

# MIDDLEBURY NATIONAL CORPORATION

30 Main Street, P.O. Box 189, Middlebury, Vermont 05753-0189

April 5, 2011

## NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To Our Shareholders:

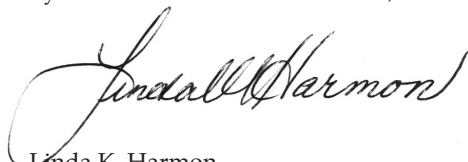
**NOTICE IS HEREBY GIVEN** that, pursuant to the call of its Directors, the Annual Meeting of Shareholders of the Middlebury National Corporation will be held at The Middlebury Inn, Middlebury, Vermont, on Tuesday, May 3, 2011, at 2:00 p.m. for the following purposes:

1. Election of three (3) Directors to serve until the 2014 Annual Meeting of Shareholders
2. To amend the Company's Restated Certificate of Incorporation in order to adopt certain housekeeping provisions. Specifically:
  - a) Correct the name of the Corporation in the certificate heading to read "Middlebury National Corporation"
  - b) Correct Article SECOND to correctly reflect the current address of Prentice-Hall Corporation System, the Company's Delaware registered agent
  - c) Update Article THIRD, the purposes clause, to change reference to "bank holding companies" to "financial holding companies"
  - d) Incorporate text of amended Article FOURTH into the certificate
  - e) To amend Article SEVENTH to narrow the scope of the mandatory indemnification provision to extend only to directors and officers and to limit the director's liability to the fullest extent permitted by law
3. To ratify the appointment of A.M. Peisch & Company, LLP, independent auditors, to serve as auditors for the Corporation for the year 2011
4. To transact any other business that may properly come before the meeting or any adjournment thereof

The close of business March 23, 2011, has been fixed as a record date for determining shareholders entitled to notice of a vote at the Annual Meeting.

The Board of Directors recommends a vote FOR proposals 1 through 3.

By order of the Board of Directors,



Linda K. Harmon  
President

# MIDDLEBURY NATIONAL CORPORATION

30 Main Street, P.O. Box 189, Middlebury, Vermont 05753-0189

## PROXY STATEMENT ANNUAL MEETING OF SHAREHOLDERS MAY 3, 2011

This proxy statement is furnished in connection with the solicitation of proxies by or on behalf of the Directors of the Middlebury National Corporation for use at the Annual Meeting of Shareholders to be held on Tuesday, May 3, 2011, at 2:00 p.m. at The Middlebury Inn, Middlebury, Vermont, or any adjournment thereof.

A proxy duly executed and returned by the shareholder will be voted as directed by the proxy. If no choice is specified, the proxy will be voted for the election of nominees set forth in the proxy. If other matters are voted upon, persons named in the proxy will take action in accordance with the recommendations of management. Any proxy may be revoked by written notice to the Secretary of the Corporation prior to the voting of the proxy.

### ELECTION OF DIRECTORS

As provided for in the Articles of Association, the Board is divided into three classes of directors: Class I, Class II, and Class III, so that approximately one third of the directors' terms expire each year. Directors whose terms expire at the 2011 Shareholders' Meeting are Linda K. Harmon, Roch F. MacIntyre, and Michael G. McLaughlin. All will stand for re-election to hold office until the year 2014 Shareholders' Meeting. The Board of Directors recommends a vote "FOR" the Election of Directors.

The persons listed below constitute the total members of the Board of Directors.

Name	Age	Position with Middlebury National Corporation and Principal Occupation	Director Since	Term Expires	Shares Beneficially Owned
<b>Class I Directors</b>					
Paul J. Carrara, Jr.	41	Director of Middlebury National Corporation and National Bank of Middlebury; Project Manager, JP Carrara & Sons, Inc., Middlebury, VT.	2002	2013	2710
Lawrence W. Miller, II	44	Director of Middlebury National Corporation and National Bank of Middlebury; State of Vermont, Secretary of the Agency of Commerce & Community Development, Montpelier, VT.	2004	2013	252
G. Kenneth Perine	59	Director of Middlebury National Corporation and National Bank of Middlebury; Executive Vice President, Middlebury National Corporation; President, National Bank of Middlebury, Middlebury, VT.	1990	2013	2792

Name	Age	Position with Middlebury National Corporation and Principal Occupation	Director Since	Term Expires	Shares Beneficially Owned
<b>Class II Directors</b>					
Linda K. Harmon	61	Director of Middlebury National Corporation and National Bank of Middlebury; President, Middlebury National Corporation. President, H&M Mountain Enterprises, Inc., DBA Mary's at Baldwin Creek, Bristol, VT.	1995	2011	650
Roch F. MacIntyre	66	Director of Middlebury National Corporation and National Bank of Middlebury; Manager, MacIntyre Services, LLC, Middlebury, VT.	1980	2011	4614
Michael G. McLaughlin	39	Director of Middlebury National Corporation and National Bank of Middlebury; VP of Business Development and Marketing at Bread Loaf Construction, Middlebury, VT.	2009	2011	76
<b>Class III Directors</b>					
Caroline R. Carpenter	45	Director of Middlebury National Corporation and National Bank of Middlebury; Executive Vice President and Information Technology Manager, National Bank of Middlebury, Middlebury, VT.	2005	2012	1644
Michael D. Schoenfeld.	59	Director of Middlebury National Corporation and National Bank of Middlebury; Middlebury College Director of Development, Dean of Enrollment Planning, The Middlebury Initiative, & Middlebury College VP of College Advancement	2010	2012	100
Sarah D. Stahl	61	Director of Middlebury National Corporation and National Bank of Middlebury; Chair, National Bank of Middlebury; Operations Manager, Vermont Folklife Center, Middlebury, VT.	1988	2012	380

#### REMUNERATION OF MANAGEMENT

Directors and officers were compensated as directors and officers of the bank, and received no compensation for their position in the holding company. All directors attended at least 75% of board meetings held in 2010. The aggregate compensation paid during 2010 to seven outside directors was \$100,550.00. The aggregate compensation paid to the eighteen officers was \$1,429,700.00. The aggregate cost for contributions to the officers' retirement plan accounts was \$282,350.00.

#### APPROVAL OF INDEPENDENT AUDITORS

A.M. Peisch & Company, LLP, a certified public accounting firm with five offices in Vermont, has been independent auditor for the Middlebury National Corporation since its organization in 1985 and for The National Bank of Middlebury many years prior to 1985. The Board of Directors recommends a vote "FOR" the appointment of A.M. Peisch & Company, LLP, as independent auditors for the year 2011.

**Proxy Statement** (continued)

**OTHER MATTERS**

The Middlebury National Corporation Board of Directors is requesting your consideration of amendments to Middlebury National Corporation's Certificate of Incorporation. The Board is recommending these changes to update the company's charter. A complete redlined version of the Certificate of Incorporation is included in an appendix to this Proxy Statement. These changes are summarized below for your review.

1. Corporate name and heading: This change is requested to correct the references to the corporation to read, "Middlebury National Corporation."
2. Address of registered agent: This change is intended to correct the mailing address for Prentice-Hall Corporation.
3. Reference to holding companies: This amendment is intended to update the reference in the body of the charter from "bank" to "financial" holding companies to reflect amendments to the Federal Bank Holding Company Act passed subsequently to our original charter adoption in 1985.
4. Incorporate text of amended ARTICLE FOURTH as approved by shareholders on April 8, 2009.
5. Mandatory indemnification: This amendment is intended to restate indemnification language to apply to directors and officers only and make indemnification of others permissive subject to the decision of the Board of Directors on a case-by-case basis. This change is intended to narrow the scope of indemnification.
6. Limit of director liability: This change is meant to adopt provisions of Delaware corporate law passed in 1986 (subsequent to the original adoption of the Middlebury National Corporation charter in 1985) limiting liability of directors to the fullest extent permitted by law. Including this type of provision in charters is now standard practice in Delaware and other states, as well as in Vermont.

If you should have any questions regarding these requested amendments to Middlebury National Corporation's Certificate of Incorporation, please contact me directly or attend our Annual Meeting. Thank you.

