

BERKSHIRE HILLS BANCORP INC

Form 10-K

March 17, 2014

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended: December 31, 2013**

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from                      to**

**Commission File Number: 000-51584**

**BERKSHIRE HILLS BANCORP, INC.**

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(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of

incorporation or organization)

**04-3510455**

(I.R.S. Employer Identification No.)

**24 North Street, Pittsfield, Massachusetts**

(Address of principal executive offices)

**01201**

(Zip Code)

Registrant's telephone number, including area code: **(413) 443-5601**

Securities registered pursuant to Section 12(b) of the Act:

**Title of each class**  
**Common stock, par value \$0.01 per share**

**Name of Exchange on which registered**  
**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: **None**

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

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Large Accelerated Filer ☐

Accelerated Filer ☒

Non-Accelerated Filer ☐

Smaller Reporting Company ☐

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates was approximately \$681 million, based upon the closing price of \$27.76 as quoted on the New York Stock Exchange as of the last business day of the registrant's most recently completed second fiscal quarter.

The number of shares outstanding of the registrant's common stock as of March 11, 2014 was 25,105,136.

**DOCUMENTS INCORPORATED BY REFERENCE:** Portions of the Proxy Statement for the 2014 Annual Meeting of Stockholders are incorporated by reference in Part III of this Form 10-K.

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**PART I**

**ITEM 1. BUSINESS**

**FORWARD-LOOKING STATEMENTS**

Certain statements contained in this document that are not historical facts may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (referred to as the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (referred to as the Securities Exchange Act), and are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You can identify these statements from the use of the words *may*, *will*, *should*, *could*, *would*, *plan*, *potential*, *estimate*, *project*, *believe*, *intend*, *anticipate*, *expect*, *target* and similar expressions. These forward-looking statements are subject to significant risks, assumptions and uncertainties, including among other things, changes in general economic and business conditions, increased competitive pressures, changes in the interest rate environment, legislative and regulatory change, changes in the financial markets, and other risks and uncertainties disclosed from time to time in documents that Berkshire Hills Bancorp files with the Securities and Exchange Commission. You should not place undue reliance on forward-looking statements, which reflect our expectations only as of the date of this report. We do not assume any obligation to revise forward-looking statements except as may be required by law.

**GENERAL**

Berkshire Hills Bancorp ( *Berkshire* or the *Company* ) is headquartered in Pittsfield, Massachusetts. Berkshire Hills Bancorp, Inc. is a Delaware corporation and the holding company for Berkshire Bank ( *the Bank* ) and Berkshire Insurance Group. Established in 1846, the Bank is one of Massachusetts' oldest and largest independent banks and is the largest banking institution based in Western Massachusetts.

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The Company profiles itself as follows (office count includes NY branches acquired in January 2014):

Berkshire's common shares are listed on the New York Stock Exchange under the trading symbol BHLB. At year-end 2013, Berkshire's closing stock price was \$27.27 and there were 25.036 million shares outstanding. Berkshire is a regional bank and financial services company providing the service capabilities of a larger institution and the focus and responsiveness of a local partner to its communities. The Company seeks to distinguish itself based on the following attributes:

- **Strong financial condition**
- **Diversified revenue drivers**
- **Established footprint in attractive markets**
- **Experienced leadership team**



- **AMEB culture**
- **Well positioned for growth**
- **Focused on long-term profitability goals and shareholder value**

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The Bank has 92 full-service banking offices in its New England and upstate New York footprint, which extends along Interstate 90 from Boston to Syracuse, and along Interstate 91 from Hartford into Vermont. The Bank also has commercial and retail lending offices located in Eastern Massachusetts. The Bank's operations include those acquired as a result of four bank mergers in 2011 - 2012:

- Rome Bancorp, Inc. ( Rome ) in April 2011, headquartered in Rome, NY
- Legacy Bancorp, Inc. ( Legacy ) in July 2011, headquartered in Pittsfield, MA
- The Connecticut Bank and Trust Company ( CBT ) in April 2012, headquartered in Hartford, CT

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- Beacon Federal Bancorp, Inc. ( Beacon ) in October 2012, headquartered in Syracuse, NY

The Bank's operations also include mortgage operations from Greenpark Mortgage Corporation ( Greenpark ) acquired in April 2012, headquartered in Needham, MA.

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The Bank acquired 20 branches in Central New York from Bank of America on January 17, 2014, with total deposits of approximately \$440 million at the date of acquisition.

The Bank serves the following regions:

- **Western New England**, with 31 banking offices, including the Company's headquarters in Pittsfield, MA. This region includes Berkshire County, MA, which is the Company's traditional market, where it has a leading market share in many of its product lines. This region also includes Southern Vermont, and many of the region's branches are in communities close to Route 7, which runs north/south through the valleys to the west of the Berkshire Hills and Green Mountains. This region is within commuting range of both Albany, New York and Springfield, Massachusetts and is known throughout the world as a tourist and recreational destination area, with vacation and second home traffic from Boston and New York City. The Pittsfield 2012 MSA GDP totaled \$5 billion. At year-end 2013, the Company had approximately \$1.0 billion in loans and \$1.5 billion in deposits in its Western New England Market.
- **New York**, with 39 banking offices serving the Albany Capital District and Central New York. Albany is the state capital and is part of New York's Tech Valley which is gaining prominence as a world technology hub including leading edge nanotechnology initiatives representing a blend of private enterprise and public investment. The Company's presence in this area is largely due to its de novo branch expansion which began in 2005. The Company's Central New York area includes operations in the Rome/Utica MSA, which were acquired with the Rome merger, together with operations in the Syracuse MSA, which were acquired with the Beacon merger. The 2014 branch acquisition is also primarily located in this market. The Albany/Schenectady 2012 MSA GDP was \$42 billion, and the Rome/Utica/Syracuse total 2012 MSA GDP was \$38 billion. At year-end 2013, Berkshire had approximately \$1.4 billion in loans and \$1.2 billion in deposits in the New York region. The New York branch purchase in January 2014 contributed an additional \$440 million in deposit balances.
- **Hartford/Springfield**, with 20 banking offices serving the market along the Connecticut River in this region, which is the second largest economic area in New England. The Bank's operations here include operations acquired with the CBT merger in 2012. This region is centrally located between Boston and New York City at the crossroads of Interstate 91, which traverses the length of New England and Interstate 90, which traverses the width of Massachusetts. This region also has easy access to Bradley International Airport, which is a major airport serving central New England. The Hartford/Springfield combined 2012 MSA GDP was \$105 billion. At year-end 2013, Berkshire had approximately \$0.7 billion in loans and \$0.9 billion in deposits in this region.
- **Eastern Massachusetts**, with several lending offices and one branch office located in towns west and north of Boston. Eastern Massachusetts is the largest economic area in New England, and the Company's banking operations extend from Worcester within the commuting and commerce area of Boston, east to Boston and its suburbs. The Bank's Asset Based Lending Group is headquartered in this region, and serves middle market businesses throughout the Company's footprint. At year-end 2013, including certain administrative balances, Berkshire had approximately \$1.1 billion in loans and \$0.2 billion in deposits in this region.

These regions are viewed as having favorable demographics and provide an attractive regional niche for the Bank to distinguish itself from larger national and super-regional banks, and from smaller community banks, while serving its market area. The Bank is the only locally headquartered regional bank serving this footprint. The Company views its footprint as comparatively stable, with modest economic growth prospects in rural areas and higher growth prospects



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in more developed areas. The strongest growth is expected to be in Eastern Massachusetts and the New York Capital District. The Company views itself as positioned to take advantage of the best growth opportunities as they develop across its geography. The Company's regions have competitive economic strengths in precision manufacturing, distribution, technology, health care, and education which are expected to continue to support above average personal incomes and wealth. As a result of its growth, the Company has increased and diversified its revenues both geographically and by product type and this has improved its flexibility in pursuing growth opportunities as they arise. The Company believes it has attractive long term growth prospects because of the Bank's positioning as one of the leading regional banks in its markets with the ability to serve retail and commercial customers with a strong product set and responsive local management. The Company also has a goal to deepen its wallet share as a result of its focused cross sales program across its various business lines including insurance and wealth management.

In addition to business acquisitions, Berkshire's expansion has been based on team and talent recruitment. In 2013, this included the recruitment of a commercial banking team in Eastern Massachusetts as well as commercial bankers in the Syracuse and Hartford markets, a middle market leasing team, new small business banking leadership and regional expansion of the mortgage banking team. Shortly after year-end, the Company announced the recruitment of a new commercial market leader for its New York Region.

The Company also pursues organic growth through ongoing business development, de novo branching, and product development. The Bank promotes itself as America's Most Exciting Bank®. It has set out to change the financial service experience. Its vision is to excel as a high performing market leader with the right people, attitude, and energy providing an engaging and exciting customer and team member experience. This brand and culture statement is expected to drive customer engagement, loyalty, market share and profitability.

The Company offers a wide range of deposit, lending, insurance, and wealth management products to retail, commercial, not-for-profit, and municipal customers in its market areas. The Company's product offerings also include retail and commercial electronic banking, commercial cash management, and commercial interest rate swaps. The Company stresses a culture of teamwork and performance excellence to produce customer satisfaction to support its strategic growth and profitability. The Company utilizes Six Sigma tools to improve operational effectiveness and efficiency. The Company converted its core banking systems to a new scalable technology platform in 2012, with goals to enhance service, efficiency, reliability, customer relationship management, distribution channels, product quality, and revenue generation. The systems provide deeper and more granular customer and operational data that Berkshire is mining in order to better inform its strategic direction and business execution. Berkshire has also expanded its mobile banking and remote capture offerings and utilizes its internet website and online banking tools to extend the convenience that it offers to customers.

The Company has recruited executives with experience in regional bank management and has augmented its management team as it has expanded into a diversified regional financial services provider. In 2013, Berkshire expanded the responsibilities of its Executive Vice President/Chief Risk Officer to also include the newly created position of Chief Administrative Officer. Through internal promotions, the Company named a new Executive Vice President/Commercial Banking, a new Senior Vice President/Chief Credit Officer, and a new Senior Vice President/Information Technology. The Company also recruited a new Senior Vice President/Principal Accounting Officer who was promoted to Executive Vice President/Chief Financial Officer shortly after year-end. Additionally, early in 2014 the Company recruited a new Senior Vice President/Treasurer.

**COMPANY WEBSITE AND AVAILABILITY OF SECURITIES AND EXCHANGE COMMISSION FILINGS**

Information regarding the Company is available through the Investor Relations tab at [berkshirebank.com](http://berkshirebank.com). The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are



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available free of charge at sec.gov and at berkshirebank.com under the Investor Relations tab. Information on the website is not incorporated by reference and is not a part of this annual report on Form 10-K.

## COMPETITION

The Company is subject to strong competition from banks and other financial institutions and financial service providers. Its competition includes national and super-regional banks such as Bank of America, TD Bank, Citizens Bank, Sovereign Bank, and Key Bank which have substantially greater resources and lending limits. Non-bank competitors include credit unions, brokerage firms, insurance providers, financial planners, and the mutual fund industry. New technology is reshaping customer interaction with financial service providers and the increase of Internet-accessible financial institutions increases competition for the Company's customers. The Company generally competes on the basis of customer service, relationship management, and the fair pricing of loan and deposit products and wealth management and insurance services. The location and convenience of branch offices is also a significant competitive factor, particularly regarding new offices. The Company does not rely on any individual, group, or entity for a material portion of its deposits.

## LENDING ACTIVITIES

**General.** The Bank originates loans in the four basic portfolio categories discussed below. Lending activities are limited by federal and state laws and regulations. Loan interest rates and other key loan terms are affected principally by the Bank's asset/liability strategy, loan demand, competition, and the supply of money available for lending purposes. These factors, in turn, are affected by general and economic conditions, monetary policies of the federal government, including the Federal Reserve, legislative tax policies and governmental budgetary matters. Most of the Bank's loans are made in its market areas and are secured by real estate located in its market areas. Lending is therefore affected by activity in these real estate markets. Loan portfolios acquired in business combinations include national commercial real estate loans acquired with Legacy and Tennessee commercial loans acquired with Beacon. The Company is reducing these acquired portfolios. The Bank does not engage in subprime lending activities. The Bank monitors and manages the amount of long-term fixed-rate lending volume. Adjustable-rate loan products generally reduce interest rate risk but may produce higher loan losses in the event of sustained rate increases. In 2012, the Bank acquired residential mortgage banking operations in Eastern Massachusetts which primarily originate residential mortgages for sale. Excluding mortgage banking operations, the Bank retains most of the loans it originates, although the Bank generally sells its longer-term, fixed-rate, one to four-family residential loans and sometimes buys and sells participations in some commercial loans.

**Loan Portfolio Analysis.** The following table sets forth the year-end composition of the Bank's loan portfolio in dollar amounts and as a percentage of the portfolio at the dates indicated. Further information about the composition of the loan portfolio is contained in the Loans footnote in the consolidated financial statements.



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### Item 1 - Table 1 - Loan Portfolio Analysis

(In millions)	2013		2012		2011		2010		2009	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
Residential mortgages	\$ 1,384.3	33%	\$ 1,324.3	33%	\$ 1,020.4	34%	\$ 645.0	30%	\$ 609.0	31%
Commercial mortgages	1,417.1	34	1,413.5	35	1,156.2	39	925.6	43	851.8	43
Commercial business	687.3	16	600.1	15	410.3	14	286.1	13	186.0	10
Total commercial loans	2,104.4	50	2,013.6	50	1,566.5	53	1,211.7	56	1,037.8	53
Consumer	691.8	17	650.7	17	369.6	13	285.5	14	314.8	16
Total loans	\$ 4,180.5	100%	\$ 3,988.6	100%	\$ 2,956.5	100%	\$ 2,142.2	100%	\$ 1,961.6	100%
Allowance for loan losses	(33.3)		(33.2)		(32.4)		(31.9)		(31.8)	
Net loans	\$ 4,147.2		\$ 3,955.4		\$ 2,924.1		\$ 2,110.3		\$ 1,929.8	

**Residential Mortgages.** The Bank offers fixed-rate and adjustable-rate residential mortgage loans with maturities of up to 30 years that are fully amortizing with monthly loan payments. Residential mortgages are generally underwritten according to the Federal National Mortgage Association ( Fannie Mae ) or the Federal Home Loan Mortgage Association ( Freddie Mac ) guidelines for loans they designate as A or A- (these are referred to as conforming loans ). Private mortgage insurance is generally required for loans with loan-to-value ratios in excess of 80%. The Bank also originates loans above conforming loan amount limits, referred to as jumbo loans, which are generally conforming to secondary market guidelines for these loans. The Bank does not offer subprime mortgage lending programs.

The Bank generally sells most of its newly originated fixed rate mortgages. It also monitors its interest rate risk position and sometimes may decide to purchase or sell seasoned mortgage loans in the secondary mortgage market. The Bank is approved as a direct seller to Fannie Mae, retaining the servicing rights. Beginning in 2012, the Bank sells the majority of its mortgages to national institutional secondary market investors on a servicing released basis. Sales of mortgages generally involve customary representations and warranties and are nonrecourse in the event of borrower default. The Bank is also an approved originator of loans for sale to the Federal Housing Administration ( FHA ), U.S. Department of Veteran Affairs ( VA ), and state housing agency programs.

The Bank offers adjustable rate ( ARM ) mortgages which do not contain interest-only or negative amortization features. After an initial term of six months to ten years, the rates on these loans generally reset every year based upon a contractual spread or margin above the average yield on U.S. Treasury securities. ARM loan interest rates may rise as interest rates rise, thereby increasing the potential for default. At year-end 2013, the Bank's adjustable rate mortgage portfolio totaled \$401 million. The Bank also originates loans to individuals for the construction and acquisition of personal residences. These loans generally provide fifteen-month construction periods followed by a permanent mortgage loan, and follow the Bank's normal mortgage underwriting guidelines.

**Commercial Mortgages.** The Bank originates commercial mortgages on properties used for business purposes such as small office buildings, industrial, healthcare, lodging, recreation, or retail facilities. This portfolio also includes commercial 1-4 family and multifamily properties. Loans may generally be made with amortizations of up to 25 years and with interest rates that adjust periodically (primarily from short-term to five years). Most commercial mortgages are originated with final maturities of ten years or less. The Bank generally requires that borrowers have debt service coverage ratios (the ratio of available cash flows before debt service to debt service) of at least 1.25 times. Loans at origination may be made up to 80% of appraised value. Generally, commercial mortgages require personal guarantees by the principals. Credit enhancements in the form of additional collateral or guarantees are normally considered for start-up businesses without a qualifying cash flow history. As part of its business activities, the Bank also enters into commercial loan participations with regional banks and purchases and sells commercial loans in its footprint.

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Commercial mortgages generally involve larger principal amounts and a greater degree of risk than residential mortgages. They also often provide higher lending spreads. Because repayment is often dependent on the successful operation or management of the properties, repayment of such loans may be affected by adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks through strict adherence to its underwriting standards and portfolio management processes.

The Bank offers interest rate swaps to certain larger commercial mortgage borrowers. These swaps allow the Bank to originate a mortgage based on short-term LIBOR rates and allow the borrower to swap into a longer term fixed rate. The Bank simultaneously sells an offsetting back-to-back swap to an investment grade national bank so that it does not retain this fixed-rate risk. The Bank also records fee income on these interest rate swaps based on the terms of the offsetting swaps with the bank counterparties.

The Bank originates construction loans to builders and commercial borrowers in and around its markets. Construction loans finance the acquisition and/or improvement of commercial and residential properties. The maximum loan to value limits for construction loans follow FDIC supervisory limits, up to a maximum of 80%. The Bank commits to provide the permanent mortgage financing on most of its construction loans on income-producing property. Advances on construction loans are made in accordance with a schedule reflecting the cost of the improvements. Construction loans include land acquisition loans up to a maximum 65% loan to value on raw land. Construction loans may have greater credit risk than permanent loans. In many cases, the loan's repayment is dependent on the completion of construction and other real estate improvements, which entails risk that construction permits may be delayed or may not be received, or that there may be delays or cost overruns during construction. Repayment is also often dependent on the sale or rental of the improved property, which depends on market conditions and the availability of permanent financing. Developers and contractors may also encounter liquidity risks or other risks related to other projects which are not being financed.

**Commercial Business Loans.** The Bank offers secured commercial term loans with repayment terms which are normally limited to the expected useful life of the asset being financed, generally not exceeding seven years. The Bank also offers revolving loans, lines of credit, letters of credit, time notes and Small Business Administration guaranteed loans. Business lines of credit have adjustable rates of interest and are payable on demand, subject to annual review and renewal. Commercial business loans are generally secured by a variety of collateral such as accounts receivable, inventory and equipment, and are generally supported by personal guarantees. Loan to value ratios depend on the collateral type and generally do not exceed 95% of the liquidation value of the collateral. Some commercial loans may also be secured by liens on real estate. The Bank generally does not make unsecured commercial loans.

The Asset Based Lending Group serves the commercial middle market in New England, as well as the Bank's market in northeastern New York. This group expands the Bank's business lending offerings to include revolving lines of credit and term loans secured by accounts receivable, inventory, and other assets to manufacturers, distributors and select service companies experiencing seasonal working capital needs, rapid sales growth, a turnaround, buyout or recapitalization with credit needs ranging from \$2 to \$25 million. Asset based lending involves monitoring loan collateral so that outstanding balances are always properly secured by business assets.

The Bank's commercial lending team in Central/Eastern Massachusetts serves the commercial middle market with expertise in health care and education financing. Additionally, the Bank has reorganized its small business lending function to expand this important business financing capability and includes the retail division in the origination of conforming small business loans in order to provide the best service to community based small businesses.



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Commercial loans are of higher risk and are made primarily on the basis of the borrower's ability to make repayment from the cash flows of its business. Further, any collateral securing such loans may depreciate over time, may be difficult to monitor and appraise and may fluctuate in value. The Bank gives additional consideration to the borrower's credit history and the guarantor's capacity to help mitigate these risks.

**Consumer Loans.** The Bank's consumer loans consist principally of home equity lines of credit, together with second mortgage loans and automobile loans. The Bank's home equity lines of credit are typically secured by first or second mortgages on borrowers' residences. Home equity lines have an initial revolving period up to fifteen years, followed by an amortizing term up to twenty years. These loans are normally indexed to the prime rate. Home equity loans also include amortizing fixed-rate second mortgages with terms up to fifteen years. Lending policies for combined debt service and collateral coverage are similar to those used for residential first mortgages, although underwriting verifications are more streamlined. The maximum combined loan-to-value is 80%. Home equity line credit risks are similar to those of adjustable-rate first mortgages, although these loans may be more sensitive to losses when interest rates are rising due to increased sensitivity to rate changes. Additionally, there may be possible compression of collateral coverage on second lien home equity lines. The Bank also includes all other consumer loans in this portfolio total, including personal secured and unsecured loans and overdraft protection facilities. The direct and indirect automobile loan portfolios are growing. For new automobiles, the amount financed could be up to 100% of the value of the vehicle, plus applicable taxes and dealer charges (i.e., warranty and insurance charges). For used automobiles, the amount of the loan was limited to the loan value of the vehicle, as established by industry guides.

**Maturity and Sensitivity of Loan Portfolio.** The following table shows contractual final maturities of selected loan categories at year-end 2013. The contractual maturities do not reflect premiums, discounts, deferred costs, and prepayments.

Item 1 - Table 2 - Loan Contractual Maturity -Scheduled Loan Amortizations are not included in the maturities presented.

Contractual Maturity (In thousands)	One Year or Less	More than One to Five Years	More Than Five Years	Total
Construction mortgage loans:				
Residential	\$ 5,773	\$ 17,397	\$	23,170
Commercial	39,514	99,503		139,017
Commercial business loans	207,164	356,694	123,435	687,293
Total	\$ 252,451	\$ 473,594	\$ 123,435	\$ 849,480

For the \$597 million of loans above which mature in more than one year, \$105 million of these loans are fixed-rate and \$492 million are variable rate.

**Loan Administration.** Lending activities are governed by a loan policy approved by the Board's Risk Management Committee. Internal staff perform and monitor post-closing loan documentation review, quality control, and commercial loan administration. The lending staff assigns a risk rating to all commercial loans. Management primarily relies on internal risk management staff to review the risk ratings of the majority of commercial loan balances.

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The Bank's lending activities follow written, non-discriminatory underwriting standards and loan origination procedures established by the Risk Management Committee and Management. The Bank's loan underwriting is based

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on a review of certain factors including risk ratings, recourse, loan-to-value ratios and material policy exceptions. The Risk Management Committee has established individual and combined loan limits and lending approval authorities. Management's Executive Loan Committee is responsible for commercial and residential loan approvals in accordance with these standards and procedures. Generally, commercial lending management has the authority to approve pass rated secured loans up to \$2 million and in conjunction with the Senior Credit Officer up to \$7.5 million (or \$5 million in the case of material policy exceptions). The Executive Loan Committee approves secured loans over these amounts (and over \$1 million unsecured).

The Bank's lending activities are conducted by its salaried and commissioned loan personnel. Designated salaried branch staff originate conforming residential mortgages and receive bonuses based on overall performance. Additionally, the Bank employs commissioned residential mortgage originators. Commercial lenders receive salaries and are eligible for bonuses based on overall performance. From time to time, the Bank will purchase whole loans or participations in loans. These loans are underwritten according to the Bank's underwriting criteria and procedures and are generally serviced by the originating lender under terms of the applicable participation agreement. The Bank routinely sells newly originated fixed rate residential mortgages in the secondary market. Customer rate locks are offered without charge and rate locked applications are generally committed for forward sale or hedged with derivative financial instruments to minimize interest rate risk pending delivery of the loans to the investors. The Bank sells a limited number of commercial loan participations on a non-recourse basis. The Bank issues loan commitments to its prospective borrowers conditioned on the occurrence of certain events. Loan origination commitments are made in writing on specified terms and conditions and are generally honored for up to sixty days from approval; some commercial commitments are made for longer terms.

The loan policy sets certain limits on concentrations of credit and requires periodic reporting of concentrations to the Risk Management Committee. Loans outstanding to the ten largest relationships averaged \$26 million each, or 5.3% of total risk based capital. Total year-end commercial construction loans outstanding were 29% of the Bank's risk based capital at year-end. The Bank's portfolio management objective has been to reduce these concentrations. The FDIC has established monitoring guidelines of 100% for this ratio. Above these guidelines, additional monitoring and risk management controls are required.

**Problem Assets.** The Bank prefers to work with borrowers to resolve problems rather than proceeding to foreclosure. For commercial loans, this may result in a period of forbearance or restructuring of the loan, which is normally done at current market terms and does not result in a troubled loan designation. For residential mortgage loans, the Bank generally follows FDIC guidelines to attempt a restructuring that will enable owner-occupants to remain in their home. However, if these processes fail to result in a performing loan, then the Bank generally will initiate foreclosure or other proceedings no later than the 90th day of a delinquency, as necessary, to minimize any potential loss. Management reports delinquent loans and non-performing assets to the Board quarterly. Loans are generally removed from accruing status when they reach 90 days delinquent, except for certain loans which are well secured and in the process of collection. Delinquent automobile loans are maintained on accrual until they reach 120 days delinquent, and then they are generally charged-off.

Real estate acquired by the Bank as a result of loan collections is classified as real estate owned until sold. When property is acquired it is recorded at fair market value less estimated selling costs at the date of foreclosure, establishing a new cost basis. Holding costs and decreases in fair value after acquisition are expensed. Interest income that would have been recorded for 2013 if nonaccruing loans had been current according to their original terms, amounted to \$1.3 million. Included in the amount is \$34 thousand related to troubled debt restructurings. The amount of interest income on those loans that was recognized in net income in 2013 was \$0.7 million. Included in this amount

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is \$101 thousand related to troubled debt restructurings. Interest income on accruing troubled debt restructurings totaled \$0.4 million for 2013. The total carrying value of troubled debt restructurings was \$10.8 million at year-end.

The following table sets forth additional information on year-end problem assets and accruing troubled debt restructurings ( TDR ). Due to accounting standards for business combinations, non-accrual loans of acquired banks are recorded as accruing on the acquisition date. Therefore, measures related to accruing and non-accruing loans reflect these standards and may not be comparable to prior periods.

Item 1 - Table 3 - Problem Assets and Accruing TDR

(In thousands)	2013	2012	2011	2010	2009
<b>Non-accruing loans:</b>					
Residential mortgages	\$ 7,868	\$ 7,466	\$ 7,010	\$ 2,173	\$ 3,304
Commercial mortgages	13,739	12,617	14,280	9,488	31,917
Commercial business	2,355	3,681	990	1,305	3,115
Consumer	3,493	1,748	1,954	746	364
Total non-performing loans	27,455	25,512	24,234	13,712	38,700
Real estate owned	2,758	1,929	1,900	3,386	30
Total non-performing assets	\$ 30,213	\$ 27,441	\$ 26,134	\$ 17,098	\$ 38,730
Troubled debt restructurings (accruing)	\$ 8,344	\$ 3,641	\$ 1,263	\$ 7,829	\$ 17,818
Accruing loans 90+ days past due	\$ 9,223	\$ 18,977	\$ 10,184	\$ 1,054	\$ 91
Total non-performing loans/total loans	0.66%	0.64%	0.82%	0.64%	1.97%
Total non-performing assets/total assets	0.53%	0.52%	0.65%	0.59%	1.43%

**Asset Classification and Delinquencies.** The Bank performs an internal analysis of its commercial loan portfolio and assets to classify such loans and assets in a manner similar to that employed by the federal banking regulators. There are four classifications for loans with higher than normal risk: Loss, Doubtful, Substandard and Special Mention. Normally an asset classified as Loss is fully charged-off. Substandard assets have one or more defined weaknesses and are characterized by the distinct possibility that the insured institution will sustain some loss if the deficiencies are not corrected. Doubtful assets have the weaknesses of substandard assets with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions and values questionable, and there is a high possibility of loss. Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated Special Mention. Please see the additional discussion of non-accruing and potential problem loans in Item 7 and additional information about loans by risk rating in the Loans Note to the consolidated financial statements.

**Allowance for Loan Losses.** The Bank's loan portfolio is regularly reviewed by management to evaluate the adequacy of the allowance for loan losses. The allowance represents management's estimate of inherent losses that are probable and estimable as of the date of the financial statements. The allowance includes a specific component for impaired loans (a specific loan loss reserve) and a general component for portfolios of all outstanding loans (a general loan loss reserve). At the time of acquisition, no allowance for loan losses is assigned to loans acquired in business combinations. These loans are carried at fair value, including the impact of expected losses, as of the acquisition date. An allowance on such loans is established subsequent to the acquisition date through the provision for loan losses based on an analysis of factors including environmental factors. The loan loss allowance is discussed further in the Note about Significant Accounting Policies in the consolidated financial statements.





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For loans covered by the loan loss allowance, management assesses specific loan loss reserves when it deems that it is probable that the Bank will be unable to collect all amounts due according to the contractual terms stipulated in the loan agreement. Management weighs various factors in its assessment, including but not limited to, its review of the borrower's payment history and the borrower's future ability to service the debt, the current value of any pledged collateral, and the strength of any guarantor support. Generally non-accruing commercial loans are deemed impaired and evaluated for specific valuation allowances. Confirmed loan losses are charged-off directly to the allowance. Losses are deemed confirmed when upon review of all the available evidence, any portion of the loan balance is deemed uncollectible. Subsequent recoveries, if any, are credited to the allowance.

For loans from business activities covered by the loan loss allowance, management estimates general loan loss reserves when it is probable that there would be credit losses in portfolios of loans with similar characteristics. Management has identified four primary loan portfolios: residential mortgages, commercial mortgages, commercial business, and consumer loans. Sub-portfolios within these primary loan portfolios are also evaluated in order to arrive at a more precise general loan loss allowance. The methodology includes a historical loss component and an environmental factors component. The historical loss component is based on the Bank's risk rating system in combination with the attribution of loss factors based on corporate default and recovery rates in the industry. The environmental factors component assesses loss potential as it may be affected by economic business conditions, lending policies and procedures, portfolio characteristics, management and staff changes, problem loan trends, and credit concentration trends. While the general loss reserve is analyzed according to the various subportfolios, the general loss reserve in aggregate is available to cover all losses in all components of the loan portfolio.

Management believes that it uses the best information available to establish the allowance for loan losses. However, future adjustments to the allowance for loan losses may be necessary, and results of operations could be adversely affected if circumstances differ substantially from the assumptions used in making its determinations. Because the estimation of inherent losses cannot be made with certainty, there can be no assurance that the existing allowance for loan losses is adequate or that increases will not be necessary should the quality of any loan or loan portfolio category deteriorate as a result of the factors discussed above. Additionally, the regulatory agencies, as an integral part of their examination process, also periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to make additional provisions for estimated losses based upon judgments different from those of management. Any material increase in the allowance for loan losses may adversely affect the Bank's financial condition and results of operations.

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The following table presents an analysis of the allowance for loan losses for the years indicated.

Item 1 - Table 4 - Allowance for Loan Loss

(In thousands)	2013	2012	2011	2010	2009
Balance at beginning of year	\$ 33,208	\$ 32,444	\$ 31,898	\$ 31,816	\$ 22,908
<i>Charged-off loans:</i>					
Residential mortgages	2,426	2,647	1,322	409	2,016
Commercial mortgages	5,026	4,229	4,046	6,403	27,596
Commercial business	2,917	697	1,443	2,685	5,945
Consumer	2,467	1,877	885	1,188	3,586
Total charged-off loans	12,836	9,450	7,696	10,685	39,143
<i>Recoveries on charged-off loans:</i>					
Residential mortgages	399	103	231	213	
Commercial mortgages	549	52	189	794	22
Commercial business	211	96	109	1,094	64
Consumer	414	373	150	140	235
Total recoveries	1,573	624	679	2,241	321
Net loans charged-off	11,263	8,826	7,017	8,444	38,822
Allowance attributed to loans acquired by merger					
Provision for loan losses	11,378	9,590	7,563	8,526	47,730
Transfer of commitment reserve					
Balance at end of year	\$ 33,323	\$ 33,208	\$ 32,444	\$ 31,898	\$ 31,816
<i>Ratios:</i>					
Net charge-offs/average loans	0.29%	0.26%	0.27%	0.42%	1.96%
Recoveries/charged-off loans	12.25	6.60	8.82	20.97	0.82
Net loans charged-off/allowance for loan losses	33.80	26.58	21.63	26.47	109.81
Allowance for loan losses/total loans	0.80	0.83	1.10	1.49	1.62
Allowance for loan losses/non-accruing loans	121.37	130.17	133.88	232.63	82.21

The following tables present year-end data for the approximate allocation of the allowance for loan losses by loan categories at the dates indicated (including an apportionment of any unallocated amount). The first table shows for each category the amount of the allowance allocated to that category as a percentage of the outstanding loans in that category. The second table shows the allocated allowance together with the percentage of loans in each category to total loans. Management believes that the allowance can be allocated by category only on an approximate basis. The allocation of the allowance to each category is not indicative of future losses and does not restrict the use of any of the allowance to absorb losses in any category. Due to the impact of accounting standards for acquired loans, data in the accompanying tables may not be comparable between accounting periods.

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## Item 1 - Table 5A - Allocation of Allowance for Loan Loss by Category

Residential mortgages	\$ 7,562	0.55%	\$ 6,444	0.49%	\$ 3,420	0.34%	\$ 3,200	0.50%	\$ 3,169
Commercial business	5,770	0.85	5,707	0.95	4,566	1.11	6,498	2.27	6,099

## Item 1 - Table 5B - Allocation of Allowance for Loan Loss

Residential mortgages	\$ 7,562	33.11%	\$ 6,444	33.20%	\$ 3,420	34.51%	\$ 3,200	30.11%	\$ 3,169
Commercial business	5,770	9.08	5,707	15.05	4,566	13.88	6,498	13.35	6,099

**INVESTMENT SECURITIES ACTIVITIES**

The securities portfolio provides cash flow to protect the safety of customer deposits and as a potential source of liquidity for funding loan commitments. The portfolio is also used to manage interest rate risk and to earn a reasonable return on investment. Decisions are made in accordance with the Company's investment policy and include consideration of risk, return, duration, and portfolio concentrations. Day-to-day oversight of the portfolio rests with the Chief Financial Officer and the Treasurer. The Asset/Liability Committee meets monthly and reviews investment strategies. The Risk Management Committee reviews all securities transactions and provides general oversight of the investment function.

The Company has historically maintained a high-quality portfolio of limited duration mortgage-backed securities, together with a portfolio of municipal bonds including national and local issuers and local economic development bonds issued to non-profit organizations. Nearly all of the mortgage-backed securities are issued by Ginnie Mae, Fannie Mae or Freddie Mac, and they generally have an average duration of three to five years. They principally consist of collateralized mortgage obligations (generally consisting of planned amortization class bonds). Other than securities issued by the above agencies, no other issuer concentrations exceeding 10% of stockholders' equity existed at year-end 2013. The municipal portfolio provides tax-advantaged yield, and the local economic development bonds were originated by the Company to area borrowers. Nearly all of the Company's available for sale municipal securities are investment grade rated and most of the portfolio carries credit

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enhancement protection. The Company also invests in equity securities of local financial institutions for a variety of reasons, particularly if it concludes the financial institution is undervalued or if the Company might consider partnering with the financial institution in the future. The Company owns restricted equity in the Federal Home Loan Bank of Boston ( FHLBB ) based on its operating relationship with the FHLBB. The Company owns an interest rate swap against a tax advantaged economic development bond issued to a local not-for-profit organization, and as a result this security is carried as a trading

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account security. The Bank did not record any material losses or write-downs of investment securities during the year and none of the Company's investment securities were other-than-temporarily impaired at year-end.

The following tables present the amortized cost and fair value of the Company's securities, by type of security, for the years indicated.

Item 1 - Table 6A - Amortized Cost and Fair Value of Securities

(In thousands)	2013		2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
<b>Securities available for sale</b>						
Municipal bonds and obligations	\$ 77,852	\$ 77,671	\$ 79,498	\$ 84,757	\$ 73,436	\$ 77,854
Mortgage-backed securities	610,326	601,429	318,245	321,685	289,084	292,707
Other bonds and obligations	61,123	58,975	35,241	34,436	30,702	28,186
Marketable equity securities	20,041	21,973	22,467	25,291	20,236	21,009
Total securities available for sale	\$ 769,342	\$ 760,048	\$ 455,451	\$ 466,169	\$ 413,458	\$ 419,756
<b>Securities held to maturity</b>						
Municipal bonds and obligations	\$ 4,244	\$ 4,244	\$ 8,295	\$ 8,295	\$ 10,349	\$ 10,349
Mortgage-backed securities	73	75	76	83	79	83
Tax advantaged economic development bonds	40,260	41,101	41,678	43,137	47,869	49,348
Other bonds and obligations	344	344	975	975	615	615
Total securities held to maturity	\$ 44,921	\$ 45,764	\$ 51,024	\$ 52,490	\$ 58,912	\$ 60,395
<b>Trading account security</b>	\$ 13,096	\$ 14,840	\$ 13,610	\$ 16,893	\$ 14,096	\$ 17,395
<b>Restricted equity securities</b>	\$ 50,282	\$ 50,282	\$ 39,785	\$ 39,785	\$ 37,118	\$ 37,118

Item 1 - Table 6B - Amortized Cost and Fair Value of Securities

(In thousands)	2013		2012		2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
U.S. Treasuries, other Government agencies and corporations	\$ 630,442	\$ 623,478	\$ 340,789	\$ 347,058	\$ 309,399	\$ 313,799
Municipal bonds and obligations	135,451	137,855	143,080	153,082	145,750	154,946
Other bonds and obligations	111,749	109,601	76,001	75,197	68,435	65,919

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Total Securites	\$	877,642	\$	870,934	\$	559,870	\$	575,337	\$	523,584	\$	534,664
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The schedule includes available-for-sale and held-to-maturity securities as well as the trading security and restricted equity securities.

The following table summarizes year-end 2013 amortized cost, weighted average yields and contractual maturities of debt securities. A significant portion of the mortgage-based securities are planned amortization class bonds. Their expected durations are 3-5 years at current interest rates, but the contractual maturities shown reflect the underlying maturities of the collateral mortgages. Additionally, the mortgage-based securities maturities shown below are based on final maturities and do not include scheduled amortization.

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## Item 1 - Table 7 - Weighted Average Yield

(In millions)	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		More than Ten Years		Total	
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield
Municipal bonds and obligations	\$ 1.1	1.69%	\$ 4.5	4.92%	\$ 18.9	6.30%	\$ 57.6	5.66%	\$ 82.1	5.71%
Mortgage-backed securities	0.0	6.04	11.3	3.19	10.5	2.02	588.6	2.18	610.4	2.20
Other bonds and obligations	3.0	5.22	6.1	3.14	62.3	4.30	30.3	5.01	101.7	4.47
Total	\$ 4.1	4.26%	\$ 21.9	3.53%	\$ 91.7	4.45%	\$ 676.5	2.60%	\$ 794.2	2.85%

**DEPOSIT ACTIVITIES AND OTHER SOURCES OF FUNDS**

Deposits are the major source of funds for the Bank's lending and investment activities. Deposit accounts are the primary product and service interaction with the Bank's customers. The Bank serves personal, commercial, non-profit, and municipal deposit customers. Most of the Bank's deposits are generated from the areas surrounding its branch offices. The Bank offers a wide variety of deposit accounts with a range of interest rates and terms. The Bank also periodically offers promotional interest rates and terms for limited periods of time. The Bank's deposit accounts consist of interest-bearing checking, noninterest-bearing checking, regular savings, money market savings and time certificates of deposit. The Bank emphasizes its transaction deposits—checking and NOW accounts for personal accounts and checking accounts promoted to businesses. These accounts have the lowest marginal cost to the Bank and are also often a core account for a customer relationship. The Bank offers a courtesy overdraft program to improve customer service, and also provides debit cards and other electronic fee producing payment services to transaction account customers. The Bank is promoting remote deposit capture devices so that commercial accounts can make deposits from their place of business. Money market accounts have increased in popularity due to their interest rate structure. Savings accounts include traditional passbook and statement accounts. The Bank's time accounts provide maturities from three months to ten years. Additionally, the Bank offers a variety of retirement deposit accounts to personal and business customers. Deposit service fee income also includes other miscellaneous transaction and convenience services sold to customers through the branch system as part of an overall service relationship.

The Bank offers 100% insurance on all deposits as a result of a combination of insurance from the FDIC and the Massachusetts Depositors Insurance Fund, a mutual insurance fund sponsored by Massachusetts-chartered savings banks.



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The following table presents information concerning average balances and weighted average interest rates on the Bank's interest-bearing deposit accounts for the years indicated. Deposit amounts in the following tables include balances associated with discontinued operations.

Item 1 - Table 8 - Average Balance and Weighted Average Rates for Deposits

Demand	\$	655.7	17%	%	529.0	15%	%	377.9	14%	%
Money market		1,389.2	35	0.9	1,189.1	34	0.4	833.3	31	0.7
Time		1,085.8	28	1.2	1,056.0	31	1.6	902.6	33	1.8

At year-end 2013, the Bank had time deposit accounts in amounts of \$100 thousand or more maturing as follows:

Item 1 - Table 9 - Maturity of Deposits &gt; \$100,000

Maturity Period	Amount	Weighted Average Rate
Three months or less	\$ 74,379	1.49%
Over 3 months through 6 months	66,935	1.04
Over 6 months through 12 months	88,193	1.03
Over 12 months	281,239	1.48
Total	\$ 510,746	1.34%

The Company also uses borrowings from the FHLBB as an additional source of funding, particularly for daily cash management and for funding longer duration assets. FHLBB advances also provide more pricing and option alternatives for particular asset/liability needs. The FHLBB functions as a central reserve bank providing credit for member institutions. As an FHLBB member, the Company is required to own capital stock of the FHLBB. FHLBB borrowings are secured by a blanket lien on most of the Bank's mortgage loans and mortgage-related securities, as well as certain other assets. Advances are made under several different credit programs with different lending standards, interest rates, and range of maturities. The Company has a \$15 million trust preferred obligation outstanding and in September 2012 issued \$75 million in senior subordinated notes. Subject to certain limitations, the Company can also choose to issue common stock in public stock offerings and can also potentially obtain privately placed common and preferred stock, and subordinated, and senior debt from institutional and private investors.



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**DERIVATIVE FINANCIAL INSTRUMENTS**

The Company uses interest rate swap instruments for its own account to fix the interest rate on some of its borrowings, most of which are designated as cash flow hedges. The Company also offers interest rate swaps to commercial loan customers who wish to fix the interest rates on their loans, and the Company backs these swaps with offsetting swaps with national bank counterparties. These swaps are designated as economic hedges. Additionally the Company's mortgage banking activities also result in derivatives. Interest rate lock commitments are provided on applications for residential mortgages intended for resale and are accounted for as non-hedging derivatives. The Company arranges offsetting forward sales commitments for most of these rate-locks with national bank counterparties, which are designated as economic hedges.

The Company has a policy for managing its derivative financial instruments, and the policy and program activity are overseen by the Risk Management Committee. Derivative financial instruments with counterparties which are not customers are limited to a select number of national financial institutions. Collateral may be required based on financial condition tests. The Company works with third-party firms which assist in marketing derivative transactions, executing transactions, and providing information for bookkeeping and accounting purposes.

At year-end 2013, the Company held derivative financial instruments with a total notional amount of \$905 million, including cash flow hedges consisting of interest rate swaps on Federal Home Loan Bank borrowings totaling \$410 million. In conjunction with the New York branch acquisition, the Company terminated these cash flow hedges in the first quarter of 2014, and recorded an after-tax charge of approximately \$5.1 million which had no significant effect on stockholders' equity since the after-tax unrealized loss on these hedges was already recorded in other comprehensive income in stockholders' equity. Also during the first quarter of 2014, the Company entered into \$300 million of new cash flow hedges based on an analysis of its current interest rate sensitivity.

**WEALTH MANAGEMENT SERVICES**

The Company's Wealth Management Group provides consultative investment management and trust relationships to individuals, businesses, and institutions, with an emphasis on personal investment management. The Wealth Management Group has built a track record over more than a decade with its dedicated in-house investment management team. In 2012, the Wealth Management business line expanded with the integration of the Renaissance Investment Group in the Legacy merger. At year-end 2013, assets under management totaled \$1.3 billion (including custodial and investment accounts). Wealth Management services include investment management, trust administration, estate planning, and private banking. The Bank also provides a full line of investment products, financial planning, and brokerage services utilizing Commonwealth Financial Network as the broker/dealer. The Group's principal operations are in Western New England and it is expanding its services in the Company's other regions.

**INSURANCE**

As an independent insurance agent, the Berkshire Insurance Group represents a carefully selected group of financially sound, reputable insurance companies offering attractive coverage at competitive prices. The Insurance Group offers a full line of personal and commercial property and casualty insurance. It also offers employee benefits insurance and a full line of personal life, health, and financial services insurance products. Berkshire Insurance Group operates a focused cross-sell program of insurance and banking products through all offices and branches of the Bank with some of the Group's offices located within the Bank's branches. The Group's principal operations are in Western New

England, and it is expanding its services in the Company's other regions.

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**PERSONNEL**

At year-end 2013, the Company had 939 full time equivalent employees. Total employees decreased from 1,012 at the start of the year due to merger integration and restructuring initiatives. Berkshire continues to develop its staffing, including staff for new branches and hires related to team development. The Company has also developed staff with targeted skills to deepen the Company's infrastructure. The Company's employees are not represented by a collective bargaining unit.

**SUBSIDIARY ACTIVITIES**

The Company wholly-owns two active consolidated subsidiaries: the Bank and Berkshire Insurance Group. The Bank is a Massachusetts-chartered savings bank. One of the Bank's subsidiaries is Berkshire Bank Municipal Bank, which is chartered in the state of New York. Berkshire Insurance Group is incorporated in Massachusetts.

The Company also owns all of the common stock of a Delaware statutory business trust, Berkshire Hills Capital Trust I. The capital trust was organized under Delaware law to facilitate the issuance of trust preferred securities and is not consolidated into the Company's financial results. Its only activity has been the issuance of the \$15 million trust preferred security related to the junior subordinated debentures reported in the Company's consolidated financial statements.

Additional information about the subsidiaries is contained in Exhibit 21 to this report.

**SEGMENT REPORTING**

The Company has two reportable operating segments, banking and insurance. Banking includes the activities of the Bank and its subsidiaries, which provide commercial and retail banking services. Insurance includes the activities of Berkshire Insurance Group, which provides commercial and consumer insurance services. The only other consolidated financial activity of the Company is that of the Company's role as parent of the Bank and Berkshire Insurance Group. For more information about the Company's reportable operating segments, see the related note in the consolidated financial statements.

**REGULATION AND SUPERVISION**

**General**

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The Company is a Delaware corporation and savings and loan holding company registered with the Federal Reserve Board. The Bank's deposits are insured up to applicable limits by the FDIC and by the Depositors Insurance Fund of Massachusetts for amounts in excess of the FDIC insurance limits. The Bank is subject to extensive regulation by the Massachusetts Commissioner of Banks (the Commissioner) as its chartering agency, and by the FDIC, as its deposit insurer. The Bank is required to file reports with the Commissioner and the FDIC concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with, or acquisitions of, other depository institutions or branches of other institutions. The Commissioner and the FDIC conduct periodic examinations to test the Bank's safety and soundness and compliance with various regulatory requirements. As a savings and loan holding company, the Company is required by federal law to file reports with, and otherwise comply with the rules and regulations of, the Federal Reserve Board. The regulatory structure gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulatory requirements and policies,

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whether by the Commissioner, the Massachusetts legislature, the FDIC, the Federal Reserve Board or Congress, could have a material adverse impact on the Company, the Bank and their operations.

The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) made extensive changes in the regulation of insured depository institutions. Under the Dodd-Frank Act, the Office of Thrift Supervision (OTS), the previous federal regulator of the Company, was eliminated. At the same time, responsibility for the regulation and supervision of savings and loan holding companies, such as the Company, was transferred to the Federal Reserve Board, which also supervises bank holding companies. The transfer took place as of July 21, 2011.

Additionally, the Dodd-Frank Act created a new Consumer Financial Protection Bureau as an independent bureau of the Federal Reserve Board. The Consumer Financial Protection Bureau assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations, a function previously assigned to prudential regulators, and has authority to impose new requirements. However, institutions of less than \$10 billion in assets, such as the Bank, will continue to be examined for compliance with consumer protection and fair lending laws and regulations by, and be subject to the primary enforcement authority of their prudential regulator rather than the Consumer Financial Protection Bureau.

In addition, the Dodd-Frank Act directed changes in the way that institutions are assessed for deposit insurance, mandated the imposition of consolidated capital requirements on savings and loan holding companies such as the Company, mandated regulations requiring originators of certain securitized loans to retain a percentage of the risk for the transferred loans, stipulated regulatory rate-setting for certain debit card interchange fees, repealed restrictions on the payment of interest on commercial demand deposits and contained a number of reforms related to mortgage originations.

The Consumer Financial Protection Bureau has finalized the rule implementing the Ability to Pay requirements of the Dodd-Frank Act. The regulations generally require creditors to make a reasonable, good faith determination as to a borrower's ability to repay most residential mortgage loans. The final rule establishes a safe harbor for certain Qualified Mortgages, which contain certain features deemed less risky and omit certain other characteristics considered to enhance risk. The Ability to Repay final rules were effective January 10, 2014.

Many of the provisions of the Dodd-Frank Act are subject to delayed effective dates and/or require the issuance of implementing regulations. The regulatory process is ongoing and the impact on operations cannot yet be fully assessed. However, there is a significant possibility that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden, compliance costs and interest expense for the Company and the Bank.

Certain regulatory requirements applicable to the Company, including certain changes made by the Dodd-Frank Act, are referred to below or elsewhere herein. The description of statutory provisions and regulations applicable to savings institutions and their holding companies set forth in this Form 10-K does not purport to be a complete description of such statutes and regulations and their effects on the Company and is qualified in its entirety by reference to the actual laws and regulations.

**Massachusetts Banking Laws and Supervision**

**General.** As a Massachusetts-chartered depository institution, the Bank is subject to supervision, regulation and examination by the Commissioner and to various Massachusetts statutes and regulations which govern, among other things, investment powers, lending and deposit-taking activities, borrowings, maintenance of surplus and reserve accounts, distribution of earnings and payment of dividends. In addition, the Bank is subject to Massachusetts consumer protection and civil rights laws and regulations. The approval of the Commissioner is required for a



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Massachusetts-chartered institution to establish or close branches, merge with other financial institutions, organize a holding company, issue stock and undertake certain other activities.

Massachusetts regulations generally allow Massachusetts institutions to engage in activities permissible for federally chartered banks or banks chartered by another state. The Commissioner has adopted procedures reducing regulatory burdens and expense and expediting branching by well-capitalized and well-managed banks.

**Dividends.** A Massachusetts stock institution may declare cash dividends from net profits not more frequently than quarterly and non-cash dividends at any time. No dividends may be declared, credited or paid if the institution's capital stock is impaired. The approval of the Commissioner is required if the total of all dividends declared in any calendar year exceeds the total of its net profits for that year combined with its retained net profits of the preceding two years. Net profits for this purpose means the remainder of all earnings from current operations plus actual recoveries on loans and investments and other assets after deducting from the total thereof all current operating expenses, actual losses, accrued dividends on preferred stock, if any, and all federal and state taxes.

