ARROW FINANCIAL CORP
Form 10-K
March 10, 2011

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, 2010
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: $254,147,000

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

Class	Outstanding as of February 17, 2011
Common Stock, par value $1.00 per share	11,248,587

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held April 27, 2011 (Part III)

4294967295

ARROW FINANCIAL CORPORATION

FORM 10-K – TABLE OF CONTENTS

PART II

*These items are incorporated by reference to the Corporation's Proxy Statement for the Annual Meeting of Stockholders to be held April 27, 2011.

0

NOTE ON TERMINOLOGY

In this Annual Report on Form 10-K, the terms “Arrow,” “the registrant,” “the company,” “we,” “us,” and “our” generally ref Arrow Financial Corporation and 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), Loomis & LaPann, Inc. (a property and casualty insurance agency), North Country Investment Advisers, Inc. (a registered investment adviser that provides investment advice to our proprietary mutual funds) 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, 2010, 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 15 and 16 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.	10	2nd and 6th paragraph in Section D
Estimation of potential losses related to Visa litigation	Part II, Item 7.A.	24	2nd paragraph
Impact of Changing Interest Rates on Earnings	Part II, Item 7.B.I.	27	Last paragraph

	Part II, Item 7.B.1	28	2nd paragraph
	Part II, Item 7.C.II.a.	36	Last paragraph under "Indirect Loans"
	Part II, Item 7.C.II.a.	37	2nd and 4th paragraph under table
	Part II, Item 7.C.IV.	41	1st paragraph
	Part II, Item 7A.	45	Last three paragraphs
Expected Noninterest Income	Part II, Item 7.B.III.	30	Last paragraph
Adequacy of the Allowance for Loan Losses	Part II, Item 7.B.II.	29	1st 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.	35	1st paragraph under "Residential Real Estate Loans"
Liquidity	Part II, Item 7.D.	42	2nd to last paragraph in Section D "Liquidity"
Dividend Capacity	Part I, Item 1.C.	7	4th to last paragraph under Section C "Supervision and Regulation"
	Part II, Item 7.E.	43	Next to last paragraph in Section E
Pension Plan	Part II, Item 8	73	Next to last paragraph
		77	Paragraph in "Cash Flows"
Commitments to Extend Credit	Part II, Item 8	80	3rd to last paragraph
		81	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:

(a)

rapid and dramatic changes in economic and market conditions, such as the U.S. economy has recently experienced and continues to experience;

(b)

sharp fluctuations in interest rates, economic activity, and consumer spending patterns;

(c)

sudden changes in the market for products we provide, such as real estate loans;

(d)

significant new banking laws and regulations, as are presently anticipated or, as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank);

(e)

enhanced competition from unforeseen sources; and

(f)

similar uncertainties inherent in banking operations or business generally.

In the current environment of substantial economic turmoil affecting all sectors of business in the U.S., including the financial sector, all forward-looking statements should be understood as embracing a substantial degree of uncertainty far exceeding that accompanying such statements under normal economic conditions.

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. The SEC has exempted from the definition of "non-GAAP financial measures" certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. The following measures used in this Report, which are commonly utilized by financial institutions, have not been specifically exempted by the SEC and may constitute "non-GAAP financial measures" within the meaning of the SEC's new 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 or in analyzing any institution's net interest income trend line over time, to correct any analytical distortion that might otherwise arise from the fact that financial institutions vary widely in the proportions of their portfolios that are invested in tax-exempt securities, and that even a single institution may significantly alter the proportion of its own portfolio that is invested in tax-exempt obligations. Moreover, net interest income is itself a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, tax-equivalent net interest income is generally used by financial institutions, again to provide a better basis of comparison from institution to institution and to better demonstrate a single institution's performance over time. We follow these practices.

The Efficiency Ratio: Financial institutions often use an "efficiency ratio" as a measure of expense control. The efficiency ratio typically is defined as the ratio of noninterest expense to net interest income and noninterest income. Net interest income as utilized in calculating the efficiency ratio is typically expressed on a tax-equivalent basis. Moreover, most financial institutions, in calculating the efficiency ratio, also adjust both noninterest expense and noninterest income to exclude from these items (as calculated under GAAP) certain recurring component elements of income and expense, such as intangible asset amortization (deducted from noninterest expense) and securities gains or losses (excluded from noninterest income). We follow these practices.

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

Adjustments for Certain Items of Income or Expense: In addition to our disclosures of net income, earnings per share, return on average assets, return on average equity and other financial measures in accordance with GAAP, we may also provide comparative disclosures that adjust these GAAP financial measures by removing therefrom the impact of certain transactions or other material items of income or expense. We believe that the resulting non-GAAP financial measures may improve an understanding of our results of operations by separating out items that have a disproportional positive or negative impact on the particular period in question. Additionally, we believe that the adjustment for certain items allows a better comparison from period to period in our results of operations with respect to our fundamental lines of business including the commercial banking business.

We believe that the non-GAAP financial measures disclosed by us from time to time are useful in evaluating our performance and that such information should be considered as supplemental in nature and not as a substitute for or superior to the related financial information prepared in accordance with GAAP. Our non-GAAP financial measures may differ from similar measures presented by other companies.

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), a health and life insurance agency (Capital Financial Group, Inc.), a property and casualty insurance agency (Loomis and Lapann, 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	$1,641,129	$295,063

Trust Assets Under Administration and Investment Management at Year-End (Not Included in Total Assets)	$936,761	$47,633
Date Organized	1851	1988
Employees (full-time equivalent)	439	42
Offices	29	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 481 full-time equivalent employees at December 31, 2010.

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 April 2010, we acquired all the outstanding shares of Loomis & LaPann, Inc. (Loomis), a property and casualty insurance agency. The acquisition was structured as a tax-free exchange of Arrow's common stock for Loomis' common stock. Loomis' two principal officers and staff continued with Loomis after the acquisition. Including the present value of expected contingent payments, we recorded the following intangible assets as a result of the acquisition (none of which are deductible for income tax purposes): goodwill ($514 thousand) and portfolio expirations ($126 thousand). The value of the expirations is being amortized over twenty years. Under the acquisition agreement, we issued 27,027 shares of Arrow's common stock at the closing. The agreement also provided for the possibility of annual contingent post-closing payments, also payable in the form of Arrow common stock, based upon earnings of Loomis, adjusted as provided in the agreement, and satisfaction of certain other requirements over the three-year period following the closing. Maximum contingent payments are capped at $330 thousand of common stock.

In July 2008, we acquired the key operating assets, including 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 70,688 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. These contingent payments were recorded as additional goodwill at the time of payment. Total contingent payments, for the now completed five-year period, amounted to $898 thousand (36,174 shares).

2

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, 2010, the balance of these securitized loans remaining in our securities portfolio was approximately $1.5 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. During 2010, we did not foreclose on any loans held in our own portfolio nor did we foreclose on any loans that we sold and serviced for Freddie Mac.

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.

As a result of the recent financial crisis that significantly damaged the economy and the financial sector of the United States, the U.S. Congress passed, and the President signed, Dodd-Frank on July 21, 2010. In addition to making other significant legal and regulatory reforms, Dodd-Frank established a new regulatory body known as the Bureau of Consumer Financial Protection (the Bureau), which will operate as an independent entity within the Federal Reserve System and is authorized to issue rules for consumer protection, some of which likely will significantly restrain banks' profitability. Dodd-Frank also directs the federal banking authorities to issue new capital requirements for banks and holding companies which must be at least as strict as the existing capital requirements and may be much more onerous. Dodd-Frank also provided that any new issuances of trust preferred securities by bank holding companies under $15 billion in assets will no longer qualify as Tier 1 capital. Dodd-Frank is discussed further in the following section regarding Recent Legislative Developments.

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.

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 2010 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 14 "Regulatory Matters" to the consolidated 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.

D. RECENT LEGISLATIVE DEVELOPMENTS

Health Care Reform

In March 2010, comprehensive federal healthcare reform legislation was passed under the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the "Act"). Included among the major provisions of the Act, is a change in tax treatment of the federal drug subsidy paid with respect to eligible retirees. The Act contains provisions that may impact the Company's accounting for some of its benefit plans in future periods by increasing the expense associated with these plans, but at this point, we do not expect that the impact will be material. The exact extent of the Act's impact cannot be determined until final regulations are promulgated and additional interpretations become available. The Company will continue to monitor the effect of the Act.

Dodd-Frank

Dodd-Frank, enacted in July 2010, includes many provisions, including:

.

New powers for the Board of Governors of the Federal Reserve:

o

Monitor the systemic safety of the financial system and to take proactive steps to reduce or eliminate such threats.

o

Impose strict controls on large bank holding companies with total consolidated assets equal to or in excess of $50 billion (Large BHCs) and systemically significant nonbank financial companies supervised by the Fed (Significant Nonbanks) to limit the risk they might pose for the economy and to other large interconnected companies.

o

Take direct control of troubled financial companies that are considered systemically significant.

o

The Fed is given new authority to impose heightened prudential requirements on Large BHC and Significant Nonbanks, including heightened capital and liquidity requirements and other requirements such as a self-designed resolution plan.

.

Provides powers for the newly created Consumer Protection Bureau, mentioned earlier:

o

Although the Bureau will be required to consider the potential benefits and costs for financial institutions and consumers of a proposed regulation and to consider and address any objections from other Federal regulators, the Bureau's Oversight Council will not have authority to set aside a Bureau regulation except in very limited circumstances.

o

The Bureau will have broad authority to curb practices it finds to be unfair, deceptive and abusive. What constitutes "abusive" behavior may be very broadly defined and is very likely to create an environment conducive to increased litigation. This is likely to be exacerbated by the fact that State Attorneys General are authorized to enforce Federal consumer laws transferred to the Bureau and any rules issued by the Bureau as well.

o

The Bureau will have authority to supervise, examine, and take enforcement action with respect to (i) depository institutions with more than $10 billion in assets and (ii) nonbank mortgage industry participants and other Bureau designated nonbank providers of consumer financial services.

o

The Bureau will write and issue new consumer protection rules but the prudential regulatory agencies have primary examination and enforcement authority for depository institutions with $10 billion or less in assets. However, the Bureau has the right to include its examiners on a "sampling" basis in examinations conducted by the prudential regulators and is authorized to give those agencies input and recommendations with respect to consumer protection laws and to require reports and other examination documents.

o

The Act undermines current Federal preemption standards for national banks and Federal thrifts. Specifically, it increases the potential for State intervention in the operations of federally chartered depository institutions by creating new procedural hurdles to preemption determinations while also potentially narrowing the circumstances in which preemption would apply. Moreover, the Act provides statutory authority for State law enforcement authorities with respect to federally chartered depository institutions.

.

A new process is established for Federal authorities to place bank holding companies and significant nonbanks into an FDIC-operated receivership structure similar to the one in place for banks under the Federal Deposit Insurance Act. This is intended to give Federal authorities the power to act quickly to respond to potential liquidity or other crises of confidence involving non-depository institutions.

.

Establishes the equivalent of a prompt corrective action program for large bank holding companies.

.

Directs Federal bank regulators to develop specific capital requirements for holding companies and depository institutions that address activities that pose risk to the financial system, such as significant activities in higher risk areas, or concentrations in assets whose reported values are based on models.

.

Enhances the authority of the Fed to examine non-bank subsidiaries, such as mortgage affiliates, and also gives other bank regulators the opportunity to examine and take enforcement action against such entities.

.

Eliminates the Office of Thrift Supervision and reallocates savings and loan holding company supervision to the Fed; Federal savings institution supervision to the OCC; and State savings institution supervision to FDIC. However, the thrift charter is preserved and new charters may be issued by the OCC.

.

Establishes a statutory source of strength requirement for both bank and savings and loan holding companies.

.

The Volcker Rule prohibits banks and their affiliates from engaging in proprietary trading, subject to exceptions for certain types of assets and certain categories of transactions. Under the Volcker Rule, banks and their affiliates face strict limits on investment in, and sponsoring of, hedge funds and private equity funds. Sponsorship and investment in such funds will be subject to certain conditions and with ultimate investment limited to 3 percent of any single fund and an aggregate investment in all funds not to exceed 3 percent of the entity's Tier 1 capital. Existing relationships with funds that are not in conformance with Volcker Rule requirements will be have to be divested.

.

Banks that receive Federal assistance (a broadly defined term) will be required to push out certain swaps activities to affiliates.

.

The coverage of Section 23A of the Federal Reserve Act is expanded to take account of the credit exposure related to additional transactions, including derivatives transactions, along with other additional restrictions under Section 23A.

.

The Act places new restrictions on acquisitions that would result in a financial company controlling more than 10 percent of the consolidated aggregate liabilities of all financial companies.

.

Requires mortgage originators to act in the best interests of a consumer and seeks to ensure that a consumer will have the capacity to repay a loan that the consumer enters into.

.

Mandates comprehensive additional residential mortgage loan related disclosures.

.

Requires mortgage loan securitizers to retain a certain amount of risk (as established by the regulatory agencies). However, mortgages that conform to the new regulatory standards as "qualified residential mortgages" will not be subject to risk retention requirements.

Implementation of the Act will require dozens of new mandatory and discretionary rulemakings by numerous Federal regulatory agencies over the next several years. As a result, bank holding companies are likely to be faced with thousands of new pages of regulations not to mention increased litigation risk. In addition, while most of the provisions contained in Dodd-Frank are effective immediately upon enactment, many have delayed effective dates.

Earlier Federal Laws Responding to Financial Crisis. Federal laws enacted in 2008 addressing the financial crisis included EESA and ARRA, and related 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. 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 (later extended to run through December 31, 2010) 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. We opted out of this program when it was extended in 2010.

Arrow was preliminarily approved by the U.S. Treasury Department to participate in the CPP program (part of TARP). 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 19. 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.

Dodd-Frank, 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 other federal bills that would significantly affect banks have been introduced in Congress. 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.

New Federal Banking Laws 1999-2005. 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 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.

Recent Changes in Deposit Insurance Laws and Regulations. 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 18 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. Amounts expenses for FDIC insurance and the FICO assessment are included in the table of other expenses in Note 18 to the consolidated financial statements.

In February of 2011, the FDIC finalized the new assessment system to take effect in the second quarter of 2011. The final rule changes the assessment base from domestic deposits to average assets minus average tangible equity, adopts a new large-bank pricing assessment scheme, and sets a target size for the Deposit Insurance Fund. The changes will go into effect beginning with the second quarter and will be payable at the end of September. The rule (as mandated by Dodd-Frank) finalizes a target size for the Deposit Insurance Fund at 2 percent of insured deposits. It also implements a lower assessment rate schedule when the fund reaches 1.15 percent (so that the average rate over time should be about 8.5 basis points) and, in lieu of dividends, provides for a lower rate schedule when the reserve ratio reaches 2 percent and 2.5 percent. Also as mandated by Dodd-Frank, the rule changes the assessment base from adjusted domestic deposits to a bank's average consolidated total assets minus average tangible equity. We expect that the new assessment system will result in lowering our FDIC insurance assessments in 2011.

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.

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 9.

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 a wide variety of other mortgage originators, all of whom are principally affected in this business by the rate and terms set, and the lending practices established by the very large and growing government supported entities "Fannie Mae" and "Freddie Mac," who purchase and/or guarantee a very substantial dollar amount and number of mortgage loans, which in 2010 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 other types of 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	62	Chairman, President and Chief Executive Officer since 2004. Prior to 2004, Mr. Hoy served as President and Chief Executive Officer. Mr. Hoy has been with the company since 1974.
Terry R. Goodemote	47	Senior Vice President, Treasurer and Chief Financial Officer and as the Executive Vice President, Treasurer and Chief Financial Officer of Glens Falls National Bank and Trust Company ("GFNB") since 2008. Mr. Goodemote was first appointed Chief Financial Officer and Treasurer of the Company and GFNB on January 1, 2007. Prior to becoming Chief Financial Officer, Mr. Goodemote served as Senior Vice President and Head of the Accounting Division of GFNB. Mr. Goodemote started with the Company in 1992.
David S. DeMarco	49	Senior Vice President since May 1, 2009. Mr. DeMarco also serves as our Executive Vice President and Head of the Branch, Corporate Development, Financial Services & Marketing Division of GFNB since January 1, 2003. Mr. DeMarco started with the Company in 1987.
Thomas J. Murphy	52	Vice President & Corporate Secretary since May 1, 2009. Prior to that, Mr. Murphy was the Assistant Corporate Secretary of the Company beginning in 2008. Mr. Murphy also serves as Senior Vice President (2008) and Senior Trust Officer (2010), Corporate Secretary (2009), Cashier (2009) and Manager of the Personal Trust Department (2004) of GFNB. Mr. Murphy started with the Company in 2004.
Raymond F. O'Conor	55	Senior Vice President since May 1, 2009. Mr. O'Conor also serves as the Chairman, President and Chief Executive Officer of Saratoga National Bank and Trust Company ("SNB") since April 2007. Prior to that, Mr. O'Conor was President and Chief Executive Officer of SNB since January 1, 1996. Mr. O'Conor started with the Company in 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, already weak, should worsen and the U.S. experiences a prolonged economic slump, 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 region of 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 enhanced 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.

A sustained and/or significant increase in domestic interest rates 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. Recently, long-term interest rates have begun to rise, and many commentators believe that the Federal Reserve and other central banks will begin to increase short-term rates within the next 12 months or soon thereafter. Together, these developments (i.e., a rising rate environment) may negatively affect banks' profitability. See the discussion under "Changes in Net Interest Income Due to Rate," on page 27 of this Report.

If economic conditions worsen significantly and the U.S. financial markets should suffer another downturn, 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 (a "double dip" recession), we likely will experience a 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 business activity, 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, some of which we hold in our investment portfolio, 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. Specifically, changes in the fair value of our financial assets could have a significant negative impact on our asset portfolios and indirectly on our capital levels.

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 unexpected 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 more closely than it has in the past. 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 are less reflective of our particular condition or operating results than general market fluctuations, industry-wide factors or general economic or 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 new and enhanced government regulation. Even before the recent financial crisis and regulatory changes to law and regulation, we were 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. On top of the preexisting regulatory structure, the recent changes in governing law, regulations and 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. Many provisions of the Dodd-Frank are subject to additional regulation and rulemaking before implementation. In addition, Dodd-Frank requires multiple studies which could result in additional legislative action. At this time, it is difficult to predict the extent to which the Dodd-Frank or the resulting regulations and rules may adversely impact the Company. However, compliance with the Dodd-Frank may increase our costs, cause us to modify our strategies and business operations, and increase our capital requirements, any of which may have a material adverse impact on our financial condition.

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, our principal subsidiary. We own twenty-eight branch banking offices and lease seven others at market rates. We own two offices for our insurance operations.

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, 5 and 20 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. Removed and Reserved

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 Global Select Market of the NASDAQ Stock Market[R] 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 29, 2010, we distributed a 3% stock dividend on our outstanding shares of common stock.

	2010			2009		
	Sales Price		**Cash Dividends**	Sales Price		Cash Dividends
	Low	**High**	**Declared**	Low	High	Declared
First Quarter	**$23.04**	**$26.90**	**$.243**	$18.38	$24.50	$.236
Second Quarter	**22.36**	**28.49**	**.243**	21.70	26.11	.236
Third Quarter	**21.29**	**25.32**	**.243**	23.96	28.87	.236
Fourth Quarter	**24.00**	**28.51**	**.250**	23.36	26.96	.243

9

The payment of cash dividends by Arrow is determined 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 6,502 holders of record of Arrow's common stock at December 31, 2010. 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, 2010. These equity compensation plans were our 2008 Long-Term Incentive Plan ("Stock Plan"), our 2000 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 initially adopted, in 2000 and 1999, respectively. However, shareholders approved the Directors' Stock Plan at their 2008 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	466,944 (1)	$22.75	200,175 (2)
Equity Compensation Plans Not Approved by Security Holders	0	0	533,251 (3)
Total	466,944	$22.75	733,426

(1) Includes 466,944 shares of common stock issuable pursuant to outstanding stock options granted under the Stock Plan and predecessor stock plans.

(2) Includes 182,113 shares of common stock issuable under the Stock Plan and 18,062 shares of common stock available for future issuance under the Directors' Stock Plan.

(3) All 533,251 shares of common stock are available for future issuance under the ESPP.

Description of Non-Stockholder Approved Plans.

