ARROW FINANCIAL CORP
Form 10-K
March 05, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
Annual Report Pursuant to Section 13 or 15(d) of
The Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2009
Commission File Number: 0-12507
ARROW FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

New York	22-2448962
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

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
SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT - NONE
SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT
Common Stock, Par Value $1.00
(Title of Class)

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

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

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

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

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

Yes x No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter: $233,441,000

Indicate the number of shares outstanding of each of the registrant s classes of common stock.

Class	Outstanding as of February 22, 2010
Common Stock, par value $1.00 per share	10,924,856

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s Proxy Statement for the Annual Meeting of Stockholders to be held April 28, 2010 (Part III)

ARROW FINANCIAL CORPORATION

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*These items are incorporated by reference to the Corporation s Proxy Statement for the Annual Meeting of Stockholders to be held April 28, 2010.

NOTE ON TERMINOLOGY

In this Annual Report on Form 10-K, 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. 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. Subsidiaries of Glens Falls National include Capital Financial Group, Inc. (an insurance agency specializing in selling and servicing group health care policies), North Country Investment Advisers, Inc. (a registered investment adviser that provides investment advice to our proprietary mutual funds), U.S. Benefits, Inc. (a provider of administrative and recordkeeping services for more complex retirement plans) and Arrow Properties, Inc., a real estate investment trust (REIT).

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 296 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, 2009, and peer group data has been derived from such Report. This peer group is not, however, identical to either of the peer groups comprising the two bank indices included in the stock performance graphs on pages 13 and 14 of this Report.

FORWARD-LOOKING STATEMENTS

The information contained in this Annual Report on Form 10-K 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 often identify such forward-looking statements. Some of these statements, such as those included in the interest rate sensitivity analysis in Item 7A of this Report, 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 activity, both locally and nationally, as well as current management strategies for future operations and development.

Examples of forward-looking statements in this Report are referenced in the table below:

Topic	Section	Page	Location
Impact of Legislative Developments	Part I, Item 1.D.	8	Last paragraph in Section D
Impact of Changing Interest Rates on Earnings	Part II, Item 7.B.I.	24	Last paragraph
	Part II, Item 7.C.II.a.	25	3rd paragraph
	Part II,	34	Last paragraph under Indirect Loans

	Item 7.C.II.a.		
	Part II, Item 7.C.II.a.	35	1st paragraph under table
	Part II, Item 7.C.IV.	39	1st paragraph
	Part II, Item 7A.	43	Last three paragraphs
Adequacy of the Allowance for Loan Losses	Part II, Item 7.B.II.	26	1st and 2nd paragraphs under II. Provision For Loan Losses and Allowance For Loan Losses
Expected Level of Real Estate Loans	Part II, Item 7.C.II.a.	34	1st paragraph under Residential Real Estate Loans
Liquidity	Part II, Item 7.D.	40	3rd to Last paragraph in Section D Liquidity
Dividend Capacity	Part I, Item 1.C.	6	3rd to last paragraph under Section C Supervision and Regulation
	Part II, Item 7.E.	41	Next to last paragraph in Section E
Pension Plan	Part IV, Item 15	68	Next to last paragraph
		72	Paragraph in Cash Flows
Commitments to Extend Credit	Part IV, Item 15	76	1st paragraph

These statements 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 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; unexpected changes in economic and market conditions, including unanticipated fluctuations in interest rates and changes in the values of real estate and motor vehicles; severe changes in credit markets, including credit insurance markets; unforeseen developments in state and federal regulation of financial institutions; enhanced competition from unexpected sources, including governmental operation of previously private large banking organizations; new emerging technologies; unexpected loss of key personnel; and similar risks of major upheavals in financial operations and markets. Readers are cautioned not to place undue reliance on these forward-looking statements, 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.

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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 and a statement of the company s reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. As a parallel measure with Regulation G, the SEC has provided in Item 10 of its Regulation S-K, that public companies must make the same types of supplemental disclosures whenever they include non-GAAP financial measures in their filings with the SEC. 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 or SEC filings, supplemental information is not required. The following measures used in this Report, which although commonly utilized by financial institutions have not been specifically exempted by the SEC, may constitute "non-GAAP financial measures" within the meaning of the SEC's rules, although we are unable to state with certainty that the SEC would so regard them.

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, 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 back to the net interest income total. This adjustment is considered helpful in comparing one financial institution's net interest income to that of another institution, to correct any distortion that might otherwise arise from the fact that the two institutions typically will have different proportions of tax-exempt items in their portfolios. 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. 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 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 component elements, such as intangible asset amortization (deducted from noninterest expense) and securities gains or losses, including other-than-temporary impairment, (excluded from noninterest income). We follow these practices.

Tangible Book Value per Share: Tangible equity is total stockholders equity (as calculated under GAAP) 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, as a category of assets, includes many items, such as goodwill.

PART I

Item 1. Business

A. GENERAL

Our holding company, Arrow Financial Corporation, a New York corporation, was incorporated on March 21, 1983 and is registered as a bank holding company within the meaning of the Bank Holding Company Act of 1956. Arrow owns (directly or indirectly) two nationally chartered banks in New York (Glens Falls National and Saratoga National), an insurance agency (Capital Financial Group, Inc.), a registered investment adviser that advises our proprietary mutual funds (North Country Investment Advisers, Inc.), a Real Estate Investment Trust (Arrow Properties, Inc.) and four other non-bank subsidiaries whose operations are insignificant.

Subsidiary Banks (dollars in thousands)

	Glens Falls National	Saratoga National
Total Assets at Year-End	$1,571,797	$279,649
Trust Assets Under Administration and Investment Management at Year-End (Not Included in Total Assets)	$829,599	$37,555
Date Organized	1851	1988
Employees (full-time equivalent)	432	41
Offices	28	6
Counties of Operation	Warren, Washington, Saratoga, Essex & Clinton	Saratoga
Main Office	250 Glen Street Glens Falls, NY	171 So. Broadway Saratoga Springs, NY

The holding company s business consists primarily of the ownership, supervision and control of our two banks. The holding company provides various advisory and administrative services and coordinates the general policies and operation of the banks. There were 473 full-time equivalent employees at December 31, 2009.

We offer a full range of commercial and consumer banking and financial products. Our deposit base consists of deposits derived principally from the communities we serve. We target our lending activities to consumers and small and mid-sized companies in our immediate geographic areas. Through our banks' trust operations, we provide retirement planning, trust and estate administration services for individuals, and pension, profit-sharing and employee benefit plan administration for corporations.

In July 2008, we acquired the key operating assets, two employees and the trade name from U.S. Benefits, Inc., a provider of administrative and recordkeeping services for more complex retirement plans. This acquisition allows the Company to offer enhanced and broadened services to retirement plan clients and will complement the fiduciary services currently offered by the Company through its trust administrative and investment management activities.

In April 2005, we acquired from HSBC Bank USA, N.A. (HSBC) three bank branches located within our service area. Our subsidiary Glens Falls National acquired two HSBC branches located in Argyle and Salem, New York, and our subsidiary Saratoga National acquired a branch located in Corinth, New York. The banks acquired substantially all deposit liabilities, the physical facilities and certain loans related to the branches. At the closing of the acquisitions, total deposits of the three branches were approximately $62 million and the related loans were approximately $8 million. The acquisition resulted in total intangible assets, including goodwill, of approximately $5.9 million.

In November 2004, we acquired all of the outstanding shares of common stock of Capital Financial Group, Inc. (CFG), an insurance agency headquartered in South Glens Falls, New York, which specializes in group health and life insurance products. The acquisition was structured as a tax-free exchange of Arrow s common stock for CFG s common stock. CFG s president and staff continued with CFG after the acquisition. As adjusted for cumulative contingent payments, we recorded the following intangible assets as a result of the acquisition (none of which are deductible for income tax purposes): goodwill ($1.735 million), covenant not to compete ($117 thousand) and portfolio expirations ($686 thousand). The value of the covenant is being amortized over five years and the value of the expirations is being amortized over twenty years. Under the acquisition agreement, we issued 68,629 shares of Arrow s common stock at the closing. The agreement also provided for annual contingent post-closing payments of Arrow common stock, based upon earnings of CFG, adjusted as provided in the agreement, over the five-year period following the closing. We concluded that these contingent payments would be recorded as additional goodwill at the time of payment. Total contingent payments, for the now completed five-year period, amounted to $898 thousand (35,120 shares).

In 2000, we formed a subsidiary, North Country Investment Advisers, Inc. (NCIA), which is an investment adviser registered with the U. S. Securities and Exchange Commission. NCIA advises two SEC-registered mutual funds, the North Country Intermediate Bond Fund™ and the North Country Equity Growth Fund™. Currently, the investors in these funds consist primarily of individual, corporate and institutional trust customers of our Banks. However, the funds are also offered on a retail basis at most of the branch locations of our banks.

B. LENDING ACTIVITIES

Arrow engages in a wide range of lending activities, including commercial and industrial lending primarily to small and mid-sized companies; mortgage lending for residential and commercial properties; and consumer installment and home equity financing. We also maintain an active indirect lending program through our sponsorship of automobile dealer programs under which we purchase dealer paper, primarily from dealers that meet pre-established specifications. From time-to-time we sell a portion of our residential real estate loan originations into the secondary market, primarily to the Federal Home Loan Mortgage Corporation (Freddie Mac) and state housing agencies, while normally retaining the servicing rights.

In addition to sales of loans into the secondary market, we have periodically securitized some of the mortgage loans in our portfolio. In the securitized transactions, we have sold mortgage loans into a newly-formed trust and concurrently have purchased an equivalent amount of mortgage-backed securities issued by the trust that are guaranteed by Freddie Mac, with the sold loans representing the underlying collateral for the trust securities. We have no contingent liability to unrelated parties under these securitization arrangements. At December 31, 2009, the balance of these securitized loans remaining in our securities portfolio was approximately $2.1 million. In addition to interest earned on loans, we receive facility fees for various types of commercial and industrial credits, and commitment fees for extensions of letters of credit and certain types of loans.

Generally, we continue to implement lending strategies and policies that are intended to protect the quality of the loan portfolio, including strong underwriting and collateral control procedures and credit review systems. It is our policy to discontinue the accrual of interest on loans when the payment of interest and/or principal is due and unpaid for a designated period (generally 90 days) or when the likelihood of repayment is, in the opinion of management, uncertain (see Part II, Item 7.C.II.c. Risk Elements). Subsequent cash payments on loans classified as nonaccrual may be applied all to principal, although income in some cases may be recognized on a cash basis.

We lend almost exclusively to borrowers within our geographic area, with the exception of our indirect consumer lending line of business where we acquire retail paper on primarily automobile loans. We have an extensive network of automobile dealers, all of whom are located in New York State, that operate in a geographic area larger than our footprint primarily in the eastern region of upstate New York. The loan portfolio does not include any foreign loans or any other significant risk concentrations. We do not participate in loan syndications, either as originator or as a participant. Most of the portfolio, in general, is fully collateralized, and many commercial loans are further secured by personal guarantees.

We do not engage in subprime mortgage lending as a business line and we do not extend or purchase so-called Alt A, negative amortization, option ARM s or negative equity mortgage loans.

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C. SUPERVISION AND REGULATION

The following generally describes the laws and regulations to which we are subject. Bank holding companies, banks and their affiliates are extensively regulated under both federal and state law. To the extent that the following information summarizes statutory or regulatory law, it is qualified in its entirety by reference to the particular provisions of the various statutes and regulations. Any change in applicable law may have a material effect on our business and prospects.

Currently, as a result of the financial crisis that has affected the United States and most of the world s advanced nations, there has been much discussion in legal and regulatory circles about the need for fundamental financial reform in order to prevent a recurrence of the economic and financial collapse. Among the areas of banking law and regulation most commonly identified as necessitating reform are inadequate capital standards, over-reliance on securitization of loans, inconsistency or inadequacy of bank regulatory oversight, lax underwriting standards, and expansion of permitted bank activities into inappropriate non-banking business. It is impossible to predict at present what new banking laws or regulations ultimately will be enacted or promulgated or the impact thereof on our banks and our banking business, except to note that any such changes are likely to impose added restrictions on U.S. banks and banking activity generally, which may reduce profitability.

Arrow is a registered bank holding company within the meaning of the Bank Holding Company Act of 1956 (BHC Act) and is subject to regulation by the Board of Governors of the Federal Reserve System (FRB). Arrow is not a so-called financial holding company under federal banking law. Additionally, as a bank holding company under New York State law, Arrow is subject to a limited amount of regulation by the New York State Banking Department. Our two subsidiary banks are both nationally chartered banks and are subject to supervision and examination by the Office of the Comptroller of the Currency (OCC). The banks are members of the Federal Reserve System and the deposits of each bank are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (FDIC). The BHC Act generally prohibits Arrow from engaging, directly or indirectly, in activities other than banking, activities closely related to banking, and certain other financial activities. Under the BHC Act, a bank holding company must obtain FRB approval before acquiring, directly or indirectly, 5% or more of the voting shares of another bank or bank holding company (unless it already owns a majority of such shares). Bank holding companies are able to acquire banks or other bank holding companies located in all 50 states. The Gramm-Leach-Bliley Act, enacted in 1999, authorized bank holding companies to affiliate with a much broader array of other financial institutions than was previously permitted, including insurance companies, investment banks and merchant banks. See Item 1.D., Recent Legislative Developments.

An important area of banking regulation is the federal banking system s promulgation and enforcement of minimum capitalization standards for banks and bank holding companies. The FRB has adopted various "capital adequacy guidelines" for its use in the examination and supervision of bank holding companies. The FRB s risk-based capital guidelines assign risk weightings to all assets and certain off-balance sheet items and establish an 8% minimum ratio of qualified total capital to the aggregate dollar amount of risk-weighted assets (which is almost always less than the dollar amount of such assets without risk weighting). Under the risk-based guidelines, at least half of total capital must consist of "Tier 1" capital, which comprises common equity, retained earnings and a limited amount of permanent preferred stock, less goodwill. Under the FRB s guidelines, trust preferred securities may also qualify as Tier 1 capital, in an amount not to exceed 25% of Tier 1 capital. The final rule limits restricted core capital elements to a percentage of the sum of core capital elements, net of goodwill less any associated deferred tax liability. We issued trust preferred securities in 2003 and 2004 to serve as part of our core capital. Up to half of total capital may consist of so-called "Tier 2" capital, comprising a limited amount of subordinated debt, preferred stock not qualifying as Tier 1 capital, certain other instruments and a limited amount of the allowance for loan losses. The FRB s other important guideline for measuring a bank holding company s capital is the leverage ratio standard, which establishes minimum limits on the ratio of a bank holding company's "Tier 1" capital to total tangible assets (not risk-weighted). For top-rated holding companies, the minimum leverage ratio is 3%, but lower-rated companies may be required to meet substantially greater minimum ratios. Our subsidiary banks are subject to capital requirements similar to the capital requirements applicable at the holding company level described above. Our banks capital requirements have been promulgated by their primary federal regulator, the OCC. It is widely anticipated that prevailing capital guidelines will be strengthened by the regulatory authorities in upcoming years.

Under applicable law, federal banking regulators are required to take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. The regulators have established five capital classifications for banking institutions, the highest being "well-capitalized." Our holding company and both of our subsidiary banks currently qualify as well-capitalized. Under regulations adopted by the federal bank regulators, a banking institution is considered "well-capitalized" if it has a total risk-adjusted capital ratio of 10% or greater, a Tier 1 risk-adjusted capital ratio of 6% or greater and a leverage ratio of 5% or greater and is not subject to any regulatory order or written directive regarding capital maintenance. The year-end 2009 capital ratios of our holding company and our banks are set forth in Part II, Item 7.E. "Capital Resources and Dividends" and in Note 15 Regulatory Matters to the audited financial statements under Part II, Item 8 of this Report.