**Loans to One Borrower Limitations.** Massachusetts banking law grants broad lending authority. However, with certain limited exceptions, total obligations of one borrower to an institution may not exceed 20.0% of the total of the institution's capital, which is defined under Massachusetts law as the sum of the institution's capital stock, surplus account and undivided profits.

**Loans to a Bank's Insiders.** Massachusetts banking laws prohibit any executive officer, director or trustee from borrowing from or otherwise becoming indebted to, their institution, except for any of the following loans or extensions of credit: (i) loans or extensions of credit, secured or unsecured, to an officer of the institution in an amount not exceeding \$100,000; (ii) loans or extensions of credit intended or secured for educational purposes to an officer of the bank in an amount not exceeding \$200,000; (iii) loans or extensions of credit secured by a mortgage on residential real estate to be occupied in whole or in part by the officer to whom the loan or extension of credit is made, in an amount not exceeding \$750,000; and (iv) loans or extensions of credit to a director or trustee of the bank who is not also an officer of the institution in an amount permissible under the institution's loan to one borrower limit.

The loans described above require approval of the majority of the members of the institution's Board of Directors, excluding any member involved in the loan or extension of credit. No such loan or extension of credit may be granted with an interest rate or other terms that are preferential in comparison to loans granted to persons not affiliated with the institution.

**Investment Activities.** In general, Massachusetts-chartered institutions may invest in preferred and common stock of any corporation organized under the laws of the United States or any state provided such investments do not involve control of any corporation and do not, in the aggregate, exceed 4.0% of the bank's deposits. Massachusetts-chartered institutions may also invest an amount equal to 1.0% of their deposits in stocks of Massachusetts corporations or companies with substantial employment in Massachusetts which have pledged to the Commissioner that such monies will be used for further development within the Commonwealth. However, these powers are constrained by federal law.

**Regulatory Enforcement Authority.** Any Massachusetts-chartered institution that does not operate in accordance with the regulations, policies and directives of the Commissioner may be sanctioned for non-compliance, including seizure of the property and business of the institution and suspension or revocation of its charter. The Commissioner may, under certain circumstances, suspend or remove officers or directors who have

violated the law, conducted the institution's business in a manner which is unsafe, unsound or contrary to the depositors interests or been negligent in

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the performance of their duties. In addition, upon finding that a institution has engaged in an unfair or deceptive act or practice, the Commissioner may issue an order to cease and desist and impose a fine on the institution concerned. Finally, Massachusetts consumer protection and civil rights statutes applicable to the Bank permit private individual and class action lawsuits and provide for the rescission of consumer transactions, including loans, and the recovery of statutory and punitive damage and attorney's fees in the case of certain violations of those statutes.

***Depositors Insurance Fund.*** All Massachusetts-chartered savings banks are required to be members of the Depositors Insurance Fund ( DIF ), a corporation that insures savings bank deposits in excess of federal deposit insurance coverage. The DIF is a private, industry-sponsored insurance company and is not backed by the federal government or the Commonwealth of Massachusetts. The DIF is authorized to charge savings banks an annual assessment for its coverage. Such assessments may vary based on the risk classification assigned to the institution.

The DIF has recently advised the Bank that its excess deposits covered by the DIF have grown to a size at which DIF policy requires that the Bank either secure a substantial reinsurance policy, with the DIF as loss payee, or withdraw from the DIF. The Bank is evaluating its options and may withdraw from the DIF. The withdrawal from the DIF would not affect the Bank's federal deposit insurance. Under Massachusetts law, withdrawal from the DIF will require the Bank to convert from a Massachusetts savings bank to a Massachusetts trust company charter. The Company believes that the powers of a Massachusetts trust company and a Massachusetts savings bank are generally similar. The charter conversion would have some regulatory consequences for the Bank, such as the loss of grandfathered authority under federal law to invest in certain equity securities (although the Company itself can continue to make such investments). On balance, however, the Company does not believe that the Bank's change in charter, should it occur, will have a material impact on its business.

Massachusetts has other statutes or regulations that are similar to the federal provisions discussed below.

**Federal Regulations**

***Capital Requirements.*** Under FDIC regulations, federally insured state-chartered banks that are not members of the Federal Reserve System ( state non-member banks ), such as the Bank, are required to comply with minimum leverage capital requirements. For an institution determined by the FDIC to not be anticipating or experiencing significant growth and to be in general a strong banking organization, rated composite 1 under the Uniform Financial Institutions Rating System established by the Federal Financial Institutions Examination Council, the minimum capital leverage requirement is a ratio of Tier 1 capital to total average assets (as defined) of 3%. For all other institutions, the minimum leverage capital ratio is not less than 4%. Tier 1 capital is the sum of common stockholders' equity, noncumulative perpetual preferred stock (including any related surplus) and minority investments in certain subsidiaries, less intangible assets (except for certain servicing rights and credit card relationships) and certain other items.

The Bank must also comply with the FDIC risk-based capital guidelines. The FDIC guidelines require state non-member banks to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items to four risk-weighted categories ranging from 0% to 100%, with higher levels of capital being required for the categories perceived as representing greater risk.

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State non-member banks must maintain a minimum ratio of total capital to risk-weighted assets of at least 8%, of which at least one-half must be Tier 1 capital. Total capital consists of Tier 1 capital plus Tier 2 or supplementary capital items, which include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets,

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cumulative preferred stock, a portion of the net unrealized gain on equity securities and other capital instruments. The includable amount of Tier 2 capital cannot exceed the amount of the institution's Tier 1 capital.

In July 2013, the FDIC and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets); sets the leverage ratio at a uniform 4% of total assets; increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets); and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain available-for-sale securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments to executive officers if the banking organization does not hold a capital conservation buffer consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The final rule also implements the Dodd-Frank Act's directive to apply to savings and loan holding companies consolidated capital requirements that are not less stringent than those applicable to their subsidiary institutions. The final rule is effective January 1, 2015. The capital conservation buffer will be phased in from January 1, 2016 to January 1, 2019, when the full capital conservation buffer will be effective.

As a savings and loan holding company, the Company is not currently subject to any separate regulatory capital requirements, although that will change as of January 1, 2015, as is described in a subsequent section. The Bank's regulatory capital is included in the Stockholders' Equity note of the Company's financial statements in Item 8 of this report. At year-end 2013, the Bank met each of its capital requirements.

**Interstate Banking and Branching.** Federal law permits an institution, such as the Bank, to acquire another institution by merger in a state other than Massachusetts unless the other state has opted out. Federal law, as amended by the Dodd-Frank Act, authorizes de novo branching into another state to the extent that the target state allows its state chartered banks to establish branches within its borders. The Bank operates branches in New York, Vermont, Connecticut and Tennessee, as well as Massachusetts. At its interstate branches, the Bank may conduct any activity authorized under Massachusetts law that is permissible either for an institution chartered in that state (subject to applicable federal restrictions) or a branch in that state of an out-of-state national bank. The New York State Superintendent of Banks, the Vermont Commissioner of Banking and Insurance, the Connecticut Commissioner of Banking and the Tennessee Commissioner of Financial Institution may exercise certain regulatory authority over the Bank's branches in their respective states.

**Prompt Corrective Regulatory Action.** Federal law requires, among other things, that federal bank regulatory authorities take prompt corrective action with respect to banks that do not meet minimum capital requirements. For these purposes, the law establishes three categories of capital deficient institutions: undercapitalized, significantly undercapitalized and critically undercapitalized.

An institution is deemed to be well capitalized if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 6% or greater, and a leverage ratio of 5% or greater. An institution is adequately capitalized if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 4% or greater and generally a leverage ratio of 4% or greater. An institution is undercapitalized if it has a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 4%, or generally a leverage ratio of less than 4% (3%



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or less for institutions with the highest examination rating). An institution is deemed to be significantly undercapitalized if it has a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 3%, or a leverage ratio of less than 3%. An institution is considered to be critically undercapitalized if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%.

Undercapitalized banks must adhere to growth, capital distribution (including dividend) and other limitations and are required to submit a capital restoration plan. No institution may make a capital distribution, including payment as a dividend, if it would be undercapitalized after the payment. A bank's compliance with such plans is required to be guaranteed by its parent holding company in an amount equal to the lesser of 5% of the institution's total assets when deemed undercapitalized or the amount needed to comply with regulatory capital requirements. If an undercapitalized bank fails to submit an acceptable plan, it is treated as if it is significantly undercapitalized. Significantly undercapitalized banks must comply with one or more of a number of additional restrictions, including but not limited to an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce assets and cease receipt of deposits from correspondent banks or dismiss directors or officers, and restrictions on interest rates paid on deposits, compensation of executive officers and capital distributions by the parent holding company. Critically undercapitalized institutions must comply with additional sanctions including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

At December 31, 2013, the Bank met the criteria for being considered well-capitalized as defined in the prompt corrective action regulations.

In connection with the final capital rule described earlier, the federal banking agencies have adopted revisions to the prompt corrective action framework, effective January 1, 2015. Under the revised prompt corrective action requirements, insured depository institutions would be required to meet the following in order to qualify as well capitalized: (1) a common equity Tier 1 risk-based capital ratio of at least 6.5%; (2) a Tier 1 risk-based capital ratio of at least 8% (increased from 6%); (3) a total risk-based capital ratio of at least 10% (unchanged) and (4) a Tier 1 leverage ratio of 5% or greater (unchanged).

**Transactions with Affiliates.** Transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the Federal Reserve Act. In a holding company context, at a minimum, the parent holding company of an institution and any companies which are controlled by such parent holding company are affiliates of the institution. Generally, Section 23A limits the extent to which the institution or its subsidiaries may engage in covered transactions, such as loans, with any one affiliate to 10% of such institution's capital stock and surplus, and contains an aggregate limit on all such transactions with all affiliates to 20% of capital stock and surplus. Loans to affiliates and certain other specified transactions must comply with specified collateralization requirements. Section 23B requires that transactions with affiliates be on terms that are no less favorable to the institution or its subsidiary as similar transactions with non-affiliates.

Further, federal law restricts an institution with respect to loans to directors, executive officers, and principal stockholders (insiders). Loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the institution's total capital and surplus. Loans to insiders above specified amounts must receive the prior approval of the Board of Directors. Further, loans to insiders must be made on terms substantially the same as offered in comparable transactions to other persons, except that such insiders may receive preferential loans made under a benefit or compensation program that is widely available to the institution's employees and does not give preference to the insider over the employees. Federal law places additional limitations on loans to executive officers.

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**Enforcement.** The FDIC has extensive enforcement authority over insured institutions, including the Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices. The FDIC has authority under federal law to appoint a conservator or receiver for an insured institution under certain circumstances.

**Insurance of Deposit Accounts.** The Bank's deposit accounts are insured by the deposit insurance fund of the FDIC up to applicable limits. The FDIC insures deposits up to the standard maximum deposit insurance amount ( SMDIA ) of \$250,000. The deposit insurance limit was increased in response to the Dodd-Frank Act, which, among other provisions, made permanent the increase in the SMDIA from \$100,000 to \$250,000. The Dodd-Frank Act provided for temporary unlimited coverage of certain noninterest bearing transaction accounts, but such unlimited coverage expired on December 31, 2012.

The FDIC has adopted a risk-based insurance assessment system. The FDIC assigns an institution to one of four risk categories based on the institution's financial condition and supervisory ratings. An institution's assessment rate depends on the capital category and supervisory category to which it is assigned and certain adjustments set forth in FDIC regulations. Institutions deemed to present higher risk to the insurance fund pay higher assessments. The overall assessment range, including prospective adjustments, is 2.5 to 45 basis points. Assessment rates are scheduled to decline as the FDIC fund reserve ratio improves. As required by the Dodd-Frank Act, FDIC assessments are now based on each institution's total assets less Tier 1 capital, rather than deposits, as was previously the case.

FDIC insured institutions are also required to pay assessments to the FDIC to fund interest payments on bonds issued by the Financing Corporation, an agency of the federal government established to recapitalize a predecessor deposit insurance fund. These assessments will continue until the Financing Corporation bonds mature in 2017 through 2019. The assessment rate is adjusted quarterly to reflect changes in the assessment base of the fund. For the quarter ended December 31, 2013, the Financing Corporation assessment amounted to 0.64 basis points of total assets less Tier 1 capital.

Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by a regulator. Management does not know of any practice, condition or violation that might lead to termination of FDIC deposit insurance.

The Dodd-Frank Act increased the minimum target federal deposit insurance fund ratio from 1.15% of estimated insured deposits to 1.35% of estimated insured deposits. The FDIC must seek to achieve the 1.35% ratio by September 30, 2020. Insured institutions with assets of \$10 billion or more are supposed to fund the increase. The Dodd-Frank Act eliminated the 1.50% maximum fund ratio, instead leaving it to the discretion of the FDIC. The FDIC has exercised that discretion by establishing a long range fund ratio of 2.00%.

The FDIC has authority to increase insurance assessments. A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. Management cannot predict what insurance assessment rates will be in the future.

**Federal Home Loan Bank System.** The Bank is a member of the Federal Home Loan Bank system, which consists of 12 regional Federal Home Loan Banks that provide a central credit facility primarily for member institutions. The Bank, as a member, is required to acquire and hold shares of capital stock in the FHLBB.





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The Federal Home Loan Banks are required to provide funds for certain purposes including contributing funds for affordable housing programs. These requirements, and general financial results, could reduce the amount of dividends that the Federal Home Loan Banks pay to their members and result in the Federal Home Loan Banks imposing a higher rate of interest on advances to their members. Historically, the FHLBB paid dividends to member banks based on money market interest rates. Due to losses initially reported in the fourth quarter of 2008, the FHLBB suspended its dividend to members in the first quarter of 2009. The dividend remained suspended through year-end 2010, but was restored to a nominal amount in the first quarter of 2011. It has improved marginally in subsequent quarters, though it is still much lower than 2008 levels.

## **Holding Company Regulation**

**General.** Federal law allows a state savings bank that qualifies as a Qualified Thrift Lender, discussed below, to elect to be treated as a savings association for purposes of the savings and loan holding company provisions of federal law. Such election, which was made by the Bank, allows the parent holding company to be regulated as a savings and loan holding company, rather than as a bank holding company under the federal Bank Holding Company Act. As such, the Company is registered as a savings and loan holding company with the Federal Reserve Board and must adhere to the Federal Reserve Board's regulations and reporting requirements. In addition, the Federal Reserve Board, may examine, supervise and take enforcement action against the Company and its non-savings institution subsidiaries. Among other things, this authority permits the Federal Reserve Board to restrict or prohibit activities that are determined to be a serious risk to the subsidiary institution. By regulation, the Federal Reserve Board may restrict or prohibit the Bank from paying dividends. The Federal Reserve Board generally exercises its regulatory authority over the Company through the Federal Reserve Bank of Boston.

Federal law authorizes unitary savings and loan holding companies to engage in activities permitted for a financial holding company under federal law and those permitted for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance and activities that are incidental or complementary to financial activities. The Dodd-Frank Act added that any savings and loan holding company that engages in activities permissible for a financial holding company must meet the qualitative requirements for a bank holding company to be a financial holding company and conduct the activities in accordance with the requirements that would apply to a financial holding company's conduct of the activity. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act and certain additional activities authorized by Federal Reserve Board regulations.

Federal law prohibits a savings and loan holding company from, directly or indirectly, acquiring more than 5% of the voting stock of another savings association or savings and loan holding company or from acquiring such an institution or company by merger, consolidation or purchase of its assets, without prior written approval of the Federal Reserve Board. In evaluating applications by holding companies to acquire savings associations, the Federal Reserve Board considers factors such as the financial and managerial resources and future prospects of the Company and the institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community and competitive factors.

To be regulated as a savings and loan holding company (rather than as a bank holding company), the Bank must qualify as a Qualified Thrift Lender. To be a Qualified Thrift Lender, the Bank must maintain compliance with the test for a domestic building and loan association, as defined in the Internal Revenue Code, or with a Qualified Thrift Lender Test. Under the Qualified Thrift Lender Test (the QLT Test), an institution is required to maintain at least 65% of its portfolio assets (total assets less: (1) specified liquid assets up to 20% of total assets; (2) intangibles,



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including goodwill; and (3) the value of property used to conduct business) in certain qualified thrift investments (primarily residential mortgages and related investments, including certain mortgage-backed securities) in at least 9 months out of each 12-month period. At year-end 2013, the Bank maintained at least 65% of its portfolio assets in qualified thrift investments and met the QTL Test.

Savings and loan holding companies have historically not been subjected to consolidated regulatory capital requirements. The Dodd-Frank Act, however, required the Federal Reserve Board to promulgate consolidated capital requirements for bank and savings and loan holding companies that are no less stringent, both quantitatively and in terms of components of capital, than those applicable to their subsidiary depository institutions. Instruments such as cumulative preferred stock and trust-preferred securities, which are currently includable within Tier 1 capital, within certain limits by bank holding companies, would no longer be includable as Tier 1 capital, subject to certain grandfathering. The previously discussed final rule regarding regulatory capital requirements implements the Dodd-Frank Act's directives as to holding company capital requirements. Consolidated regulatory capital requirements identical to those applicable to the subsidiary depository institutions will apply to holding companies as of January 1, 2015. As is the case with institutions themselves, the capital conservation buffer will be phased in between 2016 and 2019. The Dodd-Frank Act also extended the source of strength doctrine, which has long applied to bank holding companies, to savings and loan holding companies as well. The Federal Reserve Board has promulgated regulations implementing the source of strength policy, which requires holding companies to act as a source of strength to their subsidiary depository institutions by providing capital, liquidity and other support in times of financial distress. Further, the Federal Reserve Board has issued a policy statement regarding the payment of dividends by bank holding companies that it has suggested is also applicable to savings and loan holding companies. In general, the policy provides that dividends should be paid only out of current earnings and if the prospective rate of earnings retention by the holding company appears consistent with the organization's capital needs, asset quality and overall financial condition. Regulatory guidance provides for regulatory consultation as to capital distributions in certain circumstances such as where the company's net income for the past four quarters, net of dividends previously paid over that period, is insufficient to fully fund the dividend or the company's overall rate of earnings retention is inconsistent with the company's capital needs and overall financial condition. The ability of a holding company to pay dividends may be restricted if a subsidiary depository institution becomes undercapitalized. In addition, a subsidiary institution of a saving and loan holding company must file prior notice with the Federal Reserve Board, and receive its nonobjection, before paying dividends to the parent savings and loan holding company. Federal Reserve Board guidance also provides for regulatory review of certain stock redemption and repurchase proposals. These regulatory policies could affect the ability of the Company to pay dividends, engage in stock redemptions or repurchases or otherwise engage in capital distributions.

As noted previously, the Bank may withdraw from the DIF and such withdrawal would trigger the Bank's conversion from a Massachusetts savings bank to a Massachusetts trust company charter. The charter conversion would cause the Company to become a bank holding company, rather than a savings and loan company, which requires the prior approval of the Federal Reserve Board. The Company contemplates that it would elect financial holding company status upon becoming a bank holding company in order to allow it to engage in a broader range of nonbanking activities. The most significant regulatory consequence of becoming a bank holding company is that the Federal Reserve Board's bank holding company consolidated regulatory capital requirements would become immediately applicable. The Company believes that it currently meets the bank holding company capital requirements and expects that becoming a bank holding company would not materially impact its business. With the Company as a bank holding company, rather than a savings and loan holding company, the Bank would no longer need to comply with the QTL Test.

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**Acquisition of the Company.** Under the Federal Change in Bank Control Act, a notice must be submitted to the Federal Reserve Board if any person (including a company), or group acting in concert, seeks to acquire control of a depository institution and loan holding company. A change in control may occur, and prior notice is required, upon the acquisition of 10% or more of the Company's outstanding voting stock, unless the Federal Reserve Board has found that the acquisition will not result in a change of control of the Company.

**Massachusetts Holding Company Regulation.** In addition to the federal holding company regulations, a bank holding company organized or doing business in Massachusetts must comply with regulations under Massachusetts law. Approval of the Massachusetts regulatory authorities would be required for the Company to acquire 25% or more of the voting stock of another depository institution. Similarly, prior regulatory approval would be necessary for any person or company to acquire 25% or more of the voting stock of the Company. The term bank holding company, for the purpose of Massachusetts law, is defined generally to include any company which, directly or indirectly, owns, controls or holds with power to vote more than 25% of the voting stock of each of two or more banking institutions, including commercial banks and state co-operative banks, savings banks and savings and loan association and national banks, federal savings banks and federal savings and loan associations. In general, a holding company controlling, directly or indirectly, only one banking institution will not be deemed to be a bank holding company for the purposes of Massachusetts law. Under Massachusetts law, the prior approval of the Board of Bank Incorporation is required before any of the following: any company becoming a bank holding company; any bank holding company acquiring direct or indirect ownership or control of more than 5% of the voting stock of, or all or substantially all of the assets of, a banking institution; or any bank holding company merging with another bank holding company. Although the Company is not a bank holding company for purposes of Massachusetts law, any future acquisition of ownership, control, or the power to vote 25% or more of the voting stock of another banking institution or bank holding company would cause it to become such.

**Legislation.** The U.S. Congress, state lawmaking bodies and federal and state regulatory agencies continue to consider a number of wide-ranging and comprehensive proposals for altering the structure, regulation and competitive relationships of the nation's financial institutions. Any such legislation may impact the business of the Company and the Bank.

### **Berkshire Bank Municipal Bank**

Berkshire Bank Municipal Bank is a state-chartered limited purpose commercial bank in New York, established to accept deposits of municipalities and other governmental entities in the State of New York. Berkshire Bank Municipal Bank is subject to extensive regulation, examination and supervision by the New York State Superintendent of Banks, as its primary regulator, and the FDIC, as the deposit insurer. It is also subject to regulation as to certain matters by the Federal Reserve Board. As of year-end 2013, Berkshire Bank Municipal Bank met all of its capital requirements and met the capital conditions to be classified as a well capitalized institution.

### **Other Regulations**

**Consumer Protection Laws.** The Bank is subject to federal and state consumer protection statutes and regulations applicable to depository institutions including, but not limited to, the following:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

- Home Mortgage Disclosure Act, requiring financial institutions to provide certain information about home mortgage and refinance loans;

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- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act, governing the provision of consumer information to credit reporting agencies and the use of consumer information;
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and
- Electronic Funds Transfer Act, governing automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services.

The Bank also is subject to federal laws protecting the confidentiality of consumer financial records, and limiting the ability of the institution to share non-public personal information with third parties.

The Community Reinvestment Act (CRA) establishes a requirement for federal banking agencies that, in connection with examinations of depository institutions within their jurisdiction, the agencies evaluate the record of the depository institutions in meeting the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. These factors are also considered in evaluating mergers, acquisitions and applications to open a branch or new facility. Under the CRA, institutions are assigned a rating of outstanding, satisfactory, needs to improve, or substantial non-compliance. A less than satisfactory rating would result in suspension of any growth of the Bank through acquisitions or opening de novo branches until the rating is improved. As of the most recent CRA examination by the FDIC, the Bank's CRA rating was satisfactory.

**Anti-Money Laundering Laws.** The Bank is subject to extensive anti-money laundering provisions and requirements, which require the institution to have in place a comprehensive customer identification program and an anti-money laundering program and procedures. These laws and regulations also prohibit depository institutions from engaging in business with foreign shell banks; require depository institutions to have due diligence procedures and, in some cases, enhanced due diligence procedures for foreign correspondent and private banking accounts; and improve information sharing between depository institutions and the U.S. government. The Bank has established policies and procedures intended to comply with these provisions.

## TAXATION

The Company reports its income on a calendar year basis using the accrual method of accounting. This discussion of tax matters is only a summary and is not a comprehensive description of the tax rules applicable to the Company and its subsidiaries. Further discussion of income taxation is contained in the income taxes note to the consolidated financial statements.

### Federal

The federal income tax laws apply to the Company in the same manner as to other corporations with some exceptions. The Company may exclude from income 100% of dividends received from the Bank and from Berkshire Insurance Group as members of the same affiliated group

of corporations. For federal income tax purposes, corporations may carry back net operating losses to the preceding two taxable years and forward to the succeeding twenty taxable years, subject to certain limitations.



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**State**

The Company reports income on a calendar year basis to the Commonwealth of Massachusetts. The Massachusetts income tax rate for financial institutions was 9.0% in 2013 and 9.5% in 2012. The Company's taxable income under Massachusetts tax law includes gross income as defined under the Internal Revenue Code, plus interest from non-Massachusetts municipal obligations, less deductions, but not the credits, allowable under the provisions of the Internal Revenue Code. Carry forwards and carry backs of net operating losses are not allowed under Massachusetts tax law. Also no deduction is allowed for bonus depreciation or state income taxes paid.

Massachusetts tax law generally permits special tax treatment for a qualifying limited purpose securities corporation. The Bank's three securities corporations all qualify for this treatment, and are taxed at a 1.3% rate on their gross income.

The Company also pays certain franchise taxes annually in the states of Vermont, New York, and Connecticut. These taxes were immaterial to the Company's results.

**ITEM 1A. RISK FACTORS**

The risks set forth below, in addition to the other risks described in this Annual Report on Form 10-K, may adversely affect our business, financial condition and operating results. In addition to the risks set forth below and the other risks described in this annual report, there may also be additional risks and uncertainties that are not currently known to us or that we currently deem to be immaterial that could materially and adversely affect our business, financial condition or operating results. As a result, past financial performance may not be a reliable indicator of future performance, and historical trends should not be used to anticipate results or trends in future periods. Further, to the extent that any of the information contained in this Annual Report on Form 10-K constitutes forward-looking statements, the risk factors set forth below also are cautionary statements identifying important factors that could cause our actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of us.

**Overall Business Risks**

*The Company's Business May Be Adversely Affected by Conditions in the Financial Markets and Economic Conditions Generally and Locally.*

National and local markets generally exhibit low growth conditions and stubbornly high unemployment. Federal monetary policy continues to be unusually stimulative, which has distorted financial markets and contributed to ongoing low interest rates and record stock market prices. Federal policy gridlock, uncertainties about presidential initiatives, and state and local fiscal challenges contribute to business planning uncertainties. Private sector liquidity has grown and investment has been modest, while public sector leverage has increased due to long term imbalances in taxing and spending. Regulation of the financial system continues to evolve and add to uncertainty and operating burdens. Real estate markets have improved from recessionary lows. A deterioration of business and economic conditions, particularly in our local markets, could adversely affect the credit quality of the Company's loans, results of operations and financial condition.

## Lending

### ***Continued and Prolonged Deterioration in the Housing Sector, Commercial Real Estate, and Related Markets May Adversely Affect Our Business and Financial Results.***

Commercial and residential real estate markets have been impacted by the broader economic conditions previously discussed. Real estate lending is a major business activity for the Company. Real estate market conditions affect the value and marketability of this real estate collateral, and they also affect the cash flows, liquidity, and net worth of many borrowers whose operations and finances depend on real estate market conditions. Adverse conditions in our market areas could reduce our growth rate, affect the ability of our customers to repay their loans and generally affect our financial condition and results of operations.

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***Our Emphasis on Commercial Lending May Expose Us to Increased Lending Risks, Which Could Hurt Our Profits.***

We plan to continue to emphasize the origination of commercial loans, which generally exposes us to a greater risk of nonpayment and loss because repayment of such loans often depends on the successful operations and income stream of the borrowers. Commercial loans are historically more sensitive to economic downturns. Such sensitivity includes potentially higher default rates and possible reduction of collateral values. Commercial lending involves larger loan sizes and larger relationship exposures, which can have a greater impact on profits in the event of adverse loan performance. The majority of the Company's commercial loans is secured by real estate and subject to the previously discussed real estate risk factors. Commercial lending sometimes involves construction or other development financing, which is dependent on the future success of new operations. The Company's commercial lending activities have extended across wider parts of its New England and New York markets into areas where the Company has less business experience. The Company's commercial lending includes asset based lending, which depends on the Company's processes for monitoring and being able to liquidate collateral on which these loans rely. Commercial loans may increase as a percentage of total loans, and commercial lending may continue to expose the company to increased risks.

***Our Allowance for Loan Losses May Prove to be Insufficient to Absorb Losses in Our Loan Portfolio.***

Like all financial institutions, we maintain an allowance for loan losses which is our estimate of the probable losses that are inherent in the loan portfolio as of the financial statement date. However, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially and adversely affect our operating results. The accounting measurements related to impairment and the loan loss allowance require significant estimates which are subject to uncertainty and changes relating to new information and changing circumstances. Additionally, the allowance can only reflect those losses which are reasonably estimable, and there are constraints in our ability to estimate losses in this period of unusual economic and financial stress. This is particularly relevant for our estimates of losses for pools of loans. Accordingly, at any time, there may be probable losses inherent in the portfolio but which we are not reasonably able to estimate until additional information emerges which can form the basis for a reasonable estimate.

State and federal regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by recognizing additional provisions for loan losses charged to expense, or to decrease our allowance for loan losses by recognizing loan charge-offs, net of recoveries. Any such additional provisions for loan losses or charge-offs, as required by these regulatory agencies, could have a material adverse effect on our financial condition and results of operations.

***Our Estimates Related to Accounting for Acquired Loans May Differ From Actual Results.***

Under generally accepted principles for business combinations, there is no loan loss allowance recorded for acquired loans, which are recorded at net fair value on the acquisition date. This net fair value generally includes embedded loss estimates for acquired loans with deteriorated credit quality. These estimates are based on projections of expected cash flows for these problem loans, which in many cases rely on estimates deriving from the liquidation of collateral. If the projections are inadequate, the fair value estimates may exceed the actual collectability of the balances, and this may result in the related loans being considered impaired, which would result in a reduction in interest income. If fair value estimates differ from actual collectability, then tangible book value of the Company will have been recorded incorrectly at the time of the acquisition, and subsequent earnings will differ from original estimates. Measures of tangible book value and earnings impacts of business combinations are frequently used in evaluating the merits and value of business combinations. In 2013, the Company recorded significant income resulting from collections of acquired impaired loans which exceeded the fair value estimates originally established. Additionally, accounting for acquired loans involves ongoing assessments of the timing and amount of expected loan collections. Numerous



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assumptions and estimates are integral to purchased loan accounting, and actual results could be different from prior estimates.

***New regulations could restrict our ability to originate and sell mortgage loans.***

The CFPB has issued a rule designed to clarify for lenders how they can avoid monetary damages under the Dodd-Frank Act, which would hold lenders accountable for ensuring a borrower's ability to repay a mortgage. Loans that meet this qualified mortgage definition will be presumed to have complied with the new ability-to-repay standard. Under the CFPB's rule, a qualified mortgage loan must not contain certain specified features, including:

- excessive upfront points and fees (those exceeding 3% of the total loan amount, less bona fide discount points for prime loans);
- interest-only payments;
- negative-amortization; and
- terms longer than 30 years.

Also, to qualify as a qualified mortgage, a borrower's total debt-to-income ratio may not exceed 43%. Lenders must also verify and document the income and financial resources relied upon to qualify the borrower for the loan and underwrite the loan based on a fully amortizing payment schedule and maximum interest rate during the first five years, taking into account all applicable taxes, insurance and assessments. The CFPB's rule on qualified mortgages could limit our ability or desire to make certain types of loans or loans to certain borrowers, or could make it more expensive/and or time consuming to make these loans, which could limit our growth or profitability.

**Operating**

***Our Expansion, Growth, and Acquisitions Could Negatively Impact Earnings If Not Successful.***

We plan to achieve significant growth organically, by geographic expansion, through business line expansion, and through acquisitions. We have recently expanded into new geographic markets and anticipate that we will continue to expand into additional geographic markets as we grow as a regional bank. The success of this expansion depends on our ability to continue to maintain and develop an infrastructure appropriate to support and integrate such growth. Also, our success depends on the acceptance by customers of us and our services in these new markets

and, in the case of expansion through acquisitions, our success depends on many factors, including the long-term recruitment and retention of key personnel and acquired customer relationships. The profitability of our expansion strategy also depends on whether the income we generate in the new markets will offset the increased expenses of operating a larger entity with increased personnel, more branch locations and additional product offerings. In 2013, revenues decreased in the second half of the year due to changes related to loans and operations acquired in the prior two years.

We continue to identify and evaluate opportunities to expand through acquisition of banks, insurance agencies, and wealth management firms. Some of these opportunities could result in further geographic expansion. Merger and acquisition activities are subject to a number of risks, including lending, operating, and integration risks. Growth through acquisition requires careful due diligence, evaluation of risks, and projections of future operations and financial conditions. Actual results may differ from our expectations and could have a material adverse effect on our financial condition and results of operations. Growth through acquisition also often involves the negotiation and execution of extensive merger agreements. Such agreements may give rise to litigation, constrain us in certain ways, or expose us to other risks beyond our normal operating risks.

The Company negotiated the purchase of 20 branches in Central New York in 2013, and completed this acquisition shortly after year-end 2013. The amount of deposits acquired was significantly below the amount at the time of the purchase agreement. If there is continued attrition of deposit balances or difficulties in integrating the acquired operations, the expected benefits of this acquisition may not be realized.

The Company's recruitment of new executive and commercial lending management has in several cases brought in new management who previously worked at larger institutions. These individuals have often served larger customers than the Company has historically serviced, and they have had the benefit of larger capital and administrative resources than are present in the Company's current structure. The success of this recruitment may depend on the successful integration of these individuals into the Company and may expose the Company to lending and operating losses related to large new customers in newer markets. The Company's commercial banking strategy has particularly focused on taking market share from larger national institutions and in many cases these new accounts are larger than the Company's historic accounts. Additionally, the Company's ability to service these accounts may in some cases involve arranging loan participations and syndications. These activities can expose the Company to additional lending, administrative, and liquidity risks. The Company also actively recruits in other business lines, including private banking and wealth management. This activity can give the Company additional access to large customers in its markets in order to expand our business. Such recruitment can affect the retention of new and old business, and can also be affected by competitive reactions and other relationship risks in retaining accounts.

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Operations acquired in business combinations have frequently been subject to bank regulations prior to the merger date. Related regulatory examinations may result in the identification of certain operating matters requiring remediation, undisclosed deficiencies related to regulatory compliance, deficiencies that arise as a result of integration of acquired operations and operating activities conducted by those operations subsequent to the merger date, or impacts on existing business operations which are being integrated with the acquired operations. Any identified deficiencies related to regulatory compliance may result in changes that affect operating revenues and costs, including the scope or scale of business activities and/or potential future expansion initiatives.

***Competition From Financial Institutions and Other Financial Service Providers May Adversely Affect Our Growth and Profitability.***

Competition in the banking and financial services industry is intense. We compete with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. Larger banking institutions have substantially greater resources and lending limits and may offer certain services that we do not. Local competitors with excess capital may accept lower returns on new business. There is increased competition by out-of-market competitors through the internet. Federal regulations and financial support programs may in some cases favor competitors or place us at an economic disadvantage. Our profitability depends on our continued ability to successfully compete and grow profitably in our market areas.

***We are Subject to Security and Operational Risks Relating to Our Use of Technology that Could Damage Our Reputation and Our Business.***

Security breaches of confidential information in our internet banking activities could expose us to possible liability and damage our reputation. Any compromise of our data security could also deter customers from using our internet banking services. We rely on industry standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our security systems from compromises or breaches and could result in damage to our reputation and our business. We utilize third party core banking software and for some systems we have outsourced our data processing to a third party. If our third party providers encounter difficulties or if we have difficulty in communicating with such third parties, it could significantly affect our ability to adequately process and account for customer transactions, which could significantly affect our business operations. We utilize file encryption in designated internal systems and networks and are subject to certain state and federal regulations regarding how we manage data security. Natural disasters and disaster recovery risks could affect our operating systems, which could affect our reputation. Potential problems with the management of technology security and operational risks may affect regulatory compliance, which could affect operating costs and expansion plans.

***Financial and Operating Counterparties Expose Us to Risks.***

We have increased our use of derivative financial instruments, primarily interest rate swaps, which exposes us to financial and contractual risks with counterparty banks. We maintain correspondent bank relationships, manage certain loan participations, engage in securities transactions, and engage in other activities with financial counterparties that are customary to our industry. We also utilize services from major vendors of technology, telecommunications, and other essential operating services. There is financial and operating risk in these relationships, which we seek to manage through internal controls and procedures, but there are no assurances that we will not experience loss or interruption of our business as a result of unforeseen events with these providers. Our expanded mortgage lending and mortgage banking operations have also exposed us to more counterparty transactions including the use of third parties to participate in the management





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of interest rate risk and mortgage sales and hedging. Financial and operational risks are inherent in these counterparty relationships.

***We May Not Be Able to Attract and Retain Skilled People.***

Our success depends, in large part, on our ability to attract new employees, retain and motivate our existing employees, and continue to compensate employees competitively. Competition for the best people in our industry can be intense and we may not be able to hire or retain appropriately qualified individuals. As a result of recent revenue declines and expense restructuring activities, the Company could experience changes in the retention of existing employees.

***Management Changes Could Affect Operations.***

In 2013, there were changes in executive and senior management, including vacancy periods during times of transition. Existing senior managers were promoted to executive management positions with the expectation that there would be better focus on core competencies. Transitions in the management team introduce control risks in the oversight of operating activities and in the planning and execution of strategic objectives.

***Our Controls and Procedures May Fail or Be Circumvented.***

Management regularly reviews and updates the Company's internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Company's business, results of operations and financial condition.

***New Retail Lending Operations Expose Us to New Operating Risks.***

In 2012, the Bank acquired the business assets of an established residential mortgage origination company in Eastern Massachusetts. The acquired mortgage operations have been integrated and expanded in the Bank's footprint. Following record business volumes in 2012, mortgage business volumes contracted substantially in 2013 which affected mortgage banking profitability and necessitated a restructuring of expenses and operations.

The Bank acquired consumer lending operations with the Beacon Federal acquisition in the fourth quarter of 2012. The Bank has centralized its franchise consumer lending in these acquired Syracuse operations, including indirect automobile lending and home equity lending. The Company views these acquired consumer lending operations as a significant opportunity to expand its franchise consumer lending.

These changes expose us to operating risks. The conduct of these new activities also expose the Bank to the risk of loan losses, losses related to interest rate risk management, compliance, litigation, and other risks common in consumer lending operations.

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***Derivatives and Counterparty Risks Have Increased.***

The total notional amount of derivative financial instruments more than doubled in 2012, largely due to the expanded mortgage operations. The increase includes customer interest rate lock commitments on applications for mortgages that Berkshire intends to sell, and forward sales of securities intended to hedge the interest rate risk of these rate lock commitments until the loans are closed and sold. These activities involve new derivative instruments and new broker/dealer counterparties, as well as the utilization of a new vendor responsible for managing the hedging position. Additionally, Berkshire sells closed loans on a servicing released basis under mandatory and best efforts contracts to institutional secondary market purchasers which are new counterparties for Berkshire. Berkshire could experience losses if there are failures in the controls or accounting for these activities or if there are performance failures by any of these new counterparties. The risk of loss is increased when interest rates change suddenly and if the intended hedging objectives are not achieved as a result of market or counterparty behaviors. The sudden change in interest rates in 2013 contributed to lower mortgage banking profitability in 2013.

The Bank expanded its use of interest rate swaps in 2013 related to hedging its borrowings and providing commercial loan customers with fixed interest rate payment options. Following the completion of the New York branch acquisition shortly after year-end 2013, all outstanding interest rate swaps related to Federal Home Loan Bank loans were terminated and new borrowings and interest rate swaps were entered into based on an analysis of the current interest rate profile and objectives. These terminations in hedge management were due to changed circumstances and the Company's ability to utilize its hedge accounting methods depends on its ability to forecast related economic and financial factors which could limit its ability to utilize these methods in the event of future unforeseen events.

***The Core Bank Processing System Conversion Exposes Us to Operating and Financial Risks.***

In 2012, the Bank converted its core bank processing system to a new system and a new vendor. This system was changed from primarily an in-house system run on the Bank's own computers to one that is primarily a service bureau solution running on the provider's computers and relying on long distance telecommunications. Core systems conversions involve extensive planning and operational changes that affect bank account records, customer service delivery, internal procedures, technology risk management, and other significant operating activities. The changes expose the Bank to new risks with new systems and new vendors. The Bank has worked closely with third parties to manage the related operating and financial risks. Potential problems with new systems could involve regulatory compliance risk, potentially resulting in higher operating costs or limitations on operating activities. The new systems involve new costs with the new vendor, which could exceed expectations and impact profitability and future vendor relations.

**Liquidity**

***Our Wholesale Funding Sources May Prove Insufficient to Replace Deposits at Maturity and Support Our Operations and Future Growth.***

We must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. These sources include Federal Home Loan Bank advances, proceeds from the sale of loans, and liquidity resources at the holding company. Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable costs. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may

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not increase proportionately to cover our costs. In this case, our operating margins and profitability would be adversely affected. Turbulence in the capital and credit markets may adversely affect our liquidity and financial condition and the willingness of certain counterparties and customers to do business with us. The

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Company's long term plan anticipates asset growth at a faster rate than deposit growth, which may result in increased reliance on wholesale or nontraditional funding sources. If deposits in new markets do not remain at planned levels, this could increase the possible reliance on wholesale or nontraditional funding sources.

***The Company Has Exceeded Certain Massachusetts Depositors Insurance Fund Size Thresholds, Which May Result In Changes to the Company and the Bank's Operations.***

Due to ongoing growth, the Company has exceeded certain Massachusetts Depositors Insurance Fund size thresholds and is evaluating its alternatives. Should Berkshire Bank determine to withdraw from participation in the Depositors Insurance Fund, the Bank would be required, under Massachusetts law, to convert from a Massachusetts savings bank to a Massachusetts trust company and, under federal law, the Company would be required to convert from a savings and loan holding company to a bank holding company. Such a charter conversion and holding company change would affect the overall powers and obligations of the Company and the Bank. The Bank is considering available alternatives to a charter conversion. None of these issues would affect the Bank's federal deposit insurance coverage by the FDIC and a potential withdrawal from the DIF supplemental insurance program would be expected to include a notice and transition time period for currently insured accounts. Withdrawal from DIF could have negative impact to future deposit acquisition or retention. The Company expects that any related charter changes, would be managed in an orderly manner without significant impact to business operations.

***Our Ability to Service Our Debt, Pay Dividends and Otherwise Pay Our Obligations as They Come Due Is Substantially Dependent on Capital Distributions from the Bank, and These Distributions Are Subject to Regulatory Limits and Other Restrictions.***

A substantial source of our holding company income is the receipt of dividends from the Bank, from which we service our debt, pay our obligations, and pay shareholder dividends. The availability of dividends from the Bank is limited by various statutes and regulations. It is possible, depending upon the financial condition of the Bank and other factors, that the applicable regulatory authorities could assert that payment of dividends or other types of payments are an unsafe or unsound practice. If the Bank is unable to pay dividends to us, we may not be able to service our debt, pay our obligations or pay dividends on our common stock. The inability to receive dividends from the Bank would adversely affect our business, financial condition, results of operations and prospects.

**Interest Rates**

***Changes in Interest Rates Could Adversely Affect Our Results of Operations and Financial Condition.***

Net interest income is our largest source of income. Changes in interest rates can affect the level of net interest income. The Company's interest rate sensitivity is discussed in more detail in Item 7A of this report. The Company principally manages interest rate risk by managing its volume and mix of earning assets and funding liabilities. In a changing interest rate environment, the Company may not be able to manage this risk effectively. If the Company is unable to manage interest rate risk effectively, its business, financial condition and results of operations could be materially harmed. Changes in interest rates can also affect the demand for the Company's products and services, and the supply conditions in the U.S. financial and capital markets. Changes in the level of interest rates may negatively affect the Company's ability to originate real estate loans, the value of its assets and its ability to realize gains from the sale of our assets, all of which ultimately affect our earnings. In 2013, factors related to market interest rates affected the retention of bank loans and mortgage banking revenues acquired in recent business

combinations.

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**Securities Market Values**

***Declines in the Value of Certain Investment Securities Could Require Write-Downs, Which Would Reduce Our Earnings.***

Unrealized losses on investment securities result from changes in credit spreads and liquidity issues in the marketplace, along with changes in the credit profile of individual securities issuers. The Company concluded that, as of year-end 2013, any unrealized losses are temporary in nature, and it has the intent and ability to hold these investments for a time necessary to recover its cost or stated maturity (at which time, full payment is expected). However, a continued decline in the value of these securities or other factors could result in an other-than-temporary impairment write-down which would reduce earnings. Some of the Company's securities are locally originated economic development bonds. These securities could become impaired due to economic and real estate market conditions which also affect loan risk. The Company has an investment in the stock of the Federal Home Loan Bank of Boston, which currently provides a modest dividend after a period when the dividend was suspended. If the capitalization of a Federal Home Loan Bank, including the FHLBB, became substantially diminished it could result in a write-down which would reduce our earnings. At year-end 2013, the initial promulgation of a regulatory change known as the Volker Rule would have required the write-down of a pooled trust preferred security in the Bank's portfolio. This promulgation was modified, eliminating any potential accounting impacts for the Company. Future regulatory pronouncements could affect the securities portfolio and its carrying value.

**Regulatory**

***Legislative and Regulatory Initiatives May Affect our Business Activities and Increase Operating Costs.***

The potential exists for additional federal or state laws and regulations regarding lending, funding practices, capital, and liquidity standards. Bank regulatory agencies are expected to be more active in responding to concerns and trends identified in examinations, including the expected issuance of many formal enforcement orders. In addition, new laws, regulations, and other regulatory changes may also increase our compliance costs and affect our business and operations. Moreover, the FDIC sets the cost of our FDIC insurance premiums, which can affect our profitability.

The Company is required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Regulatory capital requirements and their impact on the Company may change. It may need to raise additional capital in the future to support operations and continued growth. Our ability to raise capital, if needed, will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. If we cannot raise additional capital when needed, it could affect operations and the execution of the strategic plan, which includes further expanding operations through internal growth and acquisitions.

The Dodd-Frank Act made extensive changes in the regulation of insured depository institutions. In addition to eliminating the OTS and creating the Consumer Financial Protection Bureau, the Dodd-Frank Act, among other things, directs changes in the way that institutions are assessed for deposit insurance, mandates the imposition of consolidated capital requirements on savings and loan holding companies, requires originators of certain securitized loans to retain a percentage of the risk for the transferred loans, stipulates regulatory rate-setting for certain debit card interchange fees, repeals restrictions on the payment of interest on commercial demand deposits and contains a number of reforms related to mortgage originations. The impact of many of the provisions of the Dodd-Frank Act cannot yet be fully assessed. However, there is a

significant possibility that the Dodd-Frank Act will, at a minimum, result in increased regulatory burden, compliance costs and interest expense for the Company.



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New laws, regulations, and other regulatory changes, along with negative developments in the financial industry and the domestic and international credit markets, may significantly affect the markets in which we do business, the markets for and value of our loans and investments, and our ongoing operations, costs and profitability. For more information, see **Regulation and Supervision** in Item 1 of this report.

***New Federal Bank Capital Rules May Affect the Company's Future Condition and Performance.***

In July 2013, the Office of the Comptroller of the Currency ( OCC ), Board of Governors of the Federal Reserve System ( FRB ), and the Federal Deposit Insurance Corporation ( FDIC ) announced the adoption of new rules that revise and replace the agencies' capital rules as these federal agencies move forward with implementing capital requirements in response to agreements reached by the Basel Committee on Banking Supervision ( Basel III ). The Company is assessing the potential impact of these rules, including the impact on capital sources and capital returns.

***Provisions of Our Certificate of Incorporation, Bylaws and Delaware Law, as Well as State and Federal Banking Regulations, Could Delay or Prevent a Takeover of Us by a Third Party.***

Provisions in our certificate of incorporation and bylaws, the corporate law of the State of Delaware, and state and federal regulations could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our stockholders, or otherwise adversely affect the price of our common stock. These provisions include: limitations on voting rights of beneficial owners of more than 10% of our common stock; supermajority voting requirements for certain business combinations; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to our Board of Directors and for proposing matters that stockholders may act on at stockholder meetings. In addition, we are subject to Delaware laws, including one that prohibits us from engaging in a business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors other than the candidates nominated by our Board.

**Goodwill and Other Intangible Assets**

***Our Acquisitions Have Resulted in Significant Goodwill, Which if it Becomes Impaired Would be Required to be Written Down, Resulting in a Negative Impact on Earnings.***

The initial recording and subsequent impairment testing of goodwill and other intangible assets requires subjective judgments about the estimates of the fair value of assets acquired. Factors that may significantly affect the estimates include specific industry or market sector conditions, changes in revenue growth trends, customer behavior, competitive forces, cost structures and changes in discount rates. It is possible that future impairment testing could result in an impairment of the value of goodwill or intangible assets, or both. If we determine impairment exists at a given point in time, our earnings and the book value of the related intangible asset(s) will be reduced by the amount of the impairment. Notwithstanding the foregoing, the results of impairment testing on goodwill and core deposit intangible assets have no impact on our tangible book value or regulatory capital levels. These are non-GAAP financial measures. They are not a substitute for GAAP measures and should only be considered in conjunction with the Company's GAAP financial information.



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**Trading of our Common Stock**

***The Trading History of Our Common Stock Is Characterized By Low Trading Volume. The Value of Your Investment May be Subject To Sudden Decreases Due To the Volatility of the Price of Our Common Stock.***

The level of interest and trading in the Company's stock depends on many factors beyond our control. The market price of our common stock may be highly volatile and subject to wide fluctuations in response to numerous factors, including, but not limited to, the factors discussed in other risk factors and the following: actual or anticipated fluctuations in operating results; changes in interest rates; changes in the legal or regulatory environment; press releases, announcements or publicity relating to the Company or its competitors or relating to trends in its industry; changes in expectations as to future financial performance, including financial estimates or recommendations by securities analysts and investors; future sales of our common stock; changes in economic conditions in our marketplace, general conditions in the U.S. economy, financial markets or the banking industry; and other developments affecting our competitors or us. These factors may adversely affect the trading price of our common stock, regardless of our actual operating performance, and could prevent stockholders from selling their common stock at a desirable price.

In the past, stockholders have brought securities class action litigation against a company following periods of volatility in the market price of their securities. We could be the target of similar litigation in the future, which could result in substantial costs and divert management's attention and resources.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

The Company's headquarters are located in owned and leased facilities located in Pittsfield, Massachusetts. The Company also owns or leases other facilities within its primary market areas: Berkshire County, Massachusetts; Pioneer Valley (Springfield area), Massachusetts; Southern Vermont; the Capital Region (Albany area), New York; Central New York; Northern Connecticut; and Central/Eastern Massachusetts. The Company has 92 full-service branches in Massachusetts, New York, Connecticut, and Vermont (including one branch in Tennessee held for sale following a bank acquisition).

The Company also has 7 regional headquarters. The 7 regional locations are full-service commercial offices located in Pittsfield, Massachusetts; Springfield, Massachusetts; Albany, New York; Syracuse, New York; Hartford, Connecticut; Westborough, Massachusetts; and Burlington, Massachusetts. In addition, the Company has 5 residential mortgage lending locations in Central/Eastern, Massachusetts.

