

ARROW FINANCIAL CORP
Form 10-Q
May 08, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the Quarterly Period Ended March 31, 2015

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

Commission File Number: 0-12507

ARROW FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York
(State or other jurisdiction of
incorporation or organization)
250 GLEN STREET, GLENS FALLS, NEW YORK 12801
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (518) 745-1000

22-2448962
(I.R.S. Employer
Identification No.)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the 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 Smaller reporting company

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of April 30, 2015
Common Stock, par value \$1.00 per share	12,636,663

ARROW FINANCIAL CORPORATION
FORM 10-Q
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PART I - Financial Information

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(In Thousands, Except Share and Per Share Amounts)

(Unaudited)

	March 31, 2015	December 31, 2014	March 31, 2014
ASSETS			
Cash and Due From Banks	\$37,941	\$35,081	\$40,056
Interest-Bearing Deposits at Banks	73,654	11,214	35,994
Investment Securities:			
Available-for-Sale	393,133	366,139	429,230
Held-to-Maturity (Approximate Fair Value of \$312,500 at March 31, 2015; \$308,566 at December 31, 2014; and \$322,335 at March 31, 2014)	305,175	302,024	317,632
Federal Home Loan Bank and Federal Reserve Bank Stock	4,806	4,851	3,896
Loans	1,434,794	1,413,268	1,310,423
Allowance for Loan Losses	(15,625)	(15,570)	(14,636)
Net Loans	1,419,169	1,397,698	1,295,787
Premises and Equipment, Net	28,381	28,488	28,717
Goodwill	22,003	22,003	22,003
Other Intangible Assets, Net	3,489	3,625	3,996
Other Assets	47,777	46,297	44,270
Total Assets	\$2,335,528	\$2,217,420	\$2,221,581
LIABILITIES			
Noninterest-Bearing Deposits	\$310,878	\$300,786	\$277,086
NOW Accounts	967,537	871,671	908,028
Savings Deposits	541,750	524,648	524,670
Time Deposits of \$100,000 or More	59,886	61,797	74,127
Other Time Deposits	138,653	144,046	164,108
Total Deposits	2,018,704	1,902,948	1,948,019
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	15,895	19,421	13,787
Federal Home Loan Bank Overnight Advances	—	41,000	—
Federal Home Loan Bank Term Advances	50,000	10,000	20,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000
Other Liabilities	25,964	23,125	25,284
Total Liabilities	2,130,563	2,016,494	2,027,090
STOCKHOLDERS' EQUITY			
Preferred Stock, \$5 Par Value; 1,000,000 Shares Authorized			
Common Stock, \$1 Par Value; 20,000,000 Shares Authorized (17,079,376 Shares Issued at March 31, 2015 and December 31, 2014 and 16,744,486 Shares Issued March 31, 2014)	17,079	17,079	16,744
Additional Paid-in Capital	239,981	239,721	229,842
Retained Earnings	32,157	29,458	29,692

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Unallocated ESOP Shares (63,723 Shares at March 31, 2015; 71,748 Shares at December 31, 2014; and 79,763 Shares at March 31, 2014)	(1,300)	(1,450)	(1,650)
Accumulated Other Comprehensive Loss	(6,256	)	(7,166	)	(4,075)
Treasury Stock, at Cost (4,380,293 Shares at March 31, 2015; 4,386,001 Shares at December 31, 2014; and 4,315,156 Shares at March 31, 2014)	(76,696	)	(76,716	)	(76,062)
Total Stockholders' Equity	204,965		200,926		194,491	
Total Liabilities and Stockholders' Equity	\$2,335,528		\$2,217,420		\$2,221,581	

See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended March	
	31,	
	2015	2014
INTEREST AND DIVIDEND INCOME		
Interest and Fees on Loans	\$13,650	\$12,774
Interest on Deposits at Banks	21	13
Interest and Dividends on Investment Securities:		
Fully Taxable	1,944	2,008
Exempt from Federal Taxes	1,375	1,471
Total Interest and Dividend Income	16,990	16,266
INTEREST EXPENSE		
NOW Accounts	330	464
Savings Deposits	167	219
Time Deposits of \$100,000 or More	90	230
Other Time Deposits	202	391
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	5	4
Federal Home Loan Bank Advances	150	145
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	142	141
Total Interest Expense	1,086	1,594
NET INTEREST INCOME	15,904	14,672
Provision for Loan Losses	275	458
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	15,629	14,214
NONINTEREST INCOME		
Income From Fiduciary Activities	1,933	1,873
Fees for Other Services to Customers	2,239	2,194
Insurance Commissions	2,139	2,444
Net Gain on Securities Transactions	90	—
Net Gain on Sales of Loans	132	123
Other Operating Income	323	252
Total Noninterest Income	6,856	6,886
NONINTEREST EXPENSE		
Salaries and Employee Benefits	7,692	7,642
Occupancy Expenses, Net	2,487	2,341
FDIC Assessments	280	273
Other Operating Expense	3,496	3,210
Total Noninterest Expense	13,955	13,466
INCOME BEFORE PROVISION FOR INCOME TAXES	8,530	7,634
Provision for Income Taxes	2,675	2,314
NET INCOME	\$5,855	\$5,320
Average Shares Outstanding:		
Basic	12,633	12,601

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Diluted	12,671	12,625
Per Common Share:		
Basic Earnings	\$0.46	\$0.42
Diluted Earnings	0.46	0.42

Share and Per Share Amounts have been restated for the September 2014 2% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In Thousands)

(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Net Income	\$5,855	\$5,320
Other Comprehensive Income, Net of Tax:		
Net Unrealized Securities Holding Gains		
Arising During the Period	745	241
Reclassification Adjustments for Securities Gains	55	—
Included in Net Income		
Amortization of Net Retirement Plan Actuarial Loss	117	70
Accretion of Net Retirement Plan Prior		
Service Credit	(7	) (13
Other Comprehensive Income	910	298
Comprehensive Income	\$6,765	\$5,618

See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unallo-cated ESOP Shares	Accumu-lated Other Com- prehensive Loss	Treasury Stock	Total
Balance at December 31, 2014	\$17,079	\$239,721	\$29,458	\$ (1,450)	\$ (7,166)	\$ (76,716)	\$200,926
Net Income	—	—	5,855	—	—	—	5,855
Other Comprehensive Income	—	—	—	—	910	—	910
Cash Dividends Paid, \$.25 per Share	—	—	(3,156)	—	—	—	(3,156)
Stock Options Exercised, Net (3,027 Shares)	—	40	—	—	—	30	70
Shares Issued Under the Directors' Stock Plan (431 Shares)	—	7	—	—	—	4	11
Shares Issued Under the Employee Stock Purchase Plan (4,370 Shares)	—	68	—	—	—	43	111
Stock-Based Compensation Expense	—	82	—	—	—	—	82
Purchase of Treasury Stock (2,120 Shares)	—	—	—	—	—	(57)	(57)
Allocation of ESOP Stock (8,025 Shares)	—	63	—	150	—	—	213
Balance at March 31, 2015	\$17,079	\$239,981	\$32,157	\$ (1,300)	\$ (6,256)	\$ (76,696)	\$204,965
Balance at December 31, 2013	\$16,744	\$229,290	\$27,457	\$ (1,800)	\$ (4,373)	\$ (75,164)	\$192,154
Net Income	—	—	5,320	—	—	—	5,320
Other Comprehensive Income	—	—	—	—	298	—	298
Cash Dividends Paid, \$.245 per Share ¹	—	—	(3,085)	—	—	—	(3,085)
Stock Options Exercised, Net (19,308 Shares)	—	284	—	—	—	190	474
Shares Issued Under the Employee Stock Purchase Plan (4,272 Shares)	—	63	—	—	—	42	105
Stock-Based Compensation Expense	—	90	—	—	—	—	90
Tax Benefit for Disposition of Stock Options	—	5	—	—	—	—	5
Purchase of Treasury Stock (45,608 Shares)	—	—	—	—	—	(1,165)	(1,165)
Acquisition of Subsidiaries (3,595 Shares)	—	56	—	—	—	35	91
	—	54	—	150	—	—	204

Allocation of ESOP Stock (7,878
Shares)

Balance at March 31, 2014	\$16,744	\$229,842	\$29,692	\$(1,650)	\$(4,075)	\$(76,062)	\$194,491
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¹ Cash dividends paid per share have been adjusted for the September 2014 2% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Three Months Ended March	
	31,	
	2015	2014
Cash Flows from Operating Activities:		
Net Income	\$5,855	\$5,320
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	275	458
Depreciation and Amortization	1,626	1,965
Allocation of ESOP Stock	213	204
Gains on the Sale of Securities Available-for-Sale	(90)	—
Loans Originated and Held-for-Sale	(3,970)	(4,592)
Proceeds from the Sale of Loans Held-for-Sale	3,674	4,277
Net Gains on the Sale of Loans	(132)	(123)
Net Losses on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	—	3
Contributions to Retirement Benefit Plans	(161)	(261)
Deferred Income Tax Expense (Benefit)	538	(45)
Shares Issued Under the Directors' Stock Plan	11	—
Stock-Based Compensation Expense	82	90
Net (Increase) Decrease in Other Assets	(2,420)	(1,025)
Net Increase (Decrease) in Other Liabilities	3,000	1,274
Net Cash Provided By Operating Activities	8,501	7,545
Cash Flows from Investing Activities:		
Proceeds from the Sale of Securities Available-for-Sale	2,702	—
Proceeds from the Maturities and Calls of Securities Available-for-Sale	22,829	44,907
Purchases of Securities Available-for-Sale	(51,673)	(16,905)
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	7,180	16,561
Purchases of Securities Held-to-Maturity	(10,655)	(35,328)
Net Increase in Loans	(21,712)	(44,253)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	258	289
Purchase of Premises and Equipment	(373)	(89)
Cash Paid for Subsidiaries, Net	—	(75)
Net Decrease in Other Investments	45	2,385
Net Cash Used In Investing Activities	(51,399)	(32,508)
Cash Flows from Financing Activities:		
Net Increase in Deposits	115,756	105,689
Net Decrease in Short-Term Borrowings	(44,526)	(50,990)
Federal Home Loan Bank Advances	40,000	—
Purchase of Treasury Stock	(57)	(1,165)
Stock Options Exercised, Net	70	474
Shares Issued Under the Employee Stock Purchase Plan	111	105
Tax Benefit from Exercise of Stock Options	—	5
Cash Dividends Paid	(3,156)	(3,085)
Net Cash Provided By Financing Activities	108,198	51,033
Net Increase in Cash and Cash Equivalents	65,300	26,070

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Cash and Cash Equivalents at Beginning of Period	46,295	49,980
Cash and Cash Equivalents at End of Period	\$111,595	\$76,050
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	\$1,080	\$1,628
Income Taxes	635	335
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	394	484
Acquisition of Subsidiaries	—	91

See Notes to Unaudited Interim Consolidated Financial Statements.

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NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. ACCOUNTING POLICIES

In the opinion of the management of Arrow Financial Corporation (Arrow), the accompanying unaudited consolidated interim financial statements contain all of the adjustments necessary to present fairly the financial position as of March 31, 2015, December 31, 2014 and March 31, 2014; the results of operations for the three-month periods ended March 31, 2015 and 2014; the consolidated statements of comprehensive income for the three-month periods ended March 31, 2015 and 2014; the changes in stockholders' equity for the three-month periods ended March 31, 2015 and 2014; and the cash flows for the three-month periods ended March 31, 2015 and 2014. All such adjustments are of a normal recurring nature. Certain prior period amounts have been reclassified to conform to the current presentation. The preparation of financial statements requires the use of management estimates. The unaudited consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements of Arrow for the year ended December 31, 2014, included in Arrow's 2014 Form 10-K.

New Accounting Standards Updates (ASU): During 2015, through the date of this report, the FASB issued five accounting standards updates, none of which had an immediate impact on Arrow, but could in the future.

ASU 2015-01 "Income Statement - Extraordinary and Unusual Items" eliminated the concept of extraordinary items. For Arrow, the standard is effective for the first quarter of 2016.

ASU 2015-02 "Consolidation" changed the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. For Arrow, the standard is effective for the first quarter of 2016.

ASU 2015-03 "Interest - Imputation of Interest" required debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. There were no changes to the recognition and measurement of debt issuance costs. For Arrow, the standard is effective for the first quarter of 2016.

ASU 2015-04 "Compensation-Retirement Benefits" provides several practical expedients for the measurement or, in certain circumstances, the remeasurement of defined benefit plan assets and obligations. Most of the practical expedients will not apply to Arrow, however, if used, an entity must disclose the accounting policy election and the date used to measure defined benefit plan assets and obligations. For Arrow, the standard is effective for the first quarter of 2016.

ASU 2015-05 "Intangibles - Goodwill and Other - Internal use Software" provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. For Arrow, the standard is effective for the first quarter of 2016.

Note 2. INVESTMENT SECURITIES (In Thousands)

The following table is the schedule of Available-For-Sale Securities at March 31, 2015, December 31, 2014 and March 31, 2014:

Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available- For-Sale Securities
March 31, 2015						
Available-For-Sale Securities, at Amortized Cost	\$ 150,500	\$ 73,886	\$ 145,185	\$ 16,949	\$ 1,120	\$ 387,640
Available-For-Sale Securities,	151,527	74,095	149,510	16,756	1,245	393,133

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at Fair Value						
Gross Unrealized Gains	1,049	217	4,325	19	125	5,735
Gross Unrealized Losses	22	9	—	212	—	243
Available-For-Sale Securities, Pledged as Collateral						284,708
Maturities of Debt Securities, at Amortized Cost:						
Within One Year	5,000	23,532	1,515	4,938		34,985
From 1 - 5 Years	145,500	48,471	122,340	11,010		327,321
From 5 - 10 Years	—	1,243	21,330	—		22,573
Over 10 Years	—	640	—	1,000		1,640
Maturities of Debt Securities, at Fair Value:						
Within One Year	5,005	23,573	1,532	4,947		35,057
From 1 - 5 Years	146,522	48,638	125,850	11,009		332,019
From 5 - 10 Years	—	1,244	22,128	—		23,372
Over 10 Years	—	640	—	800		1,440

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Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available- For-Sale Securities
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	\$—	\$—	\$—	\$—	\$—	\$—
12 Months or Longer	13,937	6,581	22	5,702	—	26,242
Total	\$13,937	\$6,581	\$22	\$5,702	\$—	\$26,242
Number of Securities in a Continuous Loss Position	46	7	31	22	—	106
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	\$—	\$—	\$—	\$—	\$—	\$—
12 Months or Longer	22	9	—	212	—	243
Total	\$22	\$9	\$—	\$212	\$—	\$243
December 31, 2014						
Available-For-Sale Securities, at Amortized Cost	\$137,540	\$81,582	\$124,732	\$16,988	\$1,120	\$361,962
Available-For-Sale Securities, at Fair Value	137,603	81,730	128,827	16,725	1,254	366,139
Gross Unrealized Gains	208	187	4,100	7	134	4,636
Gross Unrealized Losses	145	39	5	270	—	459
Available-For-Sale Securities, Pledged as Collateral						267,384
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	\$39,631	\$3,309	\$82	\$—	\$—	\$43,022
12 Months or Longer	28,020	14,035	1,546	10,738	—	54,339
Total	\$67,651	\$17,344	\$1,628	\$10,738	\$—	\$97,361
Number of Securities in a Continuous Loss Position	22	65	3	15	—	105
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	\$48	\$—	\$—	\$—	\$—	\$48
12 Months or Longer	97	39	5	270	—	411
Total	\$145	\$39	\$5	\$270	\$—	\$459
March 31, 2014						
Available-For-Sale Securities, at Amortized Cost	\$121,477	\$125,165	\$160,023	\$17,115	\$1,120	\$424,900

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Available-For-Sale Securities, at Fair Value	121,220	125,410	164,541	16,839	1,220	429,230
Gross Unrealized Gains	3	333	4,616	14	100	5,066
Gross Unrealized Losses	260	88	98	290	—	736
Available-For-Sale Securities, Pledged as Collateral						329,039
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	\$50,778	\$17,937	\$10,613	\$5,868	\$—	\$85,196
12 Months or Longer	6,124	3,653	4,063	3,392	—	17,232
Total	\$56,902	\$21,590	\$14,676	\$9,260	\$—	\$102,428

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Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available- For-Sale Securities
Number of Securities in a Continuous Loss Position	16	87	9	13	—	125
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	\$222	\$72	\$81	\$50	\$—	\$425
12 Months or Longer	38	16	17	240	—	311
Total	\$260	\$88	\$98	\$290	\$—	\$736

The following table is the schedule of Held-To-Maturity Securities at March 31, 2015, December 31, 2014 and March 31, 2014:

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To- Maturity Securities
March 31, 2015				
Held-To-Maturity Securities, at Amortized Cost	\$ 195,951	\$ 108,224	\$ 1,000	\$ 305,175
Held-To-Maturity Securities, at Fair Value	200,578	110,922	1,000	312,500
Gross Unrealized Gains	4,753	2,698	—	7,451
Gross Unrealized Losses	126	—	—	126
Held-To-Maturity Securities, Pledged as Collateral				285,132
Maturities of Debt Securities, at Amortized Cost:				
Within One Year	35,926	—	—	35,926
From 1 - 5 Years	89,022	43,820	—	132,842
From 5 - 10 Years	67,708	64,404	—	132,112
Over 10 Years	3,295	—	1,000	4,295
Maturities of Debt Securities, at Fair Value:				
Within One Year	35,968	—	—	35,968
From 1 - 5 Years	91,192	44,816	—	136,008
From 5 - 10 Years	70,047	66,106	—	136,153
Over 10 Years	3,371	—	1,000	4,371

Securities in a Continuous
Loss Position, at Fair Value:

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Less than 12 Months	\$—	\$—	\$—	\$—
12 Months or Longer	16,010	—	—	16,010
Total	\$ 16,010	\$—	\$—	\$ 16,010
Number of Securities in a Continuous Loss Position	585	7	—	592
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	\$—	\$—	\$—	\$—
12 Months or Longer	126	—	—	126
Total	\$ 126	\$—	\$—	\$ 126

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Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage- Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
December 31, 2014				
Held-To-Maturity Securities, at Amortized Cost	\$ 188,472	\$ 112,552	\$ 1,000	\$ 302,024
Held-To-Maturity Securities, at Fair Value	193,252	114,314	1,000	308,566
Gross Unrealized Gains	4,935	1,770	—	6,705
Gross Unrealized Losses	155	8	—	163
Held-To-Maturity Securities, Pledged as Collateral				282,640

Securities in a Continuous
Loss Position, at Fair Value:

Less than 12 Months	\$ 2,143	\$ 4,581	\$ —	\$ 6,724
12 Months or Longer	16,033	—	—	16,033
Total	\$ 18,176	\$ 4,581	\$ —	\$ 22,757
Number of Securities in a Continuous Loss Position	74	1	—	75

Unrealized Losses on
Securities in a Continuous
Loss Position:

Less than 12 Months	\$ 17	\$ 8	\$ —	\$ 25
12 Months or Longer	138	—	—	138
Total	\$ 155	\$ 8	\$ —	\$ 163

March 31, 2014

Held-To-Maturity Securities, at Amortized Cost	\$ 190,847	\$ 125,785	\$ 1,000	\$ 317,632
Held-To-Maturity Securities, at Fair Value	195,524	125,811	1,000	322,335
Gross Unrealized Gains	5,042	274	—	5,316
Gross Unrealized Losses	365	248	—	613
Held-To-Maturity Securities, Pledged as Collateral				316,632

Securities in a Continuous
Loss Position, at Fair Value:

Less than 12 Months	\$ 19,696	\$ 43,049	\$ —	\$ 62,745
12 Months or Longer	5,112	—	—	5,112
Total	\$ 24,808	\$ 43,049	\$ —	\$ 67,857
Number of Securities in a Continuous Loss Position	86	17	—	103

Unrealized Losses on

Securities in a Continuous

Loss Position:

Less than 12 Months	\$324	\$248	\$—	\$572
12 Months or Longer	41	—	—	41
Total	\$365	\$248	\$—	\$613

In the tables above, maturities of mortgage-backed-securities - residential are included based on their expected average lives. Actual maturities will differ from the table below because issuers may have the right to call or prepay obligations with or without prepayment penalties.

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In the available-for-sale category at March 31, 2015, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of \$150.5 million and a fair value of \$151.5 million. Mortgage-backed securities - residential consisted of U.S. Government Agency securities with an amortized cost of \$34.1 million and a fair value of \$35.0 million and government sponsored entity (GSE) securities with an amortized cost of \$111.1 million and a fair value of \$114.5 million. In the held-to-maturity category at March 31, 2015, mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of \$29.9 million and a fair value of \$30.6 million and GSE securities with an amortized cost of \$78.3 million and a fair value of \$80.3 million.

In the available-for-sale category at December 31, 2014, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of \$137.5 million and a fair value of \$137.6 million. Mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of \$23.0 million and a fair value of \$23.6 million and GSE securities with an amortized cost of \$101.7 million and a fair value of \$105.2 million. In the held-to-maturity category at December 31, 2014, mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of \$4.4 million and a fair value of \$4.5 million and GSE securities with an amortized cost of \$108.1 million and a fair value of \$109.8 million.

In the available-for-sale category at March 31, 2014, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of \$121.5 million and a fair value of \$121.2 million. Mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of \$30.6 million and a fair value of \$31.3 million and GSE securities with an amortized cost of \$129.4 million and a fair value of \$133.2 million. In the held-to-maturity category at March 31, 2014, mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of \$4.8 million and a fair value of \$4.8 million and GSE securities with an amortized cost of \$121.0 million and a fair value of \$121.0 million.

Securities in a continuous loss position, in the tables above for March 31, 2015, December 31, 2014 and March 31, 2014, do not reflect any deterioration of the credit worthiness of the issuing entities. U.S. Agency issues, including agency-backed collateralized mortgage obligations and mortgage-backed securities, are all rated at least Aaa by Moody's or AA+ by Standard and Poor's. The state and municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, credit analysis is performed in-house based upon data that has been submitted by the issuers to the NY State Comptroller. That analysis reflects satisfactory credit worthiness of the municipalities. Corporate and other debt securities continue to be rated above investment grade according to Moody's and Standard and Poor's. Subsequent to March 31, 2015, and through the date of filing this report, there were no securities downgraded below investment grade.

The unrealized losses on these temporarily impaired securities are primarily the result of changes in interest rates for fixed rate securities where the interest rate received is less than the current rate available for new offerings of similar securities, changes in market spreads as a result of shifts in supply and demand, and/or changes in the level of prepayments for mortgage related securities. Because we do not currently intend to sell any of our temporarily impaired securities, and because it is not more likely-than-not that we would be required to sell the securities prior to recovery, the impairment is considered temporary.

Note 3. LOANS (In Thousands)

Loan Categories and Past Due Loans

The following table presents loan balances outstanding as of March 31, 2015, December 31, 2014 and March 31, 2014 and an analysis of the recorded investment in loans that are past due at these dates. Generally, Arrow considers a loan past due 30 or more days if the borrower is two or more payments past due. Loans held-for-sale of \$828, \$398 and \$502 as of March 31, 2015, December 31, 2014 and March 31, 2014, respectively, are included in the residential real estate balances for current loans.

	Commercial	Commercial Real Estate	Consumer	Residential	Total
March 31, 2015					
Loans Past Due 30-59 Days	\$370	\$255	\$3,357	\$2,205	\$6,187
Loans Past Due 60-89 Days	48	—	428	519	995
Loans Past Due 90 or more Days	284	1,838	147	2,707	4,976
Total Loans Past Due	702	2,093	3,932	5,431	12,158
Current Loans	99,208	337,194	436,970	549,264	1,422,636
Total Loans	\$99,910	\$339,287	\$440,902	\$554,695	\$1,434,794
Loans 90 or More Days Past Due and Still Accruing Interest Nonaccrual Loans					
	\$—	\$—	\$—	\$580	\$580
	\$409	\$2,070	\$337	\$4,182	\$6,998
December 31, 2014					
Loans Past Due 30-59 Days	\$124	\$432	\$4,167	\$482	\$5,205
Loans Past Due 60-89 Days	154	7	1,225	1,495	2,881
Loans Past Due 90 or more Days	345	1,832	206	2,999	5,382
Total Loans Past Due	623	2,271	5,598	4,976	13,468
Current Loans	98,888	337,841	431,443	531,628	1,399,800
Total Loans	\$99,511	\$340,112	\$437,041	\$536,604	\$1,413,268
Loans 90 or More Days Past Due and Still Accruing Interest Nonaccrual Loans					
	\$—	\$—	\$—	\$537	\$537
	\$473	\$2,071	\$415	\$3,940	\$6,899
March 31, 2014					
Loans Past Due 30-59 Days	\$597	\$1,381	\$2,714	\$2,026	\$6,718
Loans Past Due 60-89 Days	579	237	528	438	1,782
Loans Past Due 90 or more Days	29	1,785	150	2,244	4,208
Total Loans Past Due	1,205	3,403	3,392	4,708	12,708
Current Loans	88,671	333,464	405,012	470,568	1,297,715
Total Loans	\$89,876	\$336,867	\$408,404	\$475,276	\$1,310,423

Loans 90 or More Days Past Due and Still Accruing Interest	\$—	\$—	\$—	\$347	\$347
Nonaccrual Loans	\$182	\$2,042	\$372	\$3,687	\$6,283

The Company disaggregates its loan portfolio into the following four categories:

Commercial - The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable and generally have a lower liquidation value than real estate. In the event of default by the borrower, the Company may be required to liquidate collateral at deeply discounted values. To reduce the risk, management usually obtains personal guarantees of the borrowers. In addition, the Company offers commercial construction and land development loans to finance projects, primarily within the communities that we serve. Many projects will ultimately be used by the borrowers' businesses, while others are developed for resale. These real estate loans are secured by first liens on the real estate, which may include apartments,

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commercial structures, housing businesses, healthcare facilities, and both owner-occupied and non-owner-occupied facilities. There is enhanced risk during the construction period, since the loan is secured by an incomplete project.

Commercial Real Estate - The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and both owner and non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings, and are generally originated in amounts of no more than 80% of the appraised value of the property. However, the Company also offers commercial construction and land development loans to finance projects, primarily within the communities that we serve. Many projects will ultimately be used by the borrowers' businesses, while others are developed for resale. These real estate loans are also secured by first liens on the real estate, which may include apartments, commercial structures, housing business, healthcare facilities and both owner-occupied and non-owner-occupied facilities. There is enhanced risk during the construction period, since the loan is secured by an incomplete project.

Consumer Loans - The Company offers a variety of consumer installment loans to finance personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to five years, based upon the nature of the collateral and the size of the loan. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. Several loans are unsecured, which carry a higher risk of loss. Also included in this category are automobile loans. The Company primarily finances the purchases of automobiles indirectly through dealer relationships located throughout upstate New York and Vermont. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to seven years. Indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Residential Real Estate Mortgages - Residential real estate loans consist primarily of loans secured by first or second mortgages on primary residences. We originate adjustable-rate and fixed-rate one-to-four-family residential real estate loans for the construction, purchase or refinancing of an existing mortgage. These loans are collateralized primarily by owner-occupied properties generally located in the Company's market area. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower), or have private mortgage insurance. The Company's underwriting analysis for residential mortgage loans typically includes credit verification, independent appraisals, and a review of the borrower's financial condition. Mortgage title insurance and hazard insurance are normally required. It is our general practice to underwrite our residential real estate loans to secondary market standards. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period. In addition, the Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Our policy allows for a maximum loan to value ratio of 80%, although periodically higher advances are allowed. The Company originates home equity lines of credit and second mortgage loans (loans secured by a second junior lien position on one-to-four-family residential real estate). Risk is generally reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Allowance for Loan Losses

The following table presents a roll-forward of the allowance for loan losses and other information pertaining to the allowance for loan losses:

Allowance for Loan Losses

Commercial

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	Commercial	Real Estate	Consumer	Residential	Unallocated	Total	
Roll-forward of the Allowance for Loan Losses for the Year-to-Date Periods:							
December 31, 2014	\$2,100	\$4,128	\$5,210	\$3,369	\$763	\$15,570	
Charge-offs	(16) —	(185) (89) —	(290)
Recoveries	7	—	63	—	—	70	
Provision	72	(295	) 179	349	(30	) 275
March 31, 2015	\$2,163	\$3,833	\$5,267	\$3,629	\$733	\$15,625	
December 31, 2013	\$1,886	\$3,962	\$4,478	\$3,026	\$1,082	\$14,434	
Charge-offs	(123) —	(197) (16) —	(336)
Recoveries	19	—	61	—	—	80	
Provision	15	236	244	67	(104) 458	
March 31, 2014	\$1,797	\$4,198	\$4,586	\$3,077	\$978	\$14,636	

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Allowance for Loan Losses

	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
March 31, 2015						
Allowance for loan losses - Loans Individually Evaluated for Impairment	\$—	\$—	\$—	\$ 149	\$—	\$ 149
Allowance for loan losses - Loans Collectively Evaluated for Impairment	\$2,163	\$3,833	\$5,267	\$3,480	\$733	\$15,476
Ending Loan Balance - Individually Evaluated for Impairment	\$459	\$1,492	\$107	\$2,296	\$—	\$4,354
Ending Loan Balance - Collectively Evaluated for Impairment	\$99,451	\$337,795	\$440,795	\$552,399	\$—	\$1,430,440
December 31, 2014						
Allowance for loan losses - Loans Individually Evaluated for Impairment	\$—	\$—	\$—	\$ 109	\$—	\$ 109
Allowance for loan losses - Loans Collectively Evaluated for Impairment	\$2,100	\$4,128	\$5,210	\$3,260	\$763	\$15,461
Ending Loan Balance - Individually Evaluated for Impairment	\$494	\$1,492	\$118	\$2,237	\$—	\$4,341
Ending Loan Balance - Collectively Evaluated for Impairment	\$99,017	\$338,620	\$436,923	\$534,367	\$—	\$1,408,927
March 31, 2014						
Allowance for loan losses - Loans Individually Evaluated for Impairment	\$—	\$—	\$—	\$—	\$—	\$—
Allowance for loan losses - Loans Collectively Evaluated for Impairment	\$1,797	\$4,198	\$4,586	\$3,077	\$978	\$14,636
Ending Loan Balance - Individually Evaluated for Impairment	\$214	\$1,810	\$144	\$1,913	\$—	\$4,081
Ending Loan Balance - Collectively Evaluated for Impairment	\$89,662	\$335,057	\$408,260	\$473,363	\$—	\$1,306,342

for Impairment

Through the provision for loan losses, an allowance for loan losses is maintained that reflects our best estimate of the inherent risk of loss in the Company's loan portfolio as of the balance sheet date. Additions are made to the allowance for loan losses through a periodic provision for loan losses. Actual loan losses are charged against the allowance for loan losses when loans are deemed uncollectible and recoveries of amounts previously charged off are recorded as credits to the allowance for loan losses.

Our loan officers and risk managers meet at least quarterly to discuss and review the conditions and risks associated with certain criticized and classified commercial-related relationships. In addition, our independent internal loan review department performs periodic reviews of the risk ratings on individual loans in our commercial loan portfolio. We use a two-step process to determine the provision for loan losses and the amount of the allowance for loan losses. We measure impairment on our impaired loans on a quarterly basis. Our impaired loans are generally nonaccrual loans over \$250 thousand and all troubled debt restructured loans. Our impaired loans are generally considered to be collateral dependent with the specific reserve, if any, determined based on the value of the collateral less estimated costs to sell.

The remainder of the portfolio is evaluated on a pooled basis. For each homogeneous loan pool, we estimate a total loss factor based on the historical net loss rates adjusted for applicable qualitative factors. We update the total loss factors assigned to each loan category on a quarterly basis. For the commercial, commercial construction, and commercial real estate categories, we further segregate the loan categories by credit risk profile (pools of loans graded satisfactory, special mention and substandard). Additional description of the credit risk classifications is detailed in the Credit Quality Indicators section of this note.

We determine the annualized historical net loss rate for each loan category using a trailing three-year net charge-off average. While historical net loss experience provides a reasonable starting point for our analysis, historical net losses, or even recent trends in net losses,

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do not by themselves form a sufficient basis to determine the appropriate level of the allowance for loan losses. Therefore, we also consider and adjust historical net loss factors for qualitative factors that impact the inherent risk of loss associated with our loan categories within our total loan portfolio. These include:

• Changes in the volume and severity of past due, nonaccrual and adversely classified loans

• Changes in the nature and volume of the portfolio and in the terms of loans

• Changes in the value of the underlying collateral for collateral dependent loans

• Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses

• Changes in the quality of the loan review system

• Changes in the experience, ability, and depth of lending management and other relevant staff

• Changes in international, national, regional, and local economic and business conditions and developments that affect the collectibility of the portfolio

• The existence and effect of any concentrations of credit, and changes in the level of such concentrations

• The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio or pool

Further, due to the imprecise nature of the loan loss estimation process, the risk attributes of our loan portfolio may not be fully captured in data related to the determination of loss factors used to determine our analysis of the adequacy of the allowance for loan losses. Management, therefore, has established an unallocated portion within the allowance for loan losses reflecting the imprecision that naturally exists in the allowance for loan loss estimation process. The unallocated allowance for loan losses is not considered a significant component of the overall allowance for loan loss estimation process.

Credit Quality Indicators

The following table presents the credit quality indicators by loan category at March 31, 2015, December 31, 2014 and March 31, 2014:

Loan Credit Quality Indicators

	Commercial	Commercial Real Estate	Consumer	Residential	Total
March 31, 2015					
Credit Risk Profile by Creditworthiness Category:					
Satisfactory	\$85,597	\$317,590			\$403,187
Special Mention	2,575	2,849			5,424
Substandard	11,738	18,848			30,586
Doubtful	—	—			—
Credit Risk Profile Based on Payment Activity:					
Performing			\$440,565	\$549,932	990,497
Nonperforming			337	4,763	5,100
December 31, 2014					
Credit Risk Profile by Creditworthiness Category:					
Satisfactory	85,949	317,747			403,696
Special Mention	2,442	3,718			6,160
Substandard	11,120	18,647			29,767
Doubtful	—	—			—
Credit Risk Profile Based on Payment Activity:					
Performing			436,626	532,127	968,753
Nonperforming			415	4,477	4,892
March 31, 2014					
Credit Risk Profile by Creditworthiness Category:					
Satisfactory	82,263	315,558			397,821
Special Mention	960	614			1,574
Substandard	6,653	20,695			27,348
Doubtful	—	—			—
Credit Risk Profile Based on Payment Activity:					
Performing			408,031	471,242	879,273
Nonperforming			373	4,034	4,407

We use an internally developed system of five credit quality indicators to rate the credit worthiness of each commercial loan defined as follows: 1) Satisfactory - "Satisfactory" borrowers have acceptable financial condition with satisfactory record of earnings and sufficient historical and projected cash flow to service the debt. Borrowers have satisfactory repayment histories and primary and secondary sources of repayment can be clearly identified; 2) Special Mention - Loans in this category have potential weaknesses that deserve management's close attention. If left

uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. "Special mention" assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Loans which might be assigned this risk rating include loans to borrowers with deteriorating financial strength and/or earnings record and loans with potential for problems due to weakening economic or market conditions; 3) Substandard - Loans classified as "substandard" are inadequately protected by the current sound net worth or paying capacity of the borrower or the collateral pledged, if any. Loans in this category have well defined weaknesses that jeopardize the repayment. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. "Substandard" loans may include loans which are likely to require liquidation of collateral to effect repayment, and other loans where character or ability to repay has become suspect. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard; 4) Doubtful - Loans classified as "doubtful" have all of the weaknesses inherent in those classified as "substandard" with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, conditions, and values highly questionable and improbable. Although possibility of loss is extremely high, classification of these loans as "loss" has been deferred due to specific pending factors or events which may strengthen the value (i.e. possibility of additional collateral, injection of capital, collateral liquidation, debt restructure, economic recovery, etc). Loans classified as "doubtful" need to be placed on

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non-accrual; and 5) Loss - Loans classified as "loss" are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. As of the date of the balance sheet, all loans in this category have been charged-off to the allowance for loan losses. Large commercial loans are evaluated on an annual basis, unless the credit quality indicator falls to a level of "substandard" or below, when the loan is evaluated quarterly. The credit quality indicator is one of the factors used to determine any loss, as further described in this footnote.

For the purposes of the table above, nonperforming consumer loans are those loans on nonaccrual status or are 90 days or more past due and still accruing interest.

Impaired Loans

The following table presents information on impaired loans based on whether the impaired loan has a recorded related allowance or has no recorded related allowance:

Impaired Loans

	Commercial	Commercial Real Estate	Consumer	Residential	Total
March 31, 2015					
Recorded Investment:					
With No Related Allowance	\$459	\$1,492	\$107	\$1,697	\$3,755
With a Related Allowance	—	—	—	599	599
Unpaid Principal Balance:					
With No Related Allowance	459	1,492	107	1,697	3,755
With a Related Allowance	—	—	—	599	599
December 31, 2014					
Recorded Investment:					
With No Related Allowance	\$494	\$1,492	\$118	\$1,678	\$3,782
With a Related Allowance	—	—	—	559	559
Unpaid Principal Balance:					
With No Related Allowance	494	1,492	118	1,678	3,782
With a Related Allowance	—	—	—	559	559
March 31, 2014					
Recorded Investment:					
With No Related Allowance	\$214	\$1,810	\$144	\$1,913	\$4,081
With a Related Allowance	—	—	—	—	—
Unpaid Principal Balance:					
With No Related Allowance	214	1,810	144	1,913	\$4,081
With a Related Allowance	—	—	—	—	—
For the Year-To-Date Period Ended:					
March 31, 2015					
Average Recorded Balance:					
With No Related Allowance	\$477	\$1,492	\$113	\$1,688	\$3,770
With a Related Allowance	—	—	—	579	579
Interest Income Recognized:					
With No Related Allowance	2	—	1	1	4
With a Related Allowance	—	—	—	—	—
Cash Basis Income:					
With No Related Allowance	—	—	—	—	—

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With a Related Allowance	—	—	—	—	—
March 31, 2014					
Average Recorded Balance:					
With No Related Allowance	\$218	\$1,798	\$159	\$2,111	\$4,286
With a Related Allowance	—	—	—	—	—
Interest Income Recognized:					
With No Related Allowance	3	10	2	1	16
With a Related Allowance	—	—	—	—	—
Cash Basis Income:					
With No Related Allowance	—	—	—	—	—
With a Related Allowance	—	—	—	—	—

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At March 31, 2015, December 31, 2014 and March 31, 2014, all impaired loans were considered to be collateral dependent and were therefore evaluated for impairment based on the fair value of collateral less estimated cost to sell. Interest income recognized in the table above, represents income earned after the loans became impaired and includes restructured loans in compliance with their modified terms and nonaccrual loans where we have recognized interest income on a cash basis.

Loans Modified in Trouble Debt Restructurings

The following table presents information on loans modified in trouble debt restructurings during the periods indicated. All loans were modified under Arrow's own programs. The principal modification, for all the modifications in the table below, involved payment deferrals.

Loans Modified in Trouble Debt Restructurings During the Period

	Commercial	Commercial Real Estate	Consumer	Residential	Total
For the Year-To-Date Period Ended:					
March 31, 2015					
Number of Loans	—	—	1	—	1
Pre-Modification Outstanding Recorded Investment	\$—	\$—	\$2	\$—	\$2
Post-Modification Outstanding Recorded Investment	\$—	\$—	\$2	\$—	\$2
March 31, 2014					
Number of Loans	—	—	1	—	1
Pre-Modification Outstanding Recorded Investment	\$—	\$—	\$2	\$—	\$2
Post-Modification Outstanding Recorded Investment	\$—	\$—	\$2	\$—	\$2

In general, loans requiring modification are restructured to accommodate the projected cashflows of the borrower. No loans modified during the preceding twelve months subsequently defaulted as of March 31, 2015.

Note 4. GUARANTEES (In Thousands)

The following table presents the balance for standby letters of credit for the periods ended March 31, 2015, December 31, 2014 and March 31, 2014:

Loan Commitments and Letters of Credit

	March 31, 2015	December 31, 2014	March 31, 2014
Notional Amount:			
Commitments to Extend Credit	\$259,634	\$249,803	\$235,549
Standby Letters of Credit	3,193	3,317	3,333
Fair Value:			
Commitments to Extend Credit	\$—	\$—	\$—
Standby Letters of Credit	37	39	56

Arrow is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Commitments to extend credit include home equity lines of credit, commitments for residential and commercial construction loans and other personal and commercial lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of the involvement Arrow has in particular classes of financial instruments.

Arrow's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. Arrow uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Arrow evaluates each customer's creditworthiness on a case-by-case basis. Home equity lines of credit are secured by residential real estate.

Construction commitments are secured by underlying real estate. For other lines of credit, the amount of collateral obtained, if deemed necessary by Arrow upon extension of credit, is based on management's credit evaluation of the

counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. Most of the commitments are variable rate instruments. Arrow has issued conditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit at March 31, 2015, December 31, 2014 and March 31, 2014 represent the maximum potential future payments Arrow could be required to make. Typically, these instruments have terms of 12 months or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance sheet instruments. Company policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios generally range from 50% for movable assets, such as inventory, to 100% for liquid assets, such as bank CD's. Fees for standby letters of credit typically range from 1% to 3% of the notional amount. Fees are collected upfront and are amortized over the life of the commitment. The fair values of Arrow's standby letters of credit at March 31, 2015, December 31, 2014 and March 31, 2014, in the table above, were the same as the carrying amounts. The fair value of standby letters of credit is based on the fees currently charged for similar agreements or the cost to terminate the arrangement with the counterparties. The fair value of commitments to extend credit is determined by estimating the fees to enter into similar agreements, taking into account the remaining terms and present creditworthiness of the counterparties, and for fixed rate loan commitments, the difference between the current and committed interest rates. Arrow provides several types of commercial lines of credit and standby letters of credit to its commercial customers. The pricing of these services is not isolated as Arrow considers the customer's complete deposit and borrowing relationship in pricing individual products and services. The commitments to extend credit also include commitments under home equity lines of credit, for which Arrow charges no fee. The carrying value and fair value of commitments to extend credit are not material and Arrow does not expect to incur any material loss as a result of these commitments.

Note 5. COMPREHENSIVE INCOME (In Thousands)

The following table presents the components of other comprehensive income for the three and three months ended March 31, 2015 and 2014 :

Schedule of Comprehensive Income

	Three Months Ended March 31,		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
2015			
Net Unrealized Securities Holding Gains Arising During the Period	\$ 1,225	\$(480)	\$ 745
Reclassification Adjustment for Securities Gains Included in Net Income	90	(35)	55
Amortization of Net Retirement Plan Actuarial Loss	192	(75)	117
Accretion of Net Retirement Plan Prior Service Credit	(13)	6	(7)
Other Comprehensive Income	\$ 1,494	\$(584)	\$ 910
2014			
Net Unrealized Securities Holding Gains Arising During the Period	\$ 399	\$(158)	\$ 241
Reclassification Adjustment for Securities Gains Included in Net Income	—	—	—

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Amortization of Net Retirement Plan Actuarial Loss	116	(46)	70	
Accretion of Net Retirement Plan Prior Service Credit	(22)	9	(13)
Other Comprehensive Income	\$493		\$(195)	\$298

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The following table presents the changes in accumulated other comprehensive income by component:

Changes in Accumulated Other Comprehensive Income (Loss) by Component ⁽¹⁾

	Unrealized Gains and Losses on Available-for- Sale Securities	Defined Benefit Plan Items		Total
		Net Gain (Loss)	Net Prior Service (Cost) Credit	
For the Year-To-Date periods ended:				
December 31, 2014	\$2,539	\$ (9,255)	\$ (450)	\$ (7,166)
Other comprehensive income before reclassifications	745	—	—	745
Amounts reclassified from accumulated other comprehensive income	55	117	(7)	165
Net current-period other comprehensive income	800	117	(7)	910
March 31, 2015	\$3,339	\$ (9,138)	\$ (457)	\$ (6,256)
December 31, 2013	\$2,374	\$ (6,697)	\$ (50)	\$ (4,373)
Other comprehensive income before reclassifications	241	—	—	241
Amounts reclassified from accumulated other comprehensive income	—	70	(13)	57
Net current-period other comprehensive income	241	70	(13)	298
March 31, 2014	\$2,615	\$ (6,627)	\$ (63)	\$ (4,075)

(1) All amounts are net of tax. Amounts in parentheses indicate debits.

The following table presents the reclassifications out of accumulated other comprehensive income:

Reclassifications Out of Accumulated Other Comprehensive Income ⁽¹⁾

Details about Accumulated Other Comprehensive Income (Loss) Components	Amounts Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income Is Presented
--	--	---

For the Year-to-date periods ended:

March 31, 2015

Unrealized gains and losses on available-for-sale securities	\$ (90)	) Gain on Securities Transactions
	(90)	) Total before Tax
	35	) Provision for Income Taxes
	\$ (55)	) Net of Tax
Amortization of defined benefit pension items		
Prior-service costs	\$ 13) ⁽²⁾ Salaries and Employee Benefits
Actuarial gains/(losses)	(192)) ⁽²⁾ Salaries and Employee Benefits
	(179)	) Total before Tax
	69	) Provision for Income Taxes
	\$ (110)	) Net of Tax
Total reclassifications for the period	\$ (165)	) Net of Tax

March 31, 2014

Unrealized gains and losses on available-for-sale securities	\$—	) Gain on Securities Transactions
	—	) Total before Tax
	—	) Provision for Income Taxes
	\$—	) Net of Tax
Amortization of defined benefit pension items		
Prior-service costs	22) ⁽²⁾ Salaries and Employee Benefits
Actuarial gains/(losses)	\$ (116)) ⁽²⁾ Salaries and Employee Benefits
	(94)	) Total before Tax
	37	) Provision for Income Taxes
	\$ (57)	) Net of Tax
Total reclassifications for the period	\$ (57)	) Net of Tax

(1) Amounts in parentheses indicate debits to profit/loss.

(2) These accumulated other comprehensive income components are included in the computation of net periodic pension cost.

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Note 6. STOCK BASED COMPENSATION PLANS

Under our 2013 Long-Term Incentive Plan, we granted options in the first quarter of 2015 to purchase shares of our common stock. The fair values of the options were estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of our grants is expensed over the four year vesting period. The following table presents a roll-forward of our stock option plans and grants issued during 2015:

Schedule of Share-based Compensation Arrangements

	Stock Option Plans	
Roll-Forward of Shares Outstanding:		
Outstanding at January 1, 2015	401,442	
Granted	54,500	
Exercised	(3,027)
Forfeited	—	
Outstanding at March 31, 2015	452,915	
Exercisable at Period-End	319,815	
Vested and Expected to Vest	133,100	
Roll-Forward of Shares Outstanding - Weighted Average Exercise Price:		
Outstanding at January 1, 2015	\$22.66	
Granted	25.86	
Exercised	22.78	
Forfeited	—	
Outstanding at March 31, 2015	23.04	
Exercisable at Period-End	22.11	
Vested and Expected to Vest	25.28	
Grants Issued During 2015 - Weighted Average Information:		
Fair Value	5.78	
Fair Value Assumptions:		
Dividend Yield	3.90	%
Expected Volatility	33.55	%
Risk Free Interest Rate	1.57	%
Expected Lives (in years)	7.66	

The following table presents information on the amounts expensed for the periods ended March 31, 2015 and 2014:

Share-Based Compensation Expense	For the Three Months Ended March	
	31, 2015	2014
Share-Based Compensation Expense	\$82	\$90

Arrow also sponsors an Employee Stock Purchase Plan under which employees purchase Arrow's common stock at a 5% discount below market price. Under current accounting guidance, a stock purchase plan with a discount of 5% or less is not considered a compensatory plan.

Note 7. RETIREMENT PLANS (Dollars in Thousands)

The following tables provide the components of net periodic benefit costs for the three-month period ended March 31:

	Employees' Pension Plan	Select Executive Retirement Plan	Postretirement Benefit Plans
Net Periodic Benefit Cost			
For the Three Months Ended March 31, 2015:			
Service Cost	\$353	\$3	\$43
Interest Cost	394	48	58
Expected Return on Plan Assets	(808) —	—
Amortization of Prior Service Cost (Credit)	(20	) 15	(8)
Amortization of Net Loss	138	30	24
Net Periodic Benefit Cost	\$57	\$96	\$117
Plan Contributions During the Period	\$—	\$115	\$47
Estimated Future Contributions in the Current Fiscal Year	\$—	\$345	\$141
For the Three Months Ended March 31, 2014:			
Service Cost	\$377	\$—	\$53
Interest Cost	330	61	110
Expected Return on Plan Assets	(722) —	—
Amortization of Prior Service (Credit) Cost	(11	) 18	(29)
Amortization of Net Loss	86	23	7
Net Periodic Benefit Cost	\$60	\$102	\$141
Plan Contributions During the Period	\$—	\$119	\$142

We are not required to make a contribution to our qualified pension plan in 2015, and currently, we do not expect to make a contribution in 2015. Arrow makes contributions to its other post-retirement benefit plans in an amount equal to benefit payments for the year.

Note 8. EARNINGS PER COMMON SHARE (In Thousands, Except Per Share Amounts)

The following table presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted earnings per common share (“EPS”) for periods ended March 31, 2015 and 2014. All share and per share amounts have been adjusted for the September 2014 2% stock dividend.

Earnings Per Share

	Year-to-Date Period Ended:	
	March 31, 2015	March 31, 2014
Earnings Per Share - Basic:		
Net Income	\$5,855	\$5,320
Weighted Average Shares - Basic	12,633	12,601
Earnings Per Share - Basic	\$0.46	\$0.42

Earnings Per Share - Diluted:

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Net Income	\$5,855	\$5,320
Weighted Average Shares - Basic	12,633	12,601
Dilutive Average Shares Attributable to Stock Options	38	24
Weighted Average Shares - Diluted	12,671	12,625
Earnings Per Share - Diluted	\$0.46	\$0.42
Antidilutive Shares Excluded from the Calculation of Earnings Per Share	—	—

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Note 9. FAIR VALUE OF FINANCIAL INSTRUMENTS (In Thousands)

FASB ASC Subtopic 820-10 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and requires certain disclosures about fair value measurements. We do not have any nonfinancial assets or liabilities measured at fair value on a recurring basis. The only assets or liabilities that Arrow measured at fair value on a recurring basis at March 31, 2015, December 31, 2014 and March 31, 2014 were securities available-for-sale. Arrow held no securities or liabilities for trading on such dates.

The table below presents the financial instrument's fair value and the amounts within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement:

Fair Value of Assets and Liabilities Measured on a Recurring and Nonrecurring Basis

	Fair Value	Fair Value Measurements at Reporting Date			Total Gains (Losses)
		Using:			
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Fair Value of Assets and Liabilities Measured on a Recurring Basis:					
March 31, 2015					
Securities Available-for Sale:					
U.S. Agency Obligations	\$ 151,527	\$—	\$ 151,527	\$—	
State and Municipal Obligations	74,095	—	74,095	—	
Mortgage-Backed Securities - Residential	149,510	—	149,510	—	
Corporate and Other Debt Securities	16,756	—	16,756	—	
Mutual Funds and Equity Securities	1,245	—	1,245	—	
Total Securities Available-for-Sale	\$ 393,133	\$—	\$ 393,133	\$—	
December 31, 2014					
Securities Available-for Sale:					
U.S. Agency Obligations	\$ 137,603	\$—	\$ 137,603	\$—	
State and Municipal Obligations	81,730	—	81,730	—	
Mortgage-Backed Securities - Residential	128,827	—	128,827	—	
Corporate and Other Debt Securities	16,725	—	16,725	—	
Mutual Funds and Equity Securities	1,254	—	1,254	—	
Total Securities Available-for Sale	\$ 366,139	\$—	\$ 366,139	\$—	
March 31, 2014					
Securities Available-for Sale:					
U.S. Agency Obligations	\$ 121,220	\$—	\$ 121,220	\$—	
State and Municipal Obligations	125,410	—	125,410	—	
Mortgage-Backed Securities - Residential	164,541	—	164,541	—	
Corporate and Other Debt Securities	16,839	—	16,839	—	
Mutual Funds and Equity Securities	1,220	—	1,220	—	
Total Securities Available-for Sale	\$ 429,230	\$—	\$ 429,230	\$—	
Fair Value of Assets and Liabilities Measured on a Nonrecurring Basis:					
March 31, 2015					
	\$ 529	\$—	\$—	\$ 529	\$(15)

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Other Real Estate Owned and Repossessed						
Assets, Net						
Collateral Dependent Impaired Loans	600	—	—	\$600	(149)
December 31, 2014						
Other Real Estate Owned and Repossessed						
Assets, Net						
Collateral Dependent Impaired Loans	\$393	\$—	\$—	\$393	\$(15)
March 31, 2014						
Other Real Estate Owned and Repossessed						
Assets, Net						
Collateral Dependent Impaired Loans	\$198	\$—	\$—	\$198	\$(52)

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We determine the fair value of financial instruments under the following hierarchy:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

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

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

Fair Value Methodology for Assets and Liabilities Measured on a Recurring Basis

The fair value of Level 1 securities available-for-sale are based on unadjusted, quoted market prices from exchanges in active markets. The fair value of Level 2 securities available-for-sale are based on an independent bond and equity pricing service for identical assets or significantly similar securities and an independent equity pricing service for equity securities not actively traded. The pricing service uses a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Fair Value Methodology for Assets and Liabilities Measured on a Nonrecurring Basis

The fair value of collateral dependent impaired loans was based on third-party appraisals of the collateral. The fair value of other real estate owned was based on third-party appraisals. Other assets which might have been included in this table include mortgage servicing rights, goodwill and other intangible assets. Arrow evaluates each of these assets for impairment on a quarterly basis, with no impairment recognized for these assets at March 31, 2015, December 31, 2014 and March 31, 2014.

Fair Value by Balance Sheet Grouping

The following table presents a summary of the carrying amount, the fair value or an amount approximating fair value and the fair value hierarchy of Arrow's financial instruments:

Schedule of Fair Values by Balance Sheet Grouping

	Carrying Amount	Fair Value	Fair Value Hierarchy		
			Level 1	Level 2	Level 3
March 31, 2015					
Cash and Cash Equivalents	\$ 111,595	\$ 111,595	\$ 111,595	\$—	\$—
Securities Available-for-Sale	393,133	393,133	—	393,133	—
Securities Held-to-Maturity	305,175	312,500	—	312,500	—
Federal Home Loan Bank and Federal Reserve Bank Stock	4,806	4,806	4,806	—	—
Net Loans	1,419,169	1,429,553	—	—	1,429,553
Accrued Interest Receivable	6,698	6,698	6,698	—	—
Deposits	2,018,704	2,016,098	1,820,165	195,933	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	15,895	15,895	15,895	—	—
Federal Home Loan Bank Term Advances	50,000	50,851	—	50,851	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	289	289	289	—	—
December 31, 2014					
Cash and Cash Equivalents	\$ 46,295	\$ 46,295	\$ 46,295	\$—	\$—
Securities Available-for-Sale	366,139	366,139	—	366,139	—
Securities Held-to-Maturity	302,024	308,566	—	308,566	—
Federal Home Loan Bank and Federal Reserve Bank Stock	4,851	4,851	4,851	—	—
Net Loans	1,397,698	1,405,454	—	—	1,405,454
Accrued Interest Receivable	5,834	5,834	5,834	—	—
Deposits	1,902,948	1,899,682	1,697,105	202,577	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	19,421	19,421	19,421	—	—
Federal Home Loan Bank Term Advances	51,000	51,258	41,000	10,258	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	274	274	274	—	—
March 31, 2014					
Cash and Cash Equivalents	\$ 76,050	\$ 76,050	\$ 76,050	\$—	\$—
Securities Available-for-Sale	429,230	429,230	—	429,230	—
Securities Held-to-Maturity	317,632	322,335	—	322,335	—
Federal Home Loan Bank and Federal Reserve Bank Stock	3,896	3,896	3,896	—	—

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Reserve Bank Stock					
Net Loans	1,295,787	1,306,043	—	—	1,306,043
Accrued Interest Receivable	6,808	6,808	6,808	—	—
Deposits	1,948,019	1,944,116	1,709,784	234,332	—
Federal Funds Purchased and Securities Sold Under Agreements to	13,787	13,787	13,787	—	—
Repurchase					
Federal Home Loan Bank Term Advances	20,000	20,519	—	20,519	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	405	405	405	—	—

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Fair Value Methodology for Financial Instruments Not Measured on a Recurring or Nonrecurring Basis

Securities held-to-maturity are fair valued utilizing an independent bond pricing service for identical assets or significantly similar securities. The pricing service uses a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to the pricing models include recent trades, benchmark interest rates, spreads and actual and projected cash flows.

Fair values for loans are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by type such as commercial, commercial real estate, residential mortgage, indirect and other consumer loans. Each loan category is further segmented into fixed and adjustable interest rate terms and by performing and nonperforming categories. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan. The estimate of maturity is based on historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of current economic and lending conditions. Fair value for nonperforming loans is generally based on recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discount rates are judgmentally determined using available market information and specific borrower information.

The fair value of time deposits is based on the discounted value of contractual cash flows, except that the fair value is limited to the extent that the customer could redeem the certificate after imposition of a premature withdrawal penalty.

The discount rates are estimated using the FHLBNY yield curve, which is considered representative of Arrow's time deposit rates. The fair value of all other deposits is equal to the carrying value.

The fair value of FHLBNY advances is estimated based on the discounted value of contractual cash flows. The discount rate is estimated using current rates on FHLBNY advances with similar maturities and call features.

Based on Arrow's capital adequacy, the book value of the outstanding trust preferred securities (Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts) are considered to approximate fair value since the interest rates are variable (indexed to LIBOR) and Arrow is well-capitalized.

Report of Independent Registered Public Accounting Firm
The Board of Directors and Stockholders
Arrow Financial Corporation:

We have reviewed the consolidated balance sheets of Arrow Financial Corporation and subsidiaries (the Company) as of March 31, 2015 and 2014, and related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the three-month periods ended March 31, 2015 and 2014. These consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Arrow Financial Corporation and subsidiaries as of December 31, 2014, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and in our report dated March 13, 2015, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2014, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP
Albany, New York
May 8, 2015

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

March 31, 2015

Note on Terminology - In this Quarterly Report on Form 10-Q, the terms "Arrow," "the registrant," "the company," "we," "us," and "our" generally refer to Arrow Financial Corporation and its subsidiaries as a group, except where the context indicates otherwise.

The Company and Its Subsidiaries - Arrow is a two-bank holding company headquartered in Glens Falls, New York. Our banking subsidiaries are Glens Falls National Bank and Trust Company (Glens Falls National) whose main office is located in Glens Falls, New York, and Saratoga National Bank and Trust Company (Saratoga National) whose main office is located in Saratoga Springs, New York. Our non-bank subsidiaries include Capital Financial Group, Inc. (an insurance agency specializing in selling and servicing group health care policies); three property and casualty insurance agencies: Loomis & LaPann, Inc., Upstate Agency LLC, and McPhillips Agency which is a division of Glens Falls National Insurance Agencies LLC; North Country Investment Advisers, Inc. (a registered investment adviser that provides investment advice to our proprietary mutual funds); Glens Falls National Community Development Corporation (which invests in qualifying community development projects); and Arrow Properties, Inc. (a real estate investment trust, or REIT). All of these are wholly- owned or majority owned subsidiaries of Glens Falls National.

Our Peer Group - At certain points in this Report, our performance is compared with that of our "peer group" of financial institutions. Unless otherwise specifically stated, this peer group is comprised of the group of 342 domestic bank holding companies with \$1 to \$3 billion in total consolidated assets as identified in the Federal Reserve Board's "Bank Holding Company Performance Report" for December 31, 2014 (the most recent such Report currently available), and peer group data contained herein has been derived from such Report.

Forward Looking Statements - This Quarterly Report on Form 10-Q contains statements that are not historical in nature but rather are based on our beliefs, assumptions, expectations, estimates and projections about the future. These statements are "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and involve a degree of uncertainty and attendant risk. Words such as "expects," "believes," "anticipates," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. Some of these statements, such as those included in the interest rate sensitivity analysis in Part I, Item 3, entitled "Quantitative and Qualitative Disclosures About Market Risk," are merely presentations of what future performance or changes in future performance would look like based on hypothetical assumptions and on simulation models. Other forward-looking statements are based on our general perceptions of market conditions and trends in business activity, both our own and in the banking industry generally, as well as current management strategies for future operations and development.

Examples of Forward-Looking Statements:

Topic	Page	Location
Future compliance with regulatory capital standards	34	1st paragraph under "Regulatory Capital and Increase in Stockholders' Equity"
VISA	35	"VISA Class B Common Stock"
Impact of market rate structure on net interest margin, loan yields and deposit rates	40	1st and last paragraphs under "Quarterly Taxable Equivalent Yield on Loans"
	50	Last paragraph under "Quantitative and Qualitative Disclosures about Market Risk"
Future level of residential real estate loans	40	

		2nd paragraph under "Residential Real Estate Loans"
Future level of indirect consumer loans	40	Last paragraph under "Automobile Loans"
Future level of commercial loans	40	3rd paragraph under "Commercial, Commercial Real Estate and Construction and Land Development Loans"
Impact of changes in mortgage rates	42	Paragraph under "Investment Sales, Purchases and Maturities"
Provision for loan losses	43	1st paragraph in section
Future level of nonperforming assets	44	Last 3 paragraphs under "Risk Elements"
Liquidity	46	2nd full paragraph
Fees for other services to customers	48	3rd paragraph under "Noninterest Income"

Forward-looking statements contained herein are not guarantees of future performance and involve certain risks and uncertainties that are difficult to quantify or, in some cases, to identify. In the case of all such forward-looking statements, actual outcomes and results may differ materially from what the statements predict or forecast. Factors that could cause or contribute to such differences include, but are not limited to:

- a. rapid and dramatic changes in economic and market conditions, such as the U.S. economy experienced in the early stages of the 2008-2009 "financial crisis;"
- b. sharp fluctuations in interest rates, economic activity, and consumer spending patterns;
- c. network attacks or unauthorized access to computer systems and network infrastructure, interruptions of service and other security risks;
- d. sudden changes in the market for products we provide, such as real estate loans;

significant new banking laws and regulations, including an assortment of banking regulations recently issued or still to be issued under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act or Dodd-Frank);

f. unexpected or enhanced competition from new or unforeseen sources; and

g. similar uncertainties inherent in banking operations, the financial world, or governmental finance generally, such as periodic heightened concerns about U.S. or state governmental budgets, deficits, spending and taxes.

Readers are cautioned not to place undue reliance on forward-looking statements in this Report, which speak only as of the date hereof. We undertake no obligation to revise or update these forward-looking statements to reflect the occurrence of unanticipated events. This Quarterly Report should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014.

USE OF NON-GAAP FINANCIAL MEASURES

The Securities and Exchange Commission (SEC) has adopted Regulation G, which applies to all public disclosures, including earnings releases, made by registered companies that contain “non-GAAP financial measures.” GAAP is generally accepted accounting principles in the United States of America. Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure (if a comparable GAAP measure exists) and a statement of the Company’s reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. The SEC has exempted from the definition of “non-GAAP financial measures” certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. Financial institutions like the Company and its subsidiary banks are subject to an array of bank regulatory capital measures that are financial in nature but are not based on GAAP and are not easily reconcilable to the closest comparable GAAP financial measures, even in those cases where a comparable measure exists. The Company follows industry practice in disclosing its financial condition under these various regulatory capital measures, including period-end regulatory capital ratios for itself and its subsidiary banks, in its periodic reports filed with the SEC, including this Report, and does so without compliance with Regulation G, on the widely-shared assumption that the SEC regards such non-GAAP measures to be exempt from Regulation G.

In addition, the Company uses in this Report several additional non-GAAP financial measures that are commonly utilized by financial institutions and have not been specifically exempted by the SEC from Regulation G. Some of the more significant such non-GAAP measures included in this Report are identified and described below, with a brief explanation for the Company’s usage of such measures. Where any such non-GAAP measure is used in this Report, and a comparable GAAP measure exists, a reconciliation of the non-GAAP measure to the GAAP measure is set forth in proximity to, or cross-referenced from, the non-GAAP measure.

Tax-Equivalent Net Interest Income and Net Interest Margin: Net interest income, as a component of the tabular presentation by financial institutions of Selected Financial Information regarding their recently completed operations, as well as disclosures based on that tabular presentation, is commonly presented on a tax-equivalent basis. That is, to the extent that some component of the institution’s net interest income, which is presented on a before-tax basis, is exempt from taxation (e.g., is received by the institution as a result of its holdings of state or municipal obligations), an amount equal to the tax benefit derived from that component is added to the actual before-tax net interest income total. This adjustment is considered helpful in comparing one financial institution’s net interest income to that of another institution or in analyzing any institution’s net interest income trend line over time, to correct any analytical distortion that might otherwise arise from the fact that financial institutions vary widely in the proportions of their portfolios that are invested in tax-exempt securities, and that even a single institution may significantly alter over time the proportion of its own portfolio that is invested in tax-exempt obligations. Moreover, net interest income is itself a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, tax-equivalent net interest income is generally used by financial institutions, again to provide a better basis of comparison from institution to institution and to better demonstrate a single institution’s performance over time. We follow these practices.

The Efficiency Ratio: Financial institutions often use an "efficiency ratio" as a measure of expense control. The efficiency ratio typically is defined as the ratio of noninterest expense to net interest income and noninterest income.

Net interest income as utilized in calculating the efficiency ratio is typically the same as the net interest income presented in Selected Financial Information table discussed in the preceding paragraph, i.e., it is expressed on a tax-equivalent basis. Moreover, most financial institutions, in calculating the efficiency ratio, also adjust both noninterest expense and noninterest income to exclude from these items (as calculated under GAAP) certain recurring component elements of income and expense, such as intangible asset amortization (deducted from noninterest expense) and securities gains or losses (excluded from noninterest income). We follow these practices.

Tangible Book Value per Share: Tangible equity is total stockholders' equity less intangible assets. Tangible book value per share is tangible equity divided by total shares issued and outstanding. Tangible book value per share is often regarded as a more meaningful comparative ratio than book value per share as calculated under GAAP, that is, total stockholders' equity including intangible assets divided by total shares issued and outstanding. Intangible assets includes many items, but in our case, essentially represents goodwill.

Adjustments for Certain Items of Income or Expense: In addition to our disclosures of net income, earnings per share (i.e. EPS), return on average assets (i.e. ROA), return on average equity (i.e. ROE) and other financial measures that are prepared in accordance with GAAP, we may also provide comparative disclosures that adjust these GAAP financial measures by removing the impact of certain transactions or other material items of income or expense. We believe that the resulting non-GAAP financial measures may improve an understanding of our results of operations by separating out items that have a disproportional positive or negative impact on the particular period in question.

Additionally, we believe that the adjustment for certain items allows a better comparison from period-to-period in our results of operations with respect to our fundamental lines of business including the commercial banking business. We believe that such non-GAAP financial measures disclosed by us from time-to-time are useful in evaluating our performance and that such information should be considered as supplemental in nature and not as a substitute for or superior to the related financial information prepared in accordance with GAAP.

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Selected Quarterly Information - Unaudited (dollars in thousands except per share amounts)

Quarter Ended	3/31/2015	12/31/2014	9/30/2014	6/30/2014	3/31/2014
Net Income	\$5,855	\$6,369	\$6,147	\$5,524	\$5,320

Transactions Recorded in Net Income (Net of Tax):

Net Gain (Loss) on Securities Transactions	55	—	83	(16)	—
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Share and Per Share Data: ¹

Period End Shares Outstanding	12,635	12,622	12,605	12,597	12,597
Basic Average Shares Outstanding	12,633	12,614	12,606	12,595	12,601
Diluted Average Shares Outstanding	12,671	12,655	12,621	12,616	12,625
Basic Earnings Per Share	\$0.46	\$0.50	\$0.49	\$0.44	\$0.42
Diluted Earnings Per Share	0.46	0.50	0.49	0.44	0.42
Cash Dividend Per Share	0.25	0.25	0.25	0.25	0.25

Selected Quarterly Average Balances:

Interest-Bearing Deposits at Banks	30,562	58,048	15,041	22,486	17,184	
Investment Securities	673,753	664,334	653,702	712,088	755,008	
Loans	1,422,005	1,401,601	1,361,347	1,328,639	1,284,649	
Deposits	1,949,776	1,962,698	1,861,115	1,900,399	1,887,589	
Other Borrowed Funds	69,034	56,185	67,291	60,900	68,375	
Shareholders' Equity	202,552	202,603	199,518	196,478	194,127	
Total Assets	2,248,054	2,247,576	2,154,307	2,183,611	2,176,038	
Return on Average Assets, annualized	1.06	% 1.12	% 1.13	% 1.01	% 0.99	%
Return on Average Equity, annualized	11.72	% 12.47	% 12.22	% 11.28	% 11.11	%
Return on Tangible Equity, annualized ²	13.42	% 14.28	% 14.04	% 12.99	% 12.84	%
Average Earning Assets	\$2,126,320	\$2,123,983	\$2,030,090	\$2,063,213	\$2,056,841	
Average Paying Liabilities	1,713,253	1,716,699	1,626,327	1,680,149	1,678,080	
Interest Income, Tax-Equivalent ³	18,073	18,213	17,834	17,837	17,439	
Interest Expense	1,086	1,219	1,399	1,555	1,594	
Net Interest Income, Tax-Equivalent ³	16,987	16,994	16,435	16,282	15,845	
Tax-Equivalent Adjustment ³	1,083	1,073	1,074	1,142	1,173	
Net Interest Margin, annualized ³	3.24	% 3.17	% 3.21	% 3.17	% 3.12	%

Efficiency Ratio Calculation: ⁴

Noninterest Expense	\$13,955	\$13,299	\$13,526	\$13,737	\$13,466	
Less: Intangible Asset Amortization	(91)	) (94)	) (94)	) (94)	) (106)
Net Noninterest Expense	\$13,864	\$13,205	\$13,432	\$13,643	\$13,360	
Net Interest Income, Tax-Equivalent	\$16,987	\$16,994	\$16,435	\$16,282	\$15,845	
Noninterest Income	6,856	7,060	7,351	7,019	6,886	
Less: Net Securities (Gain) Loss	(90)	) —	) (137)	) 27) —	
Net Gross Income	\$23,753	\$24,054	\$23,649	\$23,328	\$22,731	
Efficiency Ratio	58.37	% 54.90	% 56.80	% 58.48	% 58.77	%

Period-End Capital Information:

Total Stockholders' Equity (i.e. Book Value)	\$204,965	\$200,926	\$200,089	\$197,616	\$194,491
Book Value per Share	16.22	15.92	15.87	15.69	15.44

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Goodwill and Other Intangible Assets, net	25,492	25,628	25,747	25,868	25,999	
Tangible Book Value per Share ²	14.20	13.89	13.83	13.63	13.38	
Bank Regulatory Capital Ratios: ⁵						
Tier 1 Leverage Ratio	9.57	% 9.44	% 9.68	% 9.39	% 9.30	%
Common Equity Tier 1 Capital Ratio	13.27	% N/A	N/A	N/A	N/A	
Tier 1 Risk-Based Capital Ratio	14.65	% 14.47	% 14.41	% 14.49	% 14.55	%
Total Risk-Based Capital Ratio	15.73	% 15.54	% 15.48	% 15.57	% 15.62	%
Assets Under Trust Administration and Investment Management	\$1,254,823	\$1,227,179	\$1,199,930	\$1,214,841	\$1,182,661	

See Footnote on page 33

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Arrow Financial Corporation
 Selected Quarterly Information - Continued
 (Dollars In Thousands, Except Per Share Amounts - Unaudited)

Footnotes:

1. Share and Per Share Data have been restated for the September 29, 2014, 2% stock dividend.

Tangible Book Value and Tangible Equity exclude goodwill and other intangible assets, net from total equity.

2. These are non-GAAP financial measures which we believe provide investors with information that is useful in understanding our financial performance.

	3/31/2015	12/31/2014	9/30/2014	6/30/2014	3/31/2014
Total Stockholders' Equity (GAAP)	\$ 204,965	\$ 200,926	\$ 200,089	\$ 197,616	\$ 194,491
Less: Goodwill and Other Intangible assets, net	25,492	25,628	25,747	25,868	25,999
Tangible Equity (Non-GAAP)	\$ 179,473	\$ 175,298	\$ 174,342	\$ 171,748	\$ 168,492
Period End Shares Outstanding	12,635	12,622	12,605	12,597	12,597
Tangible Book Value per Share (Non-GAAP)	\$ 14.20	\$ 13.89	\$ 13.83	\$ 13.63	\$ 13.38

3. Net Interest Margin is the ratio of our annualized tax-equivalent net interest income to average earning assets. This is also a non-GAAP financial measure which we believe provides investors with information that is useful in understanding our financial performance.

	3/31/2015	12/31/2014	9/30/2014	6/30/2014	3/31/2014
Net Interest Income (GAAP)	\$ 15,904	\$ 15,921	\$ 15,361	\$ 15,140	\$ 14,672
Add: Tax-Equivalent adjustment (Non-GAAP)	1,083	1,073	1,074	1,142	1,173
Net Interest Income - Tax Equivalent (Non-GAAP)	\$ 16,987	\$ 16,994	\$ 16,435	\$ 16,282	\$ 15,845
Average Earning Assets	2,126,320	2,123,983	2,030,090	2,063,213	2,056,841
Net Interest Margin (Non-GAAP)*	3.24	% 3.17	% 3.21	% 3.17	% 3.12

4. Financial institutions often use this non-GAAP ratio as a measure of expense control. We believe that the efficiency ratio measures provides investors with information that is useful in understanding our financial performance.

5. Common Equity Tier 1 Capital Ratio (CET1), for financial institutions, was effective beginning on January 1, 2015. Our CET1 capital ratio exceeds the fully phased-in required minimum CET1 and capital Conservation Buffer of 7.00%.

	3/31/2015	12/31/2014	9/30/2014	6/30/2014	3/31/2014
Total Risk Weighted Assets	\$ 1,452,975	N/A	N/A	N/A	N/A
Common Equity Tier 1 Capital	\$ 192,865	N/A	N/A	N/A	N/A
Common Equity Tier 1 Ratio	13.27	% N/A	N/A	N/A	N/A

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Average Consolidated Balance Sheets and Net Interest Income Analysis
(see "Use of Non-GAAP Financial Measures" on page 31)
(Fully Taxable Basis using a marginal tax rate of 35%)
(Dollars In Thousands)

Three-Month Period Ended March 31:	2015			2014		
	Average Balance	Interest Income/Expense	Rate Earned/Paid	Average Balance	Interest Income/Expense	Rate Earned/Paid
Interest-Bearing Deposits at Banks	\$30,562	\$21	0.28 %	\$17,184	\$13	0.31 %
Investment Securities:						
Fully Taxable	407,665	1,948	1.94	436,477	2,012	1.87
Exempt from Federal Taxes	266,088	2,358	3.59	318,531	2,562	3.26
Loans	1,422,005	13,746	3.92	1,284,649	12,852	4.06
Total Earning Assets	2,126,320	18,073	3.45	2,056,841	17,439	3.44
Allowance for Loan Losses	(15,533)			(14,381)		
Cash and Due From Banks	31,415			30,512		
Other Assets	105,852			103,066		
Total Assets	\$2,248,054			\$2,176,038		
Deposits:						
NOW Accounts	\$914,329	330	0.15	\$857,286	464	0.22
Savings Deposits	528,276	167	0.13	510,428	219	0.17
Time Deposits of \$100,000 or More	60,370	90	0.60	75,819	230	1.23
Other Time Deposits	141,244	202	0.58	166,172	391	0.95
Total Interest-Bearing Deposits	1,644,219	789	0.19	1,609,705	1,304	0.33
Short-Term Borrowings	29,256	15	0.21	28,375	19	0.27
FHLB/NT Term Advances and Other	39,778	282	2.88	40,000	271	2.75
Long-Term Debt						
Total Interest-Bearing Liabilities	1,713,253	1,086	0.26	1,678,080	1,594	0.39
Demand Deposits	305,557			277,884		
Other Liabilities	26,692			25,947		
Total Liabilities	2,045,502			1,981,911		
Stockholders' Equity	202,552			194,127		
Total Liabilities and Stockholders' Equity	\$2,248,054			\$2,176,038		
Net Interest Income (Tax-equivalent Basis)		16,987			15,845	
Reversal of Tax Equivalent Adjustment		(1,083)	0.21 %		(1,173)	0.23 %
Net Interest Income		\$15,904			\$14,672	
Net Interest Spread			3.19 %			3.05 %
Net Interest Margin			3.24 %			3.12 %

OVERVIEW

We reported net income for the first quarter of 2015 of \$5.9 million, representing diluted earnings per share (EPS) of \$0.46. This EPS result was an increase of four cents, or 9.5%, from the EPS of \$0.42 reported for the first quarter of 2014. Return on average equity (ROE) for the 2015 quarter continued to be strong at 11.72%, up from an ROE of 11.11% for the quarter ended March 31, 2014. Return on average assets (ROA) for the 2015 first quarter was 1.06%, an increase from an ROA of 0.99% for the quarter ended March 31, 2014. Our net interest margin also increased from the year earlier quarter by 12 basis points, from 3.12% to 3.24%. Total assets were \$2.336 billion at March 31, 2015, which represented an increase of \$118.1 million, or 5.3%, from the level at December 31, 2014, and an increase of

\$113.9 million, or 5.1%, from the March 31, 2014 level.

The changes in net income, net interest income and net interest margin between the three-month periods are more fully described under the heading "RESULTS OF OPERATIONS," beginning on page 47.

Stockholders' equity was \$205.0 million at March 31, 2015, an increase of \$10.5 million, or 5.4%, from the year earlier level. Stockholders' equity was also up \$4.0 million, or 2.0%, from the December 31, 2014 level of \$200.9 million. The components of the change in stockholders' equity since year-end 2014 are presented in the Consolidated Statement of Changes in Stockholders' Equity on page 6, and are discussed in more detail in the next section.

Regulatory Capital and Increase in Stockholders' Equity: The new regulatory capital requirements, as approved by the federal bank regulatory authorities in July 2013 (the "New Capital Rules"), went into effect for the Company on January 1, 2015. At period-end, we exceeded by a substantial amount all regulatory minimum capital requirements under the New Capital Rules (including the new Common Equity Tier 1 Capital ratio) at both the holding company and bank levels. As of March 31, 2015 both of our banks, as well as our holding

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company, qualified as "well-capitalized" under the adjusted federal bank regulatory guidelines that became effective contemporaneously with the New Capital Rules. Our regulatory capital levels in recent years have consistently remained well in excess of the various required regulatory minimums in effect from time to time, and are well in excess of the currently required minimum levels under the New Capital Rules, because of our continued profitability and strong asset quality.

At March 31, 2015, our tangible book value per share (calculated based on stockholders' equity reduced by goodwill and other intangible assets) amounted to \$14.20, an increase of \$0.31, or 2.2%, from the December 31, 2014 level and an increase of \$0.82, or 6.1%, from the level as of March 31, 2014. Our total stockholders' equity at March 31, 2015 increased 5.4% over the year-earlier level, and our total book value per share increased by 5.0% over the year earlier level. In the past three months, total shareholders' equity increased 2.0% and our total book value per share increased by the same 2.0%. The increase in stockholders' equity over the first three months of 2014 principally reflected the following factors: (i) \$5.9 million net income for the period and (ii) issuance of \$0.2 million of common stock through our employee benefit and dividend reinvestment plans; offset in part by (iii) cash dividends of \$3.2 million; and (iv) repurchases of our own common stock of \$0.1 million. As of March 31, 2015, our closing stock price was \$27.15, representing a trading multiple of 1.91 to our tangible book value. As adjusted for a 2% stock dividend distributed September 29, 2014, the Company paid a quarterly cash dividend of \$.245 per share for each of the first three quarters of 2014, and a cash dividend of \$.25 per share for the last quarter of 2014 and the first quarter of 2015.

Loan Quality: The credit quality of our loan portfolio has continued in recent periods to be significantly stronger than the average for our peer group of U.S. bank holding companies with \$1 billion to \$3 billion in total assets (see page 30 for information on how we define our peer group).

Our net charge-offs for the first quarter of 2015 were \$220 thousand as compared to \$256 thousand for the comparable 2014 quarter. Our ratio of net charge-offs to average loans (annualized) for the first quarter of 2015 and 2014 were 0.06% and 0.08%, respectively. By contrast, our peer group's weighted average ratio of net charge-offs to average loans for the 2014 year was 0.15%. At March 31, 2015, our allowance for loan losses was \$15.6 million representing 1.09% of total loans, down one basis point from the December 31, 2014 ratio, reflecting the continuing strong credit quality in the loan portfolio.

Nonperforming loans were \$7.9 million at March 31, 2015, representing 0.55% of period-end loans; our year-earlier ratio was 0.53%. By way of comparison, the weighted average ratio for our peer group was 1.03% at December 31, 2014, which represented a significant improvement from the peer group's ratios of earlier years. For example, our peer group's nonperforming loans ratio was 3.60% at year-end 2010, the high-point after the onset of the 2008 recession, while our ratio has remained quite low and stable from 2008 through the date of this Report.

During the first three months of 2015, we experienced increases in outstanding balances in each of the three largest segments of our loan portfolio, without any significant deterioration in our credit quality:

Residential Real Estate Loans: These loans, including home equity loans, made up approximately 38% of our portfolio at period-end. The residential real estate market in our service area has been stable in recent periods. During the worst of the financial crisis, we did not experience a notable increase in our foreclosure or loss rates on our residential real estate loans, nor have we in ensuing periods, primarily due to the fact that we never have originated or participated in underwriting high-risk mortgage loans, such as so called "Alt A," "negative amortization," "option ARM's" or "negative equity" loans. We originated all of the residential real estate loans currently held in our portfolio and apply conservative underwriting standards to our originations.

Commercial and Commercial Real Estate Loans: These loans comprised approximately 31% of our loan portfolio at period-end. Current unemployment rates in our region remain slightly elevated from pre-crisis levels, although the local economy continues to be stable and in some areas recovering. Similarly, commercial property values in our region remain stable, and did not show significant deterioration even in the worst phases of the financial crisis. We update the appraisals on our nonperforming and watched commercial loan properties as deemed necessary, usually when the loan is downgraded or when we perceive significant market deterioration since our last appraisal.

Automobile (Primarily Through Indirect Lending) and Other Consumer Loans: These loans (primarily automobile) comprised approximately 31% of our loan portfolio. In the first three months of 2015, we did not experience any

significant change in our delinquency rate or level of nonperforming loans in this segment.

Liquidity and Access to Credit Markets: We have not experienced any liquidity problems or special concerns during 2015 to date, nor did we during 2014 or 2013. The terms of our lines of credit with our correspondent banks, the FHLB NY and the Federal Reserve Bank have not changed. In general, we rely on asset-based liquidity (i.e., funds in overnight investments and cash flow from maturing investments and loans) with liability-based liquidity as a secondary source. Our main liability-based sources are overnight borrowing arrangements with our correspondent banks, term credit arrangement advances from the FHLB NY and the Federal Reserve Bank discount window. During the recent financial crisis, many financial institutions, small and large, relied extensively on the Fed's discount window to support their liquidity positions, but we had no such need. We regularly perform a liquidity stress test and periodically test our contingent liquidity plan to ensure that we can generate an adequate amount of available funds to meet a wide variety of potential liquidity crises, including a severe crisis.

Visa Class B Common Stock: Our banks, as former member banks of Visa, continue to bear some indirect contingent liability to various third parties who may have certain claims against Visa, including class action claims, to the extent that Visa's direct liabilities resulting from such claims ultimately exceed the amounts held in a certain litigation escrow account set up by Visa to defray such liabilities using funds which would otherwise be owed by it to its member banks in redemption of their Class B Visa shares. In July 2012, Visa and MasterCard entered into a Memorandum of Understanding ("MOU") with a class of plaintiffs to settle certain covered antitrust claims against the two card companies involving merchant discounts. In December 2013, a federal judge gave final approval to the class settlement agreement in this litigation. The total cash settlement payment was set at approximately \$6.05 billion, of which Visa's share represented approximately \$4.4 billion. Visa has paid its portion of this settlement from the litigation escrow account. In the second quarter 2012, in light of the state of covered litigation at Visa at the time, which was then winding down (as it continues to do), as well as the substantial

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remaining dollar amount in the litigation escrow fund, we determined to reverse the entire amount of our 2008 VISA litigation-related accrual, which was then \$294 thousand pre-tax. This reversal reduced our other operating expenses for the year ending December 31, 2012. We believed then, and continue to believe, that the balance that Visa maintains in its escrow fund is substantially sufficient to satisfy Visa's remaining direct liability to such claims without further resort to the contingent liability of the former Visa member banks. At March 31, 2015, the Company held 27,771 shares of Visa Class B common stock and we continue not to recognize any economic value for these shares.

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CHANGE IN FINANCIAL CONDITION

Summary of Selected Consolidated Balance Sheet Data

(Dollars in Thousands)

	At Period-End			\$ Change From December	\$ Change From March	% Change From December	% Change From March		
	March 31, 2015	December 31, 2014	March 31, 2014						
Interest-Bearing Bank Balances	\$73,654	\$11,214	\$35,994	\$62,440	\$37,660	556.8	%	104.6	%
Securities Available-for-Sale	393,133	366,139	429,230	26,994	(36,097)	7.4	%	(8.4)	%
Securities Held-to-Maturity	305,175	302,024	317,632	3,151	(12,457)	1.0	%	(3.9)	%
Loans ⁽¹⁾	1,434,794	1,413,268	1,310,423	21,526	124,371	1.5	%	9.5	%
Allowance for Loan Losses	15,625	15,570	14,636	55	989	0.4	%	6.8	%
Earning Assets ⁽¹⁾	2,211,562	2,097,496	2,097,175	114,066	114,387	5.4	%	5.5	%
Total Assets	2,335,528	2,217,420	2,221,581	118,108	113,947	5.3	%	5.1	%
Demand Deposits	310,878	300,786	277,086	10,092	33,792	3.4	%	12.2	%
NOW Accounts	967,537	871,671	908,028	95,866	59,509	11.0	%	6.6	%
Savings Deposits	541,750	524,648	524,670	17,102	17,080	3.3	%	3.3	%
Time Deposits of \$100,000 or More	59,886	61,797	74,127	(1,911)	(14,241)	(3.1)	%	(19.2)	%
Other Time Deposits	138,653	144,046	164,108	(5,393)	(25,455)	(3.7)	%	(15.5)	%
Total Deposits	\$2,018,704	\$1,902,948	\$1,948,019	\$115,756	\$70,685	6.1	%	3.6	%
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	\$15,895	\$19,421	\$13,787	\$(3,526)	\$2,108	(18.2)	%	15.3	%
FHLB Advances - Overnight	—	41,000	—	(41,000)	—	(100.0)	%	—	%
FHLB Advances - Term	50,000	10,000	20,000	40,000	30,000	400.0	%	150.0	%
Stockholders' Equity	204,965	200,926	194,491	4,039	10,474	2.0	%	5.4	%

(1) Includes Nonaccrual Loans

Municipal Deposits: Fluctuations in balances of our NOW accounts and time deposits of \$100,000 or more are largely the result of municipal deposit seasonality factors. Over the past twelve months, municipal deposits on average have ranged from 28% to over 34% of our total deposits. As of March 31, 2015, typically a seasonal high point for our municipal deposits, such deposits represented 34.7% of total deposits. Municipal deposits typically are invested in NOW accounts and time deposits of short duration. Many of our municipal deposit relationships are subject to annual renewal, by formal or informal agreement.

In general, there is a seasonal pattern to municipal deposits starting with a low point during July and August. Account balances tend to increase throughout the fall and remain elevated during the winter months, due to tax deposits, and generally receive an additional boost at the end of March from the electronic deposit of state aid to school districts. In addition to these seasonal fluctuations within accounts, the overall level of municipal deposit balances fluctuates from year-to-year as some municipalities move their accounts in or out of our banks due to competitive factors. Often, the balances of municipal deposits at the end of a quarter are not representative of the average balances for that quarter. The recent financial crisis had a significant negative impact on municipal tax revenues in many regions, and consequently on municipal funds available for deposit. To date, this has not resulted in either a sustained decrease in municipal deposit levels at our banks, adjusted for seasonal fluctuations, or an overall increase in the average rate we pay on such deposits (despite the continuing strong competition for such deposits). However, if in the future interest rates begin to rise significantly or the competition for municipal deposits otherwise becomes more intense, we may

experience either or both of these adverse developments, i.e., a sustained decrease in municipal deposit levels and/or an overall increase in the average rate we pay on such deposits.

Changes in Sources of Funds: In recent periods, for cost reasons and because of the sustained growth of customer deposits even at very low rates, we have lessened our reliance on wholesale funding sources and increased our reliance on customer deposits as a source of day-to-day funding. Our total deposits increased \$115.8 million, or 6.1%, from December 31, 2014 to March 31, 2015, mainly due to an increase in our municipal deposits, principally at period-end. Our non-municipal deposit balances also increased over the past three months, again, more strongly at period-end, although we also experienced throughout the period a general shift in balances from time deposits to savings and NOW accounts, a long-running trend matching the continuing decline in recent years in prevailing deposit rates and interest rates generally. At March 31, 2015 we were a net seller of overnight funds (held as interest-bearing balances at the Federal Reserve Bank), while at December 31, 2014 we were a borrower of \$41.0 million of overnight funds from the FHLB of New York. At March 31, 2015, our term advances from the FHLB were \$50.0 million, as we added \$40 million in medium term advances during the first quarter of 2015 in order to extend the average maturity of our interest-bearing liabilities.

Changes in Earning Assets: Our loan portfolio at March 31, 2015, was up by \$21.5 million, or 1.5%, from the December 31, 2014 level and up by \$124.4 million or 9.5%, from the March 31, 2014 level. We experienced the following trends in our three largest segments:

Commercial and commercial real estate loans. Our March 31, 2015 balance for this segment was essentially 1. unchanged from the December 31, 2014 total, representing the off-setting impact of continued strong loan demand and a large payoff during the quarter.

Residential real estate loans. The period-end balance increased by \$18.1 million, or 3.4%, from December 31, 2014. 2. We continued to sell some of our residential mortgage originations during the three-month period to Freddie Mac, although a smaller percentage than we sold in the same period the prior year. Demand for new mortgage loans was modest throughout the period.

Automobile loans (primarily through indirect lending). The balance of these loans at March 31, 2015, increased by \$4.5 million, or 1.0%, from the December 31, 2014 balance, reflecting a continuation of strong automobile sales region-wide and an expansion of our dealer network for indirect lending, as dealer sales in the region rebounded from a slow start to the year due to the effects of a cold and snowy winter in the northeast.

Most of our incoming cash flows for the first three months of 2015 came from a combination of an increase in deposit balances and from the \$40 million in new FHLB advances, mentioned earlier. We used these cash-flows to fund our loan growth and purchase investment securities. We placed the remainder of these funds in overnight investments to cover the seasonal reduction in municipal deposits expected over the next two months.

Deposit Trends

The following two tables provide information on trends in the balance and mix of our deposit portfolio by presenting, for each of the last five quarters, the quarterly average balances by deposit type and the percentage of total deposits represented by each deposit type. The principal change over the period was the steady drop-off in time deposits, including time deposits of \$100,000 or more, and corresponding steady increases in lower or no-cost deposits, including demand deposits, NOW accounts and savings deposits.

Quarterly Average Deposit Balances

(Dollars in Thousands)

	Quarter Ended				
	3/31/2015	12/31/2014	9/30/2014	6/30/2014	3/31/2014
Demand Deposits	\$305,557	\$302,184	\$302,079	\$281,150	\$277,884
NOW Accounts	914,329	920,592	801,998	865,910	857,286
Savings Deposits	528,276	525,609	530,057	520,028	510,428
Time Deposits of \$100,000 or More	60,370	65,202	69,351	71,656	75,819
Other Time Deposits	141,244	149,111	157,630	161,655	166,172
Total Deposits	\$1,949,776	\$1,962,698	\$1,861,115	\$1,900,399	\$1,887,589

Percentage of Total Quarterly Average Deposits

	Quarter Ended					
	3/31/2015	12/31/2014	09/30/2014	06/30/2014	03/31/2014	
Demand Deposits	15.7	% 15.4	% 16.2	% 14.8	% 14.7	%
NOW Accounts	46.9	46.9	43.1	45.5	45.5	
Savings Deposits	27.1	26.8	28.5	27.4	27.0	
Time Deposits of \$100,000 or More	3.1	3.3	3.7	3.8	4.0	
Other Time Deposits	7.2	7.6	8.5	8.5	8.8	
Total Deposits	100.0	% 100.0	% 100.0	% 100.0	% 100.0	%

For a variety of reasons, we typically experience little growth in average deposit balances in the first quarter of each calendar year (even though municipal balances tend to grow sharply at the very end of the first quarter), little net growth or a small contraction in the second quarter of the year (when municipal deposits normally drop off), and a return to growth in the third and fourth quarters (when municipal deposits tend to increase, sometimes substantially, to and through year-end). This pattern has held true in recent periods. Growth in average deposit balances from the first quarter of 2014 to the first quarter of 2015 came primarily from municipal deposits.

Quarterly Cost of Deposits

	Quarter Ended					
	3/31/2015	12/31/2014	9/30/2014	6/30/2014	3/31/2014	
Demand Deposits	—	% —	% —	% —	% —	%
NOW Accounts	0.15	0.16	0.19	0.23	0.22	
Savings Deposits	0.13	0.13	0.16	0.17	0.17	
Time Deposits of \$100,000 or More	0.60	0.88	1.12	1.13	1.23	
Other Time Deposits	0.58	0.72	0.84	0.89	0.95	

Total Deposits	0.16	0.20	0.24	0.27	0.28
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In keeping with industry trend lines, average rates paid by us on deposits decreased steadily over the five quarters ending March 31, 2015, for deposits generally and all deposit categories individually. Over the same period, our average yield on loans also decreased, for loans generally and across almost all loan categories (see "Quarterly Taxable Equivalent Yield on Loans," page 40). We make no representations that this downward trend in average deposit rates (and average yields on loans) will persist; at some point, deposit (and loan) rates are likely to level off and perhaps move upward.

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