ARROW FINANCIAL CORP
Form 10-Q
November 12, 2013

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

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

For the Quarterly Period Ended September 30, 2013

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

Commission File Number: 0-12507

ARROW FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York	22-2448962
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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 such shorter period that the registrant was required to submit and post such files). x Yes No

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

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

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

Class	Outstanding as of October 31, 2013
Common Stock, par value $1.00 per share	12,330,466

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

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

	September 30, 2013	December 31, 2012	September 30, 2012
ASSETS			
Cash and Due From Banks	$47,513	$37,076	$43,990
Interest-Bearing Deposits at Banks	24,539	11,756	92,428
Investment Securities:			
Available-for-Sale	486,888	478,698	425,416
Held-to-Maturity (Approximate Fair Value of $278,390 at September 30, 2013, $248,252 at December 31, 2012, and $254,936 at September 30, 2012)	273,626	239,803	244,949
Federal Home Loan Bank and Federal Reserve Bank Stock	3,896	5,792	4,487
Loans	1,243,370	1,172,341	1,152,951
Allowance for Loan Losses	(14,584)	(15,298)	(15,247)
Net Loans	1,228,786	1,157,043	1,137,704
Premises and Equipment, Net	29,386	28,897	26,645
Other Real Estate and Repossessed Assets, Net	499	1,034	834
Goodwill	22,003	22,003	22,003
Other Intangible Assets, Net	4,270	4,492	4,543
Accrued Interest Receivable	6,614	5,486	6,510
Other Assets	28,838	30,716	31,006
Total Assets	$2,156,858	$2,022,796	$2,040,515
LIABILITIES			
Noninterest-Bearing Deposits	$280,326	$247,232	$259,943
NOW Accounts	839,213	758,287	769,107
Savings Deposits	516,010	442,363	443,053
Time Deposits of $100,000 or More	83,702	93,375	98,215
Other Time Deposits	176,124	189,898	201,143
Total Deposits	1,895,375	1,731,155	1,771,461
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	15,977	12,678	18,042
Federal Home Loan Bank Overnight Advances	—	29,000	—
Federal Home Loan Bank Term Advances	20,000	30,000	30,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	20,000
Accrued Interest Payable	472	584	676
Other Liabilities	22,351	23,554	24,022
Total Liabilities	1,974,175	1,846,971	1,864,201
STOCKHOLDERS’ EQUITY			
Preferred Stock, $5 Par Value; 1,000,000 Shares Authorized	—	—	—
Common Stock, $1 Par Value; 20,000,000 Shares Authorized (16,744,486 Shares Issued at September 30, 2013, 16,416,163 Shares Issued at December 31, 2012 and 16,416,163 Shares Issued at	16,744	16,416	16,416

September 30, 2012)			
Additional Paid-in Capital	228,622	218,650	217,756
Retained Earnings	24,755	26,251	23,697
Unallocated ESOP Shares (87,641 Shares at September 30, 2013, 102,890 Shares at December 31, 2012 and 107,315 Shares at September 30, 2012)	(1,800)	(2,150)	(2,150)
Accumulated Other Comprehensive Loss	(10,293)	(8,462)	(5,693)
Treasury Stock, at Cost (4,327,741 Shares at September 30, 2013, 4,288,617 Shares at December 31, 2012, and 4,274,972 Shares at September 30, 2012)	(75,345)	(74,880)	(73,712)
Total Stockholders' Equity	182,683	175,825	176,314
Total Liabilities and Stockholders' Equity	$2,156,858	$2,022,796	$2,040,515

See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
INTEREST AND DIVIDEND INCOME				
Interest and Fees on Loans	$12,846	$13,569	$38,279	$41,155
Interest on Deposits at Banks	11	23	57	80
Interest and Dividends on Investment Securities:				
Fully Taxable	1,556	2,191	4,991	7,309
Exempt from Federal Taxes	1,461	1,385	4,352	4,095
Total Interest and Dividend Income	15,874	17,168	47,679	52,639
INTEREST EXPENSE				
NOW Accounts	423	675	1,987	2,710
Savings Deposits	240	319	785	1,005
Time Deposits of $100,000 or More	297	459	921	1,636
Other Time Deposits	470	855	1,529	3,075
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	5	6	14	17
Federal Home Loan Bank Advances	167	174	539	543
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	145	155	434	468
Total Interest Expense	1,747	2,643	6,209	9,454
NET INTEREST INCOME	14,127	14,525	41,470	43,185
Provision for Loan Losses	—	150	200	670
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	14,127	14,375	41,270	42,515
NONINTEREST INCOME				
Income From Fiduciary Activities	1,688	1,563	5,020	4,786
Fees for Other Services to Customers	2,403	2,097	7,056	6,111
Insurance Commissions	2,404	2,223	6,608	6,219
Net Gain on Securities Transactions	—	64	540	709
Net Gain on Sales of Loans	166	600	1,271	1,494
Other Operating Income	278	288	689	883
Total Noninterest Income	6,939	6,835	21,184	20,202
NONINTEREST EXPENSE				
Salaries and Employee Benefits	7,856	7,964	23,114	23,661
Occupancy Expenses, Net	1,882	1,779	6,277	5,773
FDIC Assessments	269	255	800	766
Other Operating Expense	3,126	2,924	9,627	8,519
Total Noninterest Expense	13,133	12,922	39,818	38,719
INCOME BEFORE PROVISION FOR INCOME TAXES	7,933	8,288	22,636	23,998
Provision for Income Taxes	2,310	2,540	6,625	7,368
NET INCOME	$5,623	$5,748	$16,011	$16,630
Average Shares Outstanding:				

Basic	12,308	12,252	12,282	12,244
Diluted	12,344	12,273	12,302	12,262
Per Common Share:				
Basic Earnings	$0.46	$0.47	$1.30	$1.36
Diluted Earnings	0.46	0.47	1.30	1.36

Share and Per Share Amounts have been restated for the September 2013 2% stock dividend.
See Notes to Unaudited Interim Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net Income	$5,623	$5,748	$16,011	$16,630
Other Comprehensive Income (Loss), Net of Tax:				
Net Unrealized Securities Holding (Losses) Gains Arising During the Period	1,210	411	(2,213)	758
Reclassification Adjustment for Securities Gains Included in Net Income	—	(39)	(326)	(428)
Amortization of Net Retirement Plan Actuarial Loss	235	228	707	685
Accretion of Net Retirement Plan Prior Service Credit	1	(4)	1	(13)
Other Comprehensive Income (Loss)	1,446	596	(1,831)	1,002
Comprehensive Income	$7,069	$6,344	$14,180	$17,632

See Notes to Unaudited Interim Consolidated Financial Statements.