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Berkshire Insurance Group operates from 12 locations in Western Massachusetts and Syracuse, New York in both standalone premises as well as in rented space located in the Bank's premises.

In January 2014, Berkshire completed the acquisition of 20 New York branches from Bank of America, reaching more communities between Albany and Syracuse. As part of the acquisition, two branches were consolidated in Central New York. Berkshire continues to look to consolidate to decrease operating expenses where appropriate and consolidated its commercial banking team into a new regional headquarters in Burlington, Massachusetts. The

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Company also opened a new office in Loudonville, New York in January 2014, as part of its ongoing organic expansion.

In 2013, the Company identified five branches that were consolidated as part of the Company's ongoing initiative to reduce operating costs and achieve greater efficiency following its acquisitions. These locations are in communities in and around the Company's existing footprint and were consolidated due to the proximity with other locations and other business strategies.

Berkshire continues to expand its new retail branch design which eliminates traditional teller counters and provides an interactive customer service environment through pod stations which include automated cash handling technology. Berkshire currently has 14 branches based on this design. In many cases, this branch design also includes a multimedia community room which is offered for use by nonprofit community groups.

**ITEM 3. LEGAL PROCEEDINGS**

At December 31, 2013, neither the Company nor the Bank was involved in any pending legal proceedings believed by management to be material to the Company's financial condition or results of operations. Periodically, there have been various claims and lawsuits involving the Bank, such as claims to enforce liens, condemnation proceedings on properties in which the Bank holds security interests, claims involving the making and servicing of real property loans and other issues incident to the Bank's business. However, neither the Company nor the Bank is a party to any pending legal proceedings that it believes, in the aggregate, would have a material adverse effect on the financial condition or operations of the Company.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not Applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

The common shares of the Company trade on the New York Stock Exchange under the symbol BHLB. The following table sets forth the quarterly high and low sales price information and dividends declared per share of common stock in 2013 and 2012.

	High		Low		Dividends Declared
2013					
First quarter	\$	26.01	\$	23.38	\$ 0.18
Second quarter		27.84		24.62	0.18
Third quarter		29.38		24.34	0.18
Fourth quarter		27.86		24.50	0.18
2012					
First quarter	\$	24.49	\$	21.03	\$ 0.17
Second quarter		23.49		20.15	0.17
Third quarter		23.66		21.19	0.17
Fourth quarter		24.26		20.89	0.18

**Holders**

The Company had approximately 3,420 holders of record of common stock at March 7, 2014.

**Dividends**

The Company intends to pay regular cash dividends to common stockholders; however, there can be no assurance as to future dividends because they are dependent on the Company's future earnings, capital requirements, financial condition, and regulatory environment. Dividends from the Bank have been a source of cash used by the Company to pay its dividends, and these dividends from the Bank are dependent on the Bank's future earnings, capital requirements, and financial condition. Further information about dividend restrictions is provided in the Stockholders Equity note in the consolidated financial statements.

**Recent Sales of Unregistered Securities; Use of Proceeds from Registered Securities**

On September 28, 2012, the Company issued \$75.0 million principal amount of fixed to floating rate unregistered subordinated notes through a private placement to institutional investors in accordance with Rule 506 of Regulation D. The notes are due in 2027 and are redeemable at par by the Company during the final five years. The notes bear interest at a fixed rate of 6.875% for the first ten years and convert to a variable rate of interest in the final five years. The proceeds were used for Beacon merger consideration and other corporate purposes. There have been no other sales of registered or unregistered securities within the last three years.

Table of Contents**Purchases of Equity Securities by the Issuer and Affiliated Purchases**

There were no purchases of equity securities during the fourth quarter of 2013 made by or on behalf of the Company or any affiliated purchaser, as defined by Section 240.10b-18(a)(3) of the Securities and Exchange Act of 1934, of shares of the Company's common stock. On March 26, 2013, the Company authorized the purchase of up to 500 thousand shares, from time to time, subject to market conditions. The repurchase plan will continue until it is completed or terminated by the Board of Directors. The Company has no intentions to terminate this plan or to cease any potential future purchases. As of year-end 2013, there were 118 thousand shares that remain unpurchased under this plan.

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 plans or programs
October 1-31, 2013		\$		118,113
November 1-30, 2013				118,113
December 1-31, 2013				118,113
Total		\$		118,113

**Common Stock Performance Graph**

The performance graph compares the Company's cumulative stockholder return on its common stock over the last five years to the cumulative return of the NYSE Composite Index and the KBW Regional Bank Index. Total stockholder return is measured by dividing total dividends (assuming dividend reinvestment) for the measurement period plus share price change for a period by the share price at the beginning of the measurement period. The Company's cumulative stockholder return over a five-year period is based on an initial investment of \$100 on December 31, 2008.

Information used on the graph and table was obtained from a third party provider, a source believed to be reliable, but the Company is not responsible for any errors or omissions in such information.



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Index	Period Ending					
	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
Berkshire Hills Bancorp, Inc.	100.00	69.00	76.22	78.89	87.46	102.79
NYSE Composite Index	100.00	124.80	138.34	129.88	146.66	180.65
PHLX KBW Regional Banking Index	100.00	75.78	89.58	83.19	91.89	132.00

In accordance with the rules of the SEC, this section captioned "Common Stock Performance Graph," shall not be incorporated by reference into any of our future filings made under the Securities Exchange Act of 1934 or the Securities Act of 1933. The Common Stock Performance Graph, including its accompanying table and footnotes, is not deemed to be soliciting material or to be filed under the Exchange Act or the Securities Act.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA**

The following summary data is based in part on the consolidated financial statements and accompanying notes, and other schedules appearing elsewhere in this Form 10-K. Historical data is also based in part on, and should be read in conjunction with, prior filings with the SEC.

(In thousands, except per share data)	At or For the Years Ended December 31,				
	2013	2012	2011	2010	2009
<b>Selected Financial Data:</b>					
Total assets	\$ 5,672,799	\$ 5,296,809	\$ 3,992,257	\$ 2,882,298	\$ 2,700,991
Securities	870,091	573,871	533,181	405,953	420,966
Loans	4,180,523	3,988,654	2,956,570	2,142,162	1,961,658
Allowance for loan losses	(33,323)	(33,208)	(32,444)	(31,898)	(31,816)
Goodwill and intangibles	270,662	274,258	223,364	173,079	176,100
Deposits	3,848,529	4,100,409	3,101,175	2,204,441	1,986,762
Borrowings and subordinated notes	1,064,107	448,088	237,402	260,301	306,668
Total stockholders' equity	678,062	667,265	551,808	387,323	385,148
<b>Selected Operating Data:</b>					
Total interest and dividend income	\$ 203,741	\$ 175,939	\$ 138,260	\$ 112,277	\$ 115,476
Total interest expense	34,989	32,551	31,740	35,330	45,880
Net interest income	168,752	143,388	106,520	76,947	69,596
Service charges and fee income	50,525	51,265	33,727	29,859	28,181
All other non-interest income (loss)	7,707	2,791	2,076	(108)	(3,004)
Total net revenue	226,984	197,444	142,323	106,698	94,773
Provision for loan losses	11,378	9,590	7,563	8,526	47,730
Total non-interest expense	157,359	140,806	116,442	82,137	78,571
Income tax expense (benefit) - continuing operations	17,104	13,223	1,884	2,420	(15,597)
Net (loss) income from discontinued operations		(637)	914		
Net income (loss)	\$ 41,143	\$ 33,188	\$ 17,348	\$ 13,615	\$ (15,931)
Less: Cumulative preferred stock dividend and accretion					1,030
Less: Deemed dividend from preferred stock repayment					2,954
<b>Net income (loss) available to common stockholders</b>	<b>\$ 41,143</b>	<b>\$ 33,188</b>	<b>\$ 17,348</b>	<b>\$ 13,615</b>	<b>\$ (19,915)</b>
Dividends per common share	\$ 0.72	\$ 0.69	\$ 0.65	\$ 0.64	\$ 0.64
Basic earnings per common share	1.66	1.49	0.97	0.98	(1.51)
Diluted earnings per common share	1.65	1.49	0.97	0.98	(1.51)
Weighted average common shares outstanding - basic	24,802	22,201	17,885	13,862	13,189
Weighted average common shares outstanding - diluted	24,965	22,329	17,952	13,896	13,189

(1) For the years 2011 and 2010, the above schedule has been adjusted for prior year lease adjustments.



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	At or For the Years Ended December 31,				
	2013	2012	2011	2010	2009
<b>Selected Operating Ratios and Other Data:</b>					
<b>Share Data:</b>					
Book value per share	\$ 27.08	\$ 26.53	\$ 26.09	\$ 27.52	\$ 27.68
Market price at year end	\$ 27.27	\$ 23.86	\$ 22.19	\$ 22.11	\$ 20.68
<b>Performance Ratios:</b>					
Return on average assets	0.78%	0.73%	0.50%	0.50%	(0.74)%
Return on average equity	6.09	5.66	3.64	3.55	4.83
Interest rate spread	3.47	3.47	3.38	3.01	2.61
Net interest margin	3.63	3.62	3.57	3.28	3.00
Non-interest income/total net revenue	25.65	27.38	27.16	27.88	26.57
Non-interest expense/average assets	2.97	3.11	3.34	2.99	2.93
Dividend payout ratio	41.57	46.31	67.01	65.16	N/M
<b>Growth Ratios:</b>					
Total loans	4.81	34.91	38.02	9.20	(2.27)
Total deposits	(6.14)	32.22	40.68	10.96	8.59
Total net revenues	14.96	38.73	33.39	12.58	(8.15)
<b>Asset Quality Ratios:</b>					
Net loans charged-off/average total loans	0.29	0.26	0.27	0.42	1.96
Allowance for loan losses/total loans	0.80	0.83	1.10	1.49	1.62
Net loans charged-off - Business activities/average total loans- Business activities	0.24	0.34	0.32	0.42	1.96
Allowance for loan losses - Business activities/total loans - Business Activities	0.93	1.21	1.41	1.49	1.62
<b>Capital Ratios:</b>					
Tier 1 capital to average assets - bank	7.99	7.46	8.41	8.04	7.86
Total capital to risk-weighted assets - bank	11.62	11.79	11.29	10.61	10.71
Stockholders equity/total assets	11.95	12.60	13.82	13.44	14.26
Tangible common stockholders equity to tangible assets (1)	7.54	7.82	8.71	7.91	8.29

(1) All performance ratios are based on average balance sheet amounts where applicable.

(2) N/M = Not Meaningful

(3) Tangible common stockholders equity to tangible assets exclude goodwill and other intangibles. This is a non-GAAP financial measure that the Company believes provide investors with information that is useful in understanding our financial performance and condition.

(4) Generally accepted accounting principles require that loans acquired in a business combination be recorded at fair value, whereas loans from business activities are recorded at cost. The fair value of loans acquired in a business combination includes expected loan losses, and there is no loan loss allowance recorded for these loans at the time of acquisition. Accordingly, the ratio of the loan loss allowance to total loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Similarly, net loan charge-offs are normally reduced for loans acquired in a business combination since these loans are recorded net of expected loan losses. Therefore, the ratio of net loan charge-offs to average loans is reduced as a result of the existence of such loans, and this measure is not directly comparable to prior periods. Other institutions may have loans acquired in a business combination, and therefore there may be no direct comparability of these ratios

between and among other institutions.

(5) For the years 2011 and 2010, the above schedule has been adjusted for prior year lease adjustments.

Table of Contents**Average Balances, Interest and Average Yields/Cost**

The following table presents an analysis of average rates and yields on a fully taxable equivalent basis for the years presented. Tax exempt interest revenue is shown on a tax-equivalent basis for proper comparison.

Item 6 - Table 3 - Average Balance, Interest and Average Yields / Costs

(Dollars in millions)	2013			2012			2011		
	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
<b>Interest-earning assets:</b>									
Loans:									
Residential Loans	\$ 1,271.7	\$ 51.5	4.05%	\$ 1,193.9	\$ 52.7	4.42%	\$ 876.1	\$ 42.5	4.85%
Commercial Mortgages	1,380.8	74.3	5.38	1,271.6	69.1	5.44	1,058.0	52.9	5.00
Commercial Business Loans	637.9	29.6	4.64	507.9	20.4	4.01	344.3	16.5	4.79
Consumer Loans	654.7	29.6	4.52	427.5	17.8	4.17	336.7	13.4	3.98
Total Loans	3,945.1	185.0	4.69	3,400.9	160.0	4.71	2,615.1	125.3	4.79
Investment securities (2)	701.1	19.6	2.79	550.8	17.6	3.19	444.9	16.5	3.71
Federal funds sold and short-term investments	71.3	1.5	2.10	76.4	0.9	1.18	14.7		0.11
Total interest-earning assets	4,717.5	206.1	4.37	4,028.1	178.5	4.43	3,074.7	141.8	4.61
Intangible assets	272.2			241.7			207.5		
Other non-interest earning assets	317.1			262.4			201.8		
<b>Total assets</b>	<b>\$ 5,306.8</b>			<b>\$ 4,532.2</b>			<b>\$ 3,484.0</b>		
<b>Interest-bearing liabilities:</b>									
Deposits:									
NOW accounts	\$ 355.2	\$ 0.8	0.23%	\$ 304.1	\$ 0.9	0.30%	\$ 244.2	\$ 0.9	0.37%
Money market accounts	1,389.2	5.7	0.41	1,189.1	5.8	0.48	833.3	5.6	0.67
Savings accounts	442.2	0.7	0.17	390.8	0.7	0.19	369.6	0.8	0.22
Certificates of deposit	1,085.8	13.6	1.25	1,056.0	15.1	1.43	902.6	16.3	1.81
Total interest-bearing deposits	3,272.4	20.8	0.63	2,940.0	22.5	0.77	2,349.7	23.6	1.00
Borrowings and notes	655.3	14.1	2.16	432.1	10.1	2.33	250.4	8.4	3.35
Total interest-bearing liabilities	3,927.7	34.9	0.89	3,372.1	32.6	0.97	2,600.1	32.0	1.23
Non-interest-bearing demand deposits	655.7			529.0			377.9		
Other non-interest-bearing liabilities	48.1			44.8			29.8		
Total liabilities	4,631.5			3,945.9			3,007.8		
Equity	675.3			586.3			476.2		
Total liabilities and equity	\$ 5,306.8			\$ 4,532.2			\$ 3,484.0		
Net interest-earning assets	\$ 802.4			\$ 656.0			\$ 474.6		
<b>Net interest income</b>		<b>\$ 171.2</b>			<b>\$ 145.9</b>			<b>\$ 109.8</b>	
Supplementary data									
Total non-maturity deposits	\$ 2,842.3			\$ 2,413.0			\$ 1,825.0		
Total deposits	3,928.1			3,469.0			2,727.6		
Fully taxable equivalent adjustment	2.6			2.6			2.7		

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Interest rate spread	3.48%	3.47%	3.38%
Net interest margin	3.63	3.62	3.57
Cost of funds	0.77	0.84	1.08
Cost of deposits	0.53	0.65	0.87
Interest-earning assets/interest-bearing liabilities	120.50	119.45	118.25

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Notes:

- (1) The average balances of loans include nonaccrual loans, and deferred fees and costs.
- (2) The average balance of investment securities is based on amortized cost.
- (3) The above schedule includes loan and deposit balances of discontinued operations in operating accounts.
- (4) The above schedule is not adjusted for prior year lease adjustments.
- (5) The average balances of borrowings and notes include the capital lease obligation presented under other liabilities on the consolidated balance sheet.

Table of Contents**RATE/VOLUME ANALYSIS**

The following table presents the effects of rate and volume changes on the fully taxable equivalent net interest income. Tax exempt interest revenue is shown on a tax-equivalent basis for proper comparison. For each category of interest-earning assets and interest-bearing liabilities, information is provided with respect to changes attributable to (1) changes in rate (change in rate multiplied by prior year volume), (2) changes in volume (change in volume multiplied by prior year rate) and (3) changes in volume/rate (change in rate multiplied by change in volume) have been allocated proportionately based on the absolute value of the change due to the rate and the change due to volume.

Item 6 - Table 4 - Rate Volume Analysis

(In thousands)	2013 Compared with 2012			2012 Compared with 2011		
	Rate	Increase (Decrease) Due to Volume	Net	Rate	Increase (Decrease) Due to Volume	Net
<b>Interest income:</b>						
Residential Loans	\$ (4,559)	\$ 3,310	\$ (1,249)	\$ (4,064)	\$ 14,305	\$ 10,241
Commercial Loans	(1,158)	6,337	5,179	4,850	11,332	16,182
Commercial Business Loans	3,483	5,720	9,203	(2,986)	6,885	3,899
Consumer Loans	1,593	10,162	11,755	695	3,761	4,456
Total Loans	(641)	25,529	24,888	(1,505)	36,283	34,778
Investment securities	(2,012)	4,013	2,001	(2,505)	3,581	1,076
Short-term investments	667	(63)	604	35	872	907
Total interest income	(1,986)	29,479	27,493	(3,975)	40,736	36,761
<b>Interest expense:</b>						
NOW accounts	(238)	138	(100)	(229)	204	(25)
Money market accounts	(906)	892	(14)	(1,873)	1,994	121
Savings accounts	(70)	91	21	(136)	45	(91)
Certificates of deposit	(1,962)	416	(1,546)	(3,685)	2,509	(1,176)
Total deposits	(3,176)	1,537	(1,639)	(5,923)	4,752	(1,171)
Borrowings	(785)	4,846	4,061	(3,078)	4,777	1,699
Total interest expense	(3,961)	6,383	2,422	(9,001)	9,529	528
Change in net interest income	\$ 1,975	\$ 23,096	\$ 25,071	\$ 5,026	\$ 31,207	\$ 36,233

(1) The above schedule includes balances associated with discontinued operations.

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****GENERAL**



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This discussion is intended to assist in understanding the financial condition and results of operations of the Company. This discussion should be read in conjunction with the consolidated financial statements and accompanying notes contained in this report.

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**APPLICATION OF CRITICAL ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES**

The Company's significant accounting policies are described in Note 1 to the consolidated financial statements in this Form 10-K. Please see those policies in conjunction with this discussion. The accounting and reporting policies followed by the Company conform, in all material respects, to accounting principles generally accepted in the United States and to general practices within the financial services industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. While the Company bases estimates on historical experience, current information and other factors deemed to be relevant, actual results could differ from those estimates.

The SEC defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Please see those policies in conjunction with this discussion. Management believes that the following policies would be considered critical under the SEC's definition:

***Allowance for Loan Losses.*** The allowance for loan losses represents probable credit losses that are inherent in the loan portfolio at the financial statement date and which may be estimated. Management uses historical information, as well as current economic data, to assess the adequacy of the allowance for loan losses as it is affected by changing economic conditions and various external factors, which may impact the portfolio in ways currently unforeseen. Although management believes that it uses appropriate available information to establish the allowance for loan losses, future additions to the allowance may be necessary if certain future events occur that cause actual results to differ from the assumptions used in making the evaluation. Conditions in the local economy and real estate values could require the Company to increase provisions for loan losses, which would negatively impact earnings.

***Acquired Loans.*** Loans that the Company acquired in business combinations are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest. Going forward, the Company continues to evaluate reasonableness of expectations for the timing and the amount of cash to be collected. Subsequent decreases in expected cash flows may result in changes in the amortization or accretion of fair market value adjustments, and in some cases may result in the loan being considered impaired. For collateral dependent loans with deteriorated credit quality, the Company estimates the fair value of the underlying collateral of the loans. These values are discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral.

***Income Taxes.*** Significant management judgment is required in determining income tax expense and deferred tax assets and liabilities. The Company uses the asset and liability method of accounting for income taxes in which deferred tax assets and liabilities are established for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities. The realization of the net deferred tax asset generally depends upon future levels of taxable income and the existence of prior years' taxable income, to which carry back refund claims could be made. A valuation allowance is maintained for deferred tax assets that management estimates are more likely than not to be unrealizable based on available evidence at the time the estimate is made. In determining the valuation allowance, the Company uses historical and forecasted future operating results, based upon approved business plans, including a review of the eligible carry-forward periods, tax planning opportunities and other relevant considerations. These underlying assumptions can change from period to period. For example, tax law changes or variances in future projected operating performance could result in a change in the valuation allowance. Should actual



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factors and conditions differ materially from those considered by management, the actual realization of the net deferred tax asset could differ materially from the amounts recorded in the financial statements. If the Company is not able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset valuation allowance would be charged to income tax expense in the period such determination is made.

***Goodwill and Identifiable Intangible Assets.*** Goodwill and identifiable intangible assets are recorded as a result of business acquisitions and combinations. These assets are evaluated for impairment annually or whenever events or changes in circumstances indicate the carrying value of these assets may not be recoverable. When these assets are evaluated for impairment, if the carrying amount exceeds fair value, an impairment charge is recorded to income. The fair value is based on observable market prices, when practicable. Other valuation techniques may be used when market prices are unavailable, including estimated discounted cash flows and market multiples analyses. These types of analyses contain uncertainties because they require management to make assumptions and to apply judgment to estimate industry economic factors and the profitability of future business strategies. In the event of future changes in fair value, the Company may be exposed to an impairment charge that could be material.

***Determination of Other-Than-Temporary Impairment of Securities.*** The Company evaluates debt and equity securities within the Company's available for sale and held to maturity portfolios for other-than-temporary impairment ( OTTI ), at least quarterly. If the fair value of a debt security is below the amortized cost basis of the security, OTTI is required to be recognized if any of the following are met: (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. For all impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. Credit-related OTTI for all other impaired debt securities is recognized through earnings. Noncredit related OTTI for such debt securities is recognized in other comprehensive income, net of applicable taxes. In evaluating its marketable equity securities portfolios for OTTI, the Company considers its intent and ability to hold an equity security to recovery of its cost basis in addition to various other factors, including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI on marketable equity securities is recognized immediately through earnings. Should actual factors and conditions differ materially from those expected by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

***Fair Value of Financial Instruments.*** The Company uses fair value measurements to record fair value adjustments to certain financial instruments and to determine fair value disclosures. Trading assets, securities available for sale, and derivative instruments are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, or to establish a loss allowance or write-down based on the fair value of impaired assets. Further, the notes to financial statements include information about the extent to which fair value is used to measure assets and liabilities, the valuation methodologies used and its impact to earnings. For financial instruments not recorded at fair value, the notes to financial statements disclose the estimate of their fair value. Due to the judgments and uncertainties involved in the estimation process, the estimates could result in materially different results under different assumptions and conditions.

## **SUMMARY**

Berkshire produced record net income totaling \$41 million in 2013, an increase of 24% compared to \$33 million in the prior year. Earnings per share for 2013 increased by 11% to \$1.65 and included the impact of shares issued in 2012 for bank acquisitions. Results for 2013 benefited from ongoing expansion in Berkshire's New England and New York



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footprint, including a full year's benefit from operations contributed through the acquisition of Beacon Federal in October 2012.

Berkshire built a larger franchise in 2013, with more capacity to increase market share in its New England/New York footprint. The Company's achievements included:

- Entered into an agreement to purchase 20 branches in New York which in January 2014 added approximately 60,000 new customers and increased branch count by 24% to 92 branches.
- Integrated Beacon Federal operations and recruited experienced leadership establishing our brand in the Utica to Syracuse region of New York.
- Recruited experienced teams in commercial banking, leasing, small business banking, and mortgage banking.
- Opened/relocated two new commercial regional headquarters in Eastern Massachusetts.
- Opened/relocated three branches and consolidated five branches to strengthen the distribution system, and added new mobile banking features.
- Improved brand awareness through a brand refresh and strategic media partnerships.
- Added leasing and indirect lending products, insurance products, and enhanced commercial services.
- Conducted Six Sigma process improvement projects across multiple business lines.

The year's financial highlights included the following:

- 15% increase in net revenue
- 3% increase in net revenue per share
- 24% increase in net income
- 11% increase in net income per share
- 5% increase in loans
- 15% increase in commercial business loans
- 4% increase in dividends per share

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- 2% increase in book value per share
- Increased net interest margin to 3.63%
- 0.29% net loan charge-offs
- 0.53% non-performing assets/assets

Additional management accomplishments included:

- Strengthened overall talent throughout the organization and utilized this talent effectively to enhance individual career progression and performance results.
- Continued focus on overall safety and soundness with ongoing balance sheet strength and improved controls in many business lines and operating functions.
- Continued to evaluate M&A opportunities while maintaining financial disciplines.
- Managed the interest rate risk profile to balance current and future earnings in light of potential future interest rate increases.
- Sustained community and charitable support which has resulted in national recognition.

Two external events in the first half of 2013 changed the pace of the Company's earnings growth: (1) a sharp steepening of the yield curve led to a dramatic drop in residential mortgage originations throughout the industry including at Berkshire; and (2) market demand for lower grade commercial debt led to accelerated outplacement of loan balances acquired in bank

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acquisitions which were not consistent with the Company's long run balance sheet objectives. At midyear, the Company took immediate and aggressive actions to respond to these market changes and abate the downturn in revenue and earnings. Key actions included:

- Made changes in executive and senior management to refocus on core competencies and disciplines.
- Restructured and right sized staff and eliminated excess premises, resulting in a 7% decrease in fourth quarter compensation/occupancy/technology costs compared to second quarter level.
- Refocused lending originations, producing 16% annualized loan growth in the second half of the year.

Quarterly earnings reached a high of \$0.48 per share in the second quarter of 2013 and then declined to \$0.33 in the third quarter and \$0.42 in the fourth quarter. Earnings per share totaling \$1.65 in 2013 were net of \$0.22 in after-tax charges related to merger, conversion, and restructuring expenses (net of nonrecurring gains and out of period revenues). Such items contributed a credit of \$0.02 per share in the final quarter of the year. The return on assets improved from 0.73% in 2012 to 0.78% in 2013, ending the year at 0.77% in the final quarter. The return on equity improved from 5.7% in 2012 to 6.1% in 2013, ending the year at 6.2% in the final quarter.

**COMPARISON OF FINANCIAL CONDITION AT DECEMBER 31, 2013 AND 2012**

Berkshire continued to extend and deepen its banking footprint in 2013. Through organic growth, team recruitment, and product expansion, Berkshire increased its loans from business activities by 21% and produced 5% total loan growth for the year. Berkshire managed run-off of non-relationship deposits, with total deposits decreasing during the year prior to increasing with the New York deposit acquisition completed shortly after year-end. Total assets increased by 7% during the year including the benefit of additional securities purchases funded with borrowings. The Company's risk management maintained the momentum of favorable and improving asset quality while also producing significant recoveries of impaired loans which contributed to the year's income. Berkshire's capital metrics remained within its targets and liquidity was managed based on targets including the New York deposits acquired after year-end. Including these deposits, the Company maintained its targets for positioning its interest rate risk to benefit near term earnings from potential interest rate increases. As a result of expansion in recent years, the Company believes that it has diversified its earnings sources and balance sheet risks and improved its strategic positioning for market share growth and long run financial results.

**Investment Securities.** Berkshire's goal is to maintain a high quality portfolio consisting primarily of liquid investment securities with managed durations to limit the potential for market value declines in rising rate markets. Berkshire focuses on loan growth as the primary use of funds from deposit growth and the primary source of interest income. The investment portfolio provides additional liquidity and interest rate risk management flexibility, in addition to the capacity to generate higher earnings. The Company evaluates the portfolio within its overall objectives of producing growth in earnings per share and contributing to return on equity. The Company continuously evaluates options for managing the portfolio's size, risk, and duration. The Company expected to invest in investment securities in 2014 as part of its plan for the utilization of cash proceeds from the acquisition of New York deposits which was completed in January 2014.

Total securities increased by \$296 million (52%) in 2013 as the Company placed increased reliance on investment income to partially offset a decline in loan interest income following a decline in loan balances in the first half of the year. The increase in securities was concentrated in residential mortgage backed securities, which also comprised the majority of the portfolio at the start of the year. This increase included a targeted shift in the first quarter from residential mortgage loans into shorter duration mortgage backed securities to reduce interest rate risk.



The Company

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also increased its corporate bond portfolio during the year and decreased its equity securities as it took advantage of price appreciation to realize \$4.8 million in gains on certain community bank stocks during the year.

At year-end 2013, Berkshire's \$870 million securities portfolio was primarily comprised of \$602 million in mortgage-backed securities guaranteed or sponsored by the U.S. government. These securities constituted 69% of the portfolio at year-end, increasing from 56% at the start of the year. Municipal securities and development bonds were little changed, totaling \$122 million (14% of the portfolio) at year-end 2013. Other significant components of the portfolio at year-end included \$56 million of corporate bonds and trust preferred securities, \$22 million of marketable equity securities (consisting primarily of exchange traded common stock issued by community banks in the region), and \$50 million of restricted securities which mostly consisted of Federal Home Loan bank stock. Approximately 87% of the total portfolio was designated as available for sale, with the primary exceptions being the restricted stock and locally issued development bonds (classified as held to maturity municipal securities except for one security classified as a trading obligation as a result of a related interest rate swap). The net unrealized loss on securities available for sale totaled \$9.3 million, or 1.2% of cost at year-end 2013, compared to a gain of \$10.7 million, or 2.4% of cost at year-end 2012. This change was primarily due to the impact of higher interest rates on debt securities prices during the year. The Company's trust preferred securities totaled \$17 million at year-end 2013, including one pooled trust preferred security. New bank regulations at year-end requiring the future liquidation of certain classes of trust preferred securities were inapplicable to the Company's portfolio, including specific exemptions published by regulatory authorities shortly after year-end.

The Company did not record any write-downs of investment securities in 2013 and none of the Company's investment securities were classified as other-than-temporarily impaired during the year or at year-end. Gross unrealized losses on securities with unrealized losses increased to \$18 million from \$3 million. Detail on these securities, including one security with a \$1.4 million unrealized loss, is included in the Securities note in the consolidated financial statements. At year-end 2013, all available for sale debt securities carried at least one investment grade rating by a major rating agency except for the above security, and one other security with a cost under \$1 thousand. The Company's held to maturity securities are generally unrated local securities, all of which are performing and none of which is deemed criticized according to the Company's internal ratings systems.

The tax equivalent yield on investment securities declined to 2.8% in 2013 from 3.2% in 2012, reflecting the impact of portfolio turnover and growth in the ongoing low interest rate environment. The effective duration of the debt securities portfolio at year-end 2013 was estimated at approximately 4.7 years, with a year-end tax equivalent yield of approximately 2.7%. These compared to 3.0 years and 2.7%, respectively, at the prior year-end. The average life of the portfolio was estimated at 5.2 years at year-end 2013 with extension risk to 6.4 years in the event of a 200 basis point increase in market rates due to slower prepayment speeds.

**Loans.** In 2013 Berkshire enhanced its loan origination activities across its various lending functions and across its footprint. Commercial lending teams were recruited in Eastern Massachusetts, New York, and Connecticut. The Company also recruited a new commercial leasing team and expanded its small business lending program. The Company made leadership changes focused on its core competencies and utilizing senior talent assembled in recent years. In consumer lending, Berkshire shifted its origination leadership to the Syracuse team that joined the Company at the time of the Beacon Federal acquisition in the fourth quarter of 2012. This team began expanding its existing prime auto lending program across Berkshire's footprint and also implemented improvements in cross selling and processing home equity loans. In response to the downturn in residential mortgage demand, the Company restructured its mortgage operations while also upgrading its originations systems and expanding its team recruitment. The Company continues to target a business mix that satisfies its long term return on equity and interest rate sensitivity

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targets, and it uses financial derivatives with national institutional partners as an integral component of this strategy. The Company believes that its risk disciplines and high quality underwriting standards are improving the long run risk profile of its credit portfolio.

In 2013, total loans increased by \$192 million (5%). During the first half of the year, total loans decreased by \$118 million (3%). This was followed by an increase of \$310 million (8%) in the second half of the year, with increases in all major categories. Throughout the year, commercial business loans grew at a double digit annualized pace as Berkshire maintained its focus on taking market share from national banks in variable rate relationship-focused commercial business loans. The decrease in loans in the first half was concentrated in residential mortgages (\$92 million) and commercial real estate loans (\$61 million). The Company sold residential mortgages in the first quarter and replaced them with shorter duration mortgage backed securities based on the Company's interest rate risk management disciplines. The decrease in commercial real estate loans was due to runoff of acquired impaired and non-relationship balances in the first half of the year in the highly competitive market for lower quality/higher yielding assets. The Company had anticipated that these balances would be gradually reduced over time as other offsetting business was developed in these markets. The Company adhered to its credit and pricing disciplines and accepted the decrease under these conditions. Following an increase in interest rates at midyear, competitive conditions improved and total net loan growth resumed. For the year, the balance of total loans from business activities increased by \$544 million (21%) to \$3.169 billion, representing 76% of the total portfolio. The balance of loans acquired in business combinations decreased by \$352 million (26%) to \$1.011 billion, representing 24% of the total portfolio.

Berkshire's total commercial loans increased by \$91 million (5%) in 2013, while total commercial loans from business activities increased by \$225 million (15%). Eastern Massachusetts was the primary focus for commercial loan growth, including the contribution from the new Burlington (Route 128) team that was recruited in January together with the Westborough team (Route 495) recruited a year earlier. Asset based loan outstandings increased by \$39 million (15%) to \$297 million and commercial balances also grew in New York and Connecticut, including the contribution from new commercial leadership recruited in Syracuse early in the year. Commercial loan growth also included the benefit of assets acquired through regional loan participations and purchases and growth was net of SBA guaranteed loans sold during the year. At year end, total accepted commitments to originate new commercial loans totaled \$111 million compared to \$45 million at the start of the year.

Residential mortgage loan demand has generally favored fixed rate thirty year loans in recent years and the Company's mortgage banking line of business has primarily sold new originations on a flow basis in the secondary market. Additionally, the Company has periodically bought and sold seasoned loans within its regional footprint. The total balance of residential mortgages reflects the contribution from the acquisition of smaller banks with higher proportionate mortgage balances. The Company sold certain portfolio mortgages in the first half of the year as part of its interest rate risk management disciplines. Following the industry-wide downturn in mortgage demand in the middle of the year, the Company promoted ten year adjustable rate mortgages which were retained in portfolio and contributed to growth in the second half of the year. Total residential mortgages increased by \$60 million (5%) for the full year due to this growth in the second half.

The consumer loan portfolio consists primarily of home equity loans and indirect auto loans, along with direct auto loans and second mortgages. Management of consumer lending was transferred to the newly integrated Syracuse operations in 2013 following the Beacon Federal acquisition in the fourth quarter of 2012; Beacon had a strength in consumer lending reflecting its prior history as a credit union.

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All of Berkshire's consumer lending programs are targeted for prime grade loans; the Company does not operate subprime lending programs. Berkshire has expanded Beacon's existing indirect auto lending program to provide this consumer product across its geography. Total auto and other consumer loans increased by 18% during the year due to this program expansion. While home equity loans declined by 6% for the year, these balances increased by 1% in the final quarter as the Company focused on streamlining its processing and developing cross sale synergies across its geography and product lines.

The yield on average loans was little changed at 4.69% in 2013, compared to 4.71% in 2012. The benefit of purchase accounting accretion for loans acquired in bank mergers offset the yield compression experienced due to continuing low interest rates. The net accretion in 2013 included the new accretion from Beacon loans acquired in the fourth quarter of 2012. The benefit of impaired loan collections to yield accretion including recovery of nonaccretable yield was viewed as unusually high in 2013 due to favorable market conditions for impaired assets as well as the initial workout activities for impaired loans acquired through the Beacon acquisition in the fourth quarter of 2012. There is further information about the impact of accretion in the later discussion of net interest income in the results of operations section.

Berkshire favors a profile of income related interest rate risk that is neutral or asset sensitive and accepts a profile of equity at risk which is modestly liability sensitive due to market factors in the ongoing low rate environment. The Bank offers back-to-back interest rate swaps to certain commercial loan customers, which allows the Bank to book a variable rate loan while providing the customer with a contract to fix its interest rate. This allows the Company to be more competitive with national financing sources without booking long-term, fixed rate assets at current low interest rates, as well as providing a source of fee income. The percentage of loans adjusting within a year was 32% at year-end 2013, compared to 37% at the prior year-end. The percentage of loans adjusting after five years increased slightly to 39% from 37% for these periods. The Company estimated that the fair value of net loans equaled book value at year-end 2013, compared to a 1.2% excess over book value at the start of the year. This reflected changes in the portfolio during the year, as well as the impact on fair value of higher medium term interest rates at year-end 2013.

**Asset Quality.** Berkshire has a Chief Risk Officer and a Risk Committee of the Board which keep a close focus on maintaining strong asset quality, with greater focus on the loan portfolio due to the low risk characteristics of the investment portfolio. This includes setting loan portfolio objectives, maintaining sound underwriting, close portfolio oversight, and careful management of problem assets and potential problem assets. Additionally, merger due diligence is an integral component of maintaining asset quality. Acquired loans are recorded at fair value and are deemed performing regardless of their payment status. Therefore, some overall portfolio measures of asset quality are not comparable between years or among institutions as a result of recent business combinations. A general goal is to achieve significant resolutions of impaired loans acquired in bank mergers in the first year following the acquisition date. Berkshire's asset quality has reflected its strong credit disciplines together with the generally favorable economic characteristics of its footprint among U.S. regions through the last recession and recovery.

Net loan charge-offs were 0.29% of average loans in 2013 compared to 0.26% in 2012. Loans acquired in business combinations are recorded at fair value, including the impact of estimated credit losses. As these loans age, new losses are identified, and total net-charge-offs of acquired loans increased to \$4.5 million in 2013 from \$0.2 million in the prior year. Net charge-offs of loans from business activities declined to \$6.8 million from \$8.7 million. Net charge-offs of loans from business activities decreased to 0.24% of related average balances in 2013 from 0.34% in the prior year.

Year-end non-performing assets increased modestly to \$30 million in 2013 compared to \$27 million at the start of the year, measuring 0.53% of total assets compared to 0.52% at these respective dates. The increase was primarily related



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to consumer loans acquired with the Beacon acquisition in the fourth quarter of 2012. Loans which became non-performing during the year totaled \$28 million in 2013, compared to \$21 million in the prior year, including the full year impact of acquired loans. The impact of new non-performing assets was mostly offset by resolutions including upgrades, collections, and charge-offs. The ten largest non-performing loans decreased to \$11.8 million from \$12.8 million during the year and were generally well secured, with \$0.8 million in impairment reserves as of year-end. The largest non-performing loan at year-end was \$1.9 million. For loans from business activities, the ratio of non-performing loans to total loans decreased to 0.58% from 0.88% during the year.

Loans classified as performing troubled debt restructurings increased to \$8.3 million from \$3.6 million during 2013 due to a limited number of commercial credits. Loans totaling \$2.5 million which were restructured in 2013 subsequently defaulted during the year. Foreclosed real estate increased modestly to \$2.8 million from \$1.9 million during the year. Accruing loans over 90 days past due improved to 0.22% of total loans from 0.48% during the year and the majority of these balances were acquired loans which were initially recorded as accruing regardless of delinquency status based on accounting rules for business combinations. Loans delinquent 30-89 days decreased to 0.51% of total loans from 0.63% during the year. At year-end 2013, loans deemed impaired totaled \$39 million, compared to \$42 million at the prior year-end. At year-end 2013, the remaining carrying balance of purchased credit impaired loans was \$30 million and the contractual amount owed on these loans was \$53 million. The comparable measures at year-end 2012 were \$62 million and \$108 million, respectively.

**Loan Loss Allowance.** The determination of the allowance for loan losses is a critical accounting estimate. The Company's methodologies for determining the loan loss allowance are discussed in Item 1 of this report and Item 8 includes further information about the accounting policy for the loan loss allowance and the Company's accounting for the allowance in the consolidated financial statements. During 2014, the Company enhanced its allowance methodology to include historic loss rates from its own portfolio as well as historic loss rates provided by a third party ratings service.

The Company considers the allowance for loan losses appropriate to cover probable losses which can be reasonably estimated and which are inherent in the loan portfolio as of the balance sheet date. Under accounting standards for business combinations, acquired loans are recorded at fair value with no loan loss allowance on the date of acquisition. The fair value of acquired loans includes the impact of estimated loan losses for the life of the portfolio, including factors which are not probable or inherent as of the acquisition date, and including subjective assessments of risk. A loan loss allowance is recorded by the Company for the emergence of new probable and estimable losses relating to acquired loans which were not impaired as of the acquisition date. Because of the accounting for acquired loans, some measures of the loan loss allowance are not comparable to periods prior to the acquisition date or to other financial institutions.

The total amount of the loan loss allowance increased by \$0.1 million to \$33.3 million in 2013. The ratio of the allowance to total loans decreased to 0.80% from 0.83% during the year. The allowance on loans from business activities decreased to 0.93% from 1.21% of these balances. This included the impact of a decline in impaired balances, a change in loan mix, and improved environmental factors. The allowance on acquired loans increased to 0.38% from 0.10% of these balances due to increased loss estimates on collectively evaluated loans. The year-end allowance provided 3.0X coverage of 2013 net charge-offs and 1.2X coverage of year-end non-accrual loans. The specific reserve for loans from business activities individually evaluated for impairment measured 5% of the related loan balances, demonstrating the general strength of collateral support for impaired commercial loans.

The credit risk profile of the Company's loan portfolio is described in the Loan Loss Allowance note in the consolidated financial statements. The Company's risk management process focuses primary attention on loans with higher than normal risk, which includes loans rated special mention and classified (substandard and lower). These



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loans are referred to as criticized loans. Criticized loans were reduced in 2013 to \$165 million (2.9% of assets) from \$187 million (3.5% of assets) due to targeted resolutions of balances acquired in business acquisitions. The Company views its potential problem loans as those loans from business activities which are rated as classified and continue to accrue interest. These loans have a possibility of loss if weaknesses are not corrected. Classified loans acquired in business combinations are recorded at fair value and are classified as performing at the time of acquisition and therefore are not generally viewed as potential problem loans. Potential problem loans totaled \$71 million at year-end 2013 compared to \$62 million at the prior year-end. The ten largest potential problem loans totaled \$60 million at year-end 2013, with the largest such loan totaling \$18 million. This asset is an in-market commercial real estate participation loan on a retail/office property on interest-only payment terms during an interim tenant remarketing period with condition viewed as stable. The Company's evaluation of its credit risk profile also compares the amount of criticized assets to the total of the Bank's Tier 1 Capital plus the loan loss allowance. This ratio was 37% at year-end 2013, compared to 43% at the prior year-end.

**Other Assets.** Loans held for sale decreased due to the decline in mortgage originations volume. Capital expenditure activity in 2013 was routine, including de novo branches and branch relocations. As a result of restructuring activities certain assets were liquidated, written down, or held for sale at year-end. Intangible assets decreased due to scheduled amortization of intangibles recorded in recent business combinations. Total intangible assets, including goodwill, decreased to \$271 million from \$274 million during the year. The cash surrender value of life insurance increased due to additional purchases of bank owned life insurance. Net deferred tax assets decreased to \$51 million from \$58 million during the year as some assets became current due to the reversal of temporary deferrals and to ongoing earnings. The category of other assets decreased due to lower income tax receivables and lower derivatives assets resulting from changed valuations as a result of higher interest rates.

**Deposits.** Berkshire continued to develop its deposit base in its footprint during 2013 while also making strategic adjustments in its funding strategies. Ongoing organic activity included three branches that were opened/relocated and the development of administrative support in the two new Eastern Massachusetts regional offices. The acquired Beacon operations, including \$624 million in acquired deposits, were integrated in the first quarter of the year. Other retail initiatives included brand promotions and further development of small business banking, Berkshire's MyBanker service, and various cross sell programs. Berkshire negotiated the purchase of 20 branches in Central New York which added an additional \$440 million in balances when this purchase was completed shortly after year-end.

Berkshire adjusted its strategies in 2013 to reduce certain non-relationship deposit sources, including some sources that were part of the Beacon operations as well as certain commercial money market deposits. These reductions took into account the anticipated benefit of low cost deposits acquired in the branch acquisition shortly after year-end. Additionally, the Company managed its deposit sources in light of increased marginal impacts of deposit growth on the cost of participating in the Depositors Insurance Fund (DIF). As part of its restructuring program, the Company consolidated five branches during the year to better balance growth and efficiency in targeted markets.

Total deposits decreased by \$252 million (6%) to \$3.85 billion in 2013 before \$440 million in balances were added with the branch purchase in January 2014. Deposits include deposits held by Berkshire Bank Municipal Bank, which is a New York subsidiary of Berkshire Bank. The Bank is reducing its operations in this special purpose subsidiary which is restricted to municipal depositors. Total deposits in this subsidiary decreased to \$42 million at year-end 2013 from \$54 million at the start of the year and are expected to further decline in 2014.

During 2013, total demand deposits increased by 1% for the year, including 5% annualized growth in the fourth quarter. Berkshire targets low cost demand deposits as part of its relationship based development strategy for the acquisition of retail and commercial accounts.





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The average cost of deposits decreased to 0.53% in the fourth quarter of 2013 from 0.59% in the fourth quarter of the prior year. Berkshire seeks to maintain a flexible balance between supporting business volume growth in its regional markets while also supporting its net interest margin in light of ongoing yield compression for earning assets. The Company believes it has further capacity to adjust funding costs in future quarters if appropriate based on market and interest rate conditions. The Company expected the cost of the newly New York deposits to be in the range of 0.15 – 0.20% based on the higher proportion of lower cost transaction balances in the acquired branches.

The Bank is evaluating its future participation in the Depositors Insurance Fund which is supplemental to its FDIC insurance. The Bank plans to continue to pursue net organic growth of its deposits. If there are changes in this program, the Bank expects that current insured accounts will have reasonable notice and transition time if this supplemental insurance is modified. The terms of FDIC insurance are unaffected by any changes in the supplemental insurance program.

***Borrowings and Other Liabilities.*** Berkshire utilizes borrowings to manage short term liquidity, to provide overnight funding for targeted asset classes, as medium term funding for portions of the loan portfolio, and for qualifying regulatory capital to support overall balance sheet soundness. Most outstanding borrowings are from the Federal Home Loan Bank of Boston, but the Bank and the holding company also utilize other established short term funding sources. The Company balances the flexibility and cost advantage of short term borrowed funds with strategic objectives for deposit funding and liquidity.

Total borrowings increased by \$616 million to \$1.06 billion in 2013 and were the primary source of funds in 2013 for loan and investment growth and to fund targeted deposit reductions. Short term borrowings increased by \$709 million to \$873 million. All but \$10 million of short term borrowings are from the Federal Home Loan Bank of Boston and are based on normal credit terms from the FHLBB. The Company elected to extinguish certain FHLBB advances after-year end in conjunction with the New York branch purchase.

The cost of borrowings decreased to 1.69% in the fourth quarter of 2013 from 2.80% in the fourth quarter of 2012, as the volume of lower cost short-term Federal Home Loan Bank borrowings increased. The average rate on this short term debt was 0.28% at year-end 2013. The overall cost of borrowings includes the impact of related interest rate swaps. In order to obtain fixed rate medium term funds as part of its interest rate risk management, the Company primarily relies on interest rate swaps associated with designated FHLB borrowings; time deposits are also utilized to provide longer duration fixed rate funds. The Company utilized forward starting interest rate swaps to fix the interest rate on a portion of the new borrowings in 2013. The Company elected to extinguish certain FHLB borrowings with a portion of the proceeds from the New York branch acquisition early in 2014.

Other liabilities of \$82 million at year-end 2013 included \$25 million in liabilities held for sale related to a branch outside of the Company's footprint which was an operation acquired in a bank acquisition. Also included in other liabilities are derivative liabilities totaling \$12 million, which decreased from \$30 million at the prior year-end due to the impact of higher market interest rates on the loss associated with derivative financial instruments.

***Derivative Financial Instruments and Hedging Activities.*** At year-end 2013, the notional value of the Company's derivative financial instruments decreased by \$407 million to \$905 million from \$1.313 billion at the start of the year due to a \$565 million decrease in mortgage banking related derivatives. This decrease was due to the decrease in mortgage banking activity and its impact on both interest rate lock commitments and forward sale commitments that hedge these interest rate locks. There was no significant change in the year-end balance of interest rate



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swaps related to commercial loans. The notional amount of all other derivative financial instruments increased due to a \$155 million increase in cash flow hedges on the Company's FHLBB borrowings. This increase was concentrated in forward starting interest rate swaps fixing the interest rate on a portion of the \$616 million increase in FHLBB borrowings recorded during the year as a result of growth in loans and investments and a reduction in deposits.

The net fair value liability associated with derivative instruments decreased to \$4 million at year-end 2013 from \$10 million at the start of the year due to a \$9 million decrease in the loss on cash flow hedges as a result of higher interest rates, which was partially offset by a decline of \$4 million in the net fair value of mortgage banking related instruments as a result of the lower volume in the mortgage pipeline at the end of 2013.

The year-end notional amount of cash flow interest rate swaps related to FHLBB borrowings was \$410 million. All of these interest rate swaps were subsequently terminated in association with the Company's election to repay certain FHLBB advances as a result of the New York branch purchase. The terminated swaps included \$150 million currently paying at a rate of 2.61% with a weighted average maturity of 2.5 years and \$260 million which were forward starting with, on average, a rate of 1.88% and a three year swap period beginning in mid 2015. The Company entered into \$300 million in new forward starting three year cash flow swaps on different FHLBB borrowings which start in the first half of 2016 with an average pay rate of 2.29%.

**Stockholders' Equity.** Berkshire pursues a balance of capital to maintain financial soundness while using common equity efficiently with the goal to produce a strong return on equity and book value growth as a basis for shareholder value creation. A sound capital structure reduces risk and enhances shareholder return and access to capital markets to support the Company's banking activities and the markets that it serves. In its payment of dividends, management of treasury shares, issuance of equity compensation, and balancing of capital sources, the Company strives to achieve a capital structure that is attractive to the investment community and which satisfies the policy and supervision purposes of the Company's regulators. When Berkshire negotiates business combinations, it generally expects to use its common shares as a significant component of merger consideration and to balance the mix of cash and stock to arrive at a targeted capital ratio based on the characteristics of the combined banks. All of the Company's equity is owned by common stockholders.

In 2013, Berkshire increased its leverage modestly as assets grew by 7% and equity grew by 2%, with most comprehensive income being returned to shareholders through dividends and stock buybacks. The ratio of tangible equity to tangible assets decreased to 7.5% from 7.8% and the ratio of equity to assets decreased to 12.0% from 12.6%. Tangible equity is a non-GAAP financial measure commonly used by investors and it excludes goodwill and other intangible assets. Total shares outstanding decreased by 0.4% to 25.0 million and stock buybacks offset shares issued for equity compensation including option exercises. As a result, tangible book value per share increased by 4.1% to \$16.27 and total book value per share increased by 2% to \$27.08. Due to an increase to \$0.18 from \$0.17 in the quarterly dividend beginning in the fourth quarter of 2012, the total dividend increased by 4.4% in 2013 and provided a 4.6% return on starting tangible book value per share of \$15.63.

At year-end 2013, Berkshire Bank's regulatory capital ratios exceeded the requirements to be considered "well capitalized". The total risk-based capital ratio measured 11.6% and was little changed from 11.8% at the start of the year. The Company is a savings and loan holding company and is not subject to specific regulatory capital requirements as of year-end 2013.