Officer and Employee Stock Purchase Plan. The 2000 Employee Stock Purchase Plan was initially adopted by the Board of Directors in 2000. Under the plan, eligible participants (currently directors, regional advisory directors, officers, regular 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 discount on shares acquired through regular withholdings or withdrawals is 5% (maximum allowable discount under the plan is 15%). The discounted price only applies to the first $1,000 of a participant's monthly contribution; after that threshold is reached, participants may purchase additional shares of shares at 100% of market price not to exceed $1,000 per month. The total number of shares originally authorized for purchase under the plan, as adjusted, was 822,777 shares. There are maximum and minimum levels for participant contributions and levels of the discount, which the Board of Directors may change from time to time. All shares purchased under the plan are acquired directly from the Company.

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, 2005 to December 31, 2010 and the second graph presents the ten-year period from December 31, 2000 to December 31, 2010.

	TOTAL RETURN PERFORMANCE Period Ending					
Index	**12/31/05**	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**
Arrow Financial Corporation	100.00	101.17	94.41	114.99	122.41	144.40
Russell 2000 Index	100.00	118.35	116.52	77.14	98.11	124.45
NASDAQ Banks Index	100.00	112.23	88.95	64.86	54.35	64.28
Zacks $1B - $5B Bank Assets Index	100.00	113.62	84.13	69.61	55.26	64.37

TOTAL RETURN PERFORMANCE

Period Ending

Index	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	12/31/10
Arrow Financial Corporation	100.00	163.78	187.23	218.22	258.58	232.48	235.20	219.48	267.33	284.58	335.70
Russell 2000 Index	100.00	102.49	81.50	120.01	142.00	148.48	175.72	173.00	114.54	145.67	184.78
NASDAQ Banks Index	100.00	108.26	110.82	142.56	163.17	159.39	178.89	141.79	103.39	86.63	102.47
Zacks $1B - $5B Bank Assets Index	100.00	122.14	142.93	193.02	230.11	223.88	254.38	188.36	155.86	123.73	144.12

The preceding stock performance graphs shall not be deemed incorporated by reference by virtue of any general statement incorporating by reference this Report 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 2010 of Loomis & LaPann, Inc. (Loomis), an insurance agency specializing in the sale of property and casualty insurance policies, Arrow issued 27,027 shares, as adjusted, of its common stock to the former two stockholders of Loomis, in exchange for all of the issued and outstanding shares of Loomis. The terms of the acquisition included a provision under which Arrow would also pay to the two stockholders, over the

3-year period following closing, additional consideration solely in the form of additional shares of Arrow's common stock, depending on the financial performance and other results of Loomis as a subsidiary of Arrow during such period. The maximum potential value of Arrow stock to be issued under this provision is $330 thousand over the three-year period. All shares issued to the Loomis stockholders at the original closing and to be issued in post-closing adjustments are 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 two stockholders were New York residents and Loomis 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, 2010 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	12,615	$25.84	---	$2,871,016
November	19,423	25.59	10,000	2,627,916
December	5,564	27.84	---	2,627,916
Total	37,602	26.00	10,000	

[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 2010 - DRIP purchases (3,818 shares), stock options (8,797 shares); November 2010 – DRIP purchases (2,739 shares), stock options (6,684 shares); December 2010 – DRIP purchases (1,994 shares), stock options (3,570 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 only 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 2010 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:	2010	2009	2008	2007	2006
Interest and Dividend Income	$84,972	$86,857	$89,508	$86,577	$80,611
Interest Expense	23,695	26,492	32,277	40,283	34,743
Net Interest Income	61,277	60,365	57,231	46,294	45,868
Provision for Loan Losses	1,302	1,783	1,671	513	826
Net Interest Income After Provision					
for Loan Losses	59,975	58,582	55,560	45,781	45,042
Noninterest Income	17,582	19,235	15,886	16,288	15,883
Net Gains (Losses) on Securities Transactions	1,507	357	383	---	(102)
Noninterest Expense	47,418	46,592	42,393	37,930	36,807
Income Before Provision for Income Taxes	31,646	31,582	29,436	24,139	24,016
Provision for Income Taxes	9,754	9,790	8,999	6,807	7,124
Net Income	$21,892	$21,792	$20,437	$17,332	$16,892
Per Common Share: [1]					
Basic Earnings	$ 1.94	$ 1.94	$ 1.82	$ 1.52	$ 1.46
Diluted Earnings	1.94	1.93	1.81	1.51	1.44
Per Common Share: [1]					
Cash Dividends	$ .98	$ .95	$ .92	$ .89	$ .86
Book Value	13.53	12.52	11.24	10.84	10.21
Tangible Book Value [2]	12.00	11.04	9.78	9.37	8.75
Consolidated Year-End Balance Sheet Data:					
Total Assets	$1,908,336	$1,841,627	$1,665,086	$1,584,846	$1,520,217
Securities Available-for-Sale	517,364	437,706	315,414	328,496	307,902
Securities Held-to-Maturity	159,938	168,931	133,976	114,611	108,498
Loans	1,145,508	1,112,150	1,109,812	1,038,844	1,008,999
Nonperforming Assets	4,945	4,772	4,971	2,336	3,169
Deposits	1,534,004	1,443,566	1,275,063	1,204,200	1,186,397
Federal Home Loan Bank Advances	130,000	140,000	160,000	160,000	125,000
Other Borrowed Funds	73,214	93,908	79,956	73,719	68,324
Stockholders' Equity	152,259	140,818	125,802	122,256	118,130
Selected Key Ratios:					
Return on Average Assets	1.16%	1.24%	1.24%	1.11%	1.11%
Return on Average Equity	14.56	16.16	16.26	14.68	14.38
Dividend Payout [3]	50.52	49.22	50.83	58.28	59.72

[1]Share and per share amounts have been adjusted for subsequent stock splits and dividends, including the most recent September 2010 3% stock dividend.

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

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

14

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 2010 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 2010 3% stock dividend.)

	Dec 2010	Sep 2010	Jun 2010	Mar 2010	Dec 2009
Net Income	$5,188	$5,575	$5,714	$5,415	$5,117
Transactions Recorded in Net Income (Net of Tax):					
Other-Than-Temporary Impairment (OTTI) (see page 23)	$---	$---	$ ---	$ ---	$(227)
Net Securities Gains	7	373	530	---	17
Net Gains on Sales of Loans	299	285	21	13	56
Period End Shares Outstanding	11,256	11,234	11,300	11,277	11,245
Basic Average Shares Outstanding	11,239	11,257	11,307	11,260	11,238
Diluted Average Shares Outstanding	11,292	11,260	11,344	11,301	11,288
Basic Earnings Per Share	$.46	$.50	$.51	$.48	$.46
Diluted Earnings Per Share	.46	.50	.50	.48	.45
Cash Dividends Per Share	.25	.24	.24	.24	.24
Average Assets	$1,970,085	$1,880,099	$1,873,690	$1,844,173	$1,856,176
Average Equity	154,677	153,653	149,026	144,001	140,786
Return on Average Assets	1.04%	1.18%	1.22%	1.19%	1.09%
Return on Average Equity	13.31	14.39	15.38	15.25	14.42
Average Earning Assets	$1,884,402	$1,792,421	$1,790,572	$1,762,490	$1,781,464
Average Paying Liabilities	1,579,765	1,485,639	1,502,052	1,483,532	1,492,326
Interest Income, Tax-Equivalent [1]	21,554	21,829	22,530	22,512	23,032
Interest Expense	5,903	5,829	6,023	5,940	6,522
Net Interest Income, Tax-Equivalent [1]	15,651	16,000	16,507	16,572	16,510
Tax-Equivalent Adjustment	908	832	852	861	863
Net Interest Margin [1]	3.30%	3.54%	3.70%	3.81%	3.68%
Efficiency Ratio Calculation:[1]					
Noninterest Expense	$11,770	$12,106	$12,002	$11,540	$11,699
Less: Intangible Asset Amortization	(66)	(67)	(65)	(73)	(77)

Net Noninterest Expense	$11,704	$12,039	$11,937	$11,467	$11,622
Net Interest Income, Tax-Equivalent [1]	$15,651	$16,000	$16,507	$16,572	$16,510
Noninterest Income	4,738	5,305	5,028	4,018	3,805
Less: Net Securities Losses (Gains) & OTTI	(11)	(618)	(878)	---	347
Net Gross Income	$20,378	$20,687	$20,657	$20,590	$20,662
Efficiency Ratio [1]	57.43%	58.20%	57.79%	55.69%	56.25%
Period-End Capital Information:					
Tier 1 Leverage Ratio	8.78%	8.41%	8.71%	8.66%	8.43%
Total Stockholders' Equity (i.e. Book Value)	$152,259	$153,457	$152,703	$145,804	$140,818
Book Value per Share	13.53	13.66	13.51	12.93	12.52
Intangible Assets	17,241	17,209	17,206	16,630	16,712
Tangible Book Value per Share	12.00	12.13	11.99	11.46	11.04
Net Loans Charged-off as a Percentage of Average Loans, Annualized	.04%	.05%	.05%	.08%	.09%
Provision for Loan Losses as a Percentage of Average Loans, Annualized	.06	.13	.13	.14	.16
Allowance for Loan Losses as a Percentage of Loans, Period-end	1.28	1.27	1.26	1.27	1.26
Allowance for Loan Losses as a Percentage of Nonperforming Loans, Period-end	300.57	369.69	324.13	393.43	300.73
Nonperforming Loans as a Percentage of Loans, Period-end	.43	.34	.39	.32	.42
Nonperforming Assets as a Percentage of Total Assets, Period-end	.26	.20	.24	.20	.26

[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 2010 3% stock dividend.

	Dec 2010	Dec 2009	Dec 2008
Net Income	$21,892	$21,792	$20,437
Transactions Recorded in Net Income (Net of Tax):			
Other-Than-Temporary Impairment (OTTI) (see page 23)	$---	$(227)	$(971)
Net Securities Gains	910	216	231
Net Gains on Sales of Loans	618	252	64
Income from Restitution Payment (see page 30)	---	272	---
Net Gains on the Sale of Other Real Estate Owned	2	8	18
Net Gain on Sale of Merchant Bank Card Processing (see page 23)	---	1,791	---
FDIC Special Assessment (see page 23)	---	(475)	---
Net Gain on the Sale of Premises (see page 30)	---	---	69
Visa Litigation (see page 24)	---	---	185
Gain on Redemption of Visa Inc. Class B Shares (see page 24)	---	---	452
Period End Shares Outstanding	11,256	11,245	11,188
Basic Average Shares Outstanding	11,266	11,231	11,208
Diluted Average Shares Outstanding	11,300	11,281	11,269
Basic Earnings Per Share	$1.94	$1.94	$1.82
Diluted Earnings Per Share	1.94	1.93	1.81
Cash Dividends Per Share	.98	.95	.92
Average Assets	$1,892,324	$1,761,006	$1,644,210
Average Equity	150,377	134,890	125,653
Return on Average Assets	1.16%	1.24%	1.24%
Return on Average Equity	14.56	16.16	16.26
Average Earning Assets	$1,807,763	$1,688,454	$1,568,677
Average Paying Liabilities	1,512,937	1,410,022	1,303,740
Interest Income, Tax-Equivalent [1]	88,424	90,038	92,441
Interest Expense	23,695	26,492	32,277
Net Interest Income, Tax-Equivalent [1]	64,729	63,546	60,164
Tax-Equivalent Adjustment	3,452	3,181	2,933
Net Interest Margin [1]	3.58%	3.76%	3.84%
Efficiency Ratio Calculation [1]			
Noninterest Expense	$47,418	$46,592	$42,393
Less: Intangible Asset Amortization	(271)	(324)	(360)
Net Noninterest Expense	$47,147	$46,268	$42,033
Net Interest Income, Tax-Equivalent [1]	$64,729	$63,546	$60,164
Noninterest Income	19,089	19,592	16,269
Less: Net Securities Losses & OTTI	(1,507)	18	478

Net Gross Income	$82,311	$83,156	$76,911
Efficiency Ratio [1]	57.28%	55.64%	54.65%
Period-End Capital Information:			
Tier 1 Leverage Ratio (Period-end)	8.78%	8.43%	8.39%
Total Stockholders' Equity (i.e. Book Value)	$152,259	$140,818	$125,802
Book Value per Share	13.53	12.52	11.24
Intangible Assets	17,241	16,712	16,378
Tangible Book Value per Share	12.00	11.04	9.78
Net Loans Charged-off as a Percentage of Average Loans	.06%	.09%	.07%
Provision for Loan Losses as a Percentage of Average Loans	.11	.16	.16
Allowance for Loan Losses as a Percentage of Loans, Period-end	1.28	1.26	1.20
Allowance for Loan Losses as a Percentage of Nonperforming Loans, Period-end	300.57	300.73	338.05
Nonperforming Loans as a Percentage of Loans, Period-end	.43	.42	.35
Nonperforming Assets as a Percentage of Total Assets, Period-end	.26	.26	.30

[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, 2010 and our financial condition as of December 31, 2010 and 2009. 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 2010 Financial Results

We reported net income of $21.9 million for 2010, an increase of $100 thousand, or 0.5%, compared to 2009. Diluted earnings per share of $1.94 represented an increase of $.01, or .5%, from 2009.

Our net income for 2009, determined in accordance with GAAP, included a $1.8 million gain, net of tax, that we recognized on the sale of our merchant bank card processing to TransFirst, a one-time transaction which closed in that period (the "Transaction"). We have adjusted net income for the 2009 period to exclude income from this transaction. Doing so produces a non-GAAP measure, adjusted net income, as well as additional non-GAAP measures derived therefrom, i.e., adjusted diluted earnings per share, adjusted return on equity and adjusted return on assets for the 2009 period. Under SEC rules, these non-GAAP measures, if provided in a filed report such as this Report, must be accompanied by a reconciliation to the nearest comparable GAAP measure. The table below presents these non-GAAP measures for the 2009 period, as well as a reconciliation of these measures to the comparable GAAP measures for the period, and a comparison between these non-GAAP adjusted measures for the 2009 period and our comparable GAAP measures for the 2010 period, that is, our net income, diluted earnings per share, return on average assets and return on average equity for 2010, prepared in accordance with GAAP. We believe the inclusion of the non-GAAP measure for the 2009 period and the comparison between the 2010 period GAAP measures and the 2009 period non-GAAP measures is meaningful and helpful, because it better reveals the earnings from our fundamental line of business, the commercial banking business, and the trend from period to period in that business.

Reconciliation of Non-GAAP to GAAP Financial Disclosures, as required by Regulation G:

	Net Income (in thousands)	Diluted Per Share Amount	Return on Average Assets	Return on Average Equity
Twelve Month Period Ended:				
Net Income December 31, 2009 and Related Ratios (GAAP)	$21,792	$1.93	1.24%	16.16%
Adjustment:				
Net Gain on the Sale of our Merchant Bank Card Processing to TransFirst LLC ($2,966 pre-tax)	(1,791)	(.16)	(0.10)%	(1.33)%
Adjusted Net Income and Related Ratios for More Meaningful Comparison (non-GAAP)	$20,001	$1.77	1.14%	14.83%

Net Income December 31, 2010 and Related Ratios (GAAP)	$21,892	$1.94	1.16%	14.56%
Adjustment: None	---	---	---	---
Adjusted Net Income and Related Ratios for More Meaningful Comparison (GAAP)	$21,892	$1.94	1.16%	14.56%

An increase in income in the 2010 period from the sales of securities and loans had a positive impact on income for that period compared to the earlier 2009 period, in which net gains from sales of securities and loans were substantially smaller.

During 2008, our net interest margin increased primarily due to falling short-term interest rates (which has a proportionately larger impact on the cost of our deposits than on our earnings from our assets). This combined with 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 resulted in increased net income in 2008. However, during both 2009 and 2010, we experienced a decrease in our net interest margin as rates remained very low, and the increase in net interest income that we experienced was due to the growth in earning assets. Our margin compression in 2009 and 2010 resulted from the fact that our deposits were already at such low rates going into 2009 that it was not possible to effect significant additional downward repricing during this period, while our loan cash-flows continued to reprice downward.

Importantly, we did not experience significant deterioration in our loan and asset quality during 2010 despite the continuing worldwide economic recession and severe disruption in the financial markets generally, which began in 2008.

Although our earnings in 2009 was positively impacted by one significant transaction, discussed below and later in this Report, net income for 2010 was a record high for us.

Financial Market Turmoil Continues: From the third quarter of 2007 through year end 2010, 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 as high as 12,000, demonstrating a degree of volatility not seen in many decades, with the most dramatic change occurring during the fourth quarter of 2009. The U.S. economy itself experienced a similarly severe downturn in 2008 and 2009, but a less dramatic recovery in 2010. 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, throughout 2009 and 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 2010 and may continue to influence our financial condition and results of operations in forthcoming periods.

18

Decision Not to Participate in U.S. Treasury TARP CPP in 2009: 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 through the 2008-2009 downturn 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 in 2009: As we previously reported on March 2, 2009, our bank subsidiaries, Glens Falls National and Saratoga National, 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 in 2009: 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 it 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 throughout 2009 and 2010. Nonperforming loans amounted to $4.9 million at December 31, 2010, an increase of $227 thousand from the prior year-end. The ratio of nonperforming loans to period-end loans was .43% at December 31, 2010, an increase of only one basis point from one year earlier. By way of comparison, this ratio for our peer group increased during the same period by 17 basis points, from 3.33% at December 31, 2009 to 3.50% at September 30, 2010. Our loans charged-off (net of recoveries) against our allowance for loan losses were $627 thousand for 2010, as compared to $1.0 million for the prior year. At year-end 2010, the allowance for loan losses was $14.7 million, representing 1.28% of total loans, an increase of 2 basis points from the prior year-end. To date, we have not experienced significant deterioration in any of our three major loan portfolio segments:

o

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. Current unemployment rates in our region are higher than in the past few years and the number of total jobs has decreased, but 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.

o

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.

o

Indirect Automobile Loans: These loans comprise over 30% of our loan portfolio. We have not experienced any significant increases in our delinquency rate or level of charge-offs. Both delinquencies and charge-offs did increase modestly during 2009, but delinquencies actually decreased in 2010.

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 which we continue to hold 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 2010, 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 2010 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 42). 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, a few 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, 2009 and 2010: On March 28, 2008, VISA Inc. distributed to its member banks, including Glens Falls National, 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 pre-tax 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 and for which Visa had established its escrow fund. Since that time, Visa has deposited additional amounts into the escrow fund for covered litigation: $1.1 billion in December 2008, $700 million in July 2009, $500 million in May 2010 and $800 million in October 2010. These developments reduced the Company’s proportionate exposure for covered litigation but also reduced the ultimate value of its remaining Class B Visa shares, as Visa’s settlement of covered litigation claims directly reduced the value of member banks’ Class B stock. 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 its Class B shares upon Visa’s settlement of the litigation. The estimation of the Company’s proportionate share of any potential losses related to the remaining 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 December 31, 2010 consolidated balance sheet represents the fair value of our proportionate share of the remaining covered Visa litigation obligations at that date, but this value is subject to change depending upon future developments in the covered litigation.

Change in Stockholders' Equity: At December 31, 2010, our tangible book value per share (calculated based on stockholders' equity reduced by intangible assets including goodwill and other intangible assets) amounted to $12.00, an increase of $0.96, or 8.7%, from year-end 2009. Our total stockholders' equity at year-end 2010 increased 8.1% over the year-end 2009 level. Major changes to stockholders' equity included: (i) $21.9 million of net income for the year; (ii) net unrealized gain of $604 thousand in securities available-for-sale, net of taxes; and (iii) equity received from our various stock plans of $3.5 million, net of taxes; offset by (iv) cash dividends of $11.0 million; (v) net changes in our pension plans (reflected as other comprehensive income) of $387 thousand; and (vi) repurchases of our own common stock of $3.3 million. As of the last trading day of 2010, our closing stock price was $27.51, resulting in a trading multiple of 2.29 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 2010. For the year, total cash dividends (as adjusted for stock dividends) were $.98 compared to $.95 for 2009, 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 2010 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			
				2009 to 2010		2008 to 2009	
	2010	2009	2008	Amount	%	Amount	%
Interest and Dividend Income	$88,424	$90,038	$92,441	$(1,614)	(1.8)%	$(2,403)	(2.6)%
Interest Expense	23,695	26,492	32,277	(2,797)	(10.6)	(5,785)	(17.9)
Net Interest Income	$64,729	$63,546	$60,164	$ 1,183	1.9	$ 3,382	5.6

On a tax-equivalent basis, net interest income was $64.7 million in 2010, an increase of $1.2 million, or 1.9%, from $63.5 million in 2009. This compared to an increase of $3.4 million, or 5.6%, from 2008 to 2009. 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.