A holding company's ability to pay dividends or repurchase its outstanding stock, as well as its ability to expand its business through acquisitions of additional banking organizations or permitted non-bank companies, may be restricted if its capital falls below these minimum capitalization ratios or fails to meet other informal capital guidelines that the regulators may apply from time to time to specific banking organizations. In addition to these potential regulatory limitations on payment of dividends, our holding company s ability to pay dividends to our stockholders, and our subsidiary banks ability to pay dividends to our holding company are also subject to various restrictions under applicable corporate laws, including banking laws (affecting our subsidiary banks) and the New York Business Corporation Law (affecting our holding company). The ability of our holding company and banks to pay dividends in the future is, and is expected to continue to be, influenced by regulatory policies, capital guidelines and applicable law.

In cases where banking regulators have significant concerns regarding the financial condition, assets or operations of a bank or bank holding company, the regulators may take enforcement action or impose enforcement orders, formal or informal, against the organization. If the leverage ratio/Tier 1 risk-adjusted capital ratio of a bank falls below 2%, the bank may be closed and placed in receivership, with the FDIC as receiver.

The Emergency Economic Stabilization Act of 2008 (EESA), which includes the Troubled Asset Relief Program (TARP), and the American Recovery and Reinvestment Act of 2008 (the ARRA) were enacted in response to the financial crises affecting the banking system and financial markets. The EESA, the ARRA and related government programs include a variety of regulatory initiatives aimed at providing stability to the financial services industry and financial markets; however, many of these laws and programs are and will continue to impact the supervision and regulation of the banking industry. The impact of certain of these laws and programs are addressed in the following section regarding Recent Legislative Developments.

D. RECENT LEGISLATIVE DEVELOPMENTS

The recently enacted federal laws addressing the financial crisis, including EESA and ARRA, and the related, recently established governmental programs, such as the FDIC s Temporary Liquidity Guarantee Program (TLGP) and the U.S. Treasury s Capital Purchase Program (CPP), a component of TARP, are discussed at the end of this section.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 became effective October 17, 2005. The Act addressed many areas of bankruptcy practice, including consumer bankruptcy, general and small business bankruptcy, treatment of tax claims in bankruptcy, ancillary and cross-border cases, financial contract protection amendments to Chapter 12 governing family farmer reorganization, and special protection for patients of a health care business filing for bankruptcy. This Act did not have a significant impact on our earnings or on our efforts to recover collateral on secured loans. In January of 2008, Congress began to consider a bill that would give bankruptcy judges the power to alter rates, terms, balances and maturities of home mortgage loans.

The Sarbanes-Oxley Act, signed into law on July 30, 2002, adopted a number of measures having a significant impact on all publicly-traded companies, including Arrow. Generally, the Act sought to improve the quality of financial reporting of these companies by compelling them to adopt good corporate governance practices and by strengthening the independence of their auditors. The Act placed substantial additional duties on directors, officers, auditors and attorneys of public companies. Among other specific measures, the Act required that chief executive officers and chief financial officers certify to the SEC in the holding company s annual and quarterly reports filed with the SEC regarding the accuracy of its financial statements contained therein and the integrity of its internal controls. The Act also accelerated insiders' reporting requirements for transactions in company securities, restricts certain executive officer and director transactions, imposed obligations on corporate audit committees, and provided for enhanced review of company filings by the SEC. As part of the general effort to improve public company auditing, the Act places limits on consulting services that may be performed by a company's independent auditors by requiring that the company s Audit Committee of the Board of Directors evaluate amounts to determine independence. The Act created a federal public company accounting oversight board (the PCAOB) to set auditing standards, inspect registered public accounting firms, and exercise enforcement powers, subject to oversight by the SEC.

In the wake of the Sarbanes-Oxley Act, the nation s stock exchanges, including the exchange on which Arrow s stock is listed, the National Association of Securities Dealers, Inc. (NASD), promulgated a wide array of governance standards that must be followed by listed companies. The NASD standards include having a Board of Directors the majority of whose members are independent of management, and having audit, compensation and nomination committees of the Board consisting exclusively of independent directors. We have implemented a variety of corporate governance measures and procedures to comply with Sarbanes-Oxley and the amended NASD listing requirements, although we have always relied on a Board of Directors a majority of whose members are independent and independent Board committees to make important decisions regarding the company.

The USA Patriot Act initially adopted in 2001 and re-adopted by the U.S. Congress in 2006 with certain changes (the Patriot Act), imposes substantial new record-keeping and due diligence obligations on banks and other financial institutions, with a particular focus on detecting and reporting money-laundering transactions involving domestic or international customers. The U.S. Treasury Department has issued and will continue to issue regulations clarifying the Patriot Act's requirements. The Patriot Act requires all financial institutions, including banks, to establish certain anti-money laundering compliance and due diligence programs. The provisions of the Act impose substantial additional costs on all financial institutions, including ours.

In November 1999, Congress enacted the Gramm-Leach-Bliley Act (GLBA), which permitted bank holding companies to engage in a wider range of financial activities. For example, under GLBA bank holding companies may underwrite all types of insurance and annuity products and all types of securities products and mutual funds, and may engage in merchant banking activities. Bank holding companies that wish to engage in these or other financial activities generally must do so through separate financial subsidiaries and may themselves be required to register (and qualify to register) as so-called financial holding companies. A bank holding company that does not register as a financial holding company remains a bank holding company subject to substantially the same regulatory restrictions and permitted activities as applied to bank holding companies prior to GLBA (See Item I.C., Supervision and Regulation, above). We have not as yet elected to become a financial holding company . Also under GLBA, financial institutions have become subject to stringent customer privacy regulations, in addition to the privacy provisions under the Fair Credit Reporting Act Amendment of 2003.

The FDIC collects both insurance premiums on insured deposits and an assessment for the Financing Corporation (FICO) bonds.

The FICO was established by the Competitive Equality Banking Act of 1987, and is a mixed-ownership government corporation whose sole purpose was to issue bonds to insure thrift institutions. Outstanding FICO bonds, which are 30-year noncallable bonds with a principal amount of approximately $8.1 billion, mature in 2017 through 2019. FICO has assessment authority, separate from the FDIC's authority to assess risk-based premiums for deposit insurance, to collect funds from all FDIC-insured institutions sufficient to pay interest on FICO bonds. The FDIC acts as collection agent for the FICO. Since the first quarter of 2000, all FDIC-insured deposits have been assessed at the same rate by FICO. For 2009, our FICO assessment was $141 thousand.

In 2007 the FDIC resumed charging financial institutions a premium under the new risk-based assessment system. Under this system, institutions in Risk Category I (the lowest of four risk categories) will pay a rate (based on a formula) of 5 to 7 cents per $100 of assessable deposits. Both of our banks qualified for the 5 cent per $100 assessment rate during 2008.

The Federal Deposit Insurance Reform Act of 2005 allowed "eligible insured depository institutions" to share a one-time assessment credit pool of approximately $4.7 billion. Our credit amounted to $747 thousand. The credit was available to offset FDIC insurance premiums beginning in 2007, but not to offset the FICO bond assessment, which will continue through 2019. The one-time credit fully offset our FDIC insurance premiums for 2008 and offset approximately $134 thousand of our $637 thousand 2008 FDIC premiums.

In 2008, in response to the level of claims against the Bank Insurance Fund, the FDIC announced that it would raise the lowest rate from 5 cents to 12 cents per $100 of assessable deposits beginning with the first quarter of 2008, which remained in effect throughout 2008 and 2009. In addition, beginning with the second quarter of 2009, the FDIC added four new factors to the assessment rate calculation, including factors for brokered deposits, secured liabilities and unsecured liabilities (see Note 19 to the consolidated financial statements).

In 2009 the FDIC imposed a special assessment on all insured institutions, including our banks, at .05% of total assets as adjusted for Tier 1 capital. We charged $787 thousand to earnings in the second quarter of 2009 for this assessment, which was paid on September 30, 2009. In the fourth quarter of 2009, the FDIC collected prepaid assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. Based on the current rate of 12 cents per $100 in 2009 and 2010 and 15 cents per $100 for 2011 and 2012, our prepaid assessment amounted to $6.8 million. The expense will be ratably recorded over the respective periods as directed by the FDIC. We are unable to predict whether or to what extent the FDIC may elect to impose additional special assessments on insured institutions in upcoming years, although it is commonly understood that the FDIC insurance fund may not be adequate if bank failures continue at their present rate for any significant period of time and/or the cost to the FDIC of the bank failures recently resolved by it should prove even greater than was initially anticipated.

In late 2008, the FDIC adopted the TLGP to boost consumer confidence in funds deposited with insured institutions. The TLGP allowed insured institutions to participate in two areas of additional insurance: 1) full coverage of noninterest-bearing accounts through December 31, 2009 at a cost of an additional 10 cents per $100 of additional insured deposits, and 2) a guarantee of certain newly-issued unsecured short-term senior debt issued by a bank holding company or bank on or before June 30, 2009, at a cost ranging from 50 to 100 basis points. We elected to participate in both components of the TLGP, but did not issue any FDIC-guaranteed unsecured short-term debt before expiration of the program. The cost for the additional deposit insurance was $18 thousand for 2009.

Arrow was preliminarily approved by the U.S. Treasury Department to participate in the CPP; however, in January 2009, we announced that we would not participate in the CPP due to our strong financial and liquidity positions. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, page 17. Under the CPP, the U.S. Treasury purchased preferred stock in participating publicly traded financial institutions. The dividend rate on the stock was 5%, increasing to 9% in year 6 and later years. The purchase also included the issuance of stock warrants at 15% of the amount of the investment.

The EESA, the ARRA, and the related governmental programs include a variety of initiatives that could have a significant impact on the banking industry and on Arrow; however, the actual impact that these new laws and programs will have on the financial markets, the financial services industry and Arrow cannot be determined at this time. In addition, various federal bills that would significantly affect banks have been introduced in Congress, including laws that would reform the regulatory agencies. We cannot estimate the likelihood of any currently proposed banking bills being enacted into law, or the ultimate effect that any such potential legislation, if enacted, would have upon our financial condition or operations.

E. STATISTICAL DISCLOSURE (GUIDE 3)

Set forth below is an index identifying the location in this Report of various items of statistical information required to be included in this Report by the SEC s industry guide for Bank Holding Companies.

Required Information	Location in Report
Distribution of Assets, Liabilities and Stockholders' Equity; Interest Rates and Interest Differential	Part II, Item 7.B.I.
Investment Portfolio	Part II, Item 7.C.I.
Loan Portfolio	Part II, Item 7.C.II.
Summary of Loan Loss Experience	Part II, Item 7.C.III.
Deposits	Part II, Item 7.C.IV.
Return on Equity and Assets	Part II, Item 6.

Short-Term Borrowings	Part II, Item 8. Note 10.

F. COMPETITION

We face intense competition in all markets we serve. Traditional competitors are other local commercial banks, savings banks, savings and loan institutions and credit unions, as well as local offices of major regional and money center banks. Like all banks, we encounter strong competition in mortgage lending from the very large and growing government sponsored entities Fannie Mae and Freddie Mac, who guarantee government-subsidized mortgage loans, that in 2009 accounted for a large majority of the total amount of mortgage loans extended in the U.S. Additionally, non-banking financial organizations, such as consumer finance companies, insurance companies, securities firms, money market and mutual funds and credit card companies offer substantive equivalents of the various loan and financial products and transactional accounts that we offer, even though these non-banking organizations are not subject to the same regulatory restrictions and capital requirements that apply to us. Under federal banking laws, such non-banking financial organizations not only may offer products comparable to those offered by commercial banks, but also may establish or acquire their own commercial banks.

G. EXECUTIVE OFFICERS OF THE REGISTRANT

The names and ages of the executive officers of Arrow and positions held by each are presented in the following table. Officers are elected annually by the Board of Directors.

Name	Age	Positions Held and Years from Which Held
Thomas L. Hoy	61	Chairman, President and CEO since 2004. Prior to 2004, Mr. Hoy served as President and CEO. Mr. Hoy has been with the company since 1974.
Terry R. Goodemote	46	Senior Vice President, Treasurer and CFO since January 1, 2007. Prior to 2007, Mr. Goodemote was Senior Vice President and head of the Accounting Division. Mr. Goodemote has been with the company since 1992.
David S. DeMarco	48	Senior Vice President since May 1, 2009. Mr. DeMarco has been with the company since 1987.
Thomas J. Murphy	51	Vice President and Corporate Secretary since May 1, 2009. Prior to that, Mr. Murphy served as Assistant Corporate Secretary. Mr. Murphy has been with the company since 2004.
Raymond F. O Conor	54	Senior Vice President since May 1, 2009. Mr. O Conor has been with the company since 1985.

H. AVAILABLE INFORMATION

Our Internet address is *www.arrowfinancial.com*. We make available free of charge on or through our Internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as practicable after we file or furnish them with the SEC pursuant to the Exchange Act. We also make available on the internet website various other documents related to corporate operations, including our Corporate Governance Guidelines, the charters of our principal board committees, and our codes of ethics. We have adopted a financial code of ethics that applies to Arrow s chief executive officer, chief financial officer and principal accounting officer and a business code of ethics that applies to all directors, officers and employees.

Item 1A. Risk Factors

Our financial results and the market price of our stock in future periods are subject to risks arising from many factors, including the following: (Please note that the discussions below regarding potential impact on Arrow of certain of these factors that may develop in the future are not meant to provide predictions by Arrow's management that such factors will develop, but to acknowledge the possible impact that could occur if the factors do develop.)

Difficult market conditions have adversely affected the financial services industry. For many financial institutions, dramatic declines in the U.S. housing market over the past three years, with falling home prices and increasing foreclosures and unemployment, have negatively impacted the credit performance of real estate related loans and resulted in significant write-downs of asset values. To date, the impact of these adverse market conditions has been less significant on Arrow than it has been on many other U.S. financial institutions. Write-downs at many of these other institutions, initially of asset-backed securities but spreading to other securities and loans, have caused a number of those institutions to seek additional capital, to reduce or eliminate dividends, to merge with larger and stronger institutions and, in some cases, to fail. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. Generally, in the financial services sector, this market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies at many institutions, lack of consumer confidence, increased market volatility and widespread reduction of business activity. Although this turmoil has affected Arrow and our local markets less than certain other institutions and markets so far, the resulting economic pressure on consumers and lack of confidence in the financial markets has already, to some extent, adversely affected our business, financial condition and results of operations. Market developments may continue to affect consumer confidence levels and may cause adverse changes in payment patterns, causing increases in delinquencies and default rates, which may impact our charge-offs and provision for credit losses. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on Arrow and others in the financial institutions industry.

If economic conditions continue to deteriorate and the U.S. experiences a prolonged nationwide recession, the company s allowance for loan losses may not be adequate to cover actual losses. Like all financial institutions, we maintain an allowance for loan losses to provide for probable loan losses at the balance sheet date. Our allowance for loan losses is based on our historical loss experience as well as an evaluation of the risks associated with our loan portfolio, including the size and composition of the portfolio, current economic conditions and geographic concentrations within the portfolio and other factors. If the economy in our geographic market area, Northeastern New York State, should deteriorate or enter into a prolonged state of recession, this may have an additional adverse impact on our loan portfolio. If the quality of our portfolio should weaken due to this impact, our allowance for loan losses may not be adequate to cover actual loan losses, and future provisions for loan losses could materially and adversely affect financial results. Moreover, loan portfolio difficulties often accompany difficulties in other areas of our business, including growth of our business generally, thereby compounding the negative effects on earnings.