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**COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

Net income increased by \$8.0 million (24%) to \$41.1 million in 2013. Earnings per share increased by \$0.16 (11%) to \$1.65. Berkshire's results in 2013 included a full year of operations for Beacon Federal (acquired in October 2012) and CBT - The Connecticut Bank and Trust Company (acquired in April 2012). As a result, most categories of revenue, expense, income, and average balances increased due to these acquisitions in addition to organic growth from business activities.

During 2013, results were adversely affected by events in the first half of the year. An industry-wide downturn in mortgage banking revenues began near midyear due to a sharp increase in long term interest rates. Additionally, commercial lending revenues were adversely impacted by accelerated outplacements of acquired impaired and non-relationship loans due to institutional demand for these lower quality assets. The near term impact of these events was partially offset by recoveries recorded to interest income through purchased loan accretion for collections of acquired impaired loans. In response to these events, management initiated a restructuring program in the second half of the year, recording restructuring charges and lowering operating expenses. As a result of these events, net income decreased by 17% to \$18.6 million in the second half of the year from \$22.5 million in the first half of the year. Earnings per share decreased to \$0.75 from \$0.90 for these respective periods.

Operating results in both years were also affected by merger, conversion, and restructuring expenses, together with gains recorded on securities and investments in acquired banks. Berkshire views its net merger related costs as part of the economic investment for its acquisitions. Conversion expenses were primarily related to the core systems conversion in 2012 which is a long term investment in the Company's operating infrastructure. Berkshire's project management office oversees an ongoing program of Six Sigma process improvement projects. These investments are intended to contribute to long term earnings growth and franchise value. The Company expects to develop revenue synergies, operating efficiencies, and improved product and service capabilities based on the combination of its larger footprint and enhanced infrastructure.

The Company plans to resume earnings growth in 2014 based on positive operating leverage resulting from organic volume growth, disciplined expense management, and the accretive benefits of the New York branch acquisition. Berkshire plans to benefit from market share growth based on the contribution of recruited commercial banking teams as well as expanded sales teams and cross sale activity in most of its business lines.

**Total Net Revenue.** Berkshire evaluates its top line with the measure of net revenue, which is the sum of net interest income and non-interest income. The Company also evaluates net revenue before security gains/losses and nonrecurring items in order to evaluate the success of its operations. A critical focus of Berkshire's strategy is to produce positive operating leverage by growing operating revenue at a higher pace than operating expenses. Berkshire also measures revenue per share to assess the accretion to shareholder value potential based on the Company's growth initiatives.

Total net revenue increased by \$29.5 million (15%) to a record level of \$227.0 million in 2013 due to the benefit of business combinations and organic growth. Net revenue per share increased by 3% to \$9.09 in 2013 from \$8.84 in 2012. Fee income decreased to 22% of net revenue in 2013 from 26% in the prior year due to the decrease in mortgage banking income. Berkshire targets fee income at 30% or more of revenues over the long run. This ratio declined from 28% in 2010 primarily because acquired banks had a higher reliance on net interest income as a revenue source.

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Net revenue ended the year at a fourth quarter annualized run rate of approximately \$222 million, which was a 7% decrease from the fourth quarter of the previous year due to a 10% impact from the decrease in mortgage revenues from the record level

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achieved in the fourth quarter of 2012. Annualized fourth quarter revenue per share decreased by 9% to \$8.94 from \$9.78

**Net Interest Income.** Berkshire targets growth in net interest income based on increased business volumes related to market share gains in its markets. The Company also regularly evaluates the use of securities investments to contribute to income and profitability. In 2013, total loans increased by 5%, which was below the Company's targets. This was due in part to the 26% runoff of higher yielding loans acquired in business combinations which was addressed in the previous discussion of changes in financial condition. This affected net interest income, together with Berkshire's increased use of lower yielding investment as well as changes in loan mix and yield in the ongoing low interest rate environment. Total average earning assets increased by 17% in 2013 compared to 2012, including the full year benefit of business combinations.

Total net interest income increased by \$25.4 million (18%) to \$168.8 million in 2013 due to the growth in average earning assets. Interest income in 2013 also included a \$1.3 million credit for an out of period adjustment. The full year net interest margin increased slightly to 3.63% in 2013 from 3.62% in the prior year. Fourth quarter net interest income decreased by 5% from year to year, measuring \$159 million on an annualized basis in the final quarter of 2013. The fourth quarter net interest margin decreased to 3.26% from 3.67% due to the aforementioned yield compression in 2013.

Net interest income includes purchased loan accretion on loans acquired in business combinations. This includes amortization of accretable yield as well as recoveries of accretable and nonaccretable yield arising from the collection of acquired impaired loans. Due to the Company's workout activities and the premium market values for lower grade assets in 2013, total purchased loan accretion increased to \$18.1 million in 2013 from \$6.3 million in 2012. Accretion in 2013 included \$17.2 million related to commercial loans and \$2.4 million for consumer loans, less a charge of \$1.5 million for residential mortgages. The unamortized balance of net accretable yield on impaired loans decreased by \$5.7 million to \$2.6 million at the end of 2013 and was expected to be substantially fully amortized in 2014. The prospect for additional recoveries of accretable and/or non-accretable yield on future collections of acquired impaired loans is unpredictable but is expected to contribute positively to net interest income due to ongoing favorable conditions for resolving these loans. At year-end 2013, the carrying amount of purchased credit impaired loans totaled \$30 million, which was 57% of the contractual balance of these loans. At year-end 2012, the carrying amount was \$62 million, which was also 57% of the contract balance of \$108 million at that date. These balances decreased during 2013 due to active collection activities on these loans.

The yield on loans decreased to 4.26% in the fourth quarter of 2013 from 4.73% in the fourth quarter of 2012. The loan yield was 4.02% in the fourth quarter of 2013 excluding the benefit of purchased loan accretion, which totaled \$2.4 million during that quarter, compared to \$3.2 million in the same quarter of 2012. The fourth quarter yield on investment securities decreased to 2.72% from 3.17% from year to year, reflecting portfolio growth in the low rate environment. The cost of funds decreased to 0.73% from 0.84% including the impact of greater utilization of low cost short term borrowings together with ongoing reductions in deposit costs to 0.53% from 0.59%.

The quarterly net interest margin excluding loan accretion measured 3.07% in the final quarter of the year. The Company expects to realize a margin benefit from the acquisition of the low cost New York branch deposits shortly after year-end, along with the termination of interest rate swaps as a result of the deposit acquisition. While net interest income decreased by 3% from the second quarter to the fourth quarter of 2013, the Company's goal is to produce future growth in net interest income including the benefit of the branch acquisition, an increase in loan balances, further investment purchases, and additional reductions in deposit funding costs.

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The Company manages the pricing of its assets and liabilities with the objective of achieving an appropriate net interest margin and return on equity, while also achieving its asset/liability objectives. The Company strives to maintain a modestly asset sensitive interest rate risk profile so that earnings will benefit when interest rates increase from the very low levels that have existed in the most recent years. The current low level of interest rates is generally leading to tighter interest margins in the banking industry. The Company plans to actively manage its balance sheet and pricing and volume objectives to continue to balance current and long term earnings and profitability.

**Non-Interest Income.** Most of Berkshire's non-interest income is fee income, which generally represents business conducted with customers in Berkshire's markets. The Company pursues growth in market share and wallet share across its business lines, including banking, insurance, and wealth management. In commercial banking, Berkshire pursues commercial business loans with relationships that provide non-interest bearing demand deposit balances and that utilize fee services including electronic banking and cash management services.

Non-interest income increased by \$4.2 million (8%) to \$58.2 million in 2013, including a \$0.5 million out-of-period credit. Fee income decreased by 1% and the increase in non-interest income was due to gains on equity securities and increased income from bank owned life insurance. The small decrease in fee income resulted from the 58% reduction in mortgage banking revenue, which was mostly offset by other revenue, including a full year benefit from acquired operations.

The sharp industry-wide contraction in mortgage demand near mid-year was discussed in earlier sections. This followed record volumes in the prior year. The Company had anticipated a more gradual return to normalized market volumes and planned a gradual expansion of future operations to partially offset gradual market changes. The sharp spike in rates depressed revenues more than the Company anticipated. Mortgage banking revenue decreased by \$7.2 million in 2013 to \$5.2 million due to lower volume and margins. Mortgage operations were restructured in the third quarter, and the Company expanded its recruitment of sales teams in the final quarter and continuing into 2014. In the final quarter of 2013, the gross gain on sale margin was approximately 2.02%, compared to 2.21% in the prior quarter. Mortgage banking revenues also varied from quarter to quarter depending on the volume of mortgages retained for portfolio. In the second half of the year, due to the rise in rates on 30 year fixed rate mortgages, the Company promoted 10/1 adjustable rate mortgages which were retained for the portfolio.

Loan and deposit fee income increased in 2013, including the benefit of the acquired Beacon operations. Loan fee income increased by \$3.1 million (60%) to \$8.2 million, including \$3.9 million in loan servicing revenues, \$1.6 million in commercial loan interest rate swap fees, and \$1.5 million in revenue from seasoned loan sales. Deposit fees increased by \$2.7 million (18%) to \$18.3 million. These fees measured 0.47% of average deposits in 2013, compared to 0.45% in the prior year. Included in these fees were overdraft fees which measured 0.20% of average deposits, compared to 0.18% in the prior year. Wealth management fees increased by \$1.4 million (19%) to \$8.7 million in 2013, including the benefit of improved securities market prices together with organic account growth. Total wealth and investment assets under management increased in 2013 to \$1.3 billion at year-end. Insurance revenues decreased by \$0.8 million (7%) to \$10.0 million due to volume and pricing conditions. In the latter part of the year, the Company implemented new initiatives to expand the distribution of insurance products across the footprint and business lines with the goal of producing future revenue growth.

The Company recorded \$4.8 million in securities gains in 2013 due to the sale of community bank common stock to realize gains as a result of strong market price appreciation in 2013. The category of other non-interest income increased by \$1.6 million to \$2.9 million in 2013. This category included \$3.6 million in 2013 for bank



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owned life insurance and \$0.7 million in book losses on tax credit limited partnerships with an offsetting \$0.9 million credit to income tax expense.

**Provision for Loan Losses.** The provision for loan losses is a charge to earnings in an amount sufficient to maintain the allowance for loan losses at a level deemed adequate by the Company. The level of the allowance is a critical accounting estimate, which is subject to uncertainty. The level of the allowance was included in the discussion of financial condition. The provision for loan losses totaled \$11.4 million in 2013, compared to \$9.6 million in 2012. The provision for loan losses exceeded net loan charge-offs in both years, and resulted in an increase in the allowance for loan losses that was generally related to higher reserves on loans acquired in prior year business combinations as previously reported in the loan loss allowance discussion.

**Non-Interest Expense.** Berkshire's goal is to generate positive operating leverage, growing revenues through market share expansion and maintaining expense management disciplines. Expense results also include merger and systems conversion costs that the Company views as economic investments in franchise expansion and infrastructure development. The Company also incurs current costs for team recruitment, de novo branch expansion, and technology and process development as part of its long term strategy to occupy a leading position as a regional provider in its footprint. In 2013, the Company created the position of Chief Administrative Officer in order to bring more focus to the revenue synergies, expense efficiencies, and sales and service process improvements that are possible as a result of recent expansion and systems conversions. The project management office reports to this position and manages ongoing Six Sigma process improvement projects, as well as acquisition integration including the Beacon operations integrated in 2013 and the New York branch acquisition which was completed shortly after year-end. Also, in the third quarter of 2013, the Company initiated an expense restructuring program in order to focus on core competencies and adjust operations to the revenue downturn experienced during the year. The Chief Administrative Officer also oversees expenses that the Company views as non-core in assessing its operating activities.

Total non-interest expense increased by \$16.6 million to \$157.4 million in 2013 including the full year impact of operations acquired in 2012. This 12% increase was lower than the 15% revenue increase. As a result of the restructuring program, the total of compensation/occupancy/technology expense decreased by 7% in the fourth quarter compared to the second quarter, and by 9% compared to the fourth quarter of 2012. Fourth quarter annualized non-interest expense decreased to 2.70% of average assets in 2013 compared to 3.40% in the prior year. Expense included total merger, conversion, and restructuring expense totaling \$14.8 million in 2013 and \$18.0 million in the prior year. The Company does not view this expense as relating to future ongoing operating expense. Net of this expense, total fourth quarter annualized non-interest expense was 2.52% of average assets in 2013, compared to 2.83% in the prior year. Most major categories of expense increased due to acquired operations. All other expense totaling \$17.3 million in 2013 included \$3.4 million lending expense, \$3.3 million loan workout expense, and \$10.6 million in other expense. Full time equivalent staff totaled 939 at year-end 2013 compared to 1,012 at the prior year-end as a result of positions that were consolidated through integration and restructuring activities. An additional 92 full time equivalent staff were added with the purchase of 20 New York branches that was completed in January 2014.

**Income Tax Expense.** The effective income tax rate was 29% in both 2013 and 2012. Due to growth in pretax income, there was generally lower proportionate benefit related to tax advantaged income, including income from investments and bank owned life insurance. The impact of these changes would have been to increase the effective tax rate, but this was offset by a decline in merger related disallowances compared to 2012, as well as a significant reduction in the valuation allowance on deferred tax assets due to the realization of securities gains in 2013. State income tax expense in 2013 included a \$1.0 million charge related to an out-of-period adjustment. The effective tax rate includes numerous adjustments from the statutory rate which are detailed in the Income Taxes note in the consolidated financial statements.

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**Results of Segment and Parent Operations.** Berkshire Hills Bancorp ( the Parent ) has two subsidiary operating segments banking and insurance. Results in the banking segment generally followed the levels and trends of consolidated results, which have been previously discussed. In the insurance segment, a 7% decrease in revenues was partially offset by a 5% reduction in expenses, and net income decreased by \$0.2 million (15%) to \$1.2 million.

The Parent's net interest income included dividends from the banking and insurance segments and non-interest income includes undistributed earnings of these segments. Parent non-interest expense included administrative expense and professional fees related to acquisitions. Most of the Parent's revenues are non-taxable revenues from subsidiaries, and the Parent therefore receives a tax benefit related to the taxable loss generated by its expenses.

**Total Comprehensive Income.** While net income increased by 24% in 2013, total comprehensive income was unchanged at \$35.1 million in 2013 compared to 2012. The Company recorded a \$6.1 million other comprehensive loss in 2013 compared to a \$1.9 million gain in 2012. Due to higher interest rates at year-end 2013, available for sale securities changed from an unrealized gain to an unrealized loss, resulting in a \$20.0 million net change in the unrealized securities gain/loss position as a result of lower market values for fixed rate investment securities. The Company had a partially offsetting impact related to its fixed rate interest rate swaps recorded as cash flow derivative hedges. The unrealized loss on these hedges decreased by \$8.7 million in 2013. Total other comprehensive loss in 2013 also included small changes in other components and was net of a \$6.1 million tax benefit.

**Quarterly Results.** Quarterly results for 2013 and 2012 are presented in a note to the consolidated financial statements. In 2013, quarterly interest income was affected by changes in recoveries collected on acquired impaired loans which resulted in credits to purchased loan accretion included in interest income. Interest income and expense were affected by a decrease in loans and deposits in the first half of the year, followed by a resumption in growth in the second half of the year. Interest income was also affected by compression of asset yields (excluding purchased loan accretion) in the ongoing low interest rate environment. Non-interest income was affected by a decline in mortgage banking revenue which began in the second quarter of 2013. Non-interest income also included the benefit of securities gains on the sale of community bank common stock, particularly in the fourth quarter. Variances in quarterly non-interest expense were primarily due to merger, conversion, and restructuring costs recorded during the year, including the completion of the Beacon integration in the first quarter and the initiation of a restructuring program in the second half of the year. Net income in the first quarter included the impact of merger expenses. Income improved in the second quarter as these expenses declined and the effective tax rate improved. Net income decreased in the third quarter due to the downturn in mortgage revenue and the recordation of restructuring costs, despite the high level of purchased loan accretion recorded in that quarter. Income increased in the fourth quarter due to the benefit of organic loan growth and securities gains.

**COMPARISON OF OPERATING RESULTS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

Berkshire's results in 2012 and 2011 included operations acquired in both years. As a result, most categories of revenue and expense increased due to these acquisitions in addition to ongoing operations. Earnings per share were affected by shares issued as merger consideration. Eight bank branches acquired in the Legacy acquisition in the third quarter of 2011 were designated as discontinued operations and were divested in the following two quarters. All references to revenue and expense in this discussion exclude these discontinued operations. Operating results were also affected by merger and conversion expenses, and gains recorded on investments in acquired banks.

Net income increased by \$15.8 million (91%) to a record \$33.2 million in 2012, compared to \$17.3 million in 2011. Earnings per share increased by \$0.52 (54%) to \$1.49 from \$0.97. Net merger and conversion items, including



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securities gains and results of discontinued operations, totaled \$11.1 million and \$10.4 million after-tax in 2012 and 2011 respectively. These amounts equated to \$0.49 per share and \$0.57 per share in 2012 and 2011 respectively.

The fourth quarter of 2012 was the first quarter in which results included all acquired operations. Net income totaled \$9.3 million (\$0.38 per share) in that quarter. Net merger and conversion items as described above were \$3.9 million (\$0.16 per share). The fourth quarter return on equity was 5.9%.

**Total Net Revenue.** Total net revenue increased by \$55 million (39%) to a record level of \$197 million in 2012. Net revenue per share increased by 12% to \$8.84 in 2012 compared to \$7.93 in 2011, primarily reflecting the accretive revenue benefit of business combinations. Due to higher mortgage banking revenues, fee income was 26% of net revenue in 2012 compared to 24% in 2011.

**Net Interest Income.** Net interest income increased by \$37 million (35%) to \$143 million in 2012, compared to 2011, including the benefit of the bank acquisitions net of discontinued operations. This included a full year's benefit from 2011 acquisitions together with a partial year benefit from 2012 acquisitions.

The net interest margin increased to 3.62% in 2012 from 3.57% in 2011. The margin benefited from the addition of acquired bank balances. Based on fair value analyses performed as of the acquisition date, the net interest margin of acquired Beacon accounts was estimated at approximately 4.9%. This primarily reflected the higher yield assigned to acquired higher risk and impaired loans, including recording all impaired loans as accruing in accordance with accounting principles. Additionally, the yields assigned to acquired time deposits and borrowings reflected current low interest rates and remaining maturities. Berkshire estimated that its net interest margin from business activities was declining during 2012. This reflected the impact of asset repricings in the ongoing low interest rate environment, while deposit liability cost reductions were limited by competitive market conditions and the near zero level of many short term market interest rates. The net amount of purchase accounting loan accretion credited to net interest income was \$6.3 million in 2012, compared to \$3.2 million in 2011.

Changes in asset yields and funds cost in 2012 included both the full year impact of acquisitions in 2011 as well as the partial year impact of acquisitions in 2012. Changes in fourth quarter yields and costs were indicative of changes in the run rate of these data from the end of 2011 to the end of 2012. The Company operated in an ongoing low interest rate environment, with further lows in long term rates in the second half of 2012.

The yield on earning assets decreased by 18 basis points to 4.43% in 2012, with the negative impact of asset repricings partially offset by the higher yield on acquired loans. This yield was 4.49% in the fourth quarter of the year, which was unchanged from the fourth quarter of the prior year due to the benefit of Beacon assets acquired in the fourth quarter of 2012. The cost of funds decreased by 24 basis points in 2012 to 0.84%, reflecting lower deposit and borrowings costs. The cost of deposits decreased from 0.87% in 2011 to 0.65% in 2012, and declined to 0.59% in the fourth quarter of the year. This reflected the reductions in rates paid on all major categories of deposits. Lower deposit costs also reflected the strong growth rate in non-interest bearing demand deposits during the year. The cost of borrowings trended down through the third quarter of 2012 and then increased to 2.80% in the last quarter of the year. This was due to the \$75 million in subordinated debt financing issued for the Beacon acquisition at the end of the third quarter with a 6.875% coupon.

***Non-Interest Income.*** Berkshire acquired mortgage banking operations in 2012 and experienced record mortgage origination in the second half of the year due to record low interest rates. Mortgage banking became the second

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largest source of non-interest income in 2012 and was the largest source in the second half of the year. The industry also experienced unusually high margins in mortgage banking operations during the year. Non-interest income totaled \$54 million in 2012 and increased by \$18 million (51%) over the prior year including the impact of business combinations. The \$18 million increase included \$12 million in growth in mortgage banking income. Excluding mortgage banking income, all other non-interest income increased by \$6 million (18%) primarily due to the benefit of business combinations, and including the benefit of gains on the sale of seasoned loans and payments from new insurance and merchant processing vendors. Mortgage origination income totaled \$12.4 million in 2012 compared to \$0.4 million in 2011. Most mortgage production in both years was fixed rate and Berkshire sells most of its fixed rate production to the secondary markets. Income on mortgages held for sale is recorded when mortgage applications are rate locked based on hedges and forward commitments at that time.

All other loan related income totaled \$5.9 million in 2012, and included contributions from commercial loan servicing fees and interest rate swap income recorded on commercial lending activity. Deposit related fee income measured 0.45% of average deposit balances in 2012, compared to 0.50% in 2011. This reduction included the impact of deposits of acquired banks which had a lower proportion of fee producing deposit products and commercial balances.

Insurance fee income decreased by 2% in 2012. Due to changing industry conditions, the Company converted a significant portion of its policies to new carriers and surpassed its expectations for account retention. Insurance income has become less seasonal as a result of this change. Insurance income in 2012 included approximately \$1.0 million related to successful account transition management, which offset a decrease in contingency income due to adverse claims experience resulting from weather events in 2011. Wealth management income increased by 25% primarily due to a full year benefit of Legacy operations acquired in July 2011. Fourth quarter wealth management fee income increased by 13% in 2012 compared to 2011, due to account growth and improved securities market prices on which much of the income is indexed. Total assets under management, including investment account balances, increased by 14% to \$1.1 billion at year-end 2012, reflecting success in gaining market share based on service and investment performance.

The Company reported net gains totaling \$1.4 million in 2012 and \$2.0 million in 2011 which were primarily related to gains recorded at the time of the acquisition of merged banks as a result of common stock investments which had been made prior to merger discussions as part of the Company's ongoing program to invest in common stock of regional community banks. In 2012, the Company reported \$1.3 million in all other non-interest income. This included the benefit of income on bank owned life insurance policies. This benefit was partially offset by losses on tax shelter limited partnership interests; these losses are more than offset by the benefit to income tax expense due to income tax credits from these partnerships, which include low income housing and wind and solar power generation. Due to the seasoning of these partnerships, the related losses decreased, resulting in the increase in all other non-interest income.

**Provision for Loan Losses.** The provision for loan losses totaled \$10 million in 2012, compared to \$8 million in 2011. The provision for loan losses exceeded net loan charge-offs in both years, and resulted in an increase in the allowance for loan losses that was generally related to higher reserves on acquired loans as previously reported in the loan loss allowance discussion.

**Non-Interest Expense.** Total non-interest expense increased in 2012 by \$24 million (21%) to \$141 million. This included a full year's impact from 2011 acquisitions together with a partial year impact from 2012 acquisitions. Non-

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interest expense included conversion and merger related expenses totaling \$18 million in 2012 and \$20 million in 2011. Merger related expense included compensation and severance costs, professional services, and premises related charges. Conversion expense was primarily related to the Company's core systems conversion in September 2012.

Most major categories of expense increased due to the additional expenses related to acquired operations. Full time equivalent staff totaled 1,012 employees at year-end 2012 compared to 760 at year-end 2011 (excluding staff related to discontinued operations). FDIC insurance expense continued to decrease to 0.08% of average deposits in 2012, compared to 0.12% in the prior year. Expense of other real estate owned also decreased from higher levels in 2011 that resulted from write-downs of properties that were subsequently liquidated. Amortization of intangible assets increased to \$5.3 million in 2012 from \$4.2 million in the prior year, due primarily to the core deposit intangibles recorded for the bank acquisitions in both years.

***Income Tax Expense on Continuing Operations.*** The effective tax rate on income from continuing operations was 28% in 2012, compared to 10% in 2011. The increase in rate is primarily due to the higher level of pretax income and the lower proportionate benefit of tax advantaged income from investments and bank owned life insurance. These two items provided a 7% reduction in the effective tax rate in 2012, compared to the 35% federal statutory rate. Additionally, the benefit from tax credit limited partnerships and other items offset the expense of the 4% effective rate of state income taxes.

***Discontinued Operations.*** Discontinued operations consisted of eight former Legacy Bank branches held for sale in the second half of 2011. Four branches in Berkshire County were divested in the fourth quarter for a net gain. The related effective tax rate was 80% due to the non-deductibility of goodwill for income tax purposes in determining the taxable gain on divestiture. Four branches in New York were divested in January 2012 with a loss resulting from conversion expenses. Discontinued operations provided \$0.05 in earnings per share in 2011 and a loss of \$0.03 in 2012.

***Results of Segment and Parent Operations*** Results in the banking segment generally followed the levels and trends of consolidated results, which have been previously discussed. In the insurance segment, a 3% decrease in revenues was offset by a reduction in expenses so that net income was little changed between 2012 and 2011.

***Total Comprehensive Income.*** Total comprehensive income includes net income together with other comprehensive income, which was \$1.9 million in 2012 and \$1.5 million in 2011. Other comprehensive income in both years primarily resulted from unrealized securities gains related to lower market interest rates. Improved results in 2012 were partly offset by a \$2.1 million increase in the unrealized loss on derivative hedges due to higher volumes and lower rates in 2012. In 2011, results were net of a \$1.1 million net loss on pensions acquired in business combinations.

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**LIQUIDITY AND CASH FLOWS**

Liquidity is the ability to meet cash needs at all times with available cash and from established external liquidity sources or by conversion of other assets to cash at a reasonable price and in a timely manner. At year-end 2013, the parent company had \$40 million in cash and equivalents, which was unchanged from the start of the year. This cash was held on deposit in the Bank. The primary ongoing source of funding for the parent company is dividend payments from the Bank and from Berkshire Insurance Group. These subsidiaries paid \$30 million in dividends to the parent in 2013, compared to \$17 million in 2012. The Company has a \$10 million unsecured line of credit for working capital purposes; this line was fully utilized at each of the last two year-ends. The main uses of liquidity are the payment of common stockholder dividends, routine operating expenses, debt service on outstanding borrowings and debentures, purchases of treasury stock, and bank acquisitions. The Company generally expects to maintain cash on hand equivalent to normal cash uses, including common stock dividends, for at least a one year period. Sources and uses of cash at the parent are reported in the condensed financial statements of the parent company included in the notes to the consolidated financial statements. There are certain restrictions on the payment of dividends by the Bank as discussed in the Stockholders' Equity note to the consolidated financial statements. As of year-end 2013, the statutory limit on future dividend payments by the Bank totaled \$39 million. This amount is based on retained earnings of the Bank and is expected to be supplemented by future bank earnings in accordance with the statutory formula.

The Bank's primary ongoing source of liquidity is customer deposits and the main use of liquidity is the funding of loans and lending commitments. Additional routine sources are borrowings, repayments of loans and investment securities, and the sale of investment securities. In 2013, the primary uses of funds were loan growth, purchases of investment securities, and targeted reductions of non-relationship deposits. The primary source of funds was short term borrowings from the FHLBB. The Bank closely monitors its liquidity position on a daily basis. Sources of borrowings include advances from the FHLBB and borrowings at the Federal Reserve Bank of Boston. As of year-end 2013, based on its arrangements and collateral amounts, the Bank had potential borrowing capacity totaling \$416 million with the Federal Home Loan Bank of Boston. The Bank is also expanding its relationships with correspondent banks and securities firms to maintain availability for overnight borrowings and repurchase agreements. The Bank utilizes the mortgage secondary market as a source of funds for residential mortgages which are sold into that market. Secondary market counterparties include federal mortgage agencies and national financial institutions. The Bank also utilizes national bank counterparties for derivative instruments that it uses in conjunction with its borrowing and mortgage banking activities.

The greatest sources of uncertainty affecting liquidity are deposit withdrawals and usage of loan commitments, which are influenced by interest rates, economic conditions, and competition. Due to the unusual and prolonged low interest rate environment, there is uncertainty about the behavior of deposits if interest rates increase at some future time as anticipated. The Company believes that its market positioning and relationship focus will generally enhance the stability of its deposits, and it also models various scenarios for the purpose of contingency liquidity planning. The



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Bank offers 100% insurance on all deposit balances as a result of the combination of FDIC insurance and the Massachusetts Depositors Insurance Fund. Due to its growth, the Bank is considering alternatives to its use of DIF supplementary insurance and its liquidity planning has expanded as a result. The Bank relies on competitive rates, customer service, and long-standing relationships with customers to manage deposit and loan liquidity. Based on its historical experience, management believes that it has adequately provided for deposit and loan liquidity needs. Both liquidity and capital resources are managed according to policies approved by the Board of Directors and executive management and the Board reviews liquidity metrics and contingency plans on a regular basis.

## **CAPITAL RESOURCES**

The Bank must satisfy various regulatory capital requirements. Regulatory capital requirements are discussed in the Regulation and Supervision section of Item 1, in the Risk Factors discussion, and in the Stockholders' Equity note to the consolidated financial statements. Please also see management's discussion of financial condition for additional information about liquidity and capital at year-end 2013. In November, 2012, the Company renewed a universal shelf registration with the Securities and Exchange Commission for the issuance of up to \$150 million in securities, including debt securities, common stock, or preferred stock. The Company did not issue any securities under the previous registration, and does not have any specific plans for issuances under the current registration. The Company is assessing the impact of the new Basel III capital standards previously discussed in the discussion on Regulation and Supervision in this report. At this time, the Company does not anticipate any material impact on its operations from these new capital standards.

Berkshire views its earnings and related internal capital generation as a primary source of capital to support dividends and growth of the franchise. Additionally, the Company generally uses the issuance of common stock as the primary source of consideration for bank acquisitions, and such acquisitions may result in net increases or decreases in its capital ratios. Berkshire's long term objective is to generate a double digit annual return on equity, and the Company evaluates lending, investment, and acquisition decisions with this objective as a benchmark. The Capital Committee of Berkshire's Board of Directors is responsible for assisting the Board in planning for future capital needs and for ensuring compliance with regulations pertaining to capital structure and levels. The Company believes that the market for its stock is an additional capital resource over the long run. Additionally, the Company continues to monitor market conditions for Tier Two regulatory capital such as preferred stock or subordinated debt, which are additional potential future capital resources to the Company and/or the Bank.

## **AVERAGE BALANCES, INTEREST, AVERAGE YIELDS/COST AND RATE/VOLUME ANALYSIS**

Tables with the above information are presented in Item 6 of this report.

## **CONTRACTUAL OBLIGATIONS**

The year-end 2013 contractual obligations were as follows:



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## Item 7-7A - Table 1 - Contractual Obligations

(In thousands)	Total	Less than One Year	One to Three Years	Three to Five Years	After Five Years
FHLBB borrowings (1)	\$ 964,428	\$ 892,525	\$ 20,000	\$ 16,583	\$ 35,320
Subordinated notes	89,679				89,679
Operating lease obligations (2)	51,519	5,980	9,341	6,885	29,313
Purchase obligations (3)	99,304	17,607	30,469	25,614	25,614
Total Contractual Obligations	\$ 1,204,930	\$ 916,112	\$ 59,810	\$ 49,082	\$ 179,926

Merger related obligations are not included.

(1) Consists of borrowings from the Federal Home Loan Bank. The maturities extend through 2027 and the rates vary by borrowing.

(2) Consists of leases, bank branches and ATMs through 2039.

(3) Consists of obligations with multiple vendors to purchase a broad range of services.

Further information about borrowings and lease obligations is in the notes on borrowings and commitments to the financial statements.

**OFF-BALANCE SHEET ARRANGEMENTS**

In the normal course of operations, Berkshire engages in a variety of financial transactions that, in accordance with generally accepted accounting principles are not recorded in the Company's financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments and lines of credit. A further presentation of the Company's off-balance sheet arrangements is presented in the notes to the consolidated financial statements and in the above discussion relating to payments due under contractual obligations. Information about derivative financial instruments and hedging activities is reported in the related note to the consolidated financial statements, and was included in management's discussion of changes in financial condition. In addition to the contractual arrangements discussed above, at year-end 2013 the Bank had an agreement to purchase 20 branches and related deposits as described in the subsequent events note to the financial statements and this purchase was completed on January 17, 2014. This transaction included the assumption of operating lease obligations for these operations.

**FAIR VALUE MEASUREMENTS**

The most significant fair value measurements recorded by the Company are those related to assets and liabilities acquired in business combinations. These measurements are discussed further in the mergers and acquisitions note to the consolidated financial statements.

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The Company makes further measurements of fair value of certain assets and liabilities, as described in the related note in the financial statements. Recurring fair values of financial instruments primarily relate to the trading security, securities available for sale, loans held for sale, and derivative instruments. A valuation hierarchy is utilized based on generally accepted accounting principles. Measurements based on Level 3 inputs rely the most on subjective management judgments. Level 3 recurring measurements relate primarily to the trading security and derivative instruments. Non-recurring fair value measurements primarily relate to impaired loans, capitalized mortgage servicing rights, and other real estate owned. When measurement is required, these measures are generally based on Level 3 inputs.

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The Company also provides a summary of estimated fair values of financial instruments at each quarter-end. The category of financial assets with the most significant difference historically between carrying value and fair value is the net loan category, which is valued based entirely on Level 3 analysis. The fair value of loans is estimated to be at a \$7 million dollar premium to carrying value at year-end 2013, compared to a \$49 million (1.2%) premium to carrying value at year-end 2012. The premium value of loans has narrowed based on higher prepayment speeds and lower replacement yields despite the benefit of ongoing improvement in the credit profile of the portfolio. Additionally, the change in the premium value of loans reflects higher medium term interest rates at year-end 2013 compared to year-end 2012, which had a negative impact on the value of fixed rate obligations. At both measurement periods, the discount related to subordinated borrowings generally offset the excess fair value of deposits over carrying amounts and included the impact of higher interest rates at year-end 2013. The reduction in the premium value of loans therefore contributed to a reduction in the net economic value of equity related to those instruments, based solely on the measures used for the purpose of this analysis. This change reflects the pressure on net interest margins and the increase in long term interest rates at year-end 2013, but does not take into account the non-interest income generated by these customer relationships or the long term intangible value of the Company's franchise in its markets.

**IMPACT OF INFLATION AND CHANGING PRICES**

The financial statements and related financial data presented in this Form 10-K have been prepared in conformity with accounting principles generally accepted in the United States of America, which require the measurement of financial position and operating results in terms of historical dollars, without considering changes in the relative purchasing power of money over time due to inflation. Unlike many industrial companies, substantially all of the assets and liabilities of the Bank are monetary in nature. As a result, interest rates have a more significant impact on the Bank's performance than the general level of inflation. Interest rates may be affected by inflation, but the direction and magnitude of the impact may vary. A sudden change in inflation (or expectations about inflation), with a related change in interest rates, would have a significant impact on our operations.

**IMPACT OF NEW ACCOUNTING PRONOUNCEMENTS**

Please refer to the note on Recent Accounting Pronouncements in Note 1 to the consolidated financial statements for a detailed discussion of new accounting pronouncements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**MANAGEMENT OF INTEREST RATE RISK AND MARKET RISK ANALYSIS**

**Qualitative Aspects of Market Risk.** The Company's most significant form of market risk is interest rate risk. The Company seeks to avoid fluctuations in its net interest income and to maximize net interest income within acceptable levels of risk through periods of changing interest rates. The Company maintains an Asset/Liability Committee that is responsible for reviewing its asset/liability policies and interest rate risk position. This Committee meets monthly and reports trends and interest rate risk position to the Risk Management Committee and Board of Directors on a quarterly basis. The extent of the movement of interest rates is an uncertainty that could have a negative impact on the Company's earnings. The Company has managed interest rate risk by emphasizing assets with shorter-term repricing durations, periodically selling long term fixed-rate assets, promoting low cost core deposits, and using FHLBB advances to structure its liability repricing durations. The Company

also uses interest rate swaps in order to enhance its interest rate risk position and manage its balance sheet.

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**Quantitative Aspects of Market Risk.** The Company uses a simulation model to measure the potential change in net interest income that would result from both an instantaneous or ramped change in market interest rates assuming a parallel shift along the entire yield curve. The chart below shows the analysis of a ramped change. Loans, deposits and borrowings were expected to reprice at the repricing or maturity date. The Company uses prepayment guidelines set forth by market sources as well as Company generated data where applicable. Cash flows from loans and securities are assumed to be reinvested based on current operating conditions and strategies. Other assumptions about balance sheet mix are generally held constant. No material changes have been made to the methodologies used in the model.

Item 7-7A - Table 2 - Qualitative Aspects of Market Risk

Change in Interest Rates-Basis Points (Rate Ramp) (In thousands)	1- 12 Months		13- 24 Months	
	\$ Change	% Change	\$ Change	% Change
<b>At December 31, 2013</b>				
+ 300	\$ (3,395)	(2.13)	\$ (1,872)	(1.19)%
+ 200	(2,398)	(1.51)	(937)	(0.59)
+ 100	1,165	0.73	6,312	4.00
- 100	(3,664)	(2.30)	(9,262)	(5.87)
<b>At December 31, 2012</b>				
+ 300	\$ 2,018	1.35%	\$ 5,757	3.99%
+ 200	1,126	0.75	3,732	2.59
+ 100	463	0.31	1,779	1.23
- 100	(3,418)	(2.28)	(10,683)	(7.40)

At year-end 2013, the table above shows that Berkshire's net interest income at risk was estimated to be asset sensitive in the event of a 100 basis point rate increase, with modest liability sensitivity in the event of larger rate increases. This position reflected the increased use of short term FHLB borrowings prior to the acquisition of New York deposits which was completed in January 2014. The Company anticipated that its net interest income would be modestly asset sensitive in year two of all modeled two year ramp scenarios including the acquired New York deposits.

In addition to net interest income, some sources of non-interest income are sensitive to changes in interest rates and market conditions, including mortgage banking fees and commercial loan interest rate swap revenue. Mortgage banking fees declined significantly in 2013 due to a steepening of the yield curve which caused an industry-wide reduction in revenue as a result of lower volumes and margins. Changes in interest rates can also affect loan and

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security prepayment speeds, which can result in changes in the amortization of premiums and discounts. Additionally, in 2013 interest rate related changes in market conditions contributed to an accelerated outflow of impaired loans acquired in bank acquisitions. Securities market conditions contributed to growth in wealth management revenues. The Company monitors interest rate and market conditions in managing these sources of market risk to its operating results and financial condition.

The Company also estimates the sensitivity of the economic value of its equity to interest rate shocks. The Company believes that it is a strategic strength to avoid excess long term earnings at risk when interest rates rise in the future, as anticipated. At year-end 2013, the Company estimated that the economic value of equity would decrease by approximately 10% in the event of a 200 basis point interest rate shock, which was within the Company's policy limits. This reflected the impact of fixed rate assets on medium and long term modeled net interest income if interest rates increase. This estimate is subject to numerous assumptions and uncertainties and is not intended as a projection of future operating results. The acquisition of New York deposits shortly after year-end was expected to result in a significant reduction in the value of equity at risk in the event of an upward movement in interest rates due to the low cost and anticipated stability of these rural personal and small business deposits.

In the unusual current economic and financial circumstances in the national markets, modeling assumptions depend significantly on subjective judgment which cannot be readily verified by historic data. Additionally, due to the Company's expansion into new markets, it has more revenues dependent on customer behaviors in products and markets where it has less historic background for its modeling assumptions. The most significant modeling assumption relates to expectations for the interest sensitivity of non-maturity deposit accounts in a rising rate environment. The model assumes that deposit rate sensitivity will be a percentage of the market interest rate change. The rate sensitivity depends on the underlying amount of market rate change and the type of deposit account. The percentage rate movements are as follows: NOW accounts ranging between 0% and 35%; money market accounts ranging between 15% and 60%; and savings accounts ranging between 15% and 40%. The total impact of deposit sensitivity assumptions in the model results in approximately an 80 basis point upward move in deposit costs at the end of two years in the Company's model of a 200 basis point upward shift in interest rates.

One of the significant limitations of the simulation is that it assumes parallel shifts in the yield curve. Actual interest rate risks are often more complex than this scenario. Due to ongoing distortions in the markets as a result of federal monetary policy, there is elevated uncertainty about future market conditions and about customer demand and behaviors in the event of future interest rate changes. Assumption changes in 2013 were based on a review of past performance and future expectations and were not viewed as material. Further, as it grows, the Company is evaluating changes in its supplemental deposit insurance. Changes in deposit protection can result in additional sensitivity to the interest rate structure and demand for the Company's deposit products, and this sensitivity could increase when interest rates rise above the current low levels.

The market is expected to continue to experience some general yield compression if short term rates remain near zero for the next three years and if international and other economic events continue to hold down long term U.S. interest rates. The Company expects that interest rates will increase over the medium term from currently suppressed levels and that there is the potential for rate spikes based on economic or financial shocks in the domestic and global markets. Berkshire continues to target ongoing loan growth as it pursues its market share acquisition strategies, and this growth will include a mix of variable and fixed rate loans. The Company's long term target is to flexibly balance its growth, deposit funding, net interest margin, and interest rate risk management as it pursues its goals of expanding its footprint, increasing its market share, and improving its profitability.



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Berkshire has a number of business strategies to increase net interest income despite the potential for tighter market yields. These include changes in volumes and mix of interest bearing assets and liabilities, some of which are discussed above. The Company also evaluates its pricing strategies on an ongoing basis, and considers its investment, borrowings, and derivatives strategies in managing its income and risk profile. Due to the limitations and uncertainties relating to model assumptions, the modeled computations should not be relied on as projections of income. Further, the computations do not reflect any actions that management may undertake in response to changes in interest rates.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The financial statements and supplementary data required by this item are presented elsewhere in this report beginning on page F-1, in the order shown below:

Management's Report on Internal Control over Financial Reporting

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2013 and 2012

Consolidated Statements of Income for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012, and 2011

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2013, 2012, and 2011

Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012, and 2011

Notes to Consolidated Financial Statements

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

The Company's management, including the Company's Principal Executive Officer and Principal Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined in Rule 13a and 15(d) -15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") as of December 31, 2013. Based upon their evaluation, the Principal Executive Officer and Principal Financial Officer concluded that, as of that date, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the "SEC"): (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms; and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

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**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Company evaluated changes in its internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934) that occurred during the last fiscal quarter. The Company determined that there were no changes that materially affected, or were reasonably likely to materially affect, the Company's internal control over financial reporting. Management's report on internal control over financial reporting and the independent registered public accounting firm's report on the Company's internal control over financial reporting are contained in Item 8 Financial Statements and Supplementary Data.

**ITEM 9B. OTHER INFORMATION**

None.

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**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE**

For information concerning the directors of the Company, the information contained under the sections captioned "Proposals to be Voted on by Stockholders" Proposal 1 - Election of Directors in Berkshire's Proxy Statement for the 2014 Annual Meeting of Stockholders ("Proxy Statement") is incorporated by reference.

The following table sets forth certain information regarding the executive officers of the Company.

Name	Age	Position
Michael P. Daly	52	Chairman, President & Chief Executive Officer
George F. Bacigalupo	59	Executive Vice President, Commercial Banking
Sean A. Gray	37	Executive Vice President, Retail Banking
Josephine Iannelli	41	Executive Vice President, Chief Financial Officer
Linda A. Johnston	61	Executive Vice President, Human Resources
Richard M. Marotta	55	Executive Vice President, Chief Risk & Administrative Officer

The executive officers are elected annually and hold office until their successors have been elected and qualified or until they are removed or replaced. Mr. Daly is employed pursuant to a three-year employment agreement which renews automatically if not otherwise terminated pursuant to its terms.

**BIOGRAPHICAL INFORMATION**

*Michael P. Daly* has served as President and Chief Executive Officer since October 2002. Before these appointments, Mr. Daly served as Executive Vice President and Senior Loan Officer of the Bank. He has been an employee since 1986. He has served as a Director of the Company and the Bank since 2002. In December 2012, Mr. Daly was promoted to Chairman of the Board.

*George F. Bacigalupo* was promoted to Executive Vice President of Commercial Banking in October 2013 having previously served as Senior Vice President, Chief Credit Officer since 2011. Mr. Bacigalupo is responsible for business banking, including the asset based lending and leasing business lines. Previously, Mr. Bacigalupo was EVP of Specialty Lending at TD Banknorth, where he established the ABL and other middle-market lending groups and oversaw commercial banking relationships with \$5 billion in total committed credit. Subsequently, at TD Bank, he was the Senior Lender for New England.

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*Sean A. Gray* was promoted to Executive Vice President, Retail Banking in 2010, having previously served as Senior Vice President, Retail Banking since April 2008. Mr. Gray manages retail banking (including deposits, lending, fee services, branches, and call center) along with mortgage banking, small business banking, marketing, deposit operations and facilities. Mr. Gray joined the Company in January 2007 as First Vice President, Retail Banking. Prior to joining the Bank, Mr. Gray was Vice President and Consumer Market Manager at Bank of America, in Waltham, Massachusetts.

*Josephine Iannelli* was promoted to Executive Vice President, Chief Financial Officer in January 2014 having previously served as Senior Vice President, Chief Accounting Officer since March 2013. In her current role, she manages the Company's accounting and finance functions. Ms. Iannelli has 20 years of financial experience beginning with accounting policy roles at KPMG and KeyCorp. She joined National City Corporation in 2002 leading

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the accounting policy group and served in various roles at the bank through their acquisition and integration into PNC Financial. She has also provided independent accounting consulting services for top ten national banks.

*Linda A. Johnston* was promoted to Executive Vice President, Human Resources in 2010, having previously served as Senior Vice President since November 2002. Ms. Johnston manages the Company's human resources functions and serves as a key advisor to the Compensation Committee of the Company's Board of Directors. She is also a Director of the Company's Foundations. Ms. Johnson has been with the Company for more than 30 years.

*Richard M. Marotta* joined the Company as Executive Vice President and Chief Risk Officer in January, 2010 and was promoted to Chief Administrative Officer in July 2013. He is responsible for overall risk management, commercial credit underwriting, loan workout, loan review, loan documentation, commercial loan servicing, compliance, information technology, and project management. Mr. Marotta was previously Executive Vice President and Group Head, Asset Recovery at KeyBank. He has extensive career experience in credit and risk management, including asset based lending portfolios.

Reference is made to the cover page of this report and to the section captioned "Other Information Relating to Directors and Executive Officers - Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement for information regarding compliance with Section 16(a) of the Exchange Act. For information concerning the audit committee and the audit committee financial expert, reference is made to the section captioned "Corporate Governance - Committees of the Board of Directors and Audit Committee" in the Proxy Statement.

For information concerning the Company's code of ethics, the information contained under the section captioned "Corporate Governance - Code of Business Conduct" in the Proxy Statement is incorporated by reference. A copy of the Company's code of ethics is available to stockholders on the Company's website at [www.berkshirebank.com](http://www.berkshirebank.com).

## **ITEM 11. EXECUTIVE COMPENSATION**

For information regarding executive compensation, the sections captioned "Director Compensation", "Compensation Discussion and Analysis", and "Executive Compensation" in the Proxy Statement are incorporated herein by reference.

For information regarding the Compensation Committee Report, the section captioned "Compensation Committee Report" in the Proxy Statement is incorporated herein by reference.

## **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

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### (a) Security Ownership of Certain Beneficial Owners

Information required by this item is incorporated herein by reference to the section captioned **Stock Ownership** in the Proxy Statement.

### (b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the section captioned **Stock Ownership** in the Proxy Statement.

### (c) Changes in Control

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Management of Berkshire knows of no arrangements, including any pledge by any person of securities of Berkshire, the operation of which may at a subsequent date result in a change in control of the registrant.

## (d) Equity Compensation Plan Information

The following table sets forth information, as of December 31, 2013, about Company common stock that may be issued upon exercise of options under stock-based benefit plans maintained by the Company, as well as the number of securities available for issuance under equity compensation plans:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	420,000	\$ 21.73	333,000
Equity compensation plans not approved by security holders			
Total	420,000	\$ 21.73	333,000

In 2013, the Company's shareholders approved a new equity compensation plan which was to become effective by action of the Board of Directors. That plan was made effective shortly after year-end 2013, and the available shares from that plan are not included in the plan information provided above.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this item is incorporated herein by reference to the sections captioned "Other Information Relating to Directors and Executive Officers," "Transactions with Related Persons," and "Procedures Governing Related Persons Transactions" in the Proxy Statement.

Information regarding director independence is incorporated herein by reference to the section captioned "Proposals to be Voted on by Stockholders - Proposal 1 - Election of Directors" in the Proxy Statement.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information required by this item is incorporated herein by reference to the section captioned "Proposals to be Voted on by Stockholders" Proposal 3 "Ratification of the Independent Registered Public Accounting Firm" in the Proxy Statement.



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**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

(a) [1] **Financial Statements**

- Report of Independent Registered Public Accounting Firm
- Consolidated Balance Sheets as of December 31, 2013 and 2012
- Consolidated Statements of Income for the Years Ended December 31, 2013, 2012 and 2011
- Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2013, 2012 and 2011
- Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2013, 2012 and 2011
- Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012 and 2011
- Notes to Consolidated Financial Statements

The consolidated financial statements required to be filed in our Annual Report on Form 10-K are included in Part II, Item 8 hereof.

[2] **Financial Statement Schedules**

All financial statement schedules are omitted because the required information is either included or is not applicable.

[3] **Exhibits**

- 3.1 Certificate of Incorporation of Berkshire Hills Bancorp, Inc. (1)
- 3.2 Amended and Restated Bylaws of Berkshire Hills Bancorp, Inc.(2)
- 4.1 Form of Common Stock Certificate of Berkshire Hills Bancorp, Inc. (1)
- 4.2 Note Subscription Agreement by and among Berkshire Hills Bancorp, Inc. and certain subscribers dated September 20, 2012 (3)
- 10.1 Amended and Restated Employment Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Michael P. Daly (4)

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- 10.2 Amended and Restated Supplemental Executive Retirement Agreement between Berkshire Bank and Michael P. Daly (5)
- 10.3 Three Year Executive Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and George F. Bacigalupo
- 10.4 Three-Year Executive Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Josephine Iannelli
- 10.5 Amended and Restated Three Year Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Richard M. Marotta (6)
- 10.6 Amended and Restated Three Year Change in Control Agreement by and among Berkshire Bank, Berkshire Hills Bancorp, Inc. and Sean A. Gray (7)
- 10.7 Form of Split Dollar Agreement entered into with Michael P. Daly, Sean A. Gray, and Richard M.

