BERKSHIRE BANCORP INC /DE/
Form 10-Q
May 15, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **March 31, 2013**

or

¨ **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: 0-13649

**BERKSHIRE BANCORP INC.**

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| **Delaware** | **94-2563513** |
| (State or Other Jurisdiction of | (I.R.S. Employer |

Incorporation or Organization) Identification No.)

**160 Broadway, New York, New York** **10038**
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: **(212) 791-5362**

**N/A**
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨ Accelerated filer ¨

Non-accelerated filer ¨ Smaller reporting company x
(Do not check if a smaller reporting company)

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

As of May 10, 2013, there were 14,416,198 outstanding shares of the issuer's Common Stock, $.10 par value.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**FORWARD-LOOKING STATEMENTS**

***Forward-Looking Statements.*** *Statements in this Quarterly Report on Form 10-Q that are not based on historical fact may be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "believe", "may", "will", "expect", "estimate", "anticipate", "continue" or similar terms identify forward-looking statements. A wide variety of factors could cause the actual results and experiences of Berkshire Bancorp Inc. (the "Company") to differ materially from the results expressed or implied by the Company's forward-looking statements. Some of the risks and uncertainties that may affect operations, performance, results of the Company's business, the interest rate sensitivity of its assets and liabilities, and the adequacy of its loan loss allowance, include, but are not limited to: (i) deterioration in local, regional, national or global economic conditions which could result, among other things, in an increase in loan delinquencies, a decrease in property values, or a change in the housing turnover rate; (ii) changes in market interest rates or changes in the speed at which market interest rates change; (iii) changes in laws and regulations affecting the financial services industry; (iv) changes in competition; (v) changes in consumer preferences; (vi) changes in banking technology; (vii) ability to maintain key members of management; (viii) possible disruptions in the Company's operations at its banking facilities; (ix) cost of compliance with new corporate governance requirements, rules and regulations; and other factors referred to in this Quarterly Report and in Item 1A, "Risk Factors", of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012.*

*Certain information customarily disclosed by financial institutions, such as estimates of interest rate sensitivity and the adequacy of the loan loss allowance, are inherently forward-looking statements because, by their nature, they represent attempts to estimate what will occur in the future.*

*The Company cautions readers not to place undue reliance upon any forward-looking statement contained in this Quarterly Report. Forward-looking statements speak only as of the date they were made and the Company assumes no obligation to update or revise any such statements upon any change in applicable circumstances.*

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**QUARTERLY REPORT ON FORM 10-Q**

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

**(Dollars in Thousands, Except Share Data)**

| ASSETS | March 31, 2013 **(unaudited)** | December 31, 2012 |
|---|---|---|
| Cash and due from banks **(including restricted cash Of $3,872 and $4,083, respectively)** | $ 7,445 | $ 8,637 |
| Interest bearing deposits | 125,166 | 140,517 |
| Total cash and cash equivalents | 132,611 | 149,154 |
| Investment Securities: | | |
| Available-for-sale, at fair value | 348,643 | 355,114 |
| Federal Home Loan Bank of New York stock | 843 | 887 |
| Held-to-maturity, fair value of $270 in 2013 and $283 in 2012 | 270 | 275 |
| Total investment securities | 349,756 | 356,276 |
| Loans, net of unearned income | 297,646 | 295,165 |
| Less: allowance for loan losses | (10,705 ) | (11,008 ) |
| Net loans | 286,941 | 284,157 |
| Accrued interest receivable | 3,114 | 3,099 |
| Premises and equipment, net | 7,059 | 7,113 |
| Real Estate Owned | — | 225 |
| Deferred Tax Asset, net | 14,686 | 16,392 |
| Other assets | 5,520 | 11,629 |
| Total assets | $ 799,687 | $ 828,045 |
| Commitments and Contingencies | | |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Deposits: | | |
| Non-interest bearing | $ 75,805 | $ 84,163 |
| Interest bearing | 534,566 | 558,307 |
| Total deposits | 610,371 | 642,470 |
| Securities sold under agreements to repurchase | 45,000 | 45,000 |
| Borrowings | 564 | 1,539 |
| Accrued interest payable | 1,897 | 1,699 |
| Other liabilities | 4,513 | 3,031 |
| Total liabilities | 662,345 | 693,739 |
| Commitment and Contingencies | | |
| Stockholders' equity | | |
| Preferred stock - $.01 Par value: 2,000,000 shares authorized - none issued | — | — |
| Common stock - $.10 par value | | |
| Authorized — 25,000,000 shares | | |
| Issued — 14,416,198 shares | | |
| Outstanding — | | |

| | | |
|---|---|---|
| March 31, 2013, 14,416,198 shares | | |
| December 31, 2012, 14,416,198 shares | 1,441 | 1,441 |
| Additional paid-in capital | 143,903 | 143,903 |
| Accumulated Deficit | (7,110) | (8,061) |
| Accumulated other comprehensive loss, net | (892) | (2,977) |
| Total stockholders' equity | 137,342 | 134,306 |
| Total liabilities and stockholders' equity | $ 799,687 | $ 828,045 |

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

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME**

**(Dollars In Thousands, Except Per Share Data)**

**(unaudited)**

| | For The Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| INTEREST INCOME | | |
| Loans, including related fees | $ 4,227 | $ 4,905 |
| Investment securities | 2,196 | 2,437 |
| Interest bearing deposits | 95 | 59 |
| Total interest income | 6,518 | 7,401 |
| INTEREST EXPENSE | | |
| Deposits | 959 | 1,226 |
| Securities sold under agreements to repurchase | 380 | 444 |
| Interest expense on borrowings | 8 | 197 |
| Total interest expense | 1,347 | 1,867 |
| Net interest income | 5,171 | 5,534 |
| PROVISION FOR LOAN LOSSES | (303) | — |
| Net interest income after provision for loan losses | 5,474 | 5,534 |
| NON-INTEREST INCOME | | |
| Service charges on deposit accounts | 124 | 86 |
| Investment securities gains | 21 | 220 |
| Other income | 382 | 217 |
| Total non-interest income | 527 | 523 |
| NON-INTEREST EXPENSE | | |
| Salaries and employee benefits | 2,702 | 2,480 |
| Net occupancy expense | 593 | 584 |
| Equipment expense | 89 | 78 |
| FDIC assessment | 300 | 300 |
| Data processing expense | 127 | 112 |
| Other | 652 | 636 |
| Total non-interest expense | 4,463 | 4,190 |
| Income before provision for taxes | 1,539 | 1,867 |
| Provision for income taxes | 587 | (269) |
| Net income | $ 951 | $ 2,136 |
| Dividends on preferred stock | - | - |
| Income (loss) allocated to common stockholders | $ 951 | $ 2,136 |
| Net income (loss) per common share: | | |
| Basic | $ 0.07 | $ 0.15 |
| Diluted | $ 0.07 | $ 0.15 |

| | | |
|---|---|---|
| Number of shares used to compute net income (loss) per common share: | | |
| Basic | 14,417 | 14,443 |
| Diluted | 14,417 | 14,443 |

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

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

**(in thousands)**

**(unaudited)**

| | For The Three Months Ended March 31, 2013 | 2012 |
|---|---|---|
| Net earnings | $ 951 | $ 2,136 |
| Other comprehensive income, net of tax: | | |
| Unrealized gains on available-for-sale securities, net of taxes of $1,706 and $4,008, in 2013 and 2012, respectively | 2,085 | 6,012 |
| Reclassification adjustment for realized gains (losses) included in net earnings, net of taxes of $0 and $88, in 2013 and 2012, respectively | — | 132 |
| Other comprehensive income | $ 2,085 | $ 5,880 |
| Comprehensive income | $ 3,036 | $ 8,016 |

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

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

**For The Three Months Ended March 31, 2013 and 2012**

(Dollars In Thousands, Except Share Data)