The domestic interest rate environment could negatively affect the company s net interest income. An institution s net interest income is significantly affected by market rates of interest, including short-term and long-term rates and the relationship between the two. Interest rates are highly sensitive to many factors, which are beyond our control, including general economic conditions, policies of various governmental and regulatory agencies such as the Federal Reserve Board, and actions taken by foreign central banks. Like all financial institutions, the Company s balance sheet is affected by fluctuations in interest rates. Many commentators believe that the Federal Reserve and other central banks will begin to increase prevailing rates within the next 12 months or soon thereafter, and that this development may negatively affect banks   profitability. See the discussion under   Changes in Net Interest Income Due to Rate,   on page 24 of this Report.

If economic conditions worsen and the U.S. financial markets continue to experience difficulties, the company may experience limited access to credit markets. As discussed under Part I, Item 7.D.   Liquidity,   the company has relationships with various third parties to provide overnight and longer-term credit arrangements. As these third parties themselves have difficulty in accessing their own credit markets then we may, in turn, experience a decrease in our capacity to borrow funds from them or other third parties traditionally relied upon by banks for liquidity.

If the value of real estate in our market area were to decline materially, a significant portion of our loan portfolio could become under-collateralized, which might have a material adverse effect on us. In addition to considering the financial strength and cash flow characteristics of borrowers, we often secure loans with real estate collateral, which in each case provides an alternate source of repayment in the event of default by the borrower. This real property may deteriorate in value during the time the credit is outstanding. If we are required to liquidate the collateral securing a loan to satisfy the debt during a period of reduced real estate values, our earnings and capital could be adversely affected. Furthermore, the possibility of legislative changes at the Federal or State level, related to foreclosure proceedings, may result in negative impacts to financial institutions.

If securities prices should significantly decline in upcoming periods, we likely will experience a continuing reduction in income from fiduciary activities. The most significant portion of the income we earn from managing assets in our fiduciary capacity is tied to the market value of those assets, i.e., investment securities.

We are subject to the local economies where we operate, and unfavorable economic conditions in these areas could have a material adverse effect on our financial condition and results of operations. Our success depends upon the growth in population, income levels and deposits in our geographic market area. Unpredictable and unfavorable economic conditions unique to our market area may have an adverse effect on the quality of our loan portfolio and financial performance. As a community bank, we are less able than our larger regional competitors to spread the risk of unfavorable local economic conditions over a larger market area. Moreover, we cannot give any assurances that we will benefit from any unique and favorable economic conditions in our market area, even if they do occur.

Current levels of market volatility. The market for certain investment securities, including mortgage-backed securities, has been highly volatile or inactive, and may not stabilize or resume in the near future. This volatility can result in significant fluctuation in the prices of those securities, which could affect the results of our operations.

Changes in accounting standards may materially impact the company s financial statements. From time-to-time, the Financial Accounting Standards Board (FASB) changes the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we may be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial statements.

The company s business could suffer if it loses key personnel unexpectedly or fails to provide for an orderly management succession. Our success depends, in large part, on our ability to retain our key personnel for the duration of their expected terms of service, and to arrange for an orderly succession of other, equally skilled personnel. Competition for the best people in our business can be intense. While our Board of Directors actively reviews succession plans, any sudden change at the senior management level may adversely affect our business.

The company relies on other companies to provide key components of the company s business infrastructure. Third-party vendors provide key components of our business infrastructure such as internet connections, network access and mutual fund distribution. These parties are beyond our control, and any problems caused or experienced by these third parties, including their not providing us their services or performing such services poorly, or not being able to continue to perform such services, could adversely affect our ability to deliver products and services to our customers and conduct our business.

The soundness of other financial institutions could adversely affect Arrow. Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. Arrow has exposure to many different counterparties, and we routinely execute transactions with counterparties in the financial industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other financial institutions. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could lead to market-wide liquidity problems and to losses or defaults by Arrow or by other institutions and organizations. Many of these transactions expose Arrow to credit risk in the event of default of our counterparty or client. In addition, Arrow s credit risk may be exacerbated when the collateral held by Arrow cannot be liquidated or is liquidated at prices not sufficient to recover the full amount of the financial instrument exposure due Arrow. There is no assurance that any such losses would not materially and adversely affect our results of operations.

The company faces continuing and growing security risks to its own information base and to information on its customers. The computer systems and network infrastructure that we use are always vulnerable to unforeseen problems, including theft of confidential customer information (identity theft) and interruption of service as a result of fire, natural disasters, explosion or general infrastructure failure. These problems may arise in both our internally developed systems and the systems of our third-party service providers. We constantly assess and attempt to improve our security systems and disaster preparedness, including back-up systems, but the risks in these areas are substantially escalating.

The company s stock price may begin to reflect market volatility. Our stock price can fluctuate widely in response to a variety of factors, including: actual or anticipated variations in our operating results; recommendations by securities analysts; significant acquisitions or business combinations; operating and stock price performance of other companies that investors deem comparable to us; new technology used or services offered by our competitors; news reports relating to trends, concerns and other issues in the financial services industry; and changes in government regulations. Many of these factors that may adversely affect our stock price do not directly pertain to our operating results, including general market fluctuations, industry-wide factors and economic and general political conditions and events, including terrorist attacks, economic slowdowns or recessions, interest rate changes, credit loss trends or currency fluctuations.

We may be adversely affected by government regulation. We are subject to extensive federal and state banking regulations and supervision. Banking regulations are intended primarily to protect our depositors funds and the federal deposit insurance funds, not the company s stockholders. Regulatory requirements affect our lending practices, capital structure, investment practices, dividend policy and growth. Failure to meet minimum capital requirements could result in the imposition of limitations on our operations that would adversely impact our operations and could, if capital levels dropped significantly, result in our being required to cease or scale back our operations. Changes in governing law, regulations or regulatory practices could impose additional costs on us or adversely affect our ability to obtain deposits or make loans and thereby hurt our revenues and profitability.

Item 1.B. Unresolved Staff Comments - None

Item 2. Properties

Our main office is at 250 Glen Street, Glens Falls, New York. The building is owned by us and serves as the main office for Glens Falls National Bank, our principal subsidiary. We own twenty-eight branch offices and lease six others at market rates.

In the opinion of management, the physical properties of our holding company and our subsidiary banks are suitable and adequate. For more information on our properties, see Notes 1, 6 and 21 to the Consolidated Financial Statements contained in Part II, Item 8 of this Report.

Item 3. Legal Proceedings

We are not the subject of any material pending legal proceedings, other than ordinary routine litigation occurring in the normal course of our business. On an ongoing basis, we are the subject of or a party to various legal claims, which arise in the normal course of our business. The various pending legal claims against us will not, in the opinion of management based upon consultation with counsel, result in any material liability.

Item 4. Submission of Matters to a Vote of Security Holders

None in the fourth quarter of 2009.

PART II

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

Securities

The common stock of Arrow Financial Corporation is traded on The Nasdaq Stock Market^{SM} under the symbol AROW.

The high and low prices listed below represent actual sales transactions, as reported by Nasdaq. All stock prices and cash dividends per share have been restated to reflect subsequent stock dividends. On September 28, 2009, we distributed a 3% stock dividend on our outstanding shares of common stock.

	2009			2008		
	Sales Price		**Cash Dividends**	Sales Price		Cash Dividends
	Low	**High**	**Declared**	Low	High	Declared
First Quarter	**$18.93**	**$25.23**	**$.243**	$17.96	$23.00	$.233
Second Quarter	**22.35**	**26.89**	**.243**	17.48	23.64	.233
Third Quarter	**24.68**	**29.74**	**.243**	17.27	31.77	.243
Fourth Quarter	**24.06**	**27.77**	**.250**	20.87	29.11	.243

The payment of cash dividends by Arrow is at the discretion of its Board of Directors and is dependent upon, among other things, our earnings, financial condition and other factors, including applicable legal and regulatory restrictions. See "Capital Resources and Dividends" in Part II, Item 7.E. of this report.

There were approximately 6,227 holders of record of Arrow s common stock at December 31, 2009. Arrow has no other class of stock outstanding.

Equity Compensation Plan Information

The following table sets forth certain information regarding Arrow's equity compensation plans as of December 31, 2009. These equity compensation plans were our 2009 Long Term Incentive Plan ("Stock Plan"), our 2000 Director, Officer and Employee Stock Purchase Plan ("ESPP") and our Directors' Stock Plan. Consistent with applicable law and regulation, the Stock Plan was approved by Arrow's shareholders, while the ESPP and the Directors' Stock Plan were not shareholder approved when they were adopted. However, shareholders approved the Directors Stock Plan at their 2009 annual meeting when the plan was amended to add shares.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity Compensation Plans Approved by Security Holders	439,322 (1)	$22.35	270,743 (2)
Equity Compensation Plans Not Approved by Security Holders	0	0	537,128 (3)
Total	439,322	$22.35	807,871

(1) Includes 439,222 shares of common stock issuable pursuant to outstanding stock options granted under the Stock Plan and predecessor stock plans.

(2) Includes 247,700 shares of common stock issuable under the Stock Plan and 23,043 shares of common stock available for future issuance under the Directors Stock Plan.

(3) All 537,128 shares of common stock are available for future issuance under the ESPP.

Description of Non-Stockholder Approved Plans.

Director, Officer and Employee Stock Purchase Plan. The Director, Officer and Employee Stock Purchase Plan was adopted by the Board of Directors in 2000. Under the plan, eligible participants (currently directors, officers, full-time employees and certain retirees) are permitted to acquire shares of common stock at a price that represents a small discount from the current market price of the stock by authorizing regular withholding from their paychecks or, in the case of directors or retirees, regular withdrawals from their bank deposit accounts. Participants may also purchase shares on an ad hoc basis through optional cash contributions. The maximum discount on shares acquired through regular withholdings or withdrawals is 5% (also the current discount). The discounted price only applies to the first $1,000 of a participant's monthly contribution; after that threshold is reached, shares are purchased at 100% of market price. The total number of shares originally authorized for purchase under the Plan, as adjusted, was 798,812 shares. There are maximum and minimum levels for participant contributions, which the Board of Directors may change from time to time.

Directors' Stock Plan. The Directors' Stock Plan was originally adopted by the Board of Directors in 1999, and amended in 2009 with the approval of the shareholders. It provides for the automatic issuance of shares of Common Stock to directors of Arrow and its subsidiary banks in lieu of cash director fees otherwise payable to them. The portion of directors fees payable in stock (as opposed to in cash) is fixed each year in advance by the Board of Directors. The total number of shares authorized for issuance under the Plan, as adjusted through December 31, 2009, is 64,619 shares.

STOCK PERFORMANCE GRAPHS

The following two graphs provide a comparison of the total cumulative return (assuming reinvestment of dividends) for the common stock of Arrow as compared to the Russell 2000 Index, the NASDAQ Banks Index and the Zacks $1B-$5B Bank Assets Index.

The historical information set forth below may not be indicative of the future results. The first graph presents the five-year period from December 31, 2004 to December 31, 2009 and the second graph presents the ten-year period from December 31, 1999 to December 31, 2009.

TOTAL RETURN PERFORMANCE

Period Ending

Index	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
Arrow Financial Corporation	100.00	89.91	90.96	84.89	103.40	110.07
Russell 2000 Index	100.00	104.56	123.75	121.83	80.66	102.59
NASDAQ Banks Index	100.00	97.69	109.63	86.90	63.36	53.09
Zacks $1B - $5B Bank Assets Index	100.00	109.32	118.20	105.20	63.16	73.32

TOTAL RETURN PERFORMANCE
Period Ending

Index	12/31/99	12/31/00	12/31/01	12/31/02	12/31/03	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
Arrow Financial Corporation	100.00	104.65	171.39	195.91	228.30	270.52	243.22	246.06	229.64	279.71	297.75
Russell 2000 Index	100.00	96.98	99.39	79.03	116.38	137.71	143.99	170.41	167.78	111.08	141.27
NASDAQ Banks Index	100.00	114.23	123.68	126.61	162.88	186.40	182.09	204.36	161.99	118.11	98.96
Zacks $1B - $5B Bank Assets Index	100.00	126.35	126.91	117.43	160.20	191.54	209.38	226.40	201.49	120.98	140.43

Source: Zacks Investment Research, Inc., Chicago, IL.

The preceding stock performance graphs shall not be deemed incorporated by reference by virtue of any general statement incorporating by reference this Annual Report on Form 10-K into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent the company specifically incorporates this information by reference, and shall not otherwise be deemed filed as part of such other filings.

Unregistered Sales of Equity Securities

In connection with Arrow s acquisition in 2004 of Capital Financial Group, Inc. (CFG), an insurance agency specializing in the sale of group health and life insurance products, Arrow issued 68,629 shares, as adjusted, of its common stock to the former sole stockholder of CFG, in exchange for his CFG shares. The terms of the acquisition included a post-closing purchase price adjustment provision, under which Arrow would also pay to the sole stockholder, over the 5-year period following closing, additional consideration in the form of additional shares of Arrow s common stock, depending on the financial performance of CFG as a subsidiary of Arrow during such period. Under this provision, Arrow issued an additional 35,120 shares to the sole stockholder over the now completed five year period. All shares issued to the sole stockholder at the original closing and in post-closing adjustments have been issued without registration under the Securities Act of 1933, as amended, in reliance upon the exemption for such registration set forth in Section 3(a)(11) of the Act and Rule 147 promulgated by the Securities and Exchange Commission thereunder. This exemption was available because the sole stockholder was a New York resident and CFG was a New York corporation having substantially all of its assets and business operations in the State of New York.

Issuer Purchases of Equity Securities

The following table presents information about repurchases by us during the three months ended December 31, 2009 of our common stock (our only class of equity securities registered pursuant to Section 12 of the Securities Exchange Act of 1934):

Fourth Quarter Calendar Month	Total Number of Shares Purchased[1]	Average Price Paid Per Share[1]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[2]	Maximum Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs[2]
October	15,706	$25.73	15,000	$3,444,819
November	32,394	25.19	30,100	2,686,944
December	27,000	25.45	---	2,686,944
Total	75,100	25.40	45,100	

[1]The total number of shares purchased and the average price paid per share include shares purchased in open market transactions under the Arrow Financial Corporation Automatic Dividend Reinvestment Plan (the DRIP) by the administrator of the DRIP and shares surrendered or deemed surrendered to Arrow by holders of options to acquire Arrow common stock in connection with the exercise of such options. In the months indicated, the listed number of shares purchased included the following numbers of shares purchased through such methods: October 2009 - DRIP purchases (706 shares); November 2009 DRIP purchases (2,294 shares) December 2009 DRIP purchases (17,607 shares), stock options (9,393 shares). DRIP purchases do not reflect so-called netting transactions, that is, purchases effected within the DRIP itself by the DRIP administrator consisting of monthly acquisitions of shares on behalf of purchasing participants who are investing funds in the plan from selling participants who are withdrawing funds from the plan.

[2]Includes those shares acquired by Arrow pursuant to its publicly-announced stock repurchase programs, but does not include shares purchased or subject to purchase under the DRIP or shares surrendered to Arrow upon exercise of options granted under any compensatory stock plans. Our only current publicly-announced stock repurchase program is the program approved by the Board of Directors and announced in April 2009 under which the Board authorized a twelve-month maximum cumulative purchase of $5 million in stock.

