,634	502	0.26	72,136	168	
est-earning	1,984,808	84,969	4.28	1,785,127	78,812	4.41	1,606,990	82,059	
t-earning	124,727			128,955			131,756		
s	$ 2,109,535			$ 1,914,082			$ 1,738,746		
and ers equity:									
aring									
osits	$ 154,375	741	0.48	$ 134,557	613	0.46	$ 117,584	540	
rket deposits	523,133	4,484	0.86	376,546	3,515	0.93	308,756	3,447	
d other	231,274	887	0.38	205,664	1,003	0.49	184,287	1,011	
s of deposit	630,349	9,627	1.53	692,638	12,607	1.82	644,181	12,446	
est-bearing	1,539,131	15,739	1.02	1,409,405	17,738	1.26	1,254,808	17,444	
s	152,730	3,206	2.10	143,346	3,234	2.26	154,123	3,596	
est-bearing	1,691,861	18,945	1.12	1,552,751	20,972	1.35	1,408,931	21,040	
t-bearing posits	172,258			126,737			106,549		
t-bearing	16,166			15,138			13,798		
ities	1,880,285			1,694,626			1,529,278		
holders	229,250			219,456			209,468		
	$ 2,109,535			$ 1,914,082			$ 1,738,746		

ities and rs equity								
t-earning	$ 292,947			$ 232,376			$ 198,059	
t income		$ 66,024			$ 57,840			$ 61,019
e spread(3)			3.16%			3.06%		
t margin(4)			3.33%			3.24%		
rning assets aring		117.32%			114.97%			114.06%
ntal on:								
sits, t-bearing posits	$ 1,711,389	$ 15,739	0.92%	$ 1,536,142	$ 17,738	1.15%	$ 1,361,357	$ 17,444
sits and s, including t-bearing posits	$ 1,864,119	$ 18,945	1.02%	$ 1,679,488	$ 20,972	1.25%	$ 1,515,480	$ 21,040

(1) Loans on non-accrual status are included in average balances.

(2) Includes Federal Home Loan Bank stock and associated dividends.

(3) Interest rate spread represents the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by average interest-earning assets.

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Rate/Volume Analysis

The following table sets forth the effects of changing rates and volumes on our net interest income. The rate column shows the effects attributable to changes in rate (changes in rate multiplied by prior volume). The volume column shows the effects attributable to changes in volume (changes in volume multiplied by prior rate). The net column represents the sum of the prior columns. For purposes of this table, changes attributable to changes in both rate and volume that cannot be segregated have been allocated proportionally based on the changes due to rate and the changes due to volume.

	Years Ended December 31, 2012 Compared to 2011 Increase (Decrease) Due to			Years Ended December 31, 2011 Compared to 2010 Increase (Decrease) Due to		
(In thousands)	Volume	Rate	Net	Volume	Rate	Net
Interest Income:						
Loans	$ 16,097	$ (6,204)	$ 9,893	$ 2,531	$ (3,833)	$ (1,302)
Securities and certificates of deposits	(2,008)	(1,558)	(3,566)	564	(2,843)	(2,279)
Other interest-earning assets	(138)	(32)	(170)	309	25	334
Total	13,951	(7,794)	6,157	3,404	(6,651)	(3,247)
Interest Expense:						
Deposits	416	(2,415)	(1,999)	1,779	(1,485)	294
Borrowings	205	(233)	(28)	(246)	(116)	(362)
Total	621	(2,648)	(2,027)	1,533	(1,601)	(68)
Change in net interest income	$ 13,330	$ (5,146)	$ 8,184	$ 1,871	$ (5,050)	$ (3,179)

Results of Operations for the Years Ended December 31, 2012, 2011 and 2010

Net Income

Our primary source of income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and investments, and interest expense, which is the interest that we pay on our deposits and borrowings. Changes in levels of interest rates affect our net interest income. A secondary source of income is non-interest income, which includes revenue that we receive from providing products and services. The majority of our non-interest income generally comes from customer service fees, loan fees, bank-owned life insurance, mortgage banking gains and gains on sales of securities.

Net income information is as follows:

	Years Ended December 31,			Change 2012/2011		Change 2011/2010	
(Dollars in thousands)	2012	2011	2010	Amount	Percent	Amount	Percent
Net interest income	$ 66,024	$ 57,840	$ 61,019	$ 8,184	14.1%	$ (3,179)	(5.2)%
Provision for loan losses	8,581	3,663	3,181	4,918	134.3	482	15.2
Non-interest income	21,261	15,388	11,721	5,873	38.2	3,667	31.3
Non-interest expenses	59,948	50,994	48,804	8,954	17.6	2,190	4.5
Net income	12,426	11,970	13,374	456	3.8	(1,404)	(10.5)
	0.59%	0.63%	0.77%	(0.04)	(6.3)%	(0.14)	(18.2)%

Return on average assets							
Return on average equity	5.42%	5.45%	6.38%	(0.03)	(0.6)%	(0.93)	(14.6)%

The Company recorded a pre-tax gain of $4.8 million on June 8, 2012 due to the sale of Hampshire First Bank, which was 43% owned by the Company, to NBT Bancorp, Inc. and NBT Bank, N.A. On an after-tax basis, this gain increased net income by $2.9 million, or $0.13 per diluted share, for the year ended December 31, 2012.

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Net Interest Income

Net interest income increased $8.2 million, or 14.1%, to $66.0 million for the year ended December 31, 2012 from $57.8 million for the year ended December 31, 2011. The net interest rate spread and net interest margin were 3.16% and 3.33%, respectively, for the year ended December 31, 2012 compared to 3.06% and 3.24%, respectively, for the year ended December 31, 2011. The increase in net interest income was due primarily to strong loan growth along with a decline in the cost of funds for the year ended December 31, 2012 compared to 2011.

The average balance of the Company s loan portfolio increased $320.4 million, or 26.0%, to $1.551 billion, which was partially offset by the decline in the yield on loans of 48 basis points to 4.90% for the year ended December 31, 2012 compared to the year ended December 31, 2011. The Company s cost of total deposits declined 23 basis points to 0.92%, which was partially offset by the increase in the average balance of total deposits of $175.2 million, or 11.4%, to $1.711 billion for the year ended December 31, 2012 compared to the year ended December 31, 2011. The Company s yield on interest-earning assets declined 13 basis points to 4.28% for the year ended December 31, 2012 compared to 4.41% for the year ended December 31, 2011, while the cost of funds declined 23 basis points to 1.02% for the year ended December 31, 2012 compared to 1.25% for the year ended December 31, 2011.

For the year ended December 31, 2011, net interest income decreased $3.2 million, or 5.2%, to $57.8 million from $61.0 million for the year ended December 31, 2010. The net interest rate spread and net interest margin were 3.06% and 3.24%, respectively, for the year ended December 31, 2011 compared to 3.62% and 3.80%, respectively, for the year ended December 31, 2010. The decrease in net interest income was due primarily to declines in yields on loans and securities for the year ended December 31, 2011 compared to 2010.

The Company s yield on loans declined 31 basis points to 5.38%, which was partially offset by an increase in the average balance of the loan portfolio of $45.5 million, or 3.8%, to $1.230 billion for the year ended December 31, 2011 compared to the year ended December 31, 2010. For the year ended December 31, 2011, the average balance of total deposits increased $174.8 million, or 12.8%, to $1.536 billion, which was partially offset by a decline in the cost of total deposits of 13 basis points to 1.15% compared to the year ended December 31, 2010. The Company s yield on interest-earning assets declined 70 basis points to 4.41% for the year ended December 31, 2011 compared to 5.11% for the year ended December 31, 2010, while the cost of funds declined 14 basis points to 1.25% for the year ended December 31, 2011 compared to 1.39% for the year ended December 31, 2010.

Provision for Loan Losses

The Company s provision for loan losses was $8.6 million for the year ended December 31, 2012 compared to $3.7 million and $3.2 million for the years ended December 31, 2011 and 2010, respectively. For further discussion of the changes in the provision and allowance for loan losses, refer to *Management s Discussion and Analysis of Results of Operations and Financial Condition - Allowance for Loan Losses*.

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Non-Interest Income

(Dollars in thousands)	Years Ended December 31, 2012	2011	2010	Change 2012/2011 Amount	Percent	Change 2011/2010 Amount	Percent
Customer service fees	$ 6,645	$ 5,867	$ 5,823	$ 778	13.3%	$ 44	0.8%
Loan fees	339	584	636	(245)	(42.0)	(52)	(8.2)
Mortgage banking gains, net	2,371	2,125	1,811	246	11.6	314	17.3
Gain on sales of securities, net	5,568	4,464	1,790	1,104	24.7	2,674	149.4
Income from bank-owned life insurance	1,201	1,221	1,169	(20)	(1.6)	52	4.4
Equity income on investment in affiliate bank	310	1,110	492	(800)	(72.1)	618	125.6
Gain on sales of investment in affiliate bank	4,819			4,819			
Other income	8	17		(9)	(52.9)	17	
Total non-interest income	$ 21,261	$ 15,388	$ 11,721	$ 5,873	38.2%	$ 3,667	31.3%

Non-interest income increased $5.9 million, or 38.2%, to $21.3 million for the year ended December 31, 2012 from $15.4 million for the year ended December 31, 2011, primarily due to a $4.8 million gain on sale of the Hampshire First Bank affiliate and increases of $1.1 million in gain on sales of securities, net, $778,000 in customer service fees and $246,000 in mortgage banking gains, net, partially offset by decreases of $800,000 in equity income from the Hampshire First Bank affiliate and $245,000 in loan fees.

For the year ended December 31, 2011, non-interest income increased $3.7 million, or 31.3%, to $15.4 million from $11.7 million for the year ended December 31, 2010 primarily due to increases of $2.7 million in gain on sales of securities, net, $314,000 in mortgage banking gains, net, and $618,000 in equity income from Hampshire First Bank.

Non-Interest Expense

(Dollars in thousands)	Years Ended December 31, 2012	2011	2010	Change 2012/2011 Amount	Percent	Change 2011/2010 Amount	Percent
Salaries and employee benefits	$ 36,386	$ 29,474	$ 25,716	$ 6,912	23.5%	$ 3,758	14.6%
Occupancy and equipment	7,932	7,831	5,646	101	1.3	2,185	38.7
Data processing	3,511	2,909	3,200	602	20.7	(291)	(9.1)
Data processing contract termination cost			2,689			(2,689)	(100.0)
Marketing and advertising	2,537	2,450	1,968	87	3.6	482	24.5
Professional services	2,966	2,685	2,443	281	10.5	242	9.9
Foreclosed real estate expense	599	328	488	271	82.6	(160)	(32.8)

Deposit insurance		1,760		1,893		2,250		(133)	(7.0)		(357)	(15.9)
Other general and administrative		4,257		3,424		4,404		833	24.3		(980)	(22.3)
Total non-interest expenses	$	59,948	$	50,994	$	48,804	$	8,954	17.6%	$	2,190	4.5%

Non-interest expense increased $9.0 million, or 17.6%, to $59.9 million for the year ended December 31, 2012 from $51.0 million for the year ended December 31, 2011, primarily due to increases of $6.9 million in salaries and employee benefits, $602,000 in data processing expenses and $1.4 million in other non-interest expenses. The increases in non-interest expenses were primarily associated with the new branches opened and costs associated with the expansion of residential and commercial lending capacity in the past year. In addition, the increase in salaries and employee benefits reflected an increase in incentive compensation plan expense of $1.2 million to $3.1 million for the year ended December 31, 2012 from $1.9 million for the year ended December 31, 2011 based on the Company s achievement of various performance measures. The Company s

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efficiency ratio was 77.96% for the year ended December 31, 2012, excluding the gain on sale of the Hampshire First Bank affiliate, compared to 74.16% for the year ended December 31, 2011.

For the year ended December 31, 2011, non-interest expense increased $2.2 million, or 4.5%, to $51.0 million from $48.8 million for the year ended December 31, 2010, primarily due to increases of $3.8 million in salaries and employee benefits, $2.2 million in occupancy and equipment expenses, $482,000 in marketing and advertising, and $242,000 in professional services, partially offset by decreases of $980,000 in other general and administrative expenses, $357,000 in deposit insurance, $291,000 in recurring data processing costs, $160,000 in foreclosed real estate costs and a $2.7 million charge during the year ended December 31, 2010 related to termination of the contract with Mt. Washington Co-operative Bank s data processing services provider. The increases in salaries and employee benefits, and occupancy and equipment were primarily associated with the new branches opened during 2011 and costs associated with the expansion of residential and commercial lending capacity. The Company s efficiency ratio was 74.16% for the year ended December 31, 2011 compared to 65.00% for the year ended December 31, 2010, excluding the charge to terminate Mt. Washington Co-operative Bank s data processing contract.

Income Tax Provision

The Company recorded a provision for income taxes of $6.3 million for the year ended December 31, 2012, reflecting an effective tax rate of 33.7%, compared to $6.6 million, or 35.5%, for the year ended December 31, 2011. For the year ended December 31, 2010, the Company recorded a provision for income taxes of $7.4 million, reflecting an effective tax rate of 35.6%. The changes in the income tax provision were primarily due to changes in the components of pre-tax income.

Risk Management

Overview

Managing risk is an essential part of successfully managing a financial institution. Our most prominent risk exposures are credit risk, interest rate risk and market risk. Credit risk is the risk of not collecting the interest and/or the principal balance of a loan or investment when it is due. Interest rate risk is the potential reduction of net interest income as a result of changes in interest rates. Market risk arises from fluctuations in interest rates that may result in changes in the values of financial instruments, such as available-for-sale securities that are accounted for on a mark-to-market basis. Other risks that we face are operational risks, liquidity risk and reputation risk. Operational risks include risks related to fraud, regulatory compliance, processing errors, and technology and disaster recovery. Liquidity risk is the possible inability to fund obligations to depositors, lenders or borrowers. Reputation risk is the risk that negative publicity or press, whether true or not, could cause a decline in our customer base or revenue.

The Company s Risk Management Officer and the Compliance/Risk Management Committee oversee the risk management process on behalf of the Company s Board of Directors, with responsibility for the overall risk program and strategy, determining risks and implementing risk mitigation strategies in the following risk areas: interest rates, operational/compliance, liquidity, strategic, reputation, credit and legal/regulatory. The Risk Management Officer reports the activities of the Compliance/Risk Management Committee to the Audit Committee of the Board of Directors on a quarterly basis, or more often as necessary. The Risk Management Officer provides counsel to members of our management team on all issues that affect our risk positions. In addition, the Risk Management Officer is responsible for the following:

- Develops, implements and maintains a risk management program for the entire Bank to withstand regulatory scrutiny and provides operational safety and efficiency;

- Recommends policy to the Board of Directors;

- Chairs the Company s Compliance/Risk Management Committee;

- Participates in developing long-term strategic risk objectives for the Company;

Coordinates and reviews risk assessments and provides recommendations on risk controls, testing and mitigation strategies;

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- Reviews and provides recommendations and approvals for all proposed business initiatives;
- Implements and maintains the Vendor Management Program; and
- Keeps abreast of risk management and regulatory trends and mitigation strategies.

Asset/Liability Management

Our earnings and the market value of our assets and liabilities are subject to fluctuations caused by changes in the level of interest rates. We manage the interest rate sensitivity of our interest-bearing liabilities and interest-earning assets in an effort to minimize the adverse effects of changes in the interest rate environment. Deposit accounts typically react more quickly to changes in market interest rates than mortgage loans because of the shorter maturities of deposits. As a result, sharp increases in interest rates may adversely affect our earnings while decreases in interest rates may beneficially affect our earnings. To reduce the potential volatility of our earnings, we have sought to improve the match between asset and liability maturities and rates, while maintaining an acceptable interest rate spread. Our strategy for managing interest rate risk emphasizes: originating loans with adjustable interest rates; selling the residential real estate fixed-rate loans with terms greater than 10 years that we originate; promoting core deposit products; and gradually extending the maturity of funding sources, as borrowing and term deposit rates are historically low.

We have an Asset/Liability Management Committee to coordinate all aspects of asset/liability management. The committee establishes and monitors the volume, maturities, pricing and mix of assets and funding sources with the objective of managing assets and funding sources to provide results that are consistent with liquidity, growth, risk limits and profitability goals.

We analyze our interest rate sensitivity position to manage the risk associated with interest rate movements through the use of interest income simulation. The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are interest sensitive. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period.

Our goal is to manage asset and liability positions to moderate the effects of interest rate fluctuations on net interest income. Interest income simulations are completed quarterly and presented to the Asset/Liability Committee and the board of directors. The simulations provide an estimate of the impact of changes in interest rates on net interest income under a range of assumptions. The numerous assumptions used in the simulation process are reviewed by the Asset/Liability Committee and the Executive Committee on a quarterly basis. Changes to these assumptions can significantly affect the results of the simulation. The simulation incorporates assumptions regarding the potential timing in the repricing of certain assets and liabilities when market rates change and the changes in spreads between different market rates. The simulation analysis incorporates management s current assessment of the risk that pricing margins will change adversely over time due to competition or other factors.

Simulation analysis is only an estimate of our interest rate risk exposure at a particular point in time. We continually review the potential effect changes in interest rates could have on the repayment of rate sensitive assets and funding requirements of rate sensitive liabilities.