(Unaudited)

| | Common Shares | Preferred Shares | Common Stock Par Value | Preferred Stock Par Value | Additional paid-in capital | Accumulated other comprehensive (loss), net | Retained Earnings/ (Accumulated deficit) | Treasury stock | Total stockholders' equity |
|---|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2011 | 14,443 | — | $ 1,444 | $ — | $ 143,900 | $ (10,517 ) | $ (19,299 ) | $ — | $ 115,528 |
| Net income | | | | | | | 2,136 | | 2,136 |
| Other comprehensive income net of taxes | | | | | | 5,880 | | | 5,880 |
| Comprehensive income | | | | | | | | | — |
| Adjustment | | | | | | | | | — |
| Balance at March 31, 2012 | 14,443 | — | $ 1,444 | $ — | $ 143,900 | $ (4,637 ) | $ (17,163 ) | $ — | $ 123,544 |
| | | | | | | | | | |
| Balance at December 31, 2012 | 14,416 | — | $ 1,441 | $ — | $ 143,903 | $ (2,977 ) | $ (8,061 ) | $ — | $ 134,306 |
| Net income | | | | | | | 951 | | 951 |
| Other comprehensive income net of taxes | | | | | | 2,085 | | | 2,085 |
| Cash dividends - Common Stock | | | | | | | | | — |
| Adjustment | | | | | | | | | — |
| Balance at March 31, 2013 | 14,416 | — | $ 1,441 | $ — | $ 143,903 | $ (892 ) | $ (7,110 ) | $ — | $ 137,342 |

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

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(in thousands)**

**(unaudited)**

| | For The Three Months Ended March 31, 2013 | 2012 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 951 | $ 2,136 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Realized gains/(losses) on investment securities | 21 | (220) |
| Net amortization of premiums of investment securities | 442 | 601 |
| Depreciation and amortization | 116 | 122 |
| Provision for loan losses | (303) | - |
| (Increase) decrease in accrued interest receivable | (15) | 12 |
| (Increase) decrease in other real estate owned | 225 | - |
| (Increase) decrease in other assets | 6,107 | 5,217 |
| (Decrease) increase in accrued interest payable and other liabilities | 1,679 | (540) |
| Net cash provided by operating activities | 9,222 | 7,328 |
| | | |
| Cash flows from investing activities: | | |
| Investment securities available for sale | | |
| Purchases | (95,798) | (62,333) |
| Sales, maturities and calls | 105,617 | 62,509 |
| Decrease in FHLBNY stock | 44 | 52 |
| Investment securities held to maturity | | |
| Payments | 5 | 7 |
| Net decrease in loans | (2,481) | (4,835) |
| (Acquisition) sale of premises and equipment | (80) | (29) |
| Net cash provided by (used in) investing activities | 7,307 | (4,681) |
| | | |
| Cash flows from financing activities: | | |
| Net increase/(decrease) in non interest bearing deposits | (8,358) | 1,851 |
| Net increase/(decrease) in interest bearing deposits | (23,741) | 18,800 |
| Repayment of borrowings | (975) | (1,157) |
| Net cash (used in) financing activities | (33,073) | 19,494 |
| | | |
| Net increase/(decrease) in cash and cash equivalents | (16,543) | 22,141 |
| Cash and cash equivalents at beginning of period | 149,154 | 101,036 |
| Cash and cash equivalents at end of period | $ 132,611 | $ 123,177 |

| | | |
|---|---|---|
| Supplemental disclosure of cash flow information: | | |
| Cash used to pay interest | $ 1,149 | $ 2,240 |
| Cash used to pay income taxes, net of refunds | $ (6,620 ) | $ 78 |

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

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**March 31, 2013 and 2012**

**(unaudited)**

**Note 1. General**

Berkshire Bancorp Inc., a Delaware corporation, is a bank holding company registered under the Bank Holding Company Act of 1956. References herein to "Berkshire", the "Company" or "we" and similar pronouns, shall be deemed to refer to Berkshire Bancorp Inc. and its wholly-owned consolidated subsidiaries unless the context otherwise requires. Berkshire's principal activity is the ownership and management of its indirect wholly-owned subsidiary, The Berkshire Bank (the "Bank"), a New York State chartered commercial bank. The Bank is owned through Berkshire's wholly-owned subsidiary, Greater American Finance Group, Inc. ("GAFG").

The accompanying consoldiated financial statements of Berkshire Bancorp Inc. and subsidiaries include the accounts of the parent company, Berkshire Bancorp Inc., and its wholly-owned subsidiaries: The Berkshire Bank, GAFG and East 39, LLC.

We have prepared the accompanying consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim financial reporting. These consolidated financial statements, including the notes thereto, are unaudited and, in our opinion, include all adjustments, consisting of normal recurring adjustments and accruals, necessary for a fair presentation of our consolidated balance sheets, operating results, and cash flows for the periods presented. Operating results for the periods presented are not necessarily indicative of the results that may be expected for the remaining quarters of fiscal 2012 due to a variety of factors. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("GAAP") have been omitted in accordance with the rules and regulations of the SEC. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's 2012 Annual Report on Form 10-K.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 2. Earnings Per Share**

Basic earnings per common share is calculated by dividing income available to common stockholders by the weighted average common stock outstanding, excluding stock options from the calculation. As of and for the three-month periods ended March 31, 2013 and 2012, there were no potential dilutive shares. The following tables present the Company's calculation of income per common share:

| | For The Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| | Income (numerator) | Shares (denominator) | Per share amount | Income (numerator) | Shares (denominator) | Per share amount |
| | (In thousands, except per share data) | | | | | |
| Basic earnings per common share | | | | | | |
| Net income | $951 | | | $2,136 | | |
| Net income available to common stockholders | $951 | 14,417 | $ 0.07 | $2,136 | 14,443 | $ 0.15 |

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 3. Income Taxes**

The provision for income taxes consists of the following:

| | **March 31, 2013** | **March 31, 2012** |
|---|---|---|
| | (In thousands) | |
| Federal: | | |
| Current | $ - | $ - |
| Deferred | 236 | (901) |
| State and Local: | | |
| Current | 190 | 171 |
| Deferred | 161 | 461 |
| Total | 587 | (269) |

The tax effect of the principal temporary differences at March 31, 2013 and December 31, 2012 are as follows:

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| | (In thousands) | |
| Net deferred tax assets | | |
| Loan loss provision | $4,828 | $ 4,965 |
| Depreciation | (200) | (264) |
| Non accrual interest | 104 | 104 |
| Net operating loss | 7,953 | 8,245 |
| Tax Credits | 123 | 123 |
| Other | 911 | 784 |
| Unrealized loss on investment securities | 729 | 2,436 |
| Net deferred tax assets included in other assets | $14,448 | $ 16,392 |

As of March 31, 2013 and December 31, 2012, the Company had $19.6 million and $20.0 million, respectively, of federal net operating losses (“NOLs”) and $11.7 million and $12.9 million, respectively, of state NOLs available to offset future taxable income for income tax purposes that will begin to expire in 2029.

For the fiscal year ended December 31, 2011, the Company recorded a valuation reserve of $3.9 million relating primarily to NOL's. During the six months ended June 30, 2012, the valuation reserve was released due to additional current earnings and the expectation that we will recognize the remaining benefit of the NOLs within the next few years. Of the remaining deferred tax asset, management has determined that it is more likely than not that we will realize the net deferred tax asset based upon the nature and timing of the items referred to above. In order to fully realize the net deferred tax asset, the Company will need to generate future taxable income. Management has projected that the Company will generate sufficient taxable income to utilize the net deferred tax asset. However, there can be no assurance that such levels of taxable income will be generated.

In the normal course of business, the Company's Federal, New York State and New York City Corporation tax returns are subject to audit. The Company is currently open to audit by the Internal Revenue Service (the "IRS") under the statute of limitations for years after 2008. The Company was under examination by the IRS for the years 2008 and 2009. This examination was completed during 2012 with no change to the tax returns as filed.

The Company has performed an evaluation of its tax positions and has concluded that as of March 31, 2013 and December 31, 2012, there were no significant uncertain tax positions requiring additional recognition in its financial statements and does not believe that there will be any material changes in its unrecognized tax positions over the next twelve months.