Sincerely,



G. Kenneth Perine  
Executive Vice President

# Appendix to Proxy Statement

**AMENDED AND RESTATED**  
**CERTIFICATE OF INCORPORATION**  
**OF**  
**BANK OF MIDDLEBURY NATIONAL CORPORATION**

Incorporated under the name "Bank of Middlebury Corporation"  
Pursuant to an original Certificate of Incorporation filed  
With the Secretary of State on July 23, 1985

We, the undersigned, for the purpose of amending and restating the Certificate of Incorporation of Middlebury National Corporation under the laws of the State of Delaware, hereby certify as follows:

Middlebury National Corporation, a corporation organized and existing under the General Corporation Law of the State of Delaware, does hereby certify that:

1. The original Certificate of Incorporation was filed with the Secretary of State on July 23, 1985, under the name of Bank of Middlebury Corporation.

2. Pursuant to the applicable provisions of Sections 242 and 245 of the General Corporation Law of the State of Delaware, the following Amended and Restated Certificate of Incorporation was (1) duly approved and proposed by the corporation's Board of Directors, and (2) duly adopted by the holders of a majority of shares entitled to vote thereon.

3. The text of the corporation's Certificate of Incorporation, as so approved and adopted by the directors and stockholders of the corporation, is amended and restated to read in its entirety as follows:

FIRST: The name of this corporation is:

Middlebury National Corporation

SECOND: The name and address of the registered agent of the corporation in the State of Delaware is:

The Prentice-Hall Corporation System, Inc.  
2711 Centreville Road, Suite 400  
Dover, Delaware 19901-808

THIRD: The purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware, and specifically, without limiting the generality of the foregoing:

To acquire, own, control, hold with power to vote, deal in and with, and dispose of, in any manner, interests in financial institutions, including, without limitation, banks, trust companies, savings banks, national banking associations, savings and loan associations, industrial banks, investment banks, service banks, safe deposit companies, credit unions, and mutual trust investment companies, located within or without the State of Vermont, and to acquire, own, control, hold with power to vote, deal in and with, and dispose of, in any manner, interests in any other companies, corporations, partnerships, trusts, unincorporated associations, joint stock associations and other entities which are engaged in activities related to the business of banking.

To engage in, carry on, conduct, and participate in activities, enterprises and businesses permitted to be engaged in, carried on, conducted and participated in by bank-financial holding companies under applicable provisions of law.

FOURTH: ~~The total amount of capital stock which this corporation has the authority to issue is 320,000 shares of common stock, \$2.50 par value per share.~~ The amount of capital stock that the Corporation has the authority to issue is as follows:

(A) Common Stock. This Corporation shall have authority to issue 1,200,000 shares of common stock with no par value per share.

(B) Preferred Stock.

(1) The Corporation shall have authority to issue 400,000 shares of preferred stock with no par value per share. The shares of preferred stock of the Corporation may be issued from time to time in one or more series, the shares of each series to have such voting powers, full or limited, or no voting powers, and such designations, preferences, rights, powers, including voting powers and liquidation value, if any, as are stated in the resolution or resolutions providing for the issue of such series adopted by the Board of Directors as provided in Paragraph B(2) of this Article FOURTH.

(2) Authority is granted to the Board of Directors of the Corporation, subject to the provisions of this Article FOURTH and to the limitations prescribed by the Delaware General Corporation Law, to authorize the issuance of one or more series of preferred stock and with respect to each series to fix by resolution or resolutions the voting powers, full or limited, if any, of the shares of such series and to determine and fix by resolution or resolutions the designations, preferences, rights, powers, including voting powers and liquidation value, if any, of such shares. This paragraph is intended to afford to the Board of Directors the maximum authority permitted under Section 151 of the Delaware General Corporation Law.

FIFTH: The corporation is to have perpetual existence.

SIXTH: Election of directors need not be by written ballot unless the by-laws of the corporation shall so provide.

SEVENTH: (A) Indemnification. The corporation shall, to the fullest extent permitted by Section 145 of the General Corporation Law of the State of Delaware, as that section may be amended and supplemented from time to time, indemnify any ~~and all persons whom it shall have power to indemnify under that section person who is or was a director or officer of the corporation~~ against any expenses, judgments, liabilities or other matters referred to in or covered by that section. The corporation may indemnify others on a case by case basis but only to the extent permitted under Section 145 of the Delaware General Corporation Law. The indemnification provided for herein shall not be deemed exclusive of any other rights to which those seeking indemnification may be entitled under any by-laws, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in their official capacities and as to action in another capacity while holding such office, and shall continue as to a person who has ceased to be a director ~~or~~ officer, ~~employee or agent~~ and shall inure to the benefit of the heirs, executors and administrators of such a person. Any repeal or modification of any person for or with respect to any acts or omissions occurring prior to such repeal or modification.

(B) Limitation of Director Liability. A director of the corporation shall not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, notwithstanding any provision of law imposing such liability, other than liability (i) for any breach of the director's duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the Delaware General Corporation Law, as that section may be amended or supplemented from time to time, or (iv) for any transaction from which the director derived an improper personal benefit. This provision shall operate prospectively only. If the Delaware General Corporation Law is hereafter amended or supplemented to authorize corporate action further limiting or eliminating the personal liability of directors, then the liability of a director to the corporation or its stockholders shall be further limited or eliminated to the fullest extent permitted by the Delaware General Corporation Law, as so amended or supplemented from time to time. Any repeal or modification of this Article SEVENTH (B) shall be prospective only, and shall not adversely affect any limitation of the personal liability of a director of the corporation for or with respect to any acts or omissions occurring prior to such repeal or modification.

EIGHTH: New by-laws may be adopted or the by-laws may be amended or repealed by a vote of eighty percent of the outstanding stock of the corporation entitled to vote thereon. By-laws may also be adopted, amended or repealed by resolution of the Board of Directors adopted by a majority of the directors then in office.

NINTH: The number of directors which shall constitute the whole Board of Directors of the corporation shall be as specified in the by-laws of the corporation, subject to the provisions of this Article NINTH. The board is divided into three classes, Class I, Class II and Class III. Such classes shall be as nearly equal in number of directors as possible. Each director shall serve for a term ending on the third annual meeting of stockholders following the annual meeting at which such director was elected; provided, however, that the directors first elected to Class I shall serve for a term ending on the annual meeting next following the end of the calendar year 1985, the directors first elected to Class II shall serve for a term ending on the annual meeting next following the end of the calendar year 1986, and the directors first elected to Class III shall serve for a term ending on the annual meeting next following the end of the calendar year 1987. The foregoing notwithstanding, each director shall serve until his successor shall have been duly elected and qualified or until his earlier death, resignation or removal.

At each annual meeting of stockholders, the directors chosen to succeed those whose terms then expire shall be of the same class as the directors they succeed, unless, by reason of any intervening changes in the authorized number of directors, the Board shall designate one or more directors whose terms then expire as a director of another class in order more nearly to achieve equality of number of directors among the classes.

Notwithstanding the rule that the three classes shall be as nearly equal in number of directors as possible, in the event of any change in the authorized number of directors, each director then continuing to serve as such shall nevertheless continue in office until the next election of the class of which he is a member, and until his successor is elected and qualified. If any newly created directorship may, consistent with the rule that the three classes shall be as nearly equal in number of directors as possible, be allocated to one or two or more classes, the Board shall allocate it to that of the available classes whose term of office is due to expire at the earliest date following such allocation.

TENTH: (A) Except as set forth in parts (B) of this Article TENTH, the affirmative vote or consent of the holders of 80% of the shares of all classes of stock of the corporation entitled to vote for the election of directors, considered for the purposes of this Article as one class, shall be required (1) for the adoption of any agreement for the merger or consolidation of the corporation or any Subsidiary (as hereinafter defined) with or into any Other Corporation (as hereinafter defined), (2) to authorize any sale, lease, exchange, mortgage, pledge or other disposition of all, or substantially all of the assets of the corporation or any Subsidiary to any Other Corporation, (3) to authorize the issuance or transfer by the corporation of any Substantial Amount (as hereinafter defined) of securities of the corporation in exchange for the securities or assets of any Other Corporation, or (4) to engage in any other transaction the effect of which is to combine the assets and business of the corporation or any Subsidiary with any Other Corporation. Such affirmative vote or consent shall be in addition to the vote or consent of the holders of the stock of the corporation otherwise required by law, the Certificate of Incorporation of the corporation or any agreement or contract to which the corporation is a party.