The simulation uses projected repricing of assets and liabilities on the basis of contractual maturities, anticipated repayments and scheduled rate adjustments. Prepayment rates can have a significant impact on interest income simulation. Because of the large percentage of loans we hold, rising or falling interest rates have a significant impact on the prepayment speeds of our earning assets that in turn affect the rate sensitivity position. When interest rates rise, prepayments tend to slow. When interest rates fall, prepayments tend to rise. Our asset sensitivity would be reduced if prepayments slow and vice versa. While we believe such assumptions to be reasonable, there can be no assurance that assumed prepayment rates will approximate actual future mortgage-backed security and loan repayment activity.

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The following table reflects changes in estimated net interest income for the Bank due to immediate non-parallel changes in interest rates at January 1, 2013 through December 31, 2013.

Increase (Decrease)	Net Interest Income		
in Market Interest Rates	Amount	Change	Percent
(Dollars in Thousands)			
300	$ 66,176	$ (5,517)	(7.70)%
Flat	71,693		
-50	73,314	1,621	2.26

Liquidity Management

Liquidity is the ability to meet current and future financial obligations of a short-term nature. Our primary sources of funds consist of deposit inflows, loan repayments, maturities of and payments on investment securities and borrowings from the Federal Home Loan Bank of Boston. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition.

We regularly adjust our investments in liquid assets based upon our assessment of (1) expected loan demand, (2) expected deposit flows, (3) yields available on interest-earning deposits and securities and (4) the objectives of our asset/liability management policy.

Our most liquid assets are cash and cash equivalents. The levels of these assets depend on our operating, financing, lending and investing activities during any given period. At December 31, 2012, cash and cash equivalents totaled $93.2 million. In addition, at December 31, 2012, we had $69.3 million of available borrowing capacity with the Federal Home Loan Bank of Boston, including a $9.4 million line of credit. On December 31, 2012, we had $161.3 million of advances outstanding.

A significant use of our liquidity is the funding of loan originations. At December 31, 2012 and 2011, we had total loan commitments outstanding, as follows:

	December 31,	
(In thousands)	2012	2011
Unadvanced portion of existing loans:		
Construction	$ 166,482	$ 83,493
Home equity line of credit	39,698	38,085
Other lines and letters of credit	56,174	33,603
Commitments to originate:		
One-to four-family	17,752	6,417
Commercial real estate	51,540	70,544
Construction	83,078	66,481
Commercial business loans	24,355	71,491
Other loans	205	4,725
Total loan commitments outstanding	$ 439,284	$ 374,839

Historically, many of the commitments expire without being fully drawn; therefore the total amount of commitments does not necessarily represent future cash requirements.

In July 2010, we extended the contract with our core data processing provider through December 2017. This contract extension resulted in an outstanding commitment of $11.2 million as of December 31, 2012, with total annual payments of $2.2 million. In addition, we had outstanding commitments as of December 31, 2012 totaling $545,000 for the construction of two new branches in Belmont and the Allston area of Boston, Massachusetts.

Another significant use of our liquidity is the funding of deposit withdrawals. Certificates of deposit due within one year of December 31, 2012 totaled $351.0 million, or 55.9% of total certificates of deposit. If these

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maturing deposits do not remain with us, we will be required to utilize other sources of funds. Historically, a significant portion of certificates of deposit that mature have remained at the Company. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Contractual Obligations

The following table presents our contractual obligations as of December 31, 2012.

(In thousands)	Total	Up to One Year	Payments Due by Period More than One Year to Three Years	More than Three Years to Five Years	More Than Five Years
Contractual obligations:					
Long-term debt obligations	$ 161,254	$ 44,323	$ 21,000	$ 84,000	$ 11,931
Operating lease obligations	10,725	1,021	2,420	2,168	5,116
Other long-term obligations(1)	11,175	2,235	4,470	4,470	
Total	$ 183,154	$ 47,579	$ 27,890	$ 90,638	$ 17,047

(1) Consists entirely of expenses related to obligations under a data processing agreement.

Our primary investing activities are the origination of loans and the purchase of securities. Our primary financing activities consist of activity in deposit accounts and Federal Home Loan Bank advances. Deposit flows are affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors and other factors. We generally manage the pricing of our deposits to be competitive. Occasionally, we offer promotional rates on certain deposit products to attract deposits.

Capital Management

Both the Company and the Bank are subject to various regulatory capital requirements administered by the Federal Reserve Board and FDIC, respectively, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At December 31, 2012, both the Company and the Bank exceeded all of their respective regulatory capital requirements. The Bank is considered well capitalized under regulatory guidelines. See *Regulation and Supervision Federal Bank Regulation Capital Requirements, Regulatory Capital Compliance* and Note 14 *Stockholders Equity Minimum Regulatory Capital Requirements* in Notes to the Consolidated Financial Statements included in Item 8 *Financial Statements and Supplementary Data* within this report.

We may use capital management tools such as cash dividends and common share repurchases. Pursuant to Federal Reserve Board approval conditions imposed in connection with the formation of the Company, the Company has committed (i) to seek the Federal Reserve Board s prior approval before repurchasing any equity securities from Meridian and (ii) that any repurchases of equity securities from stockholders other than Meridian will be at the current market price for such stock repurchases. The Company is also subject to the Federal Reserve Board s notice provisions for stock repurchases.

As of December 31, 2012, the Company had repurchased 196,566 shares of its stock at an average price of $12.85 per share, or 21.7% of the 904,224 shares authorized for repurchase under the Company s fourth repurchase program as adopted during 2011. The Company has repurchased 1,600,494 shares at an average price of $10.45 per share since December 2008.

Off-Balance Sheet Arrangements

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with generally accepted accounting principles in the United States of America are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk.

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Such transactions are used primarily to manage customers requests for funding and take the form of loan commitments and lines of credit. For information about our loan commitments and unused lines of credit, see Note 11 *Other Commitments and Contingencies* in Notes to Consolidated Financial Statements included in Item 8 *Financial Statements and Supplementary Data* within this report.

For the year ended December 31, 2012, we engaged in no off-balance sheet transactions reasonably likely to have a material effect on our financial condition, results of operations or cash flows.

Impact of Recent Accounting Pronouncements

For a discussion of the impact of recent accounting pronouncements, see Note 1 *Summary of Significant Accounting Policie*s in Notes to Consolidated Financial Statements included in Item 8 *Financial Statements and Supplementary Data* within this report.

Effect of Inflation and Changing Prices

The financial statements and related financial data presented in this Annual Report have been prepared in accordance with generally accepted accounting principles in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars without considering the change in the relative purchasing power of money over time due to inflation. The primary impact of inflation on our operations is reflected in increased operating costs. Unlike most industrial companies, virtually all the assets and liabilities of a financial institution are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution s performance than do general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Information regarding quantitative and qualitative disclosures about market risk appears under Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, under the caption Asset/Liability Management .

ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

Index to Consolidated Financial Statements

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MANAGEMENT S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Meridian Interstate Bancorp, Inc. (the Company), is responsible for establishing and maintaining effective internal control over financial reporting. The internal control process has been designed under our supervision to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America.

Management conducted an assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2012, utilizing the framework established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company s internal control over financial reporting as of December 31, 2012 is effective.

Our internal control over financial reporting includes policies and procedures that *(a)* pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; *(b)* provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and *(c)* provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company s assets that could have a material effect on the Company s financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems designed to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

The effectiveness of the Company s internal control over financial reporting as of December 31, 2012 has been audited by Wolf & Company, P.C., an independent registered public accounting firm, as stated in their report, which follows. This report expresses an unqualified opinion on the effectiveness of the Company s internal control over financial reporting as of December 31, 2012.

Date: March 15, 2013	/s/ Richard J. Gavegnano Richard J. Gavegnano Chairman and Chief Executive Officer
Date: March 15, 2013	/s/ Mark L. Abbate Mark L. Abbate Senior Vice President, Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Meridian Interstate Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Meridian Interstate Bancorp, Inc., (the Company) as of December 31, 2012 and 2011, and the related consolidated statements of net income, comprehensive income, changes in stockholders equity and cash flows for each of the years in the three-year period ended December 31, 2012. We also have audited Meridian Interstate Bancorp, Inc. s internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Meridian Interstate Bancorp, Inc. s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company s internal control over financial reporting based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Also, because management s assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of Meridian Interstate Bancorp, Inc. s internal control over financial reporting included controls over the preparation of financial statements in accordance with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C) and to the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income. A company s internal control over financial reporting includes those policies and procedures that *(a)* pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; *(b)* provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and *(c)* provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the company s financial statements.

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

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Meridian Interstate Bancorp, Inc. and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Meridian Interstate Bancorp, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ Wolf & Company, P.C.

Boston, Massachusetts

March 15, 2013

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)	December 31, 2012	2011
ASSETS		
Cash and due from banks	$ 93,129	$ 156,622
Federal funds sold	63	63
Total cash and cash equivalents	93,192	156,685
Certificates of deposit affiliate bank		2,500
Securities available for sale, at fair value	262,785	335,230
Federal Home Loan Bank stock, at cost	12,064	12,538
Loans held for sale	14,502	4,192
Loans	1,806,843	1,354,354
Less allowance for loan losses	(20,504)	(13,053)
Loans, net	1,786,339	1,341,301
Bank-owned life insurance	36,251	35,050
Foreclosed real estate, net	2,604	3,853
Investment in affiliate bank		12,607
Premises and equipment, net	38,719	36,991
Accrued interest receivable	6,745	7,282
Prepaid deposit insurance		1,257
Deferred tax asset, net	9,710	7,434
Goodwill	13,687	13,687
Other assets	2,173	3,773
Total assets	$ 2,278,771	$ 1,974,380
LIABILITIES AND STOCKHOLDERS EQUITY		
Deposits:		
Non interest-bearing	$ 204,079	$ 145,274
Interest-bearing	1,661,354	1,459,214
Total deposits	1,865,433	1,604,488
Short-term borrowings affiliate bank		6,471
Short-term borrowings other		10,056
Long-term debt	161,254	114,923
Accrued expenses and other liabilities	18,141	18,498
Total liabilities	2,044,828	1,754,436
Commitments and contingencies (Notes 5, 7 and 11)		
Stockholders equity:		
Common stock, no par value, 50,000,000 shares authorized; 23,000,000 shares issued		
Additional paid-in capital	98,338	97,669
Retained earnings	146,959	134,533
Accumulated other comprehensive income	4,915	3,985
Treasury stock, at cost, 660,800 and 584,881 shares at December 31, 2012 and 2011, respectively	(8,331)	(7,317)
Unearned compensation ESOP, 621,000 and 662,400 shares at December 31, 2012 and 2011, respectively	(6,210)	(6,624)
	(1,728)	(2,302)

Unearned compensation restricted shares, 203,345 and 265,710 at December 31, 2012 and 2011, respectively				
Total stockholders equity		233,943		219,944
Total liabilities and stockholders equity	$	2,278,771	$	1,974,380

See accompanying notes to consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF NET INCOME

	Years Ended December 31,		
(Dollars in thousands, except per share amounts)	**2012**	**2011**	**2010**
Interest and dividend income:			
Interest and fees on loans	$ 76,050	$ 66,157	$ 67,459
Interest on debt securities	7,117	11,086	13,467
Dividends on equity securities	1,444	1,033	923
Interest on certificates of deposit	26	34	42
Interest on other interest-earning assets	254	422	168
Other interest and dividend income	78	80	
Total interest and dividend income	84,969	78,812	82,059
Interest expense:			
Interest on deposits	15,739	17,738	17,444
Interest on short-term borrowings	16	39	63
Interest on long-term debt	3,190	3,195	3,533
Total interest expense	18,945	20,972	21,040
Net interest income	66,024	57,840	61,019
Provision for loan losses	8,581	3,663	3,181
Net interest income, after provision for loan losses	57,443	54,177	57,838
Non-interest income:			
Customer service fees	6,645	5,867	5,823
Loan fees	339	584	636
Mortgage banking gains, net	2,371	2,125	1,811
Gain on sales of securities, net	5,568	4,464	1,790
Income from bank-owned life insurance	1,201	1,221	1,169
Equity income on investment in affiliate bank	310	1,110	492
Gain on sale of investment in affiliate bank	4,819		
Other income	8	17	
Total non-interest income	21,261	15,388	11,721
Non-interest expenses:			
Salaries and employee benefits	36,386	29,474	25,716
Occupancy and equipment	7,932	7,831	5,646
Data processing	3,511	2,909	3,200
Data processing contract termination cost			2,689
Marketing and advertising	2,537	2,450	1,968
Professional services	2,966	2,685	2,443
Foreclosed real estate	599	328	488
Deposit insurance	1,760	1,893	2,250
Other general and administrative	4,257	3,424	4,404
Total non-interest expenses	59,948	50,994	48,804
Income before income taxes	18,756	18,571	20,755
Provision for income taxes	6,330	6,601	7,381
Net income	$ 12,426	$ 11,970	$ 13,374

Income per share:			
Basic	$ 0.57	$ 0.55	$ 0.61
Diluted	$ 0.57	$ 0.55	$ 0.61
Weighted average shares:			
Basic	21,629,668	21,805,143	22,072,047
Diluted	21,858,381	21,931,863	22,081,005

See accompanying notes to consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)	Years Ended December 31, 2012	2011	2010
Net income	$ 12,426	$ 11,970	$ 13,374
Other comprehensive income (loss):			
Unrealized gains (losses) on securities available for sale:			
Unrealized holding gains (losses) on securities available for sale	6,933	(1,919)	5,844
Reclassification adjustments for gains realized in income	(5,568)	(4,464)	(1,790)
Net unrealized gains (losses)	1,365	(6,383)	4,054
Tax effect	(489)	2,511	(1,721)
Net-of-tax amount	876	(3,872)	2,333
Defined benefit plans:			
Supplemental director retirement plan:			
Amortization of prior service cost	28	28	28
Amortization of unrecognized loss	68		
Actuarial net losses arising during the year	(14)	(287)	(22)
	82	(259)	6
Tax effect	(24)	88	(19)
Net-of-tax amount	58	(171)	(13)
Long-term health care plan:			
Amortization of prior service cost	18	18	88
Actuarial net gain (losses) arising during the year	(30)	(33)	115
	(12)	(15)	203
Tax effect	8	5	(68)
Net-of-tax amount	(4)	(10)	135
Total other comprehensive income (loss)	930	(4,053)	2,455
Comprehensive income	$ 13,356	$ 7,917	$ 15,829

See accompanying notes to consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

Years Ended December 31, 2012, 2011 and 2010

(Dollars in thousands)	Shares of Common Stock Outstanding	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Unearned Compensation ESOP	Unearned Compensation Restricted Shares	Total
Balance at December 31, 2009	22,098,565	$ 100,972	$ 109,189	$ 5,583	$ (4,535)	$ (7,452)	$ (3,342)	$ 200,415
Net income			13,374					13,374
Other comprehensive income				2,455				2,455
Issuance of 514,109 shares to Meridian Financial Services, Incorporated, the mutual holding company	514,109	(4,505)			4,505			
Purchase of treasury stock	(188,827)				(2,091)			(2,091)
ESOP shares earned (41,400 shares)		26				414		440
Share-based compensation expense	57,030	512					506	1,018
Balance at December 31, 2010	22,480,877	97,005	122,563	8,038	(2,121)	(7,038)	(2,836)	215,611
Net income			11,970					11,970
Other comprehensive loss				(4,053)				(4,053)
Purchase of treasury stock	(392,663)				(5,196)			(5,196)
ESOP shares earned (41,400 shares)		118				414		532
Share-based compensation expense	61,195	546					534	1,080
Balance at December 31, 2011	22,149,409	97,669	134,533	3,985	(7,317)	(6,624)	(2,302)	219,944
Net income			12,426					12,426
Other comprehensive income				930				930
Purchase of treasury stock	(87,504)				(1,160)			(1,160)
ESOP shares earned (41,400 shares)		192				414		606
Share-based compensation expense	62,365	596					574	1,170
Stock options exercised	11,585	(119)			146			27
Balance at December 31, 2012	22,135,855	$ 98,338	$ 146,959	$ 4,915	$ (8,331)	$ (6,210)	$ (1,728)	$ 233,943

See accompanying notes to consolidated financial statements.