The Company's policy is to recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense. There were no accruals for interest or penalties during the three months ended March 31, 2013 or the year ended December 31, 2012.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. Loan Portfolio**

The following table sets forth information concerning the Company's loan portfolio by type of loan at the dates indicated:

| | March 31, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| | Amount | **% of Total** | Amount | **% of Total** |
| | (Dollars in thousands) | | | |
| Commercial and Industrial and Finance Leases | $25,781 | 8.6 % | $23,184 | 7.8 % |
| Secured by Real Estate | | | | |
| Residential | 80,238 | 26.9 | 84,207 | 28.5 |
| Multi family | 14,240 | 4.8 | 14,491 | 4.9 |
| Commercial Real Estate and Construction | 177,110 | 59.4 | 172,973 | 58.5 |
| Consumer | 846 | 0.3 | 899 | 0.3 |
| Total loans | 298,215 | 100.0 % | 295,754 | 100.0 % |
| Deferred loan fees | (569 ) | | (589 ) | |
| Allowance for loan losses | (10,705 ) | | (11,008 ) | |
| Loans, net | $286,941 | | $284,157 | |

The Bank had $1.2 million and $0.9 million of non-accrual loans as of March 31, 2013 and December 31, 2012, respectively, and no loans delinquent more than ninety days and still accruing interest at both March 31, 2013 and December 31, 2012. The Bank did not foreclose on any loans during the three months ended March 31, 2013. The Bank had one foreclosed real estate property, with a carrying value of $225,000 in the year ended December 31, 2012. The Bank classified the non-accrual loans as impaired loans at both March 31, 2013 and December 31, 2012. However, no specific reserves for impaired loans was made because the collateral underlying the impaired loans was deemed to be sufficient to cover any loss in the event of a default. Therefore, the allowance for loan loss is includable in the calculation of regulatory capital up to a maximum of 125% of risk-weighted assets or approximately $4.6 million and $4.6 million at March 31, 2013 and December 31, 2012, respectively.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

Average impaired loans for the three months ended March 31, 2013 and 2012 were approximately $8.8 million and $25.8 million, respectively. Interest income that would have been recognized had these loans performed in accordance with their contractual terms was $7,000 and $29,000 for the three months ended March 31, 2013 and 2012, respectively.

The following table sets forth information concerning activity in the Company's allowance for loan losses for the indicated periods.

| | For The Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| | (In thousands | |
| Balance at beginning of period | $ 11,008 | $ 17,720 |
| Provision charged to operations | (303) | — |
| Loans charge-offs | — | — |
| Recoveries | — | — |
| Balance at end of period | $ 10,705 | $ 17,720 |

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Allowance for Credit Losses and Recorded Investment in Financing Receivables**

The qualitative factors are determined based on the various risk characteristics of each loan class. Relevant risk characteristics are as follows:

**Commercial and industrial loans** - Loans in this class are made to businesses. Generally these loans are secured by assets of the business and repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer and/or business spending will have an effect on the credit quality in this loan class.

**Commercial real estate** - Loans in this class include income-producing investment properties and owner-occupied real estate used for business purposes. The underlying properties are generally located largely in our primary market area. The cash flows of the income producing investment properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates, which in turn, will have an effect on credit quality. In the case of owner-occupied real estate used for business purposes a weakened economy and resultant decreased consumer and/or business spending will have an adverse effect on credit quality.

**Construction loans** - Loans in this class primarily include land loans to local individuals, contractors and developers for developing the land for sale or for the purpose of making improvements thereon. Repayment is derived from sale of the lots/units including any pre-sold units. Credit risk is affected by market conditions, time to sell at an adequate price and cost overruns. To a lesser extent this class includes commercial development projects we finance which in most cases have an interest-only phase during construction and then convert to permanent financing. Credit risk is affected by cost overruns, market conditions and the availability of permanent financing, to the extent such permanent financing is not being provided by us.

**Residential real estate** - Loans in this class are made to and secured by owner-occupied 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 loan class. The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Multi-Family real estate** - Loans in this class are made to and secured by owner-occupied 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 loan class. The Company generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans.

**Consumer loans** - Loans in this class may be either secured or unsecured and repayment is dependent on the credit quality of the individual borrower and, if applicable, sale of the collateral securing the loan (such as automobile or other secured assets). Therefore the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class.

**Financing Leases** - Loans in this class may be either secured or unsecured and repayment is dependent on the credit quality of the individual borrower and, if applicable, sale of the collateral securing the loan (such as equipment or other secured assets). Therefore the overall health of the economy, including unemployment rates and housing prices, will have an effect on the credit quality in this loan class.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Allowance for Credit Losses and Recorded Investment in Loans**

**For the Three Months Ended March 31, 2013**

**(In thousands)**

| | **Commercial & Industrial** | **Commercial Real Estate** | Construction | Multi Family | **Residential Real Estate** | Consumer | **Finance Leases** | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| Allowance for credit losses: | | | | | | | | | |
| Beginning balance | $ 989 | $ 6,309 | $ 1,441 | $ 326 | $ 1,529 | $ 15 | $ 62 | $ 337 | $ 11,008 |
| Charge-offs | - | - | - | - | - | - | - | - | - |
| Recoveries | - | - | - | - | - | - | - | - | - |
| Provision | 155 | (179 ) | 14 | (6 ) | (128 ) | 8 | (31 ) | (136 ) | (303 ) |
| Ending balance | $ 1,144 | $ 6,130 | $ 1,455 | $ 320 | $ 1,401 | $ 23 | $ 31 | $ 201 | $ 10,705 |
| Ending balance: individually evaluated for impairment | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Ending balance: collectively evaluated for impairment | $ 1,144 | $ 6,130 | $ 1,455 | $ 320 | $ 1,401 | $ 23 | $ 31 | $ 201 | $ 10,705 |
| | | | | | | | | | |
| Financing Receivables: | | | | | | | | | |
| Ending balance | $ 25,781 | $ 151,706 | $ 24,276 | $ 14,240 | $ 80,238 | $ 846 | $ 1,128 | $ 0 | $ 298,215 |
| Ending balance: individually evaluated for impairment | $ 0 | $ 1,264 | $ 0 | $ 0 | $ 7,548 | $ 0 | $ 0 | $ 0 | $ 8,812 |
| | $ 25,781 | $ 150,442 | $ 24,276 | $ 14,240 | $ 72,690 | $ 846 | $ 1,128 | $ 0 | $ 289,403 |

Ending balance:
collectively
evaluated for
impairment

Among the loans reviewed for impairment, $2.1 million of residential loans and $1.3 million of commercial real estate loans were identified as troubled debt restructurings ("TDRs"). TDRs are the result of an economic concession being granted to borrowers experiencing financial difficulties. Certain TDRs are classified as nonperforming at the time of restructuring and may only return to performing status after considering the borrower's sustained repayment performance under the revised payment terms for a reasonable period, generally six months. We evaluated all of the impaired loans by analyzing the collateral value and by evaluating the discounted cash flow. Based on the nature of the modifications no impairment was required.

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Allowance for Credit Losses and Recorded Investment in Loans**

**For the Three Months Ended March 31, 2012**

**(In thousands)**

| | **Commercial & Industrial** | **Commercial Real Estate** | Construction | Multi Family | **Residential Real Estate** | Consumer | **Finance Leases** | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| Allowance for credit losses: | | | | | | | | | |
| Beginning balance | $ 950 | $ 7,857 | $ 609 | $ 411 | $ 6,490 | $ 53 | $ 126 | $ 1,224 | $ 17,720 |
| Charge-offs | - | - | - | - | - | - | - | - | - |
| Recoveries | - | - | - | - | - | - | - | - | - |
| Provision | (280) | 262 | 462 | (9) | (315) | (14) | (28) | (78) | 0 |
| Ending balance | $ 670 | $ 8,119 | $ 1,071 | $ 402 | $ 6,175 | $ 39 | $ 98 | $ 1,146 | $ 17,720 |
| Ending balance: individually evaluated for impairment | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Ending balance: collectively evaluated for impairment | $ 670 | $ 8,119 | $ 1,071 | $ 402 | $ 6,175 | $ 39 | $ 98 | $ 1,146 | $ 17,720 |
| Financing Receivables: | | | | | | | | | |
| Ending balance | $ 14,728 | $ 167,525 | $ 19,836 | $ 11,921 | $ 104,040 | $ 906 | $ 3,618 | $ 0 | $ 322,574 |
| Ending balance: individually evaluated for impairment | $ 102 | $ 23,245 | $ 0 | $ 0 | $ 2,360 | $ 15 | $ 0 | $ 0 | $ 25,722 |
| | $ 14,626 | $ 144,280 | $ 19,836 | $ 11,921 | $ 101,860 | $ 891 | $ 3,618 | $ 0 | $ 296,852 |