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	Marotta (8)
10.8	Non-Competition and Consulting Agreement by and among Berkshire Hills Bancorp, Inc., Berkshire Bank and J. Williar Dunlaevy, dated as of April 6, 2011 (9)
10.9	Endorsement Agreement by and among Berkshire Hills Bancorp, Inc. and Geno Auriemma dated as of May 14, 2012 (10)
10.10	Berkshire Hills Bancorp, Inc. 2011 Equity Incentive Plan (11)
10.11	Berkshire Hills Bancorp, Inc. 2013 Equity Incentive Plan (12)
10.12	Legacy Bancorp, Inc. Amended and Restated 2006 Equity Incentive Plan (13)
10.13	Berkshire Bank 2013 Executive Short Term Incentive Plan
10.14	Form of Berkshire Bank Employee Severance Compensation Plan (1)
11.0	Statement re: Computation of Per Share Earnings is incorporated herein by reference to Part II, Item 8, Financial Statements and Supplementary Data
21.0	Subsidiary Information
23.1	Consent of PricewaterhouseCoopers, LLP
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Stockholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements tagged as blocks of text and in detail

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- |      |   |
|------|---|
| (1)  | Incorporated herein by reference from the Exhibits to Form S-1, Registration Statement and amendments thereto, initially filed on March 10, 2000, Registration No. 333-32146. |
| (2)  | Incorporated herein by reference from the Exhibits to the Form 8-K as filed on December 18, 2012.   |
| (3)  | Incorporated by reference from the Exhibits to the Form 8-K as filed on September 26, 2012.   |
| (4)  | Incorporated herein by reference from the Exhibits to the Form 8-K as filed on January 6, 2009.   |
| (5)  | Incorporated herein by reference from the Exhibits to Form 10-K as filed on March 16, 2009.   |
| (6)  | Incorporated herein by reference from the Exhibits to the Form 10-K as filed on March 16, 2010.   |
| (7)  | Incorporated herein by reference from the Exhibits to the Form 10-K as filed on March 16, 2011.   |
| (8)  | Incorporated herein by reference from the Exhibit to the Form 8-K as filed on January 19, 2011.   |
| (9)  | Incorporated herein by reference from the Exhibits to the Registration Statement on Form S-4 as filed on April 20, 2011, Registration No. 333-173404.                         |
| (10) | Incorporated by reference from Exhibit 10.16 to the Form 10-Q as filed on August 16, 2012.  |
| (11) | Incorporated herein by reference from the Appendix to the Proxy Statement as filed on March 24, 2011.   |
| (12) | Incorporated herein by reference from the Appendix to the Proxy Statement as filed on April 2, 2013.  |
| (13) | Incorporated herein by reference from the Exhibits to the Form 8-K filed by Legacy Bancorp, Inc. on December 22, 2010.  |

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 17, 2014	Berkshire Hills Bancorp, Inc. By: /s/ Michael P. Daly Michael P. Daly Chairman, President & Chief Executive Officer
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Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Michael P. Daly Michael P. Daly	Chairman, President & Chief Executive Officer (principal executive officer)	March 17, 2014
/s/ Josephine Iannelli Josephine Iannelli	Executive Vice President, Chief Financial Officer (principal financial and accounting officer)	March 17, 2014
John W. Altmeyer	Director	
/s/ Lawrence A. Bossidy Lawrence A. Bossidy	Lead Independent Director	March 17, 2014
/s/ Robert M. Curley Robert M. Curley	Director	March 17, 2014
/s/ John B. Davies John B. Davies	Director	March 17, 2014
/s/ Rodney C. Dimock Rodney C. Dimock	Director	March 17, 2014
/s/ J. Williar Dunlaevy J. Williar Dunlaevy	Director	March 17, 2014
/s/ Susan M. Hill Susan M. Hill	Director	March 17, 2014
/s/ Cornelius D. Mahoney Cornelius D. Mahoney	Director	March 17, 2014
Laurie Norton Moffatt	Director	
/s/ Richard J. Murphy Richard J. Murphy	Director	March 17, 2014

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/s/ Barton D. Raser  
Barton D. Raser

Director

March 17, 2014

/s/ D. Jeffrey Templeton  
D. Jeffrey Templeton

Director

March 17, 2014

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed under the supervision of the Company's Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with generally accepted accounting principles.

As of December 31, 2013, management conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2013 was effective.

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

The effectiveness of the Company's internal control over financial reporting as of December 31, 2013 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, which follows. This report expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2013.

/s/ Michael P. Daly  
Michael P. Daly  
Chairman, President & Chief Executive Officer  
March 17, 2014

/s/ Josephine Iannelli  
Josephine Iannelli  
Executive Vice President, Chief Financial Officer  
March 17, 2014

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of

Berkshire Hills Bancorp, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows present fairly, in all material respects, the financial position of Berkshire Hills Bancorp, Inc. and its subsidiaries (the Company) at December 31, 2013 and December 31, 2012, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

/s/PricewaterhouseCoopers LLP  
Boston, Massachusetts  
March 17, 2014





Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED BALANCE SHEETS**

		December 31,	
(In thousands, except share data)	2013	2012	
<b>Assets</b>			
Cash and due from banks	\$ 56,841	\$ 63,382	
Short-term investments	18,698	34,862	
Total cash and cash equivalents	75,539	98,244	
Trading security	14,840	16,893	
Securities available for sale, at fair value	760,048	466,169	
Securities held to maturity (fair values of \$45,764 and \$52,490 in 2013 and 2012, respectively)	44,921	51,024	
Federal Home Loan Bank stock and other restricted securities	50,282	39,785	
Total securities	870,091	573,871	
Loans held for sale, at fair value	15,840	85,368	
Residential mortgages	1,384,274	1,324,251	
Commercial mortgages	1,417,120	1,413,544	
Commercial business loans	687,293	600,126	
Consumer loans	691,836	650,733	
Total loans	4,180,523	3,988,654	
Less: Allowance for loan losses	(33,323)	(33,208)	
Net loans	4,147,200	3,955,446	
Premises and equipment, net	84,459	86,461	
Other real estate owned	2,758	1,929	
Goodwill	256,871	255,199	
Other intangible assets	13,791	19,059	
Cash surrender value of bank-owned life insurance	101,530	88,198	
Deferred tax assets, net	50,711	57,729	
Other assets	54,009	75,305	
Total assets	\$ 5,672,799	\$ 5,296,809	
<b>Liabilities</b>			
Demand deposits	\$ 677,917	\$ 673,921	
NOW deposits	353,612	379,880	
Money market deposits	1,383,856	1,388,514	
Savings deposits	431,496	487,505	
Time deposits	1,001,648	1,170,589	
Total deposits	3,848,529	4,100,409	
Short-term debt	872,510	163,150	
Long-term Federal Home Loan Bank advances	101,918	195,321	
Subordinated notes	89,679	89,617	
Total borrowings	1,064,107	448,088	
Other liabilities	82,101	81,047	
Total liabilities	4,994,737	4,629,544	
Commitments and contingencies (See note 17)			
<b>Stockholders' equity</b>			

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Common stock (\$.01 par value; 50,000,000 shares authorized; 26,525,466 shares issued and 25,036,169 shares outstanding in 2013; 50,000,000 shares authorized; 26,525,466 shares issued and 25,148,522 shares outstanding in 2012)

	265	265
Additional paid-in capital	587,247	585,360
Unearned compensation	(5,563)	(3,035)
Retained earnings	141,958	122,014
Accumulated other comprehensive loss	(9,057)	(2,979)
Treasury stock, at cost (1,489,297 shares in 2013 and 1,376,9442 shares in 2012)	(36,788)	(34,360)
Total stockholders' equity	678,062	667,265
Total liabilities and stockholders' equity	\$ 5,672,799	\$ 5,296,809

*The accompanying notes are an integral part of these consolidated financial statements.*

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(In thousands, except per share data)		Years Ended December 31,		
	2013	2012	2011	
<b>Interest and dividend income</b>				
Loans	\$ 186,115	\$ 160,936	\$ 124,398	
Securities and other	17,626	15,003	13,862	
Total interest and dividend income	203,741	175,939	138,260	
<b>Interest expense</b>				
Deposits	20,859	22,482	23,372	
Borrowings and subordinated notes	14,130	10,069	8,368	
Total interest expense	34,989	32,551	31,740	
<b>Net interest income</b>	168,752	143,388	106,520	
<b>Non-interest income</b>				
Loan related income	8,247	5,152	2,724	
Mortgage banking income	5,235	12,403	436	
Deposit related fees	18,340	15,593	13,641	
Insurance commissions and fees	10,020	10,821	11,088	
Wealth management fees	8,683	7,296	5,838	
Total fee income	50,525	51,265	33,727	
Other	2,949	1,306	(37)	
Gain on sales of securities, net	4,758	300	14	
Non-recurring gain, net		1,185	2,099	
Total non-interest income	58,232	54,056	35,803	
<b>Total net revenue</b>	226,984	197,444	142,323	
<b>Provision for loan losses</b>	11,378	9,590	7,563	
<b>Non-interest expense</b>				
Compensation and benefits	71,134	64,081	49,545	
Occupancy and equipment	22,540	19,469	15,317	
Technology and communications	12,944	9,467	7,457	
Marketing and promotion	2,596	2,031	1,539	
Professional services	6,569	5,785	4,669	
FDIC premiums and assessments	3,473	3,377	3,205	
Other real estate owned and foreclosures	700	281	2,003	
Amortization of intangible assets	5,268	5,339	4,236	
Merger, restructuring and conversion related expenses	14,848	18,019	19,928	
Other	17,287	12,957	8,543	
Total non-interest expense	157,359	140,806	116,442	
Income from continuing operations before income taxes	58,247	47,048	18,318	
Income tax expense	17,104	13,223	1,884	
<b>Net income from continuing operations</b>	41,143	33,825	16,434	
(Loss) income from discontinued operations before income taxes (including gain on disposals \$63 in 2012 and \$4,962 in 2011)		(261)	4,684	
Income tax expense from discontinued operations		376	3,770	
<b>Net (loss) income from discontinued operations</b>		(637)	914	
<b>Net income</b>	\$ 41,143	\$ 33,188	\$ 17,348	
<b>Basic earnings per share:</b>				
Continuing Operations	\$ 1.66	\$ 1.52	\$ 0.92	
Discontinued operations		(0.03)	0.05	
<b>Total basic earning per share</b>	\$ 1.66	\$ 1.49	\$ 0.97	

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**Diluted earnings per share:**

Continuing Operations	\$	1.65	\$	1.52	\$	0.92
Discontinued operations				(0.03)		0.05
<b>Total diluted earnings per share</b>	<b>\$</b>	<b>1.65</b>	<b>\$</b>	<b>1.49</b>	<b>\$</b>	<b>0.97</b>

**Weighted average common shares outstanding:**

Basic	24,802	22,201	17,885
Diluted	24,965	22,329	17,952

*The accompanying notes are an integral part of these consolidated financial statements.*

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In thousands)	Years Ended December 31,		
	2013	2012	2011
Net income	\$ 41,143	\$ 33,188	\$ 17,348
<b>Other comprehensive (loss) income, before tax:</b>			
Changes in unrealized gains and losses on securities available-for-sale	(20,012)	4,419	2,329
Changes in unrealized gains and losses on derivative hedges	8,666	(2,072)	341
Changes in unrealized gains and losses on terminated swaps	942	942	942
Changes in unrealized gains and losses on pension	1,282	(136)	(1,130)
Total other comprehensive (loss) income, before tax	(9,122)	3,153	2,482
<b>Income taxes related to other comprehensive (loss) income:</b>			
Changes in unrealized gains and losses on securities available-for-sale	7,524	(1,667)	(870)
Changes in unrealized gains and losses on derivative hedges	(3,474)	688	(151)
Changes in unrealized gains and losses on terminated swaps	(489)	(324)	(391)
Changes in unrealized gains and losses on pension	(517)	56	455
<b>Total income tax benefit (expense) related to other comprehensive (loss) income</b>	<b>3,044</b>	<b>(1,247)</b>	<b>(957)</b>
Total other comprehensive (loss) income	(6,078)	1,906	1,525
<b>Total comprehensive income</b>	<b>\$ 35,065</b>	<b>\$ 35,094</b>	<b>\$ 18,873</b>

*The accompanying notes are an integral part of these consolidated financial statements.*

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

(In thousands, except per share data)	Common stock Shares	Common stock Amount	Additional paid-in capital	Unearned compensation	Retained earnings	Accumulated other comprehensive (loss) income	Treasury stock	Total
<b>Balance at January 1, 2011</b>	14,076	\$ 158	\$ 337,537	\$ (1,776)	\$ 102,648	\$ (6,410)	\$ (44,834)	\$ 387,323
Comprehensive income:								
Net income					17,348			17,348
Other net comprehensive income						1,525		1,525
Total comprehensive income								18,873
Acquisition of Legacy Bancorp, Inc	4,351	44	101,639					101,683
Acquisition of Rome Bancorp, Inc	2,661	27	55,463					55,490
Employee Stock Ownership Plan	(44)						(943)	(943)
Cash dividends declared (\$0.65 per share)					(11,910)			(11,910)
Forfeited shares	(23)		40	463			(503)	
Exercise of stock options	16				(166)		418	252
Restricted stock grants	160		(474)	(2,925)			3,399	
Stock-based compensation			3	1,447				1,450
Net tax benefit related to stock-based compensation			68					68
Other, net	(49)		28	1			(507)	(478)
<b>Balance at December 31, 2011</b>	21,148	\$ 229	\$ 494,304	\$ (2,790)	\$ 107,920	\$ (4,885)	\$ (42,970)	\$ 551,808
Comprehensive income:								
Net income					33,188			33,188
Other net comprehensive income						1,906		1,906
Total comprehensive income								35,094
Acquisition of Connecticut Bank & Trust Company	965	9	21,981					21,990
Acquisition of Beacon Federal Bancorp, Inc	2,700	27	67,978					68,005
Cash dividends declared (\$0.69 per share)					(15,634)			(15,634)
Forfeited shares	(8)		11	169			(180)	
Exercise of stock options	254				(3,460)		6,504	3,044
Restricted stock grants	108		(280)	(2,434)			2,714	
Stock-based compensation			240	2,020				2,260
Net tax benefit related to stock-based compensation			1,126					1,126
Other, net	(19)						(428)	(428)
<b>Balance at December 31, 2012</b>	25,148	\$ 265	\$ 585,360	\$ (3,035)	\$ 122,014	\$ (2,979)	\$ (34,360)	\$ 667,265
Comprehensive income:								
Net income					41,143			41,143
Other net comprehensive loss						(6,078)		(6,078)
Total comprehensive income								35,065
Cash dividends declared (\$0.72 per share)					(18,118)			(18,118)
Treasury stock purchased	(480)						(12,249)	(12,249)
Forfeited shares	(58)		224	1,330			(1,554)	
Exercise of stock options	237				(3,081)		6,126	3,045
Restricted stock grants	243		(634)	(5,958)			6,592	
Stock-based compensation			860	2,100				2,960
			1,451					1,451

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Net tax benefit related to stock-based compensation															
Other, net	(54)		(14)					(1,343)	(1,357)						
<b>Balance at December 31, 2013</b>	25,036	\$	265	\$	587,247	\$	(5,563)	\$	141,958	\$	(9,057)	\$	(36,788)	\$	678,062

*The accompanying notes are an integral part of these consolidated financial statements.*

Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)	Years ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net income	\$ 41,143	\$ 33,188	\$ 17,348
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	11,378	9,590	7,563
Net amortization of securities	1,635	1,937	1,317
Change in unamortized net loan costs and premiums	(8,350)	(1,377)	316
Premises and equipment depreciation and amortization expense	7,120	6,045	4,849
Stock-based compensation expense	2,960	2,260	1,450
Accretion of purchase accounting entries, net	(20,313)	(9,281)	(5,319)
Amortization of other intangibles	5,268	5,339	4,401
Write down of other real estate owned	135	45	2,000
Excess tax loss from stock-based payment arrangements	(1,451)	(1,126)	(68)
Income from cash surrender value of bank-owned life insurance policies	(3,518)	(2,716)	(2,120)
Gain on sales of securities and other, net	(4,758)	(1,655)	(2,113)
Net decrease (increase) in loans held for sale	69,528	(35,451)	(412)
Loss on disposition of assets	4,232	2,124	
Gain (loss) on sale of real estate	(2)	128	(50)
Net change in other	22,404	19,604	11,007
<b>Net cash provided by operating activities</b>	<b>127,411</b>	<b>28,654</b>	<b>40,169</b>
Cash flows from investing activities:			
Net decrease in trading security	512	486	464
Proceeds from sales of securities available for sale	19,386	85,711	9,522
Proceeds from maturities, calls and prepayments of securities available for sale	113,749	102,590	119,939
Purchases of securities available for sale	(443,906)	(124,183)	(201,527)
Proceeds from maturities, calls and prepayments of securities held to maturity	8,991	30,282	10,625
Purchases of securities held to maturity	(2,888)	(21,965)	(13,101)
Net change in loans	(181,039)	(160,204)	(44,849)
Acquisitions, net of cash paid		(111,328)	179,308
Net cash used for divestiture		(48,890)	(85,733)
Proceeds from surrender of bank-owned life insurance	186	766	
Purchase of bank-owned life insurance	(10,000)		
Proceeds from sale of Federal Home Loan Bank stock	2,434	6,781	3,601
Purchase of Federal Home Loan Bank stock	(12,932)		(1,387)
Proceeds of premises and equipment		260	718
Purchase of premises and equipment, net	(13,103)	(18,890)	(7,988)
Net investment in limited partnership tax credits		(565)	(4,909)
Proceeds from sale of other real estate	3,416	3,626	1,230
<b>Net cash used by investing activities</b>	<b>(515,194)</b>	<b>(255,523)</b>	<b>(34,087)</b>

(continued)



*The accompanying notes are an integral part of these consolidated financial statements.*

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Table of Contents**BERKSHIRE HILLS BANCORP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS (CONCLUDED)**

(In thousands)	2013	Years ended December 31, 2012	2011
Cash flows from financing activities:			
Net (decrease) increase in deposits	\$ (225,070)	\$ 167,002	\$ 207,919
Proceeds from Federal Home Loan Bank advances and other borrowings	1,488,182	485,625	125,480
Repayments of Federal Home Loan Bank advances and other borrowings	(872,163)	(465,970)	(296,249)
Issuance of long term debt, net		74,138	
Net proceeds from reissuance of treasury stock		3,044	252
Repurchase of treasury stock	(12,249)		
Exercise of stock options	3,045		
Excess tax loss from stock-based payment arrangements	1,451	1,126	68
Common stock cash dividends paid	(18,118)	(15,634)	(11,910)
Net cash provided by financing activities	365,078	249,331	25,560
Net change in cash and cash equivalents	(22,705)	22,462	31,642
Cash and cash equivalents at beginning of year	98,244	75,782	44,140
Cash and cash equivalents at end of year	\$ 75,539	\$ 98,244	\$ 75,782
Supplemental cash flow information:			
Interest paid on deposits	\$ 20,967	\$ 22,921	\$ 23,750
Interest paid on borrowed funds	14,056	9,376	8,292
Income taxes (refunded) paid, net	(3,729)	8,869	(164)
Acquisition of non-cash assets and liabilities:			
Assets acquired		1,185,957	1,193,018
Liabilities assumed	(1,672)	(969,598)	(1,041,910)
Acquisition s stock owned by the Company		5,193	6,284
Other non-cash changes:			
Other net comprehensive (loss) income	(6,078)	1,906	1,525
Real estate owned acquired in settlement of loans	4,378	2,243	

*The accompanying notes are an integral part of these consolidated financial statements.*

*Note: The Consolidated Statements of Cash Flows for the year ended December 31, 2011 include the cash flows from operating, investing and financing activities associated with discontinued operations.*

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Years Ended December 31, 2013, 2012 and 2011**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation and Consolidation***

The consolidated financial statements (the "financial statements") of Berkshire Hills Bancorp, Inc. and its subsidiaries (the "Company" or "Berkshire") have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The Company is a Delaware corporation and the holding company for Berkshire Bank (the "Bank"), a Massachusetts-chartered savings bank headquartered in Pittsfield, Massachusetts, and Berkshire Insurance Group, Inc. ("Berkshire Insurance Group" or "BIG"). These financial statements include the accounts of the Company, its wholly-owned subsidiaries and the Bank's consolidated subsidiaries. One of the Bank's consolidated subsidiaries is Berkshire Bank Municipal Bank, a New York-chartered limited-purpose commercial bank. In consolidation, all significant intercompany accounts and transactions are eliminated. The results of operations of companies or assets acquired are included only from the dates of acquisition. All material wholly-owned and majority-owned subsidiaries are consolidated unless GAAP requires otherwise.

***Discontinued Operations***

Assets and liabilities related to discontinued operations are carried at the lower of cost or estimated fair value in the aggregate and presented in a separate line item on the consolidated balance sheets. Revenue and expense related to discontinued operations are not reported separately, and net income related to these operations is presented in a separate line item on the consolidated statements of operations.

***Reclassifications***

Certain items in prior financial statements have been reclassified to conform to the current presentation. The Company has evaluated subsequent events for potential recognition and/or disclosure through the date these consolidated financial statements were issued.

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ

from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses; the valuation of deferred tax assets; the estimates related to the initial measurement of goodwill and intangible assets and subsequent impairment analyses; the determination of other-than-temporary impairment of securities; and the determination of fair value of financial instruments and subsequent impairment analysis.

***Business Combinations***

Business combinations are accounted for using the acquisition method of accounting. Under this method, the accounts of an acquired entity are included with the acquirer's accounts as of the date of acquisition with any excess of purchase price over the fair value of the net assets acquired (including identifiable intangibles) capitalized as goodwill.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

To consummate an acquisition, the Company will typically issue common stock and/or pay cash, depending on the terms of the acquisition agreement. The value of common shares issued is determined based upon the market price of the stock as of the closing of the acquisition.

***Cash and Cash equivalents***

Cash and cash equivalents include cash, balances due from banks, and short-term investments, all of which mature within ninety days. Due to the nature of cash and cash equivalents and the near term maturity, the Company estimated that the carrying amount of such instruments approximated fair value. The nature of the Bank's business requires that it maintain amounts due from banks which at times, may exceed federally insured limits. The Bank has not experienced any losses on such amounts and all amounts are maintained with well-capitalized institutions.

***Trading Security***

The Company elected the fair value option permitted by Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures*, on a tax advantaged economic development bond originated in 2008. The bond has been designated as a trading account security and is recorded at fair value, with changes in unrealized gains and losses recorded through earnings each period as part of non-interest income.

***Securities***

Debt securities that management has the intent and ability to hold to maturity are classified as held to maturity and carried at amortized cost. All other securities, including equity securities with readily determinable fair values, are classified as available for sale and carried at fair value, with unrealized gains and losses reported as a component of other net comprehensive income. Management determines the appropriate classification of securities at the time of purchase. Restricted equity securities, such as stock in the Federal Home Loan Bank of Boston (FHLBB) are carried at cost. There are no quoted market prices for the Company's restricted equity securities. The Bank is a member of the FHLBB, which requires that members maintain an investment in FHLBB stock, which may be redeemed based on certain conditions. The Bank reviews for impairment based on the ultimate recoverability of the cost bases in the FHLBB stock.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

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The Company evaluates debt and equity securities within the Company's available for sale and held to maturity portfolios for other-than-temporary impairment ( OTTI ), at least quarterly. If the fair value of a debt security is below the amortized cost basis of the security, OTTI is required to be recognized if any of the following are met: (1) the Company intends to sell the security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) for debt securities, the present value of expected cash flows is not sufficient to recover the entire amortized cost basis. For all impaired debt securities that the Company intends to sell, or more likely than not will be required to sell, the full amount of the depreciation is recognized as OTTI through earnings. Credit-related OTTI for all other impaired debt securities is recognized through earnings. Non-credit related OTTI for such debt securities is recognized in other comprehensive income, net of applicable taxes. In evaluating its marketable equity securities portfolios for OTTI, the Company considers its intent and

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

ability to hold an equity security to recovery of its cost basis in addition to various other factors, including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI on marketable equity securities is recognized immediately through earnings.

***Loans Held for Sale***

Loans originated prior to April 30, 2012, with the intent to be sold in the secondary market, were valued on an aggregate basis at the lower-of-cost-or-fair value. Loans originated on or after April 30, 2012, with the intent to be sold in the secondary market, are accounted for under the fair value option. Non-refundable fees and direct loan origination costs related to residential mortgage loans held for sale are recognized in noninterest income or noninterest expense as earned or incurred. Fair value is primarily determined based on quoted prices for similar loans in active markets. Gains and losses on sales of residential mortgage loans (sales proceeds minus carrying value) are recorded in noninterest income.

Loans that were previously held for investment that the Company has an active plan to sell are transferred to loans held for sale at fair value. Fair value is primarily determined based on quoted prices for similar loans in active markets or agreed upon sales prices. Gains are recorded in noninterest income to the extent that the fair value exceeds the carrying value of the loans transferred. Any reduction in the loan's value, prior to being transferred to loans held for sale, is reflected as a charge-off of the recorded investment in the loan resulting in a new cost basis, with a corresponding reduction in the allowance for loan losses. Further changes in the fair value of the loan are recognized in noninterest income or expense, accordingly.

***Loans***

Loans are reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, the unamortized balance of any deferred fees or costs on originated loans and the unamortized balance of any premiums or discounts on loans purchased or acquired through mergers. Interest income is accrued on the unpaid principal balance. Interest income includes net accretion or amortization of deferred fees or costs and of premiums or discounts. Interest income is also net of recoveries or losses recorded on acquired impaired loans. Direct loan originations costs, net of any origination fees, in addition to premiums and discounts on loans, are deferred and recognized as an adjustment of the related loan yield using the interest method. Interest on loans, excluding automobile loans, is generally not accrued on loans which are ninety days or more past due unless the loan is well-secured and in the process of collection. Past due status is based on contractual terms of the loan. Automobile loans generally continue accruing until one hundred and twenty days delinquent, at which time they are charged off. All interest accrued but not collected for loans that are placed on non-accrual or charged-off is reversed against interest income, except for certain loans designated as well-secured. The interest on non-accrual loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. All payments received on non-accrual loans are applied against the principal balance of the loan. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

***Acquired Loans***

Loans that the Company acquired in acquisitions are initially recorded at fair value with no carryover of the related allowance for credit losses. Determining the fair value of the loans involves estimating the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

amount and timing of principal and interest cash flows initially expected to be collected on the loans and discounting those cash flows at an appropriate market rate of interest.

For loans that meet the criteria stipulated in ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, the Company recognizes the accretable yield, which is defined as the excess of all cash flows expected at acquisition over the initial fair value of the loan, as interest income on a level-yield basis over the expected remaining life of the loan. The excess of the loan's contractually required payments over the cash flows expected to be collected is the nonaccretable difference. The nonaccretable difference is not recognized as an adjustment of yield, a loss accrual, or a valuation allowance. Going forward, the Company continues to evaluate whether the timing and the amount of cash to be collected are reasonably expected. Subsequent significant increases in cash flows the Company expects to collect will first reduce any previously recognized valuation allowance and then be reflected prospectively as an increase to the level yield. Subsequent decreases in expected cash flows may result in the loan being considered impaired. Interest income is not recognized to the extent that the net investment in the loan would increase to an amount greater than the estimated payoff amount.

For ASC 310-30 loans, the expected cash flows reflect anticipated prepayments, determined on a loan by loan basis according to the anticipated collection plan of these loans. The expected prepayments used to determine the accretable yield are consistent between the cash flows expected to be collected and projections of contractual cash flows so as to not affect the nonaccretable difference. For ASC 310-30 loans, prepayments result in the recognition of the nonaccretable balance as current period yield. Changes in prepayment assumptions may change the amount of interest income and principal expected to be collected.

For loans that do not meet the ASC 310-30 criteria, the Company accretes interest income on a level yield basis using the contractually required cash flows. The Company subjects loans that do not meet the ASC 310-30 criteria to ASC Topic 450, *Contingencies* by collectively evaluating these loans for an allowance for loan loss.

Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, the Company may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable yield. The Company has determined that the Company can reasonably estimate future cash flows on the Company's current portfolio of acquired loans that are past due 90 days or more and on which the Company is accruing interest and the Company expects to fully collect the carrying value of the loans.

***Allowance for Loan Losses***

The allowance for loan losses is established based upon the level of estimated probable losses in the current loan portfolio. Loan losses are charged against the allowance when management believes the collectability of a loan balance is doubtful. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses includes allowance allocations calculated in accordance with Accounting Standards Codification (ASC) Topic 310, *Receivables* and allowance allocations calculated in accordance with ASC Topic 450, *Contingencies*.



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The allowance for loan losses is allocated to loan types using both a formula-based approach applied to groups of loans and an analysis of certain individual loans for impairment. The formula-based approach emphasizes loss factors derived from actual historical and industry portfolio loss rates, which are combined with an assessment of certain qualitative factors to determine the allowance amounts allocated to the various loan categories. Allowance amounts are based on an estimate of historical average annual percentage rate of loan loss for each loan segment, a temporal estimate of the incurred loss emergence and confirmation period for each loan category, and certain qualitative risk factors considered in the computation of the allowance for loan losses.

Qualitative risk factors impacting the inherent risk of loss within the portfolio include the following:

- National and local economic and business conditions
- Level and trend of delinquencies
- Level and trend of charge-offs and recoveries
- Trends in volume and terms of loans
- Risk selection, lending policy and underwriting standards
- Experience and depth of management
- Banking industry conditions and other external factors
- Concentration risk

Risk characteristics relevant to each portfolio segment are as follows:

**Residential mortgage** The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans. The Company requires private mortgage insurance (PMI) in cases when the loan-to-value ratio exceeds 80 percent. All loans in this segment are collateralized by residential real estate and repayment is dependent on the credit quality of the individual borrower. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

**Commercial mortgage** Loans in this segment are primarily owner-occupied or income-producing properties throughout New England and Northeastern New York. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy, which in turn, will have an effect on the credit quality in this segment. Management monitors the cash flows of these loans. In addition, construction loans in this segment primarily include real estate development loans for which payment is derived from sale of the property or long term financing at completion. Credit risk is affected by cost overruns, time to sell at an adequate price, and market conditions.

**Commercial business loans** Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. Loans in this segment include asset based loans which generally have no scheduled repayment and which are closely monitored against formula based collateral advance ratios. A weakened economy, and resultant decreased consumer spending, will have an effect on the credit quality in this segment.

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**Consumer loans** Loans in this segment are primarily home equity lines of credit and second mortgages, together with automobile loans and other consumer loans. The overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this segment.

The Company utilizes a blend of historical and industry portfolio loss rates for commercial mortgage and commercial business loans that are assessed by internal risk rating. Historical loss rates for residential mortgages, home equity and other consumer loans are not risk graded but are assessed based on the total of each loan segment. This approach incorporates qualitative adjustments based upon management's assessment of various market and portfolio specific risk factors into its formula-based estimate. Due to the imprecise nature of the loan loss estimation process and ever changing conditions, the qualitative risk attributes may not adequately capture amounts of incurred loss in the formula-based loan loss components used to determine allocations in the Company's analysis of the adequacy of the allowance for loan losses.

The Company evaluates certain loans individually for specific impairment. 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. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Loans are selected for evaluation based upon a change in internal risk rating, occurrence of delinquency, loan classification, or non-accrual status. The evaluation of certain loans individually for specific impairment includes loans that were previously classified as Troubled Debt Restructurings (TDRs) or continue to be classified as TDRs. A specific allowance amount is allocated to an individual loan when such loan has been deemed impaired and when the amount of the probable loss is able to be estimated. Estimates of loss may be determined by the present value of anticipated future cash flows or the loan's observable fair market value, or the fair value of the collateral, if the loan is collateral dependent. However, for collateral dependent loans, the amount of the recorded investment in a loan that exceeds the fair value of the collateral is charged-off against the allowance for loan losses in lieu of an allocation of a specific allowance amount when such an amount has been identified definitively as uncollectible.

Large groups of small-balance homogeneous loans such as the residential mortgage, home equity and other consumer portfolios are collectively evaluated for impairment. As such, the Company does not typically identify individual loans within these groupings as impaired loans or for impairment evaluation and disclosure. The Company evaluates all TDRs for impairment on an individual loan basis regardless of loan type.

***Bank-Owned Life Insurance***

Bank-owned life insurance policies are reflected on the consolidated balance sheets at cash surrender value. Changes in the net cash surrender value of the policies, as well as insurance proceeds received, are reflected in non-interest income on the consolidated statements of operations and are not subject to income taxes.

***Foreclosed and Repossessed Assets***

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Assets acquired through, or in lieu of, loan foreclosure or repossession are held for sale and are initially recorded at the lower of the investment in the loan or fair value less estimated costs to sell at the date of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

foreclosure or repossession, establishing a new cost basis. Subsequently, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated costs to sell. Revenue and expenses from operations, changes in the valuation allowance, any direct write-downs and gains or losses on sales are included in other real estate owned expense.

***Capitalized Mortgage Servicing Rights***

Capitalized mortgage servicing rights are included in other assets in the consolidated balance sheet. Servicing assets are initially recognized as separate assets at fair value when rights are acquired through purchase or through sale of financial assets with servicing retained. The Company uses the amortization method to subsequently measure servicing assets. Under that method, capitalized mortgage servicing rights are charged to expense in proportion to and over the period of estimated net servicing income. Fair value of the mortgage servicing rights is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, prepayment speeds and default rates and losses. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the capitalized amount for the tranches. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

***Premises and Equipment***

Land is carried at cost. Buildings, improvements and equipment are carried at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized over the initial term of the lease, plus optional terms if certain conditions are met.

***Goodwill***

Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a business combination. Goodwill is assigned to reporting units, which are operating segments or one level below an operating segment. Goodwill is assigned to the Company's reporting units that are expected to benefit from the business combination. Goodwill is assessed annually for impairment, and more frequently if events or changes in circumstances indicate that there may be an impairment. Adverse changes in the economic environment, declining operations, unanticipated competition, loss of key personnel, or other factors could result in a decline in the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, a loss would be recognized in other noninterest expense to reduce the carrying amount to the implied fair value of goodwill. A goodwill impairment analysis is comprised of two steps. Step 1, used to identify instances of potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, including goodwill, the reporting unit's goodwill is not considered impaired. If the carrying amount of a reporting unit, including goodwill, exceeds its fair value, the second step of the goodwill impairment analysis is performed to measure the amount of impairment loss, if any. Step 2 of the goodwill impairment analysis compares the implied fair value of reporting unit goodwill with the carrying

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amount of that goodwill. If the carrying amount of goodwill for that reporting unit exceeds the implied fair value of that reporting unit's goodwill, an impairment loss is recognized in an amount equal to that excess. Subsequent reversals of goodwill impairment are prohibited.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

***Other Intangibles***

Intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability.

The fair values of these assets are generally determined based on appraisals and are subsequently amortized on a straight-line basis or an accelerated basis over their estimated lives. Management assesses the recoverability of these intangible assets whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount exceeds fair value, an impairment charge is recorded to income.

***Transfers of Financial Assets***

Transfers of an entire financial asset, group of entire financial assets, or a participating interest in an entire financial asset 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 to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets.

***Income Taxes***

The Company files a consolidated federal income tax return with the Bank and its subsidiaries. Calculation of the Company's provision for income taxes requires the interpretation of income tax laws and regulations and the use of estimates and judgments in its determination. The Company is subject to examination by governmental authorities that may give rise to income tax issues due to differing interpretations. Changes to the liability for income taxes also occur due to changes in income tax rates, implementation of new business strategies, resolution of issues with taxing authorities, and newly enacted statutory, judicial, and regulatory guidance.

Deferred income taxes are provided to reflect the tax effect of temporary differences between financial statement carrying amounts and the corresponding tax basis of assets and liabilities. Deferred income taxes are calculated by applying enacted statutory tax rates and tax laws to future years in which temporary differences are expected to reverse. The impact on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that the tax rate change is enacted. A deferred tax valuation allowance is established if it is more likely than not that a deferred tax asset will not be realized.

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The Company maintains reserves for certain tax positions that arise in the normal course of business. As of December 31, 2013, these positions were evaluated based on an assessment of probabilities as to the likelihood of whether a liability had been incurred. Such assessments are reviewed as events occur and adjustments to the reserves are made as appropriate.

In evaluating a tax position for recognition, the Company judgmentally evaluates whether it is more likely than not that a tax position will be sustained upon examination, including resolution of related appeals or litigation processes, based on the technical merits of the position. If the tax position meets the more likely than not recognition threshold, the tax position is measured and recognized in the Company's Consolidated Financial Statements as the largest amount of tax benefit that, in management's judgment, is greater than 50% likely of being realized upon ultimate settlement.

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***Insurance Commissions***

Commission revenue is recognized as of the effective date of the insurance policy or the date the customer is billed, whichever is later, net of return commissions related to policy cancellations. In addition, the Company may receive additional performance commissions based on achieving certain sales and loss experience measures. Such commissions are recognized when determinable, which is generally when such commissions are received or when the Company receives data from the insurance companies that allows the reasonable estimation of these amounts.

***Advertising Costs***

Advertising costs are expensed as incurred.

***Stock-Based Compensation***

The Company measures and recognizes compensation cost relating to share-based payment transactions based on the grant-date fair value of the equity instruments issued. The fair value of restricted stock is recorded as unearned compensation. The deferred expense is amortized to compensation expense based on one of several permitted attribution methods over the longer of the required service period or performance period. For performance-based restricted stock awards, the Company estimates the degree to which performance conditions will be met to determine the number of shares that will vest and the related compensation expense. Compensation expense is adjusted in the period such estimates change.

Income tax benefits related to stock compensation in excess of grant date fair value, less any proceeds on exercise, are recognized as an increase to additional paid-in capital upon vesting or exercising and delivery of the stock. Any income tax benefits that are less than grant date fair value less any proceeds on exercise would be recognized as a reduction of additional paid-in capital to the extent of previously recognized income tax benefits and then as compensation expense for the remaining amount.

***Earnings per Common Share***

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. If rights to dividends on unvested options/awards are non-forfeitable, these unvested awards/options are considered outstanding in the computation of basic earnings per share. Diluted earnings per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the

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assumed issuance. Potential common shares that may be issued by the Company relate to outstanding stock options and restricted stock awards and are determined using the treasury stock method. Treasury shares are not deemed outstanding for earnings per share calculations.

### *Wealth Management Assets*

Wealth management assets held in a fiduciary or agent capacity are not included in the accompanying consolidated balance sheets because they are not assets of the Company.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

***Derivative Instruments and Hedging Activities***

The Company enters into interest rate swap agreements as part of the Company's interest rate risk management strategy for certain assets and liabilities and not for speculative purposes. Based on the Company's intended use for the interest rate swap at inception, the Company designates the derivative as either an economic hedge of an asset or liability or a hedging instrument subject to the hedge accounting provisions of FASB ASC Topic 815, *Derivatives and Hedging*.

Interest rate swaps designated as economic hedges are recorded at fair value within other assets or liabilities. Changes in the fair value of these derivatives are recorded directly through earnings.

For interest rate swaps that management intends to apply the hedge accounting provisions of Topic 815, the Company formally documents at inception all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking the various hedges. Additionally, the Company uses dollar offset or regression analysis at the hedge's inception and for each reporting period thereafter, to assess whether the derivative used in its hedging transaction is expected to be and has been highly effective in offsetting changes in the fair value or cash flows of the hedged item. The Company discontinues hedge accounting when it is determined that a derivative is not expected to be or has ceased to be highly effective as a hedge, and then reflects changes in fair value of the derivative in earnings after termination of the hedge relationship.

The Company has characterized its interest rate swaps that qualify under Topic 815 hedge accounting as cash flow hedges. Cash flow hedges are used to minimize the variability in cash flows of assets or liabilities, or forecasted transactions caused by interest rate fluctuations, and are recorded at fair value in other assets or liabilities within the Company's balance sheets. Changes in the fair value of these cash flow hedges are initially recorded in accumulated other comprehensive loss and subsequently reclassified into earnings when the forecasted transaction affects earnings. Any hedge ineffectiveness assessed as part of the Company's quarterly analysis is recorded directly to earnings.

The Company enters into interest rate lock commitments with borrowers, and forward commitments to sell loans or to-be-announced mortgage-backed bonds to investors to hedge against the inherent interest rate and pricing risk associated with selling loans. The interest rate lock commitments generally terminate once the loan is funded, the lock period expires or the borrower decides not to contract for the loan. The forward commitments generally terminate once the loan is sold, the commitment period expires or the borrower decides not to contract for the loan. These commitments are considered derivatives which are accounted for by recognizing their estimated fair value on the Consolidated Balance Sheets as either a freestanding asset or liability. See Note 16 to the Consolidated Financial Statements for more information on interest rate lock commitments and forward commitments.

***Off-Balance Sheet Financial Instruments***

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In the ordinary course of business, the Company enters into off-balance sheet financial instruments, consisting primarily of credit related financial instruments. These financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received.

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***Fair Value Hierarchy***

The Company groups assets and liabilities that are 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 used to determine fair value.

Level 1 Valuation is based on quoted prices in active markets for identical assets or liabilities. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 Valuation is based on observable inputs other than Level 1 prices, such as 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 assets or liabilities.

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 unobservable techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

***Employee Benefits***

The Company maintains an employer sponsored 401(k) plan to which participants may make contributions in the form of salary deferrals and the Company provides matching contributions in accordance with the terms of the plan. Contributions due under the terms of the defined contribution plans are accrued as earned by employees.

Due to the Rome Bancorp acquisition in 2011, the Company inherited a noncontributory, qualified, defined benefit pension plan for certain employees who met age and service requirements; as well as other post-retirement benefits, principally health care and group life insurance. The Rome pension plan and postretirement benefits that were acquired in connection with the whole-bank acquisition in the second quarter of 2011 were frozen prior to the close of the transaction. The pension benefit in the form of a life annuity is based on the employee's combined years of service, age, and compensation.

In order to measure the expense associated with the Plans, various assumptions are made including the discount rate, expected return on plan assets, anticipated mortality rates, and expected future healthcare costs. The assumptions are based on historical experience as well as current facts and circumstances. The Company uses a December 31 measurement date for its Plans. As of the measurement date, plan assets are determined based on fair value, generally representing observable market prices. The projected benefit obligation is primarily determined based

on the present value of projected benefit distributions at an assumed discount rate.

Net periodic pension benefit costs include interest costs based on an assumed discount rate, the expected return on plan assets based on actuarially derived market-related values, and the amortization of net actuarial losses. Net periodic postretirement benefit costs include service costs, interest costs based on an assumed discount rate, and the amortization of prior service credits and net actuarial gains. Differences between expected and actual results in each year are included in the net actuarial gain or loss amount, which is recognized in other comprehensive income. The net actuarial gain or loss in excess of a 10% corridor is amortized in net periodic benefit cost over the average remaining service period of active



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participants in the Plans. The prior service credit is amortized over the average remaining service period to full eligibility for participating employees expected to receive benefits.

The Company recognizes in its statement of condition an asset for a plan's overfunded status or a liability for a plan's underfunded status. The Company also measures the Plans' assets and obligations that determine its funded status as of the end of the fiscal year and recognizes those changes in other comprehensive income, net of tax.

***Out of Period Adjustments***

In the third quarter of 2013, the Company recorded a correction of an error to recognize \$2.2 million in prior period interest income earned on loans acquired in bank acquisitions, of which \$1.3 million relates to prior years. Additionally, the Company recorded a correction of an error related to its accounting for a state income tax credit. The correction increased other income by \$613 thousand and increased the income tax provision by \$1.2 million during the quarter. The adjustment relating to prior years included \$505 thousand in other income and \$998 thousand in the income tax provision. After evaluating the quantitative and qualitative aspects of these adjustments, the Company concluded that its prior period financial statements were not materially misstated and, therefore, no restatement was required.

***Recent Accounting Pronouncements***

***Offsetting Assets and Liabilities***

In December 2011, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2011-11, *Disclosures About Offsetting Assets and Liabilities*. This project began as an attempt to converge the offsetting requirements under U.S. GAAP and International Financial Reporting Standards ("IFRS"). However, as the FASB and International Accounting Standards Board were not able to reach a converged solution with regards to offsetting requirements, they each developed convergent disclosure requirements to assist in reconciling differences in the offsetting requirements under U.S. GAAP and IFRS. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. ASU No. 2011-11 also requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. In January 2013, the FASB issued ASU No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The provisions of ASU No. 2013-01 limits the scope of the new balance sheet offsetting disclosures to the following financial instruments, to the extent they are offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the statement of financial position: (1) derivative financial instruments; (2) repurchase agreements and reverse repurchase agreements; and (3) securities borrowing and securities lending transactions. The Company adopted the provisions of ASU No. 2011-11 and ASU No. 2013-01 effective January 1, 2013. As the provisions of ASU No. 2011-11 and ASU No. 2013-01 only impacted the disclosure requirements related to the offsetting of assets and liabilities and information about instruments and transactions eligible for offset in the statement of financial position, the adoption had no impact on the Company's consolidated statements of income and condition. See Note 16 to the Consolidated Financial Statements for the disclosures required by ASU No. 2011-11 and ASU No. 2013-01.

*Reclassifications Out of Accumulated Other Comprehensive Income*

In February 2013, the FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, to improve the transparency of reporting these

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reclassifications. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 requires an entity to disaggregate the total change of each component of other comprehensive income and separately present reclassification adjustments and current period other comprehensive income. The provisions of ASU No. 2013-02 also requires that entities present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line item affected by the reclassification. If a component is not required to be reclassified to net income in its entirety, entities would instead cross reference to the related note to the financial statements for additional information. The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the Company provided these required disclosures in the notes to the Consolidated Financial Statements, the adoption of ASU No. 2013-02 had no impact on the Company's consolidated statements of income and condition. See Note 18 to the Consolidated Financial Statements for the disclosures required by ASU No. 2013-02.

***Future Application of Accounting Pronouncements***

In July 2013, the FASB issued ASU No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The provisions of ASU No. 2013-11 require an entity to present an unrecognized tax benefit, or portion thereof, in the statement of financial position as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward, with certain exceptions related to availability. ASU No. 2013-11 is effective for interim and annual reporting periods beginning after December 15, 2013. The adoption of ASU No. 2013-11 is not expected to have a material impact on the Company's Consolidated Financial Statements.

In January 2014, the FASB issued ASU No. 2014-01, *Accounting for Investments in Qualified Affordable Housing Projects*. ASU No. 2014-01 permits reporting entities to make an accounting policy election to account for investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. This new guidance also requires new disclosures for all investors in these projects. ASU No. 2014-01 is effective for interim and annual reporting periods beginning after December 15, 2014. Upon adoption, the guidance must be applied retrospectively to all periods presented. However, entities that use the effective yield method to account for investments in these projects before adoption may continue to do so for these pre-existing investments. The Company currently accounts for such investments using the effective yield method and plans to continue to do so for these pre-existing investments after adopting ASU No. 2014-01 on January 1, 2015. The Company expects investments made after January 1, 2015 to meet the criteria required for the proportional amortization method and plans to elect that accounting policy. The adoption of ASU No. 2014-01 is not expected to have a material impact on the Company's Consolidated Financial Statements.

In January 2014, the FASB issued ASU No. 2014-04, *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure*. The objective of this guidance is to clarify when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. ASU No. 2014-04 states that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage



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loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, ASU No. 2014-04 requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. ASU No. 2014-04 is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of ASU No. 2014-04 is not expected to have a material impact on the Company's Consolidated Financial Statements.

**NOTE 2. MERGERS & ACQUISITIONS**

**Beacon Federal Bancorp, Inc.**

On October 19, 2012, the Company acquired all of the outstanding common shares of Beacon Federal Bancorp, Inc. (BFED). BFED, as a Holding company, had one Banking subsidiary (Beacon Bank) that had seven branches primarily serving eastern New York State, but also including two branches in Tennessee. As a result of the transaction, BFED merged into Berkshire Hills Bancorp, and Beacon Bank merged into Berkshire Bank. This business combination is an extension of the Berkshire franchise and goodwill results from the expected synergies and earnings accretion from this combination, including future cost savings related to BFED's operations.

On the acquisition date, BFED had 5.871 million outstanding common shares, net of 1.727 million shares held by Berkshire. BFED shareholders received 2.701 million Berkshire common shares based on an exchange ratio of 0.5590 shares of Berkshire common stock for each BFED share. BFED shareholders also received a total of \$60.2 million in cash representing a payment \$20.50 per BFED share. The 2.701 million shares of Berkshire common stock issued in this exchange were valued at \$23.06 per share based on the closing price of Berkshire posted on October 18, 2012 resulting in a consideration value of \$62.3 million. The BFED shares held by Berkshire were valued at \$5.2 million, and the value in excess of the carrying value was recorded as a \$1.1 million non-recurring gain in the statement of income. BFED had a stock option plan, and as part of the acquisition agreement, Berkshire agreed to continue the vesting schedules of option holders of BFED stock with corresponding BHLB stock with a share conversion ratio of 92%. The fair value of the vested portion of the options was \$5.7 million, and was included as part of consideration paid for BFED.

The results of BFED's operations will be included in the Company's Consolidated Statement of Income from the date of acquisition.

The assets and liabilities in the BFED acquisition were recorded at their fair value based on management's best estimate using information available at the date of acquisition. Consideration paid, and fair values of BFED's assets acquired and liabilities assumed are summarized in the following tables:



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<b>Consideration Paid: (In thousands)</b>	<b>Amount</b>
Berkshire Hills Bancorp common stock issued to BFED common stockholders	\$ 62,273
Cash consideration paid to BFED common shareholders	60,183
Fair value of BFED stock options converted to Berkshire options	5,732
Fair value of BFED shares previously purchased by Berkshire	5,194
Total consideration paid	\$ 133,382

<b>Recognized amounts of identifiable assets acquired and (liabilities assumed), at fair value:</b>	<b>As Acquired</b>	<b>Fair Value Adjustment</b>	<b>As Recorded at Acquisition</b>
Cash and short term investments	\$ 7,005	\$	\$ 7,005
Investment securities	81,428	(1,346)(a)	80,082
Loans	697,797	(32,060)(b)	665,737
Premises and equipment	11,897	2,855(c)	14,752
Core deposit intangibles		1,840(d)	1,840
Other intangibles		324(e)	324
Deferred tax assets, net	6,481	12,596(f)	19,077
Other assets	27,391	(841)(g)	26,550
Deposits	(622,246)	(1,482)(h)	(623,728)
Borrowings	(78,000)	(10)(i)	(78,010)
Other liabilities	(12,661)	(2,097)(j)	(14,758)
Total identifiable net assets	\$ 119,092	\$ (20,221)	\$ 98,871
Goodwill			\$ 34,511

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Explanation of Certain Fair Value Adjustments

(a) The adjustment represents the write down of the book value of investments to their estimated fair value based on fair values on the date of acquisition.

(b) The adjustment represents the write down of the book value of loans to their estimated fair value based on current interest rates and expected cash flows, which includes an estimate of expected loan loss inherent in the portfolio. Loans that met the criteria and are being accounted for in accordance with ASC 310-30 had a carrying amount of \$78.3 million. Non-impaired loans not accounted for under 310-30 had a carrying value of \$619.5 million.

(c) The amount represents the adjustment of the book value of buildings, and furniture and equipment, to their estimated fair value based on appraisals and other methods. The adjustment includes a \$2.4 million fair value write-up of a building under a capital lease arrangement. The adjustments will be depreciated over the estimated economic lives of the assets.

(d) The adjustment represents the value of the core deposit base assumed in the acquisition. The core deposit asset was recorded as an identifiable intangible asset and will be amortized over the average life of the deposit base.

(e) Represents identified intangibles related to assumed leases and acquired wealth management and insurance customer lists, which will be amortized over the remaining useful lives.