(B) The provisions of part (A) of this Article TENTH shall not be applicable to any transaction described therein if such transaction is approved by a resolution of the Board of Directors of the corporation, provided that the directors voting in favor of such resolution include a majority of the persons who were duly elected and acting members of the Board of Directors prior to the time any such Other Corporation became a Beneficial Owner (as hereinafter defined) of 5% or more of the shares of stock of the corporation entitled to vote for the election of directors. In considering such transaction, the Board of Directors shall give due consideration to all relevant factors, including without limitation the social and economic effects on the employees and customers and other constituents of the corporation and its Subsidiaries and on the communities in which the corporation and its Subsidiaries operate or are located.

(C) The Board of Directors shall have the power and duty to determine for the purposes of this Article TENTH, on the basis of information known to such Board, if and when any Other Corporation is the Beneficial Owner of 5% or more of the outstanding shares of stock of the corporation entitled to vote for the election of directors. Any such determination, if made in good faith, shall be conclusive and binding for all purposes of this Article TENTH.

(D) As used in Article TENTH, the following terms shall have the meanings indicated:

"Other Corporation" means any person, firm, corporation, or other entity, other than a Subsidiary of the corporation, which is the Beneficial Owner of 5% or more of the shares of stock of the corporation entitled to vote in the election of directors.

"Subsidiary" means any corporation in which the corporation owns, directly or indirectly, more than 50% of the securities of such corporation entitled to vote in the election of directors.

"Substantial Amount" means any securities of the corporation having a then fair market value of more than \$500,000.

An Other Corporation (as defined above) shall be deemed to be the "Beneficial Owner" of stock if such Other Corporation or any "affiliate" or "associate" of such Other Corporation (as those terms are defined in Rule 12b-2 promulgated under the Securities Exchange Act of 1934 (15 U.S.C. 78 aaa et seq.), as amended from time to time), directly or indirectly, controls the voting of such stock or has any options, warrants, conversion or other rights to acquire such stock.

ELEVENTH: No action shall be taken by the stockholders except at an annual or special meeting of stockholders. No action shall be taken by stockholders by written consent.

TWELFTH: Special meetings of the stockholders of the corporation may be called at any time pursuant to a resolution adopted by a majority of the full Board of Directors of the corporation or by the Secretary of the corporation upon written request of one or more stockholders holding of record at least twenty-five percent of the outstanding shares of stock of the corporation entitled to vote at such meeting. Such written request shall state the purpose or purposes of the special meeting. Business transacted at any special meeting of stockholders shall be limited to matters relating to the purpose or purposes stated in the notice of such meeting.

THIRTEENTH: The corporation reserves the right to amend, alter, change or repeal any provision contained in this Restated Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred on stockholders herein are granted subject to this reservation. Notwithstanding the foregoing, the provisions set forth in Articles EIGHTH, NINTH, TENTH, ELEVENTH, TWELFTH, and this Article THIRTEENTH may not be repealed or amended in any respect and no provision inconsistent therewith may be adopted unless such repeal, amendment or adoption is approved by the affirmative vote of the holders of not less than eighty percent of the total voting power of all outstanding shares of voting stock of this corporation.

This corporation has yet to receive any payment for its stock, and this Restated Certificate of Incorporation has been duly adopted by a majority of the directors of the corporation in accordance with the provisions of Sections 241 and 245 of the Delaware General Corporation Law.

Signed this 6<sup>th</sup> day of ~~September 1985~~ September, 2011.

\_\_\_\_\_  
MIDDLEBURY NATIONAL CORPORATION

By: \_\_\_\_\_  
Robert J. Duels G. Kenneth Perine  
Executive Vice President

Attest: \_\_\_\_\_  
Walter E. Brooker Lawrence W. Miller II  
Secretary

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
and Shareholders of  
Middlebury National Corporation  
Middlebury, Vermont

We have audited the accompanying consolidated balance sheets of Middlebury National Corporation and Subsidiary (National Bank of Middlebury) as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Middlebury National Corporation and Subsidiary as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*A. M. Pevich & Company, LLP*

January 31, 2011  
Rutland, Vermont  
VT Reg. No 92-0000102

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
December 31, 2010 and 2009

	2010	2009
<b>ASSETS</b>		
Cash and cash equivalents	\$ 4,344,916	\$ 3,889,515
Interest bearing balances due from Federal Reserve Bank and other financial institutions	11,635,191	13,921,344
Securities held-to-maturity (market value of \$1,143,456 in 2010 and \$1,132,642 in 2009)	1,086,135	1,085,767
Securities available-for-sale	55,282,969	49,240,727
Restricted equity securities	1,748,100	1,748,100
Loans held for sale	375,000	-
Loans, net	179,047,609	186,121,774
Bank premises and equipment, net	9,478,935	9,826,403
Accrued interest receivable	1,024,359	1,039,926
Bank owned life insurance	5,226,141	5,032,866
Other Real Estate Owned	878,050	-
Other assets	4,907,748	5,308,803
Total assets	\$275,035,153	\$277,215,225
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>LIABILITIES</b>		
Deposits:		
Demand	\$ 30,325,406	\$ 27,161,930
NOW	79,834,491	74,919,665
Savings and money market	64,148,681	60,534,790
Time \$100,000 and over	22,043,282	25,456,807
Other time	34,075,155	38,005,692
Total deposits	230,427,015	226,078,884
Borrowed funds	9,236,717	14,152,014
Securities sold under agreements to repurchase	7,843,653	10,485,486
Other liabilities	2,598,279	2,562,734
Total liabilities	250,105,664	253,279,118
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY</b>		
Common stock, no par value 1,200,000 shares authorized, 960,000 shares issued	400,000	400,000
Surplus	1,000,000	1,000,000
Retained Earnings	23,467,868	22,498,526
Accumulated other comprehensive income	648,436	627,387
	25,516,304	24,525,913
Less: Treasury stock at cost (69,098 and 69,198 shares in 2010 and 2009, respectively)	(586,815)	(589,806)
Total shareholders' equity	24,929,489	23,936,107
Total liabilities and shareholders' equity	\$275,035,153	\$277,215,225

See notes to Consolidated Financial Statements.

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**Years Ended December 31, 2010 and 2009**

	2010	2009
Interest income		
Interest and fees on loans	\$ 9,819,826	\$10,516,582
Interest and dividends on securities		
Mortgage-backed securities	875,497	1,119,567
U.S. Government agencies	382,992	89,138
Corporate debt	-	121,070
States and political subdivisions	429,245	450,752
Other securities	77,520	77,520
Interest on federal funds sold, Federal Reserve Bank and other interest bearing balances	14,479	19,264
<b>Total interest income</b>	<b>11,599,559</b>	<b>12,393,893</b>
Interest expense		
Interest on time \$100,000 and over	459,026	682,740
Interest on other deposits	910,078	1,370,912
Interest on borrowings	427,654	637,532
<b>Total interest expense</b>	<b>1,796,758</b>	<b>2,691,184</b>
<b>Net interest income</b>	<b>9,802,801</b>	<b>9,702,709</b>
Less: provision for loan losses	661,600	653,000
<b>Net interest income after provision for loan loss</b>	<b>9,141,201</b>	<b>9,049,709</b>
Other operating income		
Service charges on deposit accounts	388,622	463,006
Other service charges, collection and exchange	187,578	178,329
Debit/Credit card interchange	733,410	609,180
Gain on sale of loans	865,745	720,218
Gain on sale of securities	145,381	193,165
Income from bank owned life insurance	193,275	191,463
Other	276,174	120,766
<b>Total other operating income</b>	<b>2,790,185</b>	<b>2,476,127</b>
Other operating expenses		
Salaries	4,147,038	3,967,546
Pension and other employee benefits	1,336,807	1,352,900
Occupancy expense	806,284	820,937
Equipment expense	582,204	600,744
FDIC insurance expense	363,641	454,445
Other	2,822,009	2,683,700
<b>Total other operating expenses</b>	<b>10,057,983</b>	<b>9,880,272</b>
<b>Income before income taxes</b>	<b>1,873,403</b>	<b>1,645,564</b>
Income tax expense	191,377	81,000
<b>Net income</b>	<b>\$ 1,682,026</b>	<b>\$ 1,564,564</b>
<b>Earnings per share</b>	<b>\$1.89</b>	<b>\$1.76</b>

See notes to Consolidated Financial Statements.