Item 6. Selected Financial Data

FIVE YEAR SUMMARY OF SELECTED DATA

Arrow Financial Corporation and Subsidiaries

(Dollars In Thousands, Except Per Share Data)

Consolidated Statements of Income Data:	2009	2008	2007	2006	2005
Interest and Dividend Income	$86,857	$89,508	$86,577	$80,611	$72,127
Interest Expense	26,492	32,277	40,283	34,743	24,114
Net Interest Income	60,365	57,231	46,294	45,868	48,013
Provision for Loan Losses	1,783	1,671	513	826	1,030
Net Interest Income After Provision					
for Loan Losses	58,582	55,560	45,781	45,042	46,983
Noninterest Income	19,235	15,886	16,288	15,883	14,584
Net (Losses) Gains on Securities Transactions	357	383	---	(102)	364
Noninterest Expense	46,592	42,393	37,930	36,807	35,189
Income Before Provision for Income Taxes	31,582	29,436	24,139	24,016	26,742
Provision for Income Taxes	9,790	8,999	6,807	7,124	8,103
Net Income	$21,792	$20,437	$17,332	$16,892	$18,639
Per Common Share: [1]					
Basic Earnings	$ 2.00	$ 1.88	$ 1.57	$ 1.50	$ 1.64
Diluted Earnings	1.99	1.87	1.56	1.48	1.61
Per Common Share: [1]					
Cash Dividends	$ .98	$ .95	$ .91	$ .89	$ .84
Book Value	12.90	11.58	11.17	10.52	10.37
Tangible Book Value [2]	11.37	10.07	9.65	9.01	8.84
Consolidated Year-End Balance Sheet Data:					
Total Assets	$1,841,627	$1,665,086	$1,584,846	$1,520,217	$1,519,603
Securities Available-for-Sale	437,706	315,414	328,496	307,902	317,061
Securities Held-to-Maturity	168,931	133,976	114,611	108,498	118,123
Loans	1,112,150	1,109,812	1,038,844	1,008,999	996,545
Nonperforming Assets	4,772	4,971	2,336	3,169	2,372
Deposits	1,443,566	1,275,063	1,204,200	1,186,397	1,165,763
Federal Home Loan Bank Advances	140,000	160,000	160,000	125,000	157,000
Other Borrowed Funds	93,908	79,956	73,719	68,324	63,054
Stockholders Equity	140,818	125,802	122,256	118,130	117,421
Selected Key Ratios:					
Return on Average Assets	1.24%	1.24%	1.11%	1.11%	1.28%

Return on Average Equity	16.16	16.26	14.68	14.38	15.94
Dividend Payout [3]	49.25	51.04	58.39	59.87	52.27

[1]Share and per share amounts have been adjusted for subsequent stock splits and dividends, including the most recent September

2009 3% stock dividend.

[2]Tangible book value excludes intangible assets from total equity.

[3]Dividend Payout Ratio cash dividends per share to fully diluted earnings per share.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following table presents selected quarterly information for the fourth quarter of 2009 and the preceding four quarters:

Selected Quarterly Information:

(Dollars In Thousands, Except Per Share Amounts)

(Share and per share amounts have been adjusted for the September 2009 3% stock dividend.)

	Dec 2009	Sep 2009	Jun 2009	Mar 2009	Dec 2008
Net Income	$5,117	$5,062	$4,931	$6,682	$5,012
Transactions Recorded in Net Income (Net of Tax):					
Other-Than-Temporary Impairment (OTTI) (see page 21)	$(227)	$---	$ ---	$ ---	$(242)
Net Securities Gains	17	29	2	167	249
Net Gains on Sales of Loans	56	10	141	46	31
Net Gain on Sale of					
Merchant Bank Card Processing (see page 20)	---	---	161	1,630	---
Income from Restitution Payment (see page 29)	---	---	272	---	---
FDIC Special Assessment (see page 20)	---	---	(475)	---	---
Period End Shares Outstanding	10,917	10,916	10,909	10,901	10,863
Basic Average Shares Outstanding	10,910	10,912	10,901	10,892	10,840
Diluted Average Shares Outstanding	10,959	10,982	10,948	10,922	10,906
Basic Earnings Per Share	$.47	$.46	$.45	$.61	$.42
Diluted Earnings Per Share	.47	.46	.45	.61	.42
Cash Dividends Per Share	.25	.24	.24	.24	.24
Average Assets	$1,856,176	$1,778,893	$1,725,739	$1,681,096	$1,687,366
Average Equity	140,786	136,397	133,718	128,507	127,136
Return on Average Assets	1.09%	1.13%	1.15%	1.61%	1.18%
Return on Average Equity	14.42	14.72	14.79	21.09	15.68
Average Earning Assets	$1,781,464	$1,706,626	$1,653,637	$1,610,007	$1,615,240
Average Paying Liabilities	1,492,326	1,417,218	1,382,451	1,346,413	1,345,344
Interest Income, Tax-Equivalent [1]	23,032	22,499	22,245	22,262	23,446
Interest Expense	6,522	6,462	6,716	6,792	7,541
Net Interest Income, Tax-Equivalent [1]	16,510	16,037	15,529	15,470	15,905
Tax-Equivalent Adjustment	863	835	744	739	727
Net Interest Margin [1]	3.68%	3.73%	3.77%	3.90%	3.92%

Efficiency Ratio Calculation:[1]					
Noninterest Expense	$11,699	$11,401	$12,119	$11,373	$11,273
Less: Intangible Asset Amortization	(77)	(79)	(79)	(89)	(89)
Net Noninterest Expense	$11,622	$11,322	$12,040	$11,284	$11,184
Net Interest Income, Tax-Equivalent [1]	$16,510	$16,037	$15,529	$15,470	$15,905
Noninterest Income	3,805	3,976	4,844	6,967	4,152
Less: Net Securities Losses (Gains) & OTTI	347	(48)	(4)	(277)	(12)
Net Gross Income	$20,662	$19,965	$20,369	$22,160	$20,045
Efficiency Ratio [1]	56.25%	56.71%	59.11%	50.92%	55.79%

Period-End Capital Information:					
Tier 1 Leverage Ratio	8.43%	8.37%	8.77%	8.64%	8.39%
Total Stockholders Equity (i.e. Book Value)	$140,818	$139,304	$134,586	$132,539	$125,802
Book Value per Share	12.90	12.76	12.71	12.52	11.58
Intangible Assets	16,712	16,353	16,440	16,450	16,378
Tangible Book Value per Share	11.37	11.26	11.15	10.97	10.07
Net Loans Charged-off as a Percentage of Average Loans, Annualized	.09%	.08%	.09%	.12%	.14%
Provision for Loan Losses as a Percentage of Average Loans, Annualized	.16	.15	.15	.18	.32
Allowance for Loan Losses as a Percentage of Loans, Period-end	1.26	1.25	1.25	1.22	1.20
Allowance for Loan Losses as a Percentage of Nonperforming Loans, Period-end	300.73	299.07	383.40	352.65	338.05
Nonperforming Loans as a Percentage of Loans, Period-end	.42	.42	.32	.35	.35
Nonperforming Assets as a Percentage of Total Assets, Period-end	.26	.26	.23	.27	.30

[1] See Use of Non-GAAP Financial Measures on page 4.

Selected Twelve-Month Information:

(Dollars In Thousands, Except Per Share Amounts)

Share and per share amounts have been adjusted for the September 2009 3% stock dividend.

	Dec 2009	Dec 2008	Dec 2007
Net Income	$21,792	$20,437	$17,332
Transactions Recorded in Net Income (Net of Tax):			
Other-Than-Temporary Impairment (OTTI) (see page 21)	$(227)	$(971)	$---
Net Securities Gains	216	231	---
Net Gains on Sales of Loans	252	64	25
Income from Restitution Payment (see page 29)	272	---	---
Net Gains (Losses) on the Sale of Other Real Estate Owned	---	18	(2)
Net Gain on the Sale of Premises (see page 29)	---	69	---
Visa Litigation (see page 21)	---	185	(362)
Gain on Redemption of Visa Inc. Class B Shares (see page 21)	---	452	---
Period End Shares Outstanding	10,917	10,863	10,946
Basic Average Shares Outstanding	10,904	10,882	11,036
Diluted Average Shares Outstanding	10,953	10,941	11,109
Basic Earnings Per Share	$2.00	$1.88	$1.57
Diluted Earnings Per Share	1.99	1.87	1.56
Cash Dividends Per Share	.98	.95	.91
Average Assets	$1,761,006	$1,644,210	$1,558,251
Average Equity	134,890	125,653	118,082
Return on Average Assets	1.24%	1.24%	1.11%
Return on Average Equity	16.16	16.26	14.68
Average Earning Assets	$1,688,454	$1,568,677	$1,486,707
Average Paying Liabilities	1,410,022	1,303,740	1,229,882
Interest Income, Tax-Equivalent [1]	90,038	92,441	89,498
Interest Expense	26,492	32,277	40,283
Net Interest Income, Tax-Equivalent [1]	63,546	60,164	49,215
Tax-Equivalent Adjustment	3,181	2,933	2,921
Net Interest Margin [1]	3.76%	3.84%	3.31%
Efficiency Ratio Calculation [1]			
Noninterest Expense	$46,592	$42,393	$37,930
Less: Intangible Asset Amortization	(324)	(360)	(394)
Net Noninterest Expense	$46,268	$42,033	$37,536
Net Interest Income, Tax-Equivalent [1]	$63,546	$60,164	$49,215
Noninterest Income	19,592	16,269	16,288
Less: Net Securities Losses & OTTI	18	478	---
Net Gross Income	$83,156	$76,911	$65,503
Efficiency Ratio [1]	55.64%	54.65%	57.30%

Period-End Capital Information:			
Tier 1 Leverage Ratio (Period-end)	8.43%	8.39%	8.37%
Total Stockholders Equity (i.e. Book Value)	$140,818	$125,802	$122,256
Book Value per Share	12.90	11.58	11.17
Intangible Assets	16,712	16,378	16,590
Tangible Book Value per Share	11.37	10.07	9.65
Net Loans Charged-off as a Percentage of Average Loans	.09%	.07%	.04%
Provision for Loan Losses as a Percentage of Average Loans	.16	.16	.05
Allowance for Loan Losses as a Percentage of Loans, Period-end	1.26	1.20	1.19
Allowance for Loan Losses as a Percentage of Nonperforming Loans, Period-end	300.73	338.05	567.81
Nonperforming Loans as a Percentage of Loans, Period-end	.42	.35	.21
Nonperforming Assets as a Percentage of Total Assets, Period-end	.26	.30	.15

[1] See Use of Non-GAAP Financial Measures on page 4.

CRITICAL ACCOUNTING POLICIES

In order to prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, we were required to make estimates and assumptions that affected the amounts reported in these statements. There are uncertainties inherent in making these estimates and assumptions, which could materially affect our results of operations and financial position. We consider the following to be critical accounting policies:

The allowance for loan losses: The adequacy of the allowance for loan losses is sensitive to changes in current economic conditions that may make it difficult for borrowers to meet their contractual obligations. Any downward trend in the economy, regional or national, may require us to increase the allowance for loan losses resulting in a negative impact on our results of operations and financial condition at the same time that other areas of our operations, including new loan originations and assets under administration in our trust department may also be experiencing negative pressures from the same underlying negative economic conditions.

Liabilities for retirement plans: We have a variety of pension and retirement plans. Liabilities under these plans rely on estimates of future salary increases, numbers of employees and employee retention, discount rates and long-term rates of return on plan investments. Changes in these assumptions due to changes in the financial markets, the economy, our own operations or applicable law and regulation may result in material changes to our liability for postretirement expense, with consequent impact on our results of operations and financial condition.

Valuation allowance for deferred tax assets: Accounting standards require a reduction in the carrying amount of deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. Our analysis of the need for a valuation allowance for deferred tax assets is, in part, based on an estimate of future taxable income.

Goodwill: Accounting standards require that goodwill be tested for impairment at a level of reporting referred to as a reporting unit. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. The first step of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. The second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of a reporting unit s goodwill with the carrying amount of that goodwill.

Other than temporary decline in the value of debt and equity securities: Accounting standards require that, for individual securities classified as either available-for-sale or held-to-maturity, an enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary. When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If we intend to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment s amortized cost basis and its fair value at the balance sheet date. If we do not intend to sell the security and it is not more likely than not that we will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. Any significant economic downturn might result, and historically have on occasion resulted, in an other-than-temporary impairment in securities held in our portfolio.

Valuation methods for securities available-for-sale measured at fair value on a recurring basis: Most of the available-for-sale portfolio, which includes U.S. Treasury and agency securities, mortgage-backed securities, collateralized mortgage obligations, municipal securities, corporate debt and equity securities are priced using industry-standard models that consider various assumptions that include time value, yield curves, volatility factors, prepayment speeds, default rates, loss severity, current market and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are either observable in the marketplace, derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Municipal and corporate securities are valued using a type of matrix, or grid, pricing in which securities are benchmarked against the treasury rate based on credit rating. These model and matrix measurements are classified as Level 2 in the fair value hierarchy.

The following discussion and analysis focuses on and reviews our results of operations for each of the years in the three-year period ended December 31, 2009 and our financial condition as of December 31, 2009 and 2008. The discussion below should be read in conjunction with the selected quarterly and annual information set forth above and the consolidated financial statements and other financial data presented elsewhere in this Report. When necessary, prior-year financial information has been reclassified to conform to the current-year presentation.

A. OVERVIEW

Summary of 2009 Financial Results

We reported net income of $21.8 million for 2009, an increase of $1.4 million, or 6.6%, compared to 2008. Diluted earnings per share of $1.99 represented an increase of $.12, or 6.4%, from 2008. During 2008, both our net interest margin and net interest income increased due to a combination of falling short-term interest rates (which has a proportionately larger impact on the cost of our deposits than on our earnings from our assets), a market-wide return of a positively-sloped yield curve (which has a proportionately larger impact on our earning assets than on our liabilities) and a 5.5% increase in average earning assets. However, during 2009, we experienced a small decrease in our net interest margin as rates remained very low, and our increase in income reflected asset growth almost exclusively. Most of our deposits were already at such low rates going into 2009 that it was not possible to effect significant additional downward repricing, while our loan cash-flows continued to reprice downward during the year.

Importantly, we still did not experience significant deterioration in our loan and asset quality during 2009 despite the continuing worldwide economic recession and severe disruption in the financial markets generally, which began in 2008.

Although earnings in 2009 and 2008 were impacted by certain significant transactions, discussed below and later in this report, net income for 2009 was a record high for us.

Financial Market Turmoil: Over the past fifteen months, the Dow Jones Industrial Average (Dow Jones) lurched from a high of over 14,000 to a low of under 8,000, and then rebounded to 10,000, demonstrating a degree of volatility not seen in many decades, with the most dramatic change occurring during the fourth quarter of 2009. The financial sector and particularly banks have been severely affected, suffering major losses on mortgages and other credit portfolios and an industry-wide loss of short-term liquidity. In addition, bank failures have continued to occur with regularity, through 2009 and into 2010, and are expected to persist for the foreseeable future. Many community banks, like our company, have not experienced significant losses in their loan or investment portfolios or the liquidity concerns that many of our larger contemporaries have experienced, but expanding problems in commercial real estate portfolios throughout the U.S. now threaten many of these community banks. However, the magnitude of turmoil in the markets did have an impact on our operations during 2009 and may continue to influence our financial condition and results of operations in forthcoming periods.

Decision Not to Participate in U.S. Treasury TARP CCP: As previously disclosed in our Current Report in Form 8-K filed with the SEC on January 27, 2009, our Board of Directors determined in late January 2009, after we had applied for participation by the Company in the U.S. Government s Capital Purchase Plan (an element of the larger Troubled Assets Relief Program), and after we had been preliminarily approved by the Department of Treasury for participation, that we would not proceed ahead and sell shares of our preferred stock to the Treasury Department but would decline to participate. The basic reason for the Board s decision, as discussed in the Form 8-K, was that the Company s financial and liquidity positions remained sufficiently strong at year-end such that the potential loss of Board and management flexibility entailed in participation in the program was deemed too high a cost to warrant participation.