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Cash flows from operating activities:			
Net income	$ 12,426	$ 11,970	$ 13,374
Adjustments to reconcile net income to net cash provided by operating activities:			
Accretion of acquisition fair value adjustments	(440)	(1,821)	(3,594)
ESOP shares earned	606	532	440
Provision for loan losses	8,581	3,663	3,181
(Accretion) amortization of net deferred loan origination costs/fees	(9)	266	84
Net amortization of securities available for sale	288	672	1,103
Capitalization of mortgage servicing rights	(708)	(141)	(359)
Amortization of mortgage servicing rights	313	193	216
Change in valuation allowance on mortgage servicing rights	70		
Depreciation and amortization expense	2,125	2,300	2,472
Gain on sales of securities, net	(5,568)	(4,464)	(1,790)
Gain on sales of loans held in portfolio, net			(352)
Loss (gain) and provision for foreclosed real estate	385	11	(117)
Deferred income tax (benefit) provision	(2,781)	611	1,149
Income from bank-owned life insurance	(1,201)	(1,221)	(1,169)
Equity income on investment in affiliate bank	(310)	(1,110)	(492)
Gain on sale of investment in affiliate bank	(4,819)		
Share-based compensation expense	1,170	1,080	1,018
Net changes in:			
Loans held for sale	(10,310)	8,821	(7,139)
Accrued interest receivable	537	261	61
Prepaid deposit insurance	1,257	1,769	2,088
Other assets	1,925	3,269	(842)
Accrued expenses and other liabilities	(287)	6,417	(184)
Net cash provided by operating activities	3,250	33,078	9,148
Cash flows from investing activities:			
Cash provided by business combination			14,422
Maturities of certificates of deposit	2,500		3,100
Purchases of certificates of deposit		(2,500)	
Activity in securities available for sale:			
Proceeds from maturities, calls and principal payments	164,894	164,415	68,645
(Purchase) redemption of mutual funds, net	(4,784)	4,855	8,131
Proceeds from sales	38,743	43,417	12,278
Purchases	(108,570)	(189,578)	(105,380)
Proceeds from sale of investment in affiliate bank	6,600		
Loans originated, net of principal payments received	(455,030)	(174,094)	(55,819)
Proceeds from sales of fixed-rate loans held in portfolio			34,488
Purchases of premises and equipment	(3,770)	(4,783)	(2,977)
Redemption of Federal Home Loan Bank stock	474		
Capitalized costs on foreclosed real estate	(8)	(58)	(369)
Proceeds from sales of foreclosed real estate	1,957	2,226	3,989
Net cash used in investing activities	(356,994)	(156,100)	(19,492)

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MERIDIAN INTERSTATE BANCORP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

(In thousands)	Years Ended December 31, 2012	2011	2010
Cash flows from financing activities:			
Net increase in deposits	260,981	145,344	153,911
Net change in borrowings with maturities less than three months	(16,527)	4,541	(13,224)
Proceeds from Federal Home Loan Bank advances with maturities of three months or more	90,000		25,475
Repayment of Federal Home Loan Bank advances with maturities of three months or more	(43,070)	(20,475)	(18,200)
Stock options exercised	27		
Purchase of treasury stock	(1,160)	(5,196)	(2,091)
Net cash provided by financing activities	290,251	124,214	145,871
Net change in cash and cash equivalents	(63,493)	1,192	135,527
Cash and cash equivalents at beginning of year	156,685	155,493	19,966
Cash and cash equivalents at end of year	$ 93,192	$ 156,685	$ 155,493
Supplemental cash flow information:			
Interest paid on deposits	$ 15,846	$ 18,424	$ 18,926
Interest paid on borrowings	3,857	4,591	5,030
Income taxes paid, net of refunds	8,011	2,868	7,004
Non-cash investing and financing activities:			
Transfers from loans to foreclosed real estate	1,085	1,952	2,967
Receipt of common stock from sale of investment in affiliate bank	11,136		
In conjunction with the acquisition detailed in Note 2 to the Consolidated Financial Statements:			
Fair value of assets acquired, net of cash acquired			450,576
Fair value of liabilities assumed			464,998

See accompanying notes to consolidated financial statements.

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Meridian Interstate Bancorp, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of Meridian Interstate Bancorp, Inc., a 59.5%-owned subsidiary of Meridian Financial Services, Incorporated (Meridian), a mutual holding company, and all other entities in which it has a controlling financial interest (collectively referred to as the Company). The Company was formed in a corporate reorganization in 2006 and owns East Boston Savings Bank and its subsidiaries (the Bank) and Meridian Interstate Funding Corporation, which was established in 2008 to fund a loan to the Company s Employee Stock Ownership Plan (ESOP). The Bank s subsidiaries include Prospect, Inc., which engages in securities transactions on its own behalf, EBOSCO, LLC and Berkeley Riverbend Estates LLC, both of which hold foreclosed real estate; and East Boston Investment Services, Inc., which is authorized for third-party investment sales and is currently inactive. All significant intercompany balances and transactions have been eliminated in consolidation.

The Company held a 43% share in Hampshire First Bank, a New Hampshire chartered bank, organized and headquartered in Manchester, New Hampshire, which was accounted for using the equity method of accounting, under which the Company s share of the net income or loss of the affiliate was recognized as income or loss in the Company s consolidated statement of net income. On November 16, 2011, Hampshire First Bank entered into an Agreement and Plan of Merger with NBT Bancorp, Inc. (NBTB) and NBT Bank, N.A. which was completed on June 8, 2012, with the Company recognizing a pre-tax gain of $4.8 million and receiving $6.6 million of cash and 547,481 NBTB shares with a fair value $11.1 million as proceeds from the sale.

Business and Operating Segments

The Company provides loan and deposit services to its customers through its local banking offices in the greater Boston metropolitan area. The Company is subject to competition from other financial institutions including commercial banks, other savings banks, credit unions, mortgage banking companies and other financial service providers.

Generally, financial information is to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments. Management evaluates the Company s performance and allocates resources based on a single segment concept. Accordingly, there is no separately identified material operating segment for which discrete financial information is available. The Company does not derive revenues from, or have assets located in foreign countries, nor does it derive revenues from any single customer that represents 10% or more of the Company s total revenues.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the evaluation of goodwill for impairment, other-than-temporary impairment of securities and the valuation of deferred tax assets.

Significant Concentrations of Credit Risk

Most of the Company s activities are with customers located within Massachusetts. Note 3 includes the types of securities in which the Company invests and Note 4 includes the types of lending in which the Company engages. The Company believes that it does not have any significant concentration in any one industry or customer. Within the securities portfolio, the Company has a significant amount of corporate debt and marketable equity securities issued by companies in the financial services sector. Given the current market conditions, this sector continues to have an enhanced level of credit risk.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Reclassification

Certain amounts in the 2011 and 2010 consolidated financial statements have been reclassified to conform to the 2012 presentation.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include amounts due from banks and federal funds sold on a daily basis, which mature overnight or on demand. The Company may from time to time have deposits in financial institutions which exceed the federally insured limits. At December 31, 2012, the Company had a concentration of cash on deposit at the Federal Reserve Bank amounting to $47.0 million.

Certificates of Deposit

Certificates of deposits are purchased from FDIC-insured depository institutions, have an original maturity of greater than ninety days and are carried at cost. Certificate of deposits at December 31, 2011 were all with an affiliate bank, and exceeded the FDIC insurance limit of $250,000 at December 31, 2011.

Fair Value Hierarchy

The Company groups its assets and liabilities measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 Valuation is based on quoted prices in active markets for identical assets or liabilities. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuation is based on observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using unobservable inputs to pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Transfers between levels are recognized at the end of a reporting period, if applicable.

Securities Available for Sale

Securities are classified as available for sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported as a separate component in other comprehensive income/loss, net of tax effects. Purchase premiums and discounts are recognized in interest income using the effective interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Each reporting period, the Company evaluates all securities with a decline in fair value below the amortized cost of the investment to determine whether or not the impairment is deemed to be other-than-temporary (OTTI). OTTI is required to be recognized if (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. Marketable equity securities are evaluated for OTTI based on the severity and duration of the impairment and, if deemed to be other than temporary, the declines in fair value are reflected in earnings as realized losses. For impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. For all other impaired debt securities, credit-related OTTI is recognized through earnings and non-credit related OTTI is recognized in other comprehensive income/loss, net of applicable taxes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Federal Home Loan Bank Stock

The Bank, as a member of the Federal Home Loan Bank (FHLB) system, is required to maintain an investment in capital stock of the FHLB. Based on redemption provisions of the FHLB, the stock has no quoted market value and is carried at cost. At its discretion, the FHLB may declare dividends on the stock. The Company reviews for impairment based on the ultimate recoverability of the cost basis on the FHLB stock. As of December 31, 2012 and 2011, no impairment has been recognized.

Loans Held For Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Loans

The Company grants mortgage, commercial and consumer loans to customers. The Company s loan portfolio includes residential real estate, commercial real estate, construction, commercial and consumer segments. Residential real estate loans include classes for one-to four-family, multi-family and home equity lines of credit.

A substantial portion of the loan portfolio is represented by mortgage loans throughout eastern Massachusetts. The ability of the Company s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and net deferred loan origination costs or fees. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method over the terms of the loans.

Loans that were acquired in connection with the Mt. Washington Co-operative Bank acquisition (see Note 2) were recorded at fair value with no carryover of the related allowance for loan losses. The fair value of the acquired loans involved estimating the amount and timing of principal and interest cash flows expected to be collected on the loans and discounting those cash flows at a market rate of interest. The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loan. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the nonaccretable discount. The nonaccretable discount includes estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows require the Company to evaluate the need for an additional allowance for loan losses. Subsequent improvement in expected cash flows results in the reversal of a corresponding amount of the nonaccretable discount which is reclassified as accretable discount that is recognized into interest income over the remaining life of the loan.

The accrual of interest on all loans is discontinued at the time the loan is 90 days past due, unless the credit is well secured and in process of collection. Past-due status is based on contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. All interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses

The allowance for loan losses represents management s estimate of the probable losses inherent in the loan portfolio and is established as losses are estimated to have occurred through a provision for loan losses charged

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The adequacy of the allowance for loan losses is evaluated on a regular basis by management. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of general, allocated and unallocated components, as further described below.

General Component

The general component of the allowance for loan losses is based on historical loss experience adjusted for qualitative factors stratified by loan segments and classes. Management uses a rolling average of historical losses based on a time frame appropriate to capture relevant loss data for each loan segment. This historical loss factor is adjusted for the following qualitative factors: levels/trends in delinquent and non-accrual loans; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; national and local economic trends and conditions, and industry conditions. There were no changes in the Company s policies or methodology pertaining to the general component of the allowance for loan losses during 2012 or 2011.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate loans The Company primarily originates loans with a loan-to-value ratio of 80% or less and does not grant subprime loans. The Company may also originate loans with loan-to-value ratios up to 95% (100% for first time home buyers only) with such value measured at origination; however, private mortgage insurance is generally required for loans with a loan-to-value ratio over 80%. All loans in this segment are collateralized by residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

Commercial real estate loans Loans in this segment are primarily income-producing properties such as apartment buildings and properties used for business purposes such as office buildings, industrial facilities and retail facilities. These properties are generally located in the greater Boston metropolitan area and certain other areas in eastern Massachusetts, and in southeastern New Hampshire and Maine. The underlying cash flows generated by the properties can be adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, could have an effect on the credit quality in this segment. Management obtains rent rolls annually and continually monitors the cash flows of these loans.

Construction loans Loans in this segment primarily include loans for construction of commercial development projects, including apartment buildings, small industrial buildings and retail and office buildings. The Company also originates loans to individuals and to builders to finance the construction of residential dwellings. Most of these construction loans provide for the payment of only interest during the construction phase, which is usually up to 12 to 24 months, although some construction loans are renewed, generally for one or two additional years. At the end of the construction phase, the loan may convert to a permanent mortgage loan or the loan may be paid in full. Loans generally can be made with a maximum loan to value ratio of 80% of the appraised market value upon completion of the project. Management carefully monitors the existing construction portfolio for performance and project completion, with a goal of moving completed commercial projects to the commercial real estate portfolio and reviewing sales based projects for tracking toward construction goals.

Commercial business loans Loans in this segment are made to businesses in the Company s market area and are generally secured by real estate or other assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, could have an effect on the credit quality in this segment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Consumer loans Loans in this segment may include automobile loans, loans secured by passbook or certificate accounts and overdraft loans and repayment is dependent on the credit quality of the individual borrower.

Allocated Component

The allocated component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for multi-family residential, commercial real estate, construction and commercial loans by either the present value of expected future cash flows discounted at the loan s effective interest rate or the fair value of the collateral if the loan is collateral dependent.

An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential real estate loans for impairment disclosures, unless such loans are subject to a troubled debt restructuring agreement.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

The Company periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring (TDR). All TDRs are initially classified as impaired.

Unallocated Component

An unallocated component may be maintained to cover uncertainties that could affect management s 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 allocated and general components of the allowance for loan losses.

Bank-Owned Life Insurance

The Bank has purchased insurance policies on the lives of certain directors, executive officers and employees. Bank-owned life insurance policies are reflected on the consolidated balance sheets at cash surrender value. Changes in net cash surrender value of the policies, as well as insurance proceeds received, are reflected in non-interest income on the consolidated statements of net income and are not subject to income taxes.

Premises and Equipment

Land is carried at cost. Buildings, equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization, computed on the straight-line method over the estimated useful lives of the assets or the expected terms of the leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured. It is general practice to charge the cost of maintenance and repairs to earnings when incurred; major expenditures for improvements are capitalized and depreciated.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Servicing

The Company services residential real estate loans for others. Mortgage servicing assets are recognized as separate assets when rights are acquired through the sale of financial assets. For sale of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on fair value. The Company uses an internal valuation model to estimate the fair value of servicing rights. This model is utilized to calculate the present value of projected future cash flows and requires estimates of numerous market assumptions, such as interest rates, prepayment assumptions, servicing costs, discount rates, and the payment performance of the underlying loans. The measurement of the fair value of servicing rights is limited by the existing conditions and the assumptions utilized as of a particular point in time. Those same assumptions may not be appropriate if applied at a different point in time.

Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. Changes in the valuation allowance are reported in loan fee income.

Derivative Financial Instruments

Derivative financial instruments are recognized as assets and liabilities on the consolidated balance sheet and measured at fair value, if material.

Derivative Loan Commitments

Residential real estate loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. Loan commitments that are derivatives are recognized at fair value on the consolidated balance sheet in other assets and other liabilities with changes in their fair values recorded in mortgage-banking gains, if material.

Forward Loan Sale Commitments

To protect against the price risk inherent in derivative loan commitments, the Company utilizes both mandatory delivery and best efforts forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments. Forward sale commitments are recognized at fair value on the consolidated balance sheet in other assets and other liabilities with changes in their fair values recorded in mortgage-banking gains, if material.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. The excess, if any, of the loan balance over the fair value of the asset at the time of transfer from loans to foreclosed assets is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less costs to sell. Revenue and expenses from operations, changes in the valuation allowance, any direct write-downs and gains or losses on sales are included in foreclosed real estate expense.

Valuation of Goodwill and Analysis for Impairment

The Company s goodwill resulted from the acquisition of another financial institution accounted for under the acquisition method of accounting. The amount of goodwill recorded at acquisition is impacted by the recorded fair value of the assets acquired and liabilities assumed, which is an estimate determined by the use of internal or other valuation techniques.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Goodwill is subject to an annual review by management that first assesses qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. The Company would not be required to calculate the fair value of the Company unless management determines, based on the qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. If the two-step quantitative goodwill impairment test is necessary, step one compares the book value of the Company to the fair value of the Company. If test one is failed, a more detailed analysis is performed, which involves measuring the excess of the fair value of the reporting unit, as determined in step one, over the aggregate fair value of the individual assets, liabilities, and identifiable intangibles by utilizing a comparable analysis of relevant price multiples in recent market transactions. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

Transfers of Financial Assets

Transfers of an entire financial asset, a group of entire financial assets, or participating interest in an entire financial asset are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets.

During the normal course of business, the Company may transfer a portion of a financial asset, for example, a participation loan or the government guaranteed portion of a loan. In order to be eligible for sales treatment, the transfer of the portion of the loan must meet the criteria of a participating interest. If it does not meet the criteria of a participating interest, the transfer must be accounted for as a secured borrowing. In order to meet the criteria for a participating interest, all cash flows from the loan must be divided proportionately, the rights of each loan holder must have the same priority, the loan holders must have no recourse to the transferor other than standard representations and warranties and no loan holder has the right to pledge or exchange the entire loan.

Advertising

Advertising costs are expensed as incurred.

Supplemental Executive Retirement Plans

The Company accounts for certain supplemental executive retirement benefits on the net periodic pension cost method using an actuarial model that allocates pension costs over the service period of employees in the plan. The Company accounts for the over-funded or under-funded status of its defined benefit plan as an asset or liability in its consolidated balance sheets and recognizes changes in the funded status in the year in which the changes occur through other comprehensive income or loss.

Share-Based Compensation Plans

The Company measures and recognizes compensation cost relating to share-based payment transactions based on the grant-date fair value of the equity instruments issued. Share-based compensation is recognized over the period the employee is required to provide service for the award. Reductions in compensation expense associated with forfeited options are estimated at the date of grant, and this estimated forfeiture rate is adjusted quarterly based on actual forfeiture experience. The Company uses the Black-Scholes option-pricing model to determine the fair value of stock options granted.

Employee Stock Ownership Plan

Compensation expense for the Employee Stock Ownership Plan (ESOP) is recorded at an amount equal to the shares allocated by the ESOP multiplied by the average fair market value of the shares during the period. The Company recognizes compensation expense ratably over the year based upon the Company s estimate of the number of shares expected to be allocated by the ESOP. Unearned compensation applicable to the ESOP is reflected as a reduction of stockholder s equity in the consolidated balance sheets. The difference between the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

average fair market value and the cost of the shares allocated by the ESOP is recorded as an adjustment to additional paid-in capital.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. A valuation allowance is established against deferred tax assets when, based upon the available evidence including historical and projected taxable income, it is more likely than not that some or all of the deferred tax assets will not be realized. The Company does not have any uncertain tax positions at December 31, 2012 or 2011 which require accrual or disclosure. The Company records interest and penalties as part of income tax expense. No interest or penalties were recorded for the years ended December 31, 2012, 2011 and 2010.

Income tax benefits related to stock compensation in excess of grant date fair value, less any proceeds on exercise, are recognized as an increase to additional paid-in capital upon vesting or exercising and delivery of the stock. Any income tax effects related to stock compensation that are less than grant date fair value less any proceeds on exercise would be recognized as a reduction of additional paid-in capital to the extent of previously recognized income tax benefits and then through income tax expense for the remaining amount.

Treasury Stock

Common stock shares repurchased are recorded as treasury stock at cost.

Earnings Per Share

Basic earnings per share excludes dilution and is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. If rights to dividends on unvested stock awards are non-forfeitable, these unvested stock awards are considered outstanding in the computation of basic earnings per share. Diluted earnings per share is computed in a manner similar to that of basic earnings per share except that the weighted-average number of common shares outstanding is increased to include the number of incremental common shares (computed using the treasury method) that would have been outstanding if all potentially dilutive common stock equivalents (such as options) were issued during the period. Unallocated common shares held by the ESOP are shown as a reduction in stockholders equity and are not included in the weighted-average number of common shares outstanding for either basic or diluted earnings per share calculations.

Basic and diluted earnings per share have been computed based on the following:

	Years Ended December 31,		
(Dollars in thousands, except per share amounts)	**2012**	**2011**	**2010**
Net income available to common stockholders	$ 12,426	$ 11,970	$ 13,374
Average number of common shares outstanding	21,470,945	21,603,084	21,819,129
Effect of unvested stock awards	158,723	202,059	252,918
Basic weighted average shares outstanding	21,629,668	21,805,143	22,072,047
Effect of dilutive stock options	228,713	126,720	8,958
Diluted weighted average shares outstanding	21,858,381	21,931,863	22,081,005
Earnings per share:			
Basic	$ 0.57	$ 0.55	$ 0.61

Diluted	$ 0.57	$ 0.55	$ 0.61

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Options for 17,500, 58,600 and 309,340 shares, respectively, were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive for the years ended December 31, 2012, 2011 and 2010.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income (loss). The components of accumulated other comprehensive income, included in stockholders equity, are as follows:

(In thousands)	**December 31, 2012**	**December 31, 2011**
Securities available for sale:		
Net unrealized gain on securities available for sale	$ 9,063	$ 7,698
Tax effect	(3,615)	(3,126)
Net-of-tax amount	5,448	4,572
Defined benefit plans:		
Supplemental director retirement plan:		
Unrecognized net actuarial loss	(302)	(356)
Unrecognized prior service cost	(90)	(118)
Total	(392)	(474)
Tax effect	137	161
Net-of-tax amount	(255)	(313)
Long-term health care plan:		
Unrecognized net actuarial loss	(161)	(107)
Unrecognized prior service cost	(266)	(308)
Total	(427)	(415)
Tax effect	149	141
Net-of-tax amount	(278)	(274)
	$ 4,915	$ 3,985

Unrecognized prior service costs amounting to $28,000 and $18,000, included in accumulated other comprehensive income at December 31, 2012, are expected to be recognized as a component of net periodic retirement plan cost and long-term health care cost, respectively, for the year ending December 31, 2013. Additionally, actuarial losses amounting to $60,000, included in other comprehensive income at December 31, 2012, are expected to be recognized as a component of net periodic retirement plan cost for the year ended December 31, 2013.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS.*

ASU 2011-04 clarifies and expands the disclosures pertaining to unobservable inputs used in Level 3 fair value measurements, including the disclosure of quantitative information related to (1) the valuation processes used, (2) the sensitivity of the fair value

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, and (3) use of a nonfinancial asset in a way that differs from the asset s highest and best use. ASU 2011-04 also requires, for public companies, disclosure of the level within the fair value hierarchy for assets and liabilities not measured at fair value in the consolidated financial statements but for which the fair value is disclosed. The amendments in ASU 2011-04 are to be applied prospectively. The Company adopted ASU 2011-04 during the first quarter of 2012 resulting in additional disclosures see Note 15.

In June 2011, the FASB issued ASU No. 2011-05, *Comprehensive Income (Topic 220)*, *Presentation of Comprehensive Income*. ASU No. 2011-05 amends the disclosure requirements for the presentation of comprehensive income, with no change in measurement. The amended guidance eliminates the option to present components of other comprehensive income (OCI) as part of the statement of changes in stockholders equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive financial statements. The Company adopted ASU 2011-05 during the first quarter 2012 resulting in an additional financial statement see Consolidated Statements of Comprehensive Income.

In August 2012, the FASB issued ASU No. 2012-03, *Technical Amendments and Corrections to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 114, Technical Amendments Pursuant to SEC Release No. 33-9250, and Corrections Related to FASB Accounting Standards Update 2010-22*. ASU No. 2012-03 amends various SEC paragraphs: (a) pursuant to the issuance of Staff Accounting Bulletin No. 114; (b) pursuant to the issuance of the SEC s Final Rule, Technical Amendments to Commission Rules and Forms Related to the FASB s Accounting Standards Codification, Release Nos. 33-9250, 34-65052, and IC-29748 August 8, 2011; and (c) related to ASU 2010-22, Accounting for Various Topics. The adoption was effective upon issuance and did not have a material impact on the Company s consolidated financial statements.

In October 2012, the FASB issued ASU No. 2012-04, *Technical Corrections and Improvements.* ASU No. 2012-04 clarifies the FASB Accounting Standards Codification (the Codification) or corrects unintended application of guidance and includes amendments identifying when the use of fair value should be linked to the definition of fair value in *Fair Value Measurement (Topic 820).* Amendments to the Codification without transition guidance are effective upon issuance; amendments subject to transitions guidance will be effective the fiscal periods beginning after December 15, 2012. The adoption is not expected to have a material impact on the Company s consolidated financial statements.

2. ACQUISITION

In an effort to expand and diversify its market area, the Company completed its acquisition of Mt. Washington Co-operative Bank, a Massachusetts-chartered mutual co-operative bank (Mt. Washington), on January 4, 2010 through the merger of Mt. Washington with and into the Bank. Each Mt. Washington branch office has become a branch office of East Boston Savings Bank, and such branch offices now operate under the name Mt. Washington Bank, A Division of East Boston Savings Bank. Pursuant to the merger agreement, the Company issued 514,109 shares of its common stock to Meridian, the Company s top-tier mutual holding company. The shares issued reflect the value of Mt. Washington as determined by the average of two independent appraisals. The shares were issued in a private placement exempt from registration under Section 4(2) of the Securities Act of 1933, as amended. In addition, the Company contributed $15.0 million of capital to the Bank in connection with the acquisition.

The Company accounted for the acquisition using the acquisition method. Accordingly, the Company recorded merger and acquisition expenses of $284,000 for the year ended December 31, 2010. The acquisition method also requires an acquirer to recognize the assets acquired and the liabilities assumed at their fair values as of the acquisition date.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a summary of the estimated fair value of assets acquired and liabilities assumed as of the date of the acquisition:

Assets acquired and liabilities assumed	Amount (In thousands)
Cash and cash equivalents	$ 14,422
Certificates of deposit	100
Securities available for sale, at fair value	45,491
Federal Home Loan Bank Stock, at cost	7,933
Loans held for sale	4,919
Loans, net	345,320
Bank-owned life insurance	8,939
Foreclosed real estate, net	1,747
Premises and equipment, net	10,618
Accrued interest receivable	1,373
Deferred tax asset, net	6,875
Goodwill	13,687
Other assets	3,574
Total assets acquired	$ 464,998
Deposits	$ 380,438
FHLB Borrowings	80,932
Accrued expenses and other liabilities	3,628
Total liabilities assumed	$ 464,998

The following is a summary of the unaudited pro forma financial results of operations as if the Company acquired Mt. Washington on January 1, 2010:

(In thousands, except per share amounts)	Year Ended December 31, 2010
Net interest income	$ 61,176
Net income	13,583
Net income per share Basic	0.62
Net income per share Diluted	0.62

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. SECURITIES AVAILABLE FOR SALE

The amortized cost and fair values of securities available for sale, with gross unrealized gains and losses, follows:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2012				
Debt securities:				
Corporate bonds:				
Financial services	$ 76,044	$ 2,480	$ (71)	$ 78,453
Industry and manufacturing	14,846	449		15,295
Consumer products and services	12,259	355		12,614
Technology	2,506		(29)	2,477
Healthcare	11,041	461		11,502
Other	1,018	61		1,079
Total corporate bonds	117,714	3,806	(100)	121,420
Government-sponsored enterprises	53,084	94	(29)	53,149
Municipal bonds	7,236	225		7,461
Residential mortgage-backed securities:				
Government-sponsored enterprises	16,280	1,019	(1)	17,298
Private label	3,169	140		3,309
Total debt securities	197,483	5,284	(130)	202,637
Marketable equity securities:				
Common stocks:				
Financial services	11,354	622	(67)	11,909
Industry and manufacturing	10,922	1,329	(157)	12,094
Consumer products and services	11,849	1,284	(59)	13,074
Technology	1,847	11	(8)	1,850
Healthcare	3,757	560	(9)	4,308
Other	2,677	422		3,099
Total common stocks	42,406	4,228	(300)	46,334
Money market mutual funds	13,833		(19)	13,814
Total marketable equity securities	56,239	4,228	(319)	60,148
Total securities available for sale	$ 253,722	$ 9,512	$ (449)	$ 262,785

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2011				
Debt securities:				
Corporate bonds:				
Financial services	$ 75,235	$ 871	$ (2,012)	$ 74,094
Industry and manufacturing	27,023	911	(11)	27,923
Consumer products and services	26,087	1,092	(15)	27,164
Technology	12,762	177	(22)	12,917
Healthcare	20,104	885		20,989
Other	2,535	82		2,617
Total corporate bonds	163,746	4,018	(2,060)	165,704
Government-sponsored enterprises	82,898	299	(2)	83,195
Municipal bonds	7,401	173		7,574
Residential mortgage-backed securities:				
Government-sponsored enterprises	25,296	1,369	(1)	26,664
Private label	7,322	77	(344)	7,055
Total debt securities	286,663	5,936	(2,407)	290,192
Marketable equity securities:				
Common stocks:				
Financial services	4,808	304	(547)	4,565
Industry and manufacturing	5,215	862	(36)	6,041
Consumer products and services	13,553	1,812	(113)	15,252
Technology	2,479	687	(23)	3,143
Healthcare	2,461	432		2,893
Other	3,304	809		4,113
Total common stocks	31,820	4,906	(719)	36,007
Money market mutual funds	9,049		(18)	9,031
Total marketable equity securities	40,869	4,906	(737)	45,038
Total securities available for sale	$ 327,532	$ 10,842	$ (3,144)	$ 335,230

At December 31, 2012 and 2011, securities with an amortized cost of $37.9 million and $6.4 million, respectively, were pledged as collateral for Federal Home Loan Bank of Boston borrowings and Federal Reserve Bank discount window borrowings.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The amortized cost and fair value of debt securities by contractual maturity at December 31, 2012 are as follows. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without prepayment penalties.

	Within 1 year		Over 1 year to 5 years		Over 5 years		Total	
(In thousands)	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**	**Amortized Cost**	**Fair Value**
Corporate bonds:								
Financial services	$ 3,294	$ 3,372	$ 66,171	$ 68,239	$ 6,579	$ 6,842	$ 76,044	$ 78,453
Industry and manufacturing	1,000	1,002	13,846	14,293			14,846	15,295
Consumer products and services	996	1,016	11,263	11,598			12,259	12,614
Technology			2,506	2,477			2,506	2,477
Healthcare			11,041	11,502			11,041	11,502
Other			1,018	1,079			1,018	1,079
Total corporate bonds	5,290	5,390	105,845	109,188	6,579	6,842	117,714	121,420
Government-sponsored enterprises			97	101	52,987	53,048	53,084	53,149
Municipal bonds	1,460	1,463	4,377	4,515	1,399	1,483	7,236	7,461
Residential mortgage-backed securities:								
Government-sponsored enterprises			4	4	16,276	17,294	16,280	17,298
Private label					3,169	3,309	3,169	3,309
Total	$ 6,750	$ 6,853	$ 110,323	$ 113,808	$ 80,410	$ 81,976	$ 197,483	$ 202,637

For the years ended December 31, 2012, 2011 and 2010, proceeds from sales of securities available for sale amounted to $38.7 million, $43.4 million and $12.3 million, respectively. Gross gains of $5.7 million, $5.0 million and $2.0 million and gross losses of $100,000, $486,000 and $219,000, respectively, were realized on those sales.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Information pertaining to securities available for sale as of December 31, 2012 and 2011, with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than Twelve Months		Over Twelve Months	
(In thousands)	**Gross Unrealized Losses**	**Fair Value**	**Gross Unrealized Losses**	**Fair Value**
December 31, 2012				
Debt securities:				
Corporate bonds:				
Financial services	$ 14	$ 2,986	$ 57	$ 4,442
Technology	29	2,477		
Total corporate bonds	43	5,463	57	4,442
Government-sponsored enterprises	29	8,962		
Residential mortgage-backed securities:				
Government-sponsored enterprises	1	8		
Total debt securities	73	14,433	57	4,442
Marketable equity securities:				
Common stocks:				
Financial services	46	7,193	21	217
Industry and manufacturing	157	2,654		
Consumer products and services	59	1,077		
Technology	8	936		
Healthcare	9	612		
Total common stocks	279	12,472	21	217
Money market mutual funds			19	1,004
Total marketable equity securities	279	12,472	40	1,221
Total temporarily impaired securities	$ 352	$ 26,905	$ 97	$ 5,663

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands)	Less Than Twelve Months Gross Unrealized Losses	Less Than Twelve Months Fair Value	Over Twelve Months Gross Unrealized Losses	Over Twelve Months Fair Value
December 31, 2011				
Debt securities:				
Corporate bonds:				
Financial services	$ 1,937	$ 39,418	$ 75	$ 923
Industry and manufacturing	11	1,937		
Consumer products and services	15	1,695		
Technology	22	2,488		
Total corporate bonds	1,985	45,538	75	923
Government-sponsored enterprises	2	998		
Residential mortgage-backed securities:				
Government-sponsored enterprises	1	212		
Private label	231	5,736	113	322
Total debt securities	2,219	52,484	188	1,245
Marketable equity securities:				
Common stocks:				
Financial services	443	2,126	104	620
Industry and manufacturing	36	688		
Consumer products and services	113	1,880		
Technology	23	737		
Total common stocks	615	5,431	104	620
Money market mutual funds			18	985
Total marketable equity securities	615	5,431	122	1,605
Total temporarily impaired securities	$ 2,834	$ 57,915	$ 310	$ 2,850

The Company determined no securities were other-than-temporarily impaired for the years ended December 31, 2012 and 2011. Management evaluates securities for other-than-temporary impairment on a quarterly basis, with more frequent evaluation for selected issuers or when economic or market concerns warrant such evaluations.

As of December 31, 2012, the net unrealized gain on the total debt securities portfolio was $5.2 million. At December 31, 2012, 15 debt securities had unrealized losses with aggregate depreciation of 0.7% from the Company s amortized cost basis. In analyzing a debt issuer s financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, industry analysts reports and, to a lesser extent given the relatively insignificant levels of depreciation in the Company s debt portfolio, spread differentials between the effective rates on instruments in the portfolio compared to risk-free rates. The unrealized losses are primarily caused by (a) recent declines in profitability and near-term profit forecasts by industry analysts resulting from a decline in the level of business activity and (b) recent downgrades by several industry analysts. The contractual terms of these investments do not permit the companies to settle the security at a price less than the par value of the investment. The Company currently does not believe it is probable that it will be unable to collect all amounts due according to the contractual terms of the investments. Therefore, it is expected that the bonds would not be settled at a price less

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

than the par value of the investment. Because (1) the Company does not intend to sell the securities; (2) the Company does not believe it is more likely than not that the Company will be required to sell the securities before recovery of its amortized cost basis; and (3) the present value of expected cash flows is sufficient to recover the entire amortized cost basis of the securities, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2012.

As of December 31, 2012, the net unrealized gain on the total marketable equity portfolio was $3.9 million. At December 31, 2012, 19 marketable equity securities have unrealized losses with aggregate depreciation of 2.3% from the Company s cost basis. Two equity securities had fair value declines of 15.0% or more for less than twelve months, with net unrealized losses of $116,000. Although the issuers have shown declines in earnings as a result of the weakened economy, no credit issues have been identified that cause management to believe the decline in market value is other than temporary, and the Company has the ability and intent to hold these investments until a recovery of fair value. In analyzing an equity issuer s financial condition, management considers industry analysts reports, financial performance and projected target prices of investment analysts within a one-year time frame. A decline of 10% or more in the value of an acquired equity security is generally the triggering event for management to review individual securities for liquidation and/or classification as other-than-temporarily impaired. Impairment losses are recognized when management concludes that declines in the value of equity securities are other than temporary, or when they can no longer assert that they have the intent and ability to hold depreciated equity securities for a period of time sufficient to allow for any anticipated recovery in fair value. Unrealized losses on marketable equity securities that are in excess of 25% of cost and that have been sustained for more than twelve months are generally considered-other-than temporary and charged to earnings as impairment losses, or realized through sale of the security.

4. LOANS

A summary of loans follows:

(Dollars in thousands)	December 31, 2012	2011
Real estate loans:		
Residential real estate:		
One-to four-family	$ 443,228	$ 417,889
Multi-family	178,948	176,668
Home equity lines of credit	60,907	60,989
Commercial real estate	795,642	528,585
Construction	173,255	93,158
Total real estate loans	1,651,980	1,277,289
Commercial business loans	147,814	71,544
Consumer	7,143	5,195
Total loans	1,806,937	1,354,028
Allowance for loan losses	(20,504)	(13,053)
Net deferred loan origination (fees) costs	(94)	326
Loans, net	$ 1,786,339	$ 1,341,301

The Company has transferred a portion of its originated commercial real estate loans to participating lenders. The amounts transferred have been accounted for as sales and are therefore not included in the Company s accompanying balance sheets. The Company and participating lenders share ratably in any gains or losses that may result from a borrower s lack of compliance with contractual terms of the loan. The Company continues to service the loans on behalf of the participating lenders and, as such, collects cash payments from the borrowers, remits payments to participating lenders and disburses required escrow funds to relevant parties. At

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2012 and 2011, the Company was servicing loans for participants aggregating $41.1 million and $25.6 million, respectively.

As a result of the Mt. Washington Co-operative Bank acquisition in January 2010, the Company acquired loans at fair value of $345.3 million. Included in this amount was $27.7 million of loans with evidence of deterioration of credit quality since origination for which it was probable, at the time of the acquisition, that the Company would be unable to collect all contractually required payments receivable. The Company s evaluation of loans with evidence of credit deterioration as of the acquisition date resulted in a nonaccretable discount of $7.6 million, which is defined as the loan s contractually required payments receivable in excess of the amount of its cash flows expected to be collected. The Company considered factors such as payment history, collateral values, and accrual status when determining whether there was evidence of deterioration of the loan s credit quality at the acquisition date.

The following is a summary of the outstanding balance of the acquired loans with evidence of credit deterioration:

(In thousands)	December 31, 2012	December 31, 2011
Real estate loans:		
Residential real estate:		
One-to four-family	$ 7,581	$ 7,754
Multi-family	1,280	1,862
Home equity lines of credit	568	624
Commercial real estate	1,646	3,265
Construction		1,588
Total real estate loans	11,075	15,093
Commercial business loans	78	90
Consumer	4	4
Outstanding principal balance	11,157	15,187
Discount	(2,595)	(3,167)
Carrying amount	$ 8,562	$ 12,020

A rollforward of accretable yield follows:

(In thousands)	Years Ended December 31, 2012	Years Ended December 31, 2011
Beginning Balance	$ 1,181	$
Reclassification from nonaccretable discount		1,188
Accretion	(44)	(7)
Disposals	(90)	
Ending Balance	$ 1,047	$ 1,181

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

An analysis of the allowance for loan losses and related information follows:

	At or For the Year Ended December 31, 2012								
(In thousands)	One-to four-family	Multi-family	Home equity lines of credit	Commercial real estate	Construction	Commercial business	Consumer	Unallocated	Total
Beginning balance	$ 1,861	$ 1,361	$ 245	$ 6,980	$ 1,430	$ 1,061	$ 115	$	$ 13,053
Provision for loan losses	919	114	33	3,917	2,382	1,102	114		8,581
Charge-offs	(599)	(72)	(52)	(719)	(398)		(164)		(2,004)
Recoveries	326	28		227	242	11	40		874
Ending balance	$ 2,507	$ 1,431	$ 226	$ 10,405	$ 3,656	$ 2,174	$ 105	$	$ 20,504
Amount of allowance for loan losses for loans deemed to be impaired	$ 128	$ 90	$	$ 204	$ 227	$	$	$	$ 649
Amount of allowance for loan losses for loans not deemed to be impaired	2,379	1,341	226	10,201	3,429	2,174	105		19,855
	$ 2,507	$ 1,431	$ 226	$ 10,405	$ 3,656	$ 2,174	$ 105	$	$ 20,504
Amount of allowance for loan losses for loans acquired with deteriorated credit quality included above	$ 31	$ 90	$	$ 9	$	$	$	$	$ 130
Loans deemed to be impaired	$ 4,486	$ 5,784	$ 22	$ 12,146	$ 18,319	$ 424	$		$ 41,181
Loans not deemed to be impaired	438,742	173,164	60,885	783,496	154,936	147,390	7,143		1,765,756
	$ 443,228	$ 178,948	$ 60,907	$ 795,642	$ 173,255	$ 147,814	$ 7,143		$ 1,806,937

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At or For the Year Ended December 31, 2011								
(In thousands)	One-to four-family	Multi-family	Home equity lines of credit	Commercial real estate	Construction	Commercial business	Consumer	Unallocated	Total
Beginning balance	$ 1,130	$ 1,038	$ 227	$ 5,238	$ 2,042	$ 448	$ 32	$	$ 10,155
Provision (credit) for loan losses	795	280	136	1,875	(240)	685	132		3,663
Charge-offs	(192)		(123)	(150)	(869)	(72)	(96)		(1,502)
Recoveries	128	43	5	17	497		47		737
Ending balance	$ 1,861	$ 1,361	$ 245	$ 6,980	$ 1,430	$ 1,061	$ 115	$	$ 13,053
Amount of allowance for loan losses for loans deemed to be impaired	$ 211	$ 44	$ 8	$ 220	$ 3	$ 4	$	$	$ 490
Amount of allowance for loan losses for loans not deemed to be impaired	1,650	1,317	237	6,760	1,427	1,057	115		12,563
	$ 1,861	$ 1,361	$ 245	$ 6,980	$ 1,430	$ 1,061	$ 115	$	$ 13,053
Amount of allowance for loan losses for loans acquired with deteriorated credit quality included above	$ 79	$ 44	$	$	$ 3	$	$	$	$ 126
Loans deemed to be impaired	$ 5,352	$ 5,257	$ 124	$ 12,739	$ 34,265	$ 1,115	$		$ 58,852
Loans not deemed to be impaired	412,537	171,411	60,865	515,846	58,893	70,429	5,195		1,295,176
	$ 417,889	$ 176,668	$ 60,989	$ 528,585	$ 93,158	$ 71,544	$ 5,195		$ 1,354,028

	Year Ended December 31, 2010								
(In thousands)	One-to four-family	Multi-family	Home equity lines of credit	Commercial real estate	Construction	Commercial business	Consumer	Unallocated	Total
Beginning balance	$ 1,730	$ 467	$ 128	$ 4,435	$ 1,859	$ 586	$ 37	$	$ 9,242
Provision (credit) for loan losses	141	642	221	1,181	944	(53)	105		3,181
Charge-offs	(826)	(71)	(122)	(378)	(1,322)	(93)	(199)		(3,011)
Recoveries	85				561	8	89		743
Ending balance	$ 1,130	$ 1,038	$ 227	$ 5,238	$ 2,042	$ 448	$ 32	$	$ 10,155

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables provide information about the Company s past due and non-accrual loans:

(In thousands)	December 31, 2012 30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans on Non-accrual
Real estate loans:					
Residential real estate:					
One-to four-family	$ 3,996	$ 2,476	$ 8,990	$ 15,462	$ 18,870
Multi-family			364	364	976
Home equity lines of credit	767	674	754	2,195	2,674
Commercial real estate	1,722	379	3,671	5,772	8,844
Construction	496		6,553	7,049	7,785
Total real estate loans	6,981	3,529	20,332	30,842	39,149
Commercial business loans	201		318	519	424
Consumer	479	132		611	
Total	$ 7,661	$ 3,661	$ 20,650	$ 31,972	$ 39,573

(In thousands)	December 31, 2011 30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans on Non-accrual
Real estate loans:					
Residential real estate:					
One-to four-family	$ 5,399	$ 2,652	$ 6,204	$ 14,255	$ 15,795
Multi-family	2,350	659	436	3,445	1,605
Home equity lines of credit	1,695	552	892	3,139	1,765
Commercial real estate	3,834		3,641	7,475	11,588
Construction	475	2,511	16,316	19,302	22,434
Total real estate loans	13,753	6,374	27,489	47,616	53,187
Commercial business loans	51	5	266	322	508
Consumer	510	210		720	
Total	$ 14,314	$ 6,589	$ 27,755	$ 48,658	$ 53,695

At December 31, 2012 and 2011, the Company did not have any accruing loans past due 90 days or more. Delinquent loans at December 31, 2012 and 2011 included $2.3 million and $5.2 million of loans acquired with evidence of credit deterioration. At December 31, 2012 and 2011, non-accrual loans included $3.9 million and $6.8 million of loans acquired with evidence of credit deterioration.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables provide information with respect to the Company s impaired loans:

	At or For the Year Ended December 31, 2012					
(In thousands)	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**	**Interest Income Recognized on Cash Basis**
Impaired loans without a valuation allowance:						
One-to four-family	$ 2,157	$ 2,465		$ 2,319	$ 137	$ 96
Multi-family	5,419	5,893		8,580	717	717
Home equity lines of credit	22	22		23	1	1
Commercial real estate	9,752	10,054		12,080	778	443
Construction	16,726	17,818		21,276	1,306	686
Commercial business loans	424	502		674	54	54
Total	34,500	36,754		44,952	2,993	1,997
Impaired loans with a valuation allowance:						
One-to four-family	2,329	2,330	$ 128	2,191	108	100
Multi-family	365	482	90	379	35	
Home equity lines of credit						
Commercial real estate	2,394	2,394	204	2,399	79	55
Construction	1,593	1,787	227	1,751	122	20
Commercial business loans						
Total	6,681	6,993	649	6,720	344	175
Total impaired loans	$ 41,181	$ 43,747	$ 649	$ 51,672	$ 3,337	$ 2,172

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	At or For the Year Ended December 31, 2011					
(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
Impaired loans without a valuation allowance:						
One-to four-family	$ 3,542	$ 4,044		$ 3,588	$ 260	$ 230
Multi-family	4,821	4,849		4,259	391	390
Home equity lines of credit	100	100		100	7	7
Commercial real estate	7,624	7,988		7,194	632	522
Construction	33,110	34,193		25,670	2,472	1,750
Commercial business loans	514	617		449	77	69
Total	49,711	51,791		41,260	3,839	2,968
Impaired loans with a valuation allowance:						
One-to four-family	1,810	1,960	$ 211	1,697	84	58
Multi-family	436	482	44	87	37	25
Home equity lines of credit	24	24	8	24	1	1
Commercial real estate	5,115	5,115	220	5,189	327	188
Construction	1,155	1,740	3	1,179	100	
Commercial business loans	601	601	4	241	46	46
Total	9,141	9,922	490	8,417	595	318
Total impaired loans	$ 58,852	$ 61,713	$ 490	$ 49,677	$ 4,434	$ 3,286

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Year Ended December 31, 2010		
(In thousands)	Average Recorded Investment	Interest Income Recognized	Interest Income Recognized on Cash Basis
Impaired loans without a valuation allowance:			
One-to four-family	$ 3,745	$ 274	$ 227
Multi-family	3,286	364	337
Home equity lines of credit	107	11	11
Commercial real estate	3,836	457	403
Construction	16,504	1,330	997
Commercial business loans	89	11	9
Total	27,567	2,447	1,984
Impaired loans with a valuation allowance:			
One-to four-family	673	56	56
Multi-family			
Home equity lines of credit	5	2	2
Commercial real estate	5,165	179	170
Construction	148	18	7
Commercial business loans	8	1	1
Total	5,999	256	236
Total impaired loans	$ 33,566	$ 2,703	$ 2,220

At December 31, 2012, additional funds of $2.8 million are committed to be advanced in connection with impaired construction loans.

The following table summarizes the troubled debt restructurings (TDRs) at the dates indicated:

	December 31,	
(In thousands)	2012	2011
TDRs on accrual status:		
One-to four-family	$ 1,992	$ 1,269
Multi-family	110	
Home equity lines of credit	22	
Commercial real estate	1,393	
Construction	3,319	
Total TDRs on accrual status	6,836	1,269
TDRs on non-accrual status:		
One-to four-family	2,493	2,052
Commercial real estate	4,466	4,663
Construction	3,838	7,715
Total TDRs on non-accrual status	10,797	14,430

Total TDRs	$	17,633	$	15,699

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a summary of troubled debt restructurings modified during the periods indicated:

	Years Ended December 31,								
	2012			2011			2010		
(Dollars In thousands)	Number of Loans	Pre-Modification Balance	Post-Modification Balance	Number of Loans	Pre-Modification Balance	Post-Modification Balance	Number of Loans	Pre-Modification Balance	Post-Modification Balance
Real estate loans:									
One-to four-family	6	$ 1,433	$ 1,433	9	$ 2,185	$ 2,185	5	$ 1,036	$ 1,036
Multi-family	1	110	110						
Commercial real estate	1	1,395	1,395	1	3,450	3,450	1	4,797	4,797
Construction				2	2,237	2,237	1	4,181	4,181
Total	8	$ 2,938	$ 2,938	12	$ 7,872	$ 7,872	7	$ 10,014	$ 10,014

The following provides information on how loans were modified as TDRs during the periods indicated:

	Years Ended December 31,		
(In thousands)	2012	2011	2010
Adjusted interest rates	$ 1,433	$ 5,635	$ 5,458
Combination of rate and maturity	1,505	2,237	4,556
Total	$ 2,938	$ 7,872	$ 10,014

The Company generally places loans modified as TDRs on non-accrual status for a minimum period of six months. Loans modified as TDRs qualify for return to accrual status once they have demonstrated performance with the modified terms of the loan agreement for a minimum of six months. TDRs are reported as impaired loans with an allowance established as part of the allocated component of the allowance for loan losses when the discounted cash flows of the impaired loan is lower than the carrying value of that loan. TDRs may be removed from impairment disclosures in the year following the restructure if the borrower demonstrates compliance with the modified terms and the restructuring agreement specifies an interest rate equal to that which would be provided to a borrower with similar credit at the time of restructuring. At December 31, 2012 and 2011, the allowance for loan losses included an allocated component of $226,000 and $81,000, respectively, with no charge-offs related to the TDRs modified during the year.

The following is a summary of TDRs that defaulted or were 90 days past due in the first twelve months after restructure:

	Years Ended December 31,			
	2012		2011	
(Dollars In thousands)	Number of Loans	Recorded Investment	Number of Loans	Recorded Investment
Real estate loans:				
One-to four-family	5	$ 908	3	$ 812
Construction			2	6,031
Total	5	$ 908	5	$ 6,843

Loans modified as TDRs with payment defaults are considered in the allocated component of the allowance for loan losses for each of the Company s loan portfolio segments. The Company s historical loss experience factors include charge-offs on loans modified as TDRs, if any, as adjusted for additional qualitative factors such as levels/trends in delinquent and non-accrual loans.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company utilizes a nine grade internal loan rating system for multi-family, commercial real estate, construction and commercial loans as follows:

Loans rated 1, 2, 3 and 3A: Loans in these categories are considered pass rated loans with low to average risk.

Loans rated 4 and 4A: Loans in these categories are considered special mention. These loans are starting to show signs of potential weakness and are being closely monitored by management.

Loans rated 5: Loans in this category are considered substandard. Generally, a loan is considered substandard if it is inadequately protected by the current net worth and paying capacity of the obligors and/or the collateral pledged. There is a distinct possibility that the Company will sustain some loss if the weakness is not corrected.

Loans rated 6: Loans in this category are considered doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, highly questionable and improbable.

Loans rated 7: Loans in this category are considered uncollectible (loss) and of such little value that their continuance as loans is not warranted.

On an annual basis, or more often if needed, the Company formally reviews the ratings on all multi-family, commercial real estate, construction and commercial business loans. The Company also engages an independent third-party to review a significant portion of loans within these segments on at least an annual basis. Management uses the results of these reviews as part of its annual review process.

The following tables provide information with respect to the Company s risk rating:

	December 31, 2012			
(In thousands)	**Multi-family residential real estate**	**Commercial real estate**	**Construction**	**Commercial business**
Loans rated 1 4A	$ 172,825	$ 784,060	$ 154,969	$ 147,258
Loans rated 5	6,123	11,582	18,286	556
Loans rated 6				
Loans rated 7				
Total	$ 178,948	$ 795,642	$ 173,255	$ 147,814

	December 31, 2011			
(In thousands)	**Multi-family residential real estate**	**Commercial real estate**	**Construction**	**Commercial business**

Loans rated 1 4A	$ 165,754	$ 516,059	$ 62,992	$ 70,650
Loans rated 5	10,914	12,526	30,166	894
Loans rated 6				
Loans rated 7				
Total	$ 176,668	$ 528,585	$ 93,158	$ 71,544

For one-to four-family real estate loans, home equity lines of credit and consumer loans, management uses delinquency reports as the key credit quality indicator.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. SERVICING

Loans serviced for others by the Company are not included in the accompanying consolidated balance sheets. The risks inherent in mortgage service assets relate primarily to changes in prepayments that result from shifts in mortgage interest rates. The unpaid principal balances of mortgage loans serviced for others amounted to $174.3 million, $127.4 million and $134.4 million at December 31, 2012, 2011 and 2010, respectively.

Included in loans serviced for others at December 31, 2012, 2011 and 2010 is $80.1 million, $60.6 million and $57.1 million, respectively, of loans serviced for the Federal Home Loan Bank of Boston with a recourse provision whereby the Company may be obligated to participate in potential losses on a limited basis when a realized loss on foreclosure occurs. Losses are borne in priority order by the borrower, PMI insurance, the Federal Home Loan Bank and the Company. At December 31, 2012, 2011 and 2010, the maximum contingent liability associated with loans sold with recourse is $3.0 million, $1.9 million and $2.9 million, respectively, which is not recorded in the consolidated financial statements. The Company has never repurchased any loans or incurred any losses under these recourse provisions.

The fair value of servicing rights was determined using discounts rates ranging from 7.50% to 10.50% and projected prepayment speeds from the Securities Industry & Financial Markets Association PSA tables ranging from 362 to 435.

The following summarizes mortgage servicing rights capitalized and amortized, along with the aggregate activity in related valuation allowances:

	Years Ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Mortgage servicing rights:			
Balance at beginning of year	$ 533	$ 585	$ 442
Additions	708	141	359
Amortization	(313)	(193)	(216)
Balance at end of year	928	533	585
Valuation allowance:			
Balance at beginning of year			
Write-downs	70		
Balance at end of year	70		
Mortgage servicing assets, net	$ 858	$ 533	$ 585
Fair value of mortgage servicing assets	$ 1,065	$ 533	$ 585

The following servicing fees are included in loan fee income:

	Years Ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Contractually specified servicing fees	$ 354	$ 288	$ 300
Late fees	10	11	6
Ancillary fees	3	2	2

	$ 367	$ 301	$ 308

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. FORECLOSED REAL ESTATE

At December 31, 2012, foreclosed assets consist of one townhouse construction development project, two commercial properties and three residential properties held for sale.

Foreclosed real estate is presented net of an allowance for losses. An analysis of the allowance for losses on foreclosed real estate is as follows:

	Years Ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Balance at beginning of year	$ 638	$ 413	$ 400
Provision for losses	418	241	63
Charge-offs	(541)	(16)	(50)
Balance at end of year	$ 515	$ 638	$ 413

Expenses applicable to foreclosed real estate include the following:

	Years Ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Net gain on sales	$ (33)	$ (230)	$ (180)
Provision for losses	418	241	63
Operating expenses, net of rental income	214	317	605
Total foreclosed real estate expenses	$ 599	$ 328	$ 488

7. PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation and amortization of premises and equipment follows:

	December 31,		Estimated Useful
(In thousands)	**2012**	**2011**	**Lives**
Land and land improvements	$ 8,243	$ 7,731	N/A
Buildings	32,850	31,809	40 years
Leasehold improvements	4,022	3,188	5-20 years
Equipment	14,398	13,002	3-7 years
	59,513	55,730	
Less accumulated depreciation and amortization	(20,794)	(18,739)	
	$ 38,719	$ 36,991	

Depreciation and amortization expense for the years ended December 31, 2012, 2011 and 2010 amounted to $2.1 million, $2.3 million and $2.5 million respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Lease Commitments

The Company is obligated under non-cancelable operating lease agreements for banking offices and facilities. These leases have terms with renewal options, the cost of which is not included below. The leases generally provide that real estate taxes, insurance, maintenance and other related costs are to be paid by the Company. At December 31, 2012, future minimum lease payments are as follows:

Years Ending December 31,	**Amount (In thousands)**
2013	$ 1,021
2014	1,205
2015	1,215
2016	1,139
2017	1,029
Thereafter	5,116
	$ 10,725

Total rent expense for all operating leases amounted to $963,000, $708,000 and $441,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

8. DEPOSITS

A summary of deposit balances, by type, follows:

	December 31,	
(In thousands)	**2012**	**2011**
Demand deposits	$ 204,079	$ 145,274
NOW deposits	180,629	153,651
Money market deposits	606,861	445,868
Regular and other deposits	245,634	213,266
Total non-certificate accounts	1,237,203	958,059
Term certificates less than $100,000	300,648	322,482
Term certificates $100,000 and greater	327,582	323,947
Total term certificates	628,230	646,429
Total deposits	$ 1,865,433	$ 1,604,488

A summary of term certificates, by maturity, follows:

(Dollars in thousands)	December 31, 2012		December 31, 2011	
Maturing	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Within 1 year	$ 350,988	1.06%	$ 371,924	1.43%
Over 1 year to 2 years	151,237	1.63	110,827	1.76
Over 2 years to 3 years	74,701	2.14	89,221	2.09
Over 3 years to 4 years	30,120	2.30	43,904	2.88
Over 4 years to 5 years	18,261	1.84	27,265	2.37
Greater than 5 years	2,923	4.44	3,288	4.45
	$ 628,230	1.42%	$ 646,429	1.73%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. BORROWINGS

Long-term debt consists of FHLB advances as follows:

(Dollars in thousands)	December 31, 2012			December 31, 2011		
Maturing During the Year Ending December 31,		Amount	Weighted Average Rate		Amount	Weighted Average Rate
2012	$		%	$	42,693	2.27%
2013		44,323	3.10		44,730	2.90
2014		4,000	2.37		4,000	2.37
2015		17,000	2.25		17,000	2.25
2016		6,500	3.99		6,500	3.99
2017		77,500	1.35			
2018						
2019		11,931	1.23			
	$	161,254	2.05%	$	114,923	2.61%

At December 31, 2012, advances amounting to $31.5 million are callable by the FHLB prior to maturity.

At December 31, 2011, short-term borrowings consisted of federal funds purchased from our affiliate bank of $6.5 million and federal funds purchased from a non-affiliate institution of $10.1 million, both with a weighted average rate of 0.15%.

As of December 31, 2012, the Company also has an available line of credit of $9.4 million with the FHLB at an interest rate that adjusts daily. No amounts were drawn on the line of credit as of December 31, 2012 and 2011. All borrowings from the FHLB are secured by investment securities (see Note 3) and a blanket lien on qualified collateral, principally of first mortgage loans on owner-occupied residential property held in the Bank s portfolio.

10. INCOME TAXES

Allocation of federal and state income taxes between current and deferred portions is as follows:

	Years Ended December 31,					
(In thousands)		2012		2011		2010
Current tax provision:						
Federal	$	7,269	$	4,805	$	4,145
State		1,842		1,185		2,087
Total current provision		9,111		5,990		6,232
Deferred tax provision (benefit):						
Federal		(2,246)		500		1,857
State		(535)		111		(267)
Total deferred provision (benefit)		(2,781)		611		1,590

Change in valuation reserve						(441)
Total deferred provision		(2,781)		611		1,149
Total tax provision	$	6,330	$	6,601	$	7,381

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	Years Ended December 31,		
	2012	**2011**	**2010**
Statutory federal tax rate	35.0%	35.0%	34.0%
Increase (decrease) resulting from:			
State taxes, net of federal tax benefit	4.5	4.5	6.4
Dividends received deduction	(1.9)	(1.4)	(1.0)
Bank-owned life insurance	(2.2)	(2.3)	(1.1)
Tax exempt income	(3.1)	(0.5)	(0.2)
Non-deductible acquisition expenses			0.2
Change in valuation reserve			(2.2)
Other, net	1.4	0.2	(0.5)
Effective tax rates	33.7%	35.5%	35.6%

The components of the net deferred tax asset are as follows:

	December 31,	
(In thousands)	**2012**	**2011**
Deferred tax assets:		
Federal	$ 11,816	$ 9,050
State	3,353	2,675
	15,169	11,725
Deferred tax liabilities:		
Federal	(4,372)	(3,450)
State	(1,087)	(841)
	(5,459)	(4,291)
Net deferred tax asset	$ 9,710	$ 7,434

The tax effects of each item that give rise to deferred tax assets are as follows:

	December 31,	
(In thousands)	**2012**	**2011**
Net unrealized gain on securities available for sale	$ (3,615)	$ (3,126)
Depreciation and amortization	(1,293)	(422)
Other-than-temporary impairment losses	97	175
Allowance for loan losses	8,376	5,332

Employee benefit and retirement plans		3,102		2,654
Acquisition accounting		2,581		2,930
Other, net		462		(109)
Net deferred tax asset	$	9,710	$	7,434

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company reduces deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is not more likely than not that some portion or all of the deferred tax assets will be realized. The Company assesses the realizability of its deferred tax assets by assessing the likelihood of the Company generating federal and state tax income, as applicable, in future periods in amounts sufficient to offset the deferred tax charges in the periods they are expected to reverse. Based on this assessment, management concluded that a valuation allowance was not required as of December 31, 2012, 2011 and 2010.

A summary of the change in the net deferred tax asset is as follows:

	Years Ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Balance at beginning of year	$ 7,434	$ 5,441	$ 1,523
Deferred tax benefit (provision)	2,781	(611)	(1,149)
Deferred tax effects of:			
Change in net unrealized gain (loss) on securities available for sale	(489)	2,511	(1,721)
Acquisition			6,875
Amortization of defined benefit plan net actuarial loss and prior service cost	(16)	93	(87)
Balance at end of year	$ 9,710	$ 7,434	$ 5,441

The federal income tax reserve for loan losses at the Company s base year is $9.8 million. If any portion of the reserve is used for purposes other than to absorb loan losses, approximately 150% of the amount actually used (limited to the amount of the reserve) would be subject to taxation in the year in which used. As the Company intends to use the reserve to absorb only loan losses, a deferred tax liability of $4.0 million has not been provided.

The Company s income tax returns are subject to review and examination by federal and state taxing authorities. The Company is currently open to audit under the applicable statutes of limitations by the Internal Revenue Service for the years ended December 31, 2009 through 2012. The years open to examination by state taxing authorities vary by jurisdiction; no years prior to 2009 are open. Mt. Washington s final income tax return as of January 4, 2010 is also open to audit.

11. OTHER COMMITMENTS AND CONTINGENCIES AND DERIVATIVES

In the normal course of business, there are outstanding commitments and contingencies which are not reflected in the accompanying consolidated financial statements.

Loan Commitments

The Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company s exposure to credit loss in the event of nonperformance by the other party to the financial instrument for loan commitments is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance sheet instruments.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of outstanding financial instruments whose contract amounts represent credit risk is as follows:

	December 31,	
(In thousands)	**2012**	**2011**
Unadvanced portion of existing loans:		
Construction	$ 166,482	$ 83,493
Home equity line of credit	39,698	38,085
Other lines and letters of credit	56,174	33,603
Commitments to originate:		
One-to four-family	17,752	6,417
Commercial real estate	51,540	70,544
Construction	83,078	66,481
Commercial business loans	24,355	71,491
Other loans	205	4,725
Total loan commitments outstanding	$ 439,284	$ 374,839

Commitments to originate loans are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments are expected to expire without being drawn upon, the total commitments do not necessarily represent future cash requirements. The Company evaluates each customer s credit worthiness on a case by case basis. The amount of collateral obtained, if deemed necessary by the Company for the extension of credit, is based upon management s credit evaluation of the borrower. Collateral held includes, but is not limited to, residential real estate and deposit accounts.

Unfunded commitments under lines of credit are commitments for possible future extensions of credit to existing customers. These lines of credit are collateralized if deemed necessary and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed. Letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

Derivative Loan Commitments

Residential real estate loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Company enters into commitments to fund residential real estate loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A residential loan commitment requires the Company to originate a loan at a specific interest rate upon the completion of various underwriting requirements. Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from the exercise of the loan commitment might decline from the inception of the rate lock to funding of the loan due to increases in loan interest rates. If interest rates increase, the value of these commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increase. Derivative loan commitments with a notional amount of $35.9 million and $23.3 million were outstanding at December 31, 2012 and 2011, respectively. The fair value of such commitments was an asset of $288,000 and $536,000 at December 31, 2012 and 2011, respectively and is included in other assets.

Forward Loan Sale Commitments

To protect against the price risk inherent in derivative loan commitments, the Company utilizes both mandatory delivery and best efforts forward loan sale commitments to mitigate the risk of potential

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

decreases in the values of loans that would result from the exercise of the derivative loan commitments. Under a mandatory delivery contract, the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. If the Company fails to deliver the amount of mortgages necessary to fulfill the commitment by the specified date, it is obligated to pay the investor a pair-off fee, based then-current market prices, to compensate the investor for the shortfall. Under a best efforts contract, the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor and the investor commits to a price that it will purchase the loan from the Company if the loan to the underlying borrower closes. The Company generally enters into forward sale contracts on the same day it commits to lend funds to a potential borrower. The Company expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. Forward loan sale commitments with a notional amount of $44.4 million and $10.8 million were outstanding at December 31, 2012 and 2011, respectively. The fair value of such commitments was a liability of $12,000 and $28,000 at December 31, 2012 and 2011, respectively and is included in other liabilities.

The following table presents the fair values of derivative instruments in the balance sheet.

	December 31, 2012					
	Assets			Liabilities		
(In thousands)	Balance Sheet Location		Fair Value	Balance Sheet Location		Fair Value
Derivative loan commitments	Other assets	$	288	N/A	$	
Forward loan sale commitments	N/A			Other liabilities		12
Total		$	288		$	12

	December 31, 2011					
	Assets			Liabilities		
(In thousands)	Balance Sheet Location		Fair Value	Balance Sheet Location		Fair Value
Derivative loan commitments	Other assets	$	536	N/A	$	
Forward loan sale commitments	N/A			Other liabilities		28
Total		$	536		$	28

The following table presents information pertaining to the Company s derivative instruments included in the consolidated statement of income.

Derivative Instrument	Location of Gain (Loss)		Year Ended December 31, 2012 Amount of Gain (Loss) (In thousands)		Year Ended December 31, 2011 Amount of Gain (Loss)
Derivative loan commitments	Mortgage banking gains, net	$	(248)	$	536
Forward loan sale commitments	Mortgage banking gains, net		16		(28)
Total		$	(232)	$	508

For the year ended December 31, 2012, the Company recognized net mortgage banking gains of $2.4 million, consisting of $2.6 million in net gains on sale of loans and $232,000 in net derivative mortgage banking losses. For the year ended December 31, 2011, the Company recognized net mortgage banking gains of $2.1 million, consisting of $1.6 million in net gains on sale of loans and $508,000 in net derivative mortgage banking gains.

Other Commitments

In July 2010, we extended the contract with our core data processing provider through December 2017. This contract extension resulted in an outstanding commitment of $11.2 million as of December 31, 2012, with total

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

annual payments of $2.2 million. In addition, we had outstanding commitments as of December 31, 2012 totaling $545,000 for the construction of two new branches in Belmont and the Allston area of Boston, Massachusetts.

Employment and Change in Control Agreements

The Company has entered into employment agreements with certain senior executives which provide for a minimum annual salary, subject to increase at the discretion of the Board of Directors, and other benefits. The agreements may be terminated for cause by the Company without further liability on the part of the Bank, or by the executives with prior written notice to the Board of Directors. The Company also has change in control agreements with several officers which provide a severance payment in the event employment is terminated in conjunction with a defined change in control.

Legal Claims

Various legal claims may arise from time to time in the normal course of business, but in the opinion of management, these claims are not expected to have a material effect on the Company s consolidated financial statements.

12. EMPLOYEE BENEFIT PLANS

401(k) Plan

The Company has a 401(k) plan to provide retirement benefits for eligible employees. Under this plan, each employee reaching the age of eighteen and having completed at least three months of service in any one twelve-month period, beginning with such employee s date of employment, can elect to be a participant in the retirement plan. All participants are fully vested upon entering the plan. The Company contributes an amount equal to three percent of an employee s compensation regardless of the employee s contributions and makes matching contributions equal to fifty percent of the first six percent of an employee s compensation contributed to the Plan. For the years ended December 31, 2012, 2011 and 2010, expense attributable to the plan amounted to $1.1 million, $970,000 and $920,000, respectively.

Supplemental Executive Retirement Benefits Officers and Directors

The Company has supplemental retirement benefit agreements with certain officers. The present value of the estimated future benefits is accrued over the required service periods. At December 31, 2012 and 2011, the accrued liability for these agreements amounted to $3.5 million and $2.7 million, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company also has a Supplemental Executive Retirement Plan for certain directors which provide for a defined benefit obligation, based on the director s final average compensation. The plan is unfunded for tax purposes. The Company expects to contribute $196,000 to the plan in 2013. Information pertaining to the activity in the plan is as follows:

(In thousands)	2012	2011	2010
	Years Ended December 31,		
Change in plan assets:			
Fair value of plan assets at beginning of year	$	$	$
Employer contribution	302		
Benefits payments	(302)		
Fair value of plan assets at end of year			
Change in benefit obligation:			
Benefit obligation at beginning of year	1,245	828	674
Service cost	91	87	78
Interest cost	42	43	39
Benefit payments	(302)		
Actuarial loss	15	287	37
Benefit obligation at end of year	1,091	1,245	828
Funded status	$ (1,091)	$ (1,245)	$ (828)
Accrued benefit obligation	$ (1,091)	$ (1,245)	$ (828)
Accumulated benefit obligation	$ (1,006)	$ (1,153)	$ (729)

The assumptions used to determine benefit obligations are as follows:

	Years Ended December 31,		
	2012	2011	2010
Discount rate	3.50%	4.25%	5.25%
Rate of compensation increase	3.00%	3.00%	3.00%
Retirement age	72	72	72

The components of net periodic benefit cost are as follows:

(In thousands)	2012	2011	2010
	Years Ended December 31,		
Service cost	$ 91	$ 87	$ 78
Interest cost	42	43	39
Recognition of prior service cost	28	28	28

Amortization of unrecognized loss		68				
	$	229	$	158	$	145

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The assumptions used to determine net periodic benefit costs are as follows:

	Years Ended December 31,		
	2012	2011	2010
Discount rate	4.25%	5.25%	5.75%
Rate of compensation increase	3.00%	3.00%	3.00%
Retirement age	72	72	72

The expected future benefit payments for the directors plan are as follows:

Year Ending December 31,	Amount (In thousands)
2013	$ 196
2014	355
2015	342
2016	
2017	
2018-2022	576

Supplemental executive retirement benefit expense for officers and directors amounted to $1.0 million, $791,000 and $700,000 for the years ended December 31, 2012, 2011 and 2010, respectively.