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**Years ended December 31, 2010 and 2009**

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
<b>Balance, December 31, 2008</b>	\$400,000	\$1,000,000	\$21,646,604	\$(11,062)	\$(589,806)	\$22,445,736
Comprehensive income						
Net income	-	-	1,564,564	-	-	1,564,564
Other comprehensive income, net of tax						
Net changes in unrealized loss on securities available- for-sale - Net of tax \$328,898	-	-	-	638,449	-	<u>638,449</u>
Total comprehensive income	-	-	-	-	-	<u>2,203,013</u>
Sale of treasury stock	-	-	-	-	-	-
Cash dividends declared (\$ .80 per share)	-	-	(712,642)	-	-	(712,642)
<b>Balance, December 31, 2009</b>	\$400,000	\$1,000,000	\$22,498,526	\$627,387	\$(589,806)	\$23,936,107
Comprehensive income						
Net income	-	-	1,682,026	-	-	1,682,026
Other comprehensive income, net of tax						
Net changes in unrealized gain (loss) on securities available- for-sale - Net of tax \$10,843	-	-	-	21,049	-	<u>21,049</u>
Total comprehensive income	-	-	-	-	-	<u>1,703,075</u>
Sale of treasury stock	-	-	-	-	2,991	2,991
Cash dividends declared (\$ .80 per share)	-	-	(712,684)	-	-	(712,684)
<b>Balance, December 31, 2010</b>	\$400,000	\$1,000,000	\$23,467,868	\$648,436	\$(586,815)	\$24,929,489

See notes to Consolidated Financial Statements.

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**Years ended December 31, 2010 and 2009**

	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 1,682,026	\$ 1,564,564
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	686,938	687,799
Provision for possible loan losses	661,600	653,000
Provision for deferred taxes	(226,584)	(399,429)
Increase in accrued income tax	42,868	353,187
Decrease in interest receivable	15,567	75,742
Net amortization (accretion)	109,334	(32,911)
Net increase in loans held for sale	375,000	-
Decrease in interest payable	(24,907)	(33,465)
Increase in bank owned life insurance	(193,275)	(191,463)
Change in other - Net	565,174	(1,040,801)
Gain on sale of assets	(932)	-
Securities gains	(145,381)	(193,165)
Gain on sale of loans	(865,745)	(720,218)
Net cash provided by operating activities	2,681,683	722,840
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Securities held-to-maturity		
Maturities / paydowns	-	999,800
Securities available-for-sale		
Sales, maturities, and paydowns	21,597,771	14,494,076
Purchases	(27,572,442)	(24,160,276)
Net change in federal funds and interest bearing balances	2,286,153	(6,388,818)
Net increase in loans	5,650,260	(4,303,732)
Proceeds from sale of fixed asset	9,500	-
Capital acquisitions	(278,832)	(514,405)
Net cash provided (used) by investing activities	1,692,410	(19,873,355)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in demand deposits,		
NOW accounts and savings accounts	11,692,193	14,933,628
Net increase (decrease) in certificates of deposit	(7,344,062)	7,059,776
Increase (decrease) in securities sold under agreement	(2,641,833)	550,393
Decrease in borrowed funds	(4,915,297)	(3,026,845)
Sale of Treasury Stock	2,991	-
Dividend payments	(712,684)	(712,642)
Net cash provided (used) by financing activities	(3,918,692)	18,804,310
Net increase (decrease) in cash and cash equivalents	455,401	(346,205)
Cash and cash equivalents		
Beginning	3,889,515	4,235,720
Ending	\$ 4,344,916	\$ 3,889,515

(continued)

**MIDDLEBURY NATIONAL CORPORATION AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS** (continued)  
**Years ended December 31, 2010 and 2009**

	2010	2009
<b>SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION</b>		
Cash payments for:		
Interest	\$1,821,965	\$2,724,649
Income taxes	\$ 390,529	\$146,721

**SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING  
AND FINANCING ACTIVITIES**

Unrealized gain on securities available-for-sale	\$31,892	\$ 967,347
Other real estate acquired in settlement of loans - net	\$ 878,050	\$ -

See notes to Consolidated Financial Statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Significant Accounting Policies**

The accounting policies of Middlebury National Corporation and Subsidiary are in conformity with U.S. generally accepted accounting principles and general practices within the banking industry. The following is a description of the more significant policies.

**Basis of consolidation**

The consolidated financial statements include the accounts of Middlebury National Corporation (Company) and the National Bank of Middlebury (Bank), its wholly owned subsidiary. All significant intercompany accounts have been eliminated.

**Nature of operations**

Middlebury National Corporation is a one bank holding company located in Middlebury, Vermont. Its subsidiary, National Bank of Middlebury, provides a variety of financial services to individuals and business customers through its six branches in west central Vermont, which is primarily a small business and manufacturing area. The Bank's primary deposit products are checking and savings accounts and certificates of deposit. Its primary lending products are commercial, real estate and consumer loans.

**Concentration of risk**

The Company's operations are affected by various risk factors, including interest rate risk, credit risk and risk from geographic concentration of lending activities. Management attempts to manage interest rate risk through various asset/liability management techniques designed to match maturities of assets and liabilities. Loan policies and administration are designed to provide assurance that loans will only be granted to credit worthy borrowers, although credit losses are expected to occur because of subjective factors and factors beyond the control of the Company. Although the Company has a diversified loan portfolio and economic conditions are stable, most of its lending activities are conducted within the geographic area where it is located. As a result, the Company and its borrowers may be especially vulnerable to the consequences of changes in the local economy. Note 3 discusses the types of investments the Company invests in, and Note 5 discusses the type of lending the Company engages in.

**Use of estimates**

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. It is reasonably possible that a change in estimate may occur in the near term related to the determination of the allowance for loan losses, accumulated depreciation based on estimated useful lives of depreciable assets and deferred tax assets.

## **Note 1. Significant Accounting Policies (continued)**

### **Presentation of cash flows**

For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents include cash on hand and amounts due from banks (including cash items in process of clearing).

### **Investment securities**

Debt securities the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and reported at amortized cost adjusted for amortization of premiums and accretion of discounts using methods approximating the interest method. Debt and equity securities not classified as held-to-maturity are classified as available-for-sale. Investments classified as available-for-sale are carried at market value with unrealized gains and losses reported as a net amount in other comprehensive income net of tax. The specific identification method is used to determine realized gains and losses on sales of securities available-for-sale.

Declines in the fair value of individual held-to-maturity and available-for-sale securities below their cost that are other than temporary, result in write-downs of the individual securities to their fair value. The related write downs are included in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

### **Restricted equity investments**

Restricted equity securities are comprised of Federal Reserve Bank stock and Federal Home Loan Bank of Boston stock. These securities are carried at cost. As a member of the Federal Reserve Bank (FRB), the Bank is required to invest in FRB stock in an amount equal to 3% of the capital stock and surplus.

As a member of the Federal Home Loan Bank of Boston (FHLBB), the Bank is required to invest in \$100 par value stock of the FHLBB. The stock is nonmarketable, and when redeemed, the Company would receive from the FHLBB an amount equal to the par value of the stock.

### **Loans**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal, reduced by an allowance for loan losses and unearned fees. Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Sales are made with limited recourse. Net unrealized losses are recognized through a valuation allowance by charges to income.

Loan interest income is accrued daily on the outstanding balances. Accrual of interest is discontinued when a loan is specifically determined to be impaired or when the loan is delinquent 90 days and management believes, after considering collection efforts and other factors that the borrower's financial condition is such that collection of interest is doubtful. Any unpaid interest previously accrued on those loans is removed from income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Interest payments received on such loans are generally applied as a reduction of the loan principal balance. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Loans are charged off when collection of principal is considered doubtful. Past due status is determined on a contractual basis.

Loan origination and commitment fees and certain direct loan origination costs are being deferred and amortized as an adjustment of the related loans' yield. The Bank is generally amortizing these amounts over the contractual life. Premiums and discounts on purchased loans are recognized over the expected lives of the loans using methods that approximate the interest method.