Sale of Merchant Bank Card Processing to TransFirst: As we previously reported on March 2, 2009, our bank subsidiaries, Glens Falls National Bank and Trust Company and Saratoga National Bank and Trust Company, sold their merchant bank card processing business for an initial cash payment at closing of $3 million to TransFirst LLC (TransFirst) and a bank designated by TransFirst. In connection with the sale, we entered into a relationship with TransFirst under which TransFirst will provide merchant bank card processing to merchant customers of our subsidiary banks. The gain was offset, in part, by an estimated $300 thousand cost to terminate certain pre-existing agreements for a net gain of $2.7 million, which we recognized in the first quarter of 2009. In the second quarter of 2009, a post-closing adjustment to the purchase price substantially eliminated the termination fees related to the pre-existing agreements such that our net gain on the sale of the business as adjusted increased $266 thousand to approximately $2.97 million.

FDIC Special Assessment & Prepayment: The FDIC announced during the second quarter of 2009 that they would levy a special assessment on all FDIC insured financial institutions to rebuild the FDIC s insurance fund which has recently been depleted by bank failures. The special assessment was set at 0.05% of an institution s total assets less Tier 1 capital. Institutions were instructed to estimate and accrue the expense in the second quarter of 2009. We determined that our expense was $787 thousand, which we accrued on June 30, 2009. During the third quarter of 2009 the FDIC announced that they would not impose any additional special assessments in the remainder of 2009, but would generate additional much-needed cash for the insurance fund by requiring insured institutions to prepay in the fourth quarter of 2009 their projected assessments for the fourth quarter of 2009 and all of 2010, 2011 and 2012. Our prepayment amount of $6.8 million, will be amortized, as required by bank regulatory guidance, into expense during the relevant periods to which such assessment relates.

Economic recession and loan quality: As the economic recession got underway in late 2008, our market area of northeastern New York was relatively sheltered from falling real estate values and increasing unemployment. As the recession became stronger and deeper in late 2009, even northeastern New York began to feel the impact of the worsening national economy reflected in a slow-down in real estate sales and increasing unemployment rates. By year-end 2009, we had experienced a decline in the credit quality of our loan portfolio, although by standard measures our portfolio continued to appear stronger than the average for our peer group. Nonperforming loans amounted to \$4.7 million at December 31, 2009, an increase of \$734 thousand from the prior year-end. The ratio of nonperforming loans to period-end loans was .42% at December 31, 2009, an increase from .35% one year earlier. By way of comparison, this ratio for our peer group increased during the same period by 107 basis points, from 2.39% at December 31, 2008 to 3.46% at December 31, 2009. Our loans charged-off (net of recoveries) against our allowance for loan losses were \$1.0 million for 2009, as compared to \$800 thousand for the prior year. At year-end 2009, the allowance for loan losses was \$14.0 million, representing 1.26% of total loans, essentially the same as at the prior year-end. To date, we have not experienced significant deterioration in any of our three major loan portfolio segments:

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Commercial Loans: We lend to small and medium size businesses, which typically do not encounter liquidity problems, since we often also provide support for their supplementary liquidity needs. However, current unemployment rates in our region are higher than in the past few years and the number of total jobs has decreased, although these trends are largely attributable to a few changes in the local operations of a small number of larger corporations. Commercial property values have not shown significant deterioration and we update the appraisals on our nonperforming and watched commercial properties as deemed necessary, usually when the loan is downgraded or when we perceive significant market deterioration since our last appraisal.

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Residential Real Estate Loans: We have not experienced a notable increase in our foreclosure rates, primarily due to the fact that we did not originate or participate in underwriting subprime or other high-risk mortgage loans, such as so called Alt A, negative amortization, option ARM s or negative equity loans.

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Indirect Automobile Loans: These loans comprise over 30% of our loan portfolio. We have not experienced any significant change in our delinquency rate or level of charge-offs, although both delinquencies and charge-offs did increase modestly during 2009.

Investment securities and other-than-temporary impairment: Prior to Lehman s bankruptcy in September 2008, we held a $2.0 million par value senior unsecured bond issued by Lehman. Immediately after the bankruptcy, the fair value of the bond decreased significantly. We deemed the decline to be other-than-temporary in the third quarter 2008, and, accordingly, recognized a non-cash other-than-temporary impairment charge to earnings of $731 thousand net of tax (a $.07 reduction in diluted earnings per share). After further deterioration in the bond, we recognized an additional charge to earnings of $241 thousand net of tax (a $.02 reduction in diluted earnings per share) in the fourth quarter of 2008. The remaining estimated value of our Lehman bond of $400 thousand was included in non-performing assets as of December 31, 2008. During 2009, we sold the bond at an additional loss of $60 thousand. Also during 2009, we recognized a $375 thousand impairment charge on one inactively-traded common stock held in our available-for-sale portfolio. We did not hold any preferred or common stock of Fannie Mae or Freddie Mac. As of year-end, we had not experienced any impairment issues with our holdings of mortgage-backed securities or CMO s. Mortgage-backed securities held by the company are comprised of pass-through securities backed by conventional residential mortgages and guaranteed by government agencies or government sponsored entities. We do not hold any private-label mortgage-backed securities or securities backed by subprime or other high risk non-traditional mortgage loans.

Liquidity and access to credit markets: We have not experienced any liquidity issues during 2009 and through the date of this report. The terms of our lines of credit with our correspondent banks, the FHLBNY and the Federal Reserve Bank have not changed, except for some increases in the maximum borrowing capacity (see our general liquidity discussion on page 40). 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 (overnight lending arrangements with our correspondent banks, FHLBNY overnight and term advances and the Federal Reserve Bank discount window, as our main sources). During the recent period of bank failures, some institutions experienced a run on deposits, even though there was no reasonable expectation that depositors would lose any of their insured deposits. We maintain, and periodically test, a contingent liquidity plan whose purpose is to ensure that we can generate an adequate amount of cash to meet a wide variety of potential liquidity crises.

VISA Transactions in 2008 and 2009: On March 28, 2008, VISA Inc. distributed to its member banks, including Glens Falls National Bank and Trust Company, by way of a mandatory redemption of 38.7% of the Visa Class B shares held by the member banks, some of the proceeds realized by Visa from the initial public offering and sale of its Class A shares just then completed. With another portion of the IPO proceeds, Visa established a $3 billion escrow fund to cover certain, but not all, of its continuing litigation liabilities under various antitrust claims, which its member banks are otherwise required to bear. Accordingly, during the first quarter of 2008, we recorded the following transactions:

A gain of $749 thousand from the mandatory redemption by Visa from us of 38.7% of our Class B Visa Inc. shares, reflected as an increase in noninterest income, and

A reversal of $306 thousand of the $600 thousand accrual previously recorded by us at December 31, 2007, representing our then estimated proportional share of Visa litigation costs, which reversal was reflected as a reduction in 2008 other operating expense.

In October 2008, Visa announced that it had settled a lawsuit with Discover Financial Services, which was part of the covered litigation for which the Visa member banks remained contingently liable. In December 2008, Visa deposited an additional $1.1 billion into the escrow fund for covered litigation. On July 16, 2009, Visa announced that it had deposited an additional $700 million into the escrow fund. These developments reduced the Company s proportionate exposure for covered litigation but also reduced the ultimate value of its remaining Class B Visa shares. However, the Company had not previously recognized the value of its remaining Class B shares in accordance with SEC guidance, thus the Company did not recognize any income or expense in any of the periods presented as a result of the reduced value of those shares upon Visa s settlement of the litigation. The estimation of the Company s proportionate share of any potential losses related to the covered litigation is extremely difficult and involves a high degree of uncertainty. Management has determined that the remaining $294 thousand liability included in Other Liabilities on our year-end 2008 consolidated balance sheet remained the fair value of our proportionate share of the remaining covered Visa litigation obligation as of December 31, 2009, but this value is subject to change depending upon future developments in the covered litigation.

Change in Stockholders Equity: At December 31, 2009, our tangible book value per share (calculated based on stockholders equity reduced by intangible assets including goodwill and other intangible assets) amounted to $11.37, an increase of $1.30, or 12.9%, from year-end 2008. Our total stockholders equity at year-end 2009 increased 11.9% over the year-end 2008 level. Major changes to stockholders equity included: i) $21.8 million of net income for the year; ii) a $707 thousand net unrealized gain in securities available-for-sale; iii) gains on our pension plan (reflected as other comprehensive income) of $1.5 million; offset by iv) cash dividends of $10.6 million; and by (v) repurchases of our own common stock of $3.8 million. As of the last trading day of 2009, our closing stock price was $25.00, resulting in a trading multiple of 2.20 to our tangible book value. The Company and each of its subsidiary banks also continue to remain classified as well-capitalized under regulatory guidelines. As mentioned above, due to our strong capital, financial and liquidity positions, we did not participate in the U.S. Treasury s Capital Purchase Program (a component of TARP).

The Board of Directors declared a quarterly cash dividend of $.25 per share for the fourth quarter of 2009. For the year, total cash dividends (as adjusted for stock dividends) were $.98 compared to $.95 for 2008, an increase of $.03, or 3.2%.

B. RESULTS OF OPERATIONS

The following analysis of net interest income, the provision for loan losses, noninterest income, noninterest expense and income taxes, highlights the factors that had the greatest impact on our results of operations for 2009 and the prior two years.

I. NET INTEREST INCOME (Tax-equivalent Basis)

Net interest income represents the difference between interest, dividends and fees earned on loans, securities and other earning assets and interest paid on deposits and other sources of funds. Changes in net interest income result from changes in the level and mix of earning assets and sources of funds (volume) and changes in the yields earned and interest rates paid (rate). Net interest margin is the ratio of net interest income to average earning assets. Net interest income may also be described as the product of average earning assets and the net interest margin. As described in the section entitled Use of Non-GAAP Financial Measures on page 4 of this Report we calculate net interest income on a tax-equivalent basis using a marginal tax rate of 35%.

CHANGE IN NET INTEREST INCOME

(Dollars In Thousands) (Tax-equivalent Basis)

	Years Ended December 31,			Change From Prior Year			
				2008 to 2009		2007 to 2008	
	2009	2008	2007	Amount	%	Amount	%
Interest and Dividend Income	$90,038	$92,441	$89,498	$(2,403)	(2.6)%	$ 2,943	3.3 %
Interest Expense	26,492	32,277	40,283	(5,785)	(17.9)	(8,006)	(19.9)
Net Interest Income	$63,546	$60,164	$49,215	$ 3,382	5.6	$10,949	22.3

On a tax-equivalent basis, net interest income was $63.5 million in 2009, an increase of $3.4 million, or 5.6%, from $60.2 million in 2008. This compared to an increase of $10.9 million, or 22.3%, from 2007 to 2008. Factors contributing to the increase in net interest income over the three-year period are discussed in the following portions of this Section B.I.

In the following table, net interest income components are presented on a tax-equivalent basis. Changes between periods are attributed to movement in either the average daily balances or average rates for both earning assets and interest-bearing liabilities. Changes attributable to both volume and rate have been allocated proportionately between the categories.

	2009 Compared to 2008			2008 Compared to 2007		
	Change in Net Interest Income Due to:			Change in Net Interest Income Due to:		
Interest and Dividend Income:	Volume	Rate	Total	Volume	Rate	Total
Federal Funds Sold	$ (464)	$ ---	$ (464)	$ (195)	$ (439)	$ (634)

Interest-Bearing Bank Balances	160	(68)	92	57	---	57
Investment Securities:						
Taxable	1,353	(2,779)	(1,426)	1,152	665	1,817
Non-Taxable	1,373	(738)	635	324	(328)	(4)
Loans	1,892	(3,132)	(1,240)	3,229	(1,522)	1,707
Total Interest and Dividend Income	4,314	(6,717)	(2,403)	4,567	(1,624)	2,943
Interest Expense:						
Deposits:						
NOW Accounts	1,159	(1,160)	(1)	1,001	(2,696)	(1,695)
Savings Deposits	290	(1,587)	(1,297)	217	(792)	(575)
Time Deposits of $100,000 or More	(504)	(1,369)	(1,873)	(392)	(2,645)	(3,037)
Other Time Deposits	220	(1,517)	(1,297)	(625)	(2,140)	(2,765)
Total Deposits	1,165	(5,633)	(4,468)	201	(8,273)	(8,072)
Short-Term Borrowings	14	(674)	(660)	221	(821)	(600)
Long-Term Debt	(147)	(510)	(657)	1,025	(359)	666
Total Interest Expense	1,032	(6,817)	(5,785)	1,447	(9,453)	(8,006)
Net Interest Income	$3,282	$ 100	$ 3,382	$3,120	$7,829	$10,949

The following table reflects the components of our net interest income, setting forth, for years ended December 31, 2009, 2008 and 2007 (i) average balances of assets, liabilities and stockholders' equity, (ii) interest and dividend income earned on earning assets and interest expense incurred on interest-bearing liabilities, (iii) average yields earned on earning assets and average rates paid on interest-bearing liabilities, (iv) the net interest spread (average yield less average cost) and (v) the net interest margin (yield) on earning assets. Interest income and interest rate information is presented on a tax-equivalent basis (see the discussion under Use of Non-GAAP Financial Measures on page 4 of this Report). The yield on securities available-for-sale is based on the amortized cost of the securities. Nonaccrual loans are included in average loans.

Average Consolidated Balance Sheets and Net Interest Income Analysis

(Tax-equivalent basis using a marginal tax rate of 35%)

(Dollars in Thousands)

Years Ended:	2009			2008			2007		
	Average Balance	Interest Income or Expense	Rate Earned or Paid	Average Balance	Interest Income or Expense	Rate Earned or Paid	Average Balance	Interest Income or Expense	Rate Earned or Paid
Federal Funds Sold	$ ---	$ ---	---%	$ 17,472	$ 464	2.66%	$ 22,022	$ 1,098	4.99%
Interest-Bearing Deposits at Banks	56,920	149	0.26	5,997	57	0.95	---	---	---
Investment Securities:									
Taxable	362,059	14,739	4.07	332,530	16,182	4.87	308,482	14,365	4.66
Non-Taxable	167,716	8,453	5.04	141,294	7,801	5.52	135,347	7,805	5.77
Loans	1,101,759	66,697	6.05	1,071,384	67,937	6.34	1,020,856	66,230	6.49
Total Earning Assets	1,688,454	90,038	5.33	1,568,677	92,441	5.89	1,486,707	89,498	6.02
Allowance for Loan Losses	(13,626)			(12,658)			(12,323)		
Cash and Due From Banks	28,096			32,505			33,180		
Other Assets	58,082			55,686			50,687		
Total Assets	$1,761,006			$1,644,210			$1,558,251		
Deposits:									
NOW Accounts	$ 460,096	5,172	1.12	$ 367,351	5,173	1.41	$ 315,614	6,868	2.18
Savings Deposits	307,133	2,101	0.68	281,208	3,398	1.21	266,007	3,973	1.49
Time Deposits of $100,000 Or More	155,378	3,718	2.39	172,055	5,591	3.25	180,606	8,628	4.78
Other Time Deposits	249,575	7,331	2.94	243,247	8,628	3.55	258,042	11,393	4.42
Total Interest-Bearing Deposits	1,172,182	18,322	1.56	1,063,861	22,790	2.14	1,020,269	30,862	3.02
Short-Term Borrowings	59,566	129	0.22	58,473	789	1.35	49,355	1,389	2.81
FHLBNY Advances and	178,274	8,041	4.51	181,406	8,698	4.79	160,258	8,032	5.01

Long-Term Debt									
Total Interest-Bearing Funds	1,410,022	26,492	1.88	1,303,740	32,277	2.48	1,229,882	40,283	3.28
Demand Deposits	191,504			189,999			186,474		
Other Liabilities	24,590			24,818			23,813		
Total Liabilities	1,626,116			1,518,557			1,440,169		
Stockholders Equity	134,890			125,653			118,082		
Total Liabilities and Stockholders Equity	$1,761,006			$1,644,210			$1,558,251		
Net Interest Income (Tax-equivalent Basis)		63,546			60,164			49,215	
Reversal of Tax Equivalent Adjustment		(3,181)	.19%		(2,933)	.19%		(2,921)	.20%
Net Interest Income		$60,365			$57,231			$46,294	
Net Interest Spread			3.45%			3.41%			2.74%
Net Interest Margin			3.76%			3.84%			3.31%

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CHANGES IN NET INTEREST INCOME DUE TO RATE

YIELD ANALYSIS (Tax-equivalent basis)	December 31,		
	2009	2008	2007
Yield on Earning Assets	5.33%	5.89%	6.02%
Cost of Interest-Bearing Liabilities	1.88	2.48	3.28
Net Interest Spread	3.45%	3.41%	2.74%
Net Interest Margin	3.76%	3.84%	3.31%

Following two years of decreases in net interest income in 2006 and 2005 (during a period of rising interest rates), we experienced a modest increase in net interest income in 2007, a significant increase in 2008 followed by another strong increase in 2009. In all periods, we experienced a benefit from an increase in average earning assets, but the substantial increase in 2008 was largely attributable to a period of falling interest rates and the benefit we experience from paying liabilities repricing downwards more quickly than our earning assets.

