WACHOVIA CORP NEW
Form 4
February 16, 2006

# FORM 4

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

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

**STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES**

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL

| | |
|---|---|
| OMB Number: | 3235-0287 |
| Expires: | January 31, 2005 |
| Estimated average burden hours per response... | 0.5 |

(Print or Type Responses)

1. Name and Address of Reporting Person *
JULIAN DAVID M

(Last) (First) (Middle)

WACHOVIA CORPORATION, ONE WACHOVIA CENTER

(Street)

CHARLOTTE, NC 28288-0201

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
WACHOVIA CORP NEW [WB]

3. Date of Earliest Transaction (Month/Day/Year)
02/15/2006

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Principal Acct Off and EVP

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

**Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned**

| 1.Title of Security (Instr. 3) | 2. Transaction Date (Month/Day/Year) | 2A. Deemed Execution Date, if any (Month/Day/Year) | 3. Transaction Code (Instr. 8) | | 4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5) | | | 5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4) | 6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4) | 7. Nature of Indirect Beneficial Ownership (Instr. 4) |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Code | V | Amount | (A) or (D) | Price | | | |
| Common Stock | 02/15/2006 | | M | | 15,500 | A | $ 34.92 | 26,356 | D | |
| Common Stock | 02/15/2006 | | S | | 15,500 | D | $ 55.72 | 10,856 (2) | D | |
| Common Stock | | | | | | | | 475.8407 | I | By 401(k) plan |

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

**Persons who respond to the collection of information contained in this form are not required to respond unless the form**

SEC 1474 (9-02)

**displays a currently valid OMB control number.**

**Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned**
**(*e.g.*, puts, calls, warrants, options, convertible securities)**

| 1. Title of Derivative Security (Instr. 3) | 2. Conversion or Exercise Price of Derivative Security | 3. Transaction Date (Month/Day/Year) | 3A. Deemed Execution Date, if any (Month/Day/Year) | 4. Transaction Code (Instr. 8) | | 5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5) | | 6. Date Exercisable and Expiration Date (Month/Day/Year) | | 7. Title and Amount of Underlying Securities (Instr. 3 and 4) | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | Code | V | (A) | (D) | Date Exercisable | Expiration Date | Title | Amount or Number of Shares |
| ESOP (Right to Buy) (1) | $ 34.92 | 02/15/2006 | | M | | | 15,500 | 12/31/2003 | 07/31/2011 | Common Stock | 15,500 |

# Reporting Owners

| Reporting Owner Name / Address | Relationships | | | |
|---|---|---|---|---|
| | Director | 10% Owner | Officer | Other |
| JULIAN DAVID M<br>WACHOVIA CORPORATION<br>ONE WACHOVIA CENTER<br>CHARLOTTE, NC 28288-0201 | | | Principal Acct Off and EVP | |

# Signatures

| David M. Julian | 02/16/2006 |
|---|---|
| **Signature of Reporting Person | Date |

# Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

**(1)** Provisions exist with respect to these shares to allow for the withholding of shares to satisfy tax withholding obligations and t he withholding of shares in payment of the exercise price.

**(2)** As of 2/15/06, includes 7,799 shares of unvested restricted stock with respect to which provisions exist to allow for the withholding of shares to satisfy tax withholding obligations.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. the Corporation s net interest margin, net interest income, fee income and net income

Interest and fees on loans and securities, net of interest paid on deposits and borrowings, are a large part of the Corporation s net income. Interest rates are key drivers of the Corporation s net interest margin and subject to many factors beyond the control of the Corporation. As interest rates change, net interest income is affected. Rapidly changing interest rates in the future could result in interest expense increasing faster than interest income because of divergence in financial instrument maturities and/or competitive pressures. Further, substantially higher interest rates

generally reduce loan demand and may result in slower loan growth. Decreases or increases in interest rates could have a negative effect on the spreads between the interest rates earned on assets and the rates of interest paid on liabilities, and therefore decrease net interest income. Also, changes in interest rates might also impact the values of equity and debt securities under management and administration by the Wealth Management Division which may have a negative impact on fee income. See the section captioned Net Interest Income in the MD&A section of this Annual Report on Form 10-K for additional details regarding interest rate risk.

*Provision for loan and lease losses and level of non-performing loans may need to be modified in connection with internal or external changes*

All borrowers carry the potential to default and our remedies to recover may not fully satisfy money previously loaned. We maintain an allowance for loan losses, which is a reserve established through a provision for loan losses charged to expense, which represents the Corporation s best estimate of probable credit losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of the Corporation, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance for loan losses reflects the Corporation s continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic conditions; and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires us to make significant estimates of current credit risks using existing qualitative and quantitative information, all of which may undergo material changes.

Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of our control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review our allowance for loan losses and may require an increase in the provision for loan losses or the recognition of additional loan charge-offs, based on judgments different than those of the Corporation. An increase in the allowance for loan losses results in a decrease in net income, and possibly risk-based capital, and may have a material adverse effect on our financial condition and results of operations.

The design of the allowance for loan loss methodology is a dynamic process that must be responsive to changes in environmental factors. Accordingly, at times the allowance methodology may be modified in order to incorporate changes in various factors including, but not limited to, levels and trends of delinquencies and charge-offs, trends in volume and types of loans, national and economic trends and industry conditions.

*The Corporation s controls and procedures may fail or be circumvented*

The Corporation diligently reviews and updates the its internal controls over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any failure or undetected circumvention of these controls could have a material adverse impact on our financial condition and results of operations.

*Decreased residential mortgage origination, volume and pricing decisions of competitors could affect our net income*

The Corporation originates, sells and services residential mortgage loans. Changes in interest rates and pricing decisions by our loan competitors affect demand for the Corporation s residential mortgage loan products, the revenue realized on the sale of loans and revenues received from servicing such loans for others, ultimately reducing the Corporation s net income. New regulations, increased regulatory reviews, and/or changes in the structure of the secondary mortgage markets which the Corporation utilizes to sell mortgage loans may be introduced and may increase costs and make it more difficult to operate a residential mortgage origination business.

*The Corporation s performance and financial condition may be adversely affected by regional economic conditions and real estate values*

The Bank s loan and deposit activities are largely based in eastern Pennsylvania. As a result, the Corporation s consolidated financial performance depends largely upon economic conditions in this eastern Pennsylvania region. This region experienced deteriorating local economic conditions during 2008 through 2011, and a continued downturn in the regional real estate market could harm our financial condition and results of operations because of the geographic concentration of loans within this regional area and because a large percentage of our loans are secured by real property. If there is further decline in real estate values, the collateral for the Corporation s loans will provide less security. As a result, the Corporation s ability to recover on defaulted loans by selling the underlying real estate will be diminished, and the Bank will be more likely to suffer losses on defaulted loans.

Additionally, a significant portion of the Corporation s loan portfolio is invested in commercial real estate loans. Often in a commercial real estate transaction, repayment of the loan is dependent on rental income. Economic conditions may affect the tenant s ability to make rental payments on a timely basis, and may cause some tenants not to renew their leases, each of which may impact the debtor s ability to make loan payments. Further, if expenses associated with commercial properties increase dramatically, the tenant s ability to repay, and therefore the debtor s ability to make timely loan payments, could be adversely affected.

All of these factors could increase the amount of the Corporation s non-performing loans, increase its provision for loan and lease losses and reduce the Corporation s net income.

*Economic troubles may negatively affect our leasing business*

The Corporation s leasing business which began operations in September 2006, consists of nation-wide leasing various types of equipment to businesses with an average original equipment cost of approximately $21 thousand per lease. Continued economic sluggishness may result in higher credit losses than we would experience in our traditional lending business, as well as potential increases in state regulatory burdens such as state income taxes, personal property taxes and sales and use taxes.

*A general economic slowdown could further impact Wealth Management Division revenues*

A general economic slowdown could decrease the value of Wealth Management Division assets under management and administration resulting in lower fee income, and clients potentially seeking alternative investment opportunities with other providers, which resulting in lower fee income to the Corporation.

*Our ability to realize our deferred tax asset may be reduced, which may adversely impact results of operations*

Realization of a deferred tax asset requires us to exercise significant judgment and is inherently uncertain because it requires the prediction of future occurrences. The deferred tax asset may be reduced in the future if estimates of future income or our tax planning strategies do not support the amount of the deferred tax asset. If it is determined that a valuation allowance of its deferred tax asset is necessary, the Corporation may incur a charge to earnings.

*Environmental risk associated with our lending activities could affect our results of operations and financial condition*

A significant portion of our loan portfolio is secured by real property. In the course of our business, we may own or foreclose and take title to real estate and could become subject to environmental liabilities with respect to these properties. We may become responsible to a governmental agency or third parties for property damage, personal injury, investigation and clean-up costs incurred by those parties in connection with environmental contamination, or may be required to investigate or clean-up hazardous or toxic substances, or chemical releases at a property. The costs associated with environmental investigation or remediation activities could be substantial. If we were to become subject to significant environmental liabilities, it could have a material adverse effect on our results of operations and financial condition.

*Technological systems failures, interruptions and security breaches could negatively impact our operations*

Communications and information systems are essential to the conduct of our business, as we use such systems to manage our customer relationships, our general ledger, our deposits, and our loans. While we have established policies and procedures to prevent or limit the impact of systems failures, interruptions, and security breaches, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, any compromise of our security systems could deter customers from using our web site and our online banking service, which involve the transmission of confidential information. Although we rely on commonly used security and processing systems to provide the security and authentication necessary to effect the secure transmission of data, these precautions may not protect our systems from compromises or breaches of security.

In addition, we outsource certain of our data processing to third-party providers. If our third-party providers encounter difficulties, or if we have difficulty in communicating with them, our ability to adequately process and account for customer transactions could be affected, and our business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any systems failure, interruption, or breach of security could damage our reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to civil litigation and possible financial liability. Any of these occurrences could have a material adverse effect on our financial condition and results of operations.

Additionally, financial products and services have become increasingly technology-driven. Our ability to meet the needs of our customers competitively, and in a cost-efficient manner, is dependent on our ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of our competitors have greater resources to invest in technology than we do and may be better equipped to market new technology-driven products and services. The ability to keep pace with technological change is important, and the failure to do so on our part could have a material adverse impact on our business and therefore on our financial condition and results of operations.

*The Corporation is subject to certain operational risks, including, but not limited to, customer or employee fraud and data processing system failures and errors*

Employee errors and misconduct could subject us to financial losses or regulatory sanctions and seriously harm our reputation. Misconduct by our employees could include hiding unauthorized activities from us, improper or unauthorized activities on behalf of our customers or improper use of confidential information. It is not always possible to prevent employee errors and misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases. Employee errors could also subject us to financial claims for negligence.

We maintain a system of internal controls and insurance coverage to mitigate operational risks, including data processing system failures and errors and customer or employee fraud. Should our internal controls fail to prevent or detect an occurrence, or if any resulting loss is not insured or exceeds applicable insurance limits, it could have a material adverse effect on our business, results of operations and financial condition.

*Potential acquisitions may disrupt the Corporation s business and dilute shareholder value*

We regularly evaluate opportunities to strengthen our current market position by acquiring and investing in banks and in other complementary businesses, or opening new branches. As a result, we may engage in negotiations or discussions that, if they were to result in a transaction, could have a material effect on our operating results and financial condition, including short and long-term liquidity. Our acquisition activities could be material to us. For example, we could issue additional shares of common stock in a purchase transaction, which could dilute current shareholders ownership interest. These activities could require us to use a substantial amount of cash, other liquid assets, and/or incur debt. In addition, if goodwill recorded in connection with our prior or potential future acquisitions were determined to be impaired, then we would be required to recognize a charge against our earnings, which could materially and adversely affect our results of operations during the period in which the impairment was recognized. Any potential charges for impairment related to goodwill would not impact cash flow, tangible capital or liquidity.

Our acquisition activities could involve a number of additional risks, including the risks of:

- incurring time and expense associated with identifying and evaluating potential acquisitions and negotiating potential transactions, resulting in the Corporation s attention being diverted from the operation of our existing business;
- using inaccurate estimates and judgments to evaluate credit, operations, management, and market risks with respect to the target institution or assets;
- potential exposure to unknown or contingent liabilities of banks and businesses we acquire;
- the time and expense required to integrate the operations and personnel of the combined businesses;
- experiencing higher operating expenses relative to operating income from the new operations;
- creating an adverse short-term effect on our results of operations;
- losing key employees and customers as a result of an acquisition that is poorly received; and

risk of significant problems relating to the conversion of the financial and customer data of the entity being acquired into the Corporation s financial and customer product systems.

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There is no assurance that we will be successful in overcoming these risks or any other problems encountered in connection with pending or potential acquisitions. Our inability to overcome these risks could have an adverse effect on our levels of reported net income, ROE and ROA, and our ability to achieve our business strategy and maintain our market value.

*Attractive acquisition opportunities may not be available to us in the future which could limit the growth of our business*

We may not be able to sustain a positive rate of growth or be able to expand our business. We expect that other banking and financial service companies, many of which have significantly greater resources than us, will compete with us in acquiring other financial institutions if we pursue such acquisitions. This competition could increase prices for potential acquisitions that we believe are attractive. Also, acquisitions are subject to various regulatory approvals. If we fail to receive the appropriate regulatory approvals for a transaction, we will not be able to consummate such transaction which we believe to be in our best interests. Among other things, our regulators consider our capital, liquidity, profitability, regulatory compliance and levels of goodwill and intangibles when considering acquisition and expansion proposals. Other factors, such as economic conditions and legislative considerations, may also impede or prohibit our ability to expand our market presence. If we are not able to successfully grow our business, our financial condition and results of operations could be adversely affected.

*The financial services industry is very competitive, and such competition could affect our operating results*

The Corporation faces competition in attracting and retaining deposits, making loans, and providing other financial services such as trust and investment management services throughout the Corporation s market area. The Corporation s competitors include other community banks, larger banking institutions, trust companies and a wide range of other financial institutions such as credit unions, registered investment advisors, financial planning firms, leasing companies, government-sponsored enterprises, on-line banking enterprises, mutual fund companies, insurance companies and other non-bank businesses. Many of these competitors have substantially greater resources than the Corporation. This is especially evident in regards to advertising and public relations spending. For a more complete discussion of our competitive environment, see Business Competition in Item 1 above. If the Corporation is unable to compete effectively, the Corporation may lose market share and income from deposits, loans, and other products may be reduced.

Additionally, increased competition among financial services companies due to consolidation of certain competing financial institutions and the conversion of certain investment banks to bank holding companies may adversely affect our ability to market our products and services.

*The Corporation s common stock is subordinate to all of our existing and future indebtedness; regulatory and contractual restrictions may limit or prevent us from paying dividends on our common stock; and we are not limited on the amount of indebtedness we and our subsidiaries may incur in the future*

Our common stock ranks junior to all indebtedness, including our outstanding subordinated debentures, and other non-equity claims on the Corporation with respect to assets available to satisfy claims on the Corporation, including in a liquidation of the Corporation. Additionally, unlike indebtedness, where principal and interest would customarily be payable on specified due dates, in the case of our common stock, dividends are payable only when, as and if authorized and declared by our Board of Directors and depend on, among other things, our results of operations, financial condition, debt service requirements, other cash needs and any other factors our Board of Directors deems relevant. Under Pennsylvania law we are subject to restrictions on payments of dividends out of lawfully available funds. Also, the Corporation s right to participate in a distribution of assets upon a subsidiary s liquidation or reorganization is subject to the prior claims of the subsidiary s creditors.

In addition, we are not limited by our common stock in the amount of debt or other obligations we or our subsidiaries may incur in the future. Accordingly, we and our subsidiaries may incur substantial amounts of additional debt and other obligations that will rank senior to our common stock or to which our common stock will be structurally subordinated.

*There may be future sales of additional common stock or other dilution of our equity, which may adversely affect the market price of our common stock*

We are not restricted from issuing additional common stock or other securities. Additionally, our shareholders may in the future approve the authorization of additional classes or series of stock which may have distribution or other rights senior to the rights of our common stock, or may be convertible into or exchangeable for, or may represent the right to receive, common stock or substantially similar securities. The future issuance of shares of our common stock or any other such future equity classes or series could have a dilutive effect on the holders of our common stock. Additionally, the market value of our common stock could decline as a result of sales by us of a large number of shares of common stock or any future class or series of stock in the market or the perception that such sales could occur.

*Downgrades in U.S. government and federal agency securities could adversely affect the Corporation*

In addition to causing economic and financial market disruptions, any downgrades in U.S. government and federal agency securities, or failures to raise the U.S. debt limit if necessary in the future, could, among other things, materially adversely affect the market value of the U.S. and other government and governmental agency securities that we hold, the availability of those securities as collateral for borrowing, and our ability to access capital markets on favorable terms, as well as have other material adverse effects on the operation of our business and our financial results and condition. In particular, it could increase interest rates and disrupt payment systems, money markets, and long-term or short-term fixed income markets, adversely affecting the cost and availability of funding, which could negatively affect profitability. Also, the adverse consequences as a result of the downgrade could extend to the borrowers of the loans the bank makes and, as a result, could adversely affect its borrowers ability to repay their loans.

*Additional risk factors also include the following all of which may reduce revenues and/or increase expenses and/or pull the Corporation s attention away from core banking operations which may ultimately reduce the Corporation s net income:*

- Inability to hire or retain key professionals, management and staff;
- Changes in securities analysts estimates of financial performance;
- Volatility of stock market prices and volumes;
- Rumors or erroneous information;
- Changes in market values of similar companies;
- New developments in the banking industry;
- Variations in quarterly or annual operating results;
- New litigation or changes in existing litigation;
- Regulatory actions;
- Changes in accounting policies or procedures as may be required by the Financial Accounting Standards Board or other regulatory agencies.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

As of December 31, 2012, the Corporation owns or leases 19 full-service branch locations, seven limited-service Life Care Community branches and eight other office properties which serve as administrative offices.

The total minimum cash lease payments for office, branch office (including ground leases) and life care community locations amounts to $254 thousand per month.

The following table details the Corporation s properties and deposits as of December 31, 2012:

| Property Address | Owned/Leased | Net Book Value as of December 31, 2012 (dollars in thousands) | Total Deposits as of December 31, 2012 (dollars in thousands) |
|---|---|---|---|
| **Full Service Branches:** | | | |
| 801 Lancaster Ave., Bryn Mawr, PA 19010* | Owned | $ 5,066 | $ 675,979 |
| 50 W. Lancaster Ave., Ardmore, PA 19003 | Leased | 2,291 | 97,283 |
| 5000 Pennell Rd., Aston, PA 19014 | Leased | 423 | 23,597 |
| 135 E. City Avenue, Bala Cynwyd, PA 19004 | Leased | 2,235 | 4 |
| 3218 Edgemont Ave., Brookhaven, PA 19015 | Owned | 726 | 59,169 |
| US Rts. 1 and 100, Chadds Ford, PA 19317 | Leased | 57 | 28,216 |
| 23 E. Fifth St., Chester, PA 19013 | Leased | 87 | 27,113 |
| 31 Baltimore Pk., Chester Heights, PA 19017 | Leased | 459 | 51,974 |
| 237 N. Pottstown Pk., Exton, PA 19341 | Leased | 794 | 57,042 |
| 18 W. Eagle Rd., Havertown, PA 19083 | Owned | 1,160 | 77,281 |
| 106 E. Street Rd., Kennett Square, PA 19348 | Leased | 534 | 23,338 |
| 22 W. State St., Media, PA 19063 | Owned | 3,377 | 63,739 |
| 3601 West Chester Pk., Newtown Square, PA 19073 | Leased | 1,124 | 50,858 |
| 39 W. Lancaster Ave., Paoli, PA 19301 | Owned | 1,519 | 67,217 |
| 330 Dartmouth Ave., Swarthmore, PA 19081 | Owned | 728 | 50,733 |
| 849 Paoli Pk., West Chester, PA 19380 | Leased | 1,374 | 36,852 |
| 330 E. Lancaster Ave., Wayne, PA 19087 | Owned | 1,290 | 124,605 |
| One Tower Bridge, West Conshohocken, PA 19428 | Leased | 4 | 20,784 |
| 1000 Rocky Run Parkway, Wilmington, DE 19803 | Leased | 569 | 65,977 |
| **Life Care Community Offices:** | | | |
| 601 N. Ithan Ave., Bryn Mawr, PA 19010 | Leased | | 5,183 |
| 1400 Waverly Rd, Gladwyne, PA 19035 | Leased | | 4,226 |
| 3300 Darby Rd., Haverford, PA 19041 | Leased | | 6,065 |
| 11 Martins Run, Media, PA 19063 | Leased | | 3,696 |
| 535 Gradyville Rd., Newtown Square, PA 19073 | Leased | | 9,511 |
| 404 Cheswick Pl., Bryn Mawr, PA 19010 | Leased | | 3,272 |
| 1615 E. Boot Rd., West Chester, PA 19380 | Leased | | 968 |
| **Other Administrative Offices:** | | | |
| 2, 6 S. Bryn Mawr Ave., Bryn Mawr, PA 19010 | Leased | 532 | Not applicable |
| 10 S. Bryn Mawr Ave., Bryn Mawr, PA 19010*** | Owned | 814 | Not applicable |
| 4093 W. Lincoln Hwy., Exton, PA 19341** | Leased | | Not applicable |
| 16 Campus Blvd., Newtown Square, PA 19073** | Leased | | Not applicable |
| 322 E. Lancaster Ave., Wayne, PA 19087 | Owned | 2,575 | Not applicable |
| 1 West Chocolate Avenue, Hershey, PA 17033*** | Leased | 10 | Not applicable |
| 20 Montchanin Rd, Suite 185 Greenville, DE 19807** | Leased | | Not applicable |
| 20 North Waterloo Rd, Devon PA 19380*** | Leased | 101 | Not applicable |
| **Subsidiary Offices:** | | | |
| Lau Associates 20 Montchanin Rd, Suite 110, Greenville, DE 19087 | Leased | 214 | Not applicable |
| BMTC-DE 20 Montchanin Rd, Suite 100 Greenville, DE 19807 | Leased | 41 | Not applicable |
| **Total:** | | 28,104 | $ 1,634,682 |

* *Corporate headquarters and executive offices*

** *Lending office*
*** *Wealth Management office*

**ITEM 3. LEGAL PROCEEDINGS**

Neither the Corporation nor any of its subsidiaries is a party to, nor is any of their property the subject of, any material legal proceedings other than ordinary routine litigation incident to their businesses.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable

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**PART II**

**ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Corporation s common stock is traded on the NASDAQ Stock Market under the symbol BMTC. As of December 31, 2012, there were 577 holders of record of the Corporation s common stock.

**Range of Market Prices of Common Stock and Cash Dividends**

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | High Bid | Low Bid | Dividend Declared | High Bid | Low Bid | Dividend Declared |
| 1st Quarter | $ 22.88 | $ 19.40 | $ 0.16 | $ 21.45 | $ 16.85 | $ 0.15 |
| 2nd Quarter | $ 22.67 | $ 19.90 | $ 0.16 | $ 21.24 | $ 19.11 | $ 0.15 |
| 3rd Quarter | $ 22.99 | $ 20.61 | $ 0.16 | $ 21.06 | $ 16.02 | $ 0.15 |
| 4th Quarter | $ 22.90 | $ 19.97 | $ 0.16 | $ 19.76 | $ 15.19 | $ 0.15 |

The information regarding dividend restrictions is set forth in Note 25 Dividend Restrictions in the accompanying Notes to Consolidated Financial Statements in this Annual Report on Form 10-K.

**Comparison of Cumulative Total Return Chart**

The following chart compares the yearly percentage change in the cumulative shareholder return on the Corporation s common stock during the five years ended December 31, 2012, with (1) the Total Return for the NASDAQ Market Index; (2) the Total Return Index for SNL Bank and Thrift Index; and (3) the Total Return Index for SNL Mid-Atlantic Bank Index . This comparison assumes $100.00 was invested on December 31, 2007, in our common stock and the comparison groups and assumes the reinvestment of all cash dividends prior to any tax effect and retention of all stock dividends.

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**Five Year Cumulative Total Return Summary**

| | For The Twelve Months Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | **2007** | **2008** | **2009** | **2010** | **2011** | **2012** |
| Bryn Mawr Bank Corporation | $ 100.00 | $ 90.07 | $ 69.83 | $ 83.45 | $ 96.15 | $ 113.21 |
| NASDAQ Market Index | $ 100.00 | $ 60.02 | $ 87.24 | $ 103.08 | $ 102.26 | $ 120.42 |
| SNL Bank and Thrift | $ 100.00 | $ 57.51 | $ 56.74 | $ 63.34 | $ 49.25 | $ 66.14 |
| SNL Mid-Atlantic Bank | $ 100.00 | $ 55.09 | $ 57.99 | $ 67.67 | $ 50.82 | $ 68.08 |

**Equity Compensation Plan Information**

Equity compensation plan information is incorporated by reference to Item 12 of this Annual Report on Form 10-K. Additional information regarding the Corporation s stock option plans can be found at Note 19 Stock Based Compensation in the accompanying Notes to Consolidated Financial Statements found in this Annual Report on Form 10-K.

**Issuer Purchases of Equity Securities**

The following tables present the repurchasing activity of the Corporation during the fourth quarter of 2012:

**Shares Repurchased in the 4th Quarter of 2012 (1) (2)**

| Period: | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plan or Programs |
|---|---|---|---|---|
| Oct. 1, 2012 Oct. 31,2012 | | | | 195,705 |
| Nov. 1, 2012 Nov. 30, 2012 | | | | 195,705 |
| Dec. 1, 2012 Dec. 31, 2012 | | | | 195,705 |
| Total | | | | |

(1) *On February 24, 2006, the Board of Directors of the Corporation adopted a new stock repurchase program (the 2006 Program ) under which the Corporation may repurchase up to 450,000 shares of the Corporation s common stock, not to exceed $10 million. The 2006 Program was publicly announced in a Press Release dated February 24, 2006. There is no expiration date on the 2006 Program. All shares purchased through the 2006 Program were accomplished in open market transactions.*

(2) *In October, November and December 2012, no shares were purchased by the Corporation s Deferred Compensation Plans through open market transactions by the Corporation s Wealth Management Division investment personnel.*

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**ITEM 6. SELECTED FINANCIAL DATA**

| **Earnings** *(dollars in thousands)* | **As of or for the Twelve Months Ended December 31,** 2012 | 2011 | 2010 | 2009* | 2008* |
|---|---|---|---|---|---|
| Interest income | $ 73,323 | $ 74,562 | $ 64,897 | $ 56,892 | $ 57,934 |
| Interest expense | 8,588 | 11,661 | 12,646 | 16,099 | 20,796 |
| Net interest income | 64,735 | 62,901 | 52,251 | 40,793 | 37,138 |
| Provision for loan and lease losses | 4,003 | 6,088 | 9,854 | 6,884 | 5,596 |
| Net interest income after provision for loan and lease losses | 60,732 | 56,813 | 42,397 | 33,909 | 31,542 |
| Non-interest income | 46,386 | 34,059 | 29,299 | 28,470 | 21,472 |
| Non-interest expense | 74,901 | 61,729 | 58,206 | 46,542 | 38,676 |
| Income before income taxes | 32,217 | 29,143 | 13,490 | 15,837 | 14,338 |
| Income taxes | 11,070 | 9,541 | 4,444 | 5,500 | 5,013 |
| Net Income | $ 21,147 | $ 19,602 | $ 9,046 | $ 10,337 | $ 9,325 |
| **Per Share Data** | | | | | |
| Weighted-average shares outstanding | 13,090,110 | 12,659,824 | 10,680,377 | 8,732,004 | 8,566,938 |
| Dilutive potential common shares | 151,736 | 82,313 | 12,312 | 16,719 | 34,233 |
| Adjusted weighted-average shares | 13,241,846 | 12,742,137 | 10,692,689 | 8,748,723 | 8,601,171 |
| Earnings per common share: | | | | | |
| Basic | $ 1.62 | $ 1.55 | $ 0.85 | $ 1.18 | $ 1.09 |
| Diluted | $ 1.60 | $ 1.54 | $ 0.85 | $ 1.18 | $ 1.08 |
| Dividends declared | $ 0.64 | $ 0.60 | $ 0.56 | $ 0.56 | $ 0.54 |
| Dividends declared per share to net income per basic common share | 39.5% | 38.7% | 65.9% | 47.5% | 49.5% |
| Shares outstanding at year end | 13,412,690 | 13,106,353 | 12,181,247 | 8,866,420 | 8,592,259 |
| Book value per share | $ 15.18 | $ 14.07 | $ 13.14 | $ 11.72 | $ 10.76 |
| Tangible book value per share | $ 11.08 | $ 10.81 | $ 11.11 | $ 10.40 | $ 9.55 |
| **Profitability Ratios** | | | | | |
| Tax-equivalent net interest margin | 3.85% | 3.96% | 3.79% | 3.70% | 3.84% |
| Return on average assets | 1.15% | 1.13% | 0.61% | 0.88% | 0.89% |
| Return on average equity | 10.91% | 11.10% | 6.72% | 10.55% | 10.01% |
| Non-interest expense to net-interest income and non-interest income | 67.4% | 63.7% | 71.4% | 67.2% | 66.0% |
| Non-interest expense to net-interest income and non-interest income | 41.7% | 35.1% | 35.9% | 41.1% | 36.6% |
| Average equity to average total assets | 10.57% | 10.19% | 9.02% | 8.30% | 8.91% |
| **Financial Condition** | | | | | |
| Total assets | $ 2,035,885 | $ 1,773,373 | $ 1,730,388 | $ 1,238,821 | $ 1,151,346 |
| Total liabilities | 1,832,321 | 1,588,994 | 1,570,350 | 1,134,885 | 1,058,933 |
| Total shareholders equity | 203,564 | 184,379 | 160,038 | 103,936 | 92,413 |
| Interest-earning assets | 1,879,412 | 1,629,607 | 1,600,125 | 1,164,617 | 1,061,139 |
| Portfolio loans and leases | 1,398,456 | 1,295,392 | 1,196,717 | 885,739 | 899,577 |
| Investment securities | 318,061 | 275,258 | 320,047 | 208,224 | 108,329 |
| Goodwill | 32,897 | 24,689 | 17,659 | 6,301 | 4,629 |
| Intangible assets | 21,998 | 18,014 | 7,064 | 5,421 | 5,729 |
| Deposits | 1,634,682 | 1,382,369 | 1,341,432 | 937,887 | 869,490 |
| Borrowings | 170,718 | 183,158 | 204,724 | 169,388 | 169,939 |
| Wealth assets under management, administration, supervision and brokerage | 6,663,212 | 4,831,631 | 3,412,890 | 2,871,143 | 2,146,399 |
| **Capital Ratios** | | | | | |
| Ratio of tangible common equity to tangible assets | 7.60% | 8.19% | 7.93% | 7.51% | 7.19% |
| Tier 1 capital to risk weighted assets | 11.02% | 11.16% | 11.21% | 9.41% | 8.81% |
| Total regulatory capital to risk weighted assets | 12.02% | 13.74% | 13.62% | 12.53% | 11.29% |
| **Asset quality** | | | | | |
| Allowance as a percentage of portfolio loans and leases | 1.03% | 0.98% | 0.86% | 1.18% | 1.15% |
| Non-performing loans and leases as a percentage of portfolio loans and leases | 1.06% | 1.11% | 0.79% | 0.78% | 0.65% |

**Amounts in 2008 and 2009 have not been adjusted to reflect the immaterial effect of the correction of an immaterial accounting error. For more information, refer to Note 1-B in the Notes to Consolidated Financial Statements.*

Information related to accounting changes may be found under the caption New Accounting Pronouncements at Note 1-W in the accompanying Notes to Consolidated Financial Statements found in this Annual Report on Form 10-K.

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**ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OPERATIONS ( MD&A )**

**Brief History of the Corporation**

The Bryn Mawr Trust Company (the Bank ) received its Pennsylvania banking charter in 1889 and is a member of the Federal Reserve System. In 1986, Bryn Mawr Bank Corporation (the Corporation ) was formed and on January 2, 1987, the Bank became a wholly-owned subsidiary of the Corporation. The Bank and Corporation are headquartered in Bryn Mawr, Pennsylvania, a western suburb of Philadelphia. The Corporation and its subsidiaries offer a full range of personal and business banking services, consumer and commercial loans, equipment leasing, mortgages, insurance and wealth management services, including investment management, trust and estate administration, retirement planning, custody services, and tax planning and preparation from 19 full-service branches and seven limited-hour, retirement community offices throughout Montgomery, Delaware and Chester counties of Pennsylvania and New Castle county in Delaware. The common stock of the Corporation trades on the NASDAQ Stock Market ( NASDAQ ) under the symbol BMTC.

The Corporation operates in a highly competitive market area that includes local, national and regional banks as competitors along with savings banks, credit unions, insurance companies, trust companies, registered investment advisors and mutual fund families. The Corporation and its subsidiaries are regulated by many agencies including the Securities and Exchange Commission ( SEC ), NASDAQ, Federal Deposit Insurance Corporation ( FDIC ), the Federal Reserve and the Pennsylvania Department of Banking. The goal of the Corporation is to become the preeminent community bank and wealth management organization in the Philadelphia area.

During the three years ended December 31, 2012, the Corporation completed the following transactions:

**First Bank of Delaware**

On November 17, 2012, the acquisition of $70.3 million of deposits, $76.6 million of loans and a branch location from First Bank of Delaware ( FBD ), by the Corporation was completed. The transaction, which was accounted for as a business combination, enabled the Corporation to expand its banking arm into the Delaware market by opening its first full-service branch there, complementing its existing wealth management operations in the state.

**Davidson Trust Company**

On May 15, 2012, the acquisition of Davidson Trust Company ( DTC ) by the Corporation was completed. The transaction was accounted for as a business combination. The acquisition of DTC initially increased the Corporation s wealth management division assets under management by $1.0 billion. The structure of the Corporation s existing wealth management segment allowed for the immediate integration of DTC and was able to take advantage of the various synergies that exist between the two companies.

**The Private Wealth Management Group of The Hershey Trust Company**

On May 27, 2011, the acquisition of the Private Wealth Management Group of the Hershey Trust Company ( PWMG ) by the Corporation was completed. The transaction was accounted for as a business combination. The acquisition of PWMG initially increased the Corporation s wealth management division assets under management by $1.1 billion. The acquisition of PWMG allowed the Corporation to establish a presence in central Pennsylvania by maintaining the former PWMG offices in Hershey, Pennsylvania.

**First Keystone Financial, Inc.**

On July 1, 2010, the merger of First Keystone Financial, Inc. ( FKF ) with and into the Corporation, and the two step merger of FKF s wholly-owned subsidiary, First Keystone Bank with and into the Bank, were completed.

The transaction was accounted for as a business combination. The merger with FKF, a federally chartered thrift institution with assets of approximately $480 million, enabled the Corporation to increase its regional footprint

with the addition of eight full service branch locations, primarily in Delaware County, Pennsylvania. The geographic locations of the acquired branches were such that it was not necessary to close any of the former FKF branches. By expanding into these new areas within Delaware County, Pennsylvania, the Corporation has been able to extend its successful sales culture as well as offer its reputable wealth management products and other value-added services to a wider segment of the region s population.

**Results of Operations**

The following is Management s discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in the accompanying consolidated financial statements. The Corporation s consolidated financial condition and results of operations are comprised primarily of the Bank s financial condition and results of operations. Current performance does not guarantee, and may not be indicative of, similar performance in the future. For more information on the factors that could affect performance, see Special Cautionary Notice Regarding Forward Looking Statements on page 57 of this Item.

**Critical Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Corporation and its subsidiaries conform to U.S. generally accepted accounting principles ( GAAP ). All inter-company transactions are eliminated in consolidation and certain reclassifications are made when necessary in order to conform the previous years financial statements to the current year s presentation. In preparing the consolidated financial statements, Management is required to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. Therefore, actual results could differ from these estimates.

**The allowance for loan and lease losses** (the Allowance ) involves a higher degree of judgment and complexity than other significant accounting policies. The allowance for loan and lease losses is calculated with the objective of maintaining a reserve level believed by the Corporation to be sufficient to absorb estimated probable credit losses. The Corporation s determination of the adequacy of the allowance is based on periodic evaluations of the loan and lease portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, expected loan commitment usage, the amounts and timing of expected future cash flows on impaired loans and leases, value of collateral, estimated losses on consumer loans and residential mortgages and general amounts for historical loss experience. The process also considers economic conditions and inherent risks in the loan and lease portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from the Corporation s estimates, additional provision for loan and lease losses (the Provision ) may be required that would adversely impact earnings in future periods. See the section of this document titled *Asset Quality and Analysis of Credit Risk* for additional information.

**Other significant accounting policies** are presented in Note 1 in the accompanying financial statements. The Corporation s Summary of Significant Accounting Policies has not substantively changed any aspect of its overall approach in the application of the foregoing policies.

**Overview of General Economic, Regulatory and Governmental Environment**

Despite the uncertainty surrounding the ultimate outcome of the nation s remaining budgetary agreement, the general economic outlook is showing slow but steady improvement. Unemployment rates are moving lower and consumer balance sheets have improved to a level of quality not seen since the early 1990 s. Debt levels have been reduced and asset levels recouped much of the losses from the Great Recession. Throughout the last four years, consumers have reduced the amount of disposable personal income that has been committed to meeting total financial obligations (auto, mortgage, insurance and taxes) from a historically high level of 19% to slightly below 16% representing the healthiest level in more than 20 years.

The housing market has been showing a gradual improvement over the last few quarters, as measured by new building permits as well as an improvement in new and existing home sales. This improvement has occurred amid a favorable backdrop of historically low mortgage rates. In addition to the forecasted improvement in the housing market, consumer spending on durable goods should also show a marked improvement as we move through the year. Improvement in consumers balance sheets has been met by a banking industry now adequately capitalized and willing to make credit available at very attractive rates.

The initial reaction to the American Taxpayer Relief Act of 2012 has been positive for the markets since many of the individual tax policy uncertainties have been settled. The Bush-era personal income tax rates have been made permanent for those individuals making under $400,000 and capital gains, dividend income, and estate tax rates have been set going forward with unemployment benefits having been extended for another year. However, many uncertainties remain to be addressed in the areas of corporate tax rates and incentives as well as the required governmental spending reductions that will become necessary to reduce the deficit.

The Federal Reserve s continued efforts to maintain low interest rates during the months ahead, coupled with relatively high unemployment rates and low capacity utilization rates, should continue to contain the underlying inflationary pressure over the near to intermediate term. In the long term however, the magnitude of future inflationary pressure will depend on the government s resolve in completing the actions that are necessary to restore a climate of fiscal discipline by reducing the size of the fiscal budget deficit. Through the next few years, economic growth is likely to remain under historically average trends given the expected impact of a combination of government spending reductions and revenue increases needed to reduce the level of our ongoing federal deficit. This deleveraging would likely moderate the underlying growth potential of the United States as well as many of the other major economies over the next five to seven years.

**Executive Overview**

**2012 Compared to 2011**

*Income Statement*

The Corporation reported net income of $21.1 million or $1.60 diluted earnings per share for the twelve months ended December 31, 2012, as compared to $19.6 million, or $1.54 diluted earnings per share, for the same period in 2011. Return on average equity ( ROE ) and return on average assets ( ROA ) for the twelve months ended December 31, 2012, were 10.91% and 1.15%, respectively, as compared to 11.08% and 1.14%, respectively, for the same period in 2011. The increase in net income for the twelve months ended December 31, 2012, as compared to the same period in 2011, was largely related to a $12.3 million increase in non-interest income, comprised primarily of increases in wealth management revenue and gains on sale of residential mortgage loans. Also contributing to the net income increase was a $1.8 million increase in net interest income and a $2.1 million decrease in Provision between the periods. These improvements were substantially offset by a $13.2 million increase in non-interest expense and a $1.5 million increase in income tax expense for the twelve months ended December 31, 2012, as compared to the same period in 2011.

The $1.8 million, or 2.9% increase in the Corporation s tax-equivalent net interest income for the twelve months ended December 31, 2012, as compared to the same period in 2011, was attributed to a $3.1 million, or 26.4%, decrease in tax-equivalent interest expense offset by a $1.2 million, or 1.6%, decrease in tax-equivalent interest income for the twelve months ended December 31, 2012, as compared to the same period in 2011. The Corporation s tax-equivalent net interest margin declined to 3.85% for the twelve months ended December 31, 2012 from 3.96% for the same period in 2011.

For the twelve months ended December 31, 2012, the provision for loan and lease losses of $4.0 million was a decrease of $2.1 million from the $6.1 million for the same period in 2011. This decrease was partially the result of a $1.3 million, or 35.4%, decline in net loan charge-offs for the twelve months ended December 31, 2012, as compared to the same period in 2011. The decrease in net loan charge-offs was concentrated in the commercial mortgage, leasing and residential mortgage segments of the portfolio.

Non-interest income for the twelve months ended December 31, 2012 was $46.4 million, an increase of $12.3 million, or 36.2%, as compared to the same period in 2011. Largely contributing to the increase in non-interest income was an $8.1 million, or 37.5%, increase in fees for wealth management services, as the additions of PWMG in May 2011 and DTC in May 2012 had a significant impact on wealth management revenue. Augmenting the wealth management revenue increase was a $4.2 million, or 167.6%, increase in the gain on sale of residential mortgage loans for the twelve months ended December 31, 2012, as compared to the same period in 2010. During 2012, the Corporation experienced a surge in the volume of residential mortgage loan originations, as the low interest rate climate spurred on another refinancing boom.

Non-interest expense for the twelve months ended December 31, 2012, was $74.9 million, an increase of $13.2 million, or 21.3%, as compared to the same period in 2011. Contributing to this increase were a $6.3 million increase in salaries and employee benefits and a $2.1 million increase in due diligence and merger-related expenses. During 2012, the Corporation completed two transactions which not only accounted for the due diligence and merger-related expense increase, but also added overhead costs in the form of salaries and employee benefits as well as occupancy costs related to the new employees and facilities.

*Balance Sheet*

Asset quality remained relatively stable as of December 31, 2012. The allowance for loan and lease losses of $14.4 million was 1.03% of portfolio loans and leases, as of December 31, 2012, as compared to $12.8 million, or 0.98% of portfolio loans and leases, at December 31, 2011. The increase in the Allowance as of December 31, 2012, as compared to December 31, 2011, is reflective of the increase in the balance of loan portfolio between the dates.

Total portfolio loans and leases of $1.40 billion at December 31, 2012 increased $103.1 million, or 8.0%, as compared to $1.30 billion at December 31, 2011. The loan growth was concentrated in the commercial mortgage and commercial and industrial segments of the portfolio and was largely related to the $76.6 million of loans acquired from FBD.

The Corporation s investment portfolio at December 31, 2012 had a fair market value of $316.6 million, as compared to $273.8 million at December 31, 2011, as cash inflows from maturities, calls and pay downs as well as deposit inflows were reinvested.

Deposits of $1.63 billion, as of December 31, 2012, increased $252.3 million from December 31, 2011. The 18.3% increase was partially the result of the $70.3 million of deposits acquired from FBD, along with significant organic growth concentrated in the money market segment of the portfolio.

**2011 Compared to 2010**

*Income Statement*

In general, the differences in the results of operations for the twelve months ended December 31, 2011, as compared to the same period in 2010, were significantly impacted by the July 1, 2010 merger with FKF and the May 27, 2011 acquisition of PWMG. The Corporation reported net income of $19.6 million or $1.54 diluted earnings per share for the twelve months ended December 31, 2011, as compared to $9.0 million, or $0.85 diluted earnings per share, for the same period in 2010. ROE and ROA for the twelve months ended December 31, 2011, were 11.08% and 1.14%, respectively, as compared to 6.72% and 0.61%, respectively, for the same period in 2010. The increase in net income and, in turn, ROE and ROA for the twelve months ended December 31, 2011, as compared to the same period in 2010, was primarily related to a $10.7 million increase in net interest income, a $4.8 million increase in non-interest income and a $3.8 million decrease in Provision. These improvements were partially offset by a $3.5 million increase in non-interest expense and a $5.1 million increase in income tax expense for the twelve months ended December 31, 2011, as compared to the same period in 2010

The $10.4 million, or 19.6% increase in the Corporation s tax-equivalent net interest income for the twelve months ended December 31, 2011, as compared to the same period in 2010, was largely attributed to a $9.4 million, or 14.3%, increase in tax-equivalent interest income for the twelve months ended December 31, 2011, as compared to the same period in 2010 which was primarily the result of a $209.0 million increase in average portfolio loans between the periods. The Corporation s tax-equivalent net interest margin increased to 3.96% for the twelve months ended December 31, 2011 from 3.79% for the same period in 2010.

For the twelve months ended December 31, 2011, the provision for loan and lease losses of $6.1 million was a decrease of $3.8 million, or 38.2%, from the $9.9 million for the same period in 2010. This decrease resulted from the $6.4 million, or 63.9%, decline in net loan charge-offs for the twelve months ended December 31, 2011, as compared to the same period in 2010. The decrease in net loan charge-offs was primarily related to the $6.7 million decrease in net charge-offs of commercial and industrial loans between the periods. Increases in non-performing loans, primarily related to two residential construction loan relationships which became non-performing during 2011, required additional Provision, partially offsetting the charge-off declines.

Non-interest income for the twelve months ended December 31, 2011 was $34.1 million, an increase of $4.8 million, or 16.2%, as compared to the same period in 2010. Largely contributing to the increase in non-interest income for the twelve months ended December 31, 2011 was a $6.2 million, or 39.8%, increase in fees for wealth management services. This increase was primarily attributable to the May 27, 2011 acquisition of PWMG, which initially added $1.1 billion to the Corporation s assets under management, administration, supervision and brokerage. Partially offsetting the increase in wealth management revenues was a $2.2 million decrease in the gain on sale of residential mortgage loans for the twelve months ended December 31, 2011, as compared to the same period in 2010. During 2011, the Corporation experienced a decline in the volume of residential mortgage loan originations, as the refinancing boom of 2010 dropped off and did not continue into 2011. In addition, the Corporation elected to retain a larger portion of the originated residential loans in its portfolio.

Non-interest expense for the twelve months ended December 31, 2011, was $61.7 million, an increase of $3.5 million, or 6.1%, as compared to the same period in 2010. Contributing to this increase were a $4.2 million increase in salaries and benefits expenses, a $1.7 million increase in occupancy-related expenses, a $756 thousand increase in impairment of mortgage servicing rights, a $1.5 million increase in other operating expenses and a $1.0 million increase in intangible asset amortization. These increases were substantially offset by a $5.2 million decrease in due diligence and merger-related expenses between the periods.

**Components of Net Income**

Net income is comprised of five major elements:

**Net Interest Income**, or the difference between the interest income earned on loans, leases and investments and the interest expense paid on deposits and borrowed funds;

**Provision For Loan and Lease Losses**, or the amount added to the Allowance to provide for estimated inherent losses on portfolio loans and leases;

**Non-Interest Income** which is made up primarily of wealth management revenue, gains and losses from the sale of residential mortgage loans, gains and losses from the sale of available for sale investment securities and other fees from loan and deposit services;

**Non-Interest Expense**, which consists primarily of salaries and employee benefits, occupancy, intangible asset amortization, professional fees and other operating expenses; and

**Income Taxes,** which include state and federal jurisdictions.

**Net Interest Income**

**Rate/Volume Analyses (Tax-equivalent Basis)***

The rate volume analysis in the table below analyzes dollar changes in the components of interest income and interest expense as they relate to the change in balances (volume) and the change in interest rates (rate) of tax-equivalent net interest income for the years 2012 as compared to 2011 and 2011 as compared to 2010, allocated by rate and volume. The change in interest income / expense due to both volume and rate has been allocated to changes in volume.

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| *(dollars in thousands)* | 2012 Compared to 2011 | | | 2011 Compared to 2010 | | |
| *increase/(decrease)* | Volume | Rate | Total | Volume | Rate | Total |
| Interest Income: | | | | | | |
| Interest-bearing deposits with banks | $ 18 | $ (6) | $ 12 | $ (53) | $ (11) | $ (64) |
| Investment securities taxable | 306 | (1,109) | (803) | 559 | (304) | 255 |
| Investment securities nontaxable | 207 | (234) | (27) | (688) | (88) | (776) |
| Loans and leases | 3,384 | (3,798) | (414) | 11,972 | (1,997) | 9,975 |
| Total interest income | 3,915 | (5,147) | (1,232) | 11,790 | (2,400) | 9,390 |
| Interest expense: | | | | | | |
| Savings, NOW and market rate accounts | 444 | (1,133) | (689) | 646 | (645) | 1 |
| Wholesale non-maturity deposits | (69) | 14 | (55) | 24 | (101) | (77) |
| Wholesale time deposits | (139) | (94) | (233) | (134) | (196) | (330) |
| Time deposits | (361) | (417) | (778) | 339 | (246) | 93 |
| Borrowed funds long-term | 88 | (1,403) | (1,315) | (859) | 179 | (680) |
| Borrowed funds short-term | 5 | (8) | (3) | 15 | (7) | 8 |
| Total interest expense | (32) | (3,041) | (3,073) | 31 | (1,016) | (985) |
| Interest differential | $ 3,947 | $ (2,106) | $ 1,841 | $ 11,759 | $ (1,384) | $ 10,375 |

* *The tax rate used in the calculation of the tax-equivalent income is 35%.*

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**Analysis of Interest Rates and Interest Differential**

The table below presents the major asset and liability categories on an average daily basis for the periods presented, along with tax-equivalent interest income and expense and key rates and yields:

| | For the Year Ended December 31, | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2012 | | | 2011 | | | 2010 | | |
| *(dollars in thousands)* | Average Balance | Interest Income/ Expense | Average Rates Earned/ Paid | Average Balance | Interest Income/ Expense | Average Rates Earned/ Paid | Average Balance | Interest Income/ Expense | Average Rates Earned/ Paid |
| Assets: | | | | | | | | | |
| Interest-bearing deposits with banks | $ 60,389 | $ 127 | 0.21% | $ 52,390 | $ 115 | 0.22% | $ 73,521 | $ 179 | 0.24% |
| Investment securities available for sale: | | | | | | | | | |
| Taxable | 299,598 | 4,060 | 1.36% | 281,970 | 4,868 | 1.73% | 251,318 | 4,620 | 1.84% |
| Tax Exempt | 16,685 | 302 | 1.81% | 10,239 | 329 | 3.21% | 27,173 | 1,105 | 4.07% |
| Total investment securities available for sale | 316,283 | 4,362 | 1.38% | 292,209 | 5,197 | 1.78% | 278,491 | 5,725 | 2.06% |
| Investment securities trading | 1,431 | 37 | 2.59% | 1,339 | 32 | 2.39% | 1,383 | 25 | 1.81% |
| Loans and leases[(1)(2)(3)] | 1,310,883 | 69,140 | 5.27% | 1,250,071 | 69,554 | 5.56% | 1,041,109 | 59,579 | 5.72% |
| Total interest-earning assets | 1,688,986 | 73,666 | 4.36% | 1,596,009 | 74,898 | 4.69% | 1,394,504 | 65,508 | 4.70% |
| Cash and due from banks | 12,890 | | | 12,078 | | | 11,750 | | |
| Allowance for loan and lease losses | (13,469) | | | (11,397) | | | (10,248) | | |
| Other assets | 144,594 | | | 134,996 | | | 96,145 | | |
| Total assets | $ 1,833,001 | | | $ 1,731,686 | | | $ 1,492,151 | | |
| Liabilities: | | | | | | | | | |
| Savings, NOW, and market rate accounts | $ 828,675 | 2,268 | 0.27% | $ 722,850 | 2,957 | 0.41% | $ 594,756 | $ 2,957 | 0.50% |
| Wholesale non-maturity deposits | 46,815 | 169 | 0.36% | 67,793 | 224 | 0.33% | 62,875 | 301 | 0.48% |
| Wholesale time deposits | 17,256 | 88 | 0.51% | 30,429 | 321 | 1.05% | 38,379 | 651 | 1.70% |
| Time deposits | 195,778 | 1,507 | 0.77% | 232,084 | 2,285 | 0.98% | 201,947 | 2,192 | 1.09% |
| Total interest-bearing deposits | 1,088,524 | 4,032 | 0.37% | 1,053,156 | 5,787 | 0.55% | 897,957 | 6,101 | 0.68% |
| Subordinated debentures | 18,327 | 931 | 5.08% | 22,500 | 1,123 | 4.99% | 22,500 | 1,129 | 5.02% |
| Junior subordinated debentures | | | | 11,580 | 1,050 | 9.06% | 6,076 | 493 | 8.13% |
| Short-term borrowings | 13,525 | 21 | 0.16% | 11,380 | 25 | 0.21% | 5,838 | 16 | 0.28% |
| FHLB advances and other borrowings | 163,888 | 3,604 | 2.20% | 145,421 | 3,676 | 2.53% | 177,882 | 4,907 | 2.76% |
| Total interest-bearing liabilities | 1,284,264 | 8,588 | 0.67% | 1,244,037 | 11,661 | 0.94% | 1,110,253 | 12,646 | 1.14% |
| Non-interest-bearing deposits | 329,631 | | | 287,553 | | | 222,715 | | |
| Other liabilities | 25,242 | | | 23,573 | | | 24,601 | | |
| Total non-interest-bearing liabilities | 354,873 | | | 311,126 | | | 247,316 | | |
| Total liabilities | 1,639,137 | | | 1,555,163 | | | 1,357,569 | | |
| Shareholders equity | 193,864 | | | 176,523 | | | 134,582 | | |
| Total liabilities and shareholders equity | $ 1,833,001 | | | $ 1,731,686 | | | $ 1,492,151 | | |
| Net interest spread | | | 3.69% | | | 3.75% | | | 3.56% |
| Effect of non-interest-bearing sources | | | 0.16% | | | 0.21% | | | 0.23% |
| Net interest income/margin on earning assets | | $ 65,078 | 3.85% | | $ 63,237 | 3.96% | | $ 52,862 | 3.79% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Tax-equivalent adjustment (tax rate 35%) | $ | 343 | 0.02% | $ | 336 | 0.02% | $ | 611 | 0.04% |

(1) *Non-accrual loans have been included in average loan balances, but interest on non-accrual loans has not been included for purposes of determining interest income.*

(2) *Includes portfolio loans and leases and loans held for sale.*

(3) *Interest on loans and leases includes deferred (costs) fees of $(12), $24 and $106*

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**Tax-Equivalent Net Interest Income and Margin 2012 Compared to 2011**

The tax-equivalent net interest margin declined 11 basis points to 3.85% for the twelve months ended December 31, 2012, as compared to 3.96%, for the same period in 2011.

Tax-equivalent net interest income for the twelve months ended December 31, 2012 of $65.1 million, was $1.9 million, or 2.9%, higher than the tax-equivalent net interest income of $63.2 million for the same period in 2011. Although the decline in tax-equivalent yield earned on interest-bearing assets outpaced the decline in tax-equivalent rate paid on interest-bearing liabilities, there was a $93.0 million increase in average interest-earning assets, compared to only a $40.2 million increase in average interest-bearing liabilities between the periods.

The significant growth in average interest-bearing assets included a $60.8 million increase in average loans, much of which was the result of loan originations, as opposed to the acquisition of loans from FBD, which occurred midway through the fourth quarter of 2012. In addition, the strategic decision to prepay the Corporation s $22.5 million of subordinated debt during the third and fourth quarters of 2012 contributed to the reduction in tax-equivalent rate paid on interest-bearing liabilities.

**Tax-Equivalent Net Interest Income and Margin 2011 Compared to 2010**

The tax-equivalent net interest margin increased 17 basis points to 3.96% for the twelve months ended December 31, 2011, as compared to 3.79%, for the same period in 2010.

Tax-equivalent net interest income for the twelve months ended December 31, 2011, of $63.2 million, was $10.4 million, or 19.6%, higher than the tax-equivalent net interest income of $52.8 million for the same period in 2010. This increase was primarily the result of the $201.5 million increase in average interest-earning assets for the twelve months ended December 31, 2011, as compared to the same period in 2010. The increase in average interest-earning assets was not only related to the assets acquired in the July 1, 2010 merger with FKF, which were present for all of 2011, as opposed to only six months during 2010; it was also the result of the organic loan growth of $98.7 million which occurred during the twelve months ended December 31, 2011.

Partially offsetting the increase in interest-earning assets was the $133.8 million increase in average interest-bearing liabilities for the twelve months ended December 31, 2011, as compared to the same period in 2010. This increase was largely related to the deposits and other borrowings assumed in the FKF merger. During the twelve months ended December 31, 2011, the balance of interest-bearing liabilities declined $24.7 million, as FHLB advances and other borrowings decreased by $12.3 million and the Corporation elected to prepay its $12.0 million of 9.7% junior subordinated debentures, which had been acquired in the merger with FKF. The tax-equivalent average rate paid on interest-bearing liabilities for the twelve months ended December 31, 2011 was 0.94%, a decrease of 20 basis points from 1.14% for the same period in 2010. Largely contributing to this decrease was the 13 basis point decline in tax-equivalent rates paid on interest-bearing deposits, as lower-rate money market deposits and non-interest-bearing deposits replaced the scheduled run-off of higher-rate time and wholesale deposits.

**Tax-Equivalent Net Interest Margin Quarterly Comparison**

The tax-equivalent net interest margin and related components for the past five quarters are shown in the table below:

| Quarter | Year | Earning-Asset Yield | Interest-Bearing Liability Cost | Net Interest Spread | Effect of Non-Interest-Bearing Sources | Tax-Equivalent Net Interest Margin |
|---|---|---|---|---|---|---|
| 4th | 2012 | 4.27% | 0.54% | 3.73% | 0.13% | 3.86% |
| 3rd | 2012 | 4.28% | 0.66% | 3.62% | 0.16% | 3.78% |
| 2nd | 2012 | 4.39% | 0.72% | 3.67% | 0.17% | 3.84% |
| 1st | 2012 | 4.51% | 0.76% | 3.75% | 0.18% | 3.93% |
| 4th | 2011 | 4.59% | 0.88% | 3.71% | 0.20% | 3.91% |

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**Interest Rate Sensitivity**

The Corporation actively manages its interest rate sensitivity position. The objectives of interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve sustainable growth in net interest income. The Corporation s Asset Liability Committee ( ALCO ), using policies and procedures approved by the Corporation s Board of Directors, is responsible for the management of the Corporation s interest rate sensitivity position. The Corporation manages interest rate sensitivity by changing the mix, pricing and re-pricing characteristics of its assets and liabilities, through the management of its investment portfolio, its offerings of loan and selected deposit terms and through wholesale funding. Wholesale funding consists of multiple sources including borrowings from the FHLB, the Federal Reserve Bank of Philadelphia s discount window, certificates of deposit from institutional brokers, Certificate of Deposit Account Registry Service ( CDARS ), Insured Network Deposit ( IND ) Program, Institutional Deposit Corporation ( IDC ) and Pennsylvania Local Government Investment Trust ( PLGIT ).

The Corporation uses several tools to manage its interest rate risk including interest rate sensitivity analysis, or Gap Analysis, market value of portfolio equity analysis, interest rate simulations under various rate scenarios and tax-equivalent net interest margin reports. The results of these reports are compared to limits established by the Corporation s ALCO policies and appropriate adjustments are made if the results are outside the established limits.

The following table demonstrates the annualized result of an interest rate simulation and the estimated effect that a parallel interest rate shift, or shock , in the yield curve and subjective adjustments in deposit pricing, might have on the Corporation s projected net interest income over the next 12 months.

This simulation assumes that there is no growth in interest-earning assets or interest-bearing liabilities over the next twelve months. The changes to net interest income shown below are in compliance with the Corporation s policy guidelines.

**Summary of Interest Rate Simulation**

| *(dollars in thousands)* | December 31, 2012 Estimated Change In Net Interest Income Over Next 12 Months | |
|---|---|---|
| **Change in Interest Rates** | | |
| +300 basis points | $ 6,029 | 8.23% |
| +200 basis points | $ 3,425 | 4.68% |
| +100 basis points | $ 1,203 | 1.64% |
| -100 basis points | $ (1,817) | (2.48)% |

The interest rate simulation above demonstrates that the Corporation s balance sheet as of December 31, 2012 is asset sensitive, indicating that an increase in interest rates will have a positive impact on net interest income over the next 12 months while a decrease in interest rates will negatively impact net interest income. In the above simulation, net interest income will increase if rates increase 100, 200 or 300 basis points. Because the Corporation s internal prime loan rate is set, as of December 31, 2012, at 3.99%, or 74 basis points above the Wall Street Journal Prime Rate of 3.25%, a 100 basis point increase in interest rates would have a less significant effect than it would had the Corporation not set this prime rate limit. The 100 basis point decrease scenario shows a $1.82 million, or 2.48%, decrease in net interest income over the next twelve months as many of the Corporation s liabilities bear rates of interest below 1.00% and therefore would not be able to sustain the entire decrease. The four scenarios are directionally consistent with the December 31, 2011 simulation, but reflect a higher interest income increase and percentage change in net interest income due to the current rate environment.

The interest rate simulation is an estimate based on assumptions, which are based on past behavior of customers, along with expectations of future behavior relative to interest rate changes. In today s uncertain economic

environment and the current extended period of very low interest rates, the reliability of the Corporation s interest rate simulation model is more uncertain than in other periods. Actual customer behavior may be significantly different than expected behavior, which could cause an unexpected outcome and may result in lower net interest income.

**Gap Report**

The interest sensitivity, or Gap report, identifies interest rate risk by showing repricing gaps in the Corporation s balance sheet. All assets and liabilities are reflected based on behavioral sensitivity, which is usually the earliest of either: repricing, maturity, contractual amortization, prepayments or likely call dates. Non-maturity deposits, such as NOW, savings and money market accounts are spread over various time periods based on the expected sensitivity of these rates considering liquidity and the investment preferences of the Corporation. Non-rate-sensitive assets and liabilities are spread over time periods to reflect the Corporation s view of the maturity of these funds.

Non-maturity deposits (demand deposits in particular), are recognized by the Bank s regulatory agencies to have different sensitivities to interest rate environments. Consequently, it is an accepted practice to spread non-maturity deposits over defined time periods in order to capture that sensitivity. Commercial demand deposits are often in the form of compensating balances, and fluctuate inversely to the level of interest rates; the maturity of these deposits is reported as having a shorter life than typical retail demand deposits. Additionally, the Bank s regulatory agencies have suggested distribution limits for non-maturity deposits. However, the Corporation has taken a more conservative approach than these limits would suggest by forecasting these deposit types with a shorter maturity. The following table presents the Corporation s Gap Analysis as of December 31, 2012:

| *(dollars in millions)* | **0 to 90 Days** | **91 to 365 Days** | **1 - 5 Years** | **Over 5 Years** | **Non-Rate Sensitive** | **Total** |
|---|---|---|---|---|---|---|
| Assets: | | | | | | |
| Interest-bearing deposits with banks | $ 159.5 | $ | $ | $ | $ | $ 159.5 |
| Investment securities[1] | 61.6 | 58.4 | 155.0 | 43.1 | | 318.1 |
| Loans and leases[2] | 430.5 | 164.1 | 634.7 | 172.6 | | 1,401.9 |
| Allowance | | | | | (14.4) | (14.4) |
| Cash and due from banks | | | | | 16.2 | 16.2 |
| Other assets | | | | | 154.6 | 154.6 |
| Total assets | $ 651.6 | $ 222.5 | $ 789.7 | $ 215.7 | $ 156.4 | $ 2,035.9 |
| Liabilities and shareholders equity: | | | | | | |
| Demand, non-interest-bearing | $ 26.2 | $ 78.7 | $ 114.8 | $ 180.0 | $ | $ 399.7 |
| Savings, NOW and market rate | 68.7 | 206.1 | 475.4 | 208.6 | | 958.8 |
| Time deposits | 91.1 | 89.8 | 37.4 | 0.3 | | 218.6 |
| Wholesale non-maturity deposits | 45.2 | | | | | 45.2 |
| Wholesale time deposits | 6.4 | 0.6 | 5.4 | | | 12.4 |
| Short-term borrowings | 9.4 | | | | | 9.4 |
| FHLB advances and other borrowings | 41.3 | 11.2 | 108.2 | 0.6 | | 161.3 |
| Other liabilities | | | | | 26.9 | 26.9 |
| Shareholders equity | 7.3 | 21.8 | 116.3 | 58.2 | | 203.6 |
| Total liabilities and shareholders equity | $ 295.6 | $ 408.2 | $ 857.5 | $ 447.7 | $ 26.9 | $ 2,035.9 |
| Interest-earning assets | $ 651.6 | $ 222.5 | $ 789.7 | $ 215.7 | $ | $ 1,879.5 |
| Interest-bearing liabilities | 262.1 | 307.7 | 626.4 | 209.5 | | 1,405.7 |
| Difference between interest-earning assets and interest-bearing liabilities | $ 389.5 | $ (85.2) | $ 163.3 | $ 6.2 | $ | $ 473.8 |
| Cumulative difference between interest earning assets and interest-bearing liabilities | $ 389.5 | $ 304.3 | $ 467.6 | $ 473.8 | $ | $ 473.8 |
| Cumulative earning assets as a % of cumulative interest bearing liabilities | 249% | 153% | 139% | 134% | | |

[(1)] *Investment securities include available for sale and trading.*
[(2)] *Loans include portfolio loans and leases and loans held for sale.*

The table above indicates that the Corporation is asset sensitive and should experience an increase in net interest income in the near term, if interest rates rise. Accordingly, if rates decline, net interest income should decline. Actual results may differ from expected results for many reasons including market reactions, competitor responses, customer behavior and/or regulatory actions.

**Fair Value Adjustments Impacting the Statement of Income**

The following table details the actual effect for the twelve month periods ended December 31, 2012, 2011 and 2010, and the projected effect, for each of the five years ending December 31, 2017, and thereafter, of the accretable and amortizable fair value adjustments attributable to the FKF merger and the FBD transaction, on net interest income, net non-interest income and pretax income. The projected accretion and amortization is subject to change in future periods related to, among other things, changes in the Corporation s estimates of loan cash flows, deposit maturities, loan prepayments, and prepayments of FHLB advances.

| | | Actual For the Twelve Months Ended December 31, | | | Projected For the Twelve Months Ending December 31, | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Income Statement Effect | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Thereafter |
| **Interest income/expense:** | | | | | | | | | | |
| Loans | Income | $ 657 | $ 1,548 | $ 1,706 | $ 2,216 | $ 2,187 | $ 1,628 | $ 1,235 | $ 481 | $ 1,913 |
| Investment securities | Expense | (554) | (570) | (630) | | | | | | |
| Deposits | Income | 564 | 545 | 391 | 349 | 23 | | | | |
| FHLB advances | Income | 1,450 | 552 | 442 | 142 | 125 | 125 | 121 | 121 | 9 |
| Jr. subordinated debentures | Income | 78 | 55 | | | | | | | |
| **Net interest income** | | 2,195 | 2,130 | 1,909 | 2,707 | 2,335 | 1,753 | 1,356 | 602 | 1,922 |
| **Non-interest income/expense:** | | | | | | | | | | |
| Premises and equipment | Expense | 46 | 93 | 93 | 111 | 111 | 111 | 111 | 111 | 1,390 |
| Other liabilities | Income | | | (76) | (39) | | | | | |
| **Net non-interest expense** | | 46 | 93 | 17 | 72 | 111 | 111 | 111 | 111 | 1,390 |
| **Pretax income effect** | | $ 2,149 | $ 2,037 | $ 1,892 | $ 2,635 | $ 2,224 | $ 1,642 | $ 1,245 | $ 491 | $ 532 |

**Provision for Loan and Lease Losses**

**Loans Acquired in Mergers and Acquisitions**

In accordance with GAAP, the loans acquired from FKF and FBD were recorded at their fair value with no carryover of the previously associated allowance for loan loss.

Certain loans were acquired which exhibited deteriorated credit quality since origination and for which the Corporation does not expect to collect all contractual payments. Accounting for these *purchased credit-impaired* loans is done in accordance with ASC 310-30, Accounting for Certain Loans or Debt Securities Acquired in a Transfer . The loans were recorded at fair value, reflecting the present value of the amounts expected to be collected. Income recognition on these loans is based on a reasonable expectation about the timing and amount of cash flows to be collected. Acquired loans deemed impaired and considered collateral dependent, with the timing of the sale of loan collateral indeterminate, remain on non-accrual status and have no accretable yield.

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Management evaluates purchased credit-impaired loans individually for further impairment. The balance of the Corporation s loan and lease portfolio is evaluated on either an individual basis or on a collective basis for impairment. Refer to Notes 5-F and 5-H in the Notes to Consolidated Financial Statements for a more information regarding the Corporation s impaired loans and leases.

**General Discussion of the Allowance for Loan and Lease Losses**

The balance of the allowance for loan and lease losses is determined based on the Corporation s review and evaluation of the loan and lease portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions, and other pertinent factors, including the Corporation s assumptions as to future delinquencies, recoveries and losses.

Increases to the Allowance are implemented through a corresponding Provision (expense) in the Corporation s statement of income. Loans and leases deemed uncollectible are charged against the Allowance. Recoveries of previously charged-off amounts are credited to the Allowance.

While the Corporation considers the Allowance to be adequate, based on information currently available, future additions to the Allowance may be necessary due to changes in economic conditions or the Corporation s assumptions as to future delinquencies, recoveries and losses and the Corporation s intent with regard to the disposition of loans. In addition, the Pennsylvania Department of Banking and the Federal Reserve Bank of Philadelphia, as an integral part of their examination process, periodically review the Corporation s Allowance.

The Corporation s Allowance is the combination of four components that are calculated based on various independent methodologies. All components of the Allowance are based on Management s estimates. These estimates are summarized earlier in this document under the heading Critical Accounting Policies, Judgments and Estimates.

The four components of the Allowance are as follows:

**Specific Loan Evaluation Component** Includes the specific evaluation of larger classified loans

**Historical Charge-Off Component** Applies a rolling, twelve quarter, historical charge-off rate to pools of non-classified loans

**Additional Qualitative Factors Component** The loan and lease portfolios are broken down into multiple homogenous sub classifications, upon which multiple factors (such as delinquency trends, economic conditions, loan terms, credit grade, state of origination, industry, regulatory environment and other relevant information) are evaluated, resulting in an Allowance amount for each of the sub classifications. The sum of these amounts comprises the Additional Qualitative Factors Component.

**Unallocated Component** This amount represents a reserve against all loans for factors not included in the components mentioned above.

As part of the process of allocating the Allowance to the different segments of the loan and lease portfolio, Management considers certain credit quality indicators. For the commercial mortgage, construction and commercial and industrial loan segments, periodic reviews of the individual loans are performed by both in-house employees as well as an external loan review service. The results of these reviews are reflected in the risk grade assigned to each loan. These internally assigned grades are as follows:

**Pass** Loans considered satisfactory with no indications of deterioration.

**Special mention** Loans classified as special mention have a potential weakness that deserves Management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution s credit position at some future date.

**Substandard** Loans classified as substandard are inadequately protected by the current net worth and payment capacity of the obligor or of the collateral pledged, if any. Substandard loans have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

**Doubtful** Loans classified as doubtful have all 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 currently existing facts, conditions, and values, highly questionable and improbable. Loan balances classified as doubtful have been reduced by partial charge-offs and are carried at their net realizable values.

Consumer credit exposure, which includes residential mortgages, home equity lines and loans, leases and consumer loans, are assigned a credit risk profile based on payment activity (that is, their delinquency status).

Refer to Note 5-F in the Notes to Consolidated Financial Statements for details regarding credit quality indicators associated with the Bank s loan and lease portfolio.

**Portfolio Segmentation** The Corporation s loan and lease portfolio is divided into specific segments of loans and leases having similar characteristics. These segments are as follows:

Commercial mortgage

Home equity lines and loans

Residential mortgage

Construction

Commercial and industrial

Consumer

Leases

Refer to Note 5 in the Notes to Consolidated Financial Statements and page 49 of this MD&A under the heading Portfolio Loans and Leases for details of the Corporation s loan and lease portfolio, broken down by portfolio segment.

**Impairment Measurement** In accordance with guidance provided by ASC 310-10, Accounting by Creditors for Impairment of a Loan , the Corporation employs one of three methods to determine and measure impairment:

the Present Value of Future Cash Flow Method;

the Fair Value of Collateral Method;

the Observable Market Price of a Loan Method.

The majority of loans and leases are evaluated for impairment on a collective basis. However, loans and leases for which there is an indication that all contractual payments may not be collectible are evaluated for impairment on an individual basis. Loans that are evaluated on an individual basis include non-performing loans, troubled debt restructurings and purchased credit-impaired loans.

**Nonaccrual Loans** In general, loans and leases that are delinquent on contractually due principal or interest payments for more than 89 days are placed on nonaccrual status and any unpaid interest is reversed as a charge to interest income. When the loan resumes payment, all payments (principal and interest) are applied to reduce principal. After a period of six months of satisfactory performance, the loan may be placed back on accrual status. Any interest payments received during the nonaccrual period that had been applied to reduce principal are reversed and recorded as a deferred fee which accretes to interest income over the remaining term of the loan or

lease. In certain cases, the Corporation may have information about a particular loan or lease that may indicate a future disruption or curtailment of contractual payments. In these cases, the Corporation will preemptively place the loan or lease on nonaccrual status.

**Troubled Debt Restructurings ( TDRs )** The Corporation follows guidance provided by ASC 310-40, Troubled Debt Restructurings by Creditors. A restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor s financial difficulties grants a concession to the debtor that it would not otherwise consider in the normal course of business. A concession may include an extension of repayment terms which would not normally be granted, a reduction of interest rate or the forgiveness of principal and/or accrued interest. If the debtor is experiencing financial difficulty and the creditor has granted a concession, the Corporation will make the necessary disclosures related to the TDR. In certain cases, a modification may be made in an effort to retain a customer who is not experiencing financial difficulty. This type of modification is not considered to be a TDR. Once a loan or lease has been modified and is considered a TDR, it is reported as an impaired loan or lease. If the loan or lease deemed a TDR has performed for at least six months at the level prescribed by the modification, it is not considered to be non-performing; however, it will generally continue to be reported as impaired. Loans and leases that have performed for at least six months are reported as TDRs in compliance with modified terms.

Refer to Notes 5-G in the Notes to Consolidated Financial Statements for more information regarding the Corporation s TDRs.

**Charge-off Policy** The Corporation s charge-off policy is that, on a periodic basis, not less often than quarterly, delinquent and non-performing loans that exceed the following limits are considered for charge-off:

Open-ended consumer loans exceeding 180 days past due.

Closed-ended consumer loans exceeding 120 days past due.

All commercial/business purpose loans exceeding 180 days past due.

All leases exceeding 120 days past due.

Any other loan or lease, for which the Corporation has reason to believe collectibility is unlikely, and for which sufficient collateral does not exist, is also charged off.

Refer to Notes 5-F in the Notes to Consolidated Financial Statements for more information regarding the Corporation s charge-offs and factors which influenced Management s judgment with respect thereto.

**Asset Quality and Analysis of Credit Risk**

As of December 31, 2012, total non-performing loans and leases of $14.8 million representing 1.06% of portfolio loans and leases, as compared to 1.11%, or $14.3 million, as of December 31, 2011. The $453 thousand increase in non-performing loans and leases is comprised of a $1.2 million increase in nonperforming commercial and industrial loans and a $520 thousand increase in nonperforming residential mortgages. These increases were substantially offset by reductions of $412 thousand and $858 thousand in nonperforming commercial mortgages and construction loans, respectively, between the dates.

The Provision for the twelve month periods ended December 31, 2012, 2011 and 2010 was $4.0 million, $6.1 million and $9.9 million, respectively. As of December 31, 2012, the Allowance of $14.3 million represents 1.03% of portfolio loans and leases, as compared to the Allowance, as of December 31, 2011, of $12.8 million, which represented 0.98% of portfolio loans and leases as of that date. The increase in the Allowance, as a percentage of portfolio loans and leases, from December 31, 2011 to December 31, 2012, is reflective of the growth of the Corporation s loan portfolio, the increase in nonperforming loans and leases, as well as Management s analysis of qualitative factors affecting the loan portfolio.

As of December 31, 2012, the Corporation had other real estate owned ( OREO ) valued at $906 thousand, as compared to $549 thousand as of December 31, 2011. The four properties comprising the balance as of December 31, 2012 were the result of foreclosures of loans acquired from FKF and include one residential property, two commercial properties and one parcel of undeveloped land. All properties are recorded at their fair value less costs to sell.

As of December 31, 2012, the Corporation had $11.1 million of TDRs, of which $8.0 million are in compliance with the modified terms, and hence, excluded from non-performing loans and leases. As of December 31, 2011, the Corporation had $11.5 million of TDRs, of which $7.2 million were in compliance with the modified terms.

Impaired loans and leases are those for which it is probable that the Corporation will not be able to collect all scheduled principal and interest payments in accordance with the original terms of the loans and leases. Included in impaired loans and leases are non-accrual loans and leases and TDRs. Purchased credit-impaired loans are not included in impaired loan and lease totals. As of December 31, 2012, the Corporation had $22.0 million of impaired loans and leases, as compared to impaired loans and leases of $20.0 million as of December 31, 2011. Refer to Notes 5-H in the Notes to Consolidated Financial Statements for more information regarding the Corporation s impaired loans and leases.

The Corporation continues to be diligent in its credit underwriting process and very proactive with its loan review process, including the services of an independent outside loan review firm, which helps identify developing credit issues. These proactive steps include the procurement of additional collateral (preferably outside the current loan structure) whenever possible and frequent contact with the borrower. Management believes that timely identification of credit issues and appropriate actions early in the process serve to mitigate overall losses.

The list below identifies certain key characteristics of the Corporation s loan and lease portfolio. Refer to the loan and lease portfolio tables in Note 5 in the Notes to Consolidated Financial Statements and page 49 of this MD&A under the heading Portfolio Loans and Leases for further details.

**Portfolio Loans and Leases** The Corporation s $1.4 billion loan and lease portfolio is predominantly based in the Corporation s traditional market areas of Chester, Delaware and Montgomery counties of Pennsylvania and in the greater Philadelphia area, none of which has experienced the real estate price appreciation and subsequent decline that many other areas of the country have experienced. The Corporation has observed a slight increase in new construction in the local area.