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

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unallo-cated ESOP Shares	Accumu-lated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2012	$16,416	$218,650	$26,251	$ (2,150)	$ (8,462)	$(74,880)	$175,825
Net Income	—	—	16,011	—	—	—	16,011
Other Comprehensive (Loss) Income	—	—	—	—	(1,831)	—	(1,831)
2% Stock Dividend (328,323 Shares)	328	8,152	(8,480)	—	—	—	—
Cash Dividends Paid, $.74 per Share [1]	—	—	(9,027)	—	—	—	(9,027)
Stock Options Exercised, Net (44,849 Shares)	—	524	—	—	—	441	965
Shares Issued Under the Directors' Stock Plan (4,255 Shares)	—	64	—	—	—	42	106
Shares Issued Under the Employee Stock Purchase Plan (14,668 Shares)	—	204	—	—	—	144	348
Shares Issued for Dividend Reinvestment Plans (33,539 Shares)	—	525	—	—	—	326	851
Stock-Based Compensation Expense	—	281	—	—	—	—	281
Tax Benefit for Disposition of Stock Options	—	17	—	—	—	—	17
Purchase of Treasury Stock (61,075 Shares)	—	—	—	—	—	(1,512)	(1,512)
Acquisition of Subsidiaries (9,503 Shares)	—	139	—	—	—	94	233
Allocation of ESOP Stock (16,969 Shares)	—	66	—	350	—	—	416
Balance at September 30, 2013	$16,744	$228,622	$24,755	$ (1,800)	$ (10,293)	$(75,345)	$182,683
Balance at December 31, 2011	$16,094	$207,600	$23,947	$ (2,500)	$ (6,695)	$(72,061)	$166,385
Net Income	—	—	16,630	—	—	—	16,630
Other Comprehensive (Loss) Income	—	—	—	—	1,002	—	1,002
2% Stock Dividend (321,886 Shares)	322	7,738	(8,060)	—	—	—	—

Cash Dividends Paid, $.72 per Share [1]	—	—	(8,820)	—	—	—	(8,820)
Stock Options Exercised, Net (66,498 Shares)	—	789	—	—	—	661	1,450
Shares Issued Under the Directors' Stock Plan (3,667 Shares)	—	52	—	—	—	36	88
Shares Issued Under the Employee Stock Purchase Plan (14,913 Shares)	—	199	—	—	—	148	347
Shares Issued for Dividend Reinvestment Plans (55,870 Shares)	—	813	—	—	—	556	1,369
Stock-Based Compensation Expense	—	315	—	—	—	—	315
Tax Benefit for Disposition of Stock Options	—	53	—	—	—	—	53
Purchase of Treasury Stock (127,983 Shares)	—	—	—	—	—	(3,145)	(3,145)
Acquisition of Subsidiaries (9,356 Shares)	—	140	—	—	—	93	233
Allocation of ESOP Stock (12,291 Shares)	—	57	—	350	—	—	407
Balance at September 30, 2012	$16,416	$217,756	$23,697	$(2,150)	$(5,693)	$(73,712)	$176,314

[1] Cash dividends paid per share have been adjusted for the September 2013 2% stock dividend.

See Notes to Unaudited Interim Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
Cash Flows from Operating Activities:	2013	2012
Net Income	$16,011	$16,630
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Loan Losses	200	670
Depreciation and Amortization	6,908	6,555
Allocation of ESOP Stock	416	407
Gains on the Sale of Securities Available-for-Sale	(527)	(719)
Gains on the Sale of Securities Held-to-Maturity	(18)	—
Losses on the Sale of Securities Held-to-Maturity	5	—
Losses on the Sale of Securities Available-for-Sale	—	10
Loans Originated and Held-for-Sale	(41,545)	(40,991)
Proceeds from the Sale of Loans Held-for-Sale	44,057	42,561
Net Gains on the Sale of Loans	(1,271)	(1,494)
Net Losses (Gains) on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	87	(50)
Contributions to Pension Plans	(354)	(244)
Deferred Income Tax Benefit	(83)	(547)
Shares Issued Under the Directors' Stock Plan	106	88
Stock-Based Compensation Expense	281	315
Net Decrease in Other Assets	2,611	943
Net (Decrease) Increase in Other Liabilities	(653)	1,837
Net Cash Provided By Operating Activities	26,231	25,971
Cash Flows from Investing Activities:		
Proceeds from the Sale of Securities Available-for-Sale	16,284	17,015
Proceeds from the Maturities and Calls of Securities Available-for-Sale	89,857	175,193
Purchases of Securities Available-for-Sale	(121,287)	(63,383)
Proceeds from the Sale of Securities Held-to-Maturity	1,181	—
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	35,214	35,483
Purchases of Securities Held-to-Maturity	(71,573)	(130,769)
Net Increase in Loans	(73,948)	(23,080)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	1,214	827
Purchase of Premises and Equipment	(1,935)	(5,153)
Cash Paid for Subsidiaries, Net	(75)	(75)
Net Decrease in Other Investments	1,896	2,235
Net Cash (Used In) Provided By Investing Activities	(123,172)	8,293
Cash Flows from Financing Activities:		
Net Increase in Deposits	164,220	127,415
Net Decrease in Short-Term Borrowings	(25,701)	(50,251)
Repayments of Federal Home Loan Bank Term Advances	(10,000)	(10,000)
Purchase of Treasury Stock	(1,512)	(3,145)
Stock Options Exercised, Net	965	1,450
Shares Issued Under the Employee Stock Purchase Plan	348	347

Tax Benefit from Exercise of Stock Options	17	53
Shares Issued for Dividend Reinvestment Plans	851	1,369
Cash Dividends Paid	(9,027)	(8,820)
Net Cash Provided By Financing Activities	120,161	58,418
Net Increase in Cash and Cash Equivalents	23,220	92,682
Cash and Cash Equivalents at Beginning of Period	48,832	43,736
Cash and Cash Equivalents at End of Period	$72,052	$136,418
Supplemental Disclosures to Statements of Cash Flow Information:		
Interest on Deposits and Borrowings	$6,318	$9,922
Income Taxes	6,086	5,991
Non-cash Investing and Financing Activity:		
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	764	1,084
Acquisition of Subsidiaries	233	233

See Notes to Unaudited Interim Consolidated Financial Statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. ACCOUNTING POLICIES

In the opinion of the management of Arrow Financial Corporation (Arrow), the accompanying unaudited consolidated interim financial statements contain all of the adjustments necessary to present fairly the financial position as of September 30, 2013, December 31, 2012 and September 30, 2012; the results of operations for the three and nine-month periods ended September 30, 2013 and 2012; the consolidated statements of comprehensive income for the three and nine-month periods ended September 30, 2013 and 2012; the changes in stockholders' equity for the nine-month periods ended September 30, 2013 and 2012; and the cash flows for the nine-month periods ended September 30, 2013 and 2012. All such adjustments are of a normal recurring nature. The preparation of financial statements requires the use of management estimates. The unaudited consolidated interim financial statements should be read in conjunction with the audited annual consolidated financial statements of Arrow for the year ended December 31, 2012, included in Arrow's 2012 Form 10-K.

New Accounting Standards Updates (ASU): During 2013, through the date of this report, the FASB issued eleven accounting standards updates. Nine did not apply to Arrow. ASU 2013-02 "Comprehensive Income" requires additional disclosures relating to reclassifications out of accumulated other comprehensive income. Since the ASU was effective for this Form 10-Q, the new disclosures are included in Note 5 - Comprehensive Income. ASU 2013-10 "Derivatives and Hedging" now allows the federal funds effective swap rate as a benchmark interest rate for hedge accounting. While this has no current impact on Arrow, it may provide us an option for future swaps that we did not have before the ASU.