### **Allowance for loan losses**

The allowance for loan losses is maintained at a level, which, in management's judgment, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectability of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, and economic conditions. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Although management uses

**Note 1. Significant Accounting Policies (continued)**

available information to recognize losses on loans, because of uncertainties associated with local economic conditions, collateral values, and future cash flows on impaired loans, it is reasonably possible that a material change could occur in the allowance for loan losses in the near term. However, the amount of the change that is reasonably possible cannot be estimated. The allowance is increased by a provision for loan losses, which is charged to expense, and reduced by charge-offs, net of recoveries

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Impairment is measured on a loan-by-loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures.

**Bank premises and equipment**

Bank premises and equipment are stated at cost, less an allowance for depreciation. The provision for depreciation is computed primarily on the straight-line method over the estimated useful lives of the related assets. Improvements to leased property are amortized over the lesser of the term of the lease or life of the improvements. The cost of assets sold or otherwise disposed of, and the related allowance for depreciation, are eliminated from the accounts and the resulting gains or losses are reflected in the income statement. Maintenance and repairs are charged to current expenses as incurred and the cost of major renewals and improvements are capitalized.

**Other real estate owned**

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the lower of the Bank's carrying amount or fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, these assets are carried at the lower of their new cost basis or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed. Valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its costs or fair value less cost to sell.

**Intangible Assets**

Intangible assets consist of core deposit intangibles resulting from the acquisition of deposit liabilities. The premium paid to acquire core deposits is being amortized over ten years on a straight-line method. Net intangible assets at December 31, 2010 and 2009 aggregated \$484,443 and \$553,649, respectively, and are included in the caption "Other Assets" on the balance sheets.

**Mortgage servicing**

The Bank recognizes as separate assets, rights to service mortgage loans for others, however those servicing rights are acquired. When the Bank acquires mortgage servicing rights through either the purchase or origination of mortgage loans (originated mortgage servicing rights) and sells or securitizes those loans with servicing rights retained, it allocates the total cost of the mortgage loans to the mortgage servicing rights and the loans (without the mortgage servicing rights) based on their relative fair values. To determine the fair value of the servicing rights created, the Bank uses the market prices under comparable servicing sale contracts. The cost of mortgage servicing rights is amortized in proportion to, and over the period of, estimated net servicing revenues. Impairment of mortgage servicing rights is assessed based on the fair value of those rights. Fair values are estimated using discounted cash flows based on a current market interest rate.

**Pension Costs**

Pension costs relating to the Bank's defined contribution plan are charged to employee benefits expense and are funded as accrued.

**Advertising Cost**

The Bank expenses advertising costs as incurred.

**Income taxes**

The Company recognizes income taxes under the asset and liability method. Under this method, net deferred tax

**Note 1. Significant Accounting Policies (continued)**

assets and liabilities are established for the temporary differences between the accounting basis and the tax basis of the Company's assets and liabilities at tax rates expected to be in effect when the amounts related to such temporary differences are realized or settled. Adjustments to the Company's deferred tax assets are recognized as deferred income tax expense or benefit based on management's judgments relating to the realizability of such assets. The Company files a consolidated tax return with its subsidiary.

Generally accepted accounting standards prescribe a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Management reviews the inventory of tax positions taken at each reporting period to assess the more-likely-than-not recognition threshold. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

**Off-balance-sheet financial instruments**

In the ordinary course of business the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable.

**Earnings per share**

Earnings per share are computed using the weighted average number of shares of common stock outstanding during the year, which was 890,852 and 890,802 shares for 2010 and 2009, respectively.

**Transfers of financial assets**

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

**Comprehensive income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities net of tax, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

The components of other comprehensive income and related tax effects are as follows:

	2010	2009
Change in unrealized holding gain on available-for-sale securities	\$177,273	\$1,160,512
Reclassification adjustment for (gains) losses realized in income	(145,381)	(193,165)
Net unrealized gains	31,892	967,347
Tax effect	(10,843)	(328,898)
Net of tax amount	\$ 21,049	\$ 638,449

**Accounting Pronouncements**

In June 2009, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification (ASC) Topic 860, Transfers and Servicing. The standard requires additional information about transfers of financial assets, clarify when sales treatment is warranted and revise treatment of Variable Interest Entities for consolidation purposes. This guidance is effective for reporting periods beginning after November 15, 2009 and did not have a significant impact on the Company's financial statements.

In January 2010, the FASB issued Accounting Standards Update ("ASU") 2010-06, "Improving disclosures about Fair Value Measurements". The guidance requires more robust disclosures about the different classes of assets

**Note 1. Significant Accounting Policies** (continued)

and liabilities measured at fair value, the valuation techniques and inputs used, the activity in Level 3 fair value measurements, and the transfers between Levels 1, 2 and 3. The guidance is effective for reporting periods beginning after December 15, 2009 and did not have a significant impact on the Company's financial statements.

In July 2010, the FASB also issued ASU 2010-20 "Receivables (Topic 310), Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses". The standard requires an entity to provide disclosures that facilitate financial statement users' evaluation of the nature of the credit risk inherent in the entity's loan portfolio, how that risk is analyzed and assessed in arriving at the allowance for loan losses and the changes and reasons for those changes in the allowance for loan losses. The standard is effective for reporting periods ending on or after December 15, 2011 for non-public entities. The adoption of this guidance will require significant additional disclosures in the December 31, 2011 financial statements.

**Note 2. Restrictions on Cash and Due from Banks**

The Bank is required to maintain reserve balances in cash with the Federal Reserve Bank of Boston. The totals of those reserve balances were approximately \$246,000 and \$241,000 at December 31, 2010 and 2009, respectively. In addition, the Bank contracted to maintain clearing balances of \$100,000 at December 31, 2010 and 2009.

The nature of the Bank's business requires that it maintain amounts due from banks, which at times, may exceed federally insured limits. No losses have been experienced in that account.

**Note 3. Investment Securities**

Investment securities held-to-maturity consist of the following:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2010				
States & political subdivisions	\$ 1,086,135	\$ 57,321	\$ -	\$ 1,143,456
December 31, 2009				
States & political subdivisions	\$ 1,085,767	\$ 46,875	\$ -	\$ 1,132,642

Investment securities available-for-sale consist of the following:

December 31, 2010				
U.S. Government and agency securities	\$18,331,458	\$244,449	\$ 2,541	\$18,573,366
Mortgage-backed securities	25,057,573	581,363	80,841	25,558,095
State & political subdivisions	9,911,459	240,049	-	10,151,508
Preferred Stock	1,000,000	-	-	1,000,000
	\$54,300,490	\$1,065,861	\$83,382	\$55,282,969
December 31, 2009				
U.S. Government and agency securities	\$18,175,007	\$40,489	\$49,030	\$18,166,466
Mortgage-backed securities	19,200,325	745,305	2,435	19,943,195
State & political subdivisions	9,914,808	216,258	-	10,131,066
Preferred Stock	1,000,000	-	-	1,000,000
	\$48,290,140	\$1,002,052	\$51,465	\$49,240,727

Restricted equity securities consisted of the following at December 31:

	2010	2009
Federal Home Loan Bank of Boston Stock	\$1,706,100	\$1,706,100
Federal Reserve Bank of Boston Stock	42,000	42,000
	\$1,748,100	\$1,748,100

Assets, principally U.S. Government, Municipal and Mortgage-backed securities, with amortized cost of \$32,244,556 and \$32,443,352 and with fair values of \$32,975,524 and \$33,300,835 at December 31, 2010 and 2009, respectively were pledged to secure public deposits and for other purposes required or permitted by law.

**Note 3. Investment Securities** (continued)

The following is a summary of maturities of securities held-to-maturity and available-for-sale as of December 31, 2010:

	Securities held-to-maturity		Securities available-for-sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	\$ -	\$ -	\$ 1,000,015	\$ 1,004,060
After one year through five years	-	-	17,991,737	18,234,083
After five years through ten years	1,086,135	1,143,456	9,251,165	9,486,731
After ten years	-	-	-	-
Mortgage backed securities	-	-	25,057,573	25,558,095
Other Securities	-	-	1,000,000	1,000,000
	\$1,086,135	\$1,143,456	\$54,300,490	\$55,282,969

Proceeds from the sale of available-for-sale securities amounted to \$2,337,785 and \$3,040,677 in 2010 and 2009, respectively. Gross realized gains were \$145,381 and \$193,165 in 2010 and 2009, respectively.