	2010 Compared to 2009 Change in Net Interest Income Due to:			2009 Compared to 2008 Change in Net Interest Income Due to:		
Interest and Dividend Income:	Volume	Rate	Total	Volume	Rate	Total
Federal Funds Sold	$ ---	$ ---	$ ---	$ (464)	$ ---	$ (464)
Interest-Bearing Bank Balances	7	1	8	160	(68)	92
Investment Securities:						

Fully Taxable	1,945	(1,950)	(5)	1,353	(2,779)	(1,426)
Exempt from Federal Taxes	1,518	(974)	544	1,373	(738)	635
Loans	1,954	(4,115)	(2,161)	1,892	(3,132)	(1,240)
Total Interest and Dividend Income	5,424	(7,038)	(1,614)	4,314	(6,717)	(2,403)
Interest Expense:						
Deposits:						
NOW Accounts	858	(448)	410	1,159	(1,160)	(1)
Savings Deposits	344	(309)	35	290	(1,587)	(1,297)
Time Deposits of $100,000 or More	(488)	(327)	(815)	(504)	(1,369)	(1,873)
Other Time Deposits	(11)	(1,420)	(1,431)	220	(1,517)	(1,297)
Total Deposits	703	(2,504)	(1,801)	1,165	(5,633)	(4,468)
Short-Term Borrowings	9	(14)	(5)	14	(674)	(660)
Long-Term Debt	(680)	(311)	(991)	(147)	(510)	(657)
Total Interest Expense	32	(2,829)	(2,797)	1,032	(6,817)	(5,785)
Net Interest Income	$5,392	$(4,209)	$ 1,183	$3,282	$ 100	$ 3,382

The following table reflects the components of our net interest income, setting forth, for years ended December 31, 2010, 2009 and 2008 (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:	2010			2009			2008		
	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%
Interest-Bearing Deposits at Banks	59,771	157	0.26	56,920	149	0.26	5,997	57	0.95
Investment Securities:									
Fully Taxable	413,212	14,734	3.57	362,059	14,739	4.07	332,530	16,182	4.87
Exempt from Federal Taxes	200,062	8,997	4.50	167,716	8,453	5.04	141,294	7,801	5.52
Loans	1,134,718	64,536	5.69	1,101,759	66,697	6.05	1,071,384	67,937	6.34
Total Earning Assets	1,807,763	88,424	4.89	1,688,454	90,038	5.33	1,568,677	92,441	5.89
Allowance for Loan Losses	(14,385)			(13,626)			(12,658)		
Cash and Due From Banks	28,717			28,096			32,505		
Other Assets	70,229			58,082			55,686		
Total Assets	$1,892,324			$1,761,006			$1,644,210		
Deposits:									
NOW Accounts	$ 541,161	5,582	1.03	$ 460,096	5,172	1.12	$ 367,351	5,173	1.41
Savings Deposits	361,949	2,136	0.59	307,133	2,101	0.68	281,208	3,398	1.21
Time Deposits of $100,000 Or More	133,770	2,903	2.17	155,378	3,718	2.39	172,055	5,591	3.25

Other Time Deposits	249,192	5,900	2.37	249,575	7,331	2.94	243,247	8,628	3.55
Total Interest-Bearing Deposits	1,286,072	16,521	1.28	1,172,182	18,322	1.56	1,063,861	22,790	2.14
Short-Term Borrowings	64,083	124	0.19	59,566	129	0.22	58,473	789	1.35
FHLBNY Advances and Long-Term Debt	162,782	7,050	4.33	178,274	8,041	4.51	181,406	8,698	4.79
Total Interest-Bearing Funds	1,512,937	23,695	1.57	1,410,022	26,492	1.88	1,303,740	32,277	2.48
Demand Deposits	205,497			191,504			189,999		
Other Liabilities	23,513			24,590			24,818		
Total Liabilities	1,741,947			1,626,116			1,518,557		
Stockholders' Equity	150,377			134,890			125,653		
Total Liabilities and Stockholders' Equity	$1,892,324			$1,761,006			$1,644,210		
Net Interest Income (Tax-equivalent Basis)		64,729			63,546			60,164	
Reversal of Tax Equivalent Adjustment		(3,452)	.19%		(3,181)	.19%		(2,933)	.19%
Net Interest Income		$61,277			$60,365			$57,231	
Net Interest Spread			3.32%			3.45%			3.41%
Net Interest Margin			3.58%			3.76%			3.84%

22

CHANGES IN NET INTEREST INCOME DUE TO RATE

YIELD ANALYSIS (Tax-equivalent basis)	December 31,		
	2010	2009	2008
Yield on Earning Assets	4.89%	5.33%	5.89%
Cost of Interest-Bearing Liabilities	1.57	1.88	2.48
Net Interest Spread	3.32%	3.45%	3.41%
Net Interest Margin	3.58%	3.76%	3.84%

Following two years of decreases in net interest income in 2006 and 2005 (during a period of rising interest rates), we have experienced four successive years of increases in net interest income from 2007 through 2010. In all periods, we experienced a benefit from an increase in average earning assets, although 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 $1.2 million, or 1.9%, from 2009 to 2010. Net interest income increased $3.4 million, or 5.6%, from 2008 to 2009. In 2010, an increase in average earning assets, net of a smaller increase in average paying liabilities (i.e., changes in volume) had a $5.4 million positive impact on net interest income, while changes in rates provided a $4.2 million negative 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

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 Interest Rates. From mid-2006 to fall 2007, the Fed maintained elevated short-term rates, with a federal funds target rate of 5.25%. In September 2007, 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 2007 meeting of the Board of Governors, the fed funds rate had decreased 100 basis points, to 4.25%, and in early 2008, the Fed, in response to continuing liquidity concerns in the credit markets, further lowered the targeted federal funds rate by an additional 125 basis points, to 3.00%. In the ensuing year, the Fed in a series of rate reductions lowered the target rate to the maximum extent possible; by January 2009, the fed funds target rate was at an unprecedented low of 0% to .25%, where it has remained up to the present. We saw an immediate impact in the reduced cost of our deposits when rates began to fall in 2007, and our deposit costs continued falling in 2008 and 2009 and to a much lesser extent throughout 2010. Yields on our earning assets have also fallen in the last two years, but at least initially the drop in our asset yields was not as significant as the decline in our deposit rates. As a result, our net interest margins generally increased in late 2007 and early 2008, positively impacting our net interest income.

Changes in the Yield Curve. An additional 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 (i.e., lower rates for shorter-duration debt; higher rates for longer-term debt) 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. 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. The flattening of the yield curve was the most significant factor in the decrease in our net interest margin during the 2005-2007 period and consequent downward pressure on our net interest income.

At the end of the second quarter of 2007, however, the yield on longer-term securities began to increase compared to short-term investments, and the yield curve began to resume its more traditional upward sloping shape. The increase in rate spread was further enhanced when long-term rates initially held steady after the Fed began lowering short-term rates in September 2007 in response to the economic downturn. Ultimately, as the crisis deepened, long-term rates also began to decrease, while short-term rates continued to decrease, roughly in parity with each other, to the historically low levels that both short- and long-term rates presently occupy, levels that the Federal Reserve explicitly sought to perpetuate at least in the near future, through the various means at its disposal. The upward-sloping yield curve may continue, and continue to be steep, for some time, to the benefit of banks and financial institution generally. On the other hand, all lending institutions, even those like us who have avoided subprime lending problems and continue to maintain high credit quality, have experienced some pressure on credit quality in recent periods, and this may continue if the national or regional economy continues to be weak. Any credit or asset quality erosion will reduce or possibly outweigh the benefit we may experience from the return of a more positively-sloped yield curve and a highly favorable interest rate environment generally. Thus, no assurances can be given on future improvements in our net interest income or net income generally, particularly as consumer mortgage related borrowings have diminished across the economy and the redeployment of funds from maturing loans and assets into higher yielding assets has become progressively more difficult.

Effect of Rate Changes on Our Margin. In September 2007, as noted above, the Fed began lowering short-term interest rates in response to the worsening economy. From the third quarter of 2007 through mid-2008 our margin steadily improved as the rates we paid on our interest-bearing liabilities began to reprice downward more rapidly than the yields on our earning assets. This had a significant positive impact on our net interest income. From mid-2008 into 2009, our net interest margin held steady at around 3.90%, but the margin began to narrow in the last three quarters of 2009 and all four quarters of 2010 as the downward repricing of paying liabilities began to slow while interest earning assets continued to reprice downward at a steady rate. Net interest margin for the fourth quarter of 2010 was 3.30%. To a certain extent, further downward pricing of liabilities is approaching a limit and will most likely not decline much further, whereas assets continue to have room to reprice downward. If the general trend of rate reduction continues, margins, including our margin, will be under continuing pressure and slow compression may continue. In this light, no assurances can be given that our net interest income will continue to grow, even if asset growth continues and earnings may be negatively impacted in future periods.

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			
				2009 to 2010		2008 to 2009	
	2010	2009	2008	Amount	%	Amount	%
Earning Assets	$1,807,763	$1,688,454	$1,568,677	$119,309	7.1%	$119,777	7.6%
Interest-Bearing Liabilities	1,512,937	1,410,022	1,303,740	102,915	7.3	106,282	8.2
Demand Deposits	205,497	191,504	189,999	13,993	7.3	1,505	0.8
Total Assets	1,892,324	1,761,006	1,644,210	131,318	7.5	116,796	7.1
Earning Assets to Total Assets	95.53%	95.88%	95.41%				

2009 to 2010:

In general, an increase in average earning assets has a positive impact on net interest income. For 2010, average earning assets increased $119.3 million or 7.1% over 2009, while average interest-bearing liabilities increased $102.9 million or 7.3%. This combination led to a $5.4 million increase in net interest income, even though our net interest margin decreased by 18 basis points (from 3.76% to 3.58%) between the two years. (This positive effect was offset, in part, to the $4.2 million negative impact on net interest income resulting from the changes in rates during the year, discussed above.)

The $119.3 million increase in average earning assets from 2009 to 2010 reflected an increase in average loans of $33.0 million, or 3.0%, an increase of $84.1 million, or 16.2%, in investment securities and a $2.9 increase in the level of bank balances at interest. Within the loan portfolio, our three principal segments are residential real estate loans, indirect loans (primarily automobile loans) and commercial loans. The increase in average loan balances from 2009 to 2010 was principally driven by a strong demand for residential real estate loans. However, during the last six months of 2010 we began to sell our newly originated loans to Freddie Mac while retaining the loan servicing. Some of these sales were refinancing of loans that were formerly in our own portfolio. Consequently, the outstanding balance of residential real estate loans began to decrease in the fourth quarter of 2010, continuing into the early part of 2011. Average indirect loan balances decreased slightly during the year, under 1.0%, while average commercial loans balances remained essentially flat.

The $102.9 million increase in average interest-bearing liabilities was evenly divided between increases in municipal deposits balances and non-municipal account balances. The fact that our average earning assets increased more than our average paying liabilities, was attributable an increase in non-interest bearing funding sources, including non-interest bearing demand deposits, and increases in stockholders' equity.

2008 to 2009:

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.

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."

II. 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. Beginning in 2010, Note 4 to our consolidated financial statements includes all of the disclosures about our method for calculating our provision for loan losses that was formerly reported in this section of managements' discussion and analysis. Note 4 also provides information about impaired loans.

SUMMARY OF THE ALLOWANCE AND PROVISION FOR LOAN LOSSES

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

Years-Ended December 31,	2010	2009	2008	2007	2006
Loans at End of Period	$1,145,508	$1,112,150	$1,109,812	$1,038,844	$1,008,999
Average Loans	1,134,718	1,101,759	1,071,384	1,020,856	996,611
Total Assets at End of Period	1,908,336	1,841,627	1,665,086	1,584,846	1,520,217
Nonperforming Assets:					
Nonaccrual Loans:					
Commercial Real Estate	$2,237	$2,235	$2,263	$ 758	$ 708
Commercial Loans	94	309	50	73	56
Residential Real Estate Loans	916	901	100	253	452
Consumer Loans	814	945	1,056	855	822
Total Nonaccrual Loans	4,061	4,390	3,469	1,939	2,038
Loans Past Due 90 or More Days and Still Accruing Interest	810	270	457	245	739
Restructured	16	---	---	---	---
Total Nonperforming Loans	4,887	4,660	3,926	2,184	2,777
Repossessed Assets	58	59	64	63	144
Other Real Estate Owned	---	53	581	89	248
Nonaccrual Investments	---	---	400	---	---
Total Nonperforming Assets	$4,945	$4,772	$4,971	$2,336	$3,169
Allowance for Loan Losses:					
Balance at Beginning of Period	$14,014	$13,272	$12,401	$12,278	$12,241
Loans Charged-off:					
Commercial, Financial and Agricultural	(30)	(88)	(83)	(27)	(32)
Real Estate - Commercial	---	---	---	(6)	---
Real Estate - Residential	---	(25)	(25)	---	---
Installment Loans to Consumers	(864)	(1,317)	(1,184)	(797)	(1,105)
Total Loans Charged-off	(894)	(1,430)	(1,292)	(830)	(1,137)

Recoveries of Loans Previously Charged-off:					
Commercial, Financial and Agricultural	5	14	38	13	27
Real Estate – Commercial	---	---	197	17	17
Real Estate – Residential	---	6	2	2	2
Installment Loans to Consumers	262	369	255	408	302
Total Recoveries of Loans Previously Charged-off	267	389	492	440	348
Net Loans Charged-off	(627)	(1,041)	(800)	(390)	(789)
Provision for Loan Losses Charged to Expense	1,302	1,783	1,671	513	826
Balance at End of Period	$14,689	$14,014	$13,272	$12,401	$12,278
Nonperforming Asset Ratio Analysis:					
Net Loans Charged-off as a Percentage of Average Loans	.06%	.09%	.07%	.04%	.08%
Provision for Loan Losses as a Percentage of Average Loans	.11	.16	.16	.05	.08
Allowance for Loan Losses as a Percentage of Loans, Period-end	1.28	1.26	1.20	1.19	1.22
Allowance for Loan Losses as a Percentage of Nonperforming Loans	300.57	300.73	338.05	567.81	442.12
Nonperforming Loans as a Percentage of Loans, Period-end	.43	.42	.35	.21	.28
Nonperforming Assets as a Percentage of Total Assets, Period-end	.26	.26	.30	.15	.21

ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES

(Dollars in Thousands)

	2010	2009	2008	2007	2006
Commercial, Financial and Agricultural	$ 2,037	$ 1,304	$ 1,735	$ 1,634	$ 1,691
Real Estate-Commercial	3,128	4,000	3,568	3,247	3,348
Real Estate-Residential Mortgage	3,163	2,954	2,610	2,320	1,714
Indirect and Other Installment Loans to Individuals	5,088	4,901	4,859	4,369	4,517
Unallocated	1,273	855	500	831	1,008
Total	$14,689	$14,014	$13,272	$12,401	$12,278

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			
				2009 to 2010		2008 to 2009	
	2010	2009	2008	Amount	%	Amount	%
Income from Fiduciary Activities	$ 5,391	$ 5,009	$ 5,463	$ 382	7.6 %	$ (454)	(8.3)%
Fees for Other Services to Customers	7,864	8,051	8,562	(187)	(2.3)	(511)	(6.0)
Net Gains on Securities Transactions	1,507	357	383	1,150	322.1	(26)	(6.8)
Other-Than-Temporary Impairment (OTTI)	---	(375)	(1,610)	375	100.0	1,235	76.7
Net Gain on Sale of Merchant Bank Card Processing	---	2,966	---	(2,966)	(100.0)	2,966	100.0
Gain on Visa Stock Redemption	---	---	749	---	---	(749)	(100.0)
Gain on the Sale of Premises	---	---	115	---	---	(115)	(100.0)
Income from Restitution Payment	---	450	---	(450)	(100.0)	450	N/A
Insurance Commissions	2,987	2,412	2,066	575	23.8	346	16.7
Net Gains on Sales of Loans	1,024	418	106	606	145.0	312	294.3
Other Operating Income	316	304	435	12	3.9	(131)	(30.1)
Total Noninterest Income	$19,089	$19,592	$16,269	$(503)	(2.6)	$3,323	20.4

2010 compared to 2009: Total noninterest income decreased $503 thousand, or 2.6%, from 2009 to 2010. Two significant transactions involving noninterest income that occurred in 2009 were discussed in the Overview beginning on page 22: 1) the net gain on the sale of our merchant bank card processing to TransFirst in the first quarter of 2009 and, 2) the write-down of an inactively-traded common stock in 2009. Other transactions are listed in the table, above.

For 2010, income from fiduciary activities increased $382 thousand, or 7.6%, from 2009. The increase reflected a recovery in the dollar amount of assets under administration, largely a result of the general rebound in the U.S. equity and debt markets between the periods. At period-end 2010, the market value of assets under trust administration and investment management amounted to $984.4 million, an increase of $117.2 million, or 13.5%, from period-end 2009. A significant portion of our fiduciary fees are indexed to the market value of assets under administration.

Fees for other services to customers (primarily service charges on deposit accounts, revenues related to the sale of mutual funds to our customers by third party providers and servicing income on sold loans) were $7.9 million for 2010, a decrease of $187 thousand, or 2.3%, from 2009. The decrease between the two periods in fees for other services to customers was in part the result of a modest decline in revenues derived from third-party mutual fund sales. The decrease also reflected the fact that the total for the 2009 period included income from our merchant credit card processing business prior to our sale of that business at the end of the first quarter of 2009; no income from that business was earned by us in 2010 (see “Sale of Merchant Bank Card Processing to TransFirst,” in the Overview section, on page 23). Income from debit card transactions increased from $2.0 million for 2009 to $2.3 million for 2010.

Certain provisions of Dodd-Frank limited the size of interchange fees that large banks may charge on customers’ debit card transactions. Although these provisions do not directly apply to smaller community banks like ours, the law may indirectly restrict an ability to continue to charge current interchange fees because of the need to compete on price with larger banks. On November 12, 2009, the Federal Reserve issued amendments to Regulation E implementing certain provisions in the Electronic Fund Transfer Act. The new rules, which became effective on July 1, 2010, among other things, set limits on the ability of banks to provide deposit customers with overdraft protection on their deposit accounts, and to charge them overdraft fees for covered overdrafts, without the customer’s consent. We believe that these new laws and rules restricting interchange fees and overdraft fees are not likely to have a material adverse impact on our financial condition or results of operations in future periods. Our interchange fee percentage will not likely be materially reduced in upcoming periods, we believe, and debit card usage by our customers continues to grow. Moreover, we do not offer so-called “privilege”, “bounce” or similar automated overdraft protection programs of the sort that led to substantial increases in overdraft fee income at certain other banks and provided the impetus for the new consumer protection regulations restricting the use of such programs by banks.

Insurance commissions first became a significant source of noninterest income for us following our 2004 acquisition of an insurance agency, Capital Financial Group, Inc. Capital Financial specializes in selling and servicing group health care policies as well as life insurance. On April 1, 2010, we acquired a second insurance agency, Loomis & LaPann, Inc., which sells primarily property and casualty insurance to retail customers in our service area. In February of 2011, we acquired our third insurance agency, the Upstate Agency, which also specializes in property and casualty insurance to retail customers. Consequently, we expect that noninterest income from insurance commissions will continue to increase in upcoming periods as a result of our expansion of this line of business.

The volume of our sales of loan originations decreased after the second quarter of 2009 until the third quarter of 2010, when we began to resell most of our newly originated residential real estate loan originations into the secondary market (i.e., to Freddie Mac). Other operating income includes net gains on the sale of other real estate owned as well as other miscellaneous revenues. We are unable to predict at what rate we may continue to resell loan originations in future periods versus holding such loans and thereby augmenting our own portfolio. Much depends on the volume of originations, the rates attaching thereto, the ready availability of sales thereof into the secondary market and the pricing of such sales. We have generally retained servicing rights for loans originated and resold by us.

2009 compared to 2008: Total noninterest income increased $3.3 million 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 22: 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, 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.