Note 2. INVESTMENT SECURITIES (In Thousands)

The following table is the schedule of Available-For-Sale Securities at September 30, 2013, December 31, 2012 and September 30, 2012:

Available-For-Sale Securities

	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
September 30, 2013						
Available-For-Sale Securities, at Amortized Cost	$150,184	$134,059	$179,235	$17,180	$1,120	$481,778
Available-For-Sale Securities, at Fair Value	149,774	133,919	185,215	16,798	1,182	486,888
Gross Unrealized Gains	2	175	6,041	—	62	6,280
Gross Unrealized Losses	412	315	61	382	—	1,170
Available-For-Sale Securities, Pledged as Collateral						314,693
Maturities of Debt Securities, at Amortized Cost:						
Within One Year	—	53,557	20,825	—		74,382
From 1 - 5 Years	150,184	77,849	149,147	16,180		393,360
From 5 - 10 Years	—	1,973	9,263	—		11,236

Over 10 Years	—	680	—	1,000		1,680
Maturities of Debt Securities, at Fair Value:						
Within One Year	—	53,590	21,390	—		74,980
From 1 - 5 Years	149,774	77,644	153,984	15,998		397,400
From 5 - 10 Years	—	2,005	9,841	—		11,846
Over 10 Years	—	680	—	800		1,480
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$105,517	$58,710	$8,482	$15,998	$—	$188,707
12 Months or Longer	4,992	3,513	—	800	—	9,305
Total	$110,509	$62,223	$8,482	$16,798	$—	$198,012
Number of Securities in a Continuous Loss Position	30	230	4	22	—	286

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Available-For-Sale Securities	U.S. Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$405	$304	$61	$182	$—	$952
12 Months or Longer	7	11	—	200	—	218
Total	$412	$315	$61	$382	$—	$1,170
December 31, 2012						
Available-For-Sale Securities, at Amortized Cost	$122,297	$84,798	$252,480	$8,689	$1,120	$469,384
Available-For-Sale Securities, at Fair Value	122,457	84,838	261,804	8,451	1,148	478,698
Gross Unrealized Gains	204	206	9,405	—	28	9,843
Gross Unrealized Losses	44	166	81	238	—	529
Available-For-Sale Securities, Pledged as Collateral						260,292
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$72,531	$46,627	$10,230	$8,451	$—	$137,839
12 Months or Longer	—	2,149	4,968	—	—	7,117
Total	$72,531	$48,776	$15,198	$8,451	$—	$144,956
Number of Securities in a Continuous Loss Position	22	198	7	11	—	238
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$44	$160	$50	$238	$—	$492
12 Months or Longer	—	6	31	—	—	37
Total	$44	$166	$81	$238	$—	$529
September 30, 2012						
Available-For-Sale Securities, at Amortized Cost	$56,054	$62,706	$292,716	$1,000	$1,120	$413,596
Available-For-Sale Securities, at Fair Value	56,391	62,965	304,085	800	1,175	425,416
Gross Unrealized Gains	337	285	11,549	—	55	12,226
Gross Unrealized Losses	—	26	180	200	—	406
Available-For-Sale Securities, Pledged as Collateral						277,357
Securities in a Continuous Loss Position, at Fair Value:						

Less than 12 Months	$4,999	$17,432	$18,825	$800	$—	$42,056
12 Months or Longer	—	—	—	—	—	—
Total	$4,999	$17,432	$18,825	$800	$—	$42,056
Number of Securities in a Continuous Loss Position	1	73	7	1	—	82
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$—	$26	$180	$200	$—	$406
12 Months or Longer	—	—	—	—	—	—
Total	$—	$26	$180	$200	$—	$406

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The following table is the schedule of Held-To-Maturity Securities at September 30, 2013, December 31, 2012 and September 30, 2012:
Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
September 30, 2013				
Held-To-Maturity Securities, at Amortized Cost	$194,065	$78,561	$1,000	$273,626
Held-To-Maturity Securities, at Fair Value	198,548	78,842	1,000	278,390
Gross Unrealized Gains	5,018	314	—	5,332
Gross Unrealized Losses	535	33	—	568
Held-To-Maturity Securities, Pledged as Collateral				272,626
Maturities of Debt Securities, at Amortized Cost:				
Within One Year	45,615	—	—	45,615
From 1 - 5 Years	80,848	44,388	—	125,236
From 5 - 10 Years	64,057	34,173	—	98,230
Over 10 Years	3,545	—	1,000	4,545
Maturities of Debt Securities, at Fair Value:				
Within One Year	45,665	—	—	45,665
From 1 - 5 Years	82,492	44,669	—	127,161
From 5 - 10 Years	66,734	34,173	—	100,907
Over 10 Years	3,657	—	1,000	4,657
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$27,814	$29,714	$—	$57,528
12 Months or Longer	171	—	—	171
Total	$27,985	$29,714	$—	$57,699
Number of Securities in a Continuous Loss Position	97	13	—	110
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$532	$33	$—	$565
12 Months or Longer	2	—	—	2
Total	$534	$33	$—	$567

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Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
December 31, 2012				
Held-To-Maturity Securities, at Amortized Cost	$183,373	$55,430	$1,000	$239,803
Held-To-Maturity Securities, at Fair Value	191,196	56,056	1,000	248,252
Gross Unrealized Gains	7,886	626	—	8,512
Gross Unrealized Losses	63	—	—	63
Held-To-Maturity Securities, Pledged as Collateral				238,803
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$21,583	$—	$—	$21,583
12 Months or Longer	503	—	—	503
Total	$22,086	$—	$—	$22,086
Number of Securities in a Continuous Loss Position	61	—	—	61
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$62	$—	$—	$62
12 Months or Longer	1	—	—	1
Total	$63	$—	$—	$63
September 30, 2012				
Held-To-Maturity Securities, at Amortized Cost	$179,412	$64,537	$1,000	$244,949
Held-To-Maturity Securities, at Fair Value	188,127	65,809	1,000	254,936
Gross Unrealized Gains	8,718	1,272	—	9,990
Gross Unrealized Losses	3	—	—	3
Held-To-Maturity Securities, Pledged as Collateral				243,949
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$3,165	$—	$—	$3,165
12 Months or Longer	—	—	—	—
Total	$3,165	$—	$—	$3,165
Number of Securities in a Continuous Loss Position	9	—	—	9
Unrealized Losses on				

Securities in a Continuous Loss Position:				
Less than 12 Months	$3	$—	$—	$3
12 Months or Longer	—	—	—	—
Total	$3	$—	$—	$3

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

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In the available-for-sale category at September 30, 2013, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $150.2 million and a fair value of $149.8 million. Mortgage-backed securities-residential consisted of U.S. Government Agency securities with an amortized cost of $32.5 million and a fair value of $33.6 million and GSE securities with an amortized cost of $146.7 million and a fair value of $151.6 million. In the held-to-maturity category at September 30, 2013, mortgage-backed securities-residential consisted of U.S Government Agency securities with an amortized cost of $5.0 million and a fair value of $4.9 million and GSE securities with an amortized cost of $73.6 million and a fair value of $73.9 million.