The increase in net interest income was $3.4 million, or 5.6%, from 2008 to 2009. Net interest income increased $10.9 million, or 22.3%, from 2007 to 2008. In 2009, an increase in average earning assets, net of a smaller increase in average paying liabilities (i.e., changes in volume) had a $3.3 million positive impact on net interest income, while changes in rates only provided a $100 thousand positive impact on our net interest income for the year, reflecting the fact that the prevailing federal funds rates stayed in the range of 0 to .25% for all the year.

Generally, the following items have a major impact on changes in net interest income due to rate: general interest rate changes, the ratio of our rate sensitive assets to rate sensitive liabilities (interest rate sensitivity gap) during periods of interest rate changes, and changes in the level of nonperforming loans.

Impact of Interest Rate Changes 2003 2009

Our profitability is affected by the prevailing interest rate environment, both short-term rates and long-term rates, by changes in those rates, and by the relationship between short- and long-term rates (i.e., the yield curve).

Changes in Rates 2003 2009. In mid-2003, due to actions by the Federal Reserve Bank (Fed), the target rate on federal funds (funds which banks loan to one another on an overnight basis) decreased to a (then) almost unprecedented low of 1.00%, and rates paid by banks on short-term deposits similarly decreased to historically low levels. The resulting lower rates on credit provoked a substantial expansion of lending across all sectors of the U.S. economy, especially mortgage and consumer lending. In mid-2005, following this period of prolonged and, at that time, historically low interest rates, the Fed began to increase short-term rates with a series of 25 basis point increases in the targeted federal funds rate, reaching 5.25% by mid-2007. Rates paid by banks on short-term deposits similarly increased during this period, although rates paid on long-term deposits (and yields earned on long-term loans and assets) did not increase proportionately, as lending, particularly mortgage lending, continued to expand nationwide at a rapid rate.

From mid-2007 to fall 2008, the Fed did not take any actions to change short-term rates. In September 2008, however, in response to a weakening economy and a loss of liquidity in the short-term credit market, precipitated in large part by the collapse in the housing market and resulting problems in subprime residential real estate lending, the Fed began lowering the federal funds target rate, rapidly and by significant amounts.

By the December 2008 meeting of the Board of Governors, the rate had decreased 100 basis points, to 4.25%, and throughout 2009, the Fed, in response to continuing liquidity concerns in the credit markets, further lowered the targeted federal funds rate by an additional 400 basis points, to an unprecedented low range of 0% to .25% where it remained for all of 2009 and continues at present. We began to see an immediate impact in the reduced cost of our deposits when rates began to fall in 2008 and continued falling in 2009. Yields on our earning assets also began to fall, but lagged significantly behind the deposit repricing.

Changes in the Yield Curve 2005 2009. An important development with regard to the effect of rate changes on our profitability in the mid-2005 to mid-2007 period was the flattening of the yield curve, especially during 2006 and the first half of 2007. After the Fed began increasing short-term interest rates in June 2004, the yield curve did not maintain its traditional upward slope but flattened; that is, as short-term rates increased, longer-term rates stayed unchanged or even decreased. Therefore, the traditional spread between short-term rates and long-term rates (the upward yield curve) essentially disappeared, i.e., the curve flattened. In late 2006 and in early 2007, the yield curve actually inverted, with short-term rates exceeding long-term rates. The flattening of the yield curve was the most significant factor in reducing our net interest income from 2005 through 2007. We, like many banks, typically fund longer-duration assets with shorter-maturity liabilities, and the flattening of the yield curve directly diminishes the benefit of this strategy.

At the end of the second quarter of 2007, however, the yield on longer-term securities began to increase compared to short-term investments. This increase in rate spread was further enhanced when long-term rates held steady after the Fed began lowering short-term rates in September 2007. Because market perceptions and expectations have changed regarding the need to price more risk into certain long-term debt instruments, long-term rates may be expected to remain steady or rise, even though short-term rates dropped sharply in 2008 and remained low in 2009. The yield curve may continue to reflect its more traditional shape for some time. However, even lending institutions such as ours that have avoided subprime lending problems and have enjoyed continued high credit quality have nevertheless experienced some increasing pressure on credit quality in recent periods, and this may continue especially if the national or regional economy continues to weaken. Any credit or asset quality erosion will reduce or possibly outweigh the benefit we may experience from the return of a positively-sloped yield curve. Thus, no assurances can be given on future improvements in our net interest margins, net interest income or net income generally, particularly as consumer mortgage related borrowings have diminished across the economy and the redeployment of funds by bankers from maturing loans and assets into other high-quality assets has become progressively more difficult.

Effect of Rate Changes on Our Margin; Changes in Our Margins 2002 Late 2007. In addition to the shape of the yield curve, our net interest margin has traditionally been sensitive to and impacted by changes in prevailing market interest rates. Generally, there has been a negative correlation between changes in prevailing interest rates and our net interest margin, especially when rates begin to move in a different direction. Typically, when prevailing rates begin to decline, our net interest margin generally increases in immediately ensuing periods, and conversely, when prevailing rates begin to increase, our net interest margin generally decreases, as in each case earning assets reprice more slowly than interest-bearing sources of funds. This was the case for our net interest margin during the 2002 to mid-2003 period, when prevailing short-term market rates began to decline and our margin increased, and also during the mid-2003 to 2004 period, when rates began to increase and our margins experienced a negative effect. Similarly, in 2005 through mid-2007, as the Fed increased short-term rates, not only did our net interest margin suffer initially, as usual, but it continued to narrow as rates on assets, especially longer-maturity assets, never rose and the yield curve flattened. Our margin reached a low point in the fourth quarter of 2006, at 3.24%, and then increased slightly to 3.32% for each of the first two quarters of 2007. In the third quarter of 2007 the margin decreased once again, to 3.29%.

Improvement in Our Margins Late 2007 2009. From the third quarter of 2007 through mid-2008 our margin steadily improved, principally due to the fact the rates we paid on our interest-bearing liabilities began to reprice downward rapidly. The dramatic reduction in short-term interest rates after September 2007 had a significant positive impact on our net interest income and net interest margins through mid-2009. Our net interest margin held steady at around 3.90% for four successive quarters, but began to narrow in the last three quarters of 2009 as the downward repricing of paying liabilities neared its completion while interest earning assets continued to reprice downwards.

We expect that our margin may contract a bit more in future periods as the volume of downward repricing in our investment and loan portfolios exceeds the volume of downward repricing in our deposit and wholesale funding portfolios.

Moreover, our ability to reduce the rates paid on many of our nonmaturity deposit products, even if longer-term funding rates should decline in upcoming periods, is limited due to the already low levels for those products, whereas rates earned on our earning assets will likely index downwards to the full extent of the decrease in prevailing rates. A discussion of the models we use in projecting the impact on net interest income resulting from possible changes in interest rates vis-à-vis the repricing patterns of our earning assets and interest-bearing liabilities is included later in this report under Item 7.A., Quantitative and Qualitative Disclosures About Market Risk.

CHANGES IN NET INTEREST INCOME DUE TO VOLUME

AVERAGE BALANCES

(Dollars In Thousands)

	Years Ended December 31,			Change From Prior Year			
				2008 to 2009		2007 to 2008	
	2009	2008	2007	Amount	%	Amount	%
Earning Assets	$1,688,454	$1,568,677	$1,486,707	$119,777	7.6%	$81,970	5.5%
Interest-Bearing Liabilities	1,410,022	1,303,740	1,229,882	106,282	8.2	73,858	6.0
Demand Deposits	191,504	189,999	186,474	1,505	0.8	3,525	1.9

Total Assets	1,761,006	1,644,210	1,558,251	116,796	7.1	85,959	5.5
Earning Assets to Total Assets	95.88%	95.41%	95.41%				

2008 to 2009:

In general, an increase in average earning assets has a positive impact on net interest income. For 2009, average earning assets increased $119.8 million or 7.6% over 2008, while average interest-bearing liabilities increased $106.3 million or 8.2%. This combination led to a $3.3 million increase in net interest income, even though our net interest margin decreased by 8 basis points (from 3.84% to 3.76%) between the two years. (This positive effect was in addition to the $100 thousand positive impact on net interest income resulting from the changes in rates during the year, discussed above.)

The $119.8 million increase in average earning assets from 2008 to 2009 reflected an increase in average loans of $30.4 million, or 2.8%, an increase of $56.0 million, or 11.8%, in investment securities and a $33.5 increase in the level of overnight funds. Although the balance of indirect loans (which represented the second largest segment of the loan portfolio) began to decrease in the second half of 2009, the average balances increased $9.1 million, or 3.0%, in our commercial and commercial real estate loans and increased $24.2 million, or 7.0%, in our residential real estate loans.

The $106.3 million increase in average interest-bearing liabilities was primarily attributable to increases in municipal deposit balances. The fact that our average earning assets increased more than our average paying liabilities, was attributable to both an increase in non-interest bearing demand deposits together with additions to stockholders equity.

2007 to 2008:

For 2008, average earning assets increased $82.0 million or 5.5% over 2007, while average interest-bearing liabilities increased $73.9 million or 6.0%. This combination led to a $3.1 million increase in net interest income. The $82.0 million increase in average earning assets from 2007 to 2008 reflected an increase in average loans of $50.5 million, or 5.0%, and an increase of $30.0 million, or 6.8%, in investment securities, while the level of overnight funds purchased remained relatively unchanged. We experienced increases in all major categories within the loan portfolio during 2008, although the average balance of indirect loans (which represented the second largest segment of the loan portfolio) increased only 1.3% from 2007. Increases in the average balances of our other two large segments were $29.5 million, or 10.0%, in our commercial and commercial real estate loans and an increase of $18.2 million, or 5.5%, in our residential real estate loans.

The $73.9 million increase in average interest-bearing liabilities resulted from a $47.1 million increase in average deposit balances and a $30.3 million increase in the average balance of other borrowed funds.

Increases in the volume of loans and deposits, as well as yields and costs by type, are discussed later in this Report under Item 7.C. Financial Condition.

I. PROVISION FOR LOAN LOSSES AND ALLOWANCE FOR LOAN LOSSES

We consider our accounting policy relating to the allowance for loan losses to be a critical accounting policy, given the uncertainty involved in evaluating the level of the allowance required to cover credit losses inherent in the loan portfolio, and the material effect that such judgments may have on our results of operations. In addition to the following discussion, see Notes 1 and 5 to the consolidated financial statements, included in Item 8 of this Report.

Through the provision for loan losses, an allowance is maintained that reflects our best estimate of probable incurred loan losses related to specifically identified loans and losses for categories of loans in the remaining portfolio. Actual loan losses are charged against this allowance when loans are deemed uncollectible.

We use a two-step process to determine the provision for loans losses and the amount of the allowance for loan losses. We evaluate impaired commercial and commercial real estate loans over $250,000 individually, while we evaluate the remainder of the portfolio on a pooled basis as described below.

At December 31, 2009, we had three loans, over $250,000, considered impaired. Those loans had sufficient collateral and required no specific reserve. See Note 5 to the consolidated financial statements, included in Item 8 of this Report.

Homogenous Loan Pools: Under our pooled analysis, we group homogeneous loans as follows, each with its own estimated loss-rate:

i)

Secured and unsecured commercial loans,

ii)

Secured construction and development loans,

iii)

Secured commercial loans non-owner occupied,

iv)

Secured commercial loans owner occupied,

v)

One to four family residential real estate loans,

vi)

Home equity loans,

vii)

Indirect loans   low risk tiers (based on credit scores),

viii)

Indirect loans   high risk tiers, and

ix)

Other consumer loans.

Within the group of other commercial and commercial real estate loans, we sub-group loans based on our internal system of risk-rating, which is applied to all commercial and commercial real estate loans. We establish loss rates for each of these pools.

Estimated losses reflect consideration of all significant factors that affect the collectibility of the portfolio as of December 31, 2009. In our evaluation, we do both a quantitative and qualitative analysis of the homogeneous pools.

Quantitative Analysis: Quantitatively, we determine the historical loss rate for each homogeneous loan pool.

During the past five years we have had little charge-off activity on loans secured by residential real estate. Indirect consumer lending (principally automobile loans) represents a significant component of our total loan portfolio and is the only category of loans that has a history of losses that lends itself to a trend analysis. We have had two losses on commercial real estate loans in the past five years. Losses on commercial loans (other than those secured by real estate) are also historically low, but can vary widely from year-to-year; this is the most complex category of loans in our loss analysis.

Our net charge-offs for the past five years have been at or near historical lows for our company, although charge-offs increased in 2008 and 2009, (see the table on page 28). Annualized net charge-offs have ranged from .04% to .09% of average loans during this period.   In prior years this ratio was significantly higher. For example, in the mid-to-late 1990 s, the charge-off ratio ranged from .16% to .32% for our company.   The ratio for bank holding companies in our peer group was 1.32% and .70% for the years ended December 31, 2009 and 2008, respectively. The change in this peer group ratio represents a significant increase from the prior five years when the peer ratio ranged from .13% to .25%.

Qualitative Analysis: While historical loss experience provides a reasonable starting point for our analysis, historical losses, or even recent trends in losses, do not by themselves form a sufficient basis to determine the appropriate level for the allowance. Therefore, we have also considered and adjusted historical loss factors for qualitative and environmental factors that are likely to cause credit losses associated with our existing portfolio. These included:

.

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

For each homogeneous loan pool, we estimate a loss factor expressed in basis points for each of the qualitative factors above, and for historical credit losses. We update and change, if necessary, the loss-rates assigned to various pools based on the analysis of loss trends and the change in qualitative and environmental factors.

From June 2004 to June 2006, the Federal Reserve Bank increased prevailing short-term rates in an effort to slow down national economic growth and check potential increases in the inflation rate. However, from August 2007 through December 2008, the Federal Reserve Bank began to cut rates in response to the growing financial crisis in credit markets and evidence of a significant economic recession. In our market area there was little impact from these developments in credit markets and the national economy on unemployment rates, job growth and business failures until the last quarter of 2008; overall, our market area has not experienced in the past five quarters the degree of negative impact on lending, credit and property values that the U.S. as a whole has experienced, although this may change in upcoming periods.