Ending balance:
collectively
evaluated for
impairment

Among the loans reviewed for impairment, $2.4 million of residential loans and $1.3 million of commercial real estate loans were identified as troubled debt restructurings ("TDRs"). TDRs are the result of an economic concession being granted to borrowers experiencing financial difficulties. Certain TDRs are classified as nonperforming at the time of restructuring and may only return to performing status after considering the borrower's sustained repayment performance under the revised payment terms for a reasonable period, generally six months. We evaluated all of the impaired loans by analyzing the collateral value and by evaluating the discounted cash flow. Based on the nature of the modifications no impairment was required.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Age Analysis of Past Due Loans**

**As of March 31, 2013**

**(In thousands)**

| | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days | Total Past Due | Current | Total Loans | Recorded Loans > 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Commercial & industrial | $ — | $ — | $ — | $ — | $25,781 | $25,781 | $ — |
| Construction | — | — | — | — | 24,276 | 24,276 | — |
| Commercial real estate | — | — | — | — | 151,706 | 151,706 | — |
| Consumer | 21 | — | — | 21 | 668 | 689 | — |
| Overdrafts | — | — | — | — | 157 | 157 | — |
| Residential - prime | 299 | 511 | 731 | 1,541 | 78,697 | 80,238 | — |
| Residential - multi family | — | — | — | — | 14,240 | 14,240 | — |
| Finance leases | — | — | — | — | 1,128 | 1,128 | — |
| Total | $ 320 | $ 511 | $ 731 | $ 1,562 | $296,653 | $298,215 | $ — |

**Age Analysis of Past Due Loans**

**As of December 31, 2012**

**(In thousands)**

| | 30-59 Days Past Due | 60-89 Days Past Due | Greater Than 90 Days | Total Past Due | Current | Total Loans | Recorded Loans > 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| Commercial & industrial | $ — | $ — | $ — | $ — | $21,814 | $21,814 | $ — |
| Construction | — | — | — | — | 23,789 | 23,789 | — |
| Commercial real estate | 7,181 | — | — | 7,181 | 142,003 | 149,184 | — |
| Consumer | 50 | — | — | 50 | 665 | 715 | — |
| Overdrafts | — | — | — | — | 184 | 184 | — |
| Residential - prime | 6,081 | 373 | 861 | 7,315 | 76,892 | 84,207 | — |
| Residential - multi family | — | — | — | — | 14,491 | 14,491 | — |
| Finance leases | — | — | — | — | 1,370 | 1,370 | — |
| Total | $ 13,312 | $ 373 | $ 861 | $ 14,546 | $281,208 | $295,754 | $ — |

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Impaired Loans**

**For the Three Months Ended March 31, 2013**

**(In thousands)**

| | Recorded Loan | Unpaid Principal Balance | Related Allowance | Average Recorded Loan | Interest Income Recognized | Interest Income Foregone |
|---|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | | |
| Commercial & industrial | $ — | $ — | $ — | $ — | $ — | $ — |
| Construction | — | — | — | — | — | — |
| Commercial real estate | 1,263 | 1,263 | — | 1,270 | 21 | — |
| Consumer | 13 | 13 | — | 13 | 0 | — |
| Residential - prime | 7,536 | 7,536 | — | 7,566 | 132 | 7 |
| Residential - multi family | — | — | — | — | — | — |
| Finance leases | — | — | — | — | — | — |
| **Total** | $ 8,812 | $ 8,812 | $ — | $ 8,849 | $ 153 | $ 7 |
| Commercial | 1,263 | 1,263 | — | 1,270 | 21 | — |
| Consumer | 13 | 13 | — | 13 | 0 | — |
| Residential | 7,536 | 7,536 | — | 7,566 | 132 | 7 |

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Impaired Loans**

**For the Year Ended December 31, 2012**

**(In thousands)**

| | Recorded Loan | Unpaid Principal Balance | Related Allowance | Average Recorded Loan | Interest Income Recognized | Interest Income Foregone |
|---|---|---|---|---|---|---|
| With no related allowance recorded: | | | | | | |
| Commercial & industrial | $ — | $ — | $ — | $ — | $ — | $ — |
| Construction | — | — | — | — | — | — |
| Commercial real estate | 1,277 | 1,277 | — | 1,307 | 87 | — |
| Consumer | 13 | 13 | — | 15 | — | — |
| Residential - prime | 7,596 | 7,596 | — | 7,640 | 355 | 6 |
| Residential - multi family | — | — | — | — | — | — |
| Finance leases | — | — | — | — | — | — |
| Total | $ 8,886 | $ 8,886 | $ — | $ 8,962 | $ 442 | $ 6 |
| Commercial | 1,277 | 1,277 | — | 1,307 | 87 | — |
| Consumer | 13 | 13 | — | 15 | — | — |
| Residential | 7,596 | 7,596 | — | 7,640 | 355 | 6 |
| Finance leases | — | — | — | — | — | — |

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Loans on Nonaccrual Status**

**As of**

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| | (In thousands) | |
| Commercial & industrial | $— | $ — |
| Construction | — | — |
| Commercial real estate | — | — |
| Consumer | — | — |
| Residential | 1,163 | 861 |
| Residential - multi family | — | — |
| Finance leases | — | — |
| Total | $1,163 | $ 861 |

**Credit Exposure**

**Credit Risk Profile by Internally Assigned Grades**

**For the Three Months Ended March 31, 2013**

**(In thousands)**

| | **Commercial & Industrial** | Commercial Real Estate Construction | **Commercial Real Estate Other** |
|---|---|---|---|
| Grade: | | | |

| | | | |
|---|---|---|---|
| Pass | $ 23,710 | $ 14,606 | $ 131,189 |
| Watch | 1,850 | — | 10,407 |
| Special Mention | 104 | — | 439 |
| Substandard | 117 | 9,670 | 9,671 |
| Total | $ 25,781 | $ 24,276 | $ 151,706 |

| | Residential | Multi Family | **Finance Leases** |
|---|---|---|---|
| Grade: | | | |
| Pass | $ 71,881 | $ 14,240 | $ — |
| Watch | 578 | — | — |
| Special Mention | 1,158 | — | — |
| Substandard | 6,621 | — | 1,128 |
| Total | $ 80,238 | $ 14,240 | $ 1,128 |

| | **Consumer Overdrafts** | **Consumer Other** |
|---|---|---|
| Performing | $ 157 | $ 689 |
| Nonperforming | — | — |
| Total | $ 157 | $ 689 |

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

**Credit Exposure**

**Credit Risk Profile by Internally Assigned Grades**

**For the Year Ended December 31, 2012**

**(In thousands)**

| | **Commercial & Industrial** | Commercial Real Estate Construction | **Commercial Real Estate Other** |
|---|---|---|---|
| Grade: | | | |
| Pass | $ 21,679 | $ 23,789 | $ 115,547 |
| Watch | — | — | 8,226 |
| Special Mention | — | — | 5,970 |
| Substandard | 135 | — | 19,441 |
| Total | $ 21,814 | $ 23,789 | $ 149,184 |

| | Residential | Multi Family |
|---|---|---|
| Grade: | | |
| Pass | $ 76,097 | $ 14,491 |
| Watch | 716 | — |
| Special Mention | 1,086 | — |
| Substandard | 6,308 | — |
| Total | $ 84,207 | $ 14,491 |

| | **Consumer Overdrafts** | **Consumer Other** | **Finance Leases** |
|---|---|---|---|
| Performing | $ 184 | $ 715 | $ 1,370 |
| Nonperforming | — | — | — |
| Total | $ 184 | $ 715 | $ 1,370 |

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 4. - (continued)**

The Company utilizes a grade risk rating system for commercial and industrial, commercial real estate and construction loans.