In the available-for-sale category at September 30, 2012, U.S. agency obligations consisted solely of U.S. Government Agency securities with an amortized cost of $56.1 million and a fair value of $56.4 million. Mortgage-backed securities-residential consisted of US Government Agency securities with an amortized cost of $40.6 million and a fair value of $42.1 million and GSE securities with an amortized cost of $262.0 million and a fair value of $252.1 million. In the held-to-maturity category at September 30, 2012, mortgage-backed securities-residential consisted of GSE securities with an amortized cost of $64.5 million and a fair value of $65.8 million.

Securities in a continuous loss position, in the tables above for September 30, 2013, December 31, 2012 and September 30, 2012 do not reflect any deterioration of the credit worthiness of the issuing entities. U.S. Agency issues, including agency-backed collateralized mortgage obligations and mortgage-backed securities, are all rated at least Aaa by Moody's or AA+ by Standard and Poor's. The state and municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, credit analysis is performed in-house based upon data that has been submitted by the issuers to the NY State Comptroller. That analysis shows no deterioration in the credit worthiness of the municipalities. Subsequent to September 30, 2013, there were no securities downgraded below investment grade.
The unrealized losses on these temporarily impaired securities are primarily the result of changes in interest rates for fixed rate securities where the interest rate received is less than the current rate available for new offerings of similar securities, changes in market spreads as a result of shifts in supply and demand, and/or changes in the level of prepayments for mortgage related securities. Because we do not currently intend to sell any of our temporarily impaired securities, and because it is not more likely-than-not that we would be required to sell the securities prior to recovery, the impairment is considered temporary.

Note 3. LOANS (In Thousands)

Loan Categories and Past Due Loans

The following table presents loan balances outstanding as of September 30, 2013, December 31, 2012 and September 30, 2012 and an analysis of the recorded investment in loans that are past due at these dates. Generally, Arrow considers a loan past due 30 or more days if the borrower is two or more payments past due. Loans held-for-sale of $1,561, $2,801 and $816 as of September 30, 2013, December 31, 2012 and September 30, 2012, respectively, are included in the residential real estate loan balances.

Past Due Loans

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
September 30, 2013							
Loans Past Due 30-59 Days	$595	$—	$—	$50	$2,230	$200	$3,075
Loans Past Due 60-89 Days	750	—	1,173	4	654	1,999	4,580
Loans Past Due 90 or more Days	53	—	1,847	—	133	2,721	4,754
Total Loans Past Due	1,398	—	3,020	54	3,017	4,920	12,409
Current Loans	85,719	33,960	260,084	7,516	389,335	454,347	1,230,961
Total Loans	$87,117	$33,960	$263,104	$7,570	$392,352	$459,267	$1,243,370
Loans 90 or More Days Past Due and Still Accruing Interest	$—	$—	$—	$—	$11	$916	$927
Nonaccrual Loans	$269	$—	$1,930	$3	$240	$3,729	$6,171
December 31, 2012							
Loans Past Due 30-59 Days	$1,045	$—	$534	$43	$2,427	$407	$4,456
Loans Past Due 60-89 Days	1,588	—	1,332	17	793	2,466	6,196
Loans Past Due 90 or more Days	494	—	1,871	—	185	1,462	4,012
Total Loans Past Due	3,127	—	3,737	60	3,405	4,335	14,664
Current Loans	102,409	29,149	241,440	6,624	345,695	432,360	1,157,677
Total Loans	$105,536	$29,149	$245,177	$6,684	$349,100	$436,695	$1,172,341
Loans 90 or More Days Past Due and Still Accruing Interest	$126	$—	$378	$—	$42	$374	$920
Nonaccrual Loans	$1,787	$—	$2,026	$1	$419	$2,400	$6,633
September 30, 2012							
Loans Past Due 30-59 Days	$831	$—	$271	$20	$2,675	$2,245	$6,042
Loans Past Due 60-89 Days	1,764	—	1,051	—	485	822	4,122
Loans Past Due 90 or more Days	216	—	621	—	148	1,278	2,263
Total Loans Past Due	2,811	—	1,943	20	3,308	4,345	12,427
Current Loans	97,612	27,265	233,238	6,837	339,922	435,650	1,140,524
Total Loans	$100,423	$27,265	$235,181	$6,857	$343,230	$439,995	$1,152,951

Loans 90 or More Days Past Due and Still Accruing Interest	$—	$—	$—	$—	$—	$150	$150
Nonaccrual Loans	$1,750	$—	$1,156	$1	$419	$2,762	$6,088

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

Commercial - The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable and generally have a lower liquidation value than real estate. In the event of default by the borrower, the Company may be required to liquidate collateral at deeply discounted values. To reduce the risk, management usually obtains personal guarantees of the borrowers.

Commercial Construction - The Company offers commercial construction and land development loans to finance projects within the communities that we serve. Many projects will ultimately be used by the borrowers' businesses, while others are developed for resale.

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These real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and both owner-occupied and nonowner-occupied facilities. There is enhanced risk during the construction period, since the loan is secured by an incomplete project.

Commercial Real Estate - The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and both owner and non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings, and are generally originated in amounts of no more than 80% of the appraised value of the property.

Other Consumer Loans - The Company offers a variety of consumer installment loans to finance personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to five years, based upon the nature of the collateral and the size of the loan. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. Several loans are unsecured, which carry a higher risk of loss.

Automobile - The Company primarily finances the purchases of automobiles indirectly through dealer relationships located throughout upstate New York and Vermont. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to seven years. The majority of indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

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

Allowance for Loan Losses

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

Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total

Roll-forward of the Allowance for Loan Losses for the Quarterly Periods:								
June 30, 2013	$1,552	$646	$3,293	$299	$4,357	$3,408	$1,123	$14,678
Charge-offs	(62)	—	—	(7)	(114)	—	—	(183)
Recoveries	8	—	—	2	79	—	—	89
Provision	209	4	15	(29)	(14)	(159)	(26)	—
September 30, 2013	$1,707	$650	$3,308	$265	$4,308	$3,249	$1,097	$14,584
June 30, 2012	$2,098	$528	$3,295	$355	$4,571	$3,451	$913	$15,211
Charge-offs	—	—	(39)	(27)	(105)	—	—	(171)
Recoveries	2	—	—	8	47	—	—	57
Provision	22	19	(82)	(11)	119	38	45	150
September 30, 2012	$2,122	$547	$3,174	$325	$4,632	$3,489	$958	$15,247

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Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total
Roll-forward of the Allowance for Loan Losses for the Year-to-Date Periods:								
December 31, 2012	$2,344	$601	$3,050	$304	$4,536	$3,405	$1,058	$15,298
Charge-offs	(850)	—	(11)	(20)	(284)	—	—	(1,165)
Recoveries	48	—	—	2	201	—	—	251
Provision	165	49	269	(21)	(145)	(156)	39	200
September 30, 2013	$1,707	$650	$3,308	$265	$4,308	$3,249	$1,097	$14,584
December 31, 2011	$1,927	$602	$3,136	$350	$4,496	$3,414	$1,078	$15,003
Charge-offs	(15)	—	(206)	(69)	(281)	(33)	—	(604)
Recoveries	5	—	—	17	156	—	—	178
Provision	205	(55)	244	27	261	108	(120)	670
September 30, 2012	$2,122	$547	$3,174	$325	$4,632	$3,489	$958	$15,247
September 30, 2013								
Allowance for loan losses - Loans Individually Evaluated for Impairment	$—	$—	$—	$—	$—	$—	$—	$—
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$1,707	$650	$3,308	$265	$4,308	$3,249	$1,097	$14,584
Ending Loan Balance - Individually Evaluated for Impairment	$25	$—	$1,497	$—	$169	$1,720	$—	$3,411
Ending Loan Balance - Collectively Evaluated for Impairment	$87,092	$33,960	$261,607	$7,570	$392,183	$457,547	$—	$1,239,959

December 31, 2012								
Allowance for loan losses - Loans Individually Evaluated for Impairment	$853	$—	$—	$—	$—	$—	$—	$853
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$1,491	$601	$3,050	$304	$4,536	$3,405	$1,058	$14,445
Ending Loan Balance - Individually Evaluated for Impairment	$1,432	$—	$2,528	$—	$203	$1,090	$—	$5,253
Ending Loan Balance - Collectively Evaluated for Impairment	$104,104	$29,149	$242,649	$6,684	$348,897	$435,605	$—	$1,167,088

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Allowance for Loan Losses

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Unallocated	Total
September 30, 2012								
Allowance for loan losses - Loans Individually Evaluated for Impairment	$ 809	$ —	$—	$—	$—	$—	$—	$809
Allowance for loan losses - Loans Collectively Evaluated for Impairment	$ 1,313	$ 547	$3,174	$325	$4,632	$3,489	$958	$14,438
Ending Loan Balance - Individually Evaluated for Impairment	$ 1,553	$ —	$1,574	$—	$204	$1,512	$—	$4,843
Ending Loan Balance - Collectively Evaluated for Impairment	$ 98,870	$ 27,265	$233,607	$6,857	$343,026	$438,483	$—	$1,148,108

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

Our loan officers and risk managers meet at least quarterly to discuss and review the conditions and risks associated with certain criticized and classified commercial-related relationships. In addition, our independent internal loan review department performs periodic reviews of the risk ratings on individual loans in our commercial loan portfolio.

We use a two-step process to determine the provision for loan losses and the amount of the allowance for loan losses. We measure impairment on our impaired loans on a quarterly basis. Our impaired loans are generally nonaccrual loans over $250 thousand and all troubled debt restructured loans. Our impaired loans are generally considered to be collateral dependent with the specific reserve, if any, determined based on the value of the collateral less estimated costs to sell.

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

We determine the historical net loss rate for each loan category using a trailing three-year net charge-off average. While historical net loss experience provides a reasonable starting point for our analysis, historical net losses, or even recent trends in net losses, do not by themselves form a sufficient basis to determine the appropriate level of the allowance for loan losses. Therefore, we also consider and adjust historical net loss factors for qualitative factors that impact the inherent risk of loss associated with our loan categories within our total loan portfolio. These include:

- Changes in the volume and severity of past due, nonaccrual and adversely classified loans
- Changes in the nature and volume of the portfolio and in the terms of loans
- Changes in the value of the underlying collateral for collateral dependent loans
- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses
- Changes in the quality of the loan review system
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectibility of the portfolio
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio or pool

Further, due to the imprecise nature of the loan loss estimation process, the risk attributes of our loan portfolio may not be fully captured in data related to the determination of loss factors used to determine our analysis of the adequacy of the allowance for loan losses.

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Management, therefore, has established an unallocated portion within the allowance for loan losses reflecting the imprecision that naturally exists in the allowance for loan loss estimation process. The unallocated allowance for loan losses is not considered a significant component of the overall allowance for loan loss estimation process.

Credit Quality Indicators

The following table presents the credit quality indicators by loan category at September 30, 2013, December 31, 2012 and September 30, 2012:

Loan Credit Quality Indicators

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
September 30, 2013							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	$78,706	$33,133	$241,437				$353,276
Special Mention	2,313	—	3,004				5,317
Substandard	6,098	827	18,663				25,588
Doubtful	—	—	—				—
Credit Risk Profile Based on Payment Activity:							
Performing				$7,567	$392,112	$454,620	854,299
Nonperforming				3	240	4,647	4,890
December 31, 2012							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	97,085	27,913	225,312				350,310
Special Mention	192	—	1,419				1,611
Substandard	6,872	1,236	18,446				26,554
Doubtful	1,387	—	—				1,387
Credit Risk Profile Based on Payment Activity:							
Performing				6,683	348,676	433,922	789,281
Nonperforming				1	424	2,773	3,198
September 30, 2012							
Credit Risk Profile by Creditworthiness Category:							
Satisfactory	93,095	25,993	214,239				333,327
Special Mention	279	—	1,537				1,816
Substandard	7,049	1,272	19,405				27,726
Doubtful	—	—	—				—
Credit Risk Profile Based on Payment Activity:							
Performing				6,856	342,811	437,082	786,749
Nonperforming				1	419	2,913	3,333

We use an internally developed system of five credit quality indicators to rate the credit worthiness of each commercial loan defined as follows: 1) Satisfactory - "Satisfactory" borrowers have acceptable financial condition with satisfactory record of earnings and sufficient historical and projected cash flow to service the debt. Borrowers have satisfactory repayment histories and primary and secondary sources of repayment can be clearly identified; 2) Special Mention - Loans in this category have potential weaknesses that deserve management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution’s credit position at some future date. "Special mention" assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. Loans which might be assigned this risk rating include loans to borrowers with deteriorating financial strength and/or earnings record and loans with potential for problems due to weakening economic or market conditions; 3) Substandard - Loans classified as “substandard” are inadequately protected by the current sound net worth or paying capacity of the borrower or the collateral pledged, if any. Loans in this category have well defined weaknesses that jeopardize the repayment. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. “Substandard” loans may include loans which are likely to require liquidation of collateral to effect repayment, and other loans where character or ability to repay has become suspect. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual

assets classified substandard; 4) Doubtful - Loans classified as “doubtful” have all of the weaknesses inherent in those classified as “substandard” with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of current existing facts, conditions, and values highly questionable and improbable. Although possibility of loss is extremely high, classification of these loans as “loss” has been deferred due to specific pending factors or events which may strengthen the value (i.e. possibility of additional collateral, injection of capital, collateral liquidation, debt restructure, economic recovery, etc). Loans classified as “doubtful” need to be placed on non-accrual; and 5) Loss - Loans classified as “loss” are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. As of the date of the balance sheet, all loans in this category have been charged-off to the allowance for loan losses. Commercial loans are evaluated on an annual basis, unless the credit quality indicator falls to a level of "substandard" or below, when the loan is evaluated quarterly. The credit quality indicator is one of the factors used to determine any loss, as further described in this footnote.
For the purposes of the table above, nonperforming consumer loans are those loans on nonaccrual status or are 90 days or more past due and still accruing interest.

Impaired Loans

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

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
September 30, 2013							
Recorded Investment:							
With No Related Allowance	$25	$—	$1,497	$—	$169	$1,720	$3,411
With a Related Allowance	—	—	—	—	—	—	—
Unpaid Principal Balance:							
With No Related Allowance	25	—	1,497	—	169	1,720	3,411
With a Related Allowance	—	—	—	—	—	—	—
December 31, 2012							
Recorded Investment:							
With No Related Allowance	$45	$—	$2,528	$—	$203	$1,090	$3,866
With a Related Allowance	1,387	—	—	—	—	—	1,387
Unpaid Principal Balance:							
With No Related Allowance	45	—	2,695	—	203	1,090	4,033
With a Related Allowance	1,387	—	—	—	—	—	1,387
September 30, 2012							
Recorded Investment:							
With No Related Allowance	$52	$—	$1,574	$—	$204	$1,512	$3,342
With a Related Allowance	1,501	—	—	—	—	—	1,501
Unpaid Principal Balance:							
With No Related Allowance	52	—	1,741	—	204	1,512	$3,509
With a Related Allowance	1,501	—	—	—	—	—	1,501
For the Quarter Ended:							
September 30, 2013							
Average Recorded Balance:							
With No Related Allowance	$29	$—	$1,489	$—	$177	$1,399	$3,094

With a Related Allowance	—	—	—	—	—	—	—
Interest Income Recognized:							
With No Related Allowance	1	—	—	—	1	2	4
With a Related Allowance	—	—	—	—	—	—	—
Cash Basis Income:							
With No Related Allowance	—	—	—	—	—	—	—
With a Related Allowance	—	—	—	—	—	—	—

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Impaired Loans

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
September 30, 2012							
Average Recorded Balance:							
With No Related Allowance	$55	$—	$1,600	$—	$209	$1,501	$3,365
With a Related Allowance	1,571	—	—	—	—	—	1,571
Interest Income Recognized:							
With No Related Allowance	2	—	10	—	4	3	19
With a Related Allowance	—	—	—	—	—	—	—
Cash Basis Income:							
With No Related Allowance	—	—	10	—	—	—	10
With a Related Allowance	—	—	—	—	—	—	—
For the Year-To-Date Period Ended:							
September 30, 2013							
Average Recorded Balance:							
With No Related Allowance	$35	$—	$2,013	$—	$186	$1,405	$3,639
With a Related Allowance	694	—	—	—	—	—	694
Interest Income Recognized:							
With No Related Allowance	3	—	—	—	6	6	15
With a Related Allowance	72	—	—	—	—	—	72
Cash Basis Income:							
With No Related Allowance	—	—	—	—	—	—	—
With a Related Allowance	72	—	—	—	—	—	72
September 30, 2012							
Average Recorded Balance:							
With No Related Allowance	$59	$—	$1,717	$—	$229	$1,703	$3,708
With a Related Allowance	687	—	—	—	—	—	687
Interest Income Recognized:							
With No Related Allowance	5	—	54	—	9	7	75
With a Related Allowance	—	—	—	—	—	—	—
Cash Basis Income:							
With No Related Allowance	—	—	54	—	—	—	54
With a Related Allowance	—	—	—	—	—	—	—

At September 30, 2013, December 31, 2012 and September 30, 2012, all impaired loans were considered to be collateral dependent and were therefore evaluated for impairment based on the fair value of collateral less estimated cost to sell. There was no allowance for loan losses allocated to impaired loans at September 30, 2013. Interest income recognized in the table above, represents income earned after the loans became impaired and includes restructured loans in compliance with their modified terms and nonaccrual loans where we have recognized interest income on a cash basis.

Loans Modified in Trouble Debt Restructurings

The following table presents information on loans modified in trouble debt restructurings during the periods indicated:
Loans Modified in Trouble Debt Restructurings During the Period

	Commercial	Commercial Construction	Commercial Real Estate	Other Consumer	Automobile	Residential	Total
For the Quarter Ended:							
September 30, 2013							
Number of Loans	—	—	—	—	2	—	2
Pre-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$16	$—	$16
Post-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$16	$—	$16
September 30, 2012							
Number of Loans	—	—	2	—	5	—	7
Pre-Modification Outstanding Recorded Investment	$—	$—	$47	$—	$41	$—	$88
Post-Modification Outstanding Recorded Investment	$—	$—	$47	$—	$41	$—	$88
For the Year-To-Date Period Ended:							
September 30, 2013							
Number of Loans	—	—	—	—	7	—	7
Pre-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$57	$—	$57
Post-Modification Outstanding Recorded Investment	$—	$—	$—	$—	$57	$—	$57
September 30, 2012							
Number of Loans	—	—	2	—	12	—	14
Pre-Modification Outstanding Recorded Investment	$—	$—	$47	$—	$101	$—	$148
Post-Modification Outstanding Recorded Investment	$—	$—	$47	$—	$101	$—	$148

In general, loans requiring modification are restructured to accommodate the projected cash-flows of the borrower. As indicated in the table above, no loans modified during the preceding twelve months subsequently defaulted as of September 30, 2013.

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Note 4. GUARANTEES (In Thousands)

The following table presents the balance for standby letters of credit for the periods ended September 30, 2013, December 31, 2012 and September 30, 2012:

Loan Commitments and Letters of Credit

	09/30/2013	12/31/2012	09/30/2012
Notional Amount:			
Commitments to Extend Credit	$243,254	$198,405	$216,540
Standby Letters of Credit	3,525	10,929	11,367
Fair Value:			
Commitments to Extend Credit	$—	$—	$—
Standby Letters of Credit	56	118	81

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

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

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Arrow evaluates each customer's creditworthiness on a case-by-case basis. Home equity lines of credit are secured by residential real estate. Construction commitments are secured by underlying real estate. For other lines of credit, the amount of collateral obtained, if deemed necessary by Arrow upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies, but may include accounts receivable, inventory, property, plant and equipment, and income-producing commercial properties. Most of the commitments are variable rate instruments.

Arrow has issued conditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit at September 30, 2013, December 31, 2012 and September 30, 2012 represent the maximum potential future payments Arrow could be required to make. Typically, these instruments have terms of 12 months or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance sheet instruments. Company policies governing loan collateral apply to standby letters of credit at the time of credit extension. Loan-to-value ratios will generally range from 50% for movable assets, such as inventory, to 100% for liquid assets, such as bank CD's. Fees for standby letters of credit range from 1% to 3% of the notional amount. Fees are collected upfront and are amortized over the life of the commitment. The fair values of Arrow's standby letters of credit at September 30, 2013, December 31, 2012 and September 30, 2012, in the table above, were the same as the carrying amounts. The fair value of standby letters of credit is based on the fees currently charged for similar agreements or the cost to terminate the arrangement with the counterparties.

The fair value of commitments to extend credit is determined by estimating the fees to enter into similar agreements, taking into account the remaining terms and present creditworthiness of the counterparties, and for fixed rate loan commitments, the difference between the current and committed interest rates. Arrow provides several types of commercial lines of credit and standby letters of credit to its commercial customers. The pricing of these services is not isolated as Arrow considers the customer's complete deposit and borrowing relationship in pricing individual products and services. The commitments to extend credit also include commitments under home equity lines of credit, for which Arrow charges no fee. The carrying value and fair value of commitments to extend credit are not material and Arrow does not expect to incur any material loss as a result of these commitments.

Note 5. COMPREHENSIVE INCOME (In Thousands)

The following table presents the components of other comprehensive income for the three and nine months ended September 30, 2013 and 2012 :

Schedule of Comprehensive Income

	Three Months Ended September 30,			Nine Months Ended September 30,		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
2013						
Net Unrealized Securities Holding Gains Arising During the Period	$2,003	$(793)	$1,210	$(3,664)	$1,451	$(2,213)
Reclassification Adjustment for Securities Gains Included in Net Income	—	—	—	(540)	214	(326)
Amortization of Net Retirement Plan Actuarial Loss	390	(155)	235	1,173	(466)	707
Accretion of Net Retirement Plan Prior Service Credit	1	—	1	1	—	1
Other Comprehensive Income	$2,394	$(948)	$1,446	$(3,030)	$1,199	$(1,831)
2012						
Net Unrealized Securities Holding Gains Arising During the Period	$679	$(268)	$411	$1,256	$(498)	$758
Reclassification Adjustment for Securities Gains Included in Net Income	(64)	25	(39)	(709)	281	(428)
Amortization of Net Retirement Plan Actuarial Loss	377	(149)	228	1,134	(449)	685
Accretion of Net Retirement Plan Prior Service Credit	(7)	3	(4)	(22)	9	(13)
Other Comprehensive Income	$985	$(389)	$596	$1,659	$(657)	$1,002

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

Changes in Accumulated Other Comprehensive Income by Component [1]

	Unrealized Gains and Losses on Available-for-Sale Securities	Defined Benefit Plan Items		
		Net Gain (Loss)	Net Prior Service (Cost) Credit	Total
For the Quarter-To-Date periods ended:				
June 30, 2013	$1,876	$(13,564)	$(51)	$(11,739)
Other comprehensive income before reclassifications	1,210	—	—	1,210
Amounts reclassified from accumulated other comprehensive income	—	235	1	236
Net current-period other comprehensive income	1,210	235	1	1,446
September 30, 2013	$3,086	$(13,329)	$(50)	$(10,293)
June 30, 2012	$6,766	$(13,252)	$197	$(6,289)
Other comprehensive income before reclassifications	411	—	—	411
Amounts reclassified from accumulated other comprehensive income	(39)	228	(4)	185
Net current-period other comprehensive income	372	228	(4)	596
September 30, 2012	$7,138	$(13,024)	$193	$(5,693)
For the Year-To-Date periods ended:				
December 31, 2012	$5,625	$(14,036)	$(51)	$(8,462)
Other comprehensive income before reclassifications	(2,213)	—	—	(2,213)
Amounts reclassified from accumulated other comprehensive income	(326)	707	1	382
Net current-period other comprehensive income	(2,539)	707	1	(1,831)
September 30, 2013	$3,086	$(13,329)	$(50)	$(10,293)
December 31, 2011	$6,808	$(13,709)	$206	$(6,695)
Other comprehensive income before reclassifications	758	—	—	758
Amounts reclassified from accumulated other comprehensive income	(428)	685	(13)	244
Net current-period other comprehensive income	330	685	(13)	1,002
September 30, 2012	$7,138	$(13,024)	$193	$(5,693)

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

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

Reclassifications Out of Accumulated Other Comprehensive Income [(1)]

Details about Accumulated Other Comprehensive Income Components	Amounts Reclassified from Accumulated Other Comprehensive Income		Affected Line Item in the Statement Where Net Income Is Presented
For the Quarter-to-date periods ended:			
September 30, 2013			
Unrealized gains and losses on available-for-sale securities			
	$—		Gain on Securities Transactions
	—		Total before tax
	—		Provision for Income Taxes
	$—		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	$(1	) (2)	Salaries and Employee Benefits
Actuarial gains/(losses)	(390	) (2)	Salaries and Employee Benefits
	(391	)	Total before tax
	155		Provision for Income Taxes
	$(236	)	Net of tax
Total reclassifications for the period	$(236	)	Net of tax
September 30, 2012			
Unrealized gains and losses on available-for-sale securities			
	$64		Gain on Securities Transactions
	64		Total before tax
	(25	)	Provision for Income Taxes
	$39		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	$7	(2)	Salaries and Employee Benefits
Actuarial gains/(losses)	(377	) (2)	Salaries and Employee Benefits
	(370	)	Total before tax
	146		Provision for Income Taxes
	$(224	)	Net of tax
Total reclassifications for the period	$(185	)	Net of tax

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Reclassifications Out of Accumulated Other Comprehensive Income [1]

Details about Accumulated Other Comprehensive Income Components	Amounts Reclassified from Accumulated Other Comprehensive Income		Affected Line Item in the Statement Where Net Income Is Presented
For the Year-to-date periods ended:			
September 30, 2013			
Unrealized gains and losses on available-for-sale securities			
	$540		Gain on Securities Transactions
	540		Total before tax
	(214	)	Provision for Income Taxes
	$326		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	$(1	) [2]	Salaries and Employee Benefits
Actuarial gains/(losses)	(1,173	) [2]	Salaries and Employee Benefits
	(1,174	)	Total before tax
	466		Provision for Income Taxes
	$(708	)	Net of tax
Total reclassifications for the period	$(382	)	Net of tax
September 30, 2012			
Unrealized gains and losses on available-for-sale securities			
	$709		Gain on Securities Transactions
	709		Total before tax
	(281	)	Provision for Income Taxes
	$428		Net of tax
Amortization of defined benefit pension items			
Prior-service costs	22	[2]	Salaries and Employee Benefits
Actuarial gains/(losses)	$(1,134	) [2]	Salaries and Employee Benefits
	(1,112	)	Total before tax
	440		Provision for Income Taxes
	$(672	)	Net of tax
Total reclassifications for the period	$(244	)	Net of tax

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

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

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Note 6. STOCK BASED COMPENSATION PLANS

Under our 2008 Long-Term Incentive Plan, we granted options in the first quarter of 2013 to purchase shares of our common stock. The fair values of the options were estimated on the date of grant using the Black-Scholes option-pricing model. The fair value of our grants is expensed over the four year vesting period. Share and per share amounts have been restated for the September 2013 2% stock dividend.

The following table presents a roll-forward of our stock option plans and grants issued during 2013:
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Schedule of Share-based Compensation Arrangements

	Stock Option Plans	
Roll-Forward of Shares Outstanding:		
Outstanding at January 1, 2013	451,233	
Granted	10,200	
Exercised	(45,742	)
Forfeited	(12,429	)
Outstanding at September 30, 2013	403,262	
Exercisable at Period End	284,622	
Vested and Expected to Vest	403,262	
Roll-Forward of Shares Outstanding - Weighted Average Exercise Price:		
Outstanding at January 1, 2013	$22.61	
Granted	23.80	
Exercised	21.10	
Forfeited	22.50	
Outstanding at September 30, 2013	22.82	
Exercisable at Period End	22.22	
Vested and Expected to Vest	22.82	
Grants Issued During 2013 - Weighted Average Information:		
Fair Value	5.46	
Fair Value Assumptions:		
Dividend Yield	4.20	%
Expected Volatility	36.57	%
Risk Free Interest Rate	1.31	%
Expected Lives (in years)	6.71	

The following table presents information on the amounts expensed and remaining amounts to be expensed for the periods ended September 30, 2013 and 2012:

Share-Based Compensation Expense

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2013	2012	2013	2012
Share-Based Compensation Expense	$92	$108	$281	$315

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

Note 7. RETIREMENT PLANS (Dollars in Thousands)