Information pertaining to securities with gross unrealized losses at December 31, 2010 and 2009, aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
December 31, 2010						
U.S. Government Securities	\$ 2,975,180	\$2,541	\$-	\$-	\$ 2,975,180	\$2,541
Mortgage-backed Securities	10,660,872	80,841	-	-	10,660,872	80,841
	\$13,636,052	\$83,382	\$-	\$-	\$13,636,052	\$83,382
December 31, 2009						
U.S. Government Securities	\$13,928,630	\$49,030	\$-	\$-	\$13,928,630	\$49,030
Mortgage-backed Securities	1,947,836	2,435	-	-	1,947,836	2,435
	\$15,876,466	\$51,465	\$-	\$-	\$15,876,466	\$51,465

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At December 31, 2010, the fourteen debt securities with unrealized losses have depreciated less than 1% from the Bank's amortized cost basis. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other-than-temporary.

**Note 4. Loan Servicing**

Mortgage loans serviced for others are not included in the accompanying statements of financial condition. The unpaid principal balances of mortgage loans serviced for others were \$74,976,350 and \$59,652,533 at December 31, 2010 and 2009, respectively.

Mortgage servicing rights totaled \$369,148 and \$263,812 at December 31, 2010 and 2009, respectively. Mortgage servicing rights of \$207,822 and \$206,032 were capitalized in 2010 and 2009, respectively. Amortization of mortgage servicing rights was \$102,486 and \$76,775 in 2010 and 2009, respectively.

**Note 5. Loans**

Loans at December 31, 2010 and 2009 were as follows:

	2010	2009
Commercial	\$ 12,310,044	\$ 14,582,488
Real estate:		
Construction and land development	7,848,633	5,974,641
Residential	110,241,964	111,898,437
Commercial	46,717,259	47,005,207
Total real estate	164,807,856	164,878,285
Installment	1,607,708	1,778,442
Other	2,572,096	6,920,656
	181,297,704	188,159,871
Less: Allowance for loan losses	(2,386,448)	(2,264,210)
Deferred loan costs	136,353	226,113
	\$179,047,609	\$186,121,774

The total recorded investment in impaired loans amounted to \$2,425,387 and \$455,118 at December 31, 2010 and 2009, respectively, of which, \$2,071,916 and \$455,118 had allowances determined in accordance with U.S. generally accepted accounting principles. The average recorded investment in impaired loans amounted to approximately \$1,131,442 and \$411,414 for the years ended December 31, 2010 and 2009, respectively. The allowance for loan losses related to impaired loans amounted to \$318,569 and \$113,357 at December 31, 2010 and 2009. Interest payments on impaired loans of \$74,370 and \$-0- were received in both 2010 and 2009, respectively.

In addition the Bank had other nonaccrual loans of approximately \$209,104 and \$928,684 at December 31, 2010 and 2009, respectively, for which impairment had not been recognized. If interest on these loans had been recognized at the original interest rates, interest income would have increased approximately \$1,014 and \$36,529 for the years ended December 31, 2010 and 2009, respectively. Loans totaling \$46,845 and \$541,855 were delinquent 90 days or more and not in non-accrual status at December 31, 2010 and 2009, respectively.

The Bank has no commitments to loan additional funds to borrowers with impaired or nonaccrual loans.

**Note 6. Allowance for Loan Losses**

Changes in the allowance for loan losses during the years ended December 31, 2010 and 2009 were as follows:

	2010	2009
Balance at beginning of year	\$2,264,210	\$1,724,215
Recoveries credited to allowance	6,082	4,352
Provisions charged to operations	661,600	653,000
	2,931,892	2,381,567
Losses charged to allowance	(545,444)	(117,357)
Balance at end of year	\$2,386,448	\$2,264,210

**Note 7. Bank Premises and Equipment**

Bank premises and equipment at December 31, 2010 and 2009 were as follows:

	2010	2009
Land	\$ 454,000	\$ 454,000
Bank Building and improvements	8,882,283	8,602,913
Equipment	3,918,637	3,895,504
Construction in progress	2,105	182,829
Land for future expansion	264,674	264,674
	<u>13,521,699</u>	<u>13,399,920</u>
Allowances for depreciation and amortization	(4,042,764)	(3,573,517)
	<u>\$ 9,478,935</u>	<u>\$ 9,826,403</u>

Depreciation included in the statements of income amounted to \$617,732 in 2010 and \$618,593 in 2009, of which \$374,339 and \$384,232, respectively, represented equipment depreciation.

The bank leases its Brandon, Bristol and Route 7 South branches, under operating leases, which expire in 2012, 2024 and 2025, respectively. The Route 7 South lease includes two renewal options of ten years each and the Brandon lease contains one five year renewal option. Rental expense on these properties was \$102,516 and \$98,366 for 2010 and 2009, respectively. Minimum annual rentals, excluding common area charges, are as follows:

Years Ended December 31,

2011	\$104,391
2012	79,377
2013	77,627
2014	78,224
2015	86,336
Thereafter	836,728
	<u>\$1,262,683</u>

**Note 8. Investments Carried at Equity**

The Bank purchased various partnership interests in limited partnerships. These were partnerships established to acquire, own and rent residential housing for low and moderate income Vermonters located in Vermont, and a limited liability company that offers trust and brokerage services. The investments are accounted for under the equity method of accounting. These equity investments, which are included in other assets, are recorded at cost and adjusted for the Bank's proportionate share of the partnership's undistributed earnings or losses. The carrying values of these investments were \$1,615,560 and \$1,740,449 at December 31, 2010 and 2009 respectively. The provision for net undistributed losses of the partnerships charged to earnings was \$189,837 and \$198,264 for 2010 and 2009 respectively, and is included in other operating expense. The earnings for the Trust Company amounted to \$64,947 and \$2,363 for 2010 and 2009 respectively, and is included in other income.

**Note 9. Intangible Assets**

The Bank had the following intangible assets

	December 31,	
	2010	2009
Amortized Intangible Assets		
Core deposit intangibles	\$692,061	\$692,061
Less accumulated amortization	207,618	138,412
	<u>\$484,443</u>	<u>\$553,649</u>

Amortization expense for the period ended December 31, 2010 and 2009 was \$69,206, respectively.

**Note 9. Intangible Assets (continued)**

The aggregate amortization expense for the next five years is:

2011	\$69,206
2012	69,206
2013	69,206
2014	69,206
2015	69,206
Thereafter	<u>138,413</u>
	<u>\$484,443</u>

**Note 10. Deposits**

The maturity distribution of time deposits at December 31, 2010 is as follows:

One year or less	\$29,260,160
Year one to two	16,012,940
Year two to three	6,502,950
Thereafter	<u>4,342,387</u>
	<u>\$56,118,437</u>

U.S. Treasury, Agency, and Municipal securities with a cost of \$21,875,832 and \$21,359,462 and a market value of \$22,282,308 and \$21,851,018 were pledged to collateralize certain municipal deposits at December 31, 2010 and 2009, respectively.

**Note 11. Repurchase Agreements**

Repurchase agreements at December 31, 2010 and 2009 are as follows:

Securities sold under agreements to repurchase	2010		2009	
	Amount	Weighted average rate	Amount	Weighted average rate
Daily rollover	<u>\$7,843,653</u>	<u>0.2912%</u>	<u>\$10,485,486</u>	<u>0.3428%</u>

\* Rate is adjusted on a daily basis.

The securities sold under agreements to repurchase are secured by U.S. government and agency bonds and mortgage-backed securities, all of which are under the Bank's control, with a cost of \$10,172,332 and \$10,888,103 and market values of \$10,469,840 and \$11,233,189 at December 31, 2010 and 2009, respectively.

The maximum amount of repurchase agreements outstanding at any month-end during 2010 and 2009 was \$7,843,653 and \$10,485,486, respectively. The daily average amount of repurchase agreements outstanding during 2010 and 2009 was \$6,576,739 and \$7,665,311, respectively.

**Note 12. Borrowed Funds**

Borrowed funds at December 31, 2010 and 2009 is as follows:

	2010	2009
Mortgage payable, secured by real estate, prime +1/2 currently 8.25%, due 2011.	\$ 19,704	\$ 44,582
FHLB LT Advance, 2.47% - 4.09% fixed rate, interest paid monthly, principal due 2010 through 2011	1,000,000	6,000,000
FHLB CDA Advance, 2.90% - 4.31% fixed rate, interest paid monthly, principal due in 2010 through 2012	5,000,000	5,000,000
FHLB AHP Advance, 0.25% fixed rate, interest paid monthly, principal due in 2028 through 2030	217,013	107,432
FHLBB 10 year/one year option advance, fixed rate 4.39%, principal due 2/21/17, callable 2/20/08 and quarterly thereafter	3,000,000	3,000,000
	<b>\$9,236,717</b>	<b>\$14,152,014</b>

Maturity distribution of long-term debt is as follows:

2011	\$4,019,704
2012	2,000,000
2013	-
2014	-
2015	-
Thereafter	3,217,013
	<u>\$9,236,717</u>

The Bank maintains a \$4,000,000 IDEAL Way Line of Credit with the Federal Home Loan Bank of Boston, which was unused at December 31, 2010 and 2009. Interest on these borrowings is chargeable at a rate determined daily by the Federal Home Loan Bank of Boston and payable monthly.

Collateral on these borrowings consists of Federal Home Loan Bank of Boston stock purchased by the Bank, all funds placed on deposit with the FHLBB, qualified first mortgages held by the Bank of approximately \$84 million at December 31, 2010, and any additional holdings that may be pledged as security.

The Bank also had an unsecured \$1,500,000 federal funds line of credit with Banker's Bank Northeast which was unused at December 31, 2010 and 2009.

**Note 13. Income Taxes**

The Company prepares its federal income tax return on a consolidated basis. Federal income taxes are allocated to members of the consolidated group based on taxable income.

Income tax expense included in the statements of income for the years ended December 31, 2010 and 2009 were as follows:

	2010	2009
Currently Payable	\$ 417,961	\$ 480,429
Deferred	(226,584)	(399,429)
Total income tax expense	\$ 191,377	\$ 81,000

The provision for income taxes and the reasons for the difference between tax expense and the amount computed by applying the statutory federal tax rate to income before taxes were as follows:

	2010		2009	
	Amount	Percent	Amount	Percent
Federal statutory rate of pre-tax income	\$ 636,957	34%	\$ 559,491	34%
Tax exempt income	(183,675)	( 10 )	(212,292)	( 13 )
Tax credits	(188,180)	( 10 )	(192,207)	( 12 )
Cash surrender value	(65,713)	( 4 )	(65,097)	( 4 )
Other	(8,012)	0	(8,895)	1
Total	\$ 191,377	10%	\$ 81,000	6%

The deferred income tax provision at December 31, 2010 and 2009 consisted of the following items:

	2010	2009
Depreciation/basis adjustment	\$ 13,294	\$ (51,981)
Bad debts	(41,560)	(195,066)
Non-accrual income	(15,778)	(19,791)
Deferred compensation	(37,441)	(33,202)
Deferred loan origination costs	(2,570)	(401)
Off balance sheet accrual	-	(8,160)
Tax credit carryover	(114,370)	(118,554)
Deposit intangible	(7,889)	(7,888)
Other	(56,084)	(8,334)
Mortgage servicing rights	35,814	43,948
	\$(226,584)	\$(399,429)

**Note 13. Income Taxes** (continued)

At December 31, 2010 and 2009, gross deferred tax assets and gross deferred tax liabilities were as follows:

	2010	2009
Gross deferred tax assets:		
Allowance for loan losses	\$ 710,473	\$ 668,913
Off balance sheet accrual	49,300	49,300
Non-accrual interest	42,007	26,229
Deferred compensation	431,415	393,974
Tax credit carryover	341,561	227,191
Deposit Intangible	23,666	15,777
Other	24,355	-
	<u>1,622,777</u>	<u>1,381,384</u>
Valuation allowance	-	-
	<u>1,622,777</u>	<u>1,381,384</u>
Gross deferred tax liabilities:		
Depreciation/basis adjustment	409,080	395,786
Mortgage servicing rights	125,510	89,696
Deferred loan origination costs	108,628	111,198
Unrealized gain on securities available-for-sale	334,043	323,200
Other	-	31,729
	<u>977,261</u>	<u>951,609</u>
Net deferred tax asset	<u>\$ 645,516</u>	<u>\$ 429,775</u>

Net deferred income taxes are included in the captions "Other assets" on the balance sheets at December 31, 2010 and 2009, respectively. The deferred tax asset valuation allowance did not change during 2010 and 2009.

As of December 31, 2010, the Company has general business tax credits of \$341,561 available for carryover through December 31, 2028.

Deferred tax assets are recognized subject to management's judgment that realization is more likely than not as GAAP allows for the recognition and measurement of deductible temporary differences to the extent that it is more likely than not that the deferred tax asset will be realized. Based on the temporary taxable items, historical taxable income and estimates of future taxable income, the Bank believes that it is more likely than not that the deferred tax assets at December 31, 2010 will be realized.

Based on management's evaluation, management has concluded that there were no significant uncertain tax positions requiring recognition in the Bank's financial statements at December 31, 2010. Although the Bank is not currently the subject of tax examination by the Internal Revenue Service (IRS), the Bank's tax years ended December 31, 2007 through 2010 are open to examination by the IRS under the applicable statute of limitations.

The Bank may from time-to-time be assessed interest and/or penalties by federal or state tax jurisdictions, although any such assessments historically have been minimal and immaterial to the Bank's financial results. In the event that the Bank receives an assessment for interest and/or penalties, it will be classified in the financial statements as "Other expenses".

**Note 14. Defined Contribution Pension Plan**

The Bank has a discretionary 401(k) profit sharing plan covering substantially all employees who meet certain age and service requirements. Eligible employees may contribute a percentage of their annual compensation to the plan each year. The Bank matches 100% of employee contributions up to 3% of compensation. The Bank matched \$104,310 and \$110,092, respectively, of employee contributions under this plan for the years ended December 31, 2010 and 2009, respectively.

The Bank may also make additional discretionary contributions to the plan on behalf of employees who meet the

**Note 14. Defined Contribution Pension Plan (continued)**

eligibility requirements. These contributions are allocated based on the annual salary of the participants and amounted to \$155,755 and \$199,556 for the years ended December 31, 2010 and 2009, respectively.

**Note 15. Commitments and Contingencies**

In the normal course of business, the Company is involved in various legal proceedings. In the opinion of management, after consulting with the Company's legal counsel, any liability resulting from such proceedings would not have a material adverse effect on the Company's financial statements.

**Note 16. Financial Instruments with Off-Balance-Sheet Risk**

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, standby and commercial letters of credit, interest rate caps and floors written on adjustable rate loans, and commitments to sell loans. Such instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby and commercial letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. For interest rate caps and floors written on adjustable rate loans, the contract or notional amounts do not represent exposure to credit loss. The Bank controls the credit risk of its interest rate cap agreements through credit approvals, limits, and monitoring procedures.

The Bank sells loans to the Federal Home Loan Bank of Boston (FHLBB) under the FHLBB Mortgage Partnership Finance program (MPF). The Bank shares a portion of the credit risk on each mortgage it sells into the MPF program and receives fee income in return. The Bank had \$24,817,296 and \$31,532,498 in loans outstanding with MPF at December 31, 2010 and 2009, respectively. The credit risk associated with these loans is deemed to be immaterial.

The Bank generally requires collateral or other security to support financial instruments with credit risk.

	Contract or Notional Amount	
	2010	2009
Financial instruments whose contract amount represent credit risk:		
Commitments to extend credit and available lines of credit	\$34,918,501	\$32,355,153
Standby letters of credit and commercial letters of credit	\$262,200	\$294,200
MPF credit enhancement obligation	\$ 1,270,587	\$ 1,222,586

Commitments to extend credit which are primarily at variable rates, are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. At December 31, 2010, the Bank had binding loan commitments at fixed rates totaling \$2,083,150 that are included in commitments to extend credit.

The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include real estate, accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

The Bank enters into a variety of interest rate contracts, including interest rate caps and floors written on adjustable rate loans in managing its interest rate exposure. Interest rate caps and floors on loans written by the Bank enable customers to transfer, modify, or reduce their interest rate risk.