On a quarterly basis, or more often if needed, the Company formally reviews the ratings on all classified commercial and industrial, commercial real estate and construction loans. Semi-annually, the Company engages an independent third-party to review a significant portion of loans within these segments. Management uses the results of these reviews as part of its periodic review process.

Loan Modifications
(Dollars in Thousands)

| | As of March 31, 2013 | | |
|---|---|---|---|
| Troubled Debt Restructuring | Number of Loans | Pre-Modification Outstanding Recorded Loans | Post-Modification Outstanding Recorded Loans |
| Residential - prime | 7 | $ 2,177 | $ 2,090 |
| Commercial Real Estate | 3 | 1,354 | 1,264 |
| | 10 | $ 3,531 | $ 3,354 |

| | As of December 31, 2012 | | |
|---|---|---|---|
| Troubled Debt Restructuring | Number of Loans | Pre-Modification Outstanding Recorded Loans | Post-Modification Outstanding Recorded Loans |
| Residential | 7 | $ 2,177 | $ 2,101 |
| Commercial Real Estate | 3 | 1,354 | 1,276 |
| | 10 | $ 3,531 | $ 3,377 |

The loans restructured as noted above were restructured by extending maturity dates or reducing interest rates. No loans were restructured into two notes nor are there any commitments to extend additional funds on any TDRs. The commercial real estate loans are individually evaluated for impairment with any loss recognized in the allowance for loan losses.

The following table shows our recorded investment for loans classified as TDR that are performing according to their restructured terms at the periods indicated:

| | As of March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| (Dollars in thousands) | Number of contracts | | Recorded investments | Number of contracts | | Recorded investments |
| Multi-family residential | — | $ | — | — | $ | — |
| Commercial real estate | 3 | | 1,263 | 3 | | 1,315 |
| One-to-four family – residential | 5 | | 1,285 | 7 | | 2,134 |
| Construction | — | | — | — | | — |
| Commercial business and others | — | | — | — | | — |
| Total Performing TDRs | 8 | $ | 2,548 | 10 | $ | 3,449 |

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 5. Investment Securities**

The following is a summary of held to maturity investment securities:

| | March 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| | (In thousands) | | | |
| U.S. Government Agencies | $270 | $ - | $ - | $ 270 |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| | (In thousands) | | | |
| U.S. Government Agencies | $275 | $ 8 | $ - | $ 283 |

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 5. - (continued)**

The following is a summary of available-for-sale investment securities:

| | March 31, 2013 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| | (In thousands) | | | |
| U.S. Treasury Notes | $34,866 | $40 | $ (141) | $34,765 |
| U.S. Government Agencies | 139,445 | 211 | (447) | 139,209 |
| Mortgage-backed securities | 113,517 | 1,880 | (563) | 114,834 |
| Corporate notes | 9,302 | 103 | (2) | 9,403 |
| Auction rate securities | 53,000 | — | (2,694) | 50,306 |
| Marketable equity securities and other | 126 | — | — | 126 |
| Totals | $350,256 | $2,234 | $ (3,847) | $348,643 |

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross unrealized gains | Gross unrealized losses | Fair value |
| | (In thousands) | | | |
| U.S. Treasury Notes | $24,868 | $19 | $ (37) | $24,850 |
| U.S. Government Agencies | 141,653 | 367 | (151) | 141,869 |
| Mortgage-backed securities | 127,508 | 2,343 | (255) | 129,594 |
| Corporate notes | 10,386 | 106 | (3) | 10,489 |
| Auction rate securities | 56,000 | — | (7,815) | 48,185 |
| Marketable equity Securities and other | 126 | — | — | 126 |
| Totals | $360,541 | $2,835 | $ (8,261) | $355,114 |

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 5. - (continued)**

Management uses a multi-factor approach to determine whether each investment security in an unrealized loss position is other-than-temporarily impaired ("OTTI"). An unrealized loss position exists when the current fair value of an investment is less than its amortized cost basis. The valuation factors utilized by management incorporate the ideas and concepts outlined in relevant accounting guidance. These include such factors as:

*The length of time and the extent to which the market value has been less than cost;

*The financial condition of the issuer of the security as well as the near and long-term prospect for the issuer;

*The rating of the security by a national rating agency;

*Historical volatility and movement in the fair market value of the security; and

*Adverse conditions relative to the security, issuer or industry.

The following table shows the outstanding auction rate securities at March 31, 2013 and December 31, 2012:

| | March 31, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | | (In thousands) | | |
| Preferred Shares of Money Center Banks | $53,000 | $50,306 | $56,000 | $ 48,185 |

| | | | | |
|---|---|---|---|---|
| Totals | $53,000 | $50,306 | $56,000 | $ 48,185 |

In accordance with ASC 320-10, Investment - Debt and Equity Securities, Management's impairment analysis for the corporate and auction rate securities that were in a loss position as of March 31, 2013 began with management's determination that it had the intent to hold these securities for sufficient time to recover the cost basis. Management also concluded that it was unlikely that it would be required to sell any of the securities before recovery of the cost basis.

At March 31, 2013 and December 31, 2012, the amortized cost of our auction rate securities was $53.0 million and $56.0 million, respectively. The fair value of the auction rate securities was $50.3 million and $48.2 million at March 31, 2013 and December 31, 2012, respectively.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 5. - (continued)**

The fair value of the auction rate securities is determined by management valuing the underlying security. The auction rate securities allow for conversion to the underlying preferred security after two failed auctions. As of March 31, 2013, there have been more than two failed auctions for all outstanding auction rate securities. It is our intention to continue to hold these securities and not convert to the underlying preferred securities. We also perform a discounted cash flow analysis, but we considered the market value of the underlying preferred shares to be more objective and relevant in pricing auction rate securities.

In determining whether there is OTTI, management considers the factors noted above. The financial performance indicators we review include, but are not limited to, net earnings, change in liquidity, and change in cash from operating activities, and, for money center banks, the regulatory capital ratios and the allowance for loan losses to the nonperforming loans. Through March 31, 2013, the auction rate securities have continued to pay interest at the highest rate as stipulated in the original prospectus. Currently, the interest rate paid approximates the rate paid on money market deposit accounts.

At March 31, 2013, we had 6 auction rate securities with an aggregate fair market value of $34.8 million which were below investment grade. At December 31, 2012, we had four auction rate securities with an aggregate fair market value of $30.6 million which were below investment grade.

Based upon our methodology for determining the fair value of the auction rate securities, we concluded that as of March 31, 2013, the unrealized loss for the auction rate securities is due to the market interest volatility, the continued illiquidity of the auction rate markets, and uncertainty in the financial markets as there has not been a deterioration in the credit quality of the issuer of the auction rate securities or a downgrade of additional auction rate securities from investment grade. It is not more likely than not that the Company would be required to sell the auction rate securities prior to recovery of the unrealized loss, nor does the Company intend to sell the security at the present time.

There has been one credit rating down grade on our auction rate securities subsequent to December 31, 2012.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 5. - (continued)**

The Company has investments in certain debt securities that have unrealized losses or may be otherwise impaired, but an OTTI has not been recognized in the financial statements as management believes the decline is due to the credit markets coupled with the interest rate environment.

The following table indicates the length of time individual securities that we consider temporarily impaired have been in a continuous unrealized loss position at March 31, 2013 (in thousands):

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Description of Securities | | | | | | |
| U.S. Treasury Notes | $ 14,746 | $ 140 | $ 1 | $ 1 | $ 14,747 | $ 141 |
| U.S. Government Agencies | 78,041 | 447 | — | — | 78,041 | 447 |
| Mortgage-backed securities | 29,714 | 279 | 8,889 | 284 | 38,603 | 563 |
| Corporate Notes | 671 | 2 | — | — | 671 | 2 |
| Auction rate securities | 50,306 | 2,694 | — | — | 50,306 | 2,694 |
| Total temporarily impaired securities | $ 173,478 | $ 3,562 | $ 8,890 | $ 285 | $ 182,368 | $ 3,847 |

The Company had a total of 84 debt securities with a fair market value of $182.4 million which were temporarily impaired at March 31, 2013. The total unrealized loss on these securities was $3.8 million, which is attributable to the market interest volatility, the continued illiquidity of the debt markets, and uncertainty in the financial markets. The unrealized loss on our debt securities is comprised of a loss of $2.7 million on eight auction rate securities which have declined in value due to auction failures beginning in February 2008 and a loss of $1.1 million on other debt securities. It is not more likely than not that we would sell the auction rate securities before maturity, and we have the intent to hold all of these securities to maturity and will not be required to sell these securities, due to our ratio of cash and cash equivalents of approximately 16.58% of total assets at March 31, 2013. Therefore, the unrealized losses associated with these securities are not considered to be other than temporary.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 5. - (continued)**

The amortized cost and fair value of investment securities available for sale and held to maturity, by contractual maturity, at March 31, 2013 are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | March 31, 2013 | | | |
|---|---|---|---|---|
| | Available for Sale | | Held to Maturity | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| | (In thousands) | | | |
| Due in one year or less | $22,326 | $22,372 | $ — | $ — |
| Due after one through five years | 11,991 | 12,187 | — | — |
| Due after five through ten years | 81,115 | 81,480 | 250 | 250 |
| Due after ten years | 181,698 | 182,172 | 20 | 20 |
| Auction rate securities | 53,000 | 50,306 | — | — |
| Marketable equity securities and other | 126 | 126 | — | — |
| Totals | $350,256 | $348,643 | $ 270 | $ 270 |

Gross gains realized on the sales of available-for-sale securities for the three months ended March 31, 2013, and 2012 were approximately $152,000 and $327,000, respectively. Gross losses were approximately $131,000 and $107,000 for the three months ended March 31, 2013 and 2012, respectively.

At both March 31, 2013 and December 31, 2012, securities sold under agreements to repurchase with a book value of $45.0 million were outstanding. The book value of the securities pledged for these repurchase agreements was $49.8 million and $55.9 million, respectively. As of March 31, 2013 and December 31, 2012, the Company owns investment securities to one issuer where the carrying value exceeded 10% of shareholders' equity.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 6. Deposits**

The following table summarizes the composition of the average balances of major deposit categories:

| | **Three Months Ended March 31, 2013** | | | **Twelve Months Ended December 31, 2012** | | |
|---|---|---|---|---|---|---|
| | **Average Amount** | **Average Yield** | | **Average Amount** | **Average Yield** | |
| | (Dollars in thousands) | | | | | |
| Demand deposits | $77,406 | — | | $ 74,632 | — | |
| NOW and money market | 40,004 | 0.37 | % | 27,544 | 0.29 | % |
| Savings deposits | 166,306 | 0.20 | | 201,251 | 0.18 | |
| Time deposits | 333,304 | 0.99 | | 357,706 | 1.15 | |
| Total deposits | $617,020 | 0.62 | % | $ 661,133 | 0.68 | % |

The following table provides the Weighted Average rate for each of the deposit categories:

| | As of March 31, | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | 2013 | | | 2012 | | |
| | Balance | Weighted Ave Rate | | Balance | Weighted Ave Rate | |
| Interest-bearing deposits: | | | | | | |
| Certificate of deposit accounts | $331,548 | 1.01 | % | $362,325 | 1.19 | % |
| Savings accounts | 163,061 | 0.19 | % | 210,691 | 0.12 | % |
| Money Market accounts | 10,194 | 0.14 | % | 8,153 | 0.16 | % |
| NOW accounts | 26,727 | 0.57 | % | 19,534 | 0.23 | % |
| Total interest-bearing demand deposits | 531,530 | | | 600,703 | | |
| Non-interest bearing deposits | 75,805 | | | 75,921 | | |
| Total due to depositors | 607,335 | | | 676,624 | | |
| Mortgagors' escrow deposits | 3,036 | 1.39 | % | 2,919 | 1.36 | % |
| Total Deposits | $610,371 | | | $679,543 | | |

**Note 7. Comprehensive Income (Loss)**

The Company follows the provisions of FASB ASC 220, Comprehensive Income, ("ASC 220") which includes net income as well as certain other items which result in a change to equity during the period. The following table presents the components of comprehensive income (loss):

| | For The Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| | Before tax amount | Tax (expense) benefit | Net of tax amount | Before tax amount | Tax (expense) benefit | Net of tax amount |
| | (In thousands) | | | | | |
| Unrealized gains (losses) on investment securities: | | | | | | |
| Unrealized holding gains (losses) arising During period | $3,791 | $ (1,706 ) | $ 2,085 | $10,020 | $ (4,008 ) | $ 6,012 |
| Less reclassification adjustment for gains (losses) realized in net income | — | — | 0 | 220 | (88 ) | 132 |
| Unrealized gain (loss) on investment securities | 3,791 | (1,706 ) | 2,085 | 9,800 | (3,920 ) | 5,880 |
| Other comprehensive Income (loss), net | $3,791 | $ (1,706 ) | $ 2,085 | $9,800 | $ (3,920 ) | $ 5,880 |

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**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 8. Fair Value of Financial Instruments**

FASB ASC 820, "Fair Value Measurements and Disclosure", ("ASC 820") defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input significant to the fair value measurement. There have been no material changes in valuation techniques as a result of the adoption of ASC 820.

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices in markets that are not active for identical or similar assets or liabilities; 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 - Unobservable inputs that are supported by little or no market activity and significant to the fair value of the assets or liabilities that are developed using the reporting entities' estimates and assumptions, which reflect those that market participants would use.

The Company is required to disclose the estimated fair value of its assets and liabilities considered to be financial instruments. For the Company, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments. However, many such instruments lack an available trading market, as characterized by a willing buyer and seller engaging in an exchange transaction. Also, it is the Company's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities, except for certain loans. Therefore, the Company had to use significant estimations and present value calculations to prepare this disclosure.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. The estimation methodologies used, the estimated fair values, and recorded book balances at March 31, 2013 and December 31, 2012 are outlined below.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 8. - (continued)**

| | March 31, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| | Carrying amount | Estimated fair value | Carrying amount | Estimated fair value |
| | (In thousands) | | | |
| Investment securities | $348,913 | $348,914 | $355,389 | $355,397 |
| Loans, net of unearned income | 297,646 | 306,041 | 295,165 | 305,123 |
| Time Deposits | 331,548 | 324,125 | 337,492 | 338,723 |
| Other Deposits | 278,823 | 278,823 | 304,978 | 304,978 |
| Repurchase Agreements | 45,000 | 45,820 | 45,000 | 46,138 |
| Borrowings | 564 | 565 | 1,539 | 1,548 |

The following table sets forth the fair value hierarchy for financial instruments measured at fair value at March 31, 2013 and December 31, 2012:

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | | Significant Other Observable Inputs (Level 2) | | Significant Other Unobservable Inputs (Level 3) | | Total carried at fair value | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | March 31, 2013 | December 31, 2012 | March 31, 2013 | December 31, 2012 | March 31, 2013 | December 31, 2012 | March 31, 2013 | December 31, 2012 |
| Assets: | | | | | | | | |
| Investment Securities | $41,966 | $21,234 | $256,642 | $285,978 | $50,306 | $48,185 | $348,914 | $355,397 |
| Loans, net of Unearned Income | — | — | — | — | 306,041 | 305,123 | 306,041 | 305,123 |
| Time Deposits | — | — | 324,125 | 338,723 | — | — | 324,125 | 338,723 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Other Deposits | — | — | 278,823 | 304,978 | — | — | 278,823 | 304,978 |
| Repurchase Agreements | — | — | 45,820 | 46,138 | — | — | 45,820 | 46,138 |
| Borrowings | — | — | 565 | 1,548 | — | — | 565 | 1,548 |

For cash and cash equivalents, the recorded book values of $132.6 million and $149.2 million at March 31, 2013 and December 31, 2012, respectively, approximates fair value because of the relatively short term between the origination of the instrument and its expected realization. Therefore, the Company believes the measurement of fair value of cash and cash equivalents is derived from Level 1 inputs.

The estimated fair values of investment securities are based on quoted market prices (Level 1 inputs), if available. Estimated fair values are based on quoted market prices of comparable instruments if quoted market prices are not available (Level 2 inputs). Estimated fair values are also determined using unobservable inputs that are supported by little or no market values and significant assumptions and estimates (Level 3 inputs).

The net loan portfolio at March 31, 2013 and December 31, 2012 has been valued using a present value discounted cash flow where market prices were not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk. The Company believes the fair value of portfolio loans is derived from Level 3 inputs.

The estimated fair values of demand deposits (i.e. interest (checking) and non-interest bearing demand accounts, savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e. their carrying amounts). The fair value of such deposits is derived from Level 2 inputs. The fair value of time deposits have been valued using net present value discounted cash flow and is derived from Level 2 inputs.

The fair value of commitments to extend credit is estimated based upon the amount of unamortized deferred loan commitment fees. The fair value of letters of credit is based upon the amount of unearned fees plus the estimated cost to terminate letters of credit. Fair values of unrecognized financial instruments, including commitments to extend credit, and the fair value of letters of credit are considered immaterial. As such, no disclosures are made on the fair value of commitments.

The fair value of interest rate caps, included in borrowings, are based upon the estimated amount the Company would receive or pay to terminate the contracts or agreements, taking into account current interest rates and, when appropriate, the current creditworthiness of the counterparties. The aggregate fair value for the interest rate caps were zero at both March 31, 2013 and December 31, 2012.

The fair value of borrowings and repurchase agreements approximates the carrying value due to the re-pricing of the debt. The Company measures the fair value of borrowings and repurchase agreements using Level 2 inputs.

**BERKSHIRE BANCORP INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements (continued)**

**(unaudited)**

**Note 8. - (continued)**

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

A description of the valuation methodologies used for financial instruments measured at fair value on a recurring basis, as well as the classification of the instruments pursuant to the valuation hierarchy, are as follows:

**Securities Available for Sale**

When quoted market prices are available in an active market, securities are classified within Level 1 of the fair value hierarchy. If quoted market prices are not available or accessible, then fair values are estimated using pricing models, matrix pricing, or discounted cash flow models. The fair values of securities estimated using pricing models or matrix pricing are generally classified within Level 2 of the fair value hierarchy. When discounted cash flow models are used there is omitted activity or less transparency around inputs to the valuation and securities are classified within Level 3 of the fair value hierarchy.

Level 1 securities generally include equity securities valued based on quoted market prices in active markets. Level 2 instruments include U.S. government agency obligations, state and municipal bonds, mortgage-backed securities, collateralized mortgage obligations and corporate bonds. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include 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 conditions, among other things. Level 3 securities available for sale consist of instruments that are not readily marketable and may only be redeemed with the issuer at par such as Federal Home Loan Bank and Federal Reserve Bank stock. These securities are valued at par value.

Assets measured at fair value on a recurring and nonrecurring basis at March 31, 2013 and at December 31, 2012 are summarized below.

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| | At March 31, 2013<br>Fair Value Measurement Using<br>**Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | Balance March 31,2013 |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Assets | | | | |
| Impaired Loans (1) | $— | $ — | $ 8,812 | $ 8,812 |
| Investment securities available for sale: (2) | | | | |
| U.S. Treasury Notes | $34,765 | $ — | $ — | $ 34,765 |
| U.S. Government Agencies | — | 139,209 | — | 139,209 |
| Mortgage-backed securities | — | 114,834 | — | 114,834 |
| Corporate notes | 7,201 | 2,202 | — | 9,403 |
| Auction rate securities | — | — | 50,306 | 50,306 |
| Marketable equity securities and other | — | 126 | — | 126 |
| Total Investment securities available for sale | $41,966 | $ 256,371 | $ 50,306 | $ 348,643 |
| Total assets | $41,966 | $ 256,371 | $ 59,118 | $ 357,455 |

(1) Non-recurring basis-impaired loans represent carrying amount as no write downs were taken to date.

(2) Recurring basis

The above table includes $8.6 million in net unrealized losses on the Company's available for sale securities. The Company has reviewed its investment portfolio at March 31, 2013, and determined that the unrealized losses are temporary.

| | At December, 31, 2012 Fair Value Measurement Using | | | |
|---|---|---|---|---|
| | **Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)** | **Significant Other Observable Inputs (Level 2)** | **Significant Unobservable Inputs (Level 3)** | **Balance December 31, 2012** |
| | (Dollars in thousands) | | | |
| Assets | | | | |
| Impaired Loans (1) | $— | $ — | $ 8,886 | $ 8,886 |
| Investment securities available for sale: (2) | | | | |
| U.S. Treasury Notes | $14,846 | $ 10,004 | $ — | $ 24,850 |
| U.S. Government Agencies | — | 141,869 | — | 141,869 |
| Mortgage-backed securities | — | 129,595 | — | 129,595 |
| Corporate notes | 6,388 | 4,101 | — | 10,489 |
| Municipal securities | | | | |
| Auction rate securities | — | — | 48,185 | 48,185 |
| Marketable equity securities and other | — | 126 | — | 126 |
| Total Investment securities available for sale | $21,234 | $ 285,695 | $ 48,185 | $ 355,114 |
| Total assets | $21,234 | $ 285,695 | $ 57,071 | $ 364,000 |

(1) Non-recurring basis-impaired loans represent carrying amount as no write downs were taken to date.

(2) Recurring basis

The above table includes $5.4 million in net unrealized losses on the Company's available for sale securities. The Company has reviewed its investment portfolio at December 31, 2012, and determined that the unrealized losses are temporary.

The fair value of the derivative is zero and valued as a Level 3 input.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)**

The following table presents a reconciliation for assets measured at fair value on a recurring basis for which the Company has utilized significant unobservable inputs (Level 3).

| (Dollars in thousands) | Investment Securities Available for Sale |
|---|---|
| Balance, January 1, 2013 | $ 48,185 |
| Total gains/losses (realized/unrealized) | |
| Included in earnings | 5,121 |
| Included in other comprehensive income | — |
| Purchases | — |
| Sales | (3,000 ) |
| Issuances | — |
| Settlements | — |
| Redemptions | — |
| Interest | — |
| Other than temporary impairment expense | — |
| Capital deductions for operating expenses | — |
| Balance, March 31, 2013 | $ 50,306 |
| The amount of total gains (losses) for the period included in earnings attributable to the change in unrealized gains or losses relating to assets still held at March 31, 2013 | $ — |

In accordance with FASB Accounting Standards Update (“ASU”) No. 2011-04, the Bank establishes valuation processes and procedures to ensure that the valuation techniques for investments that are categorized within Level 3 of the fair value hierarchy are fair, consistent and verifiable.

The Bank periodically tests its valuation of Level 3 investments through performing Discounted Cash Flow analysis of the investments by comparing the results of the discounted cash flow to the values obtained from valuation of the underlying collateral of the Auction Rate Securities. The following table presents additional information in accordance with ASU 2011-04 about the valuation processes utilized in measuring assets and liabilities at fair value using significant unobservable inputs (Level 3):

| Assets(at fair value) Investments in Auction Rate Securities | Fair Value at March 31, 2013 (in thousands) | Valuation Technique | Unobservable Inputs | Range of Preferred Share Pricing |
|---|---|---|---|---|
| Auction Rate Securities | $ 50,306 | Market Prices | Underlying Collateral | $22.30 to $24.33 |

**Note 9. Related Party Transactions**

In accordance with banking regulations, the Bank, from time to time, enters into lending transactions in the ordinary course of business with directors, executive officers, principal stockholders and affiliates of such persons on the same terms as those prevailing for comparable transactions with other borrowers. The following table summarizes the activity in loans to related parties. (In thousands)

| | |
|---|---|
| Balance at 12/31/12 | $4,900 |
| New Loans | — |
| Repayments | 77 |
| Balance at 3/31/13 | $4,823 |

Aggregate deposits from related parties at March 31, 2013 and December 31, 2012 amounted to approximately $48.9 million and $61.5 million, respectively. At both March 31, 2013 and December 31, there were no related party Overdrawn deposit accounts reclassified to loans.

**NOTE 10. Capital Adequacy**

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets, and of Tier I capital to average assets. Management believes that, as of March 31, 2013, the Bank meets all capital adequacy requirements to which it is subject.

As of March 31, 2013, the Bank met all regulatory requirements for classification as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that date that management believes have changed the institution's category.

The following table set forth the actual and required regulatory capital amounts and ratios of the Company and the Bank as of March 31, 2013 (dollars in thousands):

| | Actual | | **For capital adequacy purposes** | | **To be well capitalized under prompt corrective action provisions** | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| March 31, 2013 | | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | | |
| Company | 139,636 | 37.7% | 29,601 | ≥8.0% | $— | N/A |
| Bank | 129,596 | 35.6% | 29,118 | ≥8.0% | 36,397 | ≥10.0 % |
| Tier I Capital (to Risk-Weighted Assets) | | | | | | |
| Company | 134,936 | 36.5% | 14,800 | ≥4.0% | — | N/A |
| Bank | 124,970 | 34.3% | 14,559 | ≥4.0% | 21,838 | ≥6.0 % |
| Tier I Capital (to Average Assets) | | | | | | |
| Company | 135,936 | 16.9% | 31,915 | ≥4.0% | — | N/A |
| Bank | 124,970 | 15.8% | 31,647 | ≥4.0% | 39,559 | ≥5.0 % |

**Note 11. New Accounting Pronouncements**

In December 2011, the FASB issued ASU No. 2011-11, which amends Topic 210, "Balance Sheet," to require an entity to disclose both gross and net information about financial instruments, such as sales and repurchase agreements and reverse sale and repurchase agreements and securities borrowing/lending arrangements, and derivative instruments that are eligible for offset in the statement of financial position and/or subject to a master netting arrangement or similar agreement. ASU 2011-11 is effective for annual and interim periods beginning on January 1, 2013, and did not have a material effect on the consolidated statements of operations or financial condition.

In February 2013, the FASB issued ASU No. 2013-02, which amends the authoritative accounting guidance under ASC Topic 220 “Comprehensive Income.” The amendments do not change the current requirements for reporting net income or other comprehensive income in financial statements. However, the amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures required under U.S. GAAP that provide additional detail about those amounts. The amendments in this update are effective prospectively for reporting periods beginning after December 15, 2013. Early adoption is permitted. Adoption of this update is not expected to have a material effect on the Company’s consolidated results of operation or financial condition.

## ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

**Executive Summary**

We are a Delaware corporation organized in March 1979, and a bank holding company registered under the Bank Holding Company Act of 1956. We acquired The Berkshire Bank (the "Bank"), our indirect wholly-owned subsidiary in March 1999. The Bank was organized in 1987 as a New York State chartered commercial bank. Our principal activity is the ownership and management of the Bank. Our activities are primarily funded by cash on hand, rental income, income from our portfolio of investment securities and dividends, if any, received from the Bank. Our common stock is traded on the NASDAQ Stock Market under the symbol "BERK."

The Bank's principal business consists of gathering deposits from the general public and investing those deposits together with funds generated from ongoing operations and borrowings, primarily in residential and commercial loans, debt obligations issued by the U.S. Government and its agencies, debt obligations of business corporations, and mortgage-backed securities. The Bank operates from seven deposit-taking offices in New York City, four deposit-taking offices in Orange and Sullivan Counties, New York, and one deposit-taking office in Teaneck, New Jersey. The Bank's revenues are derived principally from interest on loans, and interest and dividends on investments in the securities portfolio. The Bank's primary regulator at the state level is by the New York Superintendent of Banks and the New York Banking Board, while at the federal level its primary regulator is the Federal Deposit Insurance Corporation (the "FDIC"). Deposits are insured to the maximum allowable amount by the FDIC. The Bank is a member of the Federal Home Loan Bank system. The Company, as a bank holding company, is regulated by the Federal Reserve Bank of New York.

Our results of operations depend primarily on net interest income, which is the difference between the income earned on our interest-earning assets and the cost of our interest-bearing liabilities. Net interest income is the result of our interest rate margin, which is the difference between the average yield earned on interest-earning assets and the average cost of interest-bearing liabilities, adjusted for the difference in the average balance of interest-earning assets as compared to the average balance of interest-bearing liabilities. We also generate non-interest income from loan fees, service charges on deposit accounts, mortgage servicing fees, and other fees, dividends on Federal Home Loan Bank of New York ("FHLB-NY") stock and net gains and losses on sales of securities and loans. Our operating expenses consist principally of employee compensation and benefits, occupancy and equipment costs, other general and administrative expenses and income tax expense. Our results of operations also can be significantly affected by our periodic provision for loan losses and specific provision for losses on loans.

Our investment policy, approved by the Board of Directors, is designed primarily to manage the interest rate sensitivity of our overall assets and liabilities, to generate a favorable return without incurring undue interest rate and credit risk, to complement our lending activities and to provide and maintain liquidity. In establishing our investment strategies, we consider our business and growth strategies, the economic environment, our interest rate risk exposure, our interest rate sensitivity "gap" position, the types of securities to be held, and other factors. We classify our investment securities as available for sale.

During the first quarter of 2013, upon reviewing its historical experience of defaults in its portfolio and the current loan and housing environment, the bank reduced its loan loss provision by $303 thousand. No provisions were made in the first quarter of 2012.

Net income, before the provision for income taxes, for the three months ended March 31, 2013 was $1.5 million, compared to net income, before the benefit for income taxes, for the three months ended March 31, 2012 of $1.9 million.

Net income allocated to common stockholders, after the provision for income taxes, was $1.0 million for the three months ended March 31, 2013 compared to $2.1 million for the three months ended March 31, 2012.

The following discussion and analysis is intended to provide a better understanding of the consolidated financial condition and results of operations of Berkshire Bancorp Inc. and subsidiaries. All references to earnings per share, unless stated otherwise, refer to earnings per diluted share. References to Notes herein are references to the "Notes to Consolidated Financial Statements" of the Company located in Item 1 herein.

**Critical Accounting Policies, Judgments and Estimates**

The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America ("GAAP") and general practices within the financial services industry. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

The Company considers that the determination of the allowance for loan losses involves a higher degree of judgment and complexity than any of its other significant accounting policies. The allowance for loan losses is calculated with the objective of maintaining a reserve level believed by management to be sufficient to absorb estimated credit losses.

Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires material estimates, including, among others, expected default probabilities, loss given default, the amounts and timing of expected future cash flows on impaired loans, mortgages, and general amounts for historical loss experience. The process also considers economic conditions, uncertainties in estimating losses and inherent risks in the loan portfolio. All of these factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required that would adversely impact earnings in future periods. See "Provision for Loan Losses" below in this Item 2 for further discussion of the allowance for loan losses.

The Company recognizes deferred tax assets and liabilities for the future tax effects of temporary differences, net operating loss carryforwards and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence that future realization is more likely than not. If management determines that the Company may be unable to realize all or part of net deferred tax assets in the future, a direct charge to income tax expense may be required to reduce the recorded value of the net deferred tax asset to the expected realizable amount.

The Company conducts a periodic review and evaluation of its securities portfolio, taking into account the severity and duration of each unrealized loss, as well as management's intent and ability to hold the security until the unrealized loss is substantially eliminated, in order to determine if a decline in market value of any security below its carrying value is either temporary or other than temporary. Unrealized losses on held-to-maturity securities that are deemed temporary are disclosed but not recognized. Unrealized losses on debt or equity securities available-for-sale that are deemed temporary are excluded from net income and reported net of deferred taxes as other comprehensive income or loss. All unrealized losses that are deemed other than temporary on either available-for-sale or held-to-maturity securities are recognized immediately as a reduction of the carrying amount of the security, with a charge recorded in the Company's consolidated statements of operations.

The following table presents the total dollar amount of interest income from average interest-earning assets and the resultant yields, as well as the interest expense on average interest-bearing liabilities, expressed in both dollars and rates.

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| | For The Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| | **Average Balance** | **Interest and Dividends** | **Average Yield/Rate** | **Average Balance** | **Interest and Dividends** | **Average Yield/Rate** |
| | | | (Dollars in Thousands) | | | |
| INTEREST-EARNING ASSETS: | | