BERKSHIRE BANCORP INC /DE/
Form 10-K
June 10, 2010

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

FORM 10-K

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

For the fiscal year ended December 31, 2009

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 0-13649

Berkshire Bancorp Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	94-2563513 (I.R.S. employer identification number)
160 Broadway, New York, New York (Address of principal executive offices)	10038 (Zip Code)

Registrant's telephone number, including area code: (212) 791-5362

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Traded
Common Stock, par value $.10 per share	The NASDAQ Stock Market LLC (The NASDAQ Global Market)

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 x

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

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

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 ¨ 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 the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Aggregate market value of voting and non-voting common stock held by non-affiliates of the Registrant as of June 30, 2009: $17,656,792.

Number of shares of Common Stock outstanding as of June 2, 2010: 7,054,183.

DOCUMENTS INCORPORATED BY REFERENCE: None

Forward-Looking Statements. Statements in this Annual Report on Form 10-K that are not based on historical fact may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believe", "may", "will", "expect", "estimate", "anticipate", "continue" or similar terms identify forward-looking statements. A wide variety of factors could cause the actual results and experiences of Berkshire Bancorp Inc. (the "Company") to differ materially from the results expressed or implied by the Company's forward-looking statements. Some of the risks and uncertainties that may affect operations, performance, results of the Company's business, the interest rate sensitivity of its assets and liabilities, and the adequacy of its loan loss allowance, include, but are not limited to: (i) deterioration in local, regional, national or global economic conditions which could result, among other things, in an increase in loan delinquencies, a decrease in property values, or a change in the housing turnover rate; (ii) changes in market interest rates or changes in the speed at which market interest rates change; (iii) changes in laws and regulations affecting the financial services industry; (iv) changes in competition; (v) changes in consumer preferences, (vi) changes in banking technology; (vii) ability to maintain key members of management, (viii) possible disruptions in the Company's operations at its banking facilities, (ix) cost of compliance with new corporate governance requirements, and other factors referred to in the sections of this Annual Report entitled "Business", "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Certain information customarily disclosed by financial institutions, such as estimates of interest rate sensitivity and the adequacy of the loan loss allowance, are inherently forward-looking statements because, by their nature, they represent attempts to estimate what will occur in the future.

The Company cautions readers not to place undue reliance upon any forward-looking statement contained in this Annual Report. Forward-looking statements speak only as of the date they were made and the Company assumes no obligation to update or revise any such statements upon any change in applicable circumstances.

PART I

ITEM 1. Business

General. Berkshire Bancorp Inc., a Delaware corporation, is a bank holding company registered under the Bank Holding Company Act of 1956. References herein to "Berkshire", the "Company" or "we" and similar pronouns shall be deemed to refer to Berkshire Bancorp Inc. and its wholly-owned consolidated subsidiaries unless the context otherwise requires. Berkshire's principal activity is the ownership and management of its indirect wholly-owned subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank. The Bank is owned through Berkshire's wholly-owned subsidiary, Greater American Finance Group, Inc. ("GAFG").

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC"). You may read and copy our reports or other filings made with the SEC at the SEC's Public Reference Room, located at 100 F Street, N.E., Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You can also access information that we file electronically on the SEC's website at WWW.SEC.GOV.

We do not presently have a website. However, as soon as practicable after filing with or furnishing to the SEC, we will provide at no cost, paper or electronic copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports. Requests should be directed to:

Berkshire Bancorp Inc.
Investor Relations
160 Broadway, First Floor
New York, NY 10038

Series A Preferred Shares. On October 31, 2008, the Company sold an aggregate of 60,000 shares of its 8% Non-Cumulative Mandatorily Convertible Perpetual Series A Preferred Stock (the "Series A Preferred Shares") at $1,000 per share, or $60 million in the aggregate, to the Company's Chairman of the Board and majority stockholder, and two non-affiliated investors. Each Series A Preferred Share bears non-cumulative cash dividends at the rate of 8% per annum, payable quarterly, is mandatorily convertible into 123.153 shares of our Common Stock on October 31, 2011, unless previously redeemed, and is redeemable at the option of the Company between April 30, 2009 and November 1, 2010 at a redemption price of $1,100. So long as any share of Series A Preferred Shares remains outstanding, unless the full dividends for the most recent dividend payment date have been paid or declared, no dividends may be paid or declared on the Company's Common Stock. No Series A Preferred Shares have been redeemed to date.

Business of the Bank - General. The Bank's principal business consists of gathering deposits from the general public and investing those deposits primarily in loans, debt obligations issued by the U.S. Government and its agencies, debt obligations of business corporations, and mortgage-backed securities. The Bank currently operates from seven deposit-taking offices in New York City, four deposit-taking offices in Orange and Sullivan Counties, New York and deposit taking offices in Ridgefield and Teaneck, NJ.

Branch Locations of The Berkshire Bank
December 31, 2009

4 East 39th Street New York, NY	2 South Church Street Goshen, NY
5 Broadway New York, NY	214 Harriman Drive Goshen, NY
5010 13th Avenue Brooklyn, NY	80 Route 17M Harriman, NY
1421 Kings Highway Brooklyn, NY	60 Main Street Bloomingburg, NY
4917 16th Avenue Brooklyn, NY	1119 Avenue J Brooklyn, NY
600 Broad Avenue Ridgefield, NJ	210 Pinehurst Avenue New York, NY 10033
517 Cedar Lane Teaneck, NJ	

Principal Loan Types. The Bank's principal loan types are residential and commercial mortgage loans and commercial non-mortgage loans, both unsecured and secured by personal property. The Bank's revenues come principally from interest on loans and investment securities. The Bank's primary sources of funds are deposits, borrowings and proceeds from principal and interest payments on loans and investment securities.

Operating Plan. The Bank's operating plan concentrates on obtaining deposits from a variety of businesses, professionals and retail customers and investing those funds in conservatively underwritten loans. Due to the Bank's underwriting criteria, its deposits have significantly exceeded the level of satisfactory loans available for investment in recent years. Hence, the Bank has invested a portion of its available funds in investment, mortgage-backed and auction rate securities.

Market Area. The Bank draws its customers principally from the New York City metropolitan area and the Villages of Goshen and Harriman, New York and their surrounding communities, representing most of Orange County, NY. The Bank also has a branch in Bloomingburg, New York, just over the border between Orange and Sullivan Counties. Predominantly rural with numerous small towns, many residents of Orange and Sullivan Counties work in New York City. Consequently, the health of the economy in the New York City metropolitan area has, and will continue to have a direct effect on the economic well being of residents and businesses in these counties. From time to time, the Bank may make loans or accept deposits from outside these areas, but such transactions generally represent extensions of existing local customer relationships.

Competition. The Bank's principal competitors for deposits are other commercial banks, savings banks, savings and loan associations and credit unions in the Bank's market areas, as well as money market mutual funds, insurance companies, securities brokerage firms and other financial institutions, many of which are substantially larger in size than the Bank. The Bank's competition for loans comes principally from commercial banks, savings banks, savings and loan associations, mortgage bankers, finance companies and other institutional lenders. Many of the institutions which compete with the Bank have much greater financial and marketing resources than the Bank. The Bank's principal methods of competition include loan and deposit pricing, maintaining close ties with its local communities, the quality of the personal service it provides, the types of business services it provides, and other marketing programs.

Operations of the Bank. Reference is made to the information set forth in Item 7 herein ("Management's Discussion and Analysis of Financial Condition and Results of Operations") for information as to various aspects of the Bank's operations, activities and conditions.

Subsidiary Activities. The Bank is permitted under New York State law and federal law to own subsidiaries for certain limited purposes, generally to engage in activities which are permissible for a subsidiary of a national bank. The Bank has two subsidiaries, Berkshire Agency, Inc., a company engaged in the title insurance agency business, and Berkshire 1031, a company that acts as a qualified intermediary in connection with tax free exchanges under Section 1031 of the Internal Revenue Code of 1986.

Regulation. The Company is a bank holding company under federal law and registered as such with the Federal Reserve. The Bank is a commercial bank chartered under the laws of New York State. It is subject to regulation at the state level by the New York Superintendent of Banks and the New York Banking Board, while at the federal level its primary regulator is the Federal Deposit Insurance Corporation (the "FDIC").

Both the Company and the Bank are subject to extensive state and federal regulation of their activities. The following discussion summarizes certain banking laws and regulations that affect Berkshire and the Bank. Proposals to change these laws and regulations are frequently proposed in Congress, in the New York State legislature, and before state and federal bank regulatory agencies. The likelihood and timing of any changes and the impact such changes might have on the Company are impossible to determine with any certainty. A change in applicable laws or regulations, or a change in the way such laws or regulations are interpreted by regulatory agencies or courts, may have a material impact on the business, operations and earnings of the Company, the nature and effect of which cannot be predicted.

Supervisory Actions. The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can prompt certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators involving factors such as the risk weights assigned to assets and what items may be counted as capital. Regulators also have broad discretion to require any institution to maintain higher capital levels than otherwise required by statute or regulation, even institutions that are considered "well-capitalized" under applicable regulations.

Bank Holding Company Regulation. The Federal Reserve is authorized to make regular examinations of the Company and its nonbank subsidiaries. Under federal law and Federal Reserve regulations, the activities in which the Company and its nonbank subsidiaries may engage are limited. The Company may not acquire direct or indirect ownership or control of more than 5% of the voting shares of any company, including a bank, without the prior approval of the Federal Reserve, except as specifically authorized under federal law and Federal Reserve regulations. The Company, subject to the approval of the Federal Reserve, may acquire more than 5% of the voting shares of non-banking corporations if those corporations engage in activities which the Federal Reserve deems to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. These limitations also apply to activities in which the Company engages directly rather than through a subsidiary.

The Federal Reserve has enforcement powers over the Company and its non-bank subsidiaries. This allows the Federal Reserve, among other things, to stop activities that represent unsafe or unsound practices or constitute violations of law, rules, regulations, administrative orders or written agreements with a federal bank regulator. These powers may be exercised through the issuance of cease-and-desist orders, the imposition of civil money penalties or other actions.

Federal Reserve Capital Requirements. The Federal Reserve requires that the Company, as a bank holding company, must maintain certain minimum ratios of capital to assets. The Federal Reserve's regulations divide capital into two categories. Primary capital includes common equity, surplus, undivided profits, perpetual preferred stock, mandatory convertible instruments, the allowance for loan and lease losses, contingency and other capital reserves, and minority interests in equity accounts of consolidated subsidiaries. Secondary capital includes limited-life preferred stock, subordinated notes and debentures and certain unsecured long term debt.

The Federal Reserve requires that bank holding companies maintain a minimum ratio of primary capital to total assets of 5.5% and a minimum level of total capital (primary plus secondary capital) equal to 6% of total assets. In calculating capital ratios, the allowance for loan losses, which is a component of primary capital, is added back in determining total assets. Certain capital components, such as debt and perpetual preferred stock, are includable as capital only if they satisfy certain definitional tests.

The Company must also meet a risk-based capital standard. Capital, for the risk-based capital requirement, is divided into Tier I capital and Supplementary capital, determined as discussed below in connection with the FDIC capital requirements imposed on the Bank. The Federal Reserve requires that the Bank maintain a ratio of total capital (defined as Tier I plus Supplementary capital) to risk-weighted assets of at least 8%, of which at least 4% must be Tier I capital. Risk weighted assets are also determined in a manner comparable to the determination of risk-weighted assets under FDIC regulations as discussed below.

At December 31, 2009 and 2008, the Company met the definition of a "well capitalized" bank holding company.

Inter-state Banking. Bank holding companies may generally acquire banks in any state. Federal law also permits a bank to merge with an out-of-state bank and convert any offices into branches of the resulting bank if both states have not opted out of interstate branching; permits a bank to acquire branches from an out-of-state bank if the law of the state where the branches are located permits the interstate branch acquisition; and permits banks to establish and operate new interstate branches whenever the host state opts-in to that authority. Bank holding companies and banks that want to engage in such activities must be adequately capitalized and managed.

The New York Banking Law generally authorizes interstate branching in New York as a result of a merger, purchase of assets or similar transaction. An out of state bank may not first enter New York by opening a new branch in New York,
but once a branch is acquired as described in the preceding sentence, additional new branches may be opened state wide.

Regulation of the Bank. In general, the powers of the Bank are limited to the express powers described in the New York Banking Law and powers incidental to the exercise of those express powers. The Bank is generally authorized to accept deposits and make loans on terms and conditions determined to be acceptable to the Bank. Loans may be unsecured, secured by real estate, or secured by personal property. The Bank may also invest assets in bonds, notes or other debt securities which are not in default and certain limited classes of equity securities including certain publicly traded equity securities in an amount aggregating not more than 2% of assets or 20% of capital. The Bank may also engage in a variety of other traditional activities for commercial banks, such as the issuance of letters of credit.

The exercise of these state-authorized powers is limited by FDIC regulations and other federal laws and regulations. In particular, FDIC regulations limit the investment activities of state-chartered, FDIC-insured banks such as the Bank.

Under FDIC regulations, the Bank generally may not directly or indirectly acquire or retain any equity investment that is not permissible for a national bank. In addition, the Bank may not directly or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the applicable FDIC insurance fund and the Bank is in compliance with applicable regulatory capital requirements. FDIC regulations permit real estate investments under certain circumstances. The Bank does not engage in real estate investing activity.

In May 2009, in connection with the Bank's examination by the Federal Deposit Insurance Corporation (the "FDIC") the Bank received a Joint Memorandum of Understanding (the "MOU") from the FDIC and the New York State Banking Department (the "NYSBD"), which the Bank executed. The MOU sets forth an informal understanding among the Bank, the FDIC and the NYSBD addressing asset quality, loan review, underwriting and administration and certain other concerns identified in the examination. The Bank's board has appointed a committee comprised of three directors to monitor the Bank's compliance. We do not believe that compliance with the MOU will have a material adverse effect on our results of operations or financial condition. As set forth in "Management's Discussion and Analysis of Financial Condition And Results of Operations - Capital Adequacy" and Note O to the Company's consolidated financial statements, the Bank is well capitalized for regulatory purposes as of December 31, 2009.

Loans to One Borrower. With certain exceptions, the Bank may not make loans or other extensions of credit to a single borrower, or certain related groups of borrowers, in an aggregate amount in excess of 15% of the Bank's net worth, plus an additional 10% of the Bank's net worth if such amount is secured by certain types of readily marketable collateral. In addition, the Bank is not permitted to make a mortgage loan in excess of 15% of capital stock, surplus fund and undivided profits.

FDIC Capital Requirements. The FDIC requires that the Bank maintain certain minimum ratios of capital to assets. The FDIC's regulations divide capital into two tiers. The first tier ("Tier I") includes common equity, retained earnings, certain non-cumulative perpetual preferred stock (excluding auction rate issues) and minority interests in equity accounts of consolidated subsidiaries, minus goodwill and other intangible assets (except mortgage servicing rights and purchased credit card relationships subject to certain limitations). Supplementary ("Tier II") capital includes, among other items, cumulative perpetual and long-term limited-life preferred stock, mandatorily convertible securities, certain hybrid capital instruments, term subordinated debt and the allowance for loan losses, subject to certain limitations, less required deductions.

The FDIC requires that the highest rated banks maintain a Tier I leverage ratio (Tier I capital to adjusted total assets) of at least 3.0%. All other banks subject to FDIC capital requirements must maintain a Tier I leverage ratio of 4.0% to 5.0% or more. As of December 31, 2009 and 2008, the Bank's Tier I leverage capital ratio was 9.4% and 8.9%, respectively.

The Bank must also meet a risk-based capital standard. The risk-based standard requires the Bank to maintain total capital (defined as Tier I and Tier II capital) to risk-weighted assets of at least 8%, of which at least 4% must be Tier I capital. In determining the amount of risk-weighted assets, all assets, plus certain off-balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset. As of December 31, 2009 and 2008, the Bank maintained a 15.6% and 12.2% Tier I risk-based capital ratio and a 16.9% and 13.4% total risk-based capital ratio, respectively.

In addition to the foregoing regulatory capital requirements, the FDIC Improvements Act of 1991 created a "prompt corrective action" framework, under which decreases in a depository institution's capital category trigger various supervisory actions. Pursuant to implementing regulations adopted by the FDIC, for purposes of the prompt corrective action provisions, a state-chartered, nonmember bank, such as the Bank, is deemed to be well capitalized if it has: a total risk-based capital ratio of 10% or greater; a Tier I risk-based capital ratio of 6% or greater; and a leverage ratio of 5% or greater. As of December 31, 2009 and 2008, the Bank met the definition of a "well capitalized" financial institution.

Community Reinvestment Act. The Bank must, under federal law, meet the credit needs of its community, including low and moderate income segments of its community. The FDIC is required, in connection with its examination of the Bank, to assess whether the Bank has satisfied this requirement. Failure to satisfy this requirement could adversely affect certain applications which the Bank may make, such as branch applications, merger applications, and applications for permission to purchase branches. In the case of Berkshire, the Federal Reserve will assess the record of each subsidiary bank in considering certain applications by Berkshire. The New York Banking Law contains similar provisions applicable to the Bank. As of the most recent Community Reinvestment Act examinations by the FDIC and the New York State Banking Department, the Bank received "satisfactory" ratings.

Dividends From the Bank to the Company. One source of funds for Berkshire to pay dividends to its stockholders is dividends from the Bank to Berkshire. Under the New York Banking Law, the Bank may pay dividends to Berkshire, without regulatory approval, equal to its net profits for the year in which the payment is made, plus retained net profits for the two previous years, subject to certain limits not generally relevant. The Bank's retained net profits in fiscal 2009 was $7.64 million. The Bank's aggregate retained net loss for the 2007 and 2008 fiscal years totaled approximately $74.55 million. Therefore, the Bank may not pay dividends to Berkshire without obtaining regulatory approval.

Under federal law, the Bank may not make any capital distribution to Berkshire, including any dividend or repurchase of the Bank's stock, if, after making such distribution, the Bank fails to meet the required minimum capital ratio requirements discussed above. The FDIC may prohibit the Bank from paying dividends if, in its opinion, the payment of dividends would constitute an unsafe or unsound practice.

Transactions With Related Parties. The Company, its direct non-banking subsidiaries and other companies controlled by stockholders who control the Company are affiliates, within the meaning of the Federal Reserve Act, of the Bank and its subsidiaries. The Bank's authority to engage in transactions with its "affiliates" is limited by Sections 23A and 23B of the Federal Reserve Act. Section 23A limits the aggregate amount of transactions with any individual affiliate to 10% of the capital and surplus of the Bank and also limits the aggregate amount of transactions with all affiliates to 20% of the Bank's capital and surplus. Extensions of credit to affiliates must be secured by certain specified collateral, and the purchase of low quality assets from affiliates is generally prohibited. Section 23B provides that certain transactions with affiliates, including loans and asset purchases, must be on terms and under circumstances, including credit standards, that are at least as favorable to the Bank as those prevailing at the time for comparable transactions with non-affiliated companies. In the absence of comparable transactions, such transactions may only occur under terms and circumstances, including credit standards, that in good faith would be offered to or would apply to non-affiliated companies.

In accordance with banking regulations, the Bank may make loans to its and the Company's directors, executive officers, and 10% stockholders, as well as to entities controlled by them, subject to specific federal and state limits. Among other things, these loans must (a) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features and (b) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by the Bank's Board of Directors. However, the Bank may make loans to executive officers, directors and principal stockholders on preferential terms, provided the extension of credit is made pursuant to a benefit or compensation program of the Bank that is widely available to employees of the Bank or its affiliates and does not give preference to any insider over other employees of the Bank or affiliates. The Bank has no such benefit or compensation programs.

Enforcement. The FDIC and the Banking Department have enforcement authority over the Bank. The Superintendent of the Banking Department (the "Superintendent") may order the Bank to appear and explain an apparent violation of law, to discontinue unauthorized or unsafe practices and to keep prescribed books and accounts. If any director or officer of the Bank has violated any law, or has continued unauthorized or unsafe practices in conducting the business of the Bank after having been notified by the Superintendent to discontinue such practices, the New York Banking Board may remove the individual from office after notice and an opportunity to be heard. The Superintendent also may take over control of the Bank under specified statutory criteria.

The FDIC's enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease and desist orders and to remove directors and officers. As indicated above, the FDIC is required to take prompt action to correct deficiencies in banks which do not satisfy specified FDIC capital ratio requirements. Dividends, other capital distributions or the payment of management fees to any controlling person are prohibited if, following such distribution or payment, a bank would be undercapitalized. An undercapitalized bank must file a plan to restore its capital within 45 days after being notified that it is undercapitalized. Undercapitalized, significantly undercapitalized and critically undercapitalized institutions are subject to increasing prohibitions on permitted activities, and increasing levels of regulatory supervision, based upon the severity of their capital problems. The FDIC is required to monitor closely the condition of an undercapitalized bank. Enforcement action taken by the FDIC can escalate to the appointment of a conservator or receiver of a critically undercapitalized bank.

Insurance of Accounts. Deposit insurance premiums payable to the FDIC are based upon the perceived risk of the institution to the FDIC insurance fund. The FDIC assigns an institution to one of three capital categories: (a) well capitalized, (b) adequately capitalized or (c) undercapitalized. The FDIC also assigns an institution to one of three supervisory categories based on an evaluation by the institution's primary federal regulator and information that the FDIC considers relevant to the institution's financial condition and the risk posed to the deposit insurance funds. At present, the Bank pays no deposit insurance premium based upon its risk-based categorization.

The FDIC has raised insurance premiums to cover substantial losses incurred by the Deposit Insurance Fund ("DIF") due to recent bank failures of 2009 and 2008. As a result, we expect deposit insurance premiums may be higher for the foreseeable future than they have been in the recent past. The Bank's FDIC assessments increased by 79% to $1.93 million in fiscal 2009 from $1.08 million in fiscal 2008. The increased assessment is a result of the FDIC's anticipation of greater demands on the Bank Insurance Fund in the future in response to the current unrest in the banking industry. In June 2009, the Bank paid a special assessment charged by the FDIC in the amount of $453,000.

In November 2009, the FDIC adopted a final rule imposing a 13 quarter prepayment of FDIC premiums. The Bank's prepayment amount totaled $5.59 million and was paid in December 2009. This was an estimated prepayment for the fourth quarter of 2009 through the fourth quarter of 2012. The prepayment amount will be used to offset future FDIC insurance premiums beginning in March 2010.

Reserve Requirements. The Bank must maintain non-interest-earning reserves against its transaction accounts (primarily NOW and regular checking accounts). The Bank is generally able to satisfy reserve requirements with cash on hand and other non-interest bearing deposits which it maintains for other purposes, so the reserve requirements do not impose a material financial burden on the Bank.

Governmental Policies. Our earnings are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve. Among the instruments of monetary policy used by the Federal Reserve to implement these objectives are open-market operations in U.S. Government securities and Federal funds, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve frequently uses these instruments of monetary policy, especially its open-market operations and the discount rate, to influence the level of interest rates and to affect the strength of the economy, the level of inflation or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on our business and earnings.

Personal Holding Company Status. For the fiscal years ended December 31, 2009, 2008 and 2007, the Company has been deemed to be a Personal Holding Company (a "PHC"), as defined in the Internal Revenue Code. As a PHC, we may be required to pay an additional income tax or issue a dividend to our stockholders in an amount based upon the PHC Internal Revenue Code formulas, which is primarily based upon net income. No such dividend was required to be paid in fiscal 2009, 2008 and 2007. (See Dividends in Item 5).

Employees. On March 31, 2010, the Company had one full time employee and the Bank employed 112 full time and 4 part time employees. The Bank's employees are not represented by a collective bargaining unit, and the Bank considers its relationship with its employees to be good.

ITEM 1A. Risk Factors.

Our business faces significant risks. These risks include those described below and may include additional risks and uncertainties not presently known to us or that we currently deem immaterial. Our business, financial condition and results of operations could be materially adversely affected by any of these risks, and the trading price of our common stock could decline.

Our future success depends on our ability to compete effectively in a highly competitive market and geographic area.

Our ability to return to and maintain profitability may depend in part on our ability to expand our scope of available financial services as needed to meet the needs and demands of our customers. Our business model focuses on using superior customer service to provide traditional banking services to a growing customer base. However, we face substantial competition in all phases of our operations from a variety of different competitors. We encounter competition from other commercial banks, savings and loan associations, mutual savings banks, credit unions and other financial institutions. Our competitors, including credit unions, consumer finance companies, factors, insurance companies and money market mutual funds, compete with lending and deposit-gathering services offered by us. In addition, our competitors now include securities dealers, brokers, mortgage bankers, investment advisors and finance and insurance companies who seek to offer one-stop financial services to their customers that may include services that we have not been able or allowed to offer to our customers in the past. This increasingly competitive environment is primarily a result of changes in regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial services providers. There is very strong competition for financial services in the New York state areas in which we currently conduct our business. This geographic area includes offices of many of the largest financial institutions in the world. Many of those competing institutions have much greater financial and marketing resources than we have. Due to their size, many competitors can achieve larger economies of scale and as a result may offer a broader range of products and services than we do. If we are unable to offer competitive products and services, our earnings may be negatively affected. Some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on bank holding companies like ourselves and on federally insured financial institutions like our banking subsidiary, The Berkshire Bank. As a result, these nonbank competitors have certain advantages over us in accessing funding and in providing various services. The banking business in our current primary market area is very competitive, and the level of competition we face may increase further, which may limit our asset growth and profitability.

Economic conditions either nationally or locally in areas in which our operations are concentrated may be less favorable than expected.

Deterioration in local, regional, national or global economic conditions could result in, among other things, an increase in loan delinquencies, a decrease in property values, a change in housing turnover rate or a reduction in the level of bank deposits. Particularly, a weakening of the real estate or employment market in our primary market areas could result in an increase in the number of borrowers who default on their loans and a reduction in the value of the collateral securing their loans, which in turn could have an adverse effect on our profitability. Substantially all of our real estate loans are collateralized by properties located in these market areas, and substantially all of our loans are made to borrowers who live in and conduct business in these market areas. Any material economic deterioration in these market areas could
have an adverse impact on our profitability.

Much of the Bank's lending is in New York City and upstate New York. As a result of this geographic concentration, a significant broad-based deterioration in economic conditions in the New York City metropolitan area and upstate New York could have a material adverse impact on the quality of the Bank's loan portfolio, and accordingly, our results of operations. Such a decline in economic conditions could restrict borrowers' ability to pay outstanding principal and interest on loans when due, and, consequently, adversely affect the cash flows of our business.

The Bank's loan portfolio is largely secured by real estate collateral. Conditions in real estate markets in which the collateral for the Bank's loans are located strongly influence the level of the Bank's non-performing loans and results of operations. A decline in the New York City metropolitan area and upstate New York real estate markets, as well as other external factors, could adversely affect the Bank's loan portfolio.

Recent negative developments in the financial services industry and U.S. and global credit markets may adversely impact our operations and results.

Negative developments in the capital markets during the latter half of 2007, throughout 2008 and 2009, and during 2010 to date have resulted in uncertainty in the financial markets in general with the expectation of the general economic downturn continuing for the remainder of 2010 and possibly beyond. Loan portfolio performances have deteriorated at many institutions, including the Bank, resulting from, among other factors, a weak economy and a decline in the value of the collateral supporting their loans. The competition for our deposits has increased significantly due to liquidity concerns at many of these same institutions. Stock prices of bank holding companies like ours have been negatively affected by the current condition of the financial markets, as has our ability, if needed, to raise capital or borrow in the debt markets compared to recent years. As a result, there is a potential for new federal or state laws and regulations regarding lending and funding practices and liquidity standards, and financial institution regulatory agencies are expected to be very aggressive in responding to concerns and trends identified in examinations. Negative developments in the financial services industry and the impact of new legislation in response to those developments could negatively impact our operations by restricting our business operations, including our ability to originate or sell loans, and adversely impact our financial performance.

Changes in interest rates could reduce our income and cash flows.

Our income and cash flow and the value of our assets and liabilities depend to a great extent on the difference between the interest rates earned on interest-earning assets such as loans and investment securities, and the interest rates paid on interest-bearing liabilities such as deposits and borrowings. These rates are highly sensitive to many factors which are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies, in particular, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the returns on our portfolio of investment securities and the amounts paid on deposits. If the rate of interest we pay on deposits and other borrowings increases more than the rate of interest we earn on loans and other investments, our net interest income, and therefore our earnings, could be adversely affected. In addition, there is a risk that certain deposits would not be renewed. Our earnings could also be adversely affected if the rates on our loans and other investments fall more quickly than those on our deposits and other borrowings. During 2009, interest rates continued at historic lows, a situation which has negatively affected and continues to negatively affect the yield we achieve on interest-earning assets.

Due to the recent downturn in the market, certain of the marketable securities we own may take longer to auction than initially anticipated, if at all.

Our portfolio of investment securities includes auction rate securities. From the first quarter of 2008 to the present, our balance of auction rate securities failed to auction due to sell orders exceeding buy orders. Unless we hold these securities to maturity, these funds will not be available to us until a successful auction occurs or a buyer is found outside the auction process. During 2009, we recorded approximately $2.0 million in OTTI charges related to Freddie Mac auction rate securities. In fiscal 2008 approximately $101 million of auction rate securities, at cost, were written down to approximately $63 million, based on our analysis, as an unrealized temporary decrease in fair value, which is reflected as a component of accumulated other comprehensive loss in the stockholders' equity section of our consolidated balance sheet. This is in addition to the other than temporary impairment charge recognized on auction rate securities which have preferred shares of the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") as the underlying collateral, as described elsewhere in this Report. Further discussion of the auction rate securities may also be found elsewhere in this Report under "Investment Activities."

Declines in value may adversely impact the investment portfolio.

As of December 31, 2009, we had approximately $357.5 million and $340,000 in available for sale and held to maturity investment securities, respectively. We may be required to record other-than-temporary impairment ("OTTI") charges on our investment securities if they suffer a decline in value that is related to the credit quality of the issue. Numerous factors, including lack of liquidity for re-sales of certain investment securities, absence of reliable pricing information for investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment, could have a negative effect on our investment portfolio in future periods. In 2009 and 2008, impairment charges on investment securities were $17.4 million and $94.3 million, respectively. There can be no assurances that further impairment charges will not have to be recognized. In addition, as noted in Part II Item 9A(T) - Controls and Procedures, we identified a material weakness related to our method of identification and valuation of securities for other than temporary impairment and related tax accounting. Management has revised the relevant controls and procedures with respect to these matters which, if not properly corrected, could have a negative effect on our investment portfolio in future periods.

We operate in a highly regulated environment; changes in laws and regulations and accounting principles may adversely affect us.

We are subject to extensive state and federal regulation, supervision, and legislation which govern almost all aspects of our operations. These laws may change from time to time and are primarily intended for the protection of customers, depositors, and the deposit insurance funds. The impact of any changes to these laws may negatively impact our ability to expand our services and to increase the value of our business. Regulatory authorities have extensive discretion in the exercise of their supervisory and enforcement powers. They may, among other things, impose restrictions on the operation of a banking institution, the classification of assets by such institution and such institution's allowance for loan losses. Regulatory and law enforcement authorities also have wide discretion and extensive enforcement powers under various consumer protection, civil rights and other laws, including the Gramm-Leach-Blilely Act, the Bank Secrecy Act, the Truth-in-Lending Act, the Equal Credit Opportunity Act, the Fair Housing Act and the Real Estate Settlement Procedures Act. These laws also permit private individual and class action lawsuits and provide for the recovery of attorneys fees in certain instances. Any changes to these laws or any applicable accounting principles may negatively impact our results of operations and financial condition. We are currently analyzing the Restoring American Financial Stability Act, passed by the United States Senate on May 10, 2010, and the effects such act would have on the Company's operations and financial condition if it were to become law. While we cannot predict what effect any presently contemplated or future changes in the laws or regulations or their interpretations would have, these changes could be materially adverse to our investors and stockholders.

In May 2009, in connection with the Bank's examination by the Federal Deposit Insurance Corporation (the "FDIC") the Bank received a Joint Memorandum of Understanding (the "MOU") from the FDIC and the New York State Banking Department (the "NYSBD"), which the Bank executed. The MOU sets forth an informal understanding among the Bank, the FDIC and the NYSBD addressing asset quality, loan review, underwriting and administration and certain other concerns identified in the examination. The Bank's board has appointed a committee comprised of three directors to monitor the Bank's compliance. We do not believe that compliance with the MOU will have a material adverse effect on our results of operations or financial condition. As set forth in "Management's Discussion and Analysis of Financial Condition And Results of Operations - Capital Adequacy" and Note O to the Company's consolidated financial statements, the Bank is well capitalized for regulatory purposes as of December 31, 2009.

We are required to maintain an allowance for loan losses. These reserves are based on management's judgment and may have to be adjusted in the future. Any adjustment to the allowance for loan losses, whether due to regulatory changes, economic conditions or other factors, may affect our financial condition and earnings.

We maintain an allowance for loan losses at a level believed adequate by management to absorb losses specifically identifiable and inherent in the loan portfolio. In conjunction with an internal loan review function that operates independently of the lending function, management monitors the loan portfolio to identify risks on a timely basis so that an appropriate allowance can be maintained. Based on an evaluation of the loan portfolio, management presents a periodic review of the loan loss reserve to the board of directors of the Bank, indicating any changes in the reserve since the last review and any recommendations as to adjustments in the reserve. In making its evaluation, in addition to the factors discussed below, management considers the results of recent regulatory examinations, which typically include a review of the allowance for loan losses as an integral part of the examination process.

In establishing the allowance, management evaluates individual large classified loans and nonaccrual loans, and determines an aggregate reserve for those loans based on that review. An allowance for the remainder of the loan portfolio is also determined based on historical loss experience within the components of the portfolio. These allocations may be modified if current conditions indicate that loan losses may differ from historical experience, based on economic factors and changes in portfolio mix and volume.

In addition, a portion of the allowance is established for losses inherent in the loan portfolio which have not been identified by the more quantitative processes described above. This determination inherently involves a higher degree of subjectivity, and considers risk factors that may not have yet manifested themselves in historical loss experience. Those factors include changes in levels and trends of charge-offs, delinquencies, and nonaccrual loans, trends in volume and terms of loans, changes in underwriting standards and practices, portfolio mix, tenure of loan officers and management, entrance into new geographic markets, changes in credit concentrations, and national and local economic trends and conditions. While the allowance for loan losses is maintained at a level believed to be adequate by management for estimated losses in the loan portfolio, determination of the allowance is inherently subjective, as it requires estimates, all of which may be susceptible to significant change. Changes in these estimates may impact the provisions charged to expense in future periods. Federal and state regulatory authorities, as an integral part of their examination process, review our loans and allowance for loan losses. We cannot
assure you that we will not increase the allowance for loan losses or the regulators will not require us to increase this allowance. Either of these occurrences could negatively impact Berkshire Bancorp's results of operations.

We may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial service industry, including the Federal Home Loan Bank of New York (the "FHLBNY"), commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose us to credit risk in the event of a default by a counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount due to us. Any such losses could have a material adverse effect on our financial condition and results of operations.

It may be difficult for a third party to acquire us and this could depress our common stock price.

Under our amended and restated certificate of incorporation, we have authorized 2,000,000 shares of preferred stock, of which 60,000 shares have been designated as Series A Preferred Stock, and of which the remaining 1,940,000 shares may be issued by the board of directors with terms, rights, preferences and designations as the board of directors may determine and without any vote of the stockholders, unless otherwise required by law. Issuing the preferred stock, depending upon the rights, preferences and designations set by the board of directors, may delay, deter, or prevent a change in control of the Company.

In addition, federal and state banking laws may restrict the ability of the stockholders to approve a merger or business combination or obtain control of the Company. This may tend to make it more difficult for stockholders to replace existing management or may prevent stockholders from receiving a premium for their shares of our common stock.

Issuance of Common Stock Upon Conversion of Series A Preferred Stock and Other Factors Could Depress our Common Stock Price.

At December 31, 2009, there are 60,000 shares of preferred stock outstanding which have been issued to the Company's majority stockholder and two unaffiliated entities. The preferred stock may be redeemed by the Company between April 30, 2009 and November 1, 2010 at $1,100 per share. Each preferred share is mandatorily convertible into 123.153 shares of common stock on October 31, 2011 unless previously redeemed. The availability of additional shares for sale in the market could depress our common stock price.

In addition, we have authorized 25,000,000 shares of common stock of which approximately 7,000,000 shares are issued and outstanding. The price of our common stock may be volatile at times since our common stock is thinly traded and one individual owns or controls more than 50% of our outstanding shares. It may be difficult for a stockholder to sell a significant number of shares at a time and at a price of their choosing or for a third party to purchase sufficient shares on the open market to cause a change in control of the Company, all of which could depress the price of the Company's common stock.

Our stock is not insured by any governmental agency and, therefore, investment in them involves risk.

Our securities are not deposit accounts or other obligation of any bank, and are not insured by the FDIC, or any other governmental agency, and are subject to investment risk, including the possible loss of principal.

Our Series A Preferred Shares impact net income available to our common stockholders and our earnings per share.

As long as there are Series A Preferred Shares outstanding, no dividends may be paid on our Common Stock unless all dividends on the Series A Preferred Shares have been paid in full. The dividends declared on our fixed rate Series A Preferred Shares will reduce the net income available to holders of our Common Stock and our earnings per share of Common Stock. The Series A Preferred Shares will also receive preferential treatment in the event of liquidation, dissolution or winding up of the Company.

Moreover, holders of our Common Stock are entitled to receive dividends only when, as and if declared by our board of directors. We have temporarily ceased paying a dividend on our Common Stock. The absence of cash dividends on our Common Stock could adversely affect the market price.

The Financial Sector Is Experiencing An Economic Downturn. An Increase In The Number of Non-performing Loans Will Have An Adverse Effect On Our Operations.

Virtually all of our real estate loans are secured by real estate in New York. At December 31, 2009, loans secured by real estate, including home equity loans and lines of credit, represented 88% of our total loans. Both nationally and in the State of New York, we are experiencing an economic downturn that is having a significant impact on the prices of real estate and related assets. The residential and commercial real estate sectors have been adversely affected by weakening economic conditions and may negatively impact our loan portfolio. While we believe that our total non-performing loans as a percentage of total assets are relatively low by industry standards, if loans that are currently performing become non-performing, we may need to increase our allowance for loan losses, which would have an adverse impact on our financial condition and results of operations. We added approximately $9.30 million and $4.90 million to the allowance for loan losses during the fiscal years ended December 31, 2009 and 2008, respectively.

Our FDIC Premium Could Be Substantially Higher In The Future, Which Would Have An Adverse Effect On Our Future Earnings.

Our FDIC insurance assessment was $1.93 million for 2009 compared to $1.08 million for 2008. See "Insurance of Accounts."

ITEM 1B. Unresolved Staff Comments.

Not Applicable

ITEM 2. Properties.

The following are Berkshire's and the Bank's principal facilities as of March 31, 2010:

Location	Operations	Approximate Floor Area (Sq. Ft.)	Approximate Annual Lease Rent		Expiration
New York, NY	Executive Offices	1,500	$	18,000	(1)(3)
New York, NY	Main Bank Office and Bank Branch	9,729	Owned		March 2013
Brooklyn, NY	Bank Branch	4,500	$	229,029	March 2013
Brooklyn, NY	Bank Branch	2,866	$	83,898	March 2013
Brooklyn, NY	Bank Branch	2,592	$	118,245	December 2012
Brooklyn, NY	Bank Branch	1,640	$	79,433	June 2015

New York, NY	Bank Branch	9,924	$	353,315	June 2010 (2)(3)
New York, NY	Bank Branch	3,300	$	63,263	November 2016 (2)(3)
Goshen, NY	Bank Branch	10,680	Owned		
Harriman, NY	Bank Branch	1,623	Owned		
Bloomingburg, NY	Bank Branch	1,530	$	22,806	August 2010
Ridgefield, NJ	Bank Branch	6,120	Owned		
Teaneck, NJ	Bank Branch	2,200	$	44,000	June 2014

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(1) Rented on a month to month basis from a company affiliated with Mr. Moses Marx, a director of the Company.
(2) Leased from a company affiliated with Mr. Marx, a director of the Company.
(3) Management believes the annual rent paid is comparable to the annual rent that would be paid to non-affiliated parties in a similar commercial transaction for similar commercial space.

ITEM 3. Legal Proceedings.

In the ordinary course of operations, the Bank is a party to routine litigation involving claims incidental to its banking business. Management believes that no current litigation, threatened or pending, to which we or our assets are a party, poses a substantial likelihood of potential loss or exposure which would have a material adverse effect on the financial condition or results of our operations.

ITEM 4. (Reserved)

PART II

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

The Company's Common Stock trades on the Nasdaq Global Market under the symbol BERK. The following table sets forth, for the periods indicated, the high and low sales prices for the Company's Common Stock as reported by NASDAQ.

Fiscal Year Ended December 31, 2008	High	Low
January 1, 2008 to March 31, 2008	$ 16.94	$ 13.52
April 1, 2008 to June 30, 2008	15.98	12.05
July 1, 2008 to September 30, 2008	14.71	4.71
October 1, 2008 to December 31, 2008	8.99	4.16

Fiscal Year Ended December 31, 2009	High	Low
January 1, 2009 to March 31, 2009	$ 5.00	$ 3.30
April 1, 2009 to June 30, 2009	6.00	4.00
July 1, 2009 to September 30, 2009	8.98	4.86
October 1, 2009 to December 31, 2009	7.78	5.23

As of the close of business on June 4, 2010, there were 902 holders of record of the Company's Common Stock.

Dividends

For the fiscal years ended December 31, 2009, 2008 and 2007, the Company has been deemed to be a PHC, as defined in the Internal Revenue Code. As a PHC, we may be required to pay an additional income tax or issue a dividend to our stockholders in an amount based upon applicable Internal Revenue Code formulas, which is primarily based upon net income. No such dividend was required to be paid in fiscal 2009, 2008 or 2007.

On March 23, 1999, the Board of Directors adopted a policy of paying regular cash dividends in respect of the Common Stock of the Company, payable in equal semi-annual installments. Pursuant to said policy, the Board of Directors declared and the Company paid cash dividends on its Common Stock as follows:

Declaration Date	Record Date	Payment Date	Per Share Amount
April 2, 2007	April 18, 2007	April 26, 2007	$ .09
October 3, 2007	October 18, 2007	October 25, 2007	$ .09
April 2, 2008	April 18, 2008	April 28, 2008	$ .10
October 8, 2008	October 23, 2008	October 30, 2008	$ .10

On March 31, 2009, the Company announced that it would temporarily suspend its previously announced Common Stock dividend policy and not declare or pay a semi-annual dividend in April 2009. Subsequently, the Board of Directors deemed it appropriate to continue the suspension and did not declare or pay a cash dividend in October 2009.

The declaration, payment and amount of such dividends in the future are within the discretion of the Board of Directors and will depend upon our earnings, capital requirements, financial condition and other relevant factors. So long as any Series A Preferred Shares remain outstanding, unless the full dividends for the most recent dividend payment date have been paid or declared, no dividends may be paid or declared on the Company's Common Stock.

On May 15, 2003, The Company's Board of Directors authorized the purchase of up to 450,000 shares of its Common Stock in the open market, from time to time, depending upon prevailing market conditions, thereby increasing the maximum number of shares which may be purchased by the Company from 1,950,000 shares of Common Stock to 2,400,000 shares of Common Stock. From 1990 through December 31, 2006, the Company has purchased a total of 1,898,909 shares of its Common Stock. During fiscal years 2007, 2008 and 2009 we did not purchase any shares, and at December 31, 2009 there were 501,091 shares of Common Stock which may yet be purchased under our stock repurchase plan.

Equity Compensation Plans

See Part III, Item 12 for information concerning the Company's equity compensation plans.

ITEM 6. Selected Financial Data

Not Applicable

ITEM 7. Managements' Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of Berkshire Bancorp Inc. and subsidiaries for the fiscal years ended December 31, 2009, 2008 and 2007. All references to earnings (loss) per share, unless stated otherwise, refer to loss per basic shares for the 2009 and 2008 fiscal years, and earnings per diluted shares for the 2007 fiscal year. The discussion should be read in conjunction with the consolidated financial statements and related notes (Notes located in Item 8 herein). Reference is also made to Part I, Item 1 "Business" herein.

Segments

Management has determined that the Company through its wholly owned bank subsidiary, the Bank, operates in one business segment, community banking. The Bank's principal business activity consists of gathering deposits from the general public and investing those deposits in residential and commercial mortgage loans and commercial non-mortgage loans, both unsecured and secured by personal property. In addition, the Bank invests those deposits in debt obligations issued by the U.S. Government, its agencies, business corporations and mortgage-backed securities.

Series A Preferred Shares

On October 31, 2008, the Company sold an aggregate of 60,000 Series A Preferred Shares at $1,000 per share, or $60 million in the aggregate, to the Company's Chairman of the Board and majority stockholder, and two non-affiliated investors. Each Series A Preferred Share bears non-cumulative cash dividends at the rate of 8% per annum, payable quarterly, is mandatorily convertible into 123.153 shares of our Common Stock on October 31, 2011, unless previously redeemed, and is redeemable at the option of the Company between April 30, 2009 and November 1, 2010 at a redemption price of $1,100. No Series A Preferred Shares have been redeemed to date. So long as any share of Series A Preferred Shares remains outstanding, unless the full dividends for the most recent dividend payment date have been paid or declared, no dividends may be paid or declared on the Company's Common Stock. (See Note A of Notes to Consolidated Financial Statements for further discussion of Series A Preferred Shares).

Critical Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America ("U.S. GAAP") and general practices within the financial services industry. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

The Company considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than any of its other significant accounting estimates. The allowance for loan losses is calculated with the objective of maintaining a reserve level believed by management to be sufficient to absorb estimated credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, loss given default, the amounts and timing of expected future cash flows on impaired loans, mortgages, and general amounts for historical loss experience. The process also considers economic conditions, uncertainties in estimating losses and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods. See further discussion of the allowance for loan losses in "Provision for Loan Losses."

In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350, "Intangibles-Goodwill and Other", the Company discontinued the amortization of goodwill resulting from acquisitions. Goodwill is subject to impairment testing at least annually to determine whether write-downs of the recorded balances are necessary. The Company tests for impairment based on the goodwill maintained at the Bank. A fair value is determined for each reporting unit based on at least one of three various market valuation methodologies. If the fair value of the reporting units exceed the book value, no write-down of recorded goodwill is necessary. If the fair value of the reporting unit is less, an expense may be required on the Company's books to write down the related goodwill to the carrying value. As of December 31, 2009, the goodwill was evaluated for impairment with no recognition of impairment considered necessary. The fair value of the reporting unit was substantially greater than the carrying value. However, there can be no guarantees that impairment will not be recognized in future periods.

The Company recognizes deferred tax assets and liabilities for the future tax effects of temporary differences, net operating loss carryforwards and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence that future realization is more likely than not. If management determines that the Company may be unable to realize all or part of net deferred tax assets in the future, a direct charge to income tax expense may be required to reduce the recorded value of the net deferred tax asset to the expected realizable amount.

The Company evaluates unrealized losses on securities to determine if any reduction in the fair value is other than temporary. This amount will continue to be dependent on market conditions, the occurrence of certain events or changes in circumstances of the issuer of the security, and the Company's intent and ability to hold impaired investments at the time the valuation is made. If management determines that an impairment in the investment's value is other than temporary, earnings would be charged.

The Company is required to disclose the estimated fair value of its assets and liabilities considered to be financial instruments. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments. The Company values those financial assets and financial liabilities in accordance with ASC Topic 820 "Fair Value Measurements and Disclosures." ASC Topic 820 defines fair value as 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, establishes a framework for measuring fair value, and expands disclosures about fair value measurement.

Financial assets and financial liabilities reported at fair value are required to be measured based on the following alternatives: (1) quoted prices in active markets for identical financial instruments (level 1), (2) significant other observable inputs (level 2), or (3) significant unobservable inputs (level 3). Judgement is required in selecting the appropriate level to be used to determine fair value. The majority of the investments classified as Available for Sale, were measured using level 2 inputs, which requires judgement to determine the fair value. The auction rate securities held in the investment portfolio, were measured using level 3 inputs due to the inactive market for these securities.

Discussion of Financial Condition and Results of Operations

Overview

Fiscal Year Ended December 31, 2009 Compared to Fiscal Year Ended December 31, 2008. Net loss allocated to common stockholders for the fiscal year ended December 31, 2009 was $7.0 million, or $1.00 per common share, compared to a net loss allocated to common stockholders of $79.9 million, or $11.45 per common share for the fiscal year ended December 31, 2008. Net loans decreased by approximately 8%. Investment securities increased by approximately 20% and total assets decreased by approximately 4%.

	As of and for the Fiscal Year Ended December 31,		
	2009	2008	% Inc/(Dec)
	(In millions, except per share data and percentages and bank branch information)		
Total Assets	$ 909.3	$ 943.7	(4)%
Loans, net	418.9	457.5	(8)%
Investment Securities	357.8	297.9	20%
Total Liabilities	824.0	877.8	(6)%
Deposits	713.4	726.1	(2)%
Borrowings	103.7	127.5	(19)%
Stockholders' Equity	85.2	66.0	29%
Total Income	46.1	60.3	(24)%
Interest Income	45.9	59.6	(23)%
Total Expense	61.6	146.0	(58)%
Interest Expense	17.1	30.5	(44)%
Net Interest Income	28.8	29.1	(1)%
Net (Loss)	(7.0)	(79.9)	(91)%
(Loss) Per Common Share	(1.00)	(11.45)	(91)%
Bank Branches	13	12	-

Fiscal Year Ended December 31, 2008 Compared to Fiscal Year Ended December 31, 2007. Net loss allocated to common stockholders for the fiscal year ended December 31, 2008 was $79.9 million, or $11.45 per common share, compared to net income of $5.4 million, or $.76 per diluted common share, for the fiscal year ended December 31, 2007. Net loans increased by approximately 6%. Investment securities and total assets decreased by approximately 50% and 16%, respectively.

	As of and for the Fiscal Year Ended December 31,		
	2008	2007	% Inc/(Dec)
	(In millions, except per share data and percentages and bank branch information)		
Total Income	60.3	60.2	0%
Interest Income	59.6	58.5	2%
Total Expense	146.0	52.5	178%
Interest Expense	30.5	37.8	(19)%
Net Interest Income	29.1	20.7	41%
Net Income (Loss)	(79.9)	5.4	(1,580)%
Diluted Income (Loss) Per Share	(11.45)	.76	(1,607)%
Bank Branches	12	12	-

The Company's average balances, interest, and average yields are set forth on the following table (in thousands, except percentages):

	Twelve Months Ended December 31, 2009			Twelve Months Ended December 31, 2008			Twelve Months Ended December 31, 2007		
	Average Balance	Interest and Dividends	Average Yield/Rate	Average Balance	Interest and Dividends	Average Yield/Rate	Average Balance	Interest and Dividends	Average Yield/Rate
INTEREST-EARNING ASSETS:									
Loans (1)	$ 448,394	$ 29,777	6.63%	$ 461,678	$ 32,754	7.09%	$ 389,520	$ 29,804	7.65%
Investment securities	312,966	15,506	4.95	464,927	25,456	5.48	558,742	27,178	4.86
Other (2)(5)	61,496	639	1.04	54,157	1,380	2.55	31,678	1,553	4.90
Total interest-earning assets	822,856	45,922	5.58	980,762	59,590	6.08	979,940	58,535	5.97
Noninterest-earning assets	58,828			55,244			46,070		
Total Assets	$ 881,684			$ 1,036,006			$ 1,026,010		
INTEREST-BEARING LIABILITIES:									
Interest bearing deposits	204,629	2,316	1.13	287,772	7,645	2.66	291,049	10,338	3.55
Time deposits	426,892	9,921	2.32	456,803	17,323	3.79	449,754	21,745	4.83
Other borrowings	115,869	4,866	4.20	127,343	5,555	4.36	103,112	5,710	5.54
Total interest-bearing liabilities	747,390	17,103	2.29	871,918	30,523	3.50	843,915	37,793	4.48
Demand deposits	56,544			54,452			50,647		
Noninterest-bearing liabilities	8,701			9,077			12,285		
Stockholders' equity (5)	69,049			100,559			119,163		
Total liabilities and stockholders' equity	$ 881,684			$ 1,036,006			$ 1,026,010		
Net interest income		$ 28,819			$ 29,067			$ 20,742	
Interest-rate spread (3)			3.29%			2.58%			1.49%
Net interest margin (4)			3.50%			2.96%			2.12%
Ratio of average interest-earning assets to average interest bearing liabilities	1.10			1.12			1.16		

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(1) Includes nonaccrual loans.
(2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.
(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.
(4) Net interest margin is net interest income as a percentage of average interest-earning assets.
(5) Average balances for Berkshire Bancorp Inc. (parent only) have been calculated on a monthly basis.

Changes in net interest income may also be analyzed by segregating the volume and rate components of interest income and interest expense. The following tables set forth certain information regarding changes in interest income and interest expense of the Company for the years indicated. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to (1) changes in rate (change in rate multiplied by prior volume), (2) changes in volume (changes in volume multiplied by prior rate) and (3) changes in rate-volume (change in rate multiplied by change in volume) (in thousands):

	Twelve Months Ended December 31, 2009 Versus Twelve Months Ended December 31, 2008 Increase (Decrease) Due To		
	Rate	Volume	Total
Interest-earning assets:			
Loans	$ (2,124)	$ (853)	$ (2,977)
Investment securities	(2,464)	(7,486)	(9,950)
Other	(818)	77	(741)
Total	(5,406)	(8,262)	(13,668)
Interest-bearing liabilities:			
Deposit accounts:			
Interest bearing deposits	(4,403)	(926)	(5,329)
Time deposits	(6,715)	(687)	(7,402)
Other borrowings	(204)	(485)	(689)
Total	(11,322)	(2,098)	(13,420)
Net interest income	$ 5,916	$ (6,164)	$ (248)

	Twelve Months Ended December 31, 2008 Versus Twelve Months Ended December 31, 2007 Increase (Decrease) Due To		
	Rate	Volume	Total
Interest-earning assets:			
Loans	$ (2,181)	$ 5,131	$ 2,950
Investment securities	3,464	(5,186)	(1,722)
Other	(744)	571	(173)
Total	539	516	1,055
Interest-bearing liabilities:			
Deposit accounts:			
Interest bearing deposits	(2,590)	(103)	(2,693)
Time deposits	(4,677)	255	(4,422)
Other borrowings	(1,217)	1,062	(155)
Total	(8,484)	1,214	(7,270)
Net interest income	$ 9,023	$ (698)	$ 8,325

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Provision for Loan Losses.

The allowance for loan losses is the estimated amount considered necessary to cover credit losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses that is charged against income. In determining the allowance for loan losses, management makes significant estimates which involve a high degree of judgment, subjectivity of the assumptions utilized, and potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

The allowance for loan losses has been determined in accordance with U.S. GAAP, principally FASB ASC 450, "Contingencies", ("ASC 450") and FASB ASC 310, "Receivables", ("ASC 310"). Under the above accounting principles, we are required to maintain an allowance for probable losses at the balance sheet date. We are responsible for the timely and periodic determination of the amount of the allowance required. Management believes that the allowance for loan losses is adequate to cover specifically identifiable losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

Management performs a monthly evaluation of the adequacy of the allowance for loan losses. The analysis of the allowance for loan losses has two components: specific and general allocations. Specific allocations are made for loans determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, as a practical expedient for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The Bank considers its investment in one-to-four family real estate loans and consumer loans to be smaller balance homogeneous loans and therefore excluded from separate identification for evaluation of impairment. These homogeneous loan groups are evaluated for impairment on a collective basis under FASB ASC 310.

The general allocation is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. Management also analyzes historical loss experience, delinquency trends, general economic conditions, geographic concentrations, and industry and peer comparisons. This analysis establishes factors that are applied to the loan segments to determine the amount of the general allocations. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses management has established which could have a material negative effect on the Company's financial results.

On a monthly basis, the Bank's management committee reviews the current status of various loan assets in order to evaluate the adequacy of the allowance for loan losses. In this evaluation process, specific loans are analyzed to determine their potential risk of loss. This process includes all loans, concentrating on non-accrual and classified loans. Each non-accrual or classified loan is evaluated for potential loss exposure. Any shortfall results in a recommendation of a specific allowance if the likelihood of loss is evaluated as probable. To determine the adequacy of collateral on a particular loan, an estimate of the fair market value of the collateral is based on the most current appraised value available. This appraised value is then reduced to reflect estimated liquidation expenses.

As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisal valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans. Based on the composition of our loan portfolio, management believes the primary risks are increases in interest rates, a decline in the economy, generally, and a decline in real estate market values in the New York metropolitan area. Any one or combination of these events may adversely affect our loan portfolio resulting in increased delinquencies, loan losses and future levels of loan loss provisions. Management believes the allowance for loan losses reflects the inherent credit risk in our portfolio, the level of our non-performing loans and our charge-off experience.

A loan is considered nonperforming when it becomes delinquent ninety days or when other adverse factors become known to us. We generally order updated appraisals from independent third party licensed appraisers at the time the loan is identified as nonperforming. Depending upon the property type, we receive appraisals within thirty to ninety days from the date the appraisals are ordered. Upon receipt of the appraisal, which is discounted by us to take account of estimated selling and other holding costs, we compare the adjusted appraisal amount to the carrying amount of the real estate dependent loan and record any impairment through the allowance for loan loss at that time.

As the majority of our real estate dependent loans are concentrated in the New York City metropolitan area, we do not make adjustments to the appraisals for this concentration. We do not increase the appraised value of any property. Any adjustments we make to the appraisals are to decrease the appraised value due to selling and other holding costs.

Although management believes that we have established and maintained the allowance for loan losses at adequate levels, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. Although management uses what it believes is the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change. In addition, the Federal Deposit Insurance Corporation, New York State Banking Department, and other regulatory bodies, as an integral part of their examination process, will periodically review our allowance for loan losses. Such agencies may require us to recognize adjustments to the allowance based on its judgments about information available to them at the time of their examination.

Results of Operations Fiscal Year Ended December 31, 2009 Compared to Fiscal Year Ended December 31, 2008.

Net Loss Allocated to Common Stockholders. Net loss allocated to common stockholders for the fiscal year ended December 31, 2009 was $7.0 million, or $1.00 per common share, as compared to a net loss of $79.9 million, or $11.45 per common share, for the fiscal year ended December 31, 2008. The net loss allocated to common stockholders in fiscal 2009 was primarily due to the other than temporary impairment ("OTTI") charges on securities of $17.4 million, or $2.47 per common share, and dividends on our Series A Preferred Stock of $4.8 million, or $.68 per common share, partially offset by the benefit for income taxes of $13.2 million, or, $1.87 per common share.

The net loss in fiscal 2008 was primarily due to the OTTI charges on securities of $94.3 million or $13.37 per common share. The OTTI charge was due to our investment, directly and indirectly through auction rate securities, in preferred shares of Fannie Mae and Freddie Mac. These government sponsored agencies were placed into conservatorship by the federal government in September 2008 resulting in, among other things, the suspension of dividend payments.

In January 2009, the Bank filed an arbitration proceeding with the Financial Industry Regulatory Authority against the issuing financial institution of the auction rate securities in our investment portfolio. The outcome of the arbitration process, postponed from a scheduled date in March 2010 and rescheduled for the fall of 2010 and the amount we may recover, if any, is uncertain at this time.

The Company's net income is largely dependent on interest rate levels, the demand for the Company's loan and deposit products and the strategies employed to manage the interest rate and other risks inherent in the banking business.

Interest Income. Total interest income for the fiscal year ended December 31, 2009 decreased by $13.7 million to $45.9 million from $59.6 million for the fiscal year ended December 31, 2008. The decrease in total interest income in fiscal 2009 was primarily due to the $157.9 million decrease in the average amounts of interest-earning assets to $822.9 million from $980.8 million during fiscal 2008 and the 50 basis point decrease in the average yields earned on such assets to 5.58% from 6.08% during fiscal years 2009 and 2008, respectively.

The following table presents the composition of interest income for the indicated periods:

	Fiscal 2009		Fiscal 2008	
	Interest Income	% of Total	Interest Income	% of Total
	(In thousands, except percentages)			
Loans	$ 29,777	64.84%	$ 32,754	54.96%
Investment Securities	15,506	33.77	25,456	42.72
Other	639	1.39	1,380	2.32
Total Interest Income	$ 45,922	100.00%	$ 59,590	100.00%

Loans, which are inherently risky and therefore command a higher return than our portfolio of investment securities and other interest-earning assets, increased to 54.49% of total average interest-earning assets during fiscal 2009 from 47.07% of total interest-earning assets during fiscal 2008. The average amounts of investment securities decreased to 38.03% of total average interest-earning assets during fiscal 2009 from 47.40% of total interest-earning assets during fiscal 2008. While we actively seek to originate new loans with qualified borrowers who meet the Bank's underwriting standards, our strategy has been to maintain those standards, sacrificing some current income to avoid possible large future losses in the loan portfolio.

At December 31, 2009, our portfolio of investment securities included approximately $78.9 million at cost of auction rate securities and approximately $26.5 million at cost of corporate notes, including single issuer and pooled trust preferred securities, for which an OTTI charge has not been recorded in our financial statements. The fair value of these securities, presently $66.9 million and $18.9 million, respectively, could be negatively impacted in the future. Were this to occur, we may be required to reflect a write down of certain of our securities in future periods as a charge to earnings if any of these securities are deemed to be other than temporarily impaired. Such impairment charge could be material to our results of operations.

As required by FASB ASC 320, "Investments-Debt and Equity Securities", securities are classified into three categories: trading, held-to-maturity and available-for-sale. Securities that are bought and held principally for the purpose of selling them in the near term are classified as trading securities and are reported at fair value with unrealized gains and losses included in trading account activities in the statement of income. Securities that the Bank has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost. All other securities are classified as available-for-sale. Available-for-sale securities are reported at fair value with unrealized gains and losses included, on an after-tax basis, as a separate component of stockholders' equity. The Company does not have a trading securities portfolio and has no current plans to maintain such a portfolio in the future. The Company generally classifies all newly purchased debt securities as available for sale in order to maintain the flexibility to sell those securities if the need arises. The Bank has a limited portfolio of securities classified as held to maturity, represented principally by securities purchased a number of years ago.

Federal Home Loan Bank Stock. The Bank owns stock of the FHLBNY which is necessary for it to be a member of the FHLBNY. Membership requires the purchase of stock equal to 0.20% of the Bank's mortgage related assets (investments and loans) plus 4.5% of the outstanding borrowings. The stock is redeemable at par, therefore, its cost is equivalent to its redemption value. The Bank's ability to redeem FHLBNY shares is dependent upon the redemption practices of the FHLBNY. At December 31, 2009, the FHLBNY neither placed restrictions on redemption of shares in excess of a member's required investment in stock, nor stated that it will cease paying dividends. The Bank did not consider this asset impaired at either December 31, 2009 or 2008.

The following table presents the composition of interest-earning assets for the indicated periods:

	Fiscal 2009		Fiscal 2008	
	Average Amount	% of Total	Average Amount	% of Total
	(In thousands, except percentages)			
Loans	$ 448,394	54.50%	$ 461,678	47.08%
Investment Securities	312,966	38.03	464,927	47.40
Other	61,496	7.47	54,157	5.52
Total Interest-Earning Assets	$ 822,856	100.00%	$ 980,762	100.00%

Interest Expense. Total interest expense for the fiscal year ended December 31, 2009 deceased by $13.4 million to $17.1 million from $30.5 million for the fiscal year ended December 31, 2008. The decrease in total interest expense was due to the $124.5 million decrease in the average amounts of interest-bearing liabilities to $747.4 million during fiscal 2009 from $871.9 million during fiscal 2008 and the 121 basis point decrease in the average rates paid on such liabilities to 2.29% from 3.50% during fiscal years 2009 and 2008, respectively.

The following table presents the composition of interest expense for the indicated periods:

	Fiscal 2009		Fiscal 2008	
	Interest Expense	% of Total	Interest Expense	% of Total
	(In thousands, except percentages)			
Interest-Bearing Deposits	$ 2,316	13.54%	$ 7,645	25.05%
Time Deposits	9,921	58.01	17,323	56.75
Other Borrowings	4,866	28.45	5,555	18.20
Total Interest Expense	$ 17,103	100.00%	$ 30,523	100.00%

The following table presents the composition of interest-bearing liabilities for the indicated periods:

	Fiscal 2009		Fiscal 2008	
	Average Amount	% of Total	Average Amount	% of Total
	(In thousands, except percentages)			
Interest-Bearing Deposits	$ 204,629	27.38%	$ 287,772	33.00%
Time Deposits	426,892	57.12	456,803	52.40
Other Borrowings	115,869	15.50	127,343	14.60
Total Interest-Bearing Liabilities	$ 747,390	100.00%	$ 871,918	100.00%

Net Interest Income. The Company's primary source of revenue is net interest income, or the difference between interest income earned on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities such as deposits and borrowings. The amount of interest income is dependent upon many factors including: (i) the amount of interest-earning assets that the Company can maintain based upon its funding sources; (ii) the relative amounts of interest-earning assets versus interest-bearing liabilities; and (iii) the difference between the yields earned on those assets and the rates paid on those liabilities. Non-performing loans adversely affect net interest income because they must still be funded by interest-bearing liabilities, but they do not provide interest income. Furthermore, when we designate an asset as non-performing, all interest which has been accrued but not actually received is deducted from current period income, further reducing net interest income.

For the fiscal year ended December 31, 2009, net interest income decreased by approximately $250,000 to $28.8 million from $29.1 million for the fiscal year ended December 31, 2008. The decrease in net interest income was due to the decrease in the average amounts of interest-earning assets to $822.9 million during fiscal year 2009 from $980.8 million during fiscal year 2008 and the decrease in the average yields earned on such assets to 5.58% from 6.08% during fiscal years 2009 and 2008, respectively. The decrease in net interest income was substantially offset by the decrease in the average amounts of interest-bearing liabilities to $747.4 million during fiscal year 2009 from $871.9 million during fiscal year 2008 and the decrease in the average rates paid on such liabilities to 2.29% from 3.50% during fiscal years 2009 and 2008, respectively. The Company's interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, increased by 71 basis points to 3.29% during fiscal 2009 from 2.58% during fiscal 2008.

Net Interest Margin. Net interest margin, or net interest income as a percentage of average interest-earning assets, increased by 54 basis points to 3.50% during fiscal 2009 from 2.96% during fiscal 2008. We seek to secure and retain customer deposits with competitive products and rates, while making strategic use of the prevailing interest rate environment to borrow funds at what we believe to be attractive rates. We invest such deposits and borrowed funds in what we believe to be a prudent mix of fixed and adjustable rate loans, investment securities and short-term interest-earning assets. The increase in net interest margin during fiscal 2009 was primarily due to the increase in the average amounts of higher yielding loans as a percentage of our total mix of interest-earning assets.

Non-Interest Income. Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. For the fiscal year ended December 31, 2009, total non-interest income decreased by $561,000 to $197,000 from $758,000 for the fiscal year ended December 31, 2008.

The following table presents the composition of non-interest income for the indicated periods:

	Fiscal 2009 Non-Interest Income	Fiscal 2009 % of Total	Fiscal 2008 Non-Interest Income	Fiscal 2008 % of Total
	(In thousands, except percentages)			
Service Charges on Deposits	$ 490	248.73%	$ 585	77.18%
Investment Securities Losses	(860)	(436.55)	(685)	(90.37)
Other	567	287.82	858	113.19
Total Non-Interest Income	$ 197	100.00%	$ 758	100.00%

Non-Interest Expense. Non-interest expense includes salaries and employee benefits, occupancy and equipment expenses, legal and professional fees, other operating expenses associated with the day-to-day operations of the Company and OTTI charges on investment securities. Total non-interest expense for the fiscal years ended December 31, 2009 and 2008 was $35.2 million and $110.6 million, respectively, including OTTI charges on investment securities of $17.4 million and $94.3 million, respectively. Excluding the OTTI charges, total non-interest expense during fiscal 2009 increased by $1.4 million to $17.7 million from $16.3 million during fiscal 2008. This increase was primarily due to the increase of $846,000 in our FDIC assessment and expenses related to the opening of a new bank branch.

The following table presents the composition of non-interest expense for the indicated period.

	Fiscal 2009 Non-Interest Expense	Fiscal 2009 % of Total	Fiscal 2008 Non-Interest Expense	Fiscal 2008 % of Total
	(In thousands, except percentages)			
Salaries and Employee Benefits	$ 9,517	27.06%	$ 9,366	8.46%
Net Occupancy Expense	2,150	6.11	2,079	1.88
Equipment Expense	378	1.07	386	0.35
FDIC Assessment	1,928	5.48	1,082	0.98
Data Processing Expense	452	1.29	442	0.40
Other than temporary impairment charges on securities	17,435	49.58	94,346	85.29
Other	3,311	9.41	2,915	2.64
Total Non-Interest Expense	$ 35,171	100.00%	$ 110,616	100.00%

Provision for Income Tax. For the fiscal year ended December 31, 2009, the Company recorded a benefit for income taxes of $13.2 million compared to a benefit for income taxes of $5.8 million for the fiscal year ended December 31, 2008. The tax benefit in fiscal 2009 includes the benefit from the actual losses realized on sales of investment securities.

The recorded tax benefits in 2008 relates to the OTTI charge related to the Lehman Brothers corporate note which was treated as an ordinary loss under the current federal tax code when Lehman Brothers filed for bankruptcy in September 2008. The OTTI charge related to Fannie Mae and Freddie Mac securities, both direct investments and through auction rate securities, were considered capital losses under the federal tax code. A valuation allowance was recorded on the amount of capital losses in excess of available capital gains. With the passage by the U.S. Congress of the Emergency Economic Stabilization Act in October 2008, the nature of the Fannie Mae and Freddie Mac capital losses were changed to ordinary losses. Due to this change in the tax law, we carried back as much loss as could be utilized and recognized a deferred tax benefit for the remainder.

Results of Operations Fiscal Year Ended December 31, 2008 Compared to Fiscal Year Ended December 31, 2007.

Net Income (Loss). Net loss for the fiscal year ended December 31, 2008 was $79.9 million, or $11.45 per share, as compared to net income of $5.4 million, or $.76 per share, for the fiscal year ended December 31, 2007. The net loss in fiscal 2008 was primarily due to the other than temporary impairment charges on securities of $94.3 million or $13.37 per share. The other than temporary impairment charge was due to our investment, directly and indirectly through auction rate securities, in preferred shares of Fannie Mae and Freddie Mac. These government sponsored agencies were placed into conservatorship by the federal government in September 2008 resulting in, among other things, the suspension of dividend payments on our common stock.

Interest Income. Total interest income for the fiscal year ended December 31, 2008 increased by $1.1 million to $59.6 million from $58.5 million for the fiscal year ended December 31, 2007. The increase in interest income in fiscal 2008 was primarily due to the increase in the average amount of higher yielding loans and the decrease in lower yielding investment securities as a percentage of our total interest-earning assets.

The following table presents the composition of interest income for the indicated periods:

	Fiscal 2008		Fiscal 2007	
	Interest Income	% of Total	Interest Income	% of Total
	(In thousands, except percentages)			
Loans	$ 32,754	54.96%	$ 29,804	50.92%
Investment Securities	25,456	42.72	27,178	46.43
Other	1,380	2.32	1,553	2.65
Total Interest Income	$ 59,590	100.00%	$ 58,535	100.00%

Loans grew to 54.96% of our total average interest-earning assets in fiscal 2008 from 50.92% in fiscal 2007. While we actively seek to originate new loans with qualified borrowers who meet the Bank's underwriting standards, our long-term strategy has been to maintain those standards, sacrificing some current income to avoid possible large future losses in the loan portfolio.

The following table presents the composition of interest-earning assets for the indicated periods:

	Fiscal 2008		Fiscal 2007	
	Average Amount	% of Total	Average Amount	% of Total
	(In thousands, except percentages)			
Loans	$ 461,678	47.08%	$ 389,520	39.75%
Investment Securities	464,927	47.40	558,742	57.02
Other	54,157	5.52	31,678	3.23
Total Interest-Earning Assets	$ 980,762	100.00%	$ 979,940	100.00%

Interest Expense. Total interest expense for the fiscal year ended December 31, 2008 decreased by $7.3 million to $30.5 million from $37.8 million for the fiscal year ended December 31, 2007. The decrease in interest expense was due to the decrease in the average rates paid on such liabilities, 3.50% and 4.48% in fiscal years 2008 and 2007, respectively, partially offset by the $28.0 million increase in the average amount of total interest-bearing liabilities during fiscal year 2008.

The following table presents the composition of interest expense for the indicated periods:

	Fiscal 2008		Fiscal 2007	
	Interest Expense	% of Total	Interest Expense	% of Total
	(In thousands, except percentages)			
Interest-Bearing Deposits	$ 7,645	25.05%	$ 10,338	27.35%
Time Deposits	17,323	56.75	21,745	57.54
Other Borrowings	5,555	18.20	5,710	15.11
Total Interest Expense	$ 30,523	100.00%	$ 37,793	100.00%

The following table presents the composition of interest-bearing liabilities for the indicated periods:

	Fiscal 2008		Fiscal 2007	
	Average Amount	% of Total	Average Amount	% of Total
	(In thousands, except percentages)			
Interest-Bearing Deposits	$ 287,772	33.00%	$ 291,049	34.49%
Time Deposits	456,803	52.40	449,754	53.29
Other Borrowings	127,343	14.60	103,112	12.22
Total Interest-Bearing Liabilities	$ 871,918	100.00%	$ 843,915	100.00%

Net Interest Income. The Company's primary source of revenue is net interest income, or the difference between interest income on earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities such as deposits and borrowings.

For the fiscal year ended December 31, 2008, net interest income increased by approximately $8.3 million to $29.1 million from $20.7 million for the fiscal year ended December 31, 2007. The year over year increase in net interest income was the result of the 98 basis point decrease in the average rates paid on the average amount of total interest-bearing liabilities and the 11 basis point increase in the average yields earned on the average amount of total interest-earning assets. The Company's interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, widened by 109 basis points to 2.58% during fiscal 2008 from 1.49% during fiscal 2007.

Net Interest Margin. Net interest margin, or net interest income as a percentage of average interest-earning assets, increased by 84 basis points to 2.96% during fiscal 2008 from 2.12% during fiscal 2007. We seek to secure and retain customer deposits with competitive products and rates, and to make strategic use of the prevailing interest rate environment to borrow funds at what we believe to be attractive rates. We invest such deposits and borrowed funds in a prudent mix of fixed rate and adjustable rate loans, investment securities and short-term interest-earning assets which provided an aggregate average yield of 6.08% and 5.97% in fiscal 2008 and 2007, respectively.

The average amount of loans increased by $72.2 million to $461.7 million during fiscal 2008 from $389.5 million during fiscal 2007, though the average yield on such loans decreased by 56 basis points to 7.09% in fiscal 2008 from 7.65% in fiscal 2007. The average amount of investment securities decreased by $93.8 million to $464.9 million in fiscal 2008 from $558.7 million in fiscal 2007 and the average yield on investment securities improved by 62 basis points, to 5.48% in 2008 from 4.86% in 2007. The average amount of other interest-earning assets, primarily cash and short-term investments, increased by $22.5 million to $54.2 million in 2008 from $31.7 million in 2007 and returned an average yield of 2.55% and 4.90% during the fiscal years ended December 31, 2008 and 2007, respectively.

Non-Interest Income. Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. For the fiscal year ended December 31, 2008, total non-interest income decreased by $901,000 to $758,000 from $1.66 million for the fiscal year ended December 31, 2007. The decrease is primarily due to realized loss of $685,000 on sales of investment securities during fiscal 2008.

The following table presents the composition of non-interest income for the indicated periods:

	Fiscal 2008		Fiscal 2007	
	Non-Interest Income	% of Total	Non-Interest Income	% of Total
	(In thousands, except percentages)			
Service Charges on Deposits	$ 585	77.18%	$ 658	39.66%
Investment Securities (Losses) Gains	(685)	(90.37)	86	5.18
Other	858	113.19	915	55.16
Total Non-Interest Income	$ 758	100.00%	$ 1,659	100.00%

Non-Interest Expense. Non-interest expense includes salaries and employee benefits, occupancy and equipment expenses, legal and professional fees and other operating expenses associated with the day-to-day operations of the Company. Total non-interest expense for the fiscal year ended December 31, 2008, including the other than temporary impairment charges on securities of $94.3 million, increased by $96.3 million to $110.6 million from $14.3 million for the fiscal year ended December 31, 2007. Excluding the other than temporary impairment charges, total non-interest expense for fiscal 2008 increased by $2.0 million to $16.3 million. This increase was primarily due to the increase of approximately $1.0 million in our FDIC assessment.

The following table presents the composition of non-interest expense for the indicated period.

	Fiscal 2008		Fiscal 2007	
	Non-Interest Expense	% of Total	Non-Interest Expense	% of Total
	(In thousands, except percentages)			
Salaries and Employee Benefits	$ 9,366	8.46%	$ 8,971	62.66%
Net Occupancy Expense	2,079	1.88	2,050	14.32
Equipment Expense	386	0.35	80	0.56
FDIC Assessment	1,082	0.98	86	0.60
Data Processing Expense	442	0.40	417	2.91
Other than temporary impairment charges on securities	94,346	85.29	—	
Other	2,915	2.64	2,714	18.95
Total Non-Interest Expense	$ 110,616	100.00%	$ 14,318	