Due to the imprecise nature of the loan loss estimation process and ever changing economic conditions, the risk attributes of our portfolio may not be adequately captured in data related to the formula-based loan loss components used to determine allocations in our analysis of the adequacy of the allowance for loan losses. Management, therefore, has established and held an unallocated portion within the allowance for loan losses reflecting the uncertainty of future economic conditions within our market area. This unallocated portion of the allowance was $855 thousand, or 6.1% of the total allowance for loan losses, at December 31, 2009.

SUMMARY OF THE ALLOWANCE AND PROVISION FOR LOAN LOSSES

(Dollars In Thousands) (Loans, Net of Unearned Income)

Years-Ended December 31,	**2009**	**2008**	**2007**	**2006**	**2005**
Loans at End of Period	$1,112,150	$1,109,812	$1,038,844	$1,008,999	$ 996,545
Average Loans	1,101,759	1,071,384	1,020,856	996,611	942,286
Total Assets at End of Period	1,841,627	1,665,086	1,584,846	1,520,217	1,519,603
Nonperforming Assets:					
Nonaccrual Loans:					
Commercial Real Estate	$2,235	$2,263	$ 758	$ 708	$ 597
Commercial Loans	309	50	73	56	26
Residential Real Estate Loans	901	100	253	452	59
Consumer Loans	945	1,056	855	822	1,193
Total Nonaccrual Loans	4,390	3,469	1,939	2,038	1,875
Loans Past Due 90 or More Days and Still Accruing Interest	270	457	245	739	373
Total Nonperforming Loans	4,660	3,926	2,184	2,777	2,248
Repossessed Assets	59	64	63	144	124
Other Real Estate Owned	53	581	89	248	---
Nonaccrual Investments	---	400	---	---	---
Total Nonperforming Assets	$4,772	$4,971	$2,336	$3,169	$2,372
Allowance for Loan Losses:					
Balance at Beginning of Period	$13,272	$12,401	$12,278	$12,241	$12,046
Loans Charged-off:					
Commercial, Financial and Agricultural	(88)	(83)	(27)	(32)	(134)
Real Estate - Commercial	---	---	(6)	---	---
Real Estate - Residential	(25)	(25)	---	---	(30)
Installment Loans to Individuals	(1,317)	(1,184)	(797)	(1,105)	(964)
Total Loans Charged-off	(1,430)	(1,292)	(830)	(1,137)	(1,128)
Recoveries of Loans Previously Charged-off:					
Commercial, Financial and Agricultural	14	38	13	27	18
Real Estate - Commercial	---	197	17	17	17
Real Estate - Residential	6	2	2	2	2
Installment Loans to Individuals	369	255	408	302	256
Total Recoveries of Loans Previously Charged-off	389	492	440	348	293
Net Loans Charged-off	(1,041)	(800)	(390)	(789)	(835)
Provision for Loan Losses Charged to Expense	1,783	1,671	513	826	1,030

Balance at End of Period	$14,014	$13,272	$12,401	$12,278	$12,241
Nonperforming Asset Ratio Analysis:					
Net Loans Charged-off as a Percentage of Average Loans	.09%	.07%	.04%	.08%	.09%
Provision for Loan Losses as a Percentage of Average Loans	.16	.16	.05	.08	.11
Allowance for Loan Losses as a Percentage of Loans, Period-end	1.26	1.20	1.19	1.22	1.23
Allowance for Loan Losses as a Percentage of Nonperforming Loans	300.73	338.05	567.81	442.12	544.55
Nonperforming Loans as a Percentage of Loans, Period-end	.42	.35	.21	.28	.23
Nonperforming Assets as a Percentage of Total Assets, Period-end	.26	.30	.15	.21	.16

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

(Dollars in Thousands)

	2009	2008	2007	2006	2005
Commercial, Financial and Agricultural	$ 1,304	$ 1,735	$ 1,634	$ 1,691	$ 1,574
Real Estate-Commercial	4,000	3,568	3,247	3,348	3,160
Real Estate-Residential Mortgage	2,954	2,610	2,320	1,714	1,569
Indirect and Other Installment Loans to Individuals	4,901	4,859	4,369	4,517	5,294
Unallocated	855	500	831	1,008	644
Total	$14,014	$13,272	$12,401	$12,278	$12,241

III. NONINTEREST INCOME

The majority of our noninterest income constitutes fee income from services, principally fees and commissions from fiduciary services, deposit account service charges, insurance commissions, and other recurring fee income. Net gains or losses on the sale of securities available-for-sale is another category of noninterest income.

ANALYSIS OF NONINTEREST INCOME

(Dollars In Thousands)

	Years Ended December 31,			Change From Prior Year			
				2008 to 2009		2007 to 2008	
	2009	2008	2007	Amount	%	Amount	%
Income from Fiduciary Activities	$ 5,009	$ 5,463	$ 5,572	$ (454)	(8.3)%	$ (109)	(2.0)%
Fees for Other Services to Customers	8,051	8,562	8,130	(511)	(6.0)	432	5.3
Net Gains (Losses) on Securities Transactions	357	383	---	(26)	(6.8)	383	---
Other-Than-Temporary Impairment	(375)	(1,610)	---	1,235	76.7	(1,610)	---
Net Gain on Sale of Merchant Bank Card Processing	2,966	---	---	2,966	---	---	---
Gain on Visa Stock Redemption	---	749	---	(749)	---	749	---
Gain on the Sale of Premises	---	115	---	(115)	---	115	---
Income from Restitution Payment	450	---	---	450	---	---	---
Insurance Commissions	2,412	2,066	1,869	346	16.7	197	10.5
Other Operating Income	722	541	717	181	33.5	(176)	(24.5)
Total Noninterest Income	$19,592	$16,269	$16,288	$3,323	20.4	$ (19)	(0.1)

2009 compared to 2008: Without regard to certain transactions (securities gains, OTTI, sale of the merchant bank card processing, VISA transactions, sale of premises and the restitution payment) total noninterest income was down $438 thousand, or 2.6%, from 2008 to 2009. The most significant transactions involving non-interest income occurring during 2008 and 2009 were discussed in the Overview beginning on page 19: 1) the net gain on the sale of our merchant bank card processing to TransFirst in the first quarter of 2009, 2) the write-down of our Lehman bond in 2008 and of our holdings in an inactively-traded common stock in 2009 and, 3) the 2008 gain from the Visa stock redemption.

For 2009, income from fiduciary activities decreased $454 thousand, or 8.3%, from 2008. The decrease mirrored (and resulted from) a similar and significant decrease in the fair value of assets under administration and management following the severe decline in the stock markets during 2008 to the early 2009 period.

At December 31, 2009, the fair value of assets under trust administration and investment management amounted to $867.2 million, an increase of $111.8 million, or 14.8%, from December 31, 2008. A significant portion of our fiduciary fees are indexed to the average dollar amount of assets under administration and we normally expect (and experience) a change in our fiduciary fee income proportionate to our change in average dollar assets under administration. An increase in stock market prices was not sufficient to achieve an overall increase in income from fiduciary activities for 2009 as compared to 2008, since the average balance in 2009 was still well below the average balance for 2008.

Income from fiduciary activities includes fee income from the investment advisory services performed by our affiliated investment advisor for our proprietary mutual funds. These mutual funds are the North Country Funds, which include the North Country Equity Growth Fund (NCEGX) and the North Country Intermediate Bond Fund (NCBDX). The combined funds represented a market value of $213.5 million at December 31, 2009, compared to $180.0 million at December 31, 2008.

Fees for other services to customers (primarily service charges on deposit accounts, credit card merchant fees, debit card interchange fees, revenues related to the sale of mutual funds to our customers by third party providers and servicing income on sold loans) were $8.1 million for 2009, a decrease of $511 thousand, or 6.0%, from the 2008 period. The decrease was primarily attributable to a decrease in fees we received from the merchant bank card processing business following our sale of that business in the first quarter of 2009. That decrease was offset, in part, by an increase in fees on debit cards and other fee income.

During the first quarter of 2008, Visa successfully completed an initial public offering (IPO) and used a portion of the proceeds from the IPO to fund a $3 billion litigation escrow account. As a result, in the first quarter of 2008, our subsidiary, Glens Falls National Bank and Trust Company, a Visa member bank that is contingently liable with other member banks for certain covered Visa litigation expenses, reversed litigation-related accruals of $306 thousand out of the total of $600 thousand in pre-tax charges which we had previously recognized in the fourth quarter of 2007 for such expenses. Visa used another portion of the IPO proceeds to redeem 38.7% of the Visa Class B common stock held by each of its member banks. As a result, we also recognized in the first quarter a pre-tax gain of $749 thousand representing the proceeds received by us from this partial redemption.

In 2009, we sold many of our newly originated residential real estate loans to Freddie Mac, resulting in net gains of $418 thousand, compared to $106 thousand in gains for the 2008 period which is reflected in other operating income above. Other operating income also includes net gains on the sale of other real estate owned, repossessed vehicles, fixed assets, as well as other miscellaneous revenues.

<u>2008 compared to 2007:</u> Although total noninterest income was relatively unchanged from 2007 to 2008 there were several significant transactions involving non-interest income occurring during 2007 and 2008, most notably the two items discussed in the Overview beginning on page 19: 1) the write-down of our Lehman bond, and 2) the gain from the Visa stock redemption.

For 2008, income from fiduciary activities decreased $109 thousand, or 2.0%, from 2007. The decrease followed the significant decrease in assets under administration and management following the severe decline in the stock markets principally in the last three months of 2008. At year-end 2008, the market value of assets under trust administration and investment management amounted to $755.4 million, a decrease of $205.8 million, or 21.4%, from year-end 2007. By comparison, the Dow Jones Industrial Average was 8,776 at December 31, 2008 a 33.8% decrease from 13,264 at December 31, 2007. With a significant portion of our fiduciary fees indexed to assets under administration we would normally expect this income to decrease proportionately. However, since the market decline occurred primarily in the second half of the year our total income from fiduciary activities did not fall to the full extent of the decrease in the market value of assets under administration.

Income from fiduciary activities includes income from funds under investment management in The North Country Funds, specifically the North Country Equity Growth Fund (NCEGX) and the North Country Intermediate Bond Fund (NCBDX), both of which are advised by our registered investment adviser subsidiary, North Country Investment Advisers, Inc. On a combined basis, these funds had a market value of $180.0 million and $207.1 million at December 31, 2008 and 2007, respectively. The funds were introduced in March 2001. Most of the dollars invested in these funds are derived from retirement and pension plan accounts of which our banks serve as trustee, but our North Country Funds also are offered on a retail basis through an arrangement with UVEST Financial Services Group, Inc., a third-party registered broker/dealer that provides securities brokerage services to our customers from several of our bank branches. Our company s pension plan is included as an investor in the North Country Funds, and owned shares in the funds with a market value of approximately $14.5 million at December 31, 2008 and $17.5 million at 2007.

Fees for other services to customers include deposit account service charges, debit card processing fees, merchant bankcard processing fees, safe deposit box fees and loan servicing fees. These fees amounted to $8.6 million in 2008, an increase of $432 thousand, or 5.3%, from 2007. The increase was primarily attributable to debit card activity fee income and increases in income from our third-party provider of securities brokerage services.

During 2008, we recognized a net gain of $383 thousand on the sale of $29.1 million of investment securities available-for-sale, whereas no securities were sold during 2007.

During 2008, we sold a building which we were using for storage and administrative purposes to a developer. After renovation, we agreed to lease back office space which amounted to less than 10 percent of the total building space. We recognized a gain of $115 thousand in 2008 on this sale.

In November 2004, we acquired Capital Financial Group, Inc., a local insurance agency specializing in the sale of group health and life insurance. See the more detailed discussion of the acquisition on page 5 of this Report. Insurance commission income increased from $1.9 million in 2007 to $2.1 million in 2008.

Other operating income includes net gains on the sale of loans and other real estate owned as well as other miscellaneous revenues. For 2008, other operating income decreased $176 thousand, or 24.5%, from 2007. In years prior to 2008, other operating income included data processing servicing fee income received from one unaffiliated upstate New York bank. However, this arrangement came to an end in the second quarter of 2007, following the acquisition of that institution by an unrelated company. Termination of the arrangement resulted in a reduction in fee income of $135 thousand in 2008 compared to 2007.

IV. NONINTEREST EXPENSE

Noninterest expense is a means of measuring the delivery cost of services, products and business activities of a company. The key components of noninterest expense are presented in the following table.

ANALYSIS OF NONINTEREST EXPENSE

(Dollars In Thousands)

	Years Ended December 31,	Change From Prior Year

	2009	2008	2007	2008 to 2009 Amount	2008 to 2009 %	2007 to 2008 Amount	2007 to 2008 %
Salaries and Employee Benefits	$27,042	$24,551	$21,424	$2,491	10.1%	$3,127	14.6%
Occupancy Expense of Premises, Net	3,316	3,479	3,198	(163)	(4.7)	281	8.8
Furniture and Equipment Expense	3,264	3,211	3,015	53	1.7	196	6.5
FDIC Special Assessment	787	---	---	787	---	---	---
FDIC Regular Assessment	1,783	644	139	1,139	176.9	505	363.3
VISA Related Litigation Exposure (Reversal)	---	(306)	600	306	---	(906)	(151.0)
Amortization	324	360	395	(36)	(10.0)	(35)	(8.9)
Other Operating Expense	10,076	10,454	9,159	(378)	(3.6)	1,295	14.1
Total Noninterest Expense	$46,592	$42,393	$37,930	$4,199	9.9	$4,463	11.8

2009 compared to 2008: Noninterest expense for 2009 amounted to $46.6 million, an increase of $4.2 million, or 9.9%, from 2008. One comparative measure of operating expenses for financial institutions is the efficiency ratio. The efficiency ratio (a ratio where lower is better) is calculated as the ratio of noninterest expense to the sum of tax equivalent net interest income and other income. Excluded from our calculation of the efficiency ratio is intangible asset amortization and any net securities gains or losses. The efficiency ratio might be considered a non-GAAP financial measure but is generally utilized by banks and bank analysts to assess an institution s performance. See the discussion on Use of Non-GAAP Financial Measures on page 4 of this Report. For 2009, the efficiency ratio for Arrow was 55.64%, an increase from the 2008 ratio of 54.65%. A similar ratio (total overhead expense to adjusted tax equivalent operating income) is presented in the Federal Reserve Board s Bank Holding Company Performance Report for December 31, 2009. Our 2009 ratio, 56.03%, compared favorably to the ratio for our peer group of 76.40%. For information on the calculation of our efficiency ratios on a quarterly and annual basis, see pages 17 and 18 of this Report.

Salaries and employee benefits expense increased $2.5 million, or 10.1%, from 2008 to 2009. Salary expense increased $746 thousand, or 4.3%, from 2008, due primarily to staff increases and to normal merit increases. Employee benefits increased $1.7 million, or 24.5% from 2008 to 2009. This was primarily attributable to increases in pension expenses resulting from a decrease in the investment return on the pension plan assets during 2008. The ratio of total personnel expense (salaries and employee benefits) to average assets was 1.54% for 2009, 8 basis points higher than the annualized ratio for our peer group of 1.46% at December 31, 2009.

Occupancy expense decreased $163 thousand, or 4.7%, from 2008 to 2009. The decrease was primarily attributable to decreased heating costs, which had increased in 2008 over 2007 when oil prices were at an all time high. Furniture and equipment expense increased by only $53 thousand, or 1.7%, from 2008 to 2009. The increase was primarily attributable to increases in data processing expenses.

Changes in our FDIC insurance assessment, the 2009 FDIC special assessment and the VISA related items were discussed earlier on pages 7-8.

Other operating expense decreased from 2008 to 2009, by $378 thousand, or 3.6%. The decrease was primarily attributable to a decrease in the fees paid to third party computer processing expenses.