Long-Term Health Care Plan

The Company provides long-term health care policies for certain directors and executives. The plan is unfunded and has no assets. Information pertaining to activity in the plan is as follows:

	Years Ended December 31,		
(In thousands)	**2012**	**2011**	**2010**
Change in plan assets:			
Fair value of plan assets at beginning of year	$	$	$
Employer contribution	44	44	44
Benefits payments	(44)	(44)	(44)
Fair value of plan assets at end of year			
Change in benefit obligation:			
Benefit obligation at beginning of year	759	737	694
Interest cost	30	33	37
Benefit payments	(44)	(44)	(44)
Actuarial loss	56	33	50
Benefit obligation at end of year	801	759	737
Funded status	$ (801)	$ (759)	$ (737)

Accumulated benefit obligation	$ (801)	$ (759)	$ (737)

The assumptions used to determine benefit obligations are as follows:

	Years Ended December 31,		
	2012	2011	2010
Discount rate	3.06%	4.06%	4.67%
Rate of premium increases	4.00%	4.00%	4.00%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of net periodic benefit cost are as follows:

	Years Ended December 31,		
(In thousands)	2012	2011	2010
Service cost	$	$	$
Interest cost	30	33	37
Recognition of prior service cost	18	18	88
Recognized net actuarial losses	26		
	$ 74	$ 51	$ 125

The assumptions used to determine net periodic benefit costs are as follows:

	Years Ended December 31,		
	2012	2011	2010
Discount rate	4.06%	4.67%	5.54%
Rate of premium increases	4.00%	4.00%	4.00%

The expected future contributions and benefit payments for this plan are as follows:

Year Ending December 31,	Amount (In thousands)
2013	$ 51
2014	53
2015	55
2016	58
2017	60
2018-2022	306

Share-Based Compensation Plan

On August 19, 2008, stockholders of the Company approved the 2008 Equity Incentive Plan (the Equity Incentive Plan). The Equity Incentive Plan provides for the award of up to 1,449,000 shares of common stock pursuant to grants of restricted stock awards, incentive stock options, non-qualified stock options and stock appreciation rights (SARs); provided, however, that no more than 1,035,000 shares may be issued or delivered in the aggregate pursuant to the exercise of stock options or stock appreciation rights and no more than 414,000 shares may be issued or delivered pursuant to restricted stock awards.

As of December 31, 2009, the Company had repurchased 414,000 shares of the Company s common stock at a cost of $3.7 million through a stock repurchase program to fund restricted awards under the plan. Pursuant to terms of the Equity Incentive Plan, the Board of Directors has granted stock options and restricted shares to employees and directors. The options may be treated as stock appreciation rights that are settled in stock at the option of the vested participant. All of the awards granted to date vest evenly over a five year period from the date of the grant.

The fair value of each option award is estimated on the date of grant using the Black-Scholes Option-Pricing Model. The expected volatility is based on historical volatility of the stock price. The dividend yield assumption is based on the Company s expectation of dividend payouts. The Company uses historical employee turnover data to determine the expected forfeiture rate in the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the date of grant.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company utilized the simplified method of calculating the expected term of the options granted in 2010, 2011 and 2012 because limited historical data specific to the shares exists at the present time. The simplified method is an appropriate method because the option awards are plain vanilla shares that are valued utilizing the Black-Scholes method. The weighted-average assumptions used for options granted during the years ended December 31, 2012, 2011 and 2010 are as follows:

	Weighted Average Assumptions		
	2012	2011	2010
Expected term (years)	6.50	6.50	6.50
Expected dividend yield	0.58%	0.62%	0.84%
Expected volatility	31.05%	29.84%	46.27%
Expected forfeiture rate	%	%	%
Risk-free interest rate	1.18%	1.97%	3.02%
Fair value of options granted	$ 4.38	$ 4.07	$ 4.36

The weighted average grant date fair value of options granted in 2012, 2011 and 2010 was $77,000, $208,000 and $190,000, respectively.

A summary of options under the plan as of December 31, 2012, and activity during the year then ended, is presented below:

	Number of Shares	Weighted Average Exercise Price
Options outstanding at beginning of year	933,600	$ 9.49
Granted	17,500	14.08
Exercised (options and SARs)	(24,900)	9.40
Forfeited	(28,750)	9.71
Outstanding at end of year	897,450	$ 9.58
Exercisable at end of year	593,570	$ 9.38

The following table summarizes information about options outstanding and options exercisable at December 31, 2012:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price
$8.50 - 9.00	303,150	6.70	$ 8.90	180,450	6.70	$ 8.90
$9.00 - 9.50	521,200	5.87	9.49	400,500	5.83	9.49
$10.50 - 11.00	2,500	7.57	10.75	1,000	7.57	10.75
$11.00 - 11.50	5,000	7.48	11.13	2,000	7.48	11.13
$12.00 - 12.50	20,600	8.90	12.23	4,120	8.90	12.23
$13.00 - 13.50	25,000	8.86	13.29	2,500	8.36	13.39
$13.50 - 14.00	15,000	8.52	13.73	3,000	8.52	13.73

$16.00 - 16.50	5,000	9.95	16.30	N/A	N/A	N/A
	897,450	6.38		593,570	6.15	

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The aggregate intrinsic value, which fluctuates based on changes in the fair market value of the Company s stock, is $6.5 million and $4.4 million for all outstanding and exercisable options, respectively, at December 31, 2012, based on a closing stock price of $16.78. The aggregate intrinsic value represents the total pretax intrinsic value (i.e., the difference between the Company s closing stock price on the last trading day of 2012 and the weighted-average exercise price, multiplied by the number of shares) that would have been received by the option holders had all option holders exercised their options on December 31, 2012.

Shares for the exercise of stock options are expected to come from the Company s authorized and unissued shares or treasury shares.

The following table summarizes the Company s non-vested restricted stock activity for the year ended December 31, 2012:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested restricted stock at beginning of year	177,520	$ 9.80
Granted	9,500	14.34
Vested	(62,365)	9.56
Forfeited	(5,600)	10.54
Non-vested restricted stock at end of year	119,055	10.25

The total fair value of restricted shares vested in 2012 was $1.0 million.

For the years ended December 31, 2012, 2011 and 2010, compensation expense and the related tax benefit for the plan totaled $1.2 million and $309,000, $1.1 million and $288,000, and $1.0 million and $277,000, respectively.

As of December 31, 2012, there was $2.0 million of total unrecognized compensation expense related to non-vested options and restricted shares granted under the plan. This cost is expected to be recognized over a weighted-average period of 2.1 years.

Employee Stock Ownership Plan

The Company established an ESOP for its eligible employees effective January 1, 2008 to provide eligible employees the opportunity to own Company stock. The plan is a tax-qualified retirement plan for the benefit of all Company employees. Contributions are allocated to eligible participants on the basis of compensation, subject to federal tax law limits. The ESOP acquired 828,000 shares in the stock offering with the proceeds of a loan totaling $8.3 million from the Company s subsidiary, Meridian Interstate Funding Corporation. The loan is payable annually over 20 years at a rate of 6.5%. The loan is secured by the shares purchased, which are held in a suspense account for allocation among participants as the loan is repaid. The Company s annual cash contributions to the ESOP at a minimum will be sufficient to service the annual debt of the ESOP. Shares used as collateral to secure the loan are released and available for allocation to eligible employees as the principal and interest on the loan is paid.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

At December 31, 2012, the remaining principal balance on the ESOP debt is payable as follows:

Year Ending December 31,	Amount (In thousands)
2013	$ 291
2014	310
2015	330
2016	351
2017	375
Therafter	5,384
	$ 7,041

Shares held by the ESOP include the following:

	December 31,	
(In thousands)	2012	2011
Allocated	166	125
Committed to be allocated	41	41
Unallocated	621	662
	828	828

The fair value of the unallocated shares was $10.4 million and $8.2 million at December 31, 2012 and 2011, respectively. Total compensation expense recognized in connection with the ESOP for 2012, 2011 and 2010 was $606,000, $532,000 and $440,000, respectively.

Bank-Owned Life Insurance

The Company is the sole owner of life insurance policies pertaining to certain employees. The Company has entered into agreements with these employees whereby the Company will pay to the employees estate or beneficiaries a portion of the death benefit that the Company will receive as beneficiary of such policies. These post-retirement benefits are accrued over the expected service period of the employees. Expense associated with this post-retirement benefit for the years ended December 31, 2012, 2011 and 2010 amounted to $388,000, $241,000 and $487,000, respectively.

Incentive Compensation Plan

Eligible officers and employees of the Company participate in an incentive compensation plan which is based on various factors as set forth by the Executive Committee. Incentive compensation plan expense for the years ended December 31, 2012, 2011 and 2010 amounted to $3.1 million, $1.9 million and $1.8 million, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. RELATED PARTY TRANSACTIONS

Loans

The following summarizes the activity with respect to loans made to the Company s officers and directors, and their affiliates.

(In thousands)	Years Ended December 31, 2012	2011
Balance at beginning of year	$ 6,728	$ 7,102
Additions	1,948	1,449
Reductions	(2,248)	(1,823)
Balance at end of year	$ 6,428	$ 6,728

Such loans are made in the normal course of business at the Bank s normal credit terms, including interest rate and collateral requirements, and do not represent more than a normal risk of collection.

Deposits

Deposits from related parties totaled $51.9 million and $49.1 million at December 31, 2012 and 2011, respectively. All such deposits were accepted in the ordinary course of business on substantially the same terms as those prevailing at the time for comparable transactions with other persons.

14. STOCKHOLDERS EQUITY

Minimum Regulatory Capital Requirements

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

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth in the table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2012 and 2011, that the Company and the Bank meet all capital adequacy requirements to which they are subject. As of December 31, 2012, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Bank s category.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s and the Bank s actual capital amounts and ratios follow:

(Dollars in thousands)	Actual Amount	Actual Ratio	Minimum Capital Requirement Amount	Minimum Capital Requirement Ratio	Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions Amount	Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions Ratio
December 31, 2012						
Total Capital (to Risk Weighted Assets):						
Company	$ 237,527	11.9%	$ 159,344	8.0%	N/A	N/A
Bank	201,113	10.2	157,224	8.0	$ 196,531	10.0%
Tier 1 Capital (to Risk Weighted Assets):						
Company	215,255	10.8	79,672	4.0	N/A	N/A
Bank	178,852	9.1	78,612	4.0	117,918	6.0
Tier 1 Capital (to Average Assets):						
Company	215,255	9.7	88,858	4.0	N/A	N/A
Bank	178,852	8.2	87,742	4.0	109,678	5.0
December 31, 2011						
Total Capital (to Risk Weighted Assets):						
Company	$ 217,156	13.7%	$ 127,244	8.0%	N/A	N/A
Bank	177,602	11.4	125,028	8.0	$ 156,285	10.0%
Tier 1 Capital (to Risk Weighted Assets):						
Company	202,219	12.7	63,622	4.0	N/A	N/A
Bank	162,661	10.4	62,514	4.0	93,771	6.0
Tier 1 Capital (to Average Assets):						
Company	202,219	10.4	77,525	4.0	N/A	N/A
Bank	162,661	8.5	76,328	4.0	95,410	5.0

A reconciliation of the Company s and Bank s stockholders equity to regulatory capital follows:

(In thousands)	December 31, 2012 Consolidated	December 31, 2012 Bank	December 31, 2011 Consolidated	December 31, 2011 Bank
Total stockholders equity per financial statements	$ 233,943	$ 197,399	$ 219,944	$ 180,962
Adjustments to Tier 1 capital:				
Accumulated other comprehensive income	(4,915)	(4,774)	(3,985)	(4,561)
Goodwill disallowed	(13,687)	(13,687)	(13,687)	(13,687)
Servicing assets disallowed	(86)	(86)	(53)	(53)
Total Tier 1 capital	215,255	178,852	202,219	162,661
Adjustments to total capital:				

Allowance for loan losses	20,504	20,504	13,053	13,053
45% of net unrealized gains on marketable equity securities	1,768	1,757	1,884	1,888
Total regulatory capital	$ 237,527	$ 201,113	$ 217,156	$ 177,602

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Liquidation Account

At the time of the minority stock offering which was completed on January 22, 2008, the Company established a liquidation account in the amount of $114.2 million, which is equal to the net worth of the Company as of the date of the latest consolidated balance sheet appearing in the final prospectus distributed in connection with the offering. The liquidation account is maintained for the benefit of the eligible account holders and supplemental eligible account holders who maintain their accounts at the Bank after the offering. The liquidation account is reduced annually to the extent that such account holders have reduced their qualifying deposits as of each anniversary date and amounted to $23.2 million at December 31, 2012. Subsequent increases will not restore an account holder s interest in the liquidation account. In the event of a complete liquidation, each eligible account holder will be entitled to receive balances for accounts held then.

Other Capital Restrictions

Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by the Bank to the Company. The total amount for dividends which may be paid in any calendar year cannot exceed the Bank s net income for the current year, plus the Bank s net income retained for the two previous years, without regulatory approval. At December 31, 2012, the Bank s retained earnings available for the payment of dividends was $33.3 million. Loans or advances are limited to 10% of the Bank s capital stock and surplus on a secured basis. Funds available for loans or advances by the Bank to the Company amounted to $19.7 million. In addition, dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank s capital to be reduced below applicable minimum capital requirements.

Stock Repurchase Plan

As of December 31, 2012, the Company had repurchased 196,566 shares of its stock at an average price of $12.85 per share, or 21.7% of the 904,224 shares authorized for repurchase under the Company s fourth repurchase program as adopted during 2011. The Company has repurchased 1,600,494 shares at an average price of $10.45 per share since December 2008.

15. FAIR VALUES OF ASSETS AND LIABILITIES

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The fair value of assets and liabilities is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company s various assets and liabilities. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the asset or liability.

The following methods and assumptions were used by the Company in estimating fair value disclosures:

Cash and cash equivalents The carrying amounts of cash and short-term instruments approximate fair values, based on the short-term nature of the assets.

Certificates of deposit Fair values of certificates of deposit are estimated using discounted cash flow analyses based on current market rates for similar types of deposits.

Securities available for sale All fair value measurements are obtained from a third party pricing service and are not adjusted by management. Marketable equity securities are measured at fair value utilizing quoted market prices (Level 1). Corporate bonds, obligations of government-sponsored enterprises,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

municipal bonds and mortgage-backed securities are determined by pricing models that consider standard input factors such as observable market data, benchmark yields, reported trades, broker/dealer quotes, credit spreads, benchmark securities, as well as new issue data, monthly payment information, and collateral performance, among others (Level 2).

Federal Home Loan Bank stock The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

Loans held for sale The fair value is based on commitments in effect from investors or prevailing market prices.

Loans For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using market interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for non-accrual loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Deposits The fair values disclosed for non-certificate accounts are, by definition, equal to the amount payable on demand at the reporting date which is their carrying amounts. Fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings The fair value is estimated using discounted cash flow analyses based on the current incremental borrowing rates in the market for similar types of borrowing arrangements.

Accrued interest The carrying amounts of accrued interest approximate fair value.

Forward loan sale commitments and derivative loan commitments Forward loan sale commitments and derivative loan commitments are based on fair values of the underlying mortgage loans and the probability of such commitments being exercised. Management judgment and estimation is required in determining these fair value measurements.

Off-balance sheet credit-related instruments Fair values for off-balance-sheet, credit-related financial instruments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties credit standing. The fair value of these instruments is considered immaterial.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	December 31, 2012			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Assets				
Debt securities	$	$ 202,637	$	$ 202,637
Marketable equity securities	60,148			60,148
Derivative loan commitments			288	288
Total assets	$ 60,148	$ 202,637	$ 288	$ 263,073
Liabilities				
Forward loan sale commitments	$	$	$ 12	$ 12

Total liabilities	$	$	$ 12	$ 12

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2011			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Assets				
Debt securities	$	$ 290,192	$	$ 290,192
Marketable equity securities	45,038			45,038
Derivative loan commitments			536	536
Total assets	$ 45,038	$ 290,192	$ 536	$ 335,766
Liabilities				
Forward loan sale commitments	$	$	$ 28	$ 28
Total liabilities	$	$	$ 28	$ 28

For the year ended December 31, 2012, there were no transfers in or out of Levels 1 and 2 and the changes in Level 3 assets and liabilities that are measured at fair value on a recurring basis are as follows:

	Years Ended December 31,	
(In thousands)	2012	2011
Derivative loan commitments and forward sale commitments, net:		
Beginning balance	$ 508	$
Total realized and unrealized gains (losses) included in net income	(232)	508
Ending balance	$ 276	$ 508
Total realized gain relating to instruments still held at period end	$ 276	$ 508

Assets Measured at Fair Value on a Non-recurring Basis

The Company may also be required, from time to time, to measure certain other assets on a non-recurring basis in accordance with generally accepted accounting principles. These adjustments to fair value usually result from the application of lower-of-cost-or market accounting or write-downs of individual assets.