The following tables provide the components of net periodic benefit costs for the three and nine-month periods ended September 31:

	Employees' Pension Plan	Select Executive Retirement Plan	Postretirement Benefit Plans
Net Periodic Benefit Cost			
For the Three Months Ended September 30, 2013:			
Service Cost	$367	$5	$51
Interest Cost	315	33	56
Expected Return on Plan Assets	(716)	—	—
Amortization of Prior Service Cost (Credit)	10	19	(28)
Amortization of Net Loss	311	38	41
Net Periodic Benefit Cost	$287	$95	$120
Plan Contributions During the Period	—	133	77
For the Three Months Ended September 30, 2012:			
Service Cost	$340	$19	$45
Interest Cost	468	51	98
Expected Return on Plan Assets	(755)	—	—
Amortization of Prior Service (Credit) Cost	10	11	(28)
Amortization of Net Loss	309	35	33
Net Periodic Benefit Cost	$372	$116	$148
Plan Contributions During the Period	$—	$84	$66
Net Periodic Benefit Cost			
For the Nine Months Ended September 30, 2013:			
Service Cost	$1,101	$32	$153
Interest Cost	944	81	206
Expected Return on Plan Assets	(2,148)	—	—
Amortization of Prior Service Cost (Credit)	28	59	(86)
Amortization of Net Loss	935	114	124
Net Periodic Benefit Cost	$860	$286	$397
Plan Contributions During the Period	$—	$354	$252
Estimated Future Contributions in the Current Fiscal Year	$—	$118	$84
For the Nine Months Ended September 30, 2012:			
Service Cost	$1,019	$57	$135
Interest Cost	1,406	153	279
Expected Return on Plan Assets	(2,265)	—	—

Amortization of Prior Service (Credit) Cost	30	33	(85)
Amortization of Net Loss	930	105	99
Net Periodic Benefit Cost	$1,120	$348	$428
Plan Contributions During the Period	$—	$244	$297

We are not required to make a contribution to our qualified pension plan in 2013, and currently, we do not expect to make a contribution in 2013. Arrow makes contributions to its other post-retirement benefit plans in an amount equal to actual expenses for the year.

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

The following table presents a reconciliation of the numerator and denominator used in the calculation of basic and diluted earnings per common share ("EPS") for periods ended September 30, 2013 and 2012. All share and per share amounts have been adjusted for the September 2013 2% stock dividend.

Earnings Per Share

	Quarterly Period Ended:		Year-to-Date Period Ended:	
	9/30/2013	9/30/2012	9/30/2013	9/30/2012
Earnings Per Share - Basic:				
Net Income	$5,623	$5,748	$16,011	$16,630
Weighted Average Shares - Basic	12,308	12,252	12,282	12,244
Earnings Per Share - Basic	$0.46	$0.47	$1.30	$1.36
Earnings Per Share - Diluted:				
Net Income	$5,623	$5,748	$16,011	$16,630
Weighted Average Shares - Basic	12,308	12,252	12,282	12,244
Dilutive Average Shares Attributable to Stock Options	36	21	20	18
Weighted Average Shares - Diluted	12,344	12,273	12,302	12,262
Earnings Per Share - Diluted	$0.46	$0.47	$1.30	$1.36
Antidilutive Shares Excluded from the Calculation of Earnings Per Share	47	129	47	203

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

FASB ASC Subtopic 820-10 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and requires certain disclosures about fair value measurements. We do not have any nonfinancial assets or liabilities measured at fair value on a recurring basis. The only assets or liabilities that Arrow measured at fair value on a recurring basis at September 30, 2013, December 31, 2012 and September 30, 2012 were securities available-for-sale. Arrow held no securities or liabilities for trading on such date.

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

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

		Fair Value Measurements at Reporting Date Using:		
	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fair Value of Assets and Liabilities Measured on a Recurring Basis:				
September 30, 2013				
Securities Available-for Sale:				
U.S. Agency Obligations	$149,774	$—	$149,774	$—
State and Municipal Obligations	133,919	—	133,919	—
Mortgage-Backed Securities - Residential	185,215	—	185,215	—
Corporate and Other Debt Securities	16,798	—	16,798	—
Mutual Funds and Equity Securities	1,182	—	1,182	—
Total Securities Available-for-Sale	$486,888	$—	$486,888	$—
December 31, 2012				
Securities Available-for Sale:				
U.S. Agency Obligations	$122,457	$—	$122,457	$—
State and Municipal Obligations	84,838	—	84,838	—
Mortgage-Backed Securities - Residential	261,804	—	261,804	—
Corporate and Other Debt Securities	8,451	—	8,451	—
Mutual Funds and Equity Securities	1,148	—	1,148	—
Total Securities Available-for Sale	$478,698	$—	$478,698	$—
September 30, 2012				
Securities Available-for Sale:				
U.S. Agency Obligations	$56,391	$—	$56,391	$—
State and Municipal Obligations	62,965	—	62,965	—
Mortgage-Backed Securities - Residential	304,085	—	304,085	—
Corporate and Other Debt Securities	800	—	800	—
Mutual Funds and Equity Securities	1,175	—	1,175	—
Total Securities Available-for Sale	$425,416	$—	$425,416	$—
Fair Value of Assets and Liabilities Measured on a Nonrecurring Basis:				
September 30, 2013				

Collateral Dependent Impaired Loans	$—	$—	$—	$—
Other Real Estate Owned and Repossessed Assets, Net	$499	$—	$—	$499
December 31, 2012				
Collateral Dependent Impaired Loans	$1,020	$—	$—	$1,020
Other Real Estate Owned and Repossessed Assets, Net	$1,034	$—	$—	$1,034
September 30, 2012				
Collateral Dependent Impaired Loans	$486	$—	$—	$486
Other Real Estate Owned and Repossessed Assets, Net	$834	$—	$—	$834

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

- Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;
- Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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

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

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

The fair value of collateral dependent impaired loans was based on third-party appraisals of the collateral.

The fair value of other real estate owned was based on third-party appraisals.

Other assets which might have been included in this table include mortgage servicing rights, goodwill and other intangible assets. Arrow evaluates each of these assets for impairment on a quarterly basis, with no impairment recognized for these assets at September 30, 2013, December 31, 2012 and September 30, 2012.

Fair Value by Balance Sheet Grouping

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

Schedule of Fair Values by Balance Sheet Grouping

	Carrying Amount	Fair Value	Fair Value Hierarchy Level 1	Level 2	Level 3
September 30, 2013					
Cash and Cash Equivalents	$72,052	$72,052	$72,052	$—	$—
Securities Available-for-Sale	486,888	486,888	—	486,888	—
Securities Held-to-Maturity	273,626	278,390	—	278,390	—
Federal Home Loan Bank and Federal Reserve Bank Stock	3,896	3,896	3,896	—	—
Net Loans	1,228,786	1,246,005	—	—	1,246,005
Accrued Interest Receivable	6,614	6,614	6,614	—	—
Deposits	1,895,375	1,891,086	1,635,549	255,537	—
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	15,977	15,977	15,977	—	—
Federal Home Loan Bank Term Advances	20,000	20,823	—	20,823	—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000	—	20,000	—
Accrued Interest Payable	472	472	472	—	—
December 31, 2012					
Cash and Cash Equivalents	$48,832				