2008 compared to 2007: Noninterest expense for 2008 amounted to $42.4 million, an increase of $4.5 million, or 11.8%, from 2007. For 2008, the efficiency ratio for Arrow was 54.65%, a decrease from the 2007 ratio of 57.3%. Our 2008 ratio compared favorably to the ratio for our peer group of 68.95% as of December 31, 2008. For information on the calculation of our efficiency ratios on a quarterly and annual basis, see pages 17 and 18 of this Report. Also see the discussion on Use of Non-GAAP Financial Measures on page 4 of this Report.

Salaries and employee benefits expense increased $3.1 million, or 14.6%, from 2007 to 2008. Salary expense increased $1.13 million, or 6.9%, from 2007, due primarily to staff increases and to normal merit increases. Employee benefits increased $2.0 million, or 39.2% from 2007 to 2008. This was primarily attributable to increases in incentive compensation expenses. The ratio of total personnel expense (salaries and employee benefits) to average assets was 1.49% for 2008, which was still 4 basis points less than the annualized ratio for our peer group of 1.53% at December 31, 2008.

Occupancy expense increased $281 thousand, or 8.8%, from 2007 to 2008. The increase was primarily attributable to increased heating costs (i.e., substantially increased cost of oil in 2008), as well as maintenance and real estate taxes. Furniture and equipment expense increased by $196 thousand, or 6.5%, from 2007 to 2008. The increase was primarily attributable to increases in data processing expenses.

Other operating expense increased from 2007 to 2008, by $1.3 million, or 14.1%. The increases were spread among a variety of categories, most notably legal and marketing expenses.

V. INCOME TAXES

The following table sets forth our provision for income taxes and effective tax rates for the periods presented.

INCOME TAXES AND EFFECTIVE RATES

(Dollars In Thousands)

	Years Ended December 31,			Change From Prior Year			
				2008 to 2009		2007 to 2008	
	2009	2008	2007	Amount	%	Amount	%
Provision for Income Taxes	$9,790	$8,999	$6,807	$791	8.8%	$2,192	32.2%
Effective Tax Rate	31.0%	30.6%	28.2%	0.4%	1.3	2.4%	8.5

The provisions for federal and state income taxes amounted to $9.8 million, $9.0 million and $6.8 million for 2009, 2008 and 2007, respectively. The effective income tax rates for 2009, 2008 and 2007 were 31.0%, 30.6% and 28.2%, respectively, with the increase in the effective rate between 2008 and 2009 reflecting a decrease in the ratio of tax-exempt income to total income before taxes.

C. FINANCIAL CONDITION

I. INVESTMENT PORTFOLIO

Investment securities are classified as held-to-maturity, trading, or available-for-sale, depending on the purposes for which such securities are acquired and thereafter held. Securities held-to-maturity are debt securities that we have both the positive intent and ability to hold to maturity; such securities are stated at amortized cost. Debt and equity securities that are bought and held principally for the purpose of sale in the near term are classified as trading securities and are reported at fair value with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held-to-maturity or trading securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses excluded from earnings and reported net of taxes in accumulated other comprehensive income or loss. During 2009, 2008 and 2007, we held no trading securities. Set forth below is certain information about our securities available-for-sale portfolio and securities held-to-maturity portfolio.

Securities Available-for-Sale:

The following table sets forth the carrying value of our securities available-for-sale portfolio at year-end 2009, 2008 and 2007.

SECURITIES AVAILABLE-FOR-SALE

(In Thousands)

	December 31,		
	2009	2008	2007
U.S. Treasury and Agency Obligations	$123,331	$ 11,528	$ 39,497
State and Municipal Obligations	18,913	15,446	24,206
Collateralized Mortgage Obligations	199,781	185,830	138,971
Mortgage-Backed Securities - Residential	93,017	93,849	112,458
Corporate and Other Debt Securities	1,331	7,433	11,574
Mutual Funds and Equity Securities	1,333	1,328	1,790
Total	$437,706	$315,414	$328,496

In all periods, mortgage-backed securities residential consisted solely of agency mortgage pass-through securities. Pass-through securities provide to the investor monthly portions of principal and interest pursuant to the contractual obligations of the underlying mortgages. Collateralized mortgage obligations (CMOs) separate the repayments on mortgage-backed securities into two or more components (tranches), where each tranche has a separate estimated life and yield. Our practice has been to purchase only pass-through securities and CMOs that are guaranteed by federal agencies, and the tranches of CMOs that we purchase generally are those having shorter maturities. Included in our corporate and other debt securities for each of the periods are corporate bonds that were highly rated at the time of purchase, although in some cases the securities had been downgraded before the reporting date, including our Lehman bond, which had been downgraded and partially charged off prior to December 31, 2008, and was subsequently sold in 2009. See additional disclosure on our downgraded securities holdings, including the Lehman bond, on page 21.

The following table sets forth the maturities of our securities available-for-sale portfolio as of December 31, 2009. CMOs and other mortgage-backed securities are included in the table based on their expected average lives. Mutual funds and equity securities, which have no stated maturity, are included in the after 10-years category.

MATURITIES OF SECURITIES AVAILABLE-FOR-SALE

(In Thousands)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
U.S. Treasury and Agency Obligations	$86,345	$36,986	$ ---	$ ---	$123,331
State and Municipal Obligations	9,680	4,708	1,657	2,868	18,913
Collateralized Mortgage Obligations	21,021	79,599	93,315	5,846	199,781
Mortgage-Backed Securities - Residential	4,038	39,120	13,306	36,553	93,017
Corporate and Other Debt Securities	---	80	---	1,251	1,331
Mutual Funds and Equity Securities	---	---	---	1,333	1,333
Total	$121,084	$160,493	$108,278	$47,851	$437,706

The following table sets forth the tax-equivalent yields of our securities available-for-sale portfolio at December 31, 2009.

YIELDS ON SECURITIES AVAILABLE-FOR-SALE

(Fully Tax-Equivalent Basis)

Within	After	After	After	Total
One	1 But	5 But	10 Years	

	Year	Within 5 Years	Within 10 Years		
U.S. Treasury and Agency Obligations	2.18%	2.08%	---%	---%	2.15%
State and Municipal Obligations	2.63	2.64	5.52	7.59	3.64
Collateralized Mortgage Obligations	4.31	4.65	4.83	4.01	4.68
Mortgage-Backed Securities - Residential	3.26	4.49	5.53	4.17	4.45
Corporate and Other Debt Securities	---	6.45	---	2.93	3.12
Mutual Funds and Equity Securities	---	---	---	3.97	3.97
Total	2.55	3.93	4.90	4.16	3.81

The yields on obligations of states and municipalities exempt from federal taxation were computed on a fully tax-equivalent basis using a marginal tax rate of 35%. The yields on other debt securities shown in the table above are calculated by dividing annual interest, including accretion of discounts and amortization of premiums, by the amortized cost of the securities at December 31, 2009. Dividend earnings derived from equity securities were adjusted to reflect applicable federal income tax exclusions.

At December 31, 2009 and 2008, the weighted average maturity was 4.1 and 5.1 years, respectively, for debt securities in the available-for-sale portfolio.

At December 31, 2009, the net unrealized gains on securities available-for-sale amounted to $5.2 million. The net unrealized gain or loss on such securities, net of tax, is reflected in accumulated other comprehensive income/loss. The net unrealized gains on securities available-for-sale was $4.0 million at December 31, 2008. For both periods, the net unrealized gain was primarily attributable to a change in market rates between the date of purchase and market yields at the balance sheet date.

For further information regarding our portfolio of securities available-for-sale, see Note 3 to the Consolidated Financial Statements contained in Part II, Item 8 of this Report.

Securities Held-to-Maturity:

The following table sets forth the carrying value of our portfolio of securities held-to-maturity (consisting exclusively of state and municipal obligations) at December 31 of each of the last three years.

SECURITIES HELD-TO-MATURITY

(In Thousands)

	December 31,		
	2009	2008	2007
State and Municipal Obligations	$167,931	$133,976	$114,611
Corporate and Other Debt Securities	1,000	---	---
Total	$168,931	$133,976	$114,611

For information regarding the fair value of our portfolio of securities held-to-maturity at December 31, 2009, see Note 3 to the Consolidated Financial Statements contained in Part II, Item 8 of this Report.

The following table sets forth the maturities of our portfolio of securities held-to-maturity as of December 31, 2009.

MATURITIES OF SECURITIES HELD-TO-MATURITY

(In Thousands)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
State and Municipal Obligations	$44,391	$41,753	$68,788	$12,999	$167,931
Corporate and Other Debt Securities	---	---	---	1,000	1,000
Total	$44,391	$41,753	$68,788	$13,999	$168,931

The following table sets forth the tax-equivalent yields of our portfolio of securities held-to-maturity at December 31, 2009.

YIELDS ON SECURITIES HELD-TO-MATURITY

(Fully Tax-Equivalent Basis)

Within	After 1 But	After 5 But	After	Total

	One Year	Within 5 Years	Within 10 Years	10 Years	
State and Municipal Obligations	3.72%	4.46%	5.25%	5.99%	4.71%
Corporate and Other Debt Securities	---	---	---	6.50	6.50
Total	3.72	4.46	5.25	6.03	4.72

The yields shown in the table above are calculated by dividing annual interest, including accretion of discounts and amortization of premiums, by the carrying value of the securities at December 31, 2009. Yields on obligations of states and municipalities exempt from federal taxation (which constituted the entire portfolio) were computed on a fully tax-equivalent basis using a marginal tax rate of 35%.

During 2009, 2008 and 2007, we sold no securities from the held-to-maturity portfolio. The weighted-average maturity of the held-to-maturity portfolio was 5.3 years and 4.0 years at December 31, 2009 and 2008, respectively.

II. LOAN PORTFOLIO

The amounts and respective percentages of loans outstanding represented by each principal category on the dates indicated were as follows:

a. Types of Loans

(Dollars In Thousands)

	December 31, 2009 Amount	%	2008 Amount	%	2007 Amount	%	2006 Amount	%	2005 Amount	%
Commercial, Financial and Agricultural	$ 89,222	8	$ 86,872	8	$ 79,128	8	$ 79,581	8	$ 79,917	8
Real Estate - Commercial	185,582	17	183,676	17	160,787	15	161,443	16	152,447	15
Real Estate - Construction	34,906	3	34,428	3	39,265	4	31,319	3	25,736	3
Real Estate - Residential	472,605	42	444,655	40	417,092	40	399,446	40	376,820	38
Indirect and Other Installment Loans to Individuals	329,835	30	360,181	32	342,572	33	337,210	33	361,625	36
Total Loans	1,112,150	100	1,109,812	100	1,038,844	100	1,008,999	100	996,545	100
	(14,014)		(13,272)		(12,401)		(12,278)		(12,241)	

Allowance for Loan Losses					
Total Loans, Net	$1,098,136	$1,096,540	$1,026,443	$ 996,721	$984,304

<u>Maintenance of High Quality in the Loan Portfolio:</u> During the second half of 2008 and throughout 2009, the U.S. experienced significant disruption and volatility in its financial and capital markets. A major cause of the disruption was a significant decline in residential real estate values across much of the U.S., which in turn triggered widespread defaults on subprime mortgage loans and steep devaluations of portfolios containing these loans and securities collateralized by them. In recent months, as real estate values have continued to fall in most areas of the U.S., problems have spread from subprime loans to better quality mortgage portfolios, and in some cases prime mortgage loans, as well as home equity and credit card loans. Recently, commercial real estate values have begun to decline substantially and commercial real estate mortgage portfolios have begun to experience the same problems that have beset residential mortgage portfolios over the prior 18 months. Many lending institutions have suffered sizable charge-offs and losses in their loan and investment securities portfolios in the past six quarters as a result of their origination or investment in these kinds of loans or securities.

Through December 2009, we have not experienced a significant deterioration in our loan or investment portfolios, except for the impaired securities, including the Lehman bond discussed earlier in this Report. We have never engaged in subprime mortgage lending as a business line and we do not extend or purchase any so-called Alt-A, negative amortization, option ARM, or negative equity mortgage loans. On occasion we have made loans to borrowers having a FICO score of 660 or below or have had extensions of credit outstanding to borrowers who have developed credit problems after origination resulting in deterioration of their FICO scores. We also on occasion have extended community development loans to borrowers whose creditworthiness is below our normal standards as part of the community support program we have developed in fulfillment of our statutorily-mandated duty to support low- and moderate-income borrowers within our service area. However, we are a prime lender and apply prime lending standards and this, together with the fact that the service area in which we make most of our loans has not experienced as severe a decline in property values as other parts of the U.S., are the principal reasons that we have not to date experienced significant deterioration in the real estate categories of our loan portfolio.

If, however, the current downturn in the U.S. real estate markets should continue and the U.S. and/or our local economy should continue in its current weakened state for any substantial additional period of time, we can give no assurances about the continuing high quality of our loan portfolio. In such event, we may experience elevated charge-offs, higher provisions to our loan loss reserve, and increasing expense related to asset maintenance and supervision.

<u>Residential Real Estate Loans</u>: In recent years, residential real estate and home equity loans have represented the largest segment of our loan portfolio. Residential mortgage demand has been moderate since 2004, after a several year period when demand was high. However, during 2004 and 2005 and the first quarter of 2006, we sold many of our 30-year, fixed-rate mortgage originations, while retaining the servicing rights. By the end of the first quarter of 2006, as yields on longer-term residential real estate loans began to rise, we decided to stop selling our 30-year mortgage originations and instead retain them in our portfolio. However, during the last quarter of 2008 and the first two quarters of 2009, as the government supported entities (GSEs) Fannie Mae and Freddie Mac increased their dominance of the highly stressed home mortgage market with very low-rate mortgages and we returned to our earlier practice of selling most of our mortgage originations to Freddie Mac. During 2009, only a portion of the $91.9 million of our new residential real estate loan originations was sold to Freddie Mac (with further offsets as a result of normal principal amortization and prepayments on pre-existing loans). However, if we continue in the current GSE-subsidized low-rate environment for newly originated residential real estate loans, we may elect to resell an even higher portion of our loan originations and may experience a decrease in our outstanding balances in this segment of our portfolio. Moreover, if our local economy or real estate market suffers a major downturn, the demand for residential real estate loans in our service area may decrease, which also may negatively impact our real estate portfolio and our financial performance.

Indirect Loans: In the early post-2000 years, indirect consumer loans (consisting principally of automobile loans originated through dealerships located primarily in the eastern region of upstate New York), was the largest segment of our loan portfolio. For much of this period, indirect consumer loans were the fastest growing segment of our loan portfolio, both in terms of absolute dollar amount and as a percentage of the overall portfolio. Since 2003, however, this segment of the portfolio has basically been flat, with periods of expansion followed by contraction. Over the period, the segment has experienced little growth in absolute terms and decreased as a percentage of the overall portfolio. This change in indirect loan totals was largely the result of aggressive campaigns of zero rate and other subsidized financing by auto manufacturers, commencing late 2001 and recurring periodically in the years since then.

At the end of the first quarter of 2006, we experienced an increase in indirect loans, which continued throughout the second and third quarters of 2006, for a variety of factors, including the decision by the automobile manufacturers to be less aggressive with their subsidized financing programs. In the fourth quarter of 2006, however, indirect loan balances declined by 4.3%, measured at quarter-end (although the average balance for the fourth quarter was slightly higher than the average balance for the third quarter).

In the last quarter of 2007 and the first two quarters of 2008, we encountered enhanced rate competition on indirect (auto) loans from other lenders, including finance affiliates of the auto manufacturers who increased their offerings of heavily subsidized, low- or zero-rate loans. This increasingly competitive environment, combined with softening demand for vehicles, especially for SUVs and light trucks, had a negative effect on our indirect originations, and we experienced decreases in indirect balances in the first two quarters of 2008. However during the last two quarters of 2008, as some of the major lenders in the indirect market pull