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 to 2010		2008 to 2009	
	2010	2009	2008	Amount	%	Amount	%
Salaries and Employee Benefits	$27,552	$27,042	$24,551	$510	1.9%	$2,491	10.1%
Occupancy Expense of Premises, Net	3,456	3,316	3,479	140	4.2	(163)	(4.7)
Furniture and Equipment Expense	3,393	3,264	3,211	129	4.0	53	1.7
FDIC Special Assessment	---	787	---	(787)	(100.0)	787	100.0
FDIC Regular Assessment	1,982	1,987	853	(5)	(0.3)	1,134	132.9
VISA Related Litigation Exposure (Reversal)	---	---	(306)	---	---	306	100.0
Amortization	271	324	360	(53)	(16.4)	(36)	(10.0)
Other Operating Expense	10,764	9,872	10,245	892	9.0	(373)	(3.6)
Total Noninterest Expense	$47,418	$46,592	$42,393	$ 826	1.8	$4,199	9.9

27

2010 compared to 2009: Noninterest expense for 2010 amounted to $47.4 million, an increase of $826 thousand, or 1.8%, from 2009. 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 noninterest 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 2010, the efficiency ratio for Arrow was 57.28%, an increase from the 2009 ratio of 55.64%. 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, 2010. Our 2010 ratio, 57.61%, compared favorably to the ratio for our peer group of 69.87%. For information on the calculation of our efficiency ratios on a quarterly and annual basis, see pages 19 and 20 of this Report.

Salaries and employee benefits expense increased $510 thousand, or 1.9%, from 2009 to 2010. Salary expense increased $602 thousand, or 3.3%, from 2009, due primarily to staff increases from our acquisition of Loomis (7.9 FTE's) and to normal merit increases. Employee benefits actually decreased slightly from year to year due to a decrease in pension expenses resulting from an increase in the expected investment return on the pension plan assets. The ratio of total personnel expense (salaries and employee benefits) to average assets was 1.46% for 2010, 2 basis points lower than the annualized ratio for our peer group of 1.48% at December 31, 2010.

Occupancy expense increased $140 thousand, or 4.2%, from 2009 to 2010. The increase was primarily attributable to increase in building maintenance costs. Furniture and equipment expense increased by $129 thousand, or 4.0%, from 2009 to 2010. The increase was primarily attributable to increases in data processing expenses.

Changes in our FDIC insurance assessment and the 2009 FDIC special assessment were discussed earlier on page 10.

Other operating expense increased from 2009 to 2010, by $688 thousand, or 6.8%. The increase was spread across a variety of operating expenses, most notably, legal and professional fees, telephone and director fees.

2009 compared to 2008: Noninterest expense for 2009 amounted to $46.6 million, an increase of $4.2 million, or 9.9%, from 2008. For 2009, our efficiency ratio 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 76.92%. For information on the calculation of our efficiency ratios on a quarterly and annual basis, see pages 19 and 20 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, 7 basis points higher than the annualized ratio for our peer group of 1.47% 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 page 10.

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.

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			
				2009 to 2010		2008 to 2009	
	2010	2009	2008	Amount	%	Amount	%
Provision for Income Taxes	$9,754	$9,790	$8,999	$(36)	(0.4)%	$791	8.8%
Effective Tax Rate	30.8%	31.0%	30.6%	(0.2)%	(0.6)	0.4%	1.3

The provisions for federal and state income taxes amounted to $9.8 million for both 2001 and 2009 and $9.0 million for 2008, respectively. The effective income tax rates for 2010, 2009 and 2008 were 30.8%, 31.0% and 30.6%, respectively, with primary change in the effective rates reflecting changes in 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 2010, 2009 and 2008, 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 2010, 2009 and 2008.

SECURITIES AVAILABLE-FOR-SALE

(In Thousands)

	December 31,		
	2010	2009	2008
U.S. Agency Obligations	$ 98,173	$123,331	$ 11,528
State and Municipal Obligations	89,528	18,913	15,446
Collateralized Mortgage Obligations	166,964	199,781	185,830
Mortgage-Backed Securities - Residential	159,926	93,017	93,849
Corporate and Other Debt Securities	1,417	1,331	7,433
Mutual Funds and Equity Securities	1,356	1,333	1,328
Total	$517,364	$437,706	$315,414

In all periods, mortgage-backed securities – residential consisted solely of U.S. 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 23.

The following table sets forth the maturities of our debt securities available-for-sale portfolio as of December 31, 2010. CMOs and other mortgage-backed securities are included in the table based on their expected average lives.

MATURITIES OF DEBT 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. Agency Obligations	$60,146	$38,027	$ ---	$ ---	$ 98,173
State and Municipal Obligations	68,979	16,586	1,172	2,791	89,528
Collateralized Mortgage Obligations	13,981	129,397	23,586	---	166,964
Mortgage-Backed Securities - Residential	3,113	72,581	64,613	19,619	159,926
Corporate and Other Debt Securities	---	185	---	1,232	1,417
Total	$146,219	$256,776	$ 89,371	$23,642	$516,008

The following table sets forth the tax-equivalent yields of our securities available-for-sale portfolio at December 31, 2010.

YIELDS ON SECURITIES AVAILABLE-FOR-SALE

(Fully Tax-Equivalent Basis)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
U.S. Agency Obligations	1.63%	1.50%	---%	---%	1.58%
State and Municipal Obligations	1.34	2.29	6.01	7.54	1.77
Collateralized Mortgage Obligations	3.79	4.16	3.17	---	3.98
Mortgage-Backed Securities - Residential	4.21	3.24	2.79	4.22	3.19
Corporate and Other Debt Securities	---	1.00	---	2.94	2.71
Mutual Funds and Equity Securities	---	---	---	5.49	5.49
Total	1.75	3.37	2.93	4.54	2.88

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, 2010. Dividend earnings derived from equity securities were adjusted to reflect applicable federal income tax exclusions.

At December 31, 2010 and 2009, the weighted average maturity was 4.5 and 4.1 years, respectively, for debt securities in the available-for-sale portfolio.

At December 31, 2010, the net unrealized gains on securities available-for-sale amounted to $6.2 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 $5.2 million at December 31, 2009. 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, 2010	December 31, 2009	December 31, 2008
State and Municipal Obligations	$158,938	$167,931	$133,976
Corporate and Other Debt Securities	1,000	1,000	---
Total	$159,938	$168,931	$133,976

For information regarding the fair value of our portfolio of securities held-to-maturity at December 31, 2010, 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, 2010.

MATURITIES OF DEBT 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	$19,439	$63,379	$65,062	$11,058	$158,938
Corporate and Other Debt Securities	---	---	---	1,000	1,000
Total	$19,439	$63,379	$65,062	$12,058	$159,938

The following table sets forth the tax-equivalent yields of our portfolio of securities held-to-maturity at December 31, 2010.

YIELDS ON SECURITIES HELD-TO-MATURITY

(Fully Tax-Equivalent Basis)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
State and Municipal Obligations	4.61%	3.62%	5.45%	6.09%	4.66%
Corporate and Other Debt Securities	---	---	---	6.50	6.50
Total	4.61	3.62	5.45	6.12	4.67

30

The yields 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, 2010. 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 2010, 2009 and 2008, we sold no securities from the held-to-maturity portfolio nor were there any transfers to or from the portfolio. The weighted-average maturity of the held-to-maturity portfolio was 5.3 years at year-end for both December 31, 2010 and 2009.

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,									
	2010		2009		2008		2007		2006	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial	$ 97,621	8	$ 89,222	8	$ 86,872	8	$ 79,128	8	$ 79,581	8
Commercial Real Estate – Construction	7,090	1	15,336	1	22,525	2	30,305	3	25,708	3
Commercial Real Estate – Other	214,291	19	185,582	17	183,676	17	160,787	15	161,443	16
Consumer – Other	6,482	1	11,981	1	22,870	2	21,689	2	22,080	2
Consumer – Automobile	334,656	29	317,854	29	337,311	30	320,883	31	315,130	31
Residential Real Estate	485,368	42	492,175	44	456,558	41	426,052	41	405,057	40
Total Loans	1,145,508	100	1,112,150	100	1,109,812	100	1,038,844	100	1,008,999	100
Allowance for Loan Losses	(14,689)		(14,014)		(13,272)		(12,401)		(12,278)	
Total Loans, Net	$1,130,819		$1,098,136		$1,096,540		$1,026,443		$996,721	

Maintenance of High Quality in the Loan Portfolio: In the second half of 2008 and throughout most of 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 mid-2009, as real estate values continued to fall in most areas of the U.S., problems 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. In addition, in mid- to late-2009, commercial real estate values also began to decline and commercial real estate mortgage portfolios began to experience the same problems that previously beset residential mortgage portfolios. Although the erosion of residential and commercial property values has in many markets begun to level off in recent periods, the damage to asset portfolios remains a serious concern. Many lending institutions have suffered sizable charge-offs and losses in their loan and investment securities portfolios in the past two years as a result of their origination or investment in these kinds of loans or securities.

Through year-end 2010, we have not experienced a significant deterioration in our loan or investment portfolios, except for two impaired securities discussed earlier on page 23. 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 experienced to date significant deterioration in the real estate categories of our loan portfolio.

If, however, weakness persists or worsens in the U.S. or our regional economy, we may experience elevated charge-offs, higher provisions to our loan loss reserve, and increasing expense related to asset maintenance and supervision.

Residential Real Estate Loans: In recent years, residential real estate and home equity loans have represented the largest segment of our loan portfolio. In 2010, our gross originations for residential real estate loans exceeded $94 million, as compared to $91.9 million in 2009. During the last quarter of 2008 and the first two quarters of 2009, as prevailing mortgage rates began to decline again (due primarily to the fact that the government-supported entities (GSE), Fannie Mae and Freddie Mac, began to overwhelm the home mortgage market with their very low rate structured pricing models), we sold most of our mortgage originations in the secondary market. During the second half of 2009 and the first two quarters of 2010, for a variety of reasons, we once again began to retain newly originated residential real estate loans in our loan portfolio, selling only a relatively small portion of the originations to Freddie Mac (with further offsets as a result of normal principal amortization and prepayments on pre-existing loans). After April 2010, rates on conventional mortgages began to fall. The national average for April was 5.21%, reaching a low point with an average of 4.24% for the month of October. In response, we determined to sell most of our originations to Freddie Mac, amounting to $27.2 million for the last half of 2010. If the current GSE-subsidized low-rate environment for newly originated residential real estate loans persists, we may continue to elect to sell a higher portion of our loan originations and may even experience a decrease in our outstanding balances in this segment of our portfolio. Moreover, if our local economy or real estate market suffers further major downturns, 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.

31

Indirect Loans (primarily automobile loans): In the early post-2000 years, indirect loans (primarily automobile loans originated through dealerships located primarily in the eastern region of upstate New York) were the largest segment of our loan portfolio. For much of this period, these 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.

In the last quarter of 2007 and the first two quarters of 2008, we encountered enhanced rate competition on 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 these balances in the first two quarters of 2008. However, during the last two quarters of 2008, our share of the local indirect auto loan market increased as some of the major lenders in the indirect market pulled back, including the auto companies' financing affiliates. Our portfolio at December 31, 2008 exceeded the balance at December 31, 2007 by $19.5 million, or 5.7%. However, in 2009 our outstanding balances steadily declined from month to month and our ending balance at December 31, 2009 was $28.1 million, or 7.8%, below the 2008 year-end balance.

Nationally, automobile sales rose modestly, but steadily, during 2009 and 2010 (adjusting for the spike in sales in mid-2009 under the federally subsidized "cash for clunkers" program). Concurrently with the increased loan demand, we introduced more competitive financing rates in the second quarter of 2010 and as a result experienced some growth in this portfolio in both the second and third quarters of 2010, before declining again in the fourth quarter of 2010.

During 2010, the borrowers on the newly originated indirect loans had an average credit score at origination of over 757. Our experienced lending staff not only utilizes software tools but also reviews and evaluates each loan individually. We believe our disciplined approach to evaluating risk has contributed to maintaining our strong loan quality in this portfolio. Originations of indirect loans for 2009 were approximately $127.8 million, a decrease of $50.0 million, or 36.7%, from 2008. Originations for 2010 were approximately $176.7 million. These indirect loan originations represented an increase of $48.9 million, or 38.3%, over the originations for 2009.

At December 31, 2010, indirect loans represented the second largest category of loans in our portfolio and a significant component of our business. Net charge-offs for our consumer loans in 2010, which are primarily indirect car loans, were actually less than our net-charge offs for 2009. However, if weakness in auto demand persists, our portfolio is likely to experience limited, if any, overall growth, either in real terms or as a percentage of the total portfolio, regardless of whether the auto company affiliates continue or resume their offering of highly-subsidized vehicle loans. Such weakened demand for vehicle loans could negatively impact our financial performance.

Commercial, Commercial Real Estate and Construction and Land Development Loans: In recent years, we have experienced moderate to strong demand for commercial and commercial real estate loans. These loan balances have generally increased, both in dollar amount and as a percentage of the overall loan portfolio. However, in response to the 2008-2009 recession, demand began to ease in 2009 and our outstanding balances at the end of 2009 were essentially unchanged from year-end 2008. During the first three quarters of 2010, commercial loan balances increased by only $2.7 million, or 0.9%. Substantially all commercial and commercial real estate loans in our portfolio are extended to businesses or borrowers located in our regional market. Many of the loans in the commercial portfolio have variable rates tied to prime, FHLBNY or U.S. Treasury indices. We have not experienced any significant weakening in the quality of our commercial loan portfolio in recent quarters, although during that period on a national scale the commercial real estate market has begun to show signs of significant weakness. It is entirely possible that we may experience a reduction in the demand for such loans and/or a weakening in the quality of our commercial and commercial real estate loan portfolio in upcoming periods.

The following table indicates the changing mix in our loan portfolio by including the quarterly average balances for our significant loan products for the past five quarters. The remaining quarter-by-quarter tables present the percentage of total loans represented by each category and the annualized tax-equivalent yield of each category.

LOAN PORTFOLIO

Quarterly Average Loan Balances

(Dollars In Thousands)

	Quarter Ended				
	Dec 2010	Sep 2010	Jun 2010	Mar 2010	Dec 2009
Commercial and Commercial Real Estate	$ 311,855	$ 308,445	$ 307,853	$ 306,753	$ 306,781
Residential Real Estate	368,802	375,262	371,482	364,974	355,292
Home Equity	75,263	73,285	70,926	68,725	66,037
Indirect Consumer Loans	353,758	351,294	338,950	328,566	337,582
Other Consumer Loans[1]	38,211	39,910	41,427	42,586	43,803
Total Loans	$1,147,889	$1,148,196	$1,130,638	$1,111,604	$1,109,495

Percentage of Total Quarterly Average Loans

	Quarter Ended				
	Dec 2010	Sep 2010	Jun 2010	Mar 2010	Dec 2009
Commercial and Commercial Real Estate	27.2%	26.8%	27.2%	27.6%	27.6%
Residential Real Estate	32.1	32.7	32.9	32.8	32.0
Home Equity	6.6	6.4	6.3	6.2	6.0
Indirect Consumer Loans	30.8	30.6	30.0	29.6	30.4
Other Consumer Loans[1]	3.3	3.5	3.6	3.8	4.0
Total Loans	100.0%	100.0%	100.0%	100.0%	100.0%

Quarterly Tax-Equivalent Yield on Loans

	Quarter Ended				
	Dec 2010	Sep 2010	Jun 2010	Mar 2010	Dec 2009
Commercial and Commercial Real Estate	5.81%	5.92%	6.23%	6.23%	6.19%
Residential Real Estate	5.55	5.59	5.69	5.79	5.77
Home Equity	3.04	2.96	3.04	3.11	3.14
Indirect Consumer Loans	5.41	5.64	5.94	6.19	6.26
Other Consumer Loans[1]	7.06	7.17	7.16	7.24	7.24
Total Loans	5.46	5.58	5.80	5.92	5.94

[1] Other Consumer Loans includes certain home improvement loans secured by mortgages. However, these same loan balances are reported as

Residential Real Estate in the table of period-end balances on page 35, captioned "Types of Loans."

From the fourth quarter of 2009 to the fourth quarter of 2010, the average tax equivalent yield on our loan portfolio declined by 48 basis points, from 5.94% to 5.46%, due to falling interest rates generally and heightened competitive rate pressure on new commercial and commercial real estate loans as well as automobile loans. The yields on new 30 year fixed-rate residential real estate loans also fell during the period, but we did sell a significant portion of those originations to the secondary market, specifically, to Freddie Mac, as cited earlier. The continuing trend in recent quarters, that the yield on assets declined more rapidly than our cost of funds, was discussed in more detail on page 27 above in the section entitled "Impact of Interest Rate Changes."

In general, the yield (tax-equivalent interest income divided by average loans) on our loan portfolio and other earning assets is impacted by changes in prevailing interest rates. We expect that loan yields will continue to rise and fall with changes in prevailing market rates, although the timing and degree of responsiveness will continue to be influenced by a variety of other factors, including the extent of federal government and Federal Reserve participation in the home mortgage market, the makeup of our loan portfolio, the shape of the yield curve, consumer expectations and preferences and the rate at which the portfolio expands. Additionally, there is a significant amount of cash flow from normal amortization and prepayments in all loan categories, and this cash flow reprices at current rates as new loans are generated at the current yields.

As noted in the earlier discussion, during a period of change in prevailing rates, we generally experience a time lag between the impact of the change on our deposit portfolio (which is felt relatively quickly) and the impact of the change on our loan portfolio (which occurs more slowly). This time lag tends to have a positive impact on net interest margins during the beginning of a rate decline period and a negative impact on the margin at the beginning of a rate increase period. Conversely, the repricing time lag tends to have a negative impact on our margins when a rate decrease period matures (such has been the case in recent periods), and a positive impact on margins when a rate increase period matures.

At the present time, the prevailing expectation is that rates will remain at historically low levels for a protracted period of time, as a result of adopted and pursued strategies by the Federal Reserve Board. If and when rates do increase to more normal levels, however, the repricing lag between deposits and assets may be expected to have a short-term negative effect on our net interest income and earnings.

The following table indicates the respective maturities and interest rate structure of our commercial, financial and agricultural loans and real estate - construction loans at December 31, 2010. For purposes of determining relevant maturities, loans are assumed to mature at (but not before) their scheduled repayment dates as required by contractual terms. Demand loans and overdrafts are included in the "Within 1 Year" maturity category. Most of the real estate - construction loans are made with a commitment for permanent financing, whether extended by us or unrelated third parties. The maturity distribution below reflects the final maturity of the permanent financing.

b. Maturities and Sensitivities of Loans to Changes in Interest Rates

(In Thousands)

	Within 1 Year	After 1 But Within 5 Years	After 5 Years	Total
Commercial, Financial and Agricultural	$28,479	$61,909	$7,233	$ 97,621
Real Estate - Construction	2,503	3,334	1,253	7,090
Total	$30,982	$65,243	$8,486	$104,711
Fixed Interest Rates	$ 4,424	$36,996	$7,233	$ 48,653
Variable Interest Rates	26,558	28,247	1,253	56,058
Total	$30,982	$65,243	$8,486	$104,711

COMMITMENTS AND LINES OF CREDIT

Stand-by letters of credit represent extensions of credit granted in the normal course of business, which are not reflected in the financial statements at a given date because the commitments are not funded at that time. As of December 31, 2010, our total contingent liability for standby letters of credit amounted to $8.3 million. In addition to these instruments, we also have issued lines of credit to customers, including home equity lines of credit, commitments for residential and commercial construction loans and other personal and commercial lines of credit, which also may be unfunded or only partially funded from time-to-time. Commercial lines, generally issued for a period of one year, are usually extended to provide for the working capital requirements of the borrower. At December 31, 2010, we had outstanding unfunded loan commitments in the aggregate amount of approximately $191.5 million.

c. Risk Elements

1. Nonaccrual, Past Due and Restructured Loans

The amounts of nonaccrual, past due and restructured loans for the past five years are presented in the table on page 29 under the heading "Summary of the Allowance and Provision for Loan Losses."

We designate loans as nonaccrual when the payment of interest and/or principal is due and unpaid for a designated period (generally 90 days) or when the likelihood of the full repayment of principal and interest is, in the opinion of management, uncertain. Under the Uniform Retail Credit Classification and Account Management Policy established by banking regulators, fixed-maturity consumer loans must generally be charged-off no later than when 120 days past due. Loans secured with non-real estate collateral in the process of collection are charged-down to the value of the collateral, less cost to sell. Open-end credits, residential real estate loans and commercial loans are evaluated for charge-off on a loan-by-loan basis when placed on nonaccrual status. We had no material commitments to lend additional funds on outstanding nonaccrual loans at December 31, 2010. Loans past due 90 days or more and still accruing interest are those loans which were contractually past due 90 days or more but because of expected repayments, were still accruing interest.