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- (f) Represents net deferred tax assets resulting from the fair value adjustments related to the acquired assets and liabilities, identifiable intangibles, and other purchase accounting adjustments.
- (g) The amount primarily consists of a \$0.5 million fair value adjustment to write-down other real estate owned, and a \$0.4 million write-down of mortgage servicing assets acquired, which were based on appraisals, and valuation reports, respectively. These adjustments are not accretable into earnings in the statement of income.
- (h) The adjustment is necessary because the weighted average interest rate of deposits exceeded the cost of similar funding at the time of acquisition.
- (i) Adjusts borrowings to their estimated fair value based on interest rates of similar borrowings available on the date of acquisition.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(j) Adjusts the book value of other liabilities to their estimated fair value at the acquisition date. The adjustment primarily consists of a \$4.1 million increase to an acquired capital lease obligation, and a \$2.3 write-off of deferred revenue.

Except for collateral dependent loans with deteriorated credit quality, the fair values for loans acquired from BFED were estimated using cash flow projections based on the remaining maturity and repricing terms. Cash flows were adjusted by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value using a risk-adjusted market rate for similar loans. For collateral dependent loans with deteriorated credit quality, to estimate the fair value, the Company analyzed the value of the underlying collateral of the loans, assuming the fair values of the loans were derived from the eventual sale of the collateral. Those values were discounted using market derived rates of return, with consideration given to the period of time and costs associated with the foreclosure and disposition of the collateral. There was no carryover of BFED's allowance for credit losses associated with the loans that were acquired as the loans were initially recorded at fair value.

Information about the acquired loan portfolio subject to purchased credit impaired accounting guidance (ASC 310-30) as of October 19, 2012 is, as follows:

(In thousands)	ASC 310-30 Loans
Contractually required principal and interest at acquisition	\$ 78,325
Contractual cash flows not expected to be collected (nonaccretable discount)	(25,853)
Expected cash flows at acquisition	52,472
Interest component of expected cash flows (accretable discount)	(8,998)
Fair value of acquired loans	\$ 43,474

The core deposit intangible asset recognized as part of the BFED merger is being amortized over its estimated useful life of approximately ten years utilizing an accelerated method. Other intangibles consist of leasehold intangible liabilities and customer list intangible assets, which are amortized over the estimated useful life using a straight-line method, and an accelerated method, respectively.

The goodwill, which is not amortized for book purposes, was assigned to the banking segment and is not deductible for tax purposes.

The fair value of savings and transaction deposit accounts acquired from BFED was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. The fair value of time deposits was estimated by discounting the contractual future cash flows using market rates offered for time deposits of similar remaining maturities. The fair value of borrowed funds was estimated by discounting the future cash flows using market rates for similar borrowings.

Direct merger, acquisition and integration costs of the BFED acquisition were expensed as incurred, and totaled \$5.6 million in 2013 and \$5.0 million during 2012.

**The Connecticut Bank and Trust Company**

On April 20, 2012, the Company acquired all of the outstanding common shares of The Connecticut Bank and Trust Company ( CBT ). CBT operated eight banking offices serving the Greater Hartford area and was merged with and into Berkshire Bank. This business combination is an extension of the Berkshire franchise and the goodwill recognized results from the expected synergies and earnings

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

accretion from this combination, including future cost savings related to CBT's operations. The combination was negotiated between the companies and was approved unanimously by their boards of directors.

CBT shareholders received 965 thousand shares of the Company common stock and \$9.0 million in cash. On the acquisition date, CBT had 3.6 million outstanding common shares. Through a cash/share election procedure, the Company paid \$8.25 per share for 30% of the outstanding common shares and for 70% of the outstanding shares, the Company exchanged its stock in a ratio of 0.381 shares of the Company's common stock for each share of CBT stock. The 965 thousand shares of Company common stock issued in this exchange were valued at \$22.80 per share based on the closing price of Berkshire posted on April 19, 2012 resulting in consideration paid of \$22 million. Berkshire paid \$0.2 million in cash consideration to settle all outstanding CBT options. The Company issued no new Berkshire options in connection with the merger.

As part of the acquisition, the Company repurchased and retired from the United States Department of Treasury ( Treasury ) each share of Fixed Rate Non-Cumulative Perpetual Preferred Stock, Series A, of CBT issued and outstanding for \$5.4 million and the outstanding warrant issued to the Treasury to purchase CBT common stock for \$0.8 million.

The results of CBT's operations will be included in our Consolidated Statement of Income from the date of acquisition.

The assets and liabilities in the CBT acquisition were recorded at their fair value based on management's best estimate using information available at the date of acquisition. Consideration paid, and fair values of CBT's assets acquired and liabilities assumed are summarized in the following tables:

Consideration Paid: (In thousands)	Amount
Berkshire Hills Bancorp common stock issued to CBT common stockholders	\$ 21,992
Cash consideration paid to CBT common shareholders	8,952
Repurchase of CBT's preferred stock warrant	6,290
Cash consideration paid for CBT employee stock options	150
Total consideration paid	\$ 37,384

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<b>Recognized amounts of identifiable assets acquired and (liabilities assumed), at fair value:</b>	<b>As Acquired</b>	<b>Fair Value Adjustment</b>	<b>As Recorded at Acquisition</b>
Cash and short term investments	\$ 10,567	\$	\$ 10,567
Investment securities	41,428	(46)(a)	41,382
Loans	215,773	(6,181)(b)	209,592
Premises and equipment	1,393		1,393
Core deposit intangibles		1,000(c)	1,000
Other intangibles		(238)(d)	(238)
Other assets	3,081	7,668(e)	10,749
Deposits	(209,707)	(428)(f)	(210,135)
Borrowings	(35,865)	(3,020)(g)	(38,885)
Other liabilities	(1,978)	(209)(h)	(2,187)
Total identifiable net assets	\$ 24,692	\$ (1,454)	\$ 23,238
Goodwill			\$ 14,146

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Explanation of Certain Fair Value Adjustments

- (a) The adjustment represents the write down of the book value of investments to their estimated fair value based on fair values on the date of acquisition.
- (b) The adjustment represents the write down of the book value of loans to their estimated fair value based on current interest rates and expected cash flows, which includes an estimate of expected loan loss inherent in the portfolio. Loans that met the criteria and are being accounted for in accordance with ASC 310-30 had a carrying amount of \$23.7 million. Non-impaired loans not accounted for under 310-30 had a carrying value of \$192.1 million.
- (c) The adjustment represents the value of the core deposit base assumed in the acquisition. The core deposit asset was recorded as an identifiable intangible asset and will be amortized over the average life of the deposit base.
- (d) Represents an intangible liability related to assumed leases, which was recorded as an identifiable intangible and will be amortized over the remaining life of the leases.
- (e) This amount primarily consists of adjustments in the net deferred tax assets resulting from the fair value adjustments related to the acquired assets and liabilities, identifiable intangibles, and other deferred tax items including recognition of a \$4.8 million deferred tax asset related to operating losses, which CBT had a full valuation allowance against.
- (f) The adjustment is necessary because the weighted average interest rate of deposits exceeded the cost of similar funding at the time of acquisition.
- (g) Adjusts borrowings to their estimated fair value calculated based on interest rates of similar borrowings available on the date of acquisition.
- (h) Adjusts the book value of other liabilities to their estimated fair value at the acquisition date.

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The method to determine the fair value of the loans acquired from CBT was consistent with the method used in the BFED acquisition. Accordingly, there was no carryover of CBT's allowance for credit losses associated with the loans that were acquired as the loans were initially recorded at fair value.

Information about the acquired loan portfolio subject to purchased credit impaired accounting guidance (ASC 310-30) as of April 20, 2012 is, as follows (in thousands):

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	ASC 310-30 Loans
Contractually required principal and interest at acquisition	\$ 23,726
Contractual cash flows not expected to be collected (nonaccretable discount)	(5,563)
Expected cash flows at acquisition	18,163
Interest component of expected cash flows (accretable discount)	(2,816)
Fair value of acquired loans	\$ 15,347

The core deposit intangible asset recognized as part of the CBT merger is being amortized over its estimated useful life of approximately eight years utilizing an accelerated method. Other intangibles consist of leasehold intangible liabilities, which are amortized over the life of each respective lease using a straight-line method.

The goodwill, which is not amortized for book purposes, was assigned to the banking segment and is not deductible for tax purposes.

The fair value of savings and transaction deposit accounts acquired from CBT was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. The fair value of time deposits was estimated by discounting the contractual future cash flows using market rates offered for time deposits of similar remaining maturities. The fair value of borrowed funds was estimated by discounting the future cash flows using market rates for similar borrowings.

Direct merger, acquisition and integration costs of the CBT acquisition were expensed as incurred, and totaled \$0.5 million in 2013, \$4.7 million in 2012 and \$0.6 million in 2011.

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**Greenpark Mortgage Corporation**

On April 30, 2012, Berkshire Bank acquired the operations, and purchased certain assets and assumed certain limited liabilities of Greenpark Mortgage Corporation ( Greenpark ), as contemplated by the Asset Purchase Agreement dated February 2, 2012, by and between Berkshire Bank and Greenpark. The purchase of Greenpark's operations increases the Company's consumer lending capabilities, and expands the Company's geographical footprint into eastern Massachusetts along with broadening its sources of fee-based income.

The purchase price for Greenpark's operations was \$4.0 million. Additional consideration of \$0.1 million was paid for certain prepaid assets, and \$46.5 million was paid to retire outstanding bank loans that had financed recently originated loans along with \$2.8 million in premiums on those loans representing the sellers' income on those loans had they been sold prior to April 30, 2012. Additionally, a \$1.1 million liability was recorded for contingent consideration representing the fair value of earn-out payments to the sellers of Greenpark over a five year period of time after the purchase date. While the earn-out payments are based on production of loan originations, which can vary from year to year, management calculated an expected range of \$0.2 million to \$0.3 million in annual payments using the Black Scholes model to estimate the fair value of the contingent liability. Direct acquisition and integration costs of Greenpark's operations were expensed as incurred, and totaled \$0.6 million in 2012 and the Bank did not incur any costs in 2013.

The results of Greenpark's operations are included in the Consolidated Statements of Income from the date of acquisition.

The assets and liabilities in the Greenpark transaction were recorded at their fair value based on management's best estimate using information available at the date of purchase. The Greenpark transaction is an asset purchase for legal purposes, which limits the Company's exposure to the assumption of liabilities as defined in the purchase agreement, and to any potential unknown liabilities that result from operations that occur subsequent to the purchase date. The transaction is also considered an asset purchase for tax purposes, which results in a step-up in tax basis of assets acquired and liabilities assumed along with tax deductible goodwill. For book purposes, the Company will account for the transaction as a business combination in accordance with applicable accounting guidance, as it represents an acquisition of a business with a distinct set of inputs and processes to produce outputs.

The goodwill, representing the excess of consideration paid over the net fair value of assets and liabilities acquired, is not amortized for book purposes, and is assigned to our banking segment.

Consideration paid, and fair values of Greenpark's assets acquired and liabilities assumed are summarized in the following tables:

Consideration Paid: (In thousands)	Amount
Cash purchase price	\$ 4,000
Cash paid for certain prepaid assets	58
Payoff of Greenpark's lines of credit	46,496

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Premiums paid for loans and loan commitments		2,770
Contingent purchase price		1,087
Total consideration paid	\$	54,411

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Recognized amounts of identifiable assets acquired and (liabilities assumed), at fair value:**

	<b>Amount</b>
Loans held for sale	\$ 48,408(a)
Other assets	2,621(b)
Premises and equipment	98(c)
Other Liabilities	(862)(d)
Total identifiable net assets	\$ 50,265
Goodwill	\$ 4,145

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Explanation of Certain Fair Values

- (a) Includes a portion of the cash consideration paid for premiums as described above, which adjusts the loans to fair value.
- (b) Represents the fair value of the acquired derivative associated with commitments to originate loans at a specified locked-rate ( interest rate lock commitments ).
- (c) Represents the fair value of certain acquired office equipment.
- (d) Consists of forward contracts acquired at fair value, which serves to hedge the movements in fair value of the interest rate lock commitments.

**Financial Information**

The following table discloses unaudited pro forma supplemental information from the combined results of operations of 2012 and 2011 assuming the acquisitions of BFED, CBT, and Greenpark had been completed as of January 1, 2011:

	<b>Pro Forma (unaudited)</b>			
	<b>Twelve months ended December 31,</b>		<b>2011</b>	
	<b>2012</b>		<b>2011</b>	
Net interest income	\$ 157,343	\$	146,682	
Non-interest income	67,437		64,170	
Net income from continuing operations	33,442		21,251	
<b>Pro forma earnings per share from continuing operations:</b>				
Basic	\$ 1.36	\$	0.99	
Diluted	\$ 1.35	\$	0.98	

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The unaudited pro forma supplemental information combines the historical results of Berkshire, BFED, CBT, and management's estimate of the results of Greenpark's operations under the Company's management. The unaudited pro forma information includes adjustments for scheduled amortization and accretion of fair value adjustments recorded at the time of the merger. These adjustments would have been different if they had been recorded on January 1, 2011, and they do not include the impact of prepayments. The unaudited pro forma information is also adjusted for the impacts of the actual merger financing on revenue and expense. The pro forma income does not indicate what would have occurred had the acquisitions taken place on January 1, 2011 and does not indicate expected future results. No adjustments were made to eliminate BFED and CBT's credit losses that may not have been necessary had the acquired loans been recorded at fair value as of the beginning of 2011. Adjustments were also not made to reflect any changes to the asset and liability positions in the balance sheets of the acquired companies during 2011 or 2012 that may have resulted in changes to net interest income had the acquisitions occurred as of beginning of 2011. Additionally, operating cost savings and other business synergies expected as a result of the acquisition are not reflected in the pro forma amounts. Non-

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

recurring expenses and income related to the acquisitions including professional fees, system conversion and integration costs, and the gains recorded in connection with the acquisitions are excluded in the 2012 and 2011 periods in which the amounts were recognized. In 2012 non-recurring expenses excluded from the unaudited pro forma supplemental information were \$6.7 million, \$5.2 million, and \$555 thousand for BFED, CBT, and Greenpark, respectively. Also excluded during 2012, was a \$1.1 million non-recurring gain on BFED stock that was held by the Company at the time of acquisition. In 2011 non-recurring expenses excluded from the unaudited pro forma supplemental information were \$910 thousand for CBT and none for BFED and Greenpark. Furthermore, the unaudited pro forma supplemental information is adjusted for income tax expense related to the pre-tax adjustments.

The Company has determined that it is impractical to report the amounts of revenue and earnings of the acquired entities since the acquisition dates. Due to the integration of their operations with those of the Company, the Company does not record revenue and earnings separately for these operations. The revenue and earnings of these operations are included in the consolidated statement of income.

**NOTE 3. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents include cash on hand, amounts due from banks, and short-term investments with original maturities of three months or less. Short-term investments included \$1.8 million and \$5.8 million pledged as collateral support for derivative financial contracts at year-end 2013 and 2012, respectively. The Federal Reserve Bank requires the Bank to maintain certain reserve requirements of vault cash and/or deposits. The reserve requirement, included in cash and equivalents, was \$17.2 million and \$11.3 million at year-end 2013 and 2012, respectively.

**NOTE 4. TRADING SECURITY**

The Company holds a tax advantaged economic development bond that is being accounted for at fair value. The security had an amortized cost of \$13.1 million and \$13.6 million and a fair value of \$14.8 million and \$16.9 million at year-end 2013 and 2012, respectively. Unrealized (losses) gains recorded through income on this security totaled (\$1.5) million, \$(15) thousand, and \$1.7 million for 2013, 2012, and 2011, respectively. As discussed further in Note 16 - Derivative Instruments and Hedging Activities, the Company has entered into a swap contract to swap-out the fixed rate of the security in exchange for a variable rate. The Company does not purchase securities with the intent of selling them in the near term, and there are no other securities in the trading portfolio at year-end 2013 and 2012.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 5. SECURITIES**

The following is a summary of securities available for sale ( AFS ) and securities held to maturity ( HTM ):

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>December 31, 2013</b>				
<b>Securities available for sale</b>				
<i>Debt securities:</i>				
Municipal bonds and obligations	\$ 77,852	\$ 1,789	\$ (1,970)	\$ 77,671
Government guaranteed residential mortgage-backed securities	78,885	544	(658)	78,771
Government-sponsored residential mortgage-backed securities	531,441	2,000	(10,783)	522,658
Corporate bonds	40,945	157	(1,822)	39,280
Trust preferred securities	16,927	1,249	(1,565)	16,611
Other bonds and obligations	3,250		(166)	3,084
Total debt securities	749,300	5,739	(16,964)	738,075
Marketable equity securities	20,042	2,266	(335)	21,973
<b>Total securities available for sale</b>	<b>769,342</b>	<b>8,005</b>	<b>(17,299)</b>	<b>760,048</b>
<b>Securities held to maturity</b>				
Municipal bonds and obligations	4,244			4,244
Government-sponsored residential mortgage-backed securities	73	2		75
Tax advantaged economic development bonds	40,260	1,255	(414)	41,101
Other bonds and obligations	344			344
<b>Total securities held to maturity</b>	<b>44,921</b>	<b>1,257</b>	<b>(414)</b>	<b>45,764</b>
<b>Total</b>	<b>\$ 814,263</b>	<b>\$ 9,262</b>	<b>\$ (17,713)</b>	<b>\$ 805,812</b>
<b>December 31, 2012</b>				
<b>Securities available for sale</b>				
<i>Debt securities:</i>				
Municipal bonds and obligations	\$ 79,498	\$ 5,359	\$ (100)	\$ 84,757
Government guaranteed residential mortgage-backed securities	42,305	805	(18)	43,092
Government-sponsored residential mortgage-backed securities	275,940	2,732	(79)	278,593
Corporate bonds	9,998	117	(108)	10,007
Trust preferred securities	21,784	1,089	(1,916)	20,957
Other bonds and obligations	3,459	17	(4)	3,472
Total debt securities	432,984	10,119	(2,225)	440,878
Marketable equity securities	22,467	3,187	(363)	25,291
<b>Total securities available for sale</b>	<b>455,451</b>	<b>13,306</b>	<b>(2,588)</b>	<b>466,169</b>

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**Securities held to maturity**

Municipal bonds and obligations	8,295			8,295
Government-sponsored residential mortgage-backed securities	76	7		83
Tax advantaged economic development bonds	41,678	1,837	(378)	43,137
Other bonds and obligations	975			975
<b>Total securities held to maturity</b>	<b>51,024</b>	<b>1,844</b>	<b>(378)</b>	<b>52,490</b>
<b>Total</b>	<b>\$ 506,475</b>	<b>\$ 15,150</b>	<b>\$ (2,966)</b>	<b>\$ 518,659</b>

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At year-end 2013 and 2012, accumulated net unrealized (losses)/gains on AFS securities included in accumulated other comprehensive income were \$(9.3) million and \$10.7 million, respectively. The year-end 2013 and 2012 related income tax (benefit)/liability of \$(3.5) million and \$4.0 million, respectively, was also included in accumulated other comprehensive income.

The amortized cost and estimated fair value of AFS and HTM securities by contractual maturity at year-end 2013 are presented below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations. Mortgage-backed securities are shown in total, as their maturities are highly variable. Equity securities have no maturity and are also shown in total.

(In thousands)	Available for sale		Held to maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within 1 year	\$ 3,000	\$ 3,020	\$ 1,128	\$ 1,128
Over 1 year to 5 years	7,280	7,421	3,313	3,356
Over 5 years to 10 years	54,189	52,613	27,069	27,741
Over 10 years	74,505	73,592	13,338	13,464
Total bonds and obligations	138,974	136,646	44,848	45,689
Marketable equity securities	20,042	21,973		
Residential mortgage-backed securities	610,326	601,429	73	75
<b>Total</b>	<b>\$ 769,342</b>	<b>\$ 760,048</b>	<b>\$ 44,921</b>	<b>\$ 45,764</b>

At year-end 2013 and 2012, the Company had pledged securities as collateral for certain municipal deposits and for interest rate swaps with certain counterparties. The total amortized cost and fair values of these pledged securities follows. Additionally, there is a blanket lien on certain securities to collateralize borrowings from the FHLBB, as discussed further in Note 11 - Borrowed Funds.

(In thousands)	2013		2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities pledged to swap counterparties	\$ 26,227	\$ 26,442	\$ 35,970	\$ 36,709
Securities pledged for municipal deposits	44,777	44,438	66,192	66,759
<b>Total</b>	<b>\$ 71,004</b>	<b>\$ 70,880</b>	<b>\$ 102,162</b>	<b>\$ 103,468</b>

Proceeds from the sale of AFS securities in 2013, 2012, and 2011 were \$19.4 million, \$85.5 million, and \$9.5, respectively. The components of net realized gains and losses on the sale of AFS securities are as follows. These amounts were reclassified out of accumulated other comprehensive loss and into earnings:

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(In thousands)	2013		2012		2011	
Gross realized gains	\$	4,758	\$	820	\$	14
Gross realized losses				(520)		
Net realized gain/(losses)	\$	4,758	\$	300	\$	14

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Securities with unrealized losses, segregated by the duration of their continuous unrealized loss positions, are summarized as follows:

(In thousands)	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
<b>December 31, 2013</b>						
<b>Securities available for sale</b>						
<i>Debt securities:</i>						
Municipal bonds and obligations	\$ 1,657	\$ 17,776	\$ 313	\$ 1,854	\$ 1,970	\$ 19,630
Government guaranteed residential mortgage-backed securities	658	35,631			658	35,631
Government-sponsored residential mortgage-backed securities	10,783	423,203			10,783	423,203
Corporate bonds	1,822	29,124			1,822	29,124
Trust preferred securities			1,565	2,039	1,565	2,039
Other bonds and obligations	166	3,082			166	3,082
Total debt securities	15,086	508,816	1,878	3,893	16,964	512,709
Marketable equity securities	117	1,653	218	1,782	335	3,435
<b>Total securities available for sale</b>	<b>\$ 15,203</b>	<b>\$ 510,469</b>	<b>\$ 2,096</b>	<b>\$ 5,675</b>	<b>\$ 17,299</b>	<b>\$ 516,144</b>
<b>Securities held to maturity</b>						
Tax advantaged economic development bonds	57	9,429	357	7,901	414	17,330
<b>Total securities held to maturity</b>	<b>57</b>	<b>9,429</b>	<b>357</b>	<b>7,901</b>	<b>414</b>	<b>17,330</b>
<b>Total</b>	<b>\$ 15,260</b>	<b>\$ 519,898</b>	<b>\$ 2,453</b>	<b>\$ 13,576</b>	<b>\$ 17,713</b>	<b>\$ 533,474</b>
<b>December 31, 2012</b>						
<b>Securities available for sale</b>						
<i>Debt securities:</i>						
Municipal bonds and obligations	\$ 100	\$ 4,140	\$	\$	\$ 100	\$ 4,140
Government guaranteed residential mortgage-backed securities	18	5,108			18	5,108
Government-sponsored residential mortgage-backed securities	69	31,433	10	5,366	79	36,799
Corporate bonds			108	6,892	108	6,892
Trust preferred securities	1	2,754	1,915	1,686	1,916	4,440
Other bonds and obligations	4	2,055			4	2,055
Total debt securities	192	45,490	2,033	13,944	2,225	59,434
Marketable equity securities	90	1,410	273	1,727	363	3,137
	<b>\$ 282</b>	<b>\$ 46,900</b>	<b>\$ 2,306</b>	<b>\$ 15,671</b>	<b>\$ 2,588</b>	<b>\$ 62,571</b>



**Total securities available for sale**

**Securities held to maturity**

Tax advantaged economic development bonds	378	8,129	378	8,129
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<b>Total securities held to maturity</b>	378	8,129	378	8,129
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<b>Total</b>	\$	660	\$	55,029	\$	2,306	\$	15,671	\$	2,966	\$	70,700
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*Debt Securities*

The Company expects to recover its amortized cost basis on all debt securities in its AFS and HTM portfolios. Furthermore, the Company does not intend to sell nor does it anticipate that it will be required to sell any of its securities in an unrealized loss position as of December 31, 2013, prior to this recovery. The Company undertook a comprehensive review of its investment portfolio after the final rulemaking of Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act Volcker Rule was released and determines that there were four securities that would be considered covered funds under the rule. However, subsequent to the rule being released the agencies released a list of securities that were exempted from the Volcker Rule. All four securities were on that list. Being that the Company is not required to sell said securities and anticipates full recovery of its investment, it is more likely than not that the Company will hold these securities to recovery of principal amounts. The Company's intent not to sell and assertion that it will not be required to sell these securities until recovery is supported by the Company's strong capital and liquidity positions as well as its historical low portfolio sales. The following summarizes, by investment security type, the basis for the conclusion that the debt securities in an unrealized loss position within the Company's portfolio were not other-than-temporarily impaired at year-end 2013:

AFS municipal bonds and obligations

At year-end 2013, 32 of the 132 securities in the Company's portfolio of AFS municipal bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 9% of the amortized cost of securities in unrealized loss positions. The Company continually monitors the municipal bond sector of the market carefully and periodically evaluates the appropriate level of exposure to have to the market. At this time, the Company feels that the bonds in this portfolio carry minimal risk of default and that the Company is appropriately compensated for that risk. There were no material underlying credit downgrades during 2013 and all bonds were investment grade rated. All securities are performing.

AFS residential mortgage-backed securities

At year-end 2013, 87 out of a total of 216 securities in the Company's portfolio of AFS residential mortgage-backed securities were in unrealized loss positions. Aggregate unrealized losses represented 2.4% of the amortized cost of securities in unrealized loss positions. The Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Government National Mortgage Association (GNMA) guarantees the contractual cash flows of the Company's AFS residential mortgage-backed securities. The securities are investment grade rated and there were no material underlying credit downgrades during 2013. All securities are performing.

AFS corporate bonds

At year-end 2013, 6 out of 9 securities in the Company's portfolio of AFS corporate bonds were in an unrealized loss position. The aggregate unrealized loss represents 6% of the amortized cost of bonds in unrealized loss positions. The bonds are investment grade rated, and there were

no material underlying credit downgrades during 2013. The bonds are performing.

AFS trust preferred securities

At year-end 2013, 2 out of 6 securities in the Company's portfolio of AFS trust preferred securities were in unrealized loss positions. Aggregate unrealized losses represented 43% of the amortized cost of

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securities in unrealized loss positions. The Company's evaluation of the present value of expected cash flows on these securities supports its conclusions about the recoverability of the securities' amortized cost basis. Except for the security discussed below, the aggregate unrealized loss on the other securities in unrealized loss positions represented 7% of their amortized cost. Again, excluding the security below, all trust preferred securities are carried at least one investment grade, had no material downgrades in 2013 and all are performing.

At year-end 2013, \$1.4 million of the total unrealized losses was attributable to a \$2.6 million investment in a Mezzanine Class B tranche of a \$360 million pooled trust preferred security issued by banking and insurance entities. The Company evaluated the security, with a Level 3 fair value of \$1.2 million, for potential other-than-temporary impairment ( OTTI ) at December 31, 2013 and determined that OTTI was not evident based on both the Company's intent not to sell and assertion that it will not be required to sell the security until the recovery of its remaining amortized cost and the protection from credit loss afforded by \$44 million in excess subordination above current and projected losses. The security is performing.

HTM tax advantaged economic development bonds

At year-end 2013, 2 of the 8 securities in the Company's portfolio of tax advantaged economic development bonds were in an unrealized loss position. Aggregate unrealized losses represented 2% of the amortized cost of securities in unrealized loss positions. The Company has the intent of maintaining these positions to the recovery of these securities. All securities are considered performing.

AFS other bonds and obligations

At year-end 2013, 6 of the 8 securities in the Company's portfolio of other bonds and obligations were in unrealized loss positions. Aggregate unrealized losses represented 5% of the amortized cost of securities in unrealized loss positions. The securities are investment grade rated, except one security with a book value of less than \$1,000, and there were no material underlying credit downgrades during 2013. All securities are performing.

***Marketable Equity Securities***

In evaluating its marketable equity securities portfolio for OTTI, the Company considers its more likely than not ability to hold an equity security to recovery of its cost basis in addition to various other factors, including the length of time and the extent to which the fair value has been less than cost and the financial condition and near term prospects of the issuer. Any OTTI is recognized immediately through earnings.

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At year-end 2013, 3 out of a total of 20 securities in the Company's portfolio of marketable equity securities were in an unrealized loss position. The unrealized loss represented 9% of the amortized cost of the securities. The Company has the intent and ability to hold the securities until a recovery of their cost basis and does not consider the securities other-than-temporarily impaired at year-end 2013. As new information becomes available in future periods, changes to the Company's assumptions may be warranted and could lead to a different conclusion.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 6. LOANS**

The Company's loan portfolio is segregated into the following segments: residential mortgage, commercial mortgage, commercial business, and consumer. Residential mortgage loans include classes for 1-4 family owner occupied and construction loans. Commercial mortgage loans include construction, single and multi-family, and commercial real estate classes. Commercial business loans include asset based lending loans, lease financing and other commercial business loan classes. Consumer loans include home equity, direct and indirect auto and other. These portfolio segments each have unique risk characteristics that are considered when determining the appropriate level for the allowance for loan losses.

A substantial portion of the loan portfolio is secured by real estate in western Massachusetts, southern Vermont, northeastern New York, and in the Bank's New England lending areas. The ability of many of the Bank's borrowers to honor their contracts is dependent, among other things, on the specific economy and real estate markets of these areas.

Total loans include loans from business activities and loans acquired from business combinations. Loans from business combinations are those loans acquired from the acquisitions of Beacon, CBT, Legacy Bancorp, Inc., and Rome Bancorp, Inc.

Year-end loans consisted of the following:

(In thousands)	Business Activities	2013 Acquired Loans	Total	Business Activities	2012 Acquired Loans	Total
<b>Residential mortgages:</b>						
1-4 family	\$ 1,027,737	\$ 333,367	\$ 1,361,104	\$ 870,322	\$ 427,210	\$ 1,297,532
Construction	18,158	5,012	23,170	20,344	6,375	26,719
Total residential mortgages	1,045,895	338,379	1,384,274	890,666	433,585	1,324,251
<b>Commercial mortgages:</b>						
Construction	125,247	13,770	139,017	150,694	17,131	167,825
Single and multi-family	63,493	64,827	128,320	43,332	80,488	123,820
Commercial real estate	871,271	278,512	1,149,783	768,867	353,032	1,121,899
Total commercial mortgages	1,060,011	357,109	1,417,120	962,893	450,651	1,413,544
<b>Commercial business loans:</b>						
Asset based lending	294,241	3,130	297,371	255,265	2,830	258,095
Other commercial business loans	323,196	66,726	389,922	234,662	107,369	342,031
	617,437	69,856	687,293	489,927	110,199	600,126

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Total commercial business loans							
Total commercial loans	1,677,448	426,965	2,104,413	1,452,820	560,850	2,013,670	
Consumer loans:							
Home equity	232,677	74,154	306,831	205,892	119,509	325,401	
Auto and other	213,171	171,834	385,005	76,258	249,074	325,332	
Total consumer loans	445,848	245,988	691,836	282,150	368,583	650,733	
Total loans	\$ 3,169,191	\$ 1,011,332	\$ 4,180,523	\$ 2,625,636	\$ 1,363,018	\$ 3,988,654	

Total unamortized net costs and premiums included in the year-end total loans for historical loans were the following:

(In thousands)	2013		2012	
Unamortized net loan origination costs	\$	13,898	\$	6,552
Unamortized net premium on purchased loans		3,652		4,178
Total unamortized net costs and premiums	\$	17,550	\$	10,730

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company occasionally transfers a portion of its originated commercial loans to participating lending partners. The amounts transferred have been accounted for as sales and are therefore not included in the Company's accompanying consolidated balance sheets. The Company and its lending partners share ratably in any gains or losses that may result from a borrower's lack of compliance with contractual terms of the loan. The Company continues to service the loans, collects cash payments from the borrowers, remits payments (net of servicing fees), and disburses required escrow funds to relevant parties. At year-end 2013 and 2012, the Company was servicing loans for participants totaling \$84.7 million and \$76.8 million, respectively.

In 2013, the Company purchased loans aggregating \$178.6 million and sold loans aggregating \$932.5 million. In 2012, the Company purchased loans aggregating \$166.5 million and sold loans aggregating \$780 million. Net (losses) gains on sales of loans were (\$1) million, \$11.8 million, and \$257 thousand for the years 2013, 2012, and 2011, respectively.

Most of the Company's lending activity occurs within its primary markets in Western Massachusetts, Southern Vermont and Northeastern New York. Most of the loan portfolio is secured by real estate, including residential mortgages, commercial mortgages, and home equity loans. Year-end loans to operators of non-residential buildings totaled \$556.7 million, or 13.3%, and \$493.5 million, or 12.4% of total loans in 2013 and 2012, respectively. There were no other concentrations of loans related to any one industry in excess of 10% of total loans at year-end 2013 or 2012.

At year-end 2013, the Company had pledged loans totaling \$93 million to the Federal Reserve Bank of Boston as collateral for certain borrowing arrangements. Also, residential first mortgage loans are subject to a blanket lien for FHLBB advances. See Note 11- Borrowings & Subordinated Notes.

At year-end 2013 and 2012, the Company's commitments outstanding to related parties totaled \$2.8 million and \$18.5 million, respectively, and the loans outstanding against these commitments totaled \$1.2 million and \$10.0 million, respectively. Related parties include directors and executive officers of the Company and its subsidiaries and their respective affiliates in which they have a controlling interest, and immediate family members. For the years 2013 and 2012, all related party loans were performing.

The carrying amount of the acquired loans at December 31, 2013 totaled \$1.01 billion. These loans consisted of loans determined to be impaired at the time of acquisition, which are accounted for in accordance with ASC Topic 310-30, with a carrying amount of \$29.9 million and loans that were considered not impaired at the acquisition date with a carrying amount of \$0.98 billion.

The following table summarizes activity in the accretable yield for the acquired loan portfolio that falls under the purview of ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*.

(In thousands)	2013	2012
Balance at beginning of period	\$ 8,247	\$ 1,277



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Acquisitions			11,814
Sales	(301)		
Reclassification from nonaccretable difference for loans with improved cash flows	2,252		
Changes in expected cash flows that do not affect nonaccretable difference			
Accretion	(7,639)		(4,844)
Balance at end of period	\$ 2,559	\$ 8,247	

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of past due loans at December 31, 2013 and 2012:

Business Activities Loans (in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
<b>December 31, 2013</b>							
<b>Residential mortgages:</b>							
1-4 family	\$ 2,500	\$ 623	\$ 7,382	\$ 10,505	\$ 1,017,232	\$ 1,027,737	\$ 1,451
Construction			41	41	18,117	18,158	
Total	2,500	623	7,423	10,546	1,035,349	1,045,895	1,451
<b>Commercial mortgages:</b>							
Construction	174		3,176	3,350	121,897	125,247	
Single and multi-family	139	654	679	1,472	62,021	63,493	168
Commercial real estate	622	4,801	6,912	12,335	858,936	871,271	865
Total	935	5,455	10,767	17,157	1,042,854	1,060,011	1,033
<b>Commercial business loans</b>							
Asset based lending					294,241	294,241	
Other commercial business loans	1,136	386	1,477	2,999	320,197	323,196	42
Total	1,136	386	1,477	2,999	614,438	617,437	42
<b>Consumer loans:</b>							
Home equity	732	54	1,655	2,441	230,236	232,677	572
Auto and other	524	231	390	1,145	212,026	213,171	142
Total	1,256	285	2,045	3,586	442,262	445,848	714
<b>Total</b>	<b>\$ 5,827</b>	<b>\$ 6,749</b>	<b>\$ 21,712</b>	<b>\$ 34,288</b>	<b>\$ 3,134,903</b>	<b>\$ 3,169,191</b>	<b>\$ 3,240</b>

Business Activities Loans (in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
<b>December 31, 2012</b>							
<b>Residential mortgages:</b>							
1-4 family	\$ 4,105	\$ 1,291	\$ 8,061	\$ 13,457	\$ 856,865	\$ 870,322	\$ 1,563
Construction		210	48	258	20,086	20,344	48
Total	4,105	1,501	8,109	13,715	876,951	890,666	1,611
<b>Commercial mortgages:</b>							
Construction			4,668	4,668	146,026	150,694	
Single and multi-family	616		27	643	42,689	43,332	
Commercial real estate	1,183	1,727	8,231	11,141	757,726	768,867	1,195
Total	1,799	1,727	12,926	16,452	946,441	962,893	1,195
<b>Commercial business loans</b>							
Asset based lending					255,265	255,265	
Other commercial business loans	745	372	3,427	4,544	230,118	234,662	159
Total	745	372	3,427	4,544	485,383	489,927	159
<b>Consumer loans:</b>							
Home equity	828	300	1,856	2,984	202,908	205,892	424
Auto and other	546	55	248	849	75,409	76,258	69

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Total		1,374		355		2,104		3,833		278,317		282,150		493
<b>Total</b>	\$	8,023	\$	3,955	\$	26,566	\$	38,544	\$	2,587,092	\$	2,625,636	\$	3,458

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Acquired Loans (in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
<b>December 31, 2013</b>							
<b>Residential mortgages:</b>							
1-4 family	\$ 1,891	\$ 437	\$ 2,577	\$ 4,905	\$ 328,462	\$ 333,367	\$ 805
Construction	134	32	625	791	4,221	5,012	501
Total	2,025	469	3,202	5,696	332,683	338,379	1,306
<b>Commercial mortgages:</b>							
Construction			805	805	12,965	13,770	805
Single and multi-family	350	188	1,335	1,873	62,954	64,827	512
Commercial real estate	537	518	6,108	7,163	271,349	278,512	2,925
Total	887	706	8,248	9,841	347,268	357,109	4,242
<b>Commercial business loans:</b>							
Asset based lending					3,130	3,130	
Other commercial business loans	440	135	1,239	1,814	64,912	66,726	318
Total	440	135	1,239	1,814	68,042	69,856	318
<b>Consumer loans:</b>							
Home equity	425	545	636	1,606	72,548	74,154	35
Auto and other	2,606	641	1,641	4,888	166,946	171,834	82
Total	3,031	1,186	2,277	6,494	239,494	245,988	117
<b>Total</b>	<b>\$ 6,383</b>	<b>\$ 2,496</b>	<b>\$ 14,966</b>	<b>\$ 23,845</b>	<b>\$ 987,487</b>	<b>\$ 1,011,332</b>	<b>\$ 5,983</b>

Acquired Loans (in thousands)	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Total Loans	Past Due > 90 days and Accruing
<b>December 31, 2012</b>							
<b>Residential mortgages:</b>							
1-4 family	\$ 1,817	\$ 585	\$ 2,523	\$ 4,925	\$ 422,285	\$ 427,210	\$ 1,555
Construction					6,375	6,375	
Total	1,817	585	2,523	4,925	428,660	433,585	1,555
<b>Commercial mortgages:</b>							
Construction			1,056	1,056	16,075	17,131	1,056
Single and multi-family	194	1,328	746	2,268	78,220	80,488	746
Commercial real estate	1,532	2,024	11,062	14,618	338,414	353,032	10,176
Total	1,726	3,352	12,864	17,942	432,709	450,651	11,978
<b>Commercial business loans:</b>							
Asset based lending					2,830	2,830	

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Other commercial business loans	422	577	2,177	3,176	104,193	107,369	1,764
Total	422	577	2,177	3,176	107,023	110,199	1,764
<b>Consumer loans:</b>							
Home equity	1,689	169	89	1,947	117,562	119,509	52
Auto and other	2,624	365	271	3,260	245,814	249,074	171
Total	4,313	534	360	5,207	363,376	368,583	223
<b>Total</b>	\$ 8,278	\$ 5,048	\$ 17,924	\$ 31,250	\$ 1,331,768	\$ 1,363,018	\$ 15,520

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is summary information pertaining to non-accrual loans at year-end 2013 and 2012:

(In thousands)	2013			2012		
	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
<b>Residential mortgages:</b>						
1-4 family	\$ 5,931	\$ 1,772	\$ 7,703	\$ 6,498	\$ 968	\$ 7,466
Construction	41	123	164			
Total	5,972	1,895	7,867	6,498	968	7,466
<b>Commercial mortgages:</b>						
Construction	3,176		3,176	4,668		4,668
Single and multi-family	511	823	1,334	27		27
Other	6,047	3,183	9,230	7,036	886	7,922
Total	9,734	4,006	13,740	11,731	886	12,617
<b>Commercial business loans:</b>						
Asset based lending						
Other commercial business loans	1,434	921	2,355	3,268	413	3,681
Total	1,434	921	2,355	3,268	413	3,681
<b>Consumer loans:</b>						
Home equity	1,083	602	1,685	1,432	37	1,469
Auto and other	249	1,559	1,808	179	100	279
Total	1,332	2,161	3,493	1,611	137	1,748
<b>Total non-accrual loans</b>	<b>\$ 18,472</b>	<b>\$ 8,983</b>	<b>\$ 27,455</b>	<b>\$ 23,108</b>	<b>\$ 2,404</b>	<b>\$ 25,512</b>

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Loans evaluated for impairment as of December 31, 2013 and 2012 were as follows:

**Business Activities Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Total
2013					
<b>Loans receivable:</b>					
Balance at end of year					
Individually evaluated for impairment	\$ 6,237	\$ 22,429	\$ 1,380	\$ 515	\$ 30,561
Collectively evaluated	1,039,658	1,037,582	616,057	445,333	3,138,630
Total	\$ 1,045,895	\$ 1,060,011	\$ 617,437	\$ 445,848	\$ 3,169,191

**Business Activities Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Total
2012					
<b>Loans receivable:</b>					
Balance at end of year					
Individually evaluated for impairment	\$ 6,362	\$ 30,287	\$ 2,821	\$ 1,218	\$ 40,688
Collectively evaluated	884,304	932,606	487,106	280,932	2,584,948
Total	\$ 890,666	\$ 962,893	\$ 489,927	\$ 282,150	\$ 2,625,636

**Acquired Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Total
2013					
<b>Loans receivable:</b>					
Balance at end of year					
Individually evaluated for impairment	\$ 1,568	\$ 6,295	\$ 367	\$ 154	\$ 8,384
Collectively evaluated	336,811	350,814	69,489	245,834	1,002,948
Total	\$ 338,379	\$ 357,109	\$ 69,856	\$ 245,988	\$ 1,011,332

**Acquired Loans**

(In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Total
2012					
<b>Loans receivable:</b>					
Balance at end of year					
Individually evaluated for impairment	\$ 371	\$ 886	\$	\$	\$ 1,257
Collectively evaluated	433,214	449,765	110,199	368,583	1,361,761
Total	\$ 433,585	\$ 450,651	\$ 110,199	\$ 368,583	\$ 1,363,018

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following is a summary of impaired loans at year-end 2013 and 2012 and for the years then ended:

At December 31, 2013				
Business Activities Loans				
(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	
With no related allowance:				
Residential mortgages - 1-4 family	\$ 1,575	\$ 1,575	\$	
Commercial mortgages - construction	3,176	3,176		
Commercial mortgages - single and multifamily				
Commercial mortgages - real estate	5,587	5,587		
Other commercial business loans	8	8		
Consumer - home equity	50	50		
With an allowance recorded:				
Residential mortgages - 1-4 family	\$ 1,926	\$ 2,831	\$	905
Commercial mortgages - construction				
Commercial mortgages - single and multifamily				
Commercial mortgages - real estate	(66)	153		219
Other commercial business loans	514	569		55
Consumer - home equity	142	245		103
Total				
Residential mortgages	\$ 3,501	\$ 4,406	\$	905
Commercial mortgages	8,697	8,916		219
Commercial business	522	577		55
Consumer	192	295		103
Total impaired loans	\$ 12,912	\$ 14,194	\$	1,282

At December 31, 2013				
Acquired Loans				
(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance	
<b>With no related allowance:</b>				
Residential mortgages - 1-4 family	\$ 20	\$ 20	\$	
Commercial mortgages - real estate	1,462	1,462		
Commercial business loans	367	367		
<b>With an allowance recorded:</b>				
Residential mortgages - 1-4 family	958	1,188	230	
Commercial mortgages - real estate	1,954	2,442	488	
Consumer - home equity	114	153	39	
<b>Total</b>				
Residential mortgages	\$ 978	\$ 1,208	\$ 230	
Commercial mortgages	3,416	3,904	488	
Other commercial business loans	367	367		
Consumer - home equity	114	153	39	



<b>Total impaired loans</b>	\$	4,875	\$	5,632	\$	757
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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At December 31, 2012

## Business Activities Loans

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>With no related allowance:</b>			
Residential mortgages - 1-4 family	\$ 3,408	\$ 3,408	\$
Commercial mortgages - construction	2,730	2,730	
Commercial mortgages - single and multifamily			
Commercial mortgages - real estate	3,450	3,450	
Other commercial business loans	31	31	
Consumer - home equity	602	602	
<b>With an allowance recorded:</b>			
Residential mortgages - 1-4 family	\$ 1,056	\$ 1,343	\$ 287
Commercial mortgages - construction	1,584	1,938	354
Commercial mortgages - single and multifamily			
Commercial mortgages - real estate	2,019	3,109	1,090
Other commercial business loans	1,135	2,340	1,205
Consumer - home equity	209	482	273
<b>Total</b>			
Residential mortgages	\$ 4,464	\$ 4,751	\$ 287
Commercial mortgages	9,783	11,227	1,444
Commercial business	1,166	2,371	1,205
Consumer	811	1,084	273
<b>Total impaired loans</b>	<b>\$ 16,224</b>	<b>\$ 19,433</b>	<b>\$ 3,209</b>

At December 31, 2012

## Acquired Loans

(In thousands)	Recorded Investment	Unpaid Principal Balance	Related Allowance
<b>With no related allowance:</b>			
Residential mortgages - 1-4 family	\$ 215	\$ 215	\$
Commercial mortgages - real estate	886	886	
<b>With an allowance recorded:</b>			
Residential mortgages - 1-4 family	101	156	55
<b>Total</b>			
Residential mortgages	\$ 316	\$ 371	\$ 55
Commercial mortgages	886	886	
<b>Total impaired loans</b>	<b>\$ 1,202</b>	<b>\$ 1,257</b>	<b>\$ 55</b>

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Business Activities Loans (in thousands)	For the Year Ended December 31, 2013		For the Year Ended December 31, 2012	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
<b>With no related allowance:</b>				
Residential mortgages - 1-4 family	\$ 4,842	\$ 71	\$ 2,592	\$ 28
Commercial mortgages - construction	5,068	30	624	
Commercial mortgages - single and multifamily			210	10
Commercial mortgages - real estate	7,078	67	3,667	87
Commercial business loans	723	21	17	
Consumer-home equity	1,130	8	399	1
<b>With an allowance recorded:</b>				
Residential mortgages - 1-4 family	\$ 2,898	\$ 44	\$ 2,802	\$ 27
Residential mortgages - construction				
Commercial mortgages - construction			5,280	
Commercial mortgages - single and multifamily			75	
Commercial mortgages - real estate	153		2,683	22
Commercial business loans	794	3	619	7
Consumer-home equity	247	3	542	
<b>Total</b>				
Residential mortgages	\$ 7,740	\$ 115	\$ 5,394	\$ 55
Commercial mortgages	12,299	97	12,539	119
Commercial business loans	1,517	24	636	7
Consumer loans	1,377	11	941	1
<b>Total impaired loans</b>	<b>\$ 22,933</b>	<b>\$ 247</b>	<b>\$ 19,510</b>	<b>\$ 182</b>

Acquired Loans (in thousands)	For the Year Ended December 31, 2013		For the Year Ended December 31, 2012	
	Average Recorded Investment	Cash Basis Interest Income Recognized	Average Recorded Investment	Cash Basis Interest Income Recognized
<b>With no related allowance:</b>				
Residential mortgages - 1-4 family	\$ 750	\$	\$ 520	\$
Commercial mortgages - construction	1,933	32		
Commercial mortgages - real estate	386	6	497	24
Consumer-home equity			25	
<b>With an allowance recorded:</b>				
Residential mortgages - 1-4 family	\$ 1,195	\$ 23	\$ 52	\$ 2
Commercial mortgages - real estate	2,435	68		
Commercial business loans				
Consumer-home equity	153	2		
<b>Total</b>				
Residential mortgages	\$ 1,945	\$ 23	\$ 572	\$ 2
Commercial mortgages	4,368	100	497	24
Commercial business loans	386	6		
Consumer loans	153	2	25	
<b>Total impaired loans</b>	<b>\$ 6,852</b>	<b>\$ 131</b>	<b>\$ 1,094</b>	<b>\$ 26</b>

No additional funds are committed to be advanced in connection with impaired loans.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

***Troubled Debt Restructuring Loans***

The Company's loan portfolio also includes certain loans that have been modified in a Troubled Debt Restructuring (TDR), where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. TDRs are evaluated individually for impairment and may result in a specific allowance amount allocated to an individual loan.

The following tables include the recorded investment and number of modifications for modified loans identified during the years-ended December 31, 2013, 2012, and 2011 respectively. The table includes the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured. The modifications for the year-ended December 31, 2013 were attributable to interest rate concessions, debt consolidations and maturity date extensions. The modifications for the years ended December 31, 2012 and 2011 were attributable to maturity date extensions.

		Modifications by Class		
		For the twelve months ending December 31, 2013		
	Number of	Pre-Modification	Post-Modification	
	Modifications	Outstanding Recorded	Outstanding Recorded	
		Investment (In thousands)	Investment	
<b>Troubled Debt Restructurings</b>				
Residential- 1-4 Family	\$ 7	\$ 1,152	\$ 1,152	
Residential- Construction	1	320	320	
Commercial - Single and multifamily	2	2,366	2,406	
Commercial - Other	10	3,882	3,450	
Commercial business- Other	7	443	442	
	\$ 27	\$ 8,163	\$ 7,770	

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

		Modifications by Class	
		For the twelve months ending December 31, 2012	
	Number of Modifications	Pre-Modification Outstanding Recorded Investment (In thousands)	Post-Modification Outstanding Recorded Investment
<b>Troubled Debt Restructurings</b>			
Residential- 1-4 Family	\$ 3	\$ 468	\$ 467
Commercial - Single and multifamily	4	225	225
Commercial - Other	3	2,493	2,493
Commercial business- Other	3	1,308	1,308
Consumer- Auto and other	1	133	133
	\$ 14	\$ 4,627	\$ 4,626

		Modifications by Class	
		For the twelve months ending December 31, 2011	
	Number of Modifications	Pre-Modification Outstanding Recorded Investment (In thousands)	Post-Modification Outstanding Recorded Investment
<b>Troubled Debt Restructurings</b>			
Residential- 1-4 Family	1	\$ 607	\$ 607
Commercial - Other	1	726	176
	\$ 2	\$ 1,333	\$ 783

The following table discloses the recorded investment and number of modifications for TDRs within the last year where a concession has been made, that then defaulted in the current reporting period. For the twelve months ended December 31, 2012, there were no loans that were restructured within the last twelve months that have subsequently defaulted.

	Modifications that Subsequently Defaulted	
	For the twelve months ending December 31, 2013	
	Number of Contracts	Recorded Investment
<b>Troubled Debt Restructurings</b>		
Residential- 1-4 Family	1	\$ 201
Commercial - Single and multifamily	5	261
Commercial - Other	7	1,961
Commercial business- Other	1	55
	14	\$ 2,478

The following table presents the Company's TDR activity in 2013 and 2012:

(In thousands)	2013	2012
Balance at beginning of year	\$ 4,626	\$ 1,263
Principal payments	(118)	(142)
TDR status change (1)	(1,164)	(1,124)
Other reductions (2)	(292)	
Newly identified TDRs	7,770	4,629

Balance at end of year	\$	10,822	\$	4,626
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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(1) TDR Status change classification represents TDR loans with a specified interest rate equal to or greater than the rate that the Company was willing to accept at the time of the restructuring for a new loan with comparable risk and the loan was on current payment status and not impaired based on the terms specified by the restructuring agreement.

(2) Other Reductions classification consists of transfer to other real estate owned and charge-offs to loans.

The evaluation of certain loans individually for specific impairment includes loans that were previously classified as TDRs or continue to be classified as TDRs.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 7. LOAN LOSS ALLOWANCE**

Activity in the allowance for loan losses for 2013, 2012, and 2011 was as follows:

<b>Business Activities Loans (In thousands)</b>	<b>Residential mortgages</b>	<b>Commercial mortgages</b>	<b>Commercial business</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
2013						
Balance at beginning of year	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891
Charged-off loans	1,761	3,378	2,046	917		8,102
Recoveries on charged-off loans	398	540	121	270		1,329
Provision for loan losses	2,372	(2,320)	1,493	2,825	39	4,409
Balance at end of year	\$ 6,937	\$ 13,705	\$ 5,173	\$ 3,644	\$ 68	\$ 29,527
Individually evaluated for impairment	905	219	55	103		1,282
Collectively evaluated	6,032	13,486	5,118	3,541	68	28,245
Total	\$ 6,937	\$ 13,705	\$ 5,173	\$ 3,644	\$ 68	\$ 29,527

<b>Acquired Loans (In thousands)</b>	<b>Residential mortgages</b>	<b>Commercial mortgages</b>	<b>Commercial business</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
2013						
Balance at beginning of year	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317
Charged-off loans	636	1,748	771	1,580		4,735
Recoveries on charged-off loans	1	15	84	145		245
Provision for loan losses	751	3,682	1,188	1,356	(8)	6,969
Balance at end of year	\$ 625	\$ 2,339	\$ 597	\$ 235	\$	\$ 3,796
Individually evaluated for impairment	230	488		39		757
Collectively evaluated	395	1,851	597	196		3,039
Total	\$ 625	\$ 2,339	\$ 597	\$ 235	\$	\$ 3,796

<b>Business Activities Loans (In thousands)</b>	<b>Residential mortgages</b>	<b>Commercial mortgages</b>	<b>Commercial business</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
2012						
Balance at beginning of year	\$ 3,150	\$ 22,095	\$ 4,540	\$ 2,203	\$ (90)	\$ 31,898
Charged-off loans	2,604	4,229	697	1,537		9,067
Recoveries on charged-off loans	103	52	96	165		416
Provision for loan losses	5,279	945	1,666	635	119	8,644
Balance at end of year	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891
Individually evaluated for impairment	287	1,444	1,205	273		3,209
Collectively evaluated	5,641	17,419	4,400	1,193	29	682
Total	\$ 5,928	\$ 18,863	\$ 5,605	\$ 1,466	\$ 29	\$ 31,891

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Acquired Loans (In thousands)	Residential mortgages	Commercial mortgages	Commercial business	Consumer	Unallocated	Total
2012						
Balance at beginning of year	\$ 281	\$ 158	\$ 38	\$ 87	\$ (18)	\$ 546
Charged-off loans	43			340		383
Recoveries on charged-off loans				208		208
Provision for loan losses	271	232	58	359	26	946
Balance at end of year	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317
Individually evaluated for impairment	55					55
Collectively evaluated	454	390	96	314	8	1,262
Total	\$ 509	\$ 390	\$ 96	\$ 314	\$ 8	\$ 1,317

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

<b>Business Activities Loans (In thousands)</b>	<b>Residential mortgages</b>	<b>Commercial mortgages</b>	<b>Commercial business</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
2011						
Balance at beginning of year	\$ 3,077	\$ 19,461	\$ 6,038	\$ 2,099	\$ 1,223	\$ 31,898
Charged-off loans	1,322	4,047	1,443	884		7,696
Recoveries on charged-off loans	231	189	109	150		679
Provision for loan losses	1,164	6,492	(164)	838	(1,313)	7,017
Balance at end of year	\$ 3,150	\$ 22,095	\$ 4,540	\$ 2,203	\$ (90)	\$ 31,898
Individually evaluated for impairment	449	1,722	116	488		2,775
Collectively evaluated	2,701	20,373	4,424	1,715	(90)	29,123
Total	\$ 3,150	\$ 22,095	\$ 4,540	\$ 2,203	\$ (90)	\$ 31,898

<b>Acquired Loans (In thousands)</b>	<b>Residential mortgages</b>	<b>Commercial mortgages</b>	<b>Commercial business</b>	<b>Consumer</b>	<b>Unallocated</b>	<b>Total</b>
2011						
Balance at beginning of year	\$	\$	\$	\$	\$	\$
Charged-off loans						
Recoveries on charged-off loans						
Provision for loan losses	281	158	38	87	(18)	546
Balance at end of year	\$ 281	\$ 158	\$ 38	\$ 87	\$ (18)	\$ 546
Individually evaluated for impairment						
Collectively evaluated	281	158	38	87	(18)	546
Total	\$ 281	\$ 158	\$ 38	\$ 87	\$ (18)	\$ 546

**Credit Quality Information**

The Company monitors the credit quality of its portfolio by using internal risk ratings that are based on regulatory guidance. Loans that are given a Pass rating are not considered a problem credit. Loans that are classified as Special Mention loans are considered to have potential credit problems and are evaluated closely by management. Substandard and non-accruing loans are loans for which a definitive weakness has been identified and which may make full collection of contractual cash flows questionable. Doubtful loans are those with identified weaknesses that make full collection of contractual cash flows, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The Company assigns an internal risk rating at origination and reviews the rating annual, semiannually or quarterly depending on the risk rating. The rating is also reassessed at any point in time when management becomes aware of information that may affect the borrower's ability to fulfill their obligations.

The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Loans that are current within 59 days are rated Pass. Residential mortgages that are 60-89 days delinquent are rated Special Mention. Loans delinquent for 90 days or greater are rated Substandard and generally placed on non-accrual status. Home equity loans are risk rated based on the same rating system as the Company's residential mortgages.

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Ratings for other consumer loans, including auto loans, are based on a two rating system. Loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Other consumer loans are placed on non-accrual at such time as they become Non-performing.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Acquired Loans Credit Quality Analysis*

Upon acquiring a loan portfolio, our Internal Loan Review function undertakes the same process of assigning risk ratings as historical loans, which may differ from the risk rating policy of the predecessor company. Loans which are rated Substandard or lower according to the rating process outlined below are deemed to be credit impaired loans accounted for under ASC 310-30, regardless of whether they are classified as performing or non-performing.

The Bank utilizes an eleven grade internal loan rating system for each of its acquired commercial real estate, construction and commercial loans as outlined in the Credit Quality Information section of this Note. The Company risk rates its residential mortgages, including 1-4 family and residential construction loans, based on a three rating system: Pass, Special Mention and Substandard. Residential mortgages that are current within 59 days are rated Pass. Residential mortgages that are 60 – 89 days delinquent are rated Special Mention. Residential mortgages delinquent for 90 days or greater are rated Substandard. Home equity loans are risk rated based on the same rating system as the Company's residential mortgages. Other consumer loans are rated based on a two rating system. Other consumer loans that are current within 119 days are rated Performing while loans delinquent for 120 days or more are rated Non-performing. Non-performing other consumer loans are deemed to be credit impaired loans accounted for under ASC 310-30.

The Company subjects loans that do not meet the ASC 310-30 criteria to ASC 450-20 by collectively evaluating these loans for an allowance for loan loss. The Company applies a methodology similar to the methodology prescribed for originated loans, which includes the application of environmental factors to each category of loans. The methodology to collectively evaluate the acquired loans outside the scope of ASC 310-30 includes the application of a number of environmental factors that reflect management's best estimate of the level of incremental credit losses that might be recognized given current conditions. This is reviewed as part of the allowance for loan loss adequacy analysis. As the loan portfolio matures and environmental factors change, the loan portfolio will be reassessed each quarter to determine an appropriate reserve allowance.

A decrease in the expected cash flows in subsequent periods requires the establishment of an allowance for loan losses at that time for ASC 310-30 loans. At December 31, 2013, there had not been such a decrease and therefore there was no allowance for losses on acquired loans under Subtopic ASC 310-30.

The Company presented several tables within this footnote of business activity loans and acquired loans in order to distinguish the credit performance of the newly acquired loans.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the Company's loans by risk rating at year-end 2013 and 2012:

**Business Activities Loans****Residential Mortgages**

Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	2013	2012	2013	2012	2013	2012
Grade:						
Pass	\$ 1,019,732	\$ 860,970	\$ 18,117	\$ 20,085	\$ 1,037,849	\$ 881,055
Special mention	623	1,291		210	623	1,501
Substandard	7,382	8,061	41	49	7,423	8,110
Total	\$ 1,027,737	\$ 870,322	\$ 18,158	\$ 20,344	\$ 1,045,895	\$ 890,666

**Commercial Mortgages**

Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family		Real estate		Total commercial mortgages	
	2013	2012	2013	2012	2013	2012	2013	2012
Grade:								
Pass	\$ 120,071	\$ 142,946	\$ 59,636	\$ 40,690	\$ 800,672	\$ 707,867	\$ 980,379	\$ 891,503
Special mention			140	420	8,150	5,965	8,290	6,385
Substandard	5,176	7,748	3,717	2,222	61,807	54,930	70,700	64,900
Doubtful					642	105	642	105
Total	\$ 125,247	\$ 150,694	\$ 63,493	\$ 43,332	\$ 871,271	\$ 768,867	\$ 1,060,011	\$ 962,893

**Commercial Business Loans**

Credit Risk Profile by Creditworthiness Category

(In thousands)	Asset based lending		Other		Total commercial business	
	2013	2012	2013	2012	2013	2012
Grade:						
Pass	\$ 294,241	\$ 255,265	\$ 313,984	\$ 219,172	\$ 608,225	\$ 474,437

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Special mention			884		5,857		884		5,857
Substandard			7,725		9,541		7,725		9,541
Doubtful			603		92		603		92
Total	\$	294,241	\$	255,265	\$	323,196	\$	234,662	\$ 617,437 \$ 489,927

**Consumer Loans**

Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Auto and other		Total consumer	
	2013	2012	2013	2012	2013	2012
Performing	\$ 231,594	\$ 204,460	\$ 212,922	\$ 76,079	\$ 444,516	\$ 280,539
Nonperforming	1,083	1,432	249	179	1,332	1,611
Total	\$ 232,677	\$ 205,892	\$ 213,171	\$ 76,258	\$ 445,848	\$ 282,150

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Acquired Loans****Residential Mortgages**

Credit Risk Profile by Internally Assigned Grade

(In thousands)	1-4 family		Construction		Total residential mortgages	
	2013	2012	2013	2012	2013	2012
Grade:						
Pass	\$ 330,353	\$ 424,102	\$ 1,081	\$ 6,375	\$ 331,434	\$ 430,477
Special mention	437	585			437	585
Substandard	2,577	2,523	3,931		6,508	2,523
Total	\$ 333,367	\$ 427,210	\$ 5,012	\$ 6,375	\$ 338,379	\$ 433,585

**Commercial Mortgages**

Credit Risk Profile by Creditworthiness Category

(In thousands)	Construction		Single and multi-family		Real estate		Total commercial mortgages	
	2013	2012	2013	2012	2013	2012	2013	2012
Grade:								
Pass	\$ 7,154	\$ 10,142	\$ 46,961	\$ 57,305	\$ 254,787	\$ 318,809	\$ 308,902	\$ 386,256
Special mention		1,057	4,799	10,383	9,034	6,790	13,833	18,230
Substandard	6,616	5,932	13,067	12,800	14,691	27,433	34,374	46,165
Total	\$ 13,770	\$ 17,131	\$ 64,827	\$ 80,488	\$ 278,512	\$ 353,032	\$ 357,109	\$ 450,651

**Commercial Business Loans**

Credit Risk Profile by Creditworthiness Category

(In thousands)	Asset based lending		Other		Total commercial business	
	2013	2012	2013	2012	2013	2012
Grade:						
Pass	\$ 3,130	\$ 2,830	\$ 59,615	\$ 87,325	\$ 62,745	\$ 90,155
Special mention			2,396	7,444	2,396	7,444
Substandard			4,715	12,600	4,715	12,600
Total	\$ 3,130	\$ 2,830	\$ 66,726	\$ 107,369	\$ 69,856	\$ 110,199

**Consumer Loans**



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## Credit Risk Profile Based on Payment Activity

(In thousands)	Home equity		Auto and other		Total consumer	
	2013	2012	2013	2012	2013	2012
Performing	\$ 73,552	\$ 119,472	\$ 170,275	\$ 248,974	\$ 243,827	\$ 368,446
Nonperforming	602	37	1,559	100	2,161	137
Total	\$ 74,154	\$ 119,509	\$ 171,834	\$ 249,074	\$ 245,988	\$ 368,583

The following table summarizes information about total loans rated Special Mention or lower. The table below includes consumer loans that are special mention and substandard accruing that are classified in the above table as performing based on payment activity.

(In thousands)	December 31, 2013			December 31, 2012		
	Business Activities Loans	Acquired Loans	Total	Business Activities Loans	Acquired Loans	Total
Non-Accrual	\$ 18,472	\$ 8,983	\$ 27,455	\$ 23,108	\$ 2,405	\$ 25,513
Substandard Accruing	70,667	38,891	109,558	61,745	59,243	120,988
Total Classified	89,139	47,874	137,013	84,853	61,648	146,501
Special Mention	10,081	17,853	27,934	14,097	26,793	40,890
Total Criticized	\$ 99,220	\$ 65,727	\$ 164,947	\$ 98,950	\$ 88,441	\$ 187,391

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 8. PREMISES AND EQUIPMENT**

Year-end premises and equipment are summarized as follows:

(In thousands)	2013	2012	Estimated Useful Life
Land	\$ 10,177	\$ 10,377	N/A
Buildings and improvements	69,873	71,402	5 - 39 years
Furniture and equipment	24,865	20,955	3 - 7 years
Construction in process	4,336	2,590	
Premises and equipment, gross	109,251	105,324	
Accumulated depreciation and amortization	(24,792)	(18,863)	
Premises and equipment, net	\$ 84,459	\$ 86,461	

Depreciation and amortization expense for the years 2013, 2012, and 2011 amounted to \$7.1 million, \$6.0 million, and \$4.8 million, respectively.

**NOTE 9. GOODWILL AND OTHER INTANGIBLES**

Goodwill and other intangible assets are presented in the tables below. The Company completed three significant acquisitions during 2012. In accordance with applicable accounting guidance, we allocated the amount paid to the fair value of the net assets acquired, with any excess amounts recorded as goodwill. There were no acquisitions during 2013.

The increase in goodwill in 2013 and 2012 is as follows:

(In thousands)	2013	2012
Balance, beginning of the period	\$ 255,199	\$ 202,391
Goodwill acquired:		
Connecticut Bank & Trust		14,146
Greenpark Mortgage Corporation		4,145
Beacon Federal Bancorp, Inc. (1)	1,672	34,511
Other		6
Balance, end of the period	\$ 256,871	\$ 255,199

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(1) Goodwill related to the acquisition of Beacon was adjusted due to the subsequent recognition of certain identifiable liabilities that had not been recognized as part of the original accounting.

Year-end goodwill relates to the following reporting units:

(In thousands)	2013		2012	
Banking	\$	233,695	\$	232,023
Insurance		23,176		23,176
Total	\$	256,871	\$	255,199

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company tests goodwill impairment annually in the fourth quarter or more frequently if events or changes in circumstances indicate that impairment is possible. No impairment was recorded on goodwill for 2013 and 2012.

The components of other intangible assets are as follows:

(In thousands)	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
<b>December 31, 2013</b>			
Non-maturity deposits	\$ 31,503	\$ (22,106)	\$ 9,397
Insurance contracts	7,558	(5,320)	2,238
All other intangible assets	3,894	(1,738)	2,156
Total	\$ 42,955	\$ (29,164)	\$ 13,791
<b>December 31, 2012</b>			
Non-maturity deposits	\$ 31,503	\$ (18,164)	\$ 13,339
Insurance contracts	7,558	(4,539)	3,019
All other intangible assets	3,894	(1,193)	2,701
Total	\$ 42,955	\$ (23,896)	\$ 19,059

Other intangible assets are amortized on a straight-line or accelerated basis over their estimated lives, which range from eight to eleven years. Amortization expense related to intangible assets totaled \$5.3 million in 2013, \$5.3 million in 2012, and \$4.2 million in 2011.

The estimated aggregate future amortization expense for intangible assets remaining at year-end 2013 is as follows: 2014- \$4.5 million; 2015- \$3.1 million; 2016- \$2.4 million; 2017- \$1.4 million; 2018- \$1.1 million and thereafter- \$1.3 million.

For the years 2013, 2012, and 2011, no impairment charges were identified for the Company's intangible assets.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 10. OTHER ASSETS**

Year-end other assets are summarized as follows:

(In thousands)	2013	2012
Capitalized mortgage servicing rights	\$ 4,112	\$ 3,198
Accrued interest receivable	15,070	14,731
Investment in tax credits	5,771	8,159
Prepaid FDIC insurance	739	5,872
Accrued federal and state tax receivable	5,343	13,665
Derivative assets	8,318	19,668
Assets held for sale	3,969	
Other	10,687	10,012
Total other assets	\$ 54,009	\$ 75,305

The Bank has sold loans in the secondary market and has retained the servicing responsibility and receives fees for the services provided. Mortgage loans sold and serviced for others amounted to \$641.2 million, \$603.7 million, and \$486.6 million at year-end 2013, 2012, and 2011, respectively. Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The risks inherent in mortgage servicing assets relate primarily to changes in prepayments that result from shifts in mortgage interest rates. Contractually specified servicing fees were \$1.5 million, \$2.8 million, and \$1.2 million for the years 2013, 2012, and 2011, respectively, and included as a component of loan related fees within non-interest income. The significant assumptions used in the valuation at year-end 2013 included a weighted average discount rate of 10.3% and pre-payment speed assumptions ranging from 6.96% to 15.97%.

Mortgage servicing rights activity was as follows:

(In thousands)	2013	2012
Balance at beginning of year	\$ 3,198	\$ 3,067
Additions	1,056	1,482
Amortization	(915)	(755)
Allowance Adjustment	773	(596)
Balance at end of year	\$ 4,112	\$ 3,198

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 11. DEPOSITS**

A summary of year-end time deposits is as follows:

(In thousands)	2013		2012	
Maturity date:				
Within 1 year	\$	530,781	\$	654,729
Over 1 year to 2 years		282,370		272,141
Over 2 years to 3 years		104,550		127,225
Over 3 years to 4 years		48,052		72,069
Over 4 years to 5 years		27,884		35,379
Over 5 years		8,011		9,046
Total	\$	1,001,648	\$	1,170,589
Account balances:				
Less than \$100,000	\$	490,902	\$	548,895
\$100,000 or more		510,746		621,694
Total	\$	1,001,648	\$	1,170,589

**NOTE 12. BORROWED FUNDS**

Borrowed funds at December 31, 2013 and 2012 are summarized, as follows:

	2013		2012	
(in thousands, except rates)	Principal	Weighted Average Rate	Principal	Weighted Average Rate
<b>Short-term borrowings:</b>				
Advances from the FHLBB	\$ 862,510	0.22%	\$ 153,150	0.28%
Other Borrowings	10,000	1.92	10,000	1.96
Total short-term borrowings:	872,510	0.24	163,150	0.38
<b>Long-term borrowings:</b>				
Advances from the FHLBB	101,918	1.23	195,321	1.18
Subordinated notes	74,215	7.00	74,153	7.00
Junior subordinated notes	15,464	2.09	15,464	2.16
Total long-term borrowings:	191,597	3.53	284,938	2.76
Total	\$ 1,064,107	0.83%	\$ 448,088	1.89%

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Short-term debt includes Federal Home Loan Bank of Boston ( FHLBB ) advances with an original maturity of less than one year and a short-term line-of-credit drawdown through US Bank. The Bank also maintains a \$3.0 million secured line of credit with the FHLBB that bears a daily adjustable rate calculated by the FHLBB. There was no outstanding balance on the FHLBB line of credit for the period ended December 31, 2013 and December 31, 2012. The Company is in compliance with all debt covenants as of December 31, 2013.

The Bank is approved to borrow on a short-term basis from the Federal Reserve Bank of Boston as a non-member bank. The Bank has pledged certain loans and securities to the Federal Reserve Bank to support this arrangement. No borrowings with the Federal Reserve Bank of Boston took place for the period ended December 31, 2013 and December 31, 2012.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Long-term FHLBB advances consist of advances with an original maturity of more than one year. The advances outstanding at December 31, 2013 include callable advances totaling \$5.0 million, and amortizing advances totaling \$5.5 million. The advances outstanding at December 31, 2012 include callable advances totaling \$5.0 million, and amortizing advances totaling \$5.6 million. All FHLBB borrowings, including the line of credit, are secured by a blanket security agreement on certain qualified collateral, principally all residential first mortgage loans and certain securities.

A summary of maturities of FHLBB advances at year-end 2013 and 2012 is as follows:

(In thousands)	2013		2012	
	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Fixed rate advances maturing:				
2014	\$ 882,525	0.28%	\$ 186,448	0.32%
2015			20,280	3.04
2016	1,583	0.79		
2017	5,000	4.33	1,645	0.80
2018 and beyond	5,320	7.90	5,478	3.87
Total fixed rate advances	894,428	0.35	213,851	0.67
Variable rate advances maturing:				
2014	10,000	0.32	59,620	1.33
2015	20,000	0.30	10,000	0.39
2016	10,000	0.30	20,000	0.41
2017		0.00	10,000	0.41
2018 and beyond	30,000	0.30	35,000	0.97
Total variable rate advances	70,000	0.30	134,620	0.96
Total FHLBB advances	\$ 964,428	0.32%	\$ 348,471	0.78%

In September 2012, the Company issued fifteen year subordinated notes in the amount of \$75.0 million at a discount of 1.15%. The interest rate is fixed at 6.875% for the first ten years. After ten years, the notes become callable and convert to an interest rate of three month LIBOR plus 5.113%.

The Company holds 100% of the common stock of Berkshire Hills Capital Trust I ( Trust I ) which is included in other assets with a cost of \$0.5 million. The sole asset of Trust I is \$15.5 million of the Company's junior subordinated debentures due in 2035. These debentures bear interest at a variable rate equal to LIBOR plus 1.85% and had a rate of 2.09% and 2.16% at December 31, 2013 and December 31, 2012, respectively. The Company has the right to defer payments of interest for up to five years on the debentures at any time, or from time to time, with certain limitations, including a restriction on the payment of dividends to stockholders while such interest payments on the debentures have been deferred. The Company has not exercised this right to defer payments. The Company has the right to redeem the debentures at par value. Trust I is considered a variable interest entity for which the Company is not the primary beneficiary. Accordingly, Trust I is not consolidated into the Company's financial statements.





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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 13. OTHER LIABILITIES**

Year-end other liabilities are summarized as follows:

(In thousands)	2013	2012
Derivative liabilities	\$ 11,964	\$ 29,814
Capital lease obligation	12,457	12,641
Liabilities held for sale	24,834	
Other	32,846	38,592
Total other liabilities	\$ 82,101	\$ 81,047

**NOTE 14. EMPLOYEE BENEFIT PLANS**

The Company accounts for its pension and postretirement plans by recognizing in the financial statements an asset for a plan's overfunded status or a liability for a plan's underfunded status. The Company reports changes in the funded status of its pension and postretirement plan as a component of other comprehensive income, net of applicable taxes, in the year in which changes occur.

***Pension Plans***

The Company maintains a legacy employer sponsored defined benefit pension plan (the Plan) for which participation and benefit accruals were frozen in 2011. Accordingly, no employees are permitted to commence participation in the Plan and future salary increases and years of credited service are not considered when computing an employee's benefits under the Plan. As of December 31, 2013, all minimum Employee Retirement Income Security Act (ERISA) funding requirements have been met.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Information regarding the pension plan at December 31, 2013 and 2012 is as follows:

(In thousands)	2013	2012
Change in projected benefit obligation:		
Projected benefit obligation at beginning of year/acquisition date	\$ 6,363	\$ 6,040
Interest cost	250	273
Actuarial loss	(504)	498
Benefits paid	(356)	(353)
Settlements	(87)	(95)
Projected benefit obligation at end of year	5,666	6,363
Change in fair value of plan assets:		
Fair value of plan assets at plan beginning of year/acquisition date	4,595	4,456
Actual return on plan assets	883	396
Contributions by employer	485	191
Benefits paid	(356)	(353)
Settlements	(87)	(95)
Fair value of plan assets at end of year	5,520	4,595
Underfunded status	\$ 146	\$ 1,768
Amounts Recognized in Statement of Financial Position		
Other Liabilities	\$ (146)	\$ (1,768)

Net pension cost is comprised of the following for the year ended December 31, 2013 and 2012:

<b>(In thousands)</b>	<b>2013</b>		<b>2012</b>	
Interest Cost	\$	250	\$	273
Expected return on plan assets		(367)		(350)
Amortization of unrecognized actuarial loss		101		47
Net periodic pension costs	\$	(16)	\$	(30)

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Changes in plan assets and benefit obligations recognized in accumulated other comprehensive income during 2013 and 2012 are as follows:

(In thousands)	2013	2012
Amortization of actuarial loss	\$ (101)	\$ (47)
Actuarial (gain) loss	(1,019)	451
Total (gain) loss recognized in accumulated other comprehensive income	(1,120)	404
Total (gain) loss recognized in net periodic pension cost recognized and other comprehensive income	\$ (1,136)	\$ 374

The Company expects to make cash contributions of \$280 thousand to the pension trust during the 2013 fiscal year.

The Company does not expect to amortize any amount from other comprehensive income into net periodic pension cost over the next fiscal year.

The principal actuarial assumptions used at December 31, 2013 and 2012 were as follows:

	2013	2012
Projected benefit obligation		
Discount rate	4.950%	4.050%
Net periodic pension cost		
Discount rate	4.050%	4.660%
Long term rate of return on plan assets	8.000%	8.000%

The discount rate that is used in the measurement of the pension obligation is determined by comparing the expected future retirement payment cash flows of the pension plan to the Citigroup Above Median Pension Liability Index as of the measurement date. The expected long-term rate of return on Plan assets reflects long-term earnings expectations on existing Plan assets and those contributions expected to be received during the current plan year. In estimating that rate, appropriate consideration was given to historical returns earned by Plan assets in the fund and the rates of return expected to be available for reinvestment. The rates of return were adjusted to reflect current capital market assumptions and changes in investment allocations.

The Company's overall investment strategy with respect to the Plan's assets is primarily for preservation of capital and to provide regular dividend and interest payments. The Plan's targeted asset allocation is 65% equity securities and 35% fixed-income securities. Equity securities primarily include investments in large cap core, value, and growth stocks. The fixed income portion of the Plan assets is invested in one index fund which is an investment grade, intermediate term index. Equity securities are expected to earn a return in the range of 5% to 9% and fixed income securities are expected to earn a return in the range of 2% to 6%. The long-term inflation rate was estimated to be 3%. When these overall return expectations are applied to the Plan's target allocation, we expect a future rate of return of 7% to 11%.

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The fair values for investment securities are determined by quoted prices in active markets, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3).

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The fair values of the Plan's assets by asset category and level within the fair value hierarchy are as follows at December 31, 2013:

Asset Category (In thousands)	Total	Level 1	Level 2
Equity Mutual Funds:			
Large-Cap	\$ 1,515	\$ 1,515	\$
Small-Cap	792	792	
International	637	637	
Equity Trusts			
Large-Cap	1,015		1,015
Fixed Income Trusts	1,030		1,030
Fixed Income Mutual Funds	531	531	
Total	\$ 5,520	\$ 3,475	\$ 2,045

The fair values of the Plan's assets by asset category and level within the fair value hierarchy are as follows at December 31, 2012:

Asset Category (In thousands)	Total	Level 1	Level 2
Equity Mutual Funds:			
Large-Cap	\$ 754	\$ 754	\$
Small-Cap	570	570	
Equity Trusts	529	529	
Large-Cap			
International	1,102		1,102
Fixed Income Trusts	1,640		1,640
Total	\$ 4,595	\$ 1,853	\$ 2,742

The Plan did not hold any assets classified as Level 3 during 2013 or 2012.

Estimated benefit payments under our pension plans over the next ten years at December 31, 2013 are as follows:

Year	Payments (In thousands)
2014	\$ 386
2015	389
2016	381
2017	377
2018	368
2019 - 2023	1,968



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

***Postretirement Benefits***

The Company has an unfunded post-retirement medical plan which was assumed in connection with the Rome Bancorp acquisition in 2011. The postretirement plan has been modified so that participation is closed to those employees who did not meet the retirement eligibility requirements by March 31, 2011. The Company contributes partially to medical benefits and life insurance coverage for retirees. Such retirees and their surviving spouses are responsible for the remainder of the medical benefits, including increases in premiums levels, between the total premium and the Company's contribution. Information regarding the postretirement plan at December 31, 2013 and 2012 is as follows:

(In thousands)	2013	2012
<b>Change in accumulated post retirement benefit obligation:</b>		
Accumulated postretirement benefit obligation at beginning of year	\$ 1,184	\$ 1,083
Interest cost	37	44
Participant contributions	40	51
Actuarial loss	(187)	150
Benefits paid	(78)	(144)
Amendments		
Accumulated postretirement benefit obligation at end of year	\$ 996	\$ 1,184
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of year	\$	\$
Contributions by employer	38	93
Contributions by participant	40	51
Benefits paid	(78)	(144)
Fair value of plan assets at end of year	\$	\$
<b>Amounts Recognized in Statement of Financial Position</b>		
Other Liabilities	\$ (996)	\$ (1,184)

The postretirement benefit obligation recognized in accumulated other comprehensive income and the accrued liability for the years ended December 31, 2013 and 2012 are as follows:

(In thousands)	2013	2012
Amortization of actuarial loss	\$ 25	\$ (371)
Net actuarial (gain) loss	(187)	194
Total recognized in accumulated other comprehensive income	(162)	(177)
Accrued postretirement liability recognized	\$ 1,333	\$ (1,361)

The Company expects to contribute \$88 thousand to the postretirement benefit plan during the next fiscal year. This amount is equal to the expected benefit payments in this unfunded plan.



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The amount expected to be amortized from other comprehensive income into net periodic postretirement cost over the next fiscal year is \$33 thousand.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Discount rates of 4.00% and 3.25% respectively were utilized as of December 31, 2013 and December 31, 2012, to calculate the future postretirement obligation related to the medical plan. The assumed health care cost trend rate used in measuring the accumulated post-retirement benefit obligation is expected to be 7% for 2013, and is gradually expected to decrease to 5% by 2018. This assumption may have a significant effect on the amounts reported. However, as noted above, increases in premium levels are the financial responsibility of the plan beneficiary. Thus an increase or decrease in 1% of the health care cost trend rates utilized would have had an immaterial effect on the service and interest cost as well as the accumulated post-retirement benefit obligation for the postretirement plan as of December 31, 2013.

Estimated benefit payments under the postretirement benefit plan over the next ten years at December 31, 2013 are as follows:

Year	Payments (In thousands)
2014	\$ 88
2015	87
2016	85
2017	83
2018	82
2019 - 2023	372

**401(k) Plan**

The Company provides a 401(k) Plan in which most employees participate. The Company contributes a non-elective 3% of gross annual wages for each participant, regardless of the participant's deferral, in addition to a 100% match up to 4% of gross annual wages. The Company's contributions vest immediately. Expense related to the plan was \$2.9 million in 2013, \$2.5 million in 2012, and \$1.9 million in 2011.

**Employee Stock Ownership Plan ( ESOP )**

As part of the acquisition of Beacon during 2012, along with two acquisitions during 2011, the Company acquired ESOP plans that were frozen and terminated prior to the completion of those transactions. On the acquisition dates, all amounts in the plans were vested and the loans under the plans were repaid from the sale proceeds of unallocated shares.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 15. INCOME TAXES***Provision for Income Taxes*

The components of the Company's provision for income taxes for the years ended December 31, 2013, 2012, and 2011 were, as follows:

(In thousands)	2013	2012	2011
Current:			
Federal tax expense	\$ 5,124	\$ 2,298	\$ 2,113
State tax expense	2,171	1,278	572
Total current expense	7,295	3,576	2,685
Deferred:			
Federal tax expense	9,445	9,247	1,977
State tax expense	2,115	912	992
Total deferred tax expense	11,560	10,159	2,969
Decrease in valuation allowance	(1,751)	(136)	
Total income tax expense	\$ 17,104	\$ 13,599	\$ 5,654

*Effective Tax Rate*

The following is a reconciliation of the statutory federal income tax rate to the Company's effective tax rate for the years ended December 31, 2013, 2012, and 2011:

(In thousands, except rates)	2013 Amount	Rate	2012 Amount	Rate	2011 Amount	Rate
Statutory tax rate	\$ 20,387	35.0%	\$ 16,375	35.0%	\$ 8,051	35.0%
Increase (decrease) resulting from:						
State taxes, net of federal tax benefit	2,760	4.7	1,715	3.7	1,017	4.4
Tax exempt income - investments, net	(2,211)	(3.8)	(2,187)	(4.7)	(2,222)	(9.7)
Bank-owned life insurance	(631)	(1.1)	(950)	(2.0)	(804)	(3.5)
Disallowed merger costs			523	1.1	572	2.5
Gain on Rome and Legacy					(736)	(3.2)
Non-deductible goodwill on branch divestiture			419	0.9	1,622	7.1
Tax credits, net of basis reduction	(995)	(1.7)	(1,148)	(2.5)	(1,688)	(7.3)
Reduction in valuation allowance	(1,712)	(2.9)	(428)	(0.9)		
Other, net	(494)	(0.9)	(720)	(1.5)	(158)	(0.7)

Effective tax rate	\$	17,104	29.3%	\$	13,599	29.1%	\$	5,654	24.6%
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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Deferred Tax Liabilities and Assets*

As of December 31, 2013 and 2012, significant components of the Company's deferred tax assets and liabilities were, as follows:

(In thousands)	2013		2012	
Deferred tax assets:				
Allowance for loan losses	\$	14,391	\$	16,971
Tax credit carryforwards		9,867		8,537
Net unrealized loss on swaps and securities available for sale in OCI		5,740		2,549
Employee benefit plans		5,331		5,201
Purchase accounting adjustments		18,350		27,900
Net operating loss and capital loss carryforwards		6,806		9,216
Other		3,181		3,554
Deferred tax assets, net before valuation allowances		63,666		73,928
Valuation allowance		(998)		(2,749)
Deferred tax assets, net of valuation allowances	\$	62,668	\$	71,179
Deferred tax liabilities:				
Investments	\$	(896)	\$	(1,174)
Bonus depreciation on premises and equipment		(2,836)		(3,172)
Intangible amortization		(8,225)		(9,104)
Deferred tax liabilities	\$	(11,957)	\$	(13,450)
Deferred tax assets, net	\$	50,711	\$	57,729

Deferred tax assets, net of valuation allowances, are expected to be realized through the reversal of existing taxable temporary differences and future taxable income.

*Valuation Allowances*

The components of the Company's valuation allowance on its deferred tax asset, net as of December 31, 2013 and 2012 were, as follows:

(in thousands)	2013		2012	
State net operating loss carry-forward, net of Federal tax benefit	\$	762	\$	745
State tax basis difference, net of Federal tax benefit		236		292
Federal capital loss carry-forward				1,712
Valuation allowances	\$	998	\$	2,749

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The state net operating loss carry-forward, net of Federal tax benefit was originally recorded in 2012 in connection with the Connecticut Bank and Trust Company acquisition. That valuation allowance is based on management's assessment that is it more likely than not that the Company will not be able to utilize the net operating loss carry-forwards to offset future taxable earnings in the state of Connecticut.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The state tax basis difference, net of Federal tax benefit was also originally recorded in 2012, due to management's assessment that it is more likely than not that certain deferred tax assets recorded for the difference between the book basis and the state tax basis in certain tax credit limited partnership investments (LPs) will not be realized. The decrease in the 2013 balance is due to the sale of two of the Company's tax credit LPs during 2013. Management anticipates that the remaining excess state tax basis will be realized as a capital loss upon disposition, and that it is unlikely that the Company will have capital gains against which to offset such capital losses.

The Federal capital loss carry-forward was originally recorded in connection with the Company's acquisition of Legacy Bancorp, Inc. during 2011. The release is due to having more realized and expected capital gains against which to offset the capital loss carry-forward during 2013 than was anticipated at the time of the acquisition. The reduction in the valuation allowance was recorded in accordance with the applicable guidance for income taxes as a decrease to the provision for income taxes.

The valuation allowances as of December 31, 2013 are subject to change in the future as the Company continues to periodically assess the likelihood of realizing its deferred tax assets.

***Tax Attributes***

At December 31, 2013, the Company had net operating loss carryforwards of \$19.2 million that expire beginning in 2031, capital loss carryforwards of \$0.3 million that expire beginning in 2016, general business tax credit carryforwards of \$7.0 million that expire beginning in 2027, and alternative minimum tax credit carryforwards of \$2.9 million that do not expire.

***Unrecognized Tax Benefits***

On a periodic basis, the Company evaluates its income tax positions based on tax laws and regulations and financial reporting considerations, and records adjustments as appropriate. This evaluation takes into consideration the status of taxing authorities' current examinations of the Company's tax returns, recent positions taken by the taxing authorities on similar transactions, if any, and the overall tax environment in relation to uncertain tax positions.

The following table presents changes in unrecognized tax benefits for the years ended December 31, 2013, 2012, and 2011:

(In thousands)	2013	2012	2011
Unrecognized tax benefits at January 1	\$ 492	\$ 774	\$

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Increase in gross amounts of tax positions related to prior years	321	173	774
Decrease in gross amounts of tax positions related to prior years	(150)	(140)	
Decrease due to settlement with taxing authority	(186)	(240)	
Increase in gross amounts of tax positions related to current year		50	
Decrease due to lapse in statute of limitations		(125)	
Unrecognized tax benefits at December 31	\$ 477	\$ 492	\$ 774

The Company does not expect any significant changes to its unrecognized tax benefits during the next twelve months.

As of December 31, 2013, the Company had \$477 thousand of unrecognized federal and state tax benefits that would impact the effective tax rate if recognized. The Company classifies interest and penalties, if any, related to the liability for unrecognized tax benefits as a component of the provision for income taxes. Accruals for interest and penalties were not material in 2013 and 2012.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's income tax returns, including the tax histories acquired through business combinations, remain subject to examination by the Federal Internal Revenue Service and the tax authorities of Massachusetts, New York, and Connecticut for tax years from 2010 forward.

**NOTE 16. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

At year-end 2013, the Company held derivatives with a total notional amount of \$905.1 million. That amount included \$425 million in interest rate swap derivatives that were designated as cash flow hedges for accounting purposes. The Company also had economic hedges and non-hedging derivatives totaling \$459.9 million and \$20.2 million, respectively, which are not designated as accounting hedges. Economic hedges included interest rate swaps totaling \$427 million, and \$33 million in forward commitment contracts.

As part of the Company's risk management strategy, the Company enters into interest rate swap agreements to mitigate the interest rate risk inherent in certain of the Company's assets and liabilities. Interest rate swap agreements involve the risk of dealing with both Bank customers and institutional derivative counterparties and their ability to meet contractual terms. The agreements are entered into with counterparties that meet established credit standards and contain master netting and collateral provisions protecting the at-risk party. The derivatives program is overseen by the Risk Management Committee of the Company's Board of Directors. Based on adherence to the Company's credit standards and the presence of the netting and collateral provisions, the Company believes that the credit risk inherent in these contracts was not significant at December 31, 2013.

The Company pledged collateral to derivative counterparties in the form of cash totaling \$1.8 million and securities with an amortized cost of \$26.2 million and a fair value of \$26.4 million at year-end 2013. The Company does not typically require its Commercial customers to post cash or securities as collateral on its program of back-to-back economic hedges. However certain language is written into the International Swaps Dealers Association, Inc. (ISDA) and loan documents where, in default situations, the Bank is allowed to access collateral supporting the loan relationship to recover any losses suffered on the derivative asset or liability. The Company may need to post additional collateral in the future in proportion to potential increases in unrealized loss positions.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Information about interest rate swap agreements and non-hedging derivative assets and liabilities at December 31, 2013 follows:

December 31, 2013	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Rate Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
<b>Cash flow hedges:</b>					
Interest rate swaps on FHLBB borrowings	\$ 150,000	2.5	0.25%	2.61%	\$ (3,102)
Forward-starting interest rate swaps on FHLBB borrowings	260,000	4.5		1.88%	1,015
Interest rate swaps on junior subordinated notes	15,000	0.4	2.09%	5.54%	(203)
Total cash flow hedges	425,000				(2,290)
<b>Economic hedges:</b>					
Interest rate swap on tax advantaged economic development bond	13,095	15.9	0.54%	5.09%	(1,889)
Interest rate swaps on loans with commercial loan customers	206,933	5.4	2.44%	4.68%	(6,278)
Reverse interest rate swaps on loans with commercial loan customers	206,933	5.4	4.68%	2.44%	6,286
Forward sale commitments	32,911	0.2			261
Total economic hedges	459,872				(1,620)
<b>Non-hedging derivatives:</b>					
Interest rate lock commitments	20,199	0.2			258
Total non-hedging derivatives	20,199				258
<b>Total</b>	<b>\$ 905,071</b>				<b>\$ (3,652)</b>

Information about interest rate swap agreements and non-hedging derivative asset and liabilities at December 31, 2012 follows:

December 31, 2012	Notional Amount (In thousands)	Weighted Average Maturity (In years)	Weighted Average Rate Received	Weighted Average Rate Contract pay rate	Estimated Fair Value Asset (Liability) (In thousands)
<b>Cash flow hedges:</b>					
Interest rate swaps on FHLBB borrowings	\$ 115,000	1.6	0.35%	3.47%	\$ (4,608)
Forward-starting interest rate swaps on FHLBB borrowings	140,000	5.4		2.37%	(5,810)
Interest rate swaps on junior subordinated notes	15,000	1.4	2.16%	5.54%	(704)
Total cash flow hedges	270,000				(11,122)
<b>Economic hedges:</b>					

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Interest rate swap on tax advantaged economic development bond	13,609	16.9	0.58%	5.09%	(3,473)
Interest rate swaps on loans with commercial loan customers	205,319	5.1	2.54%	5.28%	(15,219)
Reverse interest rate swaps on loans with commercial loan customers	205,319	5.1	5.28%	2.54%	14,746
Forward sale commitments	335,548	0.1			(1,336)
Total economic hedges	759,795				(5,282)
<b>Non-hedging derivatives:</b>					
Interest rate lock commitments	282,752	0.2			6,258
Total non-hedging derivatives	282,752				6,258
<b>Total</b>	<b>\$ 1,312,547</b>			<b>\$</b>	<b>(10,146)</b>

**Cash Flow Hedges**

The effective portion of unrealized changes in the fair value of derivatives accounted for as cash flow hedges is reported in other comprehensive income and subsequently reclassified to earnings in the same period or periods during which the hedged forecasted transaction affects earnings. Each quarter, the Company assesses the effectiveness of each hedging relationship by comparing the changes in cash flows of the derivative hedging instrument with the changes in cash flows of the designated hedged item or

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

transaction. The ineffective portion of changes in the fair value of the derivatives is recognized directly in earnings.

As of December 31, 2013, the Company has entered into several interest rate swaps with an aggregate notional amount of \$150 million to convert either the LIBOR based floating interest rates or the FHLBB three month fixed interest rate on a series of rolling 90 day advances on a \$150 million portfolio of FHLBB advances to fixed rates, with the objective of fixing the Company's monthly interest expense on these borrowings.

The Company has also entered into fourteen forward-starting interest rate swaps with a combined notional value of \$260 million as of year-end 2013. These swaps become effective between the first quarter of 2014 and the first quarter of 2017. The year 2014 will bring on the majority of the fourteen swaps with nine swaps coming onto the balance sheet, with durations ranging from three to five years. The three forward starting swaps will become effective in 2015 with durations of four and seven years. The final two forward starting swaps will become effective in 2016 and 2017, both with durations of one year. This hedge strategy converts the ninety day rolling FHLBB borrowings based on the FHLBB's three month fixed interest rate to fixed interest rates, thereby protecting the Company from floating interest rate variability.

The Company has entered into an interest rate swap with a notional value of \$15 million to convert the floating rate of interest on its junior subordinated debentures to a fixed rate of interest. The purpose of the hedge was to protect the Company from the risk of variability arising from the floating rate interest on the debentures. Amounts included in the Consolidated Statements of Income and in the other comprehensive income section of the Consolidated Statements of Comprehensive Income (related to interest rate derivatives designated as hedges of cash flows), were as follows:

(In thousands)	Years Ended December 31,	
	2013	2012
<b>Interest rate swaps on FHLBB borrowings:</b>		
Unrealized gain recognized in accumulated other comprehensive loss	\$ 11,783	\$ 1,157
Reclassification of unrealized loss from accumulated other comprehensive loss to interest expense	(3,620)	(3,581)
Reclassification of unrealized gain from accumulated other comprehensive loss to other non-interest expense for termination of swaps	943	942
Reclassification of unrealized deferred tax benefit from accumulated other comprehensive loss to tax expense for terminated swaps	(489)	(324)
Net tax (expense) benefit on items recognized in accumulated other comprehensive loss	(3,276)	846
<b>Interest rate swaps on junior subordinated notes:</b>		
Unrealized loss recognized in accumulated other comprehensive loss	(18)	(139)
Reclassification of unrealized loss from accumulated other comprehensive loss to interest expense	519	490

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Net tax expense on items recognized in accumulated other comprehensive loss	(197)	(157)
Other comprehensive income (loss) recorded in accumulated other comprehensive loss, net of reclassification adjustments and tax effects	\$ 5,645	\$ (766)
Net interest expense recognized in interest expense on hedged FHLBB borrowings	\$ 4,374	\$ 4,476
Net interest expense recognized in interest expense on junior subordinated notes	\$ 519	\$ 490

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Hedge ineffectiveness on interest rate swaps designated as cash flow hedges was immaterial to the Company's financial statements during the years ended 2013 and 2012. Amounts reported in accumulated other comprehensive loss related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate liabilities. See Note 25 Subsequent Events for additional information on derivatives.

**Economic hedges**

The Company has an interest rate swap with a \$13.1 million notional amount to swap out the fixed rate of interest on an economic development bond bearing a fixed rate of 5.09% in exchange for a LIBOR-based floating rate. The interest rate swap is currently held within the Company's trading portfolio under the fair value option. The intent of the economic hedge is to improve the Company's asset sensitivity to changing interest rates in anticipation of favorable average floating rates of interest over the 21-year life of the bond. The fair value changes of the economic development bond are mostly offset by fair value changes of the related interest rate swap.

The Company also offers certain derivative products directly to qualified commercial borrowers. The Company economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third-party financial institutions. The transaction allows the Company's customer to convert a variable-rate loan to a fixed rate loan. Because the Company acts as an intermediary for its customer, changes in the fair value of the underlying derivative contracts mostly offset each other in earnings. Credit valuation adjustments arising from the difference in credit worthiness of the commercial loan and financial institution counterparties totaled \$17.8 thousand at year-end 2013. The interest income and expense on these mirror image swaps exactly offset each other.

The Company utilizes forward sale commitments to hedge interest rate risk and the associated effects on the fair value of interest rate lock commitments and loans held for sale. The forward sale commitments are accounted for as derivatives with changes in fair value recorded in current period earnings.

The company uses the following types of forward sale commitments contracts:

- Best efforts loan sales,
- Mandatory delivery loan sales, and
- To be announced (TBA) mortgage-backed securities sales.

A best efforts contract refers to a loan sales agreement where the Company commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. The Company may enter into a best efforts contract once the price is known, which is shortly after the potential borrower's interest rate is locked.

A mandatory delivery contract is a loan sales agreement where the Company commits to deliver a certain principal amount of mortgage loans to an investor at a specified price on or before a specified date. Generally, the Company may enter into mandatory delivery contracts shortly after the loan closes with a customer.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company may sell to-be-announced mortgage-backed securities to hedge the changes in fair value of interest rate lock commitments and held for sale loans, which do not have corresponding best efforts or mandatory delivery contracts. These security sales transactions are closed once mandatory contracts are written. On the closing date the price of the security is locked-in, and the sale is paired-off with a purchase of the same security. Settlement of the security purchase/sale transaction is done with cash on a net-basis.

**Non-hedging derivatives**

The Company enters into interest rate lock commitments ( IRLCs ) for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance. Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. The IRLCs are free-standing derivatives which are carried at fair value with changes recorded in noninterest income in the Company's consolidated statements of income. Changes in the fair value of IRLCs subsequent to inception are based on changes in the fair value of the underlying loan. Such changes result from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, affected primarily by changes in interest rates and the passage of time.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Amounts included in the Consolidated Statements of Income related to economic hedges and non-hedging derivatives were as follows:

(In thousands)	Years Ended December 31,	
	2013	2012
<b>Economic hedges</b>		
<i>Interest rate swap on industrial revenue bond:</i>		
Unrealized gain (loss) recognized in other non-interest income	\$ 972	\$ (660)
<i>Interest rate swaps on loans with commercial loan customers:</i>		
Unrealized gain recognized in other non-interest income	6,004	3,053
<i>Reverse interest rate swaps on loans with commercial loan customers:</i>		
Unrealized loss recognized in other non-interest income	(6,004)	(3,053)
Favorable change in credit valuation adjustment recognized in other non-interest income	450	43
<i>Forward Commitments:</i>		
Unrealized gain (loss) recognized in other non-interest income	261	(1,337)
Realized gain (loss) in other non-interest income	7,501	(5,389)
<b>Non-hedging derivatives</b>		
<i>Interest rate lock commitments:</i>		
Unrealized gain recognized in other non-interest income	258	6,259
Realized (loss) gain in other non-interest income	\$ (2,467)	\$ 15,753

**Assets and Liabilities Subject to Enforceable Master Netting Arrangements***Interest Rate Swap Agreements ( Swap Agreements )*

The Company enters into swap agreements to facilitate the risk management strategies for commercial banking customers. The Company mitigates this risk by entering into equal and offsetting swap agreements with highly rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated statements of condition. The Company is party to master netting arrangements with its financial institution counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation purposes. The master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral generally in the form of marketable securities is received or posted by the counterparty with net liability positions, respectively, in accordance with contract thresholds. The Company had net asset positions with its commercial banking counterparties totaling \$7 million and \$14.7 million as of December 31, 2013 and December 31, 2012, respectively. The Company had net liability positions with its financial institution counterparties totaling \$10.2 million and \$29.8 million as of December 31, 2013 and December 31, 2012, respectively. At December 31, 2013, the Company also had a net liability position of \$0.7 million with its commercial banking counterparties as compared to zero liability at December 31, 2012. The collateral posted by the Company that covered liability positions was \$10.2 million and \$29.8 million as of December 31, 2013 and December 31, 2012, respectively.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the assets and liabilities subject to an enforceable master netting arrangement as of December 31, 2013 and December 31, 2012:

## Offsetting of Financial Assets and Derivative Assets

(in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition	Financial Instruments	Cash Collateral Received	Net Amount
As of December 31, 2013							
Interest Rate Swap							
Agreements:							
Institutional counterparties	\$	\$	\$	\$	\$	\$	\$
Commercial counterparties	7,799		7,799				7,799
Total	\$ 7,799	\$	\$ 7,799	\$	\$	\$	\$ 7,799

## Offsetting of Financial Liabilities and Derivative Liabilities

(in thousands)	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition	Financial Instruments	Cash Collateral Pledged	Net Amount
As of December 31, 2013							
Interest Rate Swap							
Agreements:							
Institutional counterparties	\$ (13,157)	\$ 1,913	\$ (11,244)	\$ 9,544	\$	\$ 1,700	\$
Commercial counterparties	(720)		(720)				(720)
Total	\$ (13,877)	\$ 1,913	\$ (11,964)	\$ 9,544	\$	\$ 1,700	\$ (720)

## Offsetting of Financial Assets and Derivative Assets

(in thousands)	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statements of Condition	Net Amounts of Assets Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition	Financial Instruments	Cash Collateral Received	Net Amount
As of December 31, 2012							

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Interest Rate Swap

Agreements:

Institutional counterparties	\$		\$		\$		\$		\$
Commercial counterparties		14,746				14,746			14,746
Total	\$	14,746	\$		\$	14,746	\$		14,746

Offsetting of Financial Liabilities and Derivative Liabilities

(in thousands)		Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statements of Condition	Net Amounts of Liabilities Presented in the Statements of Condition	Gross Amounts Not Offset in the Statements of Condition		Cash Collateral Pledged	Net Amount
As of December 31, 2012								
Interest Rate Swap								
Agreements:								
Institutional counterparties	\$	(29,814)	\$	(29,814)	\$	25,384	\$	4,430
Commercial counterparties								
Total	\$	(29,814)	\$	(29,814)	\$	25,384	\$	4,430

NOTE 17.

OTHER COMMITMENTS, CONTINGENCIES, AND OFF-BALANCE SHEET ACTIVITIES

**Credit Related Financial Instruments.** The Company 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. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying consolidated balance sheets.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company's exposure to credit loss in the event of non-performance by the other party to the financial instrument is represented by the contractual amount of these commitments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

A summary of financial instruments outstanding whose contract amounts represent credit risk is as follows at year-end:

(In thousands)	2013	2012
Commitments to originate new loans	\$ 129,699	\$ 50,218
Unused funds on commercial and other lines of credit	523,090	339,738
Unadvanced funds on home equity lines of credit	226,330	255,340
Unadvanced funds on construction and real estate loans	158,131	98,945
Standby letters of credit	14,996	28,339
Lease obligation	12,448	12,641
Total	\$ 1,064,694	\$ 785,221

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company considers standby letters of credit to be guarantees and the amount of the recorded liability related to such guarantees was not material at year-end 2013.

**Operating Lease Commitments.** Future minimum rental payments required under operating leases at year-end 2013 are as follows: 2014 - \$6.0 million; 2015 - \$5.2 million; 2016 - \$4.2 million; 2017 - \$3.7 million; 2018 - \$3.1 million and all years thereafter - \$29.3 million. The leases contain options to extend for periods up to twenty years. The cost of such rental options is not included above. Total rent expense for the years 2013, 2012, and 2011 amounted to \$5.7 million, \$4.7 million, and \$3.2 million, respectively.

**Lease Obligations.** Future obligations required under the capital lease at year-end 2013 are \$753 thousand in 2014; \$751 thousand in 2015; \$715 thousand in 2016; \$680 thousand in 2017; \$647 thousand in 2018; and \$7.5 million all years thereafter. Amortization under the capital lease is included with premises and equipment depreciation and amortization expense.

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Future obligations required under the financing lease at year-end 2013 are \$80 thousand in 2014; \$80 thousand in 2015; \$80 thousand in 2016; \$81 thousand in 2017; \$86 thousand in 2018; and \$1.8 million all years thereafter. Amortization under the financing lease is included with premises and equipment depreciation and amortization expense.

***Employment and Change in Control Agreements.*** The Company and the Bank have entered into a three-year employment agreement with one senior executive. The Company and the Bank also have change in control agreements with several officers which provide a severance payment in the event employment is terminated in conjunction with a defined change in control.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Legal Claims.** Various legal claims arise from time to time in the normal course of business. In the opinion of management, claims outstanding at year-end 2013 will have no material effect on the Company's financial statements.

**NOTE 18. STOCKHOLDERS' EQUITY AND EARNINGS PER COMMON SHARE*****Minimum Regulatory Capital Requirements***

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if imposed, could have a direct material impact on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weighting and other factors. The Company, as a savings and loan holding company, has no specific quantitative capital requirements.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital to average assets (as defined). As of year-end 2013 and 2012, the Bank met the capital adequacy requirements. Regulators may set higher expected capital requirements in some cases based on their examinations.

As of year-end 2013 and 2012, the Bank met the conditions to be classified as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the following tables.

The Bank's actual and required capital amounts were as follows:

(Dollars in thousands)	Actual		Minimum Capital Requirement		Minimum to be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2013</b>						
Total capital to risk-weighted assets	\$ 486,075	11.62%	\$ 334,555	8.00%	\$ 418,193	10.00%

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Tier 1 capital to risk-weighted assets	416,803	9.97	167,277	4.00	250,916	6.00
Tier 1 capital to average assets	416,803	7.99	208,685	4.00	260,857	5.00

**December 31, 2012**

Total capital to risk-weighted assets	\$	456,314	11.79%	\$	309,684	8.00%	\$	387,105	10.00%
Tier 1 capital to risk-weighted assets		387,548	10.01		154,842	4.00		232,263	6.00
Tier 1 capital to average assets		387,548	7.46		207,874	4.00		259,842	5.00

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A reconciliation of the Company's year-end total stockholders' equity to the Bank's regulatory capital is as follows:

<b>(In thousands)</b>	<b>2013</b>	<b>2012</b>
Total stockholders' equity per consolidated financial statements	\$ 678,062	\$ 667,265
<i>Adjustments for Bank Tier 1 Capital:</i>		
Holding company equity adjustment	(3,764)	(5,172)
Net unrealized loss (gain) on available for sale securities	5,749	(6,712)
Net unrealized loss on cash flow hedges	3,158	9,263
Disallowed goodwill and other intangible assets	(245,405)	(248,586)
Disallowed deferred taxes	(20,997)	(28,510)
Total Bank Tier 1 Capital	416,803	387,548
<i>Adjustments for total capital:</i>		
Qualifying subordinated debt	35,000	35,000
Includible allowances for loan losses	33,383	33,299
Net unrealized loss on available for sale securities includible in Tier 2 capital	889	467
Total Bank capital per regulatory reporting	\$ 486,075	\$ 456,314

*Common stock*

The Bank is subject to dividend restrictions imposed by various regulators, including a limitation on the total of all dividends that the Bank may pay to the Company in any calendar year. The total of all dividends shall not exceed the Bank's net income for the current year (as defined by statute), plus the Bank's net income retained for the two previous years, without regulatory approval. Dividends from the Bank are an important source of funds to the Company to make dividend payments on its common and preferred stock, to make payments on its borrowings, and for its other cash needs. The ability of the Company and the Bank to pay dividends is dependent on regulatory policies and regulatory capital requirements. The ability to pay such dividends in the future may be adversely affected by new legislation or regulations, or by changes in regulatory policies relating to capital, safety and soundness, and other regulatory concerns.

The payment of dividends by the Company is subject to Delaware law, which generally limits dividends to an amount equal to an excess of the net assets of a company (the amount by which total assets exceed total liabilities) over statutory capital, or if there is no excess, to the Company's net profits for the current and/or immediately preceding fiscal year.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Accumulated other comprehensive loss*

Year-end components of accumulated other comprehensive loss are as follows:

(In thousands)	2013	2012
<b>Other accumulated comprehensive income/(loss), before tax:</b>		
Net unrealized holding (loss) gain on AFS securities	\$ (9,294)	\$ 10,718
Net loss on effective cash flow hedging derivatives	(2,289)	(10,955)
Net loss on terminated swap	(3,237)	(4,179)
Net unrealized holding loss on pension plans	(500)	(1,265)
<b>Income taxes related to items of accumulated other comprehensive (loss)/income:</b>		
Net unrealized holding (loss) gain on AFS securities	3,518	(4,006)
Net loss on effective cash flow hedging derivatives	923	4,397
Net loss on terminated swap	1,312	1,801
Net unrealized holding loss on pension plans	510	510
<b>Accumulated other comprehensive loss</b>	<b>\$ (9,057)</b>	<b>\$ (2,979)</b>

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the components of other comprehensive loss for the years ended December 31, 2013, 2012, and 2011:

(In thousands)	Before Tax	Tax Effect	Net of Tax
Year Ended December 31, 2013			
Net unrealized holding loss on AFS securities:			
Net unrealized gain arising during the period	\$ (24,770)	\$ 9,444	\$ (15,326)
Less: reclassification adjustment for losses realized in net income	4,758	(1,920)	2,838
Net unrealized holding loss on AFS securities	(20,012)	7,524	(12,488)
Net gain on cash flow hedging derivatives:			
Net unrealized gain arising during the period	5,046	(2,014)	3,032
Less: reclassification adjustment for losses realized in net income	3,620	(1,460)	2,160
Net gain on cash flow hedging derivatives	8,666	(3,474)	5,192
Net gain on terminated swap:			
Net unrealized loss arising during the period	471		471
Less: reclassification adjustment for losses realized in net income	471	(489)	(18)
Net gain on terminated swap	942	(489)	453
Net unrealized holding gain on pension plans			
Net unrealized gain arising during the period	1,282	(517)	765
Less: reclassification adjustment for losses realized in net income			
Net unrealized holding gain on pension plans	1,282	(517)	765
<b>Other Comprehensive Loss</b>	\$ (9,122)	\$ 3,044	\$ (6,078)

(In thousands)	Before Tax	Tax Effect	Net of Tax
Year Ended December 31, 2012			
Net unrealized holding gain on AFS securities:			
Net unrealized gain arising during the period	\$ 2,977	\$ (1,088)	\$ 1,889
Less: reclassification adjustment for losses realized in net income	1,442	(579)	863
Net unrealized holding gain on AFS securities	4,419	(1,667)	2,752
Net loss on cash flow hedging derivatives:			
Net unrealized (loss) arising during the period	(5,653)	2,129	(3,524)
Less: reclassification adjustment for losses realized in net income	3,581	(1,441)	2,140
Net loss on cash flow hedging derivatives	(2,072)	688	(1,384)
Net gain on terminated swap:			
Net unrealized gain arising during the period	472		472
Less: reclassification adjustment for losses realized in net income	470	(324)	146
Net gain on terminated swap	942	(324)	618
Net unrealized holding loss on pension plans			
Net unrealized loss arising during the period	(136)	56	(80)
Less: reclassification adjustment for losses realized in net income			
Net unrealized holding loss on pension plans	(136)	56	(80)
<b>Other Comprehensive Income</b>	\$ 3,153	\$ (1,247)	\$ 1,906



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Before Tax	Tax Effect	Net of Tax
<b>Year Ended December 31, 2011</b>			
Net unrealized holding gain on AFS securities:			
Net unrealized gain arising during the period	\$ 2,315	\$ (865)	\$ 1,450
Less: reclassification adjustment for losses realized in net income	14	(5)	9
Net unrealized holding gain on AFS securities	2,329	(870)	1,459
Net gain on cash flow hedging derivatives:			
Net unrealized gain arising during the period	3,427	(1,391)	2,036
Less: reclassification adjustment for losses realized in net income	(3,086)	1,240	(1,846)
Netgain on cash flow hedging derivatives	341	(151)	190
Netgain on terminated swap:			
Net unrealized gain arising during the period	471		471
Less: reclassification adjustment for losses realized in net income	471	(391)	80
Netgain on terminated swap	942	(391)	551
Net unrealized holding loss on pension plans			
Net unrealized loss arising during the period	(1,130)	455	(675)
Less: reclassification adjustment for losses realized in net income			
Net unrealized holding loss on pension plans	(1,130)	455	(675)
<b>Other Comprehensive Income</b>	\$ 2,482	\$ (957)	\$ 1,525

The following table presents the changes in each component of accumulated other comprehensive income, for the years ended December 31, 2013, 2012, and 2011:

(in thousands)	Net unrealized holding gain (loss) on AFS Securities	Net loss on effective cash flow hedging derivatives	Net loss on terminated swap	Net unrealized holding gain (loss) on pension plans	Total
<b>Year Ended December 31, 2013</b>					
<b>Balance at Beginning of Year</b>	\$ 6,712	\$ (6,558)	\$ (2,378)	\$ (755)	\$ (2,979)
Other Comprehensive (Loss) Gain before reclassifications	(15,326)	3,032	471	765	(11,058)
Amounts Reclassified from Accumulated other comprehensive income	2,838	2,160	(18)		4,980
Total Other Comprehensive Loss	(12,488)	5,192	453	765	(6,078)
Balance at End of Period	\$ (5,776)	\$ (1,366)	\$ (1,925)	\$ 10	\$ (9,057)
<b>Year Ended December 31, 2012</b>					
<b>Balance at Beginning of Year</b>	\$ 3,960	\$ (5,174)	\$ (2,996)	\$ (675)	\$ (4,885)
Other Comprehensive Gain (Loss) Before reclassifications	1,889	(3,524)	472	(80)	(1,243)
Amounts Reclassified from Accumulated other comprehensive income	863	2,140	146		3,149
Total Other Comprehensive Income	2,752	(1,384)	618	(80)	1,906
Balance at End of Period	\$ 6,712	\$ (6,558)	\$ (2,378)	\$ (755)	\$ (2,979)

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**Year Ended December 31, 2011**

<b>Balance at Beginning of Year</b>	\$	2,501	\$	(5,364)	\$	(3,547)	\$	(6,410)
Other Comprehensive Gain (Loss)								
Before reclassifications		1,450		2,036		471		(675)
Amounts Reclassified from								
Accumulated other comprehensive								
income		9		(1,846)		80		(1,757)
<b>Total Other Comprehensive Income</b>		<b>1,459</b>		<b>190</b>		<b>551</b>		<b>(675)</b>
<b>Balance at End of Period</b>	\$	<b>3,960</b>	\$	<b>(5,174)</b>	\$	<b>(2,996)</b>	\$	<b>(4,885)</b>

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the amounts reclassified out of each component of accumulated other comprehensive income for the years ended December 31, 2013, 2012, and 2011:

(in thousands)	Years Ended Decemeber 31,			Affected Line Item in the Statement Where Net Income Is Presented
	2013	2012	2011	
Realized gains on AFS securities:				
	4,758	1,442	14	Non-interest income
	(1,920)	(579)	(5)	Tax expense
	2,838	863	9	
Realized gains (losses) on cash flow hedging derivatives:				
	3,620	3,581	(3,086)	Interest income
	(1,460)	(1,441)	1,240	Tax expense
	2,160	2,140	(1,846)	
Amortization of realized gains (losses) on terminated swap:				
	471	470	471	Interest income
	(489)	(324)	(391)	Tax expense
	(18)	146	80	
Total reclassifications for the period	\$ 4,980	\$ 3,149	\$ (1,757)	

**Earnings Per Common Share**

Basic earnings per common share ( EPS ) excludes dilution and is computed by dividing net income applicable to common stock by the weighted average number of common shares outstanding for the year. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock (such as stock options) were exercised or converted into additional common shares that would then share in the earnings of the entity. Diluted EPS is computed by dividing net income applicable to common stock by the weighted average number of common shares outstanding for the year, plus an incremental number of common-equivalent shares computed using the treasury stock method.

Earnings per common share has been computed based on the following (average diluted shares outstanding is calculated using the treasury stock method):

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)		Years Ended December 31,		
	2013	2012	2011	
<b>Net income from continuing operations</b>	\$ 41,143	\$ 33,825	\$ 16,434	
(Loss) income from discontinued operations before income taxes (including gain on disposal of \$63 in 2012 and \$4,962 in 2011)		(261)	4,684	
Income tax expense		376	3,770	
<b>Net (loss) income from discontinued operations</b>		(637)	914	
<b>Net income</b>	\$ 41,143	\$ 33,188	\$ 17,348	
Average number of common shares issued	26,525	24,081	19,812	
Less: average number of treasury shares	1,424	1,626	1,741	
Less: average number of unvested stock award shares	299	254	186	
Average number of basic common shares outstanding	24,802	22,201	17,885	
Plus: dilutive effect of unvested stock award shares	60	41		
Plus: dilutive effect of stock options outstanding	103	87	67	
Average number of diluted common shares outstanding	24,965	22,329	17,952	
<b>Basic earnings per share:</b>				
Continuing Operations	\$ 1.66	\$ 1.52	\$ 0.92	
Discontinued operations		(0.03)	0.05	
<b>Total basic earning per share</b>	\$ 1.66	\$ 1.49	\$ 0.97	
<b>Diluted earnings per share:</b>				
Continuing Operations	\$ 1.65	\$ 1.52	\$ 0.92	
Discontinued operations		(0.03)	0.05	
<b>Total diluted earnings per share</b>	\$ 1.65	\$ 1.49	\$ 0.97	

For the year ended 2013, 338 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the year ended 2012, 600 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations. For the year ended 2011, 394 thousand options were anti-dilutive and therefore excluded from the earnings per share calculations.

**NOTE 19. STOCK-BASED COMPENSATION PLANS**

The 2011 Equity Compensation Plan (the Plan) permits the granting of a combination of Restricted Stock awards and incentive and non-qualified stock options (Stock Options) to employees and directors. A total of 1.4 million shares was authorized under the Plan. Awards may be granted as either Restricted Stock or Stock Options provided that any shares that are granted as Restricted Stock are counted against the share limit set forth as (1) three for every one share of Restricted Stock granted and (2) one for every one share of Stock Option granted. As of year-end 2013, the Company had the ability to grant approximately 333 thousand shares under this plan.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of activity in the Company's stock compensation plans is shown below:

(Shares in thousands)	Non-vested Stock Awards Outstanding		Stock Options Outstanding	
	Number of Shares	Weighted-Average Grant Date Fair Value	Number of Shares	Weighted-Average Exercise Price
<b>Balance, December 31, 2012</b>	244	\$ 21.69	688	\$ 18.13
Granted	243	24.49		
Stock options exercised			(237)	12.85
Stock awards vested	(95)	19.50		
Forfeited	(58)	22.81	(9)	17.68
<b>Balance, December 31, 2013</b>	334	\$ 23.26	442	\$ 20.41
<b>Exercisable options, December 31, 2013</b>			420	\$ 21.73

*Stock Awards*

The total compensation cost for stock awards recognized as expense was \$2.1 million, \$2.0 million, and \$1.5 million, in the years 2013, 2012, and 2011, respectively. The total recognized tax benefit associated with this compensation cost was \$0.9 million, \$0.8 million, and \$0.6 million, respectively.

The weighted average fair value of stock awards granted was \$24.49, \$23.76, and \$20.88 in 2013, 2012, and 2011, respectively. Stock awards vest over periods up to five years and are valued at the closing price of the stock on the grant date.

The total fair value of stock awards vested during 2013, 2012, and 2011 was \$1.9 million, \$1.4 million, and \$1.3 million, respectively. The unrecognized stock-based compensation expense related to unvested stock awards was \$5.6 million as of year-end 2013. This amount is expected to be recognized over a weighted average period of two years.

*Option Awards*

Option awards are granted with an exercise price equal to the market price of the Company's stock at the date of grant, and vest over periods up to five years. The options grant the holder the right to acquire a share of the Company's common stock for each option held, and have a contractual life of ten years. As of year-end 2013, the weighted average remaining contractual term for options outstanding is four years.

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The Company generally issues shares from treasury stock as options are exercised. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The expected dividend yield and expected term are based on management estimates. The expected volatility is based on historical volatility. The risk-free interest rates for the expected term are based on the U.S. Treasury yield curve in effect at the time of the grant. The Company acquired options in the Beacon transaction in 2012 but did not grant additional options in 2013, 2012, or 2011.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The total intrinsic value of options exercised was \$2.9 million, \$2.7 million, and \$98 thousand for the years 2013, 2012, and 2011, respectively. The expense pertaining to options vesting in the years 2013, 2012, and 2011 was \$860 thousand, \$240 thousand, and \$0, respectively. The total recognized tax benefit associated with stock option expense for the years 2013, 2012 and 2011, was \$347 thousand, \$97 thousand, and \$0, respectively. The unrecognized stock-based compensation expense related to unvested stock options was \$41 thousand as of year-end 2013. This amount is expected to be recognized over a weighted average period of three months.

**NOTE 20. FAIR VALUE MEASUREMENTS**

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below. These valuation methodologies were applied to all of the Company's financial assets and financial liabilities that are carried at fair value.

**Recurring Fair Value Measurements of Financial Instruments**

The following table summarizes assets and liabilities measured at fair value on a recurring basis as of year-end 2013 and 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	December 31, 2013			
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading security	\$	\$	\$ 14,840	\$ 14,840
Available-for-sale securities:				
Municipal bonds and obligations		77,671		77,671
Government guaranteed residential mortgage-backed securities		78,771		78,771
Government-sponsored residential mortgage-backed securities		522,658		522,658
Corporate bonds		39,280		39,280
Trust preferred securities		15,372	1,239	16,611
Other bonds and obligations		3,084		3,084
Marketable equity securities	20,891	357	725	21,973
Loans held for sale		15,840		15,840
Derivative assets	242	7,799	277	8,318
Derivative liabilities		11,964		11,964

(In thousands)	December 31, 2012			
	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Trading security	\$	\$	\$ 16,893	\$ 16,893
Available-for-sale securities:				
Municipal bonds and obligations		84,757		84,757
Government guaranteed residential mortgage-backed securities		43,091		43,091
Government-sponsored residential mortgage-backed securities		278,593		278,593
Corporate bonds		10,007		10,007
Trust preferred securities		20,072	885	20,957
Other bonds and obligations		3,472		3,472
Marketable equity securities	25,291			25,291
Loans held for sale		85,368		85,368
Derivative assets (1)		14,746	6,258	21,004
Derivative liabilities (2)	282	29,818	1,055	31,155

(1) Total fair value excludes the \$1.3 million of unrealized losses on forward commitments presented under other assets on the consolidated balance sheet.

(2) Total fair value includes the \$1.3 million of unrealized losses on forward commitments presented under other assets on the consolidated balance sheet.

There were no transfers between Level 1, 2, and 3 during the years ended December 31, 2013 and 2012.

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**Trading Security at Fair Value.** The Company holds one security designated as a trading security. It is a tax advantaged economic development bond issued to the Company by a local nonprofit which provides wellness and health programs. The determination of the fair value for this security is determined based on a discounted cash flow methodology. Certain inputs to the fair value calculation are unobservable and there is little to no market activity in the security; therefore, the security meets the definition of a Level 3 security. The discount rate used in the valuation of the security is sensitive to movements in the 3-month LIBOR rate.

**Securities Available for Sale.** AFS securities classified as Level 1 consist of publicly-traded equity securities for which the fair values can be obtained through quoted market prices in active exchange

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

markets. AFS securities classified as Level 2 include most of the Company's debt securities. The pricing on Level 2 was primarily sourced from third party pricing services, overseen by management, and is based on models that consider standard input factors such as dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and condition, among other things. The Company holds one pooled trust preferred security. The Company holds one pooled trust preferred security and one privately owned equity security. Both securities fair values are based on unobservable issuer-provided financial information and the pooled security also utilizes discounted cash flow models derived from the underlying structured pool, therefore both are classified as Level 3.

**Loans held for sale.** The Company elected the fair value option for all loans held for sale (HFS) originated on or after May 1, 2012. Loans HFS are classified as Level 2 as the fair value is based on input factors such as quoted prices for similar loans in active markets.

December 31, 2013 (In thousands)	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
Loans Held for Sale	\$ 15,840	\$ 15,641	\$ 199

December 31, 2012 (In thousands)	Aggregate Fair Value	Aggregate Unpaid Principal	Aggregate Fair Value Less Aggregate Unpaid Principal
Loans Held for Sale	\$ 85,368	\$ 82,560	\$ 2,808

The changes in fair value of loans held for sale for years ended December 31, 2013 and 2012 were gains of \$2.6 million and losses of \$2.8 million, respectively. The changes in fair value are included in mortgage banking income in the Consolidated Statements of Income.

**Derivative Assets and Liabilities.**

**Interest Rate Swap.** The valuation of the Company's interest rate swaps is obtained from a third-party pricing service and is determined using a discounted cash flow analysis on the expected cash flows of each derivative. The pricing analysis is based on observable inputs for the contractual terms of the derivatives, including the period to maturity and interest rate curves.

The Company incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Company has considered the impact of netting and any applicable credit enhancements, such as collateral postings.

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Although the Company has determined that the majority of the inputs used to value its interest rate derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of year-end 2013, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Company has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Interest Rate Lock Commitments.* The Company enters into IRLCs for residential mortgage loans, which commit the Company to lend funds to a potential borrower at a specific interest rate and within a specified period of time. The estimated fair value of commitments to originate residential mortgage loans for sale is based on quoted prices for similar loans in active markets. However, this value is adjusted by a factor which considers the likelihood that the loan in a lock position will ultimately close, and by the non-refundable costs of originating the loan. The closing ratio is derived from the Bank's internal data and is adjusted using significant management judgment. The costs to originate are primarily based on the Company's internal commission rates that are not observable. As such, IRLCs are classified as Level 3 measurements.

*Forward Sale Commitments.* The Company utilizes forward sale commitments as economic hedges against potential changes in the values of the IRLCs and loans held for sale. To be announced (TBA) mortgage-backed securities forward commitment sales are classified as Level 1, and consist of publicly-traded debt securities for which identical fair values can be obtained through quoted market prices in active exchange markets. The fair values of the Company's best efforts and mandatory delivery loan sale commitments are determined similarly to the IRLCs using quoted prices in the market place that are observable, however; costs to originate and closing ratios included in the calculation are internally generated and are based on management's judgment and prior experience, which are considered factors that are not observable. As such, best efforts and mandatory forward sale commitments are classified as Level 3 measurements.

The table below presents the changes in Level 3 assets that were measured at fair value on a recurring basis at year-end 2013 and 2012.

(In thousands)	Assets (Liabilities)			
	Trading Security	Securities Available for Sale	Interest Rate Lock Commitments	Forward Commitments
Balance as of December 31, 2011	\$ 17,395	\$ 544	\$	\$
Greenpark Acquisition			2,126	(1,055)
Unrealized (loss) gain, net recognized in other non-interest income	(16)		20,687	
Unrealized gain included in accumulated other comprehensive loss		341		
Paydown of trading security	(486)			
Transfers to held for sale loans			(16,555)	
Balance as of December 31, 2012	\$ 16,893	\$ 885	\$ 6,258	\$ (1,055)
Purchase of marketable equity security		770		
Unrealized (loss) gain, net recognized in other non-interest income	(1,539)		8,722	1,074
Unrealized gain included in accumulated other comprehensive loss		309		
Paydown of trading security	(514)			
Transfers to held for sale loans			(14,722)	
Balance as of December 31, 2013	\$ 14,840	\$ 1,964	\$ 258	\$ 19
Unrealized gains (losses) relating to instruments still held at December 31, 2013	\$ 1,745	\$ (1,410)	\$ 258	\$ 19
Unrealized gains (losses) relating to instruments still held at December 31, 2012	\$ 3,284	\$ (1,717)	\$ 6,258	\$ (1,055)





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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Quantitative information about the significant unobservable inputs within Level 3 recurring assets as of December 31, 2013 and 2012 are as follows:

(In thousands)	Fair Value December 31, 2013	Valuation Techniques	Unobservable Inputs	Significant Unobservable Input Value
<b>Assets</b>				
Trading Security	\$ 14,840	Discounted Cash Flow	Discount Rate	3.39%
Forward Commitments	19	Historical Trend	Closing Ratio	94.83%
		Pricing Model	Origination Costs, per loan	2,500
Interest Rate Lock Commitment	258	Historical Trend	Closing Ratio	94.83%
		Pricing Model	Origination Costs, per loan	2,500
<b>Total</b>	<b>\$ 15,117</b>			

(In thousands)	Fair Value December 31, 2012	Valuation Techniques	Unobservable Inputs	Significant Unobservable Input Value
<b>Assets</b>				
Trading Security	\$ 16,893	Discounted Cash Flow	Discount Rate	2.08%
Forward Commitments	(1,055)	Historical Trend	Closing Ratio	93.04%
		Pricing Model	Origination Costs, per loan	2,500
Interest Rate Lock Commitment	6,258	Historical Trend	Closing Ratio	93.04%
		Pricing Model	Origination Costs	2,500
<b>Total</b>	<b>\$ 22,096</b>			

**Non-Recurring Fair Value Measurements**

The Company is required, on a non-recurring basis, to adjust the carrying value or provide valuation allowances for certain assets using fair value measurements in accordance with GAAP. The following is a summary of applicable non-recurring fair value measurements. There are no liabilities measured on a non-recurring basis.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	December 31, 2013 Level 3 Inputs	Year ended December 31, 2013 Total Losses (Gains)
<b>Assets</b>		
Impaired loans	\$ 5,542	\$ (562)
Capitalized mortgage servicing rights	4,112	(773)
Other real estate owned	2,995	2
Total	\$ 12,649	\$ (1,333)

(In thousands)	December 31, 2012 Level 3 Inputs	Year ended December 31, 2012 Total Losses
<b>Assets</b>		
Impaired loans	\$ 6,104	\$ 6,216
Capitalized mortgage servicing rights	3,198	596
Other real estate owned	1,929	46
Total	\$ 11,231	\$ 6,858

Quantitative information about the significant unobservable inputs within Level 3 non-recurring assets as of December 31, 2013 and 2012 are as follows:

(in thousands)	December 31, 2013	Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
<b>Assets</b>				
Impaired loans	\$ 5,542	Fair value of collateral	Loss severity	4.2% to 100.0% (57.41%)
			Appraised value	\$0 to \$900.0 \$(505.4)
Capitalized mortgage servicing rights	4,112	Discounted cash flow	Constant prepayment rate (CPR)	6.96% to 15.97% (8.58%)
			Discount rate	10.00% to 13.00% (10.34%)
Other real estate owned	2,995	Fair value of collateral	Appraised value	\$0 to \$774.0 \$(413.4)
Total	\$ 12,649			

(a) Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective assets in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)	December 31, 2012	Valuation Techniques	Unobservable Inputs	Range (Weighted Average) (a)
<b>Assets</b>				
Impaired loans	\$ 6,104	Fair value of collateral	Loss severity	5.24% to 100.0% (42.79%)
			Appraised value	\$15.7 to \$1,584.0 \$(863.8)
Capitalized mortgage servicing rights	3,198	Discounted cash flow	Constant prepayment rate (CPR)	13.25% to 26.02% (18.41%)
			Discount rate	11.00% to 15.50% (11.14%)
Other real estate owned	1,929	Fair value of collateral	Appraised value	\$0 to \$1,000.0 \$(457.1)
Total Assets	\$ 11,231			

(a) Where dollar amounts are disclosed, the amounts represent the lowest and highest fair value of the respective assets in the population except for adjustments for market/property conditions, which represents the range of adjustments to individuals properties.

There were no Level 1 or Level 2 nonrecurring fair value measurements for year-end 2013 and 2012.

**Impaired Loans.** Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records non-recurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Non-recurring adjustments can also include certain impairment amounts for collateral-dependent loans calculated when establishing the allowance for credit losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated valuation amount does not necessarily represent the fair value of the loan. Real estate collateral is typically valued using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace. However, the choice of observable data is subject to significant judgment, and there are often adjustments based on judgment in order to make observable data comparable and to consider the impact of time, the condition of properties, interest rates, and other market factors on current values. Additionally, commercial real estate appraisals frequently involve discounting of projected cash flows, which relies inherently on unobservable data. Therefore, real estate collateral related nonrecurring fair value measurement adjustments have generally been classified as Level 3. Estimates of fair value for other collateral that supports commercial loans are generally based on assumptions not observable in the marketplace and therefore such valuations have been classified as Level 3.

**Capitalized mortgage loan servicing rights.** A loan servicing right asset represents the amount by which the present value of the estimated future net cash flows to be received from servicing loans are expected to more than adequately compensate the Company for performing the servicing. The fair value of servicing rights is estimated using a present value cash flow model. The most important assumptions used in the valuation model are the anticipated rate of the loan prepayments and discount rates. Adjustments are only recorded when the discounted cash flows derived from the valuation model are less than the carrying value of the asset. Although some assumptions in determining fair value are based on standards used by market participants, some are based on unobservable inputs and therefore are classified in Level 3 of the valuation hierarchy.

***Other real estate owned ( OREO )***. OREO results from the foreclosure process on residential or commercial loans issued by the Bank. Upon assuming the real estate, the Company records the property at the fair value of the asset less the estimated sales costs. Thereafter, OREO properties are recorded at the lower of cost or fair value. OREO fair values are primarily determined based on Level 3 data including sales comparables and appraisals.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Summary of Estimated Fair Values of Financial Instruments**

The estimated fair values, and related carrying amounts, of the Company's financial instruments follow. Certain financial instruments and all non-financial instruments are excluded from disclosure requirements. Accordingly, the aggregate fair value amounts presented herein may not necessarily represent the underlying fair value of the Company.

(In thousands)	Carrying Amount	Fair Value	December 31, 2013		
			Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	\$ 56,841	\$ 56,841	\$ 56,841	\$	\$
Trading security	14,840	14,840			14,840
Securities available for sale	760,048	760,048	20,891	737,193	1,964
Securities held to maturity	44,921	45,764			45,764
Restricted equity securities	50,282	50,282		50,282	
Net loans	4,147,200	4,154,663			4,154,663
Loans held for sale	15,840	15,840		15,840	
Accrued interest receivable	15,072	15,072		15,072	
Cash surrender value of bank-owned life insurance policies	101,530	101,530		101,530	
Derivative assets	8,318	8,318	242	7,799	277
Assets held for sale	3,969	3,969		3,969	
Financial Liabilities					
Total deposits	\$ 3,848,529	\$ 3,848,926	\$	\$ 3,848,926	\$
Short-term debt	872,510	872,545		872,545	
Long-term Federal Home Loan Bank advances	101,918	103,660		103,660	
Subordinated notes	89,679	87,882		87,882	
Derivative liabilities	11,964	11,964		11,964	
Liabilities held for sale	24,834	24,834		24,834	

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Carrying Amount	Fair Value	December 31, 2012		
			Level 1	Level 2	Level 3
Financial Assets					
Cash and cash equivalents	\$ 63,382	\$ 63,382	\$ 63,382	\$	\$
Trading security	16,893	16,893			16,893
Securities available for sale	466,169	466,169	25,291	439,993	885
Securities held to maturity	51,024	51,024			51,024
Restricted equity securities	39,785	39,785		39,785	
Net loans	3,955,446	4,004,259			4,004,259
Loans held for sale	85,368	85,368		85,368	
Accrued interest receivable	14,731	14,731		14,731	
Cash surrender value of bank-owned life insurance policies	88,198	88,198		88,198	
Derivative assets (1)	21,004	21,004		14,746	6,258
Financial Liabilities					
Total deposits	\$ 4,100,409	\$ 4,116,999	\$	\$ 4,116,999	\$
Short-term debt	163,150	163,150		163,150	
Long-term Federal Home Loan Bank advances	195,321	199,420		199,420	
Subordinated notes	89,617	73,967		73,967	
Derivative liabilities (2)	31,155	31,155	282	29,818	1,055

(1) Total fair value excludes the \$1.3 million of unrealized losses on forward commitments presented under other assets on the consolidated balance sheet.

(2) Total fair value includes the \$1.3 million of unrealized losses on forward commitments presented under other assets on the consolidated balance sheet.

Other than as discussed above, the following methods and assumptions were used by management to estimate the fair value of significant classes of financial instruments for which it is practicable to estimate that value.

**Cash and cash equivalents.** Carrying value is assumed to represent fair value for cash and cash equivalents that have original maturities of ninety days or less.

***Restricted equity securities.*** Carrying value approximates fair value based on the redemption provisions of the issuers.

***Cash surrender value of life insurance policies.*** Carrying value approximates fair value.

***Loans, net.*** The carrying value of the loans in the loan portfolio is based on the cash flows of the loans discounted over their respective loan origination rates. The origination rates are adjusted for substandard and special mention loans to factor the impact of declines in the loan's credit standing. The fair value of the loans is estimated by discounting future cash flows using the current interest rates at which similar loans with similar terms would be made to borrowers of similar credit quality.

***Accrued interest receivable.*** Carrying value approximates fair value.



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**Deposits.** The fair value of demand, non-interest bearing checking, savings and money market deposits is determined as the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting the estimated future cash flows using market rates offered for deposits of similar remaining maturities.

**Borrowed funds.** The fair value of borrowed funds is estimated by discounting the future cash flows using market rates for similar borrowings. Such funds include all categories of debt and debentures in the table above.

**Subordinated notes.** The Company utilizes a pricing service along with internal models to estimate the valuation of its junior subordinated debentures. The junior subordinated debentures re-price every ninety days.

**Off-balance-sheet financial instruments.** Off-balance-sheet financial instruments include standby letters of credit and other financial guarantees and commitments considered immaterial to the Company's financial statements.

**NOTE 21. OPERATING SEGMENTS**

The Company has two reportable operating segments, Banking and Insurance, which are delineated by the consolidated subsidiaries of Berkshire Hills Bancorp, Inc. Banking includes the activities of the Bank and its subsidiaries, which provide retail and commercial banking, along with wealth management and investment services. Insurance includes the activities of BIG, which provides retail and commercial insurance services. The only other consolidated financial activity of the Company is the Parent, which consists of the transactions of Berkshire Hills Bancorp, Inc. Management fees for corporate services provided by the Bank to Berkshire Insurance Group and the Parent are eliminated.

The accounting policies of each reportable segment are the same as those of the Company. The Insurance segment and the Parent reimburse the Bank for administrative services provided to them. Income tax expense for the individual segments is calculated based on the activity of the segments, and the Parent records the tax expense or benefit necessary to reconcile to the consolidated total. The Parent does not allocate capital costs. Average assets include securities available-for-sale based on amortized cost.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the Company's operating segments is as follows:

(In thousands)	Banking	Insurance	Parent	Eliminations	Total Consolidated
<b>Year ended December 31, 2013</b>					
Net interest income	\$ 172,634	\$	\$ 25,618	\$ (29,500)	\$ 168,752
Provision for loan losses	11,378				11,378
Non-interest income	48,238	9,994	15,414	(15,414)	58,232
Non-interest expense	146,944	8,069	2,346		157,359
Income before income taxes	62,550	1,925	38,686	(44,914)	58,247
Income tax expense (benefit)	18,802	759	(2,457)		17,104
<b>Net income</b>	<b>\$ 43,748</b>	<b>\$ 1,166</b>	<b>\$ 41,143</b>	<b>\$ (44,914)</b>	<b>\$ 41,143</b>
Average assets (in millions)	\$ 5,279	\$ 27	\$ 741	\$ (741)	\$ 5,307

(In thousands)	Banking	Insurance	Parent	Eliminations	Consolidated
<b>Year ended December 31, 2012</b>					
Net interest income	\$ 145,167	\$	\$ 15,221	\$ (17,000)	\$ 143,388
Provision for loan losses	9,590				9,590
Non-interest income	43,330	10,726	19,678	(19,678)	54,056
Non-interest expense	128,366	8,452	3,988		140,806
Income before income taxes	50,541	2,274	30,911	(36,678)	47,048
Income tax expense (benefit)	14,597	903	(2,277)		13,223
<b>Net income from continuing operations</b>	<b>35,944</b>	<b>1,371</b>	<b>33,188</b>	<b>(36,678)</b>	<b>33,825</b>
Income from discontinued operations before income taxes (including gain on disposal of \$63)	(261)				(261)
Income tax expense	376				376
<b>Net income from discontinued operations</b>	<b>(637)</b>				<b>(637)</b>
<b>Net income</b>	<b>\$ 35,307</b>	<b>\$ 1,371</b>	<b>\$ 33,188</b>	<b>\$ (36,678)</b>	<b>\$ 33,188</b>
Average assets (in millions)	\$ 5,006	\$ 30	\$ 559	\$ (392)	\$ 5,203

(In thousands)	Banking	Insurance	Parent	Eliminations	Consolidated
<b>Year ended December 31, 2011</b>					
Net interest income	\$ 107,348	\$	\$ 3,372	\$ (4,200)	\$ 106,520
Provision for loan losses	7,563				7,563
Non-interest income	24,716	11,087	16,067	(16,067)	35,803
Non-interest expense	103,571	8,752	4,119		116,442
Income before income taxes	20,930	2,335	15,320	(20,267)	18,318
Income tax expense (benefit)	2,932	980	(2,028)		1,884
<b>Net income from continuing operations</b>	<b>17,998</b>	<b>1,355</b>	<b>17,348</b>	<b>(20,267)</b>	<b>16,434</b>
Income from discontinued operations before income taxes (including gain on disposal of \$4,962)	4,684				4,684
Income tax expense	3,770				3,770
<b>Net income from discontinued operations</b>	<b>914</b>				<b>914</b>

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<b>Net income</b>	\$	18,912	\$	1,355	\$	17,348	\$	(20,267)	\$	17,348
Average assets (in millions)	\$	3,447	\$	32	\$	435	\$	(433)	\$	3,481

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 22. CONDENSED FINANCIAL STATEMENTS OF PARENT COMPANY**

Condensed financial information pertaining only to the Parent, Berkshire Hills Bancorp, is as follows. Investment in subsidiaries at December 31, 2013 includes \$35 million of intercompany subordinated notes.

**CONDENSED BALANCE SHEETS**

(In thousands)		December 31,	
	2013		2012
<b>Assets</b>			
Cash due from Berkshire Bank	\$ 40,154	\$	39,653
Investment in subsidiaries	698,943		686,748
Other assets	41,489		43,447
Total assets	\$ 780,586	\$	769,848
<b>Liabilities and Stockholders' Equity</b>			
Short term debt	\$ 10,000	\$	10,000
Subordinated notes	89,680		89,617
Accrued expenses	2,844		2,966
Stockholders' equity	678,062		667,265
Total liabilities and stockholders' equity	\$ 780,586	\$	769,848

**CONDENSED STATEMENTS OF INCOME**

(In thousands)		Years Ended December 31,	
	2013	2012	2011
<b>Income:</b>			
Dividends from subsidiaries	29,500	17,000	\$ 4,200
Other	2,317	481	11
Total income	31,817	17,481	4,211
Interest expense	6,199	2,260	839
Operating expenses	2,346	3,988	4,119
Total expense	8,545	6,248	4,958
Income (loss) before income taxes and equity in undistributed income (loss) of subsidiaries	23,272	11,233	(747)
Income tax benefit	(2,457)	(2,277)	(2,028)
Income (loss) before equity in undistributed income (loss) of subsidiaries	25,729	13,510	1,281

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Equity in undistributed income (loss) of subsidiaries	15,414	19,678	16,067
Net income	\$ 41,143	\$ 33,188	\$ 17,348

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## CONDENSED STATEMENTS OF CASH FLOWS

(In thousands)	Years Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Net income	\$ 41,143	\$ 33,188	\$ 17,348
Adjustments to reconcile net income to net cash (used) provided by operating activities:			
Equity in undistributed income of subsidiaries	(15,414)	(19,678)	(16,067)
Other, net	763	1,897	76
Net cash provided by operating activities	26,492	15,407	1,357
Cash flows from investing activities:			
Acquisitions, net of cash paid		(64,230)	13,069
Purchase of securities	(770)		
Other, net	588	1,000	
Net cash (used) provided by investing activities	(182)	(63,230)	13,069
Cash flows from financing activities:			
Proceed from issuance of short term debt		10,000	
Proceed from issuance of long term debt		74,153	
Net proceeds from common stock	3,045		
Net proceeds from reissuance of treasury stock		3,044	252
Payment to repurchase common stock	(12,249)		
Common stock cash dividends paid	(18,118)	(15,634)	(11,910)
Other, net	1,513		
Net cash provided (used) by financing activities	(25,809)	71,563	(11,658)
Net change in cash and cash equivalents	501	23,740	2,768
Cash and cash equivalents at beginning of year	39,653	15,913	13,145
Cash and cash equivalents at end of year	\$ 40,154	\$ 39,653	\$ 15,913

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**NOTE 23. QUARTERLY DATA (UNAUDITED)**

Quarterly results of operations were as follows:

(In thousands, except per share data)	2013				2012			
	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest and dividend income	\$ 48,659	\$ 54,504	\$ 49,697	\$ 50,881	\$ 51,488	\$ 43,123	\$ 42,656	\$ 38,672
Interest expense	8,817	8,635	8,593	8,944	9,523	7,898	7,603	7,527
Net interest income	39,842	45,869	41,104	41,937	41,965	35,225	35,053	31,145
Non-interest income	15,714	12,114	15,606	14,798	17,653	14,313	12,288	9,802
Total revenue	55,556	57,983	56,710	56,735	59,618	49,538	47,341	40,947
Provision for loan losses	3,100	3,178	2,700	2,400	2,840	2,500	2,250	2,000
Non-interest expense	37,157	42,784	37,935	39,483	44,266	32,162	34,184	30,194
Income before income taxes	15,299	12,021	16,075	14,852	12,512	14,876	10,907	8,753
Income tax expense	4,762	3,917	4,038	4,387	3,183	4,847	2,921	2,272
Net income from continuing operations	10,537	8,104	12,037	10,465	9,329	10,029	7,986	6,481
Loss from discontinued operations, net of tax								(637)
<b>Net income</b>	<b>\$ 10,537</b>	<b>\$ 8,104</b>	<b>\$ 12,037</b>	<b>\$ 10,465</b>	<b>\$ 9,329</b>	<b>\$ 10,029</b>	<b>\$ 7,986</b>	<b>\$ 5,844</b>
<b>Basic earnings per share:</b>								
Continuing operations	\$ 0.43	\$ 0.33	\$ 0.49	\$ 0.42	\$ 0.39	\$ 0.46	\$ 0.37	\$ 0.31
Discontinued operations								(0.03)
<b>Total basic earnings per share</b>	<b>\$ 0.43</b>	<b>\$ 0.33</b>	<b>\$ 0.49</b>	<b>\$ 0.42</b>	<b>\$ 0.39</b>	<b>\$ 0.46</b>	<b>\$ 0.37</b>	<b>\$ 0.28</b>
<b>Diluted earnings per share:</b>								
Continuing operations	\$ 0.42	\$ 0.33	\$ 0.48	\$ 0.42	\$ 0.38	\$ 0.46	\$ 0.37	\$ 0.31
Discontinued operations								(0.03)
<b>Total diluted earnings per share</b>	<b>\$ 0.42</b>	<b>\$ 0.33</b>	<b>\$ 0.48</b>	<b>\$ 0.42</b>	<b>\$ 0.38</b>	<b>\$ 0.46</b>	<b>\$ 0.37</b>	<b>\$ 0.28</b>
<b>Weighted average shares outstanding:</b>								
Basic	24,701	24,748	24,779	24,948	24,165	21,921	21,742	20,955
Diluted	24,857	24,873	24,956	25,143	24,396	22,031	21,806	21,062

A correction was identified in 2013 for prior period interest income earned on loans acquired in bank acquisitions and the accounting for a state income tax credit, which was deemed to be immaterial in relation to quarterly results. There has been no correction to quarterly results previously disclosed for 2013. The correction for fiscal year 2013 is included in third quarter 2013 financial results.

A correction was identified in 2012 for the accounting treatment of lease agreements with contractual cost escalators, which was deemed to be immaterial in relation to quarterly results. There has been no correction to quarterly results previously disclosed for 2012. The correction for

fiscal year 2012 is included in fourth quarter 2012 financial results.

**NOTE 24. NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES**

Presented below is net interest income after provision for loan losses for the three years ended 2013, 2012, and 2011, respectively:

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands)	Years Ended December 31,		
	2013	2012	2011
Net interest income	168,752	143,388	106,520
Provision for loan losses	11,378	9,590	7,563
<b>Net interest income after provision for loan losses</b>	<b>157,374</b>	<b>133,798</b>	<b>98,957</b>
Total non-interest income	58,232	54,056	35,803
Total non-interest expense	157,359	140,806	116,442
Income from continuing operations before income taxes	58,247	47,048	18,318
Income tax expense	17,104	13,223	1,884
<b>Net income from continuing operations</b>	<b>41,143</b>	<b>33,825</b>	<b>16,434</b>
(Loss) income from discontinued operations before income taxes (including gain on disposals \$63 in 2012 and \$4,962 in 2011)		(261)	4,684
Income tax expense		376	3,770
<b>Net (loss) income from discontinued operations</b>		<b>(637)</b>	<b>914</b>
<b>Net income</b>	<b>\$ 41,143</b>	<b>\$ 33,188</b>	<b>\$ 17,348</b>

**NOTE 25. SUBSEQUENT EVENTS**

On January 17, 2014, the Company purchased and assumed twenty banking offices, which primarily services central and eastern New York State, from Bank of America, National Association into Berkshire Bank. Bank of America, National Association received \$10.5 million in cash. As of January 17, 2014, these branches had assets with a carrying value of approximately \$7.1 million, including loans outstanding with a carrying value of approximately \$4.1 million, as well as deposits with a carrying value of approximately \$441 million. The results of the branches operations will be included in our Consolidated Statement of Income from the date of acquisition. The Company incurred \$2.2 million of merger and acquisition expenses related to the branch acquisition included in Merger, restructuring and conversion related expenses in the Consolidated Statement of Income for the twelve months ended December 31, 2013. As a result of the proximity of the closing of the branch acquisition to the date these consolidated financial statements are available to be issued, the Company is still evaluating the estimated fair values of the assets acquired and the liabilities assumed. Accordingly, the amount of any goodwill and other intangible assets to be recognized in connection with this transaction is also yet to be determined. This purchase and assumption agreement had no significant effect on the Company's financial statements for the periods presented.

As a result of the Bank of America, National Association branch acquisition, on March 4, 2014 the Bank terminated all of its interest rate swaps associated with FHLB advances with 3-month LIBOR based floating interest rates with an aggregate notional amount of \$30 million, all of its interest rate swaps associated with 90 day rolling FHLB advances issued using the FHLB's 3-month fixed interest rate with an aggregate notional amount of \$145 million, and all of its forward-starting interest rate swaps associated with 90 day rolling FHLB advances issued using the FHLB's 3-month fixed interest rate with an aggregate notional amount of \$235 million, with various institutions. In the first quarter of 2014 the Bank elected to extinguish \$215 million of FHLB advances related to the terminated swaps. As a result the Bank has reclassified \$8.6 million of losses from the effective portion of the unrealized changes in the fair value of the terminated derivatives from other comprehensive loss to earnings as the forecasted transactions related to the FHLB advances will not occur.