### Note 17. Transactions with Related Parties

In the ordinary course of business, the Bank has loan, deposit and other transactions with its executive officers and directors and organizations with which such persons are associated. In the opinion of management such transactions are on substantially the same terms, including interest rates and collateral as to loans, as those prevailing at the time for comparable transactions with others.

At December 31, 2010 and 2009, loans to the parties mentioned above are as follows:

	2010	2009
Balance, beginning	\$384,585	\$321,208
New loans	140,094	104,895
Repayments	(37,692)	(41,518)
Balance, ending	\$486,987	\$384,585

Total deposits to related parties approximated \$524,061 and \$527,403 on December 31, 2010 and 2009, respectively. Amounts due officers and directors under non-qualified deferred compensation agreements were \$1,314,786 and \$1,193,500 at December 31, 2010 and 2009, respectively.

### Note 18. Fair Value of Financial Instruments

#### Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with FASB ASC 820, *Fair Value Measurements and Disclosures*, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value, a reasonable point within the range, is most representative of fair value under current market conditions.

#### Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions use to determine the fair value.

Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 – Valuation is based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 – Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as

**Note 18. Fair Value of Financial Instruments** (continued)

instruments for which determination of fair value requires significant management judgment or estimation.

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

The estimated fair values of the Bank's financial instruments at December 31, 2010 and 2009, are as follows:

	2010		2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial Assets:</b>				
Cash and cash equivalents	\$ 4,344,916	\$ 4,344,916	\$ 3,889,515	\$ 3,889,515
Investment securities	56,369,104	56,426,425	50,326,494	50,373,369
Other short-term investments	11,635,191	11,635,191	13,921,344	13,921,344
Restricted equity securities	1,748,100	1,748,100	1,748,100	1,748,100
Loans held for sale	375,000	375,000	-	-
Loans, net of allowance	179,047,609	186,712,711	186,121,774	195,862,268
Accrued interest receivable	1,024,359	1,024,359	1,039,926	1,039,926
<b>Financial liabilities:</b>				
Deposits	\$230,427,015	\$231,384,097	\$226,078,884	\$226,845,818
Repurchase agreements	7,843,653	7,843,653	10,485,486	10,485,486
Borrowed funds	9,236,717	9,538,560	14,152,014	14,447,761
Accrued interest payable	64,640	64,640	89,848	89,848

The carrying amounts in the preceding table are included in the balance sheets under the applicable captions. The estimated fair values of deferred fees on commitments to extend credit and letters of credit were immaterial at December 31, 2010 and 2009. The fair market value for all financial instruments were calculated utilizing level two valuation, except for impaired loans, which utilizes level three valuation.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

**Cash and due from banks:** The carrying amounts reported in the balance sheet for cash and due from banks approximate those assets' fair values.

**Investment securities:** Fair values for investment securities are based on quoted market prices, where available (level one valuation). If quoted market prices are not available, fair values are calculated based on a formula which uses matrices which interpolate prices according to observable inputs for similar items such as sector, credit spread, rating, maturity, and option premium (level two valuation). The carrying amounts of FHLBB and Federal Reserve Bank of Boston stock approximate fair value.

**Loans and loans held for sale:** For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying amounts. The fair values of other loans (for example, fixed rate commercial real estate and rental property mortgage loans and commercial and industrial loans) are estimated using discounted cash flow analysis, based on interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Loan fair value estimates include judgments regarding future expected loss experience and risk characteristics. Certain impaired loans are reported at the fair value of the underlying collateral if repayment is expected solely from collateral. Collateral values are estimated using Level 2 inputs based on appraisals of similar properties obtained from a third party valuation service. Fair values are estimated using Level 3 inputs based on appraisals of similar properties obtained from a third party valuation service discounted by management based on historical losses for similar collateral.

**Other real estate owned:** Other real estate owned is reported at the fair value of the underlying collateral. Collateral values are estimated using Level 3 inputs based on appraisals of similar properties obtained from a third party

**Note 18. Fair Value of Financial Instruments** (continued)  
valuation service discounted by management based on updated information.

**Deposits:** The fair values disclosed for demand deposits (for example, checking and savings accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair values for certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered on certificates to a schedule of aggregated contractual maturities on such time deposits.

**Repurchase agreements and borrowed funds:** For repurchase agreements and borrowed funds (including federal funds purchased) that reprice frequently, fair values are based on carrying amounts. The fair values for other borrowings are estimated using a discounted cash flow calculation that applies interest rates currently being offered on such debt to a schedule of aggregated contractual maturities on such debt.

**Accrued interest:** The carrying amount of accrued interest receivable and payable approximates fair value.

**Other liabilities:** Commitments to extend credit were evaluated and fair value was estimated using the fees currently charged to enter into similar agreements and the present creditworthiness of the counter parties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates.

Fair values of assets and liabilities measured on a recurring basis at December 31, 2010 and 2009 are as follows:

	Fair Value Measurements at Reporting Date Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2010				
Available-for-sale securities	\$55,282,969	\$-	\$55,282,969	\$-
December 31, 2009				
Available-for-sale securities	\$49,240,727	\$-	\$49,240,727	\$-

There were no transfers between the valuation levels during 2010 and 2009.

Fair values of assets and liabilities measured on a non-recurring basis at December 31, 2010 and 2009 are as follows:

	Fair Value Measurements at Reporting Date Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets/ Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2010				
Impaired loans	\$ 2,425,387	\$-	\$-	\$2,425,387
Other real estate owned	878,050	-	-	878,050
	\$ 3,303,437	\$-	\$-	\$3,303,437
December 31, 2009				
Impaired loans	\$ 455,118	\$-	\$-	\$ 455,118
Other real estate owned	-	-	-	-
	\$ 455,118	\$-	\$-	\$ 455,118

**Note 19. Regulatory Matters**

The Corporation (on a consolidated basis) and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Corporation's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to quantitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). Management believes, as of December 31, 2010, that the Corporation and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2010, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Corporation's and the Bank's actual capital amounts (000's omitted) and ratios are also presented in the table.

	Amount	Actual Ratio	Minimums For Capital Adequacy Purposes:		Minimums To Be Well Capitalized Under Prompt Corrective Action Provisions:	
			Amount	Ratio	Amount	Ratio
As of December 31, 2010						
Total capital (to risk weighted assets)						
Consolidated	\$26,058	13.9%	\$14,965	8.0%	N/A	N/A
Bank	\$24,230	13.1%	\$14,820	8.0%	\$18,525	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	\$23,740	12.7%	\$7,483	4.0%	N/A	N/A
Bank	\$21,912	11.8%	\$7,410	4.0%	\$11,115	6.0%
Tier 1 capital (to average assets)						
Consolidated	\$23,740	8.6%	\$10,983	4.0%	N/A	N/A
Bank	\$21,912	8.1%	\$10,871	4.0%	\$13,589	5.0%

**Note 19. Regulatory Matters (continued)**

	Amount	Actual Ratio	Minimums For Capital Adequacy Purposes:		Minimums To Be Well Capitalized Under Prompt Corrective Action Provisions:	
			Amount	Ratio	Amount	Ratio
As of December 31, 2009						
Total capital (to risk weighted assets)						
Consolidated	\$25,117	13.0%	\$15,457	8.0%	N/A	N/A
Bank	\$23,291	12.2%	\$15,307	8.0%	\$19,134	10.0%
Tier 1 capital (to risk weighted assets)						
Consolidated	\$22,708	11.8%	\$7,728	4.0%	N/A	N/A
Bank	\$20,899	10.9%	\$7,654	4.0%	\$11,480	6.0%
Tier 1 capital (to average assets)						
Consolidated	\$22,708	8.4%	\$10,822	4.0%	N/A	N/A
Bank	\$20,899	7.8%	\$10,708	4.0%	\$13,385	5.0%

The Bank is restricted as to the amount of dividends that can be paid. Dividends declared by national banks that exceed the net income (as defined) for the current year plus retained net income for the preceding two years must be approved by the OCC. Regardless of formal regulatory restrictions, the Bank may not pay dividends that would result in its capital levels being reduced below the minimum requirements shown above.

**Note 20. Subsequent Events**

The Bank has evaluated all subsequent events through January 31, 2011, the date the financial statements were available to be issued.

**Note 21. Reclassification**

Certain amounts were reclassified to conform to 2010 presentation.