The balance of loans 30-89 days past due totaled $8.6 million at December 31, 2010 and represented 0.73% of loans outstanding at that date, as compared to approximately $11.3 million, or 1.01% of loans at December 31, 2009. These non-current loans at December 31, 2010 were composed of approximately $5.1 million of consumer loans, principally indirect automobile loans, $2.1 million of residential real estate loans and $1.5 million of commercial loans.

All our impaired loans over $250 thousand are measured based on (i) the present value of expected future cash flows discounted at the loan's effective interest rate, (ii) the loan's observable market price or (iii) the fair value of the collateral, less cost to sell, if the loan is collateral dependent. We determine impairment for collateralized loans based on fair value of the collateral less estimated cost to sell. For other loans, impairment is determined by comparing the recorded value of the loan to the present value of the expected cash flows, discounted at the loan's effective interest rate. We determine the interest income recognition method for impaired loans on a loan-by-loan basis. Based upon the borrowers' payment histories and cash flow projections, interest recognition methods include full accrual or cash basis. Our method for measuring all other loans is described in detail in Note 4 to the consolidated financial statements.

During 2010, three commercial loans and one residential real estate loan over $250 thousand were considered impaired with an average recorded investment of $2.2 million. At year-end 2010, the balance of impaired loans consisted of four loans with a combined balance of $2.2 million which had no related reserve, since the fair value of the collateral exceed the carrying amount of the loans.

At December 31, 2010, nonperforming loans amounted to $4.9 million, an increase of $227 thousand from the balance at year-end 2009. Total nonperforming loans at year-end 2010 represented .43% of period-end loans, an increase from .42% at year-end 2009. By way of comparison, the ratio of nonperforming loans to average loans for our peer group at December 31, 2010 was 3.53%, up from 3.51% at December 31, 2009.

During 2010, income recognized on year-end balances of nonaccrual loans was $211 thousand. Income that would have been recognized during that period on nonaccrual loans, if such loans had been current in accordance with their original terms and had been outstanding throughout the period (or since origination if held for part of the period) was $314 thousand.

During 2009, three commercial loans over $250 thousand were considered impaired with an average recorded investment of $2.0 million. At year-end 2009, the balance of impaired loans consisted of three loans with a combined balance of $1.9 million which had no related reserve.

At December 31, 2009, nonperforming loans amounted to $4.7 million, an increase of $734 thousand from the balance at year-end 2008. Total nonperforming loans at year-end 2009 represented .42% of period-end loans, an increase from .35% at year-end 2008. By way of comparison, the ratio of nonperforming loans to average loans for our peer group at December 31, 2009 was 3.51%, up from 2.41% at December 31, 2008.

During 2009, income recognized on year-end balances of nonaccrual loans was $163 thousand. Income that would have been recognized during that period on nonaccrual loans, if such loans had been current in accordance with their original terms and had been outstanding throughout the period (or since origination if held for part of the period) was $357 thousand.

During 2008, four commercial loans over $250 thousand was considered impaired with an average recorded investment of $1.1 million. At year-end 2008, the balance of impaired loans consisted of that one loan with a balance of $2.2 million which had no related reserve.

At December 31, 2008, nonperforming loans amounted to $3.9 million, an increase of $1.7 million from the balance at year-end 2007. Total nonperforming loans at year-end 2008 represented .35% of period-end loans, a decrease from .21% at year-end 2007. The ratio of nonperforming loans to average loans for our peer group at December 31, 2008 was 2.41%, up from 1.08% at December 31, 2007.

During 2008, income recognized on year-end balances of nonaccrual loans was $208 thousand. Income that would have been recognized during that period on nonaccrual loans, if such loans had been current in accordance with their original terms and had been outstanding throughout the period (or since origination if held for part of the period) was $295 thousand.

2. Potential Problem Loans

On at least a quarterly basis, we apply an internal credit quality rating system to commercial loans that are either past due or fully performing but exhibit certain characteristics that could reflect a potential weakness. Loans are placed on nonaccrual status when the likely amount of future principal and interest payments are expected to be less than the contractual amounts, even if such loans are not 90 days past due.

Periodically we review the loan portfolio for evidence of potential problem loans. Potential problem loans are loans that are currently performing in accordance with contractual terms, but where known information about possible credit problems of the borrower causes doubt about the ability of the borrower to comply with the loan payment terms and may result in disclosure of such loans as nonperforming at some time in the future. Through our on-going credit monitoring, we consider loans which, in our internal classification system, are classified as substandard but continue to accrue interest to be potential problem loans. At December 31, 2010, we identified 99 commercial relationships totaling $27.5 million as potential problem loans. At December 31, 2009, we identified 54 commercial relationships totaling $35.0 million as potential problem loans. Factors such as payment history, value of supporting collateral, and personal or government guarantees led us to conclude that the current risk exposure on these loans did not warrant accounting for the loans as nonperforming. Although in a performing status as of year-end, these loans exhibited certain risk factors, which have the potential to cause them to become nonperforming at some point in the future.

The overall level of our performing loans that demonstrate characteristics of potential weakness from time-to-time is for the most part dependent on economic conditions in northeastern New York State, which in turn are impacted at least in part by economic conditions in the U.S. generally. On both the regional and national level, economic conditions are much weaker at present than was the case in the 2007 and earlier periods. If weak economic conditions persist, potential problems loans likely will increase.

3. Foreign Outstandings - None

4. Loan Concentrations

The loan portfolio is well diversified. There are no concentrations of credit that exceed 10% of the portfolio, other than the general categories reported in the preceding Section C.II.a. of this Item 7. For further discussion, see Note 24 to the Consolidated Financial Statements in Part II, Item 8 of this Report.

5. Other Real Estate Owned and Repossessed Assets

Other real estate owned ("OREO") consists of real property acquired in foreclosure. OREO is carried at the lower of (i) fair value less estimated cost to sell or (ii) the recorded investment in the loan at the date of foreclosure, or cost. We establish allowances for OREO losses, which are established and monitored on a property-by-property basis and reflect our ongoing estimate of the property's estimated fair value less costs to sell (when such amount is less than cost). For all periods, all OREO was held for sale. Repossessed assets for each of the five years in the table below consist of motor vehicles.

December 31,

Distribution of OREO and Repossessed Assets

(In Thousands)

	2010	2009	2008	2007	2006
Single Family 1 - 4 Units	$---	$53	$581	$ 89	$ 48
Commercial Real Estate	---	---	---	---	200
Other Real Estate Owned, Net	---	53	581	89	248
Repossessed Assets	58	59	64	63	144
Total OREO and Repossessed Assets	$58	$112	$645	$152	$392

The following table summarizes changes in the net carrying amount of OREO for each of the periods presented.

Schedule of Changes in OREO

(In Thousands)	2010	2009	2008	2007	2006
Balance at Beginning of Year	$53	$ 581	$ 89	$248	$ ---
Properties Acquired Through Foreclosure	---	54	581	115	248
Sales	(53)	(582)	(89)	(274)	---
Balance at End of Year	$ ---	$ 53	$581	$ 89	$248

There was no allowance for OREO losses at year-end 2010, 2009 or 2008. During 2010, we did not acquire any properties through foreclosure and we sold the one property remaining at the end of 2009. We started 2009 with four properties in OREO. During the year we acquired one in 2009 and sold all four properties in inventory at the beginning of the year. We started 2008 with one property in OREO. During the year we acquired four more and sold one, ending the year with four properties. We started 2007 with two properties in OREO. During the year we acquired two more and sold three, ending the year with just one property. We started 2006 with no properties in OREO. During the year we acquired two properties, which remained unsold at year-end.

III. SUMMARY OF LOAN LOSS EXPERIENCE

The information required in this section is presented in the discussion of the "Provision for Loan Losses and Allowance for Loan Losses" in Part II Item 7.B.II. beginning on page 29 of this Report, including:

.

Charge-offs and Recoveries by loan type

.

Factors that led to the amount of the Provision for Loan Losses

.

Allocation of the Allowance for Loan Losses by loan type

The percent of loans in each loan category is presented in the table of loan types in the preceding section on page 35 of this report.

IV. DEPOSITS

The following table sets forth the average balances of and average rates paid on deposits for the periods indicated.

AVERAGE DEPOSIT BALANCES

(Dollars In Thousands)

	Years Ended December 31,					
	2010		2009		2008	
	Average Balance	Rate	Average Balance	Rate	Average Balance	Rate
Demand Deposits	$ 205,497	---%	$ 191,504	---%	$ 189,999	---%
NOW Accounts	541,161	1.03	460,096	1.12	367,351	1.41
Savings Deposits	361,949	0.59	307,133	0.68	281,208	1.21
Time Deposits of $100,000 or More	133,770	2.17	155,378	2.39	172,055	3.25
Other Time Deposits	249,192	2.37	249,575	2.94	243,247	3.55
Total Deposits	$1,491,569	1.28	$1,363,686	1.34	$1,253,860	1.82

During 2010 average deposit balances increased by $127.9 million, or 9.4%, over the average for 2009. The increase was generated from our pre-existing branch network, although we did open a new branch in Queensbury, New York during the year.

During 2009 average deposit balances increased by $109.8 million, or 8.8%, over the average for 2008. The increase was generated from our pre-existing branch network.

During 2008 average deposit balances increased by $47.1 million, or 3.9%, over the average for 2007. The increase was generated from our pre-existing branch network.

We did not sell or close any branches during the covered period, 2008-2010. We did not hold any brokered deposits during 2010, 2009 and 2008.

The following table presents the quarterly average balance by deposit type for each of the most recent five quarters.

DEPOSIT PORTFOLIO

Quarterly Average Deposit Balances

(Dollars In Thousands)

	Quarter Ended				
	Dec 2010	Sep 2010	Jun 2010	Mar 2010	Dec 2009
Demand Deposits	$ 212,126	$ 217,017	$ 200,547	$ 191,950	$ 199,116
NOW Accounts	605,968	497,981	534,157	526,137	520,161
Savings Deposits	376,618	368,565	359,094	343,078	329,400
Time Deposits of $100,000 or More	124,284	130,471	133,737	146,874	155,588
Other Time Deposits	249,470	252,507	249,377	245,332	248,455
Total Deposits	$1,568,466	$1,466,541	$1,476,912	$1,453,371	$1,452,720

Fluctuations in balances of our NOW accounts and time deposits of $100,000 or more are largely the result of municipal deposit fluctuations. Municipal deposits on average represent 22% to 28% of our total deposits. Municipal deposits are typically placed in NOW accounts and time deposits of short duration. Many of our municipal deposit relationships are subject to annual renewal, by formal or informal agreements.

In general, there is a seasonal pattern to municipal deposits starting with a low point during July and August. Account balances tend to increase throughout the fall and into the winter months from tax deposits and receive an additional boost at the end of March from the electronic deposit of state funds. In addition to these seasonal fluctuations within types of accounts, the overall level of municipal deposit balances fluctuates from year-to-year as some municipalities move their accounts in and out of our banks due to competitive factors. Often, the balances of municipal deposits at the end of a quarter are not representative of the average balances for that quarter.

For a variety of reasons, including the seasonality of municipal deposits, we typically experience little net growth or a small contraction in average deposit balances in the first quarter of each calendar year, versus significant growth in the second and fourth quarters. Deposit balances followed this general pattern for 2010, enhanced by the addition of new municipal account relationships throughout the year. We also experienced growth in our non-municipal account balances, primarily in NOW accounts and money market savings accounts.

36

We typically experience a shift within the mix of deposit categories during periods of significant interest rate increases or decreases. During periods of falling rates, like the period from mid-2007 through the end of 2008, depositors tend to transfer maturing time deposits to nonmaturity interest-bearing deposit products. This continued during 2010. At December 31, 2010 time deposits represented 24.0% of total deposits, down from 27.8% at December 31, 2009. This compares to recent historical lows and highs for time deposits of 22.5% at June 30, 2004 and 40.8% at June 30, 2000. We expect this shift from time deposits to nonmaturity deposit products to continue if rates remain at their current low levels.

The total quarterly average balances as a percentage of total deposits are illustrated in the table below.

Percentage of Total Quarterly Average Deposits	Quarter Ended				
	Dec 2010	Sep 2010	Jun 2010	Mar 2010	Dec 2009
Demand Deposits	13.5%	14.8%	13.5%	13.2%	13.7%
NOW Accounts	38.7	34.0	36.2	36.2	35.8
Savings Deposits	24.0	25.1	24.3	23.6	22.7
Time Deposits of $100,000 or More	7.9	8.9	9.1	10.1	10.7
Other Time Deposits	15.9	17.2	16.9	16.9	17.1
Total Deposits	100.0%	100.0%	100.0%	100.0%	100.0%

Time deposits of $100,000 or more are to a large extent comprised of municipal deposits and are typically obtained on a competitive bid basis.

Quarterly Cost of Deposits	Quarter Ended				
	Dec 2010	Sep 2010	Jun 2010	Mar 2010	Dec 2010
Demand Deposits	---%	---%	---%	---%	---%
NOW Accounts	0.97	0.97	1.09	1.10	1.14
Savings Deposits	0.53	0.56	0.64	0.64	0.65
Time Deposits of $100,000 or More	2.31	2.24	2.18	1.98	2.09
Other Time Deposits	2.31	2.33	2.38	2.46	2.71
Total Deposits (Including Non-Interest-Bearing)	1.05	1.07	1.15	1.16	1.24

In general, rates paid by us on various types of deposit accounts are influenced by the rates being offered or paid by our competitors, which in turn are influenced by prevailing interest rates in the economy as impacted from time to time by the actions of the Federal Reserve Bank. There typically is a time lag between the Federal Reserve's actions undertaken to influence rates and the actual repricing of our deposit liabilities, although this lag is normally shorter than the lag between Federal Reserve rate actions and the repricing of our loans and other earning assets.

As demonstrated in the table above, we experienced a steady decrease in the cost of our deposits in each of the past 5 quarters following the period of falling interest rates from mid-2007 through the end of 2008. Although some maturing time deposits will continue to reprice at lower rates in forthcoming periods, the favorable reduction in the cost of deposits may not continue since most of our time deposits have already repriced to current rates and the rates on our nonmaturity deposit balances have already been reduced to (or nearly to) the lowest sustainable levels.

We do not use brokered deposits as a regular funding source and there were not any such balances carried during 2010, 2009 or 2008.

V. TIME DEPOSITS OF $100,000 OR MORE

The maturities of time deposits of $100,000 or more at December 31, 2010 are presented below. (In Thousands)

Maturing in:	
Under Three Months	$ 27,417
Three to Six Months	13,365
Six to Twelve Months	16,445
2012	31,468
2013	7,738
2014	18,134
2015	5,763
Total	$120,330

D. LIQUIDITY

Our liquidity is measured by our ability to raise cash when we need it at a reasonable cost. We must be capable of meeting expected and unexpected obligations to our customers at any time. Given the uncertain nature of customer demands as well as the need to maximize earnings, we must have available reasonably priced sources of funds, on- and off-balance sheet, that can be accessed quickly in time of need.

Overnight investments in federal funds sold, interest bearing bank balances at the Federal Reserve Bank, and cash flow from investment securities and loans, both from normal repayment cash-flows and prepayments, and the ability to quickly pledge marketable investment securities and loans to obtain funds, represent our primary sources of available liquidity. Certain investment securities are selected at purchase as available-for-sale based on their marketability and collateral value, as well as their yield and maturity. Our securities available-for-sale portfolio was $517.4 million at year-end 2010. Due to the volatility in market values, we are not able to assume that large quantities of such securities could be sold at short notice at their carrying value to provide needed liquidity. But, if market conditions are favorable resulting in unrealized gains in the available-for-sale portfolio, we may pursue modest sales of such securities conducted in an orderly fashion to provide needed liquidity.

In addition to liquidity from short-term investments, investment securities and loans, we have supplemented available liquidity with additional off-balance sheet sources such as federal funds lines of credit and credit lines with the Federal Home Loan Bank of New York ("FHLBNY"). We have established federal funds lines of credit with three correspondent banks totaling $30 million, but did not draw on those lines during 2010.

We participate in the Overnight Advance program with the FHLBNY, which allows for overnight advances up to the limit of pledged collateral, including mortgage-backed securities and loans. The amount available for overnight advances amounted to $51.8 million at December 31, 2010. During 2010, we used this facility for a short period. The average balance of these overnight advances was $398 thousand for 2010.

The balance in other short-term borrowings at December 31, 2010 consisted entirely of treasury, tax and loan balances at the Federal Reserve Bank of New York.

In addition, we have identified brokered certificates of deposit as an appropriate off-balance sheet source of funding accessible in a relatively short time period. Also, our two bank subsidiaries have each established a borrowing facility with the Federal Reserve Bank of New York, pledging certain consumer loans as collateral for potential "discount window" advances. At December 31, 2010, the amount available under this facility was $256.9 million, but there were no advances then outstanding. We measure and monitor our basic liquidity as a ratio of liquid assets to short-term liabilities, both with and without the availability of borrowing arrangements. Based on the level of overnight funds investments, available liquidity from our investment securities portfolio, cash flow from our loan portfolio, our stable core deposit base and our significant borrowing capacity, we believe that our liquidity is sufficient to meet any reasonably likely events or occurrences.

During the past several quarters, Arrow's liquidity position has been strong, as depositors and investors in the wholesale funding markets have shown no hesitations on placing or maintaining their funds with our banks. The financial markets have been challenging for many financial institutions, and in the view of many, lack of liquidity has been as great a problem as capital shortage. As a result, liquidity premiums have widened and many banks have experienced certain liquidity constraints, including substantially increased pricing to retain deposit balances. Because of Arrow's favorable credit quality and strong balance sheet, Arrow has not experienced any significant liquidity constraints through the end of 2010.

E. CAPITAL RESOURCES AND DIVIDENDS

Stockholders' equity was $152.3 million at December 31, 2010, an increase of $11.4 million, or 8.1%, from the prior year-end. The most significant positive changes to stockholders' equity included (a) net income of $21.9 million, (b) net unrealized gains in the valuation allowance for available-for-sale securities of $604 thousand, net of tax, (c) equity received from our various stock-based compensation plans of $3.5 million, offset, in part by (d) a net retirement plan losses reflected as a component of other comprehensive income of $387 thousand, (e) cash dividends of $11.0 million, and (f) purchases of our own common stock of $3.3 million.

In each of 2004 and 2003, we enhanced our regulatory capital by issuing $10 million of capital securities in private placements with institutional investors, utilizing a subsidiary Delaware business trust for that purpose. These trust preferred securities were reflected as “Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts” on our consolidated balance sheets as of December 31, 2010 and 2009. In the past, these securities were an attractive funding vehicle, although the current financial downturn has caused trust preferred securities to become less favored from both a market and regulatory perspective. Under the Federal Reserve’s current regulatory capital guidelines, trust preferred securities still qualify as Tier 1 capital, in an amount not to exceed 25% of Tier 1 capital, net of goodwill less any associated deferred tax liability. Both of our issues of trust preferred securities qualify in their entirety as Tier 1 regulatory capital. There is no current consideration, to our knowledge, that trust preferred securities will lose their status as Tier I capital under bank regulatory guidelines.

The maintenance of appropriate capital levels is a management priority. Overall capital adequacy is monitored on an ongoing basis by management and reviewed regularly by the Board of Directors. Our principal capital planning goal is to provide an adequate return to stockholders while retaining a sufficient base to provide for future expansion and comply with all regulatory standards.

Our continuing strong capital base and financial condition were key factors in our decision in January of 2009, to decline a capital investment by the U.S. Treasury under their CPP (see page 9).

One set of regulatory capital guidelines applicable to our holding company and subsidiary banks are the so-called risk-based capital measures. Under these measures, as established by federal bank regulators, the minimum ratio of "Tier 1" capital to risk-weighted assets is 4.0% and the minimum ratio of total capital to risk-weighted assets is 8.0%. For Arrow, Tier 1 capital is comprised of common stockholders' equity and the trust preferred securities issued by our two unconsolidated subsidiaries (see the second previous paragraph), less intangible assets. Total capital for the risk-based capital guidelines includes Tier 1 capital plus other qualifying regulatory capital, including a portion of our allowance for loan losses.

In addition to the risk-based capital measures, the federal bank regulatory agencies require banks and bank holding companies to satisfy another capital guideline, the Tier 1 leverage ratio (Tier 1 capital to quarterly average assets less intangible assets). The minimum Tier 1 leverage ratio is 3.0% for the most highly rated institutions. The guidelines provide that other institutions should maintain a Tier 1 leverage ratio that is at least 1.0% to 2.0% higher than the 3.0% minimum level for top-rated institutions.

The table below sets forth the capital ratios of our holding company and subsidiary banks, Glens Falls National and Saratoga National, as of December 31, 2010:

Capital Ratios:	Arrow	GFNB	SNB
Tier 1 Leverage Ratio	8.5%	8.3%	8.9%
Tier 1 Risk-Based Capital Ratio	14.4	14.3	14.3
Total Risk-Based Capital Ratio	15.7	15.5	15.5

At December 31, 2010 our holding company and both banks exceeded the minimum capital ratios established by the regulatory guidelines, and qualified as "well-capitalized", the highest category, in the capital classification scheme set by federal bank regulatory agencies (see the further discussion under "Supervision and Regulation" in Part I Item 1.C. of this Report).

Although there is considerable current speculation in banking and financial circles that bank regulatory capital guidelines will likely be adjusted in forthcoming periods so as to require a greater degree of capital protection against sudden financial stress within banks, there is no consensus on what these enhanced capital standards will look like or over what period they will be imposed on the banking section.

The source of funds for the payment of stockholder dividends by our holding company consists primarily of dividends declared and paid to the holding company by our bank subsidiaries. In addition to regulatory constrictions on payments of dividends, there are statutory limitations applicable to the payment of dividends by our bank subsidiaries. As of December 31, 2010, under this statutory limitation, the maximum amount that could have been paid by the bank subsidiaries to the holding company, without special regulatory approval, was approximately $27.8 million. The ability of our holding company and our banks to pay dividends in the future is and will continue to be influenced by regulatory policies, capital guidelines and applicable laws.

See Part II, Item 5, "Market for the Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities" for a recent history of our cash dividend payments.

F. OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of operations, we may engage in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements, or are recorded in amounts that differ from the notional amounts. These transactions involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions may be used by us for general corporate purposes or for customer needs. Corporate purpose transactions may be used to help manage credit, interest rate, and liquidity risk or to optimize capital. Customer transactions may be used to manage customers' requests for funding.

We have no off-balance sheet arrangements that are reasonably likely to have a material current or future effect on our financial condition, revenues or expenses, results of operations, liquidity or capital expenditures.

G. CONTRACTUAL OBLIGATIONS (In Thousands)

		Payments Due by Period			
		Less Than			More Than 5
Contractual Obligation	Total	1 Year	1-3 Years	3-5 Years	Years
Long-Term Debt Obligations:					
Federal Home Loan Bank Advances[1]	$130,000	$60,000	$60,000	$10,000	$ ---
Junior Subordinated Obligations					
Issued to Unconsolidated					
Subsidiary Trusts[2]	20,000	---	---	---	20,000
Operating Lease Obligations[3]	2,813	380	777	781	875
Obligations under Retirement Plans[4]	31,335	2,761	5,964	6,414	16,196
Total	$184,148	$63,141	$66,741	$17,195	$37,071

[1] See Note 10 to the Consolidated Financial Statements in Item 8 of this Report for additional information on Federal Home Loan Bank Advances, including call provisions.

[2] See Note 11 to the Consolidated Financial Statements in Item 8 of this Report for additional information on Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts (trust preferred securities).

[3] See Note 20 to the Consolidated Financial Statements in Item 8 of this Report for additional information on our Operating Lease Obligations.

[4] See Note 15 to the Consolidated Financial Statements in Item 8 of this Report for additional information on our Retirement Plans.

H. FOURTH QUARTER RESULTS

We reported net income of $5.2 million for the fourth quarter of 2010, an increase of $71 thousand, or 1.4%, from the fourth quarter of 2009. Diluted earnings per common share for the fourth quarter of 2010 were $.46, an increase of $.01, or 2.2%, from the $.45 amount for the fourth quarter of 2009. The net change in earnings was primarily affected by the following: (a) a $860 thousand decrease in tax-equivalent net interest income, (b) a $933 thousand increase in noninterest income, (c) a $258 thousand decrease in the provision for loan losses, (d) a $71 thousand increase in noninterest expense, and (iii) a $145 thousand increase in the provision for income taxes. The factors contributing to these quarter-to-quarter changes are included in the discussion of the year-to-year changes elsewhere in this Report.

SELECTED FOURTH QUARTER FINANCIAL INFORMATION

(Dollars In Thousands, Except Per Share Amounts)

	For the Quarters Ended December 31,	
	2010	2009
Interest and Dividend Income	$20,646	$22,169
Interest Expense	5,903	6,522
Net Interest Income	14,743	15,647
Provision for Loan Losses	177	435
Net Interest Income after Provision for Loan Losses	14,566	15,212
Noninterest Income	4,738	3,805
Noninterest Expense	11,770	11,699
Income Before Provision for Income Taxes	7,534	7,318
Provision for Income Taxes	2,346	2,201
Net Income	$ 5,188	$ 5,117
SHARE AND PER SHARE DATA:		
Weighted Average Number of Shares Outstanding:		
Basic	11,239	11,238
Diluted	11,292	11,288
Basic Earnings Per Common Share	$.46	$.46
Diluted Earnings Per Common Share	.46	.45
Cash Dividends Per Common Share	.25	.24
AVERAGE BALANCES:		
Assets	$1,970,085	$1,856,176
Earning Assets	1,884,402	1,781,464
Loans	1,147,889	1,109,496
Deposits	1,568,466	1,452,720
Stockholders' Equity	154,677	140,786
SELECTED RATIOS (Annualized):		
Return on Average Assets	1.04%	1.09%
Return on Average Equity	13.31%	14.42%

Net Interest Margin [1]	3.30%	3.68%
Net Charge-offs to Average Loans	.04%	.09%
Provision for Loan Losses to Average Loans	.06%	.16%

[1]Net Interest Margin is the ratio of tax-equivalent net interest income to average earning assets. (See "Use of Non-GAAP Financial Measures" on page 4).

40

SUMMARY OF QUARTERLY FINANCIAL DATA (Unaudited)

The following quarterly financial information for 2010 and 2009 is unaudited, but, in the opinion of management, fairly presents the results of Arrow.

SELECTED QUARTERLY FINANCIAL DATA

(In Thousands, Except Per Share Amounts)

	2010			
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
Total Interest and Dividend Income	**$21,651**	**$21,678**	**$20,997**	**$20,646**
Net Interest Income	**15,711**	**15,655**	**15,168**	**14,743**
Provision for Loan Losses	**375**	**375**	**375**	**177**
Net Securities Gains	**---**	**878**	**618**	**11**
Income Before Provision for Income Taxes	**7,814**	**8,306**	**7,992**	**7,534**
Net Income	**5,415**	**5,714**	**5,575**	**5,188**
Basic Earnings Per Common Share	**$.48**	**$ .51**	**$.50**	**$ .46**
Diluted Earnings Per Common Share	**.48**	**.50**	**.50**	**.46**

	2009			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total Interest and Dividend Income	$21,523	$21,501	$21,664	$22,169
Net Interest Income	14,731	14,785	15,202	15,647
Provision for Loan Losses	502	419	427	435
Net Securities Gains	277	4	48	28
Income Before Provision for Income Taxes	9,823	7,091	7,350	7,318
Net Income	6,682	4,931	5,062	5,117
Basic Earnings Per Common Share	$.60	$ .44	$.45	$ .46
Diluted Earnings Per Common Share	.59	.44	.45	.45

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

In addition to credit risk in our loan portfolio and liquidity risk, discussed earlier, our business activities also generate market risk. Market risk is the possibility that changes in future market rates (interest rates) or prices (fees for products and services) will make our position less valuable. The ongoing monitoring and management of interest rate and market risk is an important component of our asset/liability management process, which is governed by policies that are reviewed and approved annually by the Board of Directors. The Board of Directors delegates responsibility for carrying out asset/liability oversight and control to management's Asset/Liability Committee ("ALCO"). In this capacity ALCO develops guidelines and strategies impacting our asset/liability profile based upon estimated market risk sensitivity, policy limits and overall market interest rate levels and trends. We have not made use of derivatives, such as interest rate swaps, in our risk management process.

Interest rate risk is the most significant market risk affecting us. Interest rate risk is the exposure of our net interest income to changes in interest rates. Interest rate risk is directly related to the different maturities and repricing characteristics of interest-bearing assets and liabilities, as well as to the risk of prepayment of loans and early withdrawal of time deposits, and the fact that the speed and magnitude of responses to interest rate changes varies by product.

The ALCO utilizes the results of a detailed and dynamic simulation model to quantify the estimated exposure of net interest income to sustained interest rate changes. While ALCO routinely monitors simulated net interest income sensitivity over a rolling two-year horizon, it also utilizes additional tools to monitor potential longer-term interest rate risk.

The simulation model attempts to capture the impact of changing interest rates on the interest income received and interest expense paid on all interest-sensitive assets and liabilities reflected on our consolidated balance sheet. This sensitivity analysis is compared to ALCO policy limits which specify a maximum tolerance level for net interest income exposure over a one year horizon, assuming no balance sheet growth and a 200 basis point upward and a 100 basis point downward shift in interest rates, and a repricing of interest-bearing assets and liabilities at their earliest reasonably predictable repricing date. We normally apply a parallel and pro rata shift in rates over a 12 month period. However, at year-end 2010 the targeted federal funds rate was a range of 0 to .25%. For the decreasing rate simulation we applied a 100 basis point downward shift in interest rates for the long end of the yield curve with short-term rate decreases limited at zero.

Applying the simulation model analysis as of December 31, 2010, a 200 basis point increase in interest rates demonstrated a 0.1% increase in net interest income, and a 100 basis point decrease in interest rates demonstrated a 1.0% decrease in net interest income. These amounts were well within our ALCO policy limits. Historically there has existed an inverse relationship between changes in prevailing rates and our net interest income, reflecting the fact that our liabilities and sources of funds generally reprice more quickly than our earning assets.

The preceding sensitivity analysis does not represent a forecast on our part and should not be relied upon as being indicative of expected operating results. As noted elsewhere in this Report, the Federal Reserve Board took certain actions from September 2007 through December 2008 that resulted in a 500 basis point decrease in prevailing rates. We believe that decreases in prevailing interest rates will generally have a short-term positive impact on our net interest margin and net interest income, which would be mitigated or perhaps reversed over the mid- to longer-term.

We believe that increases in prevailing rates will generally have a negative impact on our margin and net interest income in the short-term, which would be mitigated or perhaps reversed over the long-term. In each case, that is, in the case of increasing or decreasing rates, the slope of the yield curve and changes in the slope of the yield curve will also affect net interest income and the net interest margin. We are not able to predict with certainty what the magnitude of these effects would be.

The hypothetical estimates underlying the sensitivity analysis are based upon numerous assumptions including: the nature and timing of changes in interest rates including yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment/replacement of asset and liability cash flows, and others. While assumptions are developed based upon current economic and local market conditions, we cannot make any assurance as to the predictive nature of these assumptions including how customer preferences or competitor influences might change.

Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will differ due to: prepayment/refinancing levels likely deviating from those assumed, the varying impact of interest rate changes on caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, unanticipated shifts in the yield curve and other internal/external variables. Furthermore, the sensitivity analysis does not reflect actions that ALCO might take in responding to or anticipating changes in interest rates.

Item 8. Financial Statements and Supplementary Data

The following audited consolidated financial statements and unaudited supplementary data are submitted herewith:

Reports of Independent Registered Public Accounting Firm

Financial Statements:

Consolidated Balance Sheets

as of December 31, 2010 and 2009

Consolidated Statements of Income

for the Years Ended December 31, 2010, 2009 and 2008

Consolidated Statements of Changes in Stockholders' Equity

for the Years Ended December 31, 2010, 2009 and 2008

Consolidated Statements of Cash Flows

for the Years Ended December 31, 2010, 2009 and 2008

Notes to Consolidated Financial Statements

Supplementary Data: (Unaudited)

Summary of Quarterly Financial Data for the Years Ended December 31, 2010 and 2009

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Arrow Financial Corporation:

We have audited the accompanying consolidated balance sheets of Arrow Financial Corporation and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Arrow Financial Corporation and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 8, 2011, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Albany, New York

March 8, 2011

42

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Arrow Financial Corporation:

We have audited Arrow Financial Corporation and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, Arrow Financial Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control—Integrated

Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Arrow Financial Corporation and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2010, and our report dated March 8, 2011 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Albany, New York

March 8, 2011

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

	December 31, 2010	December 31, 2009
ASSETS		
Cash and Due from Banks	$ 25,961	$ 44,386
Interest-Bearing Deposits at Banks	5,118	22,730
Investment Securities:		
Available-for-Sale	517,364	437,706
Held-to-Maturity (Approximate Fair Value of $162,713 in 2010 and $171,183 in 2009)	159,938	168,931
Other Investments	8,602	8,935
Loans	1,145,508	1,112,150
Allowance for Loan Losses	(14,689)	(14,014)
Net Loans	1,130,819	1,098,136
Premises and Equipment, Net	18,836	18,756
Other Real Estate and Repossessed Assets, Net	58	112
Goodwill	15,783	15,269
Other Intangible Assets, Net	1,458	1,443
Accrued Interest Receivable	6,512	7,115
Other Assets	17,887	18,108
Total Assets	$1,908,336	$1,841,627
LIABILITIES		
Noninterest-Bearing Deposits	$ 214,393	$ 198,025
NOW Accounts	569,076	516,269
Savings Deposits	382,130	336,271
Time Deposits of $100,000 or More	120,330	148,511
Other Time Deposits	248,075	244,490
Total Deposits	1,534,004	1,443,566
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	51,581	72,020
Other Short-Term Borrowings	1,633	1,888
Federal Home Loan Bank Advances	130,000	140,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000
Accrued Interest Payable	1,957	2,257
Other Liabilities	16,902	21,078
Total Liabilities	1,756,077	1,700,809
STOCKHOLDERS' EQUITY		
Preferred Stock, $5 Par Value; 1,000,000 Shares Authorized	---	---

Common Stock, $1 Par Value; 20,000,000 Shares Authorized		
(15,625,512 Shares Issued at December 31, 2010 and		
15,170,399 Shares Issued at December 31, 2009)	15,626	15,170
Additional Paid-in Capital	191,068	178,192
Retained Earnings	24,577	24,100
Unallocated ESOP Shares (132,296 Shares at December 31, 2010 and 105,167 Shares at December 31, 2009)	(2,876)	(2,204)
Accumulated Other Comprehensive Loss	(6,423)	(6,640)
Treasury Stock, at Cost (4,237,435 Shares at December 31, 2010 and 4,147,811 Shares at December 31, 2009)	(69,713)	(67,800)
Total Stockholders' Equity	152,259	140,818
Total Liabilities and Stockholders' Equity	$1,908,336	$1,841,627

See Notes to Consolidated Financial Statements.

44

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In Thousands, Except Per Share Amounts)

	Years Ended December 31,		
	2010	2009	2008
INTEREST AND DIVIDEND INCOME			
Interest and Fees on Loans	$64,283	$66,427	$67,638
Interest on Deposits at Banks	157	149	57
Interest on Federal Funds Sold	---	---	464
Interest and Dividends on Investment Securities:			
Fully Taxable	14,701	14,739	16,164
Exempt from Federal Taxes	5,831	5,542	5,185
Total Interest and Dividend Income	84,972	86,857	89,508
INTEREST EXPENSE			
NOW Accounts	5,582	5,172	5,173
Savings Deposits	2,136	2,101	3,398
Time Deposits of $100,000 or More	2,903	3,718	5,591
Other Time Deposits	5,900	7,331	8,628
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	124	129	779
Other Short-Term Borrowings	---	---	10
Federal Home Loan Bank Advances	6,458	7,340	7,462
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	592	701	1,236
Total Interest Expense	23,695	26,492	32,277
NET INTEREST INCOME	61,277	60,365	57,231
Provision for Loan Losses	1,302	1,783	1,671
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	59,975	58,582	55,560
NONINTEREST INCOME			
Income from Fiduciary Activities	5,391	5,009	5,463
Fees for Other Services to Customers	7,864	8,051	8,562
Insurance Commissions	2,987	2,412	2,066
Net Gains on Securities Transactions	1,507	357	383
Net Gains on Sale of Loans	1,024	418	106
Other-Than-Temporary Impairment on Investment Securities	---	(375)	(1,610)
Net Gain on Sale of Merchant Bank Card Processing	---	2,966	---
Gain on Visa Stock Redemption	---	---	749
Gain on Sale of Premises	---	---	115
Other Operating Income	316	754	435
Total Noninterest Income	19,089	19,592	16,269
NONINTEREST EXPENSE			
Salaries and Employee Benefits	27,552	27,042	24,551
Occupancy Expense, Net	6,849	6,580	6,690
FDIC Assessments	1,982	2,774	853
Other Operating Expense	11,035	10,196	10,299
Total Noninterest Expense	47,418	46,592	42,393

INCOME BEFORE PROVISION FOR INCOME TAXES	31,646	31,582	29,436
Provision for Income Taxes	9,754	9,790	8,999
NET INCOME	$21,892	$21,792	$20,437
Average Shares Outstanding:			
Basic	11,266	11,231	11,208
Diluted	11,300	11,281	11,269
Per Common Share:			
Basic Earnings	$ 1.94	$ 1.94	$ 1.82
Diluted Earnings	1.94	1.93	1.81

Share and Per Share Amounts have been restated for the September 2010 3% stock dividend.

See Notes to Consolidated Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In Thousands, Except Share and Per Share Amounts)

	Common Shares Issued	Common Stock	Surplus	Retained Earnings	Unallo-cated ESOP Shares	Accumulated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2007	14,728,543	$14,729	$161,476	$15,347	$(2,042)	$(4,890)	$(62,364)	$122,256
Comprehensive Income, Net of Tax:								
Net Income	---	---	---	20,437	---	---	---	20,437
Net Unrealized Securities Holding Gains Arising During the Period, Net of Tax (Pre-tax $2,860)	---	---	---	---	---	1,727	---	1,727
Reclassification Adjustment for Net Securities Gains Included in Net Income, Net of Tax (Pre-tax $383)	---	---	---	---	---	(230)	---	(230)
Reclassification Adjustment for Other-Than-Temporary Impairment, Net of Tax (Pre-tax $1,610)	---	---	---	---	---	972	---	972
Net Retirement Plan Loss (Pre-tax $11,471)	---	---	---	---	---	(6,928)	---	(6,928)
Net Retirement Plan Prior Service Cost	---	---	---	---	---	(202)	---	(202)

(Pre-tax $336)								
Amortization of Net Retirement Plan Actuarial Loss (Pre-tax $443)	---	---	---	---	---	268	---	268
Accretion of Net Retirement Plan Prior Service Credit (Pre-tax $200)	---	---	---	---	---	(121)	---	(121)
Other Comprehensive Loss								(4,514)
Comprehensive Income								15,923
Cash Dividends Paid, $.92 per Share [1]	---	---	---	(10,330)	---	---	---	(10,330)
Stock Options Exercised (79,823 Shares)	---	---	503	---	---	---	673	1,176
Shares Issued Under the Directors' Stock Plan (5,185 Shares)	---	---	78	---	---	---	43	121
Shares Issued Under the Employee Stock Purchase Plan (19,286 Shares)	---	---	266	---	---	---	162	428
Shares Issued for Dividend Reinvestment Plans (17,568 Shares)	---	---	282	---	---	---	148	430
Stock-Based Compensation Expense	---	---	115	---	---	---	---	115
Tax Benefit for Disposition of Stock Options	---	---	176	---	---	---	---	176
Purchase of Treasury Stock (195,801 Shares)	---	---	---	---	---	---	(4,325)	(4,325)
Acquisition of Subsidiary (5,129 Shares)	---	---	69	---	---	---	43	112
Acquisition of Shares by ESOP (43,262 Shares)	---	---	---	---	(1,000)	---	---	(1,000)
Allocation of ESOP Stock (30,940 Shares)	---	---	250	---	470	---	---	720

Balance at December 31, 2008	14,728,543	$14,729	$163,215	$25,454	$(2,572)	$(9,404)	$(65,620)	$125,802

(Continued on Next Page)

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY, Continued

(In Thousands, Except Share and Per Share Amounts)

	Common Shares Issued	Common Stock	Surplus	Retained Earnings	Unallo-cated ESOP Shares	Accumulated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2008	14,728,543	$14,729	$163,215	$25,454	$(2,572)	$(9,404)	$(65,620)	$125,802
Comprehensive Income, Net of Tax:								
Net Income	---	---	---	21,792	---	---	---	21,792
Net Unrealized Securities Holding Gains Arising During the Period, Net of Tax (Pre-tax $1,172)	---	---	---	---	---	707	---	707
Reclassification Adjustment for Net Securities Gains Included in Net Income, Net of Tax (Pre-tax $357)	---	---	---	---	---	(215)	---	(215)
Reclassification Adjustment for Other-Than-Temporary Impairment, Net of Tax (Pre-tax $375)	---	---	---	---	---	226	---	226
Net Retirement Plan Gain (Pre-tax $2,456)	---	---	---	---	---	1,483	---	1,483
Net Retirement Plan Prior Service Cost	---	---	---	---	---	(155)	---	(155)

(Pre-tax $257)								
Amortization of Net Retirement Plan Actuarial Loss (Pre-tax $1,370)	---	---	---	---	---	827	---	827
Accretion of Net Retirement Plan Prior Service Credit (Pre-tax $181)	---	---	---	---	---	(109)	---	(109)
Other Comprehensive Income								2,764
Comprehensive Income								24,556
3% Stock Dividend [2]	441,856	441	12,065	(12,506)	---	---	---	---
Cash Dividends Paid, $.95 per Share	---	---	---	(10,640)	---	---	---	(10,640)
Stock Options Exercised (73,797 Shares)	---	---	545	---	---	---	633	1,178
Shares Issued Under the Directors' Stock Plan (4,603 Shares)	---	---	76	---	---	---	40	116
Shares Issued Under the Employee Stock Purchase Plan (19,055 Shares)	---	---	302	---	---	---	164	466
Shares Issued for Dividend Reinvestment Plans (66,924 Shares)	---	---	1,083	---	---	---	575	1,658
Stock-Based Compensation Expense	---	---	189	---	---	---	---	189
Tax Benefit for Disposition of Stock Options	---	---	193	---	---	---	---	193
Purchase of Treasury Stock (151,078 Shares)	---	---	---	---	---	---	(3,761)	(3,761)
Acquisition of Subsidiary (19,938 Shares)	---	---	373	---	---	---	169	542
Allocation of ESOP Stock (20,103 Shares)	---	---	151	---	368	---	---	519
Balance at December 31, 2009	15,170,399	$15,170	$178,192	$24,100	$(2,204)	$(6,640)	$(67,800)	$140,818

(Continued on Next Page)

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY, Continued

(In Thousands, Except Share and Per Share Amounts)

	Common Shares Issued	Common Stock	Surplus	Retained Earnings	Unallo-cated ESOP Shares	Accumulated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2009	15,170,399	$15,170	$178,192	$24,100	$(2,204)	$(6,640)	$(67,800)	$140,818
Comprehensive Income, Net of Tax:								
Net Income	---	---	---	21,892	---	---	---	21,892
Net Unrealized Securities Holding Gains Arising During the Period, Net of Tax (Pre-tax $2,507)	---	---	---	---	---	1,514	---	1,514
Reclassification Adjustment for Net Securities Gains Included in Net Income, Net of Tax (Pre-tax $1,507)	---	---	---	---	---	(910)	---	(910)
Net Retirement Plan Loss (Pre-tax $1,811)	---	---	---	---	---	(1,093)	---	(1,093)
Net Retirement Plan Prior Service Credit (Pre-tax $242)	---	---	---	---	---	146	---	146
Amortization of Net Retirement Plan Actuarial Loss (Pre-tax $1,112)	---	---	---	---	---	672	---	672

Accretion of Net Retirement Plan Prior Service Credit (Pre-tax $186)	---	---	---	---	---	(112)	---	(112)
Other Comprehensive Income								217
Comprehensive Income								22,109
3% Stock Dividend [2]	455,113	456	9,962	(10,418)	---	---	---	---
Cash Dividends Paid, $.98 per Share	---	---	---	(10,997)	---	---	---	(10,997)
Stock Options Exercised (52,662 Shares)	---	---	352	---	---	---	446	798
Shares Issued Under the Directors' Stock Plan (5,587 Shares)	---	---	101	---	---	---	48	149
Shares Issued Under the Employee Stock Purchase Plan (19,564 Shares)	---	---	310	---	---	---	165	475
Shares Issued for Dividend Reinvestment Plans (66,177 Shares)	---	---	1,163	---	---	---	552	1,715
Stock-Based Compensation Expense	---	---	299	---	---	---	---	299
Tax Benefit for Disposition of Stock Options	---	---	105	---	---	---	---	105
Purchase of Treasury Stock (135,812 Shares)	---	---	---	---	---	---	(3,347)	(3,347)
Acquisition of Subsidiary (26,240 Shares)	---	---	459	---	---	---	223	682
Acquisition by ESOP of Arrow Stock (40,890 Shares)	---	---	---	---	(1,000)	---	---	(1,000)
	---	---	125	---	328	---	---	453

Allocation of ESOP Stock (17,616 Shares)								
Balance at December 31, 2010	15,625,512	$15,626	$191,068	$24,577	$(2,876)	$(6,423)	$(69,713)	$152,259

1 Cash dividends paid per share have been adjusted for the September 2010 3% stock dividend.

2 Included in the shares issued for the 3% stock dividend in 2010 were treasury shares of 124,042 and unallocated ESOP shares of 3,855.

See Notes to Consolidated Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in Thousands)

	Years Ended December 31,		
Cash Flows from Operating Activities:	2010	2009	2008
Net Income	$21,892	$21,792	$20,437
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Provision for Loan Losses	1,302	1,783	1,671
Depreciation and Amortization	3,563	2,813	2,571
Compensation Expense for Allocated ESOP Shares	125	151	250
Gains on the Sale of Securities Available-for-Sale	(1,507)	(550)	(422)
Losses on the Sale of Securities Available-for-Sale	---	193	39
Other-Than-Temporary Impairment	---	375	1,610
Loans Originated and Held-for-Sale	(41,030)	(24,490)	(2,311)
Proceeds from the Sale of Loans Held-for-Sale	31,760	24,908	6,830
Net Gains on the Sale of Loans	(1,024)	(418)	(106)
Net Loss (Gains) on the Sale of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	10	(2)	(133)
Contributions to Pension Plans	(1,813)	(2,304)	(6,810)
Deferred Income Tax Expense	154	705	2,203
Shares Issued Under the Directors' Stock Plan	149	116	121
Stock-Based Compensation Expense	299	189	115
Net Decrease (Increase) in Other Assets	638	(5,672)	(374)
Net Decrease in Other Liabilities	(4,627)	(625)	(96)
Net Cash Provided By Operating Activities	9,891	18,964	25,595
Cash Flows from Investing Activities:			
Proceeds from the Sale of Securities Available-for-Sale	25,497	23,979	29,079
Proceeds from the Maturities and Calls of Securities Available-for-Sale	278,804	112,401	106,671
Purchases of Securities Available-for-Sale	(382,614)	(258,026)	(120,234)
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	15,227	26,772	21,944
Purchases of Securities Held-to-Maturity	(6,532)	(61,965)	(41,493)
Net Increase in Loans	(24,259)	(4,062)	(77,333)
Proceeds from the Sales of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	612	1,299	1,164
Purchase of Premises and Equipment	(1,081)	(2,501)	(2,469)
Acquisition of Subsidiary	264	---	---
Net Decrease in Other Investments	333	---	---
Net Cash Used In Investing Activities	(93,749)	(162,103)	(82,671)
Cash Flows from Financing Activities:			
Net Increase in Deposits	90,438	168,503	70,863
Net (Decrease) Increase in Short-Term Borrowings	(20,694)	13,952	6,237
Federal Home Loan Bank Advances	10,000	---	---

Federal Home Loan Bank Repayments	(20,000)	(20,000)	---
Purchase of Treasury Stock	(3,347)	(3,761)	(4,325)
Stock Options Exercised	798	1,178	1,176
Shares Issued Under the Employee Stock Purchase Plan	475	466	428
Tax Benefit from Exercise of Stock Options	105	193	176
Treasury Stock Issued for Dividend Reinvestment Plans	1,715	1,658	430
Acquisition of Unallocated Common Stock by the ESOP	(1,000)	---	(1,000)
Allocation of Common Stock Purchased by the ESOP	328	368	470
Cash Dividends Paid	(10,997)	(10,640)	(10,330)
Net Cash Provided By Financing Activities	47,821	151,917	64,125
Net (Decrease) Increase in Cash and Cash Equivalents	(36,037)	8,778	7,049
Cash and Cash Equivalents at Beginning of Year	67,116	58,338	51,289
Cash and Cash Equivalents at End of Year	$ 31,079	$ 67,116	$ 58,338
Supplemental Disclosures to Statements of Cash Flow Information:			
Interest on Deposits and Borrowings	$23,995	$27,201	$34,415
Income Taxes	15,223	10,301	6,235
Non-cash Investing and Financing Activity:			
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	568	683	1,152
Net Unrealized Securities Holding Gains Arising During the Period, Net of Tax	1,514	707	1,727
Reclassification Adjustment for Net Securities Gains Included in Net Income, Net of Tax	(910)	(215)	(230)
Additional Shares Issued for Acquisition of Subsidiary	682	542	112
Change in Retirement Plans Net Loss and Prior Service Cost, Net of Tax	(387)	2,046	(6,983)
Fair Value of Assets from Acquisition of Subsidiary	882	---	---
Fair Value of Liabilities from Acquisition of Subsidiary	465	---	---

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (In Thousands, Except Per Share Amounts)

Arrow Financial Corporation is a bank holding company organized in 1983 under the laws of New York and registered under the Bank Holding Company Act of 1956. The accounting and reporting policies of Arrow Financial Corporation and Subsidiaries (collectively referred to herein as "Arrow" or the "Company") conform to accounting principles generally accepted in the United States of America and general practices within the banking industry in all material respects.

Principles of Consolidation - The financial statements of Arrow and its wholly owned subsidiaries are consolidated and all material inter-company transactions have been eliminated. In the "Parent Company Only" financial statements in Note 24, the investment in wholly owned subsidiaries is carried under the equity method of accounting. When necessary, prior years' consolidated financial statements have been reclassified to conform to the current-year financial statement presentation.

Cash and Cash Equivalents - Cash and cash equivalents include the following items: cash at branches, due from bank balances, cash items in the process of collection, interest-bearing bank balances and federal funds sold.

Securities - Management determines the appropriate classification of securities at the time of purchase. Securities reported as held-to-maturity are those debt securities which Arrow has both the positive intent and ability to hold to maturity and are stated at amortized cost. Securities available-for-sale are reported at fair value, with unrealized gains and losses reported in accumulated other comprehensive income or loss, net of taxes. Realized gains and losses are based upon the amortized cost of the specific security sold. A decline in the fair value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in an impairment to reduce the carrying amount to fair value. To determine whether an impairment is other-than-temporary, we consider all available information relevant to the collectibility of the security, including past events, current conditions, and reasonable and supportable forecasts when developing an estimate of cash flows expected to be collected. Evidence considered in this assessment includes the reasons for impairment, the severity and duration of the impairment, changes in value subsequent to year-end, forecasted performance of the investee, and the general market condition in the geographic area or industry the investee operates in. When an other-than-temporary impairment has occurred on a debt security, the amount of the other-than-temporary impairment recognized in earnings depends on whether we intend to sell the debt security or more likely than not will be required to sell the debt security before recovery of its amortized cost basis less any current-period credit loss. If we intend to sell the debt security or it is more likely than not that we will be required to sell the debt 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 debt security and it is not more likely than not that we will be required to sell the debt 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. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable income taxes.

Our Consolidated Statement of Income reflects the full impairment (that is, the difference between the security's amortized cost basis and fair value) on equity securities and debt securities that we intend to sell or would more-likely-than-not be required to sell before the expected recovery of the amortized cost basis. For available-for-sale and held-to-maturity debt securities that management does not intend to sell and believes that more likely-than-not will be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the rest of the fair value loss is recognized in accumulated other comprehensive income. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected using our cash flow projections, which are based on our assumptions.

Loans and Allowance for Loan Losses - Interest income on loans is accrued and credited to income based upon the principal amount outstanding. Loan fees and costs directly associated with loan originations are deferred and amortized as an adjustment to yield over the lives of the loans originated.

From time-to-time, Arrow has sold (some with servicing retained) residential real estate loans at or shortly after origination. Any gain or loss on the sale of loans, along with the value of the servicing right, is recognized at the time of sale as the difference between the recorded basis in the loan and net proceeds from the sale.

Loans are placed on nonaccrual status either due to the delinquency status of principal and/or interest (generally when past due 90 or more days) or a judgment by management that the full repayment of principal and interest is unlikely.

The allowance for loan losses is maintained by charges to operations based upon our best estimate of the probable amount of loans that we will be unable to collect based on current information and events. Provisions to the allowance for loan losses are offset by actual loan charge-offs (net of any recoveries). In general, when consumer loans are 120 days past due, an evaluation of estimated proceeds from the liquidation of the loan's collateral is compared to the loan carrying amount and a charge to the allowance for loan losses is taken for any deficiency. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions in Arrow's market area. In addition, various Federal and State regulatory agencies, as an integral part of their examination process, review Arrow's allowance for loan losses. Such agencies may require Arrow to recognize additions to the allowance in future periods, based on their judgments about information available to them at the time of their examination, which may not be currently available to management.

Impaired loans, except for large groups of smaller-balance homogeneous loans, are measured based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. If the measurement of the impaired loan is less than the recorded investment in the loan, an impairment reserve is recognized as part of the allowance for loan losses.

NOTE 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

All impaired commercial and commercial real estate loans over $250 are measured for impairment as well as all troubled debt restructured loans. Allowance for loan losses on the remaining loans are primarily determined based on historical loss factors adjusted for current trends. Arrow determines impairment for collateral dependent loans based on the fair value of the collateral less estimated costs to sell. For other loans, impairment is determined by comparing the recorded investment in the loan to the present value of the expected cash flows, discounted at the loan's effective interest rate. Arrow determines the interest income recognition method on a loan-by-loan basis. Based upon the borrowers' payment histories and cash flow projections, interest recognition methods include full accrual or cash basis.

In management's opinion, the balance of the allowance for loan losses, at each balance sheet date, is sufficient to provide for probable loan losses inherent in the corresponding loan portfolio.

Other Real Estate Owned and Repossessed Assets - Real estate acquired by foreclosure and assets acquired by repossession are recorded at the lower of the recorded investment in the loan or the fair value of the property less estimated costs to sell. Subsequent declines in fair value, after transfer to other real estate owned and repossessed assets are recognized through a valuation allowance. Such declines in fair value along with related operating expenses to administer such properties or assets are charged directly to operating expense.

Premises and Equipment - Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization included in operating expenses are computed largely on the straight-line method. The provision is based

on the estimated useful lives of the assets (buildings and improvements 20-40 years; furniture and equipment 7-10 years; data processing equipment 5-7 years) and, in the case of leasehold improvements, amortization is computed over the terms of the respective leases or their estimated useful lives, whichever is shorter. Gains or losses on disposition are reflected in earnings.

Income Taxes - Arrow accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. Arrow's policy is that deferred tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Goodwill and Other Intangible Assets – Identifiable intangible assets acquired in a business combination are capitalized and amortized. Any remaining unidentifiable intangible asset is classified as goodwill, for which amortization is not required but which must be evaluated quarterly for impairment. Arrow tests for impairment of goodwill on at least an annual basis, or when events and circumstances indicate potential impairment. The goodwill impairment test is a two-step process. The first step, used to identify potential impairment, compares the fair value of the reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, thus the second step is unnecessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any.

In April 2010, Arrow acquired all of the outstanding shares of common stock of Loomis & LaPann, Inc. in a tax-free exchange for Arrow's common stock (26,240 shares, as restated for stock dividends). Arrow recorded the following intangible assets as a result of the acquisition (none of which are deductible for income tax purposes): goodwill ($514) and expirations ($126). The value of the expirations is being amortized over twenty years. The agreement provides for annual contingent future payments of Company stock, based upon earnings and retention of certain customers, over a three-year period. The present value of these expected payments were included in the purchase price at the acquisition date, April 1, 2010.

In April 2005 Arrow completed the cash purchase of three branches from HSBC Bank USA, N.A. Arrow recorded the following intangible assets as a result of the acquisition: goodwill ($3,690) and core deposit intangible asset ($2,247). The value of the core deposit intangible asset is being amortized over ten years.

In November 2004, Arrow acquired all of the outstanding shares of common stock of Capital Financial Group, Inc. in a tax-free exchange for Arrow's common stock. The agreement provided for annual contingent future payments of Company stock, based upon earnings, over a five-year period. The final contingent payment of $542 (20,672 shares) was recorded in 2009.

The carrying amounts of other recognized intangible assets that meet recognition criteria and for which separate accounting records have been maintained (core deposit intangibles and mortgage servicing rights), have been included in the consolidated balance sheet as "Other Intangible Assets, Net." Core deposit intangibles are being amortized on a straight-line basis over a period of ten to fifteen years.

Arrow has sold residential real estate loans (primarily to Freddie Mac) with servicing retained. Mortgage servicing rights are recognized as an asset when loans are sold with servicing retained, by allocating the cost of an originated mortgage loan between the loan and servicing right based on estimated relative fair values. The cost allocated to the servicing right is capitalized as a separate asset and amortized in proportion to, and over the period of, estimated net servicing income. Capitalized mortgage servicing rights are evaluated for impairment by comparing the asset's carrying value to its current estimated fair value. Fair values are estimated using a discounted cash flow approach, which considers future servicing income and costs, current market interest rates, and anticipated prepayment, and default rates. Impairment losses are recognized through a valuation allowance for servicing rights having a current fair value that is less than amortized cost. Adjustments to increase (decrease) the valuation allowance are charged (credited) to income as a component of other operating income. There was no allowance for impairment losses at December 31, 2010 or 2009.

NOTE 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Pension and Postretirement Benefits - Arrow maintains a non-contributory, defined benefit pension plan covering substantially all employees, a supplemental pension plan covering certain executive officers selected by the Board of Directors, and certain post-retirement medical, dental and life insurance benefits for employees and retirees. The costs of these plans, based on actuarial computations of current and future benefits for employees, are charged to current operating expenses. The cost of post-retirement benefits other than pensions is recognized on an accrual basis as employees perform services to earn the benefits. Arrow recognizes the overfunded or underfunded status of our single employer defined benefit postretirement plan as an asset or liability on its consolidated balance sheet and recognizes changes in the funded status in comprehensive income in the year in which the change occurred.

Stock-Based Compensation Plans – Arrow has two stock option plans, which are described more fully in Notes 16 and 17. The Company expenses the grant date fair value of options granted. The expense is recognized over the four year vesting period of the grant.

Arrow sponsors an Employee Stock Purchase Plan ("ESPP") under which employees may purchase Arrow's common stock at a 5% discount below market price at the time of purchase. This stock purchase plan is not considered a compensatory plan.

Arrow sponsors an Employee Stock Ownership Plan (ESOP), a qualified defined contribution plan. The ESOP has borrowed funds from one of Arrow's subsidiary banks to purchase Arrow common stock. The shares pledged as collateral are reported as a reduction of Arrow's stockholders' equity. Compensation expense is recognized as shares are release for allocation to individual employee accounts equal to the difference between the current average market price and the purchase price.

Securities Sold Under Agreements to Repurchase - In securities repurchase agreements, Arrow receives cash from a counterparty in exchange for the transfer of securities to a third party custodian's account that explicitly recognizes Arrow's interest in the securities. These agreements are accounted for by Arrow as secured financing transactions, since it maintains effective control over the transferred securities, and meets other criteria for such accounting. Accordingly, the cash proceeds are recorded as borrowed funds, and the underlying securities continue to be carried in Arrow's securities available-for-sale portfolio.

Earnings Per Share ("EPS") - Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as Arrow's stock options), computed using the treasury stock method. Unallocated common shares held by Arrow's Employee Stock Ownership Plan are not included in the weighted average number of common shares outstanding for either the basic or diluted EPS calculation.