The following tables summarize the fair value hierarchy used to determine each adjustment and the carrying value of the related individual assets. The gain/loss represents the amount of write-down, charge-off or specific reserve recorded during the periods noted on the assets held at period end. There were no liabilities measured at fair value on a non-recurring basis.

	December 31, 2012			Year Ended December 31, 2012
(In thousands)	Level 1	Level 2	Level 3	Total Losses
Impaired loans	$	$	$ 7,867	$ (1,025)
Foreclosed real estate			2,604	(418)

	$		$		$	10,471	$	(1,443)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands)	December 31, 2011 Level 1	Level 2	Level 3	Year Ended December 31, 2011 Total Losses
Impaired loans	$	$	$ 4,571	$ (448)
Foreclosed real estate			3,853	(241)
	$	$	$ 8,424	$ (689)

Certain impaired loans were adjusted to fair value, less cost to sell, of the underlying collateral securing these loans resulting in losses. The loss is not recorded directly as an adjustment to current earnings, but rather as a component in determining the allowance for loan losses. Fair value was measured using appraised values of collateral and adjusted as necessary by management based on unobservable inputs for specific properties.

Certain properties in foreclosed real estate were adjusted to fair value using appraised values of collateral, less cost to sell, and adjusted as necessary by management based on unobservable inputs for specific properties. The loss on foreclosed assets represents adjustments in valuation recorded during the time period indicated and not for losses incurred on sales.

Summary of Fair Values of Financial Instruments

The estimated fair values, and related carrying amounts, of the Company s financial instruments are as follows. Certain financial instruments and all nonfinancial instruments are exempt from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein do not represent the underlying fair value of the Company.

	December 31, 2012				
	Carrying	Fair Value			
(In thousands)	Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and cash equivalents	$ 93,192	$ 93,192	$	$	$ 93,192
Securities available for sale	262,785	60,148	202,637		262,785
Federal Home Loan Bank stock	12,064			12,064	12,064
Loans and loans held for sale, net	1,800,841			1,843,529	1,843,529
Accrued interest receivable	6,745			6,745	6,745
Financial liabilities:					
Deposits	1,865,433			1,874,226	1,874,226
Borrowings	161,254		164,176		164,176
Accrued interest payable	849			849	849
On-balance sheet derivative financial instruments:					
Derivative loan commitments:					
Assets	288			288	288
Forward loan sale commitments:					
Liabilities	12			12	12

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2011				
	Carrying	Fair Value			
(In thousands)	Amount	Level 1	Level 2	Level 3	Total
Financial assets:					
Cash and cash equivalents	$ 156,685	$ 156,685	$	$	$ 156,685
Certificates of deposit	2,500		2,516		2,516
Securities available for sale	335,230	45,038	290,192		335,230
Federal Home Loan Bank stock	12,538			12,538	12,538
Loans and loans held for sale, net	1,345,493			1,382,972	1,382,972
Accrued interest receivable	7,282			7,282	7,282
Financial liabilities:					
Deposits	1,604,488			1,613,792	1,613,792
Borrowings	131,450		135,619		135,619
Accrued interest payable	972			972	972
On-balance sheet derivative financial instruments:					
Derivative loan commitments:					
Assets	536			536	536
Forward loan sale commitments:					
Liabilities	28			28	28

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. CONDENSED FINANCIAL STATEMENTS OF PARENT COMPANY

Financial information pertaining only to Meridian Interstate Bancorp, Inc. is as follows:

(In thousands)	**December 31, 2012**	**2011**
BALANCE SHEETS		
Assets		
Cash and cash equivalents subsidiary	$ 718	$
Cash and cash equivalents other	63	63
Total cash and cash equivalents	781	63
Certificates of deposit affiliate bank		2,500
Securities available for sale, at fair value	24,378	12,414
Investment in subsidiaries	207,162	190,443
Investment in affiliate bank		12,607
Other assets	2,131	2,156
Total assets	$ 234,452	$ 220,183
Liabilities and Stockholders Equity		
Accrued expenses and other liabilities	$ 509	$ 239
Stockholders equity	233,943	219,944
Total liabilities and stockholders equity	$ 234,452	$ 220,183

(In thousands)	**Years Ended December 31, 2012**	**2011**	**2010**
STATEMENTS OF INCOME			
Income:			
Interest and dividend income	$ 361	$ 220	$ 216
Equity income on investment in affiliate bank	310	1,110	492
Gain on sales of securities, net	364		
Gain on sale of investment in affiliate bank	4,819		
Total income	5,854	1,330	708
Operating expenses	880	800	568
Income before income taxes and equity in undistributed earnings of subsidiaries	4,974	530	140
Applicable income tax provision (benefit)	1,986	210	(194)
	2,988	320	334
Equity in undistributed earnings of subsidiaries	9,438	11,650	13,040

Net income	$	12,426	$	11,970	$	13,374

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(In thousands)	Years Ended December 31, 2012	2011	2010
STATEMENTS OF CASH FLOWS			
Cash flows from operating activities:			
Net income	$ 12,426	$ 11,970	$ 13,374
Adjustments to reconcile net income to net cash used by operating activities:			
Equity in undistributed earnings of subsidiaries	(9,438)	(11,650)	(13,040)
Equity income on investment in affiliate bank	(310)	(1,110)	(492)
Net amortization of securities available for sale	3	4	2
Gain on sales of securities, net	(364)		
Gain on sale of investment in affiliate bank	(4,819)		
Share-based compensation expense	295	294	301
(Increase) decrease in other assets	(66)	(125)	189
Increase (decrease) in other liabilities	270	226	(779)
Net cash used by operating activities	(2,003)	(391)	(445)
Cash flows from investing activities:			
Purchases of certificates of deposit		(2,500)	
Maturities of certificates of deposit	2,500		3,000
Activity in securities available for sale:			
Proceeds from maturities, calls and principal payments		2,000	1,000
(Purchase) redemption of mutual funds, net	(4,764)	3,509	8,888
Proceeds from sales	4,518		
Purchases			(7,049)
Proceeds from sale of investment in affiliate bank	6,600		
Capital contribution to bank subsidiary	(5,000)		(15,000)
Transfer of bank-owned life insurance to bank subsidiary			4,333
Net cash provided (used) by investing activities	3,854	3,009	(4,828)
Cash flows from financing activities:			
Purchase of treasury stock	(1,160)	(5,196)	(2,091)
Stock options exercised	27		
Net cash used by financing activities	(1,133)	(5,196)	(2,091)
Net change in cash and cash equivalents	718	(2,578)	(7,364)
Cash and cash equivalents at beginning of year	63	2,641	10,005
Cash and cash equivalents at end of year	$ 781	$ 63	$ 2,641

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

17. SELECTED QUARTERLY CONSOLIDATED FINANCIAL INFORMATION (Unaudited)

The selected quarterly financial data presented below should be read in conjunction with the Consolidated Financial Statements and related notes.

	Years Ended December 31,							
	2012				2011			
Dollars in thousands, except er share amounts)	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
nterest and dividend income	$ 22,183	$ 21,181	$ 20,968	$ 20,637	$ 19,738	$ 19,522	$ 19,541	$ 20,011
nterest expense	4,844	4,742	4,573	4,786	4,899	5,204	5,407	5,462
let interest income	17,339	16,439	16,395	15,851	14,839	14,318	14,134	14,549
rovision for loan losses	2,803	2,344	2,170	1,264	1,272	1,563	486	342
let interest income, after rovision for loan losses	14,536	14,095	14,225	14,587	13,567	12,755	13,648	14,207
lon-interest income(1)	4,169	4,539	8,660	3,893	2,953	3,521	5,384	3,530
lon-interest expenses(2)	15,517	14,366	14,799	15,266	13,610	12,262	12,485	12,637
ncome before income taxes	3,188	4,268	8,086	3,214	2,910	4,014	6,547	5,100
rovision for income taxes	1,079	1,554	2,639	1,058	946	1,384	2,382	1,889
let income	$ 2,109	$ 2,714	$ 5,447	$ 2,156	$ 1,964	$ 2,630	$ 4,165	$ 3,211
ncome per share:								
asic	$ 0.10	$ 0.13	$ 0.25	$ 0.10	$ 0.09	$ 0.12	$ 0.19	$ 0.15
iluted	$ 0.10	$ 0.12	$ 0.25	$ 0.10	$ 0.09	$ 0.12	$ 0.19	$ 0.15
Veighted Average Shares:								
asic	21,617,801	21,606,540	21,630,660	21,662,471	21,668,365	21,721,219	21,852,665	21,982,714
iluted	21,925,933	21,871,578	21,808,507	21,826,307	21,798,777	21,843,081	21,994,371	22,095,617

(1) Non-interest income fluctuates each quarter primarily due to securities gains. Non-interest income for the second quarter of 2012 includes the gain on sale of investment in affiliate bank of $4.8 million.

(2) Non-interest expenses for the fourth quarter of 2012 include an increase of $1.0 million in incentive compensation plan expense based on the Company s achievement of various performance measures. Non-interest expenses for the fourth quarter of 2011 include costs associated with the expansion of residential and commercial lending capacity and the opening of a new branch office.

ITEM 9. *CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*

None.

ITEM 9A. *CONTROLS AND PROCEDURES*

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures The Company s management, including the Company s principal executive officer and principal financial officer, have evaluated the effectiveness of the Company s disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company s disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the SEC) (1) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (2) is accumulated and communicated to the Company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Controls over Financial Reporting There have not been any changes in the Company s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

ITEM 9B. *OTHER INFORMATION*

Not applicable.

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PART III

ITEM 10. *DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT AND CORPORATE GOVERNANCE*

The information in the Corporation s definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning directors of the Corporation under the captions Election of Directors and Information About the Board of Directors ; information concerning executive officers of the Corporation under the caption Information About the Executive Officers ; and information concerning Section 16(a) compliance under the caption Section 16(a) Beneficial Ownership Reporting Compliance is incorporated herein by reference or will be filed by an amendment to this Annual Report.

ITEM 11. *EXECUTIVE COMPENSATION*

The information in the Corporation s definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning this item, under the caption Executive Compensation is incorporated herein by reference or will be filed by an amendment to this Annual Report.

ITEM 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

The information in the Corporation s definitive Proxy Statement, prepared for the 2013 Annual Meeting of Shareholders, which contains information concerning this item, under the caption Stock Ownership is incorporated herein by reference or will be filed by an amendment to this Annual Report.

Equity Compensation Plan Information

The following table provides information as of December 31, 2012, regarding shares outstanding and available for issuance under the Company s equity compensation plan. Additional information regarding stock-based compensation is presented in Note 12, Employee Benefit Plans of the notes to consolidated financial statements within Part II, Item 8, Financial Statements and Supplementary Data.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	897,450	$ 9.58	112,650
Equity compensation plans not approved by security holders			
Total	897,450	$ 9.58	112,650

ITEM 13. *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE*

The Transactions with Certain Related Persons section of the 2013 Proxy Statement is incorporated herein by reference or filed by an amendment to this Annual Report.

ITEM 14. *PRINCIPAL ACCOUNTING FEES AND SERVICES*

The Proposal II Ratification of Appointment of Independent Registered Public Accounting Firm Section of the 2013 Proxy Statement is incorporated herein by reference or filed by an amendment to this Annual Report.

PART IV

ITEM 15. ***EXHIBITS AND FINANCIAL STATEMENT SCHEDULES***

(a)(1) Financial Statements

The following documents are filed as part of this Form 10-K.

(A) Report of Independent Registered Public Accounting Firm

(B) Consolidated Balance Sheets at December 31, 2012 and 2011

(C) Consolidated Statements of Net Income Years ended December 31, 2012, 2011 and 2010

(D) Consolidated Statements of Comprehensive Income Years ended December 31, 2012, 2011 and 2010

(E) Consolidated Statements of Changes in Stockholders Equity Years ended December 31, 2012, 2011 and 2010

(F) Consolidated Statements of Cash Flows Years ended December 31, 2012, 2011 and 2010

(G) Notes to Consolidated Financial Statements.

(a)(2) Financial Statement Schedules

None.

(a)(3) Exhibits

3.1	Amended and Restated Articles of Organization of Meridian Interstate Bancorp, Inc.*
3.2	Amended and Restated Bylaws of Meridian Interstate Bancorp, Inc.****
3.3	Articles of Correction of Meridian Interstate Bancorp, Inc.***
4	Form of Common Stock Certificate of Meridian Interstate Bancorp, Inc.*
10.1	Form of East Boston Savings Bank Employee Stock Ownership Plan*
10.2	Form of East Boston Savings Bank Employee Stock Ownership Plan Trust Agreement*
10.3	East Boston Savings Bank Employee Stock Ownership Plan Loan Agreement, Pledge Agreement and Promissory Note*
10.4	Form of Amended and Restated Employment Agreement*
10.5	Form of East Boston Savings Bank Employee Severance Compensation Plan*
10.6	Form of Supplemental Executive Retirement Agreements with certain directors*
10.7	[Reserved]
10.8	[Reserved]
10.9	[Reserved]
10.10	Form of Supplemental Executive Retirement Agreement with Richard J. Gavegnano filed as an exhibit to Form 10-Q filed on May 14, 2008
10.11	Form of Employment Agreement with Richard J. Gavegnano incorporated by reference to the Form 8-K filed on January 12, 2009
10.12	Form of Employment Agreement with Deborah J. Jackson incorporated by reference to the Form 8-K filed on January 22, 2009
10.13	Form of Supplemental Executive Retirement Agreement with Deborah J. Jackson incorporated by reference to the Form 8-K filed on January 22, 2009
10.14	2008 Equity Incentive Plan**
10.15	Amendment to Supplemental Executive Retirement Agreements with Certain Directors incorporated by reference to the Form 10-K/A filed on April 8, 2009
10.16	Agreement and Plan of Merger incorporated by reference to the Form 8-K filed on July 24, 2009
10.17	Employment Agreement between Edward J. Merritt and East Boston Savings Bank***
10.18	Supplemental Executive Retirement Agreement between East Boston Savings Bank and Edward J. Merritt***
10.19	Joint Beneficiary Designation Agreement between Edward J. Merritt and Mt. Washington Co-operative Bank***
10.20	First Amendment to Joint Beneficiary Designation Agreement between Edward J. Merritt and Mt. Washington Co-operative Bank***
10.21	Change in Control Agreement between Mark Abbate and East Boston Savings Bank incorporated by reference to the Form 8-K filed on December 15, 2009
10.22	Incentive Compensation Plan
21	Subsidiaries of Registrant*
23	Consent of Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following financial statements for the year ended December 31, 2012, formatted in XBRL, which are furnished, and not filed: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders Equity (v) Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Incorporated by reference to the Registration Statement on Form S-1 of Meridian Interstate Bancorp, Inc. (File No. 333-146373), originally filed with the Securities and Exchange Commission on September 28, 2007.

** Incorporated by reference to Appendix A to the Company s Definitive Proxy Statement for its 2008 Annual Meeting, as filed with the Securities and Exchange Commission on July 11, 2008.

*** Incorporated by reference to the Company s Annual Report on Form 10-K as filed with the Securities and Exchange Commission on March 16, 2010.

**** Incorporated by reference to the Company s Form 8-K as filed with the Securities and Exchange Commission on May 17, 2012.

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SIGNATURES

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

MERIDIAN INTERSTATE BANCORP, INC.

(Registrant)

Date: March 15, 2013

By: /s/ Richard J. Gavegnano
Richard J. Gavegnano

Chairman and Chief Executive Officer

(Duly Authorized Representative)

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

Signatures	Title	Date
/s/ Richard J. Gavegnano	Chairman and Chief Executive Officer	March 15, 2013
Richard J. Gavegnano	(Principal Executive Officer)	
/s/ Mark L. Abbate	Senior Vice President, Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)	March 15, 2013
Mark L. Abbate		
/s/ Vincent D. Basile	Director	March 15, 2013
Vincent D. Basile		
/s/ Marilyn A. Censullo	Director	March 15, 2013
Marilyn A. Censullo		
/s/ Anna R. DiMaria	Director	March 15, 2013
Anna R. DiMaria		
/s/ Richard F. Fernandez	Director	March 15, 2013
Richard F. Fernandez		
/s/ Domenic A. Gambardella	Director	March 15, 2013
Domenic A. Gambardella		

/s/ Thomas J. Gunning	Director	March 15, 2013
Thomas J. Gunning		
/s/ Carl A. LaGreca	Director	March 15, 2013
Carl A. LaGreca		
/s/ Edward L. Lynch	Director	March 15, 2013
Edward L. Lynch		
/s/ Edward J. Merritt	Director	March 15, 2013
Edward J. Merritt		
/s/ Gregory F. Natalucci	Director	March 15, 2013
Gregory F. Natalucci		
/s/ James G. Sartori	Director	March 15, 2013
James G. Sartori		