Financial Instruments - Arrow is a party to certain financial instruments with off-balance sheet risk, such as: commercial lines of credit, construction lines of credit, overdraft protection, home equity lines of credit and standby letters of credit. Arrow's policy is to record such instruments when funded. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time Arrow's entire holdings of a particular financial instrument. Because no market exists for a significant portion of Arrow's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, Arrow has a trust department that contributes net fee income annually. The value of trust department customer relationships is not considered a financial instrument of the Company, and therefore this value has not been incorporated into the fair value estimates. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred taxes, premises and equipment, the value of low-cost, long-term core deposits and goodwill. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

The carrying amount of the following short-term assets and liabilities is a reasonable estimate of fair value: cash and due from banks, federal funds sold and purchased, securities sold under agreements to repurchase, demand deposits, savings, N.O.W. and money market deposits, other short-term borrowings, accrued interest receivable and accrued interest payable. The fair value estimates of other on- and off-balance sheet financial instruments, as well as the method of arriving at fair value estimates, are included in the related footnotes and summarized in Note 22. As of December 31, 2010 and 2009, and during 2010, 2009 and 2008, Arrow had no derivative instruments, other than loans pending settlement and loan commitments on loans intended for sale, the amounts of which are not material.

Fair Value Measures – 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).

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

52

NOTE 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Trust Assets and Fiduciary Income - Assets held by Arrow in a fiduciary or agency capacity for its customers are not included in the consolidated balance sheets since these assets are not assets of Arrow. Income from fiduciary activities is reported on the accrual basis.

Segment Reporting - Management evaluates the operations of Arrow based solely on one business segment – community banking, which constitutes Arrow's only segment for financial reporting purposes. Arrow provides other services, such as trust administration, retirement plan administration, advice to our proprietary mutual funds and insurance products, but these services do not rise to the quantitative thresholds for separate disclosure. Arrow operates primarily in the northeastern region of New York State in Warren, Washington, Saratoga, Essex and Clinton counties and surrounding areas.

Management's Use of Estimates -The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Our most significant estimates are the allowance for loan losses, the evaluation of other-than-temporary impairment of investment securities, goodwill impairment, pension and other postretirement liabilities, analysis of a need for a valuation allowance for deferred tax assets and other fair value calculations. Actual results could differ from those estimates.

A material estimate that is particularly susceptible to significant change in the near term is the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains appraisals for properties. The allowance for loan losses is management's best estimate of probable loan losses incurred as of the balance sheet date. While management uses available information to recognize losses on loans, future adjustments to the allowance for loan losses may be necessary based on changes in economic conditions.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 168 "The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162." Effective for interim and annual financial statements issued after September 15, 2009, the FASB Accounting Standards Codification™ (FASB ASC) became the sole source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the FASB ASC superseded all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification became nonauthoritative. FASB updates to the codification will be promulgated as “Accounting Standards Updates” (ASU). This Statement did not have a material impact on our financial condition or results of operation.

ASU 2010-28, Intangibles—Goodwill and Other (Topic 350) When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts: The amendments in this Update affect all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. The amendments in this Update modify Step 1 so that for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For public entities, the amendments in this Update are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. We have determined that this pronouncement did not have a material impact on our financial condition or results of operations.

ASU 2010-20, Receivables (Topic 310) - Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses & ASU 2011-01, Receivables (Topic 310) – Deferral of the Effective Date of Disclosures about Trouble Debt Restructurings in Update No. 2010-20: The main objective of this guidance is to provide financial statement users with greater transparency about an entity’s allowance for credit losses and the credit quality of its financing receivables. This pronouncement requires additional disclosures to assist financial statement users in assessing an entity’s credit risk exposures and evaluating the adequacy of its allowance for credit losses. These new disclosures are required for interim and annual reporting periods ending on or after December 15, 2010, except for disclosures relating to loan modifications, which were subsequently extended to interim and annual filings after June 15, 2011. We have determined that this pronouncement did not have a material impact on our financial condition or results of operations. We have included the required disclosures in Note 4 of the 2010 notes to the consolidated financial statements.

ASU 2010-12, Income Taxes (Topic 740) – Accounting for Certain Tax Effects of the 2010 Health Care Reform Acts: For measuring the impact on deferred tax assets and liabilities based on provisions of enacted law, the impact of both Acts, the Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act, should be considered. This pronouncement requires that income tax deductions for the cost of providing prescription drug coverage will be reduced by the amount of any subsidy received. The provisions were in effect for reporting periods ending on or after March 31, 2010. We have determined that this pronouncement did not have a material impact on our financial condition or results of operations.

NOTE 1:

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

ASU 2010-11, Derivatives and Hedging (Topic 815) - Scope Exception Related to Embedded Credit Derivatives: Clarifies the scope exception for embedded credit derivative features related to the transfer of credit risk in the form of subordination of one financial instrument to another. The amendments address how to determine which embedded credit derivative features, including those in collateralized debt obligations and synthetic collateralized debt obligations, are considered to be embedded derivatives that should not be analyzed for potential bifurcation and separate accounting. The amendments in this pronouncement are effective for each reporting entity at the beginning of its first fiscal quarter beginning after June 15, 2010 and did not have a material effect on our financial condition or results of operations.

ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures about Fair Value Measurements: Requires additional disclosures about fair value measurements including:

1.

Disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers.

2.

Present separately information about purchases, sales, issuances, and settlements on a gross basis (rather than net) for Level 3 fair value measurements.

3.

Present fair value disclosures for each class of assets and liabilities, and

4.

For Level 2 and 3 fair value measurements, provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements.

The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for interim and annual reporting periods beginning after December 15, 2010. This pronouncement will not have a material impact on the way we measure fair values.

NOTE 2:

CASH AND CASH EQUIVALENTS (In Thousands)

	2010	2009
Cash and Due From Banks	**$25,961**	$44,386
Interest-Bearing Deposits at Banks	**5,118**	22,730
Total Cash and Cash Equivalents	**$31,079**	$67,116
Supplemental Information:		
Total required reserves, including vault cash and Federal Reserve Bank deposits	$19,822	$19,007
Required reserve balances at the Federal Reserve Bank (Based on a two week average)	11,501	10,687
Excess reserve balances at the Federal Reserve Bank	---	12,043

Beginning in the fourth quarter of 2008, the Federal Reserve Bank began paying interest on both required reserve balances and excess reserve balances. Excess reserve balances would have been maintained as federal funds sold or overnight Federal Home Loan Bank deposits in prior periods. Bank subsidiaries are required to maintain certain reserves of vault cash and/or deposits with the Federal Reserve Bank. At both December 31, 2010 and 2009 all interest-bearing deposits at banks were held at the Federal Reserve Bank of New York.

NOTE 3:

INVESTMENT SECURITIES (In Thousands)

A summary of the amortized costs and the approximate fair values of securities at December 31, 2010 and 2009 is presented below. Amortized cost is reported net of other-than-temporary impairment charges.

Securities Available-for-Sale:

	Amortized Cost	**Fair Value**	**Gross Unrealized Gains**	**Gross Unrealized Losses**
December 31, 2010:				
U.S. Agency Obligations	**$ 97,943**	**$ 98,173**	**$ 326**	**$ 96**
State and Municipal Obligations	**89,471**	**89,528**	**72**	**15**
Collateralized Mortgage Obligations	**161,247**	**166,964**	**6,692**	**975**
Mortgage-Backed Securities - Residential	**159,636**	**159,926**	**2,532**	**2,242**
Corporate and Other Debt Securities	**1,516**	**1,417**	**---**	**99**
Mutual Funds and Equity Securities	**1,333**	**1,356**	**70**	**47**
Total Securities Available-for-Sale	**$511,146**	**$517,364**	**$9,692**	**$3,474**

December 31, 2009:				
U.S. Agency Obligations	$122,768	$123,331	$ 566	$ 3
State and Municipal Obligations	18,843	18,913	75	5
Collateralized Mortgage Obligations	196,359	199,781	4,625	1,203
Mortgage-Backed Securities - Residential	91,745	93,017	2,110	838
Corporate and Other Debt Securities	1,465	1,331	---	134
Mutual Funds and Equity Securities	1,308	1,333	31	6
Total Securities Available-for-Sale	$432,488	$437,706	$7,407	$2,189

54

NOTE 3:

SECURITIES (Continued)

Securities Held-to-Maturity:

	Amortized Cost	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
December 31, 2010				
State and Municipal Obligations	**$158,938**	**$161,713**	**$2,911**	**$136**
Corporate and Other Debt Securities	**1,000**	**1,000**	**---**	**---**
Total Securities Held-to-Maturity	**$159,938**	**$162,713**	**$2,911**	**$136**
December 31, 2009:				
State and Municipal Obligations	$167,931	$170,183	$2,706	$454
Corporate and Other Debt Securities	1,000	1,000	---	---
Total Securities Held-to-Maturity	$168,931	$171,183	$2,706	$454

As reported in the Consolidated Balance Sheets, Other Investments include Federal Home Loan Bank of New York ("FHLBNY") and Federal Reserve Bank ("FRB") stock, which are reported at cost. FHLBNY and FRB stock are restricted investment securities and amounted to $7,743 and $859 at December 31, 2010, respectively and $8,107 and $828 at December 31, 2009, respectively. The required level of FHLBNY stock is based on the amount of FHLBNY borrowings (see Note 10) and is pledged to secure those borrowings. While some Federal Home Loan Banks have stopped paying dividends and repurchasing stock upon reductions in debt levels, the FHLBNY continues to pay dividends and repurchase its stock. Accordingly, we have not recognized any impairment on our holdings of FHLBNY common stock. However, the FHLBNY has reported impairment issues among its holdings of mortgage-backed securities.

A summary of the maturities of securities as of December 31, 2010 is presented below. Mutual funds and equity securities, which have no stated maturity, are not included in the table below. Collateralized mortgage obligations and other mortgage-backed-securities are included in the schedule 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.

Debt Securities:	**Available-for-Sale**		**Held-to-Maturity**	
	Amortized Cost	**Fair Value**	**Amortized Cost**	**Fair Value**
Within One Year:				

U.S. Agency Obligations	$ 60,000	$ 60,146	$ ---	$ ---
State and Municipal Obligations	68,961	68,979	19,439	19,632
Collateralized Mortgage Obligations	13,768	13,981	---	---
Mortgage-Backed Securities - Residential	3,019	3,113	---	---
Corporate and Other Debt Securities	---	---	---	---
Total	145,748	146,219	19,439	19,632
From 1 - 5 Years:				
U.S. Agency Obligations	37,943	38,027	---	---
State and Municipal Obligations	16,554	16,586	63,379	64,200
Collateralized Mortgage Obligations	123,746	129,397	---	---
Mortgage-Backed Securities - Residential	71,914	72,581	---	---
Corporate and Other Debt Securities	185	185	---	---
Total	250,342	256,776	63,379	64,200
From 5 - 10 Years:				
State and Municipal Obligations	1,165	1,172	65,062	66,659
Collateralized Mortgage Obligations	23,733	23,586	---	---
Mortgage-Backed Securities - Residential	65,343	64,613	---	---
Total	90,241	89,371	65,062	66,659
Over 10 Years:				
State and Municipal Obligations	2,791	2,791	11,058	11,222
Collateralized Mortgage Obligations	---	---	---	---
Mortgage-Backed Securities - Residential	19,360	19,619	---	---
Corporate and Other Debt Securities	1,331	1,232	1,000	1,000
Total	23,482	23,642	12,058	12,222
Total Debt Securities	$509,813	$516,008	$159,938	$162,713

NOTE 3:

SECURITIES (Continued)

The following table sets forth the components of interest and dividend income on securities available-for-sale, securities held-to-maturity and other investments for the year ended December 31:

Components of Investment Securities Interest and Dividend Income	**2010**	2009	2008
Available-for-Sale:			
Taxable Interest Income	**$14,050**	$14,138	$15,490
Nontaxable Interest Income	**634**	468	805
Dividend Income	**54**	47	38
Total Interest and Dividend Income, on Securities Available-for-Sale	**$14,738**	$14,653	$16,333
Held-to-Maturity			
Taxable Interest Income	**$ 82**	$ 63	$ 13
Nontaxable Interest Income	**5,197**	5,074	4,380
Total Interest Income, on Securities Held-to-Maturity	**$5,279**	$5,137	$4,393
Other Investments	**$515**	$491	$623

The fair value of securities pledged to secure repurchase agreements amounted to $51,581 and $72,020 at December 31, 2010 and 2009, respectively. The fair value of securities pledged to secure public and trust deposits and for other purposes totaled $382,142 and $360,885 at December 31, 2010 and 2009, respectively. Other mortgage-backed securities at December 31, 2010 and 2009 included $1,598 and $2,147, respectively, of loans previously securitized by Arrow, which it continues to service.

Information on temporarily impaired securities at December 31, 2010 and 2009, segregated according to the length of time such securities had been in a continuous unrealized loss position, is summarized as follows:

December 31, 2010	**Less than 12 Months**		**12 Months or Longer**		**Total**	
	Fair	**Unrealized**	**Fair**	**Unrealized**	**Fair**	**Unrealized**
Available-for-Sale Portfolio:	**Value**	**Losses**	**Value**	**Losses**	**Value**	**Losses**
U.S. Agency Securities	**$ 23,928**	**$ 72**	**$ 5,976**	**$ 24**	**$ 29,904**	**$ 96**
State & Municipal Obligations	**11,632**	**11**	**2,432**	**4**	**14,064**	**15**
Collateralized Mortgage Obligations	**32,027**	**975**	**---**	**---**	**32,027**	**975**
Mortgage-Backed Securities - Residential	**69,461**	**1,957**	**12,129**	**285**	**81,590**	**2,242**
Corporate & Other Debt Securities	**283**	**48**	**949**	**51**	**1,232**	**99**
Mutual Funds and Equity Securities	**1,095**	**47**	**---**	**---**	**1,095**	**47**
Total Securities Available-for-Sale	**$138,426**	**$3,110**	**$21,486**	**$364**	**$159,912**	**$3,474**
Held-to-Maturity Portfolio						

State & Municipal Obligations	**$6,449**	**$ 73**	**$4,552**	**$ 63**	**$11,001**	**$136**

The table above for December 31, 2010 consists of 104 securities where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any deterioration of the credit worthiness of the issuing entities. Agency-backed CMOs are all rated AAA, as are the mortgage-backed securities. The 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, third party credit analysis shows no deterioration in the credit worthiness of the municipalities. Corporate and other debt securities consist of one private placement trust preferred, and one trust preferred pool. The private placement trust preferred is rated AAA by Standard & Poor's; the trust preferred pool is rated investment grade, with the privately issued securities securing the note performing. Subsequent to December 31, 2010, 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 we would be required to sell the securities prior to recovery, the impairment is considered temporary.

NOTE 3:

SECURITIES (Continued)

December 31, 2009	Less than 12 Months		12 Months or Longer		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
Available-for-Sale Portfolio:	Value	Losses	Value	Losses	Value	Losses
U.S. Agency Securities	$ 4,998	$ 3	$ ---	$ ---	$ 4,998	$ 3
State & Municipal Obligations	1,230	5	---	---	1,230	5
Collateralized Mortgage Obligations	49,034	1,184	162	19	49,196	1,203
Mortgage-Backed Securities - Residential	36,547	836	1,402	2	37,949	838
Corporate & Other Debt Securities	946	54	305	80	1,251	134
Mutual Funds and Equity Securities	20	---	20	6	40	6
Total Securities Available-for-Sale	$92,775	$2,082	$1,889	$107	$94,664	$2,189
Held-to-Maturity Portfolio						
State & Municipal Obligations	$14,270	$270	$6,624	$184	$20,894	$454

The table above for December 31, 2009 consists of 103 securities where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any deterioration of the credit worthiness of the issuing entities. Agency-backed CMOs are all rated AAA, as are the mortgage-backed securities. The municipal obligations are partially insured, with the remainder supported by the general taxing authority of the municipality and, in the cases of school districts, are supported by state aid. For any non-rated municipal securities, third party credit analysis shows no deterioration in the credit worthiness of the municipalities. Corporate and other debt securities consist of three corporate bonds, one private placement trust preferred, and one trust preferred pool. The three corporate bond issues are rated investment grade, and are performing. The private placement trust preferred is rated AAA by Standard & Poor's; the trust preferred pool is rated investment grade, with the privately issued securities securing the note performing. Mutual funds and equity securities include four common stock holdings that show unrealized losses which are not deemed to be other-than-temporarily impaired, at December 31, 2009.

These unrealized losses do not reflect deterioration in the credit worthiness of the companies, since they have adequate capital positions. 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. Since we have the intent and ability to hold these investments until a recovery of fair value, which may be until maturity for the debt securities, we do not consider these investments to be other-than-temporarily impaired at December 31, 2010.

Other-Than-Temporary Impairment

At December 31, 2010 and 2009, mutual funds and equity securities included shares of one common stock that had been deemed to be other-than-temporarily impaired in 2009. The common stock had a book value of $1,094 after the recognition of $375 in losses charged to earnings for the year ended December 31, 2009. The approximate fair value for this security was $1,050 and $1,094 at December 31, 2010 and 2009.

NOTE 4:

LOANS (In Thousands)

Loan balances outstanding as of December 31, 2010 and 2009 consisted of the following:

Loans
As of December 31, 2010 and 2009

	2010	2009
Commercial	**$ 97,621**	$ 89,222
Commercial real estate:		
Commercial real estate - construction	**7,090**	15,336
Commercial real estate - other	**214,291**	185,582
Consumer:		
Consumer – other	**6,482**	11,981
Consumer – automobile	**334,656**	317,854
Residential – prime	**485,368**	492,175
Total	**$1,145,508**	$1,112,150
Supplemental Information:		
Unamortized deferred loan origination costs, net of deferred loan origination fees, included in the above balances	**$ 1,118**	$ 1,118
Overdrawn deposit accounts, included in the above balances	**417**	661
Pledged loans secured by one-to-four family residential mortgages under a blanket collateral agreement to secure borrowings from the Federal Home Loan Bank of New York	**215,307**	237,098
Residential Real Estate Loans Serviced for Freddie Mac, not included in the balances above	**73,103**	52,078
Loans held for sale at period-end, included in the above balances	**10,294**	---
Loans to Related Parties:		
Balance at period-end	**14,987**	15,345
New loans and renewals, during the year	**1,052**	7,379
Repayments, during the year	**1,932**	4,816

Credit Quality Indicators

The following table provides information about loan credit quality at December 31, 2010:

Credit Quality Indicators
As of December 31, 2010

Commercial Credit Exposure
Credit Risk Profile by Creditworthiness Category

Indicator	Commercial	Commercial Real Estate - Construction	Commercial Real Estate - Other
Satisfactory	$94,290	$5,117	$187,070
Special Mention	160	---	7,318
Substandard	3,171	1,973	19,903
Doubtful	---	---	---
Total	$97,621	$7,090	$214,291

Consumer Credit Exposure
Credit Risk Profile Based on Payment Activity

	Consumer-Other	Consumer-Auto	Residential-Prime
Performing	$6,477	$333,847	$483,725
Nonperforming	5	809	1,643
Total	$6,482	$334,656	$485,368

NOTE 4:

LOANS (Continued)

We use an internally developed system of five credit quality indicators to rate the credit worthiness of each commercial loan. The system has eight levels of credit quality (the first three have been combined in the preceding table), 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, loans with potential for problems due to weakening economic or market conditions, loans subject to an inadequate loan agreement, loans with insufficient or flawed documentation, loans where the loan officer lacks sufficient expertise to properly control the account, and other deviations from prudent lending practice; 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. However, this classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future. Commercial loans are evaluated on an annual basis, unless the credit quality indicator falls to a level of 5 or below, when the loan is evaluated quarterly. The credit quality indictor is one of the factors used to determine any loss, as further described in this footnote.

Past Due Loans

The following table provides an analysis of the age of the recorded investment in loans that are past due at the end of the period. Consistent with regulatory instructions, Arrow considers an amortizing loan past due 30 or more days only if the borrower is two or more payments past due. Matured loans and all other loans are considered past due 30 or more days based on the payment due date. Nonaccrual loans are included in the first three columns, unless the loan is past due less than 30 days.

Age Analysis of Past Due Loans
As of December 31, 2010

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans
Commercial	$ 591	$ 377	$ 79	$ 1,047	$ 96,572	$ 97,619
Commercial Real Estate:						
Commercial Real Estate – construction	---	---	---	---	7,090	7,090
Commercial Real Estate – other	483	---	254	737	213,554	214,291
Consumer:						
Consumer-other	5	---	---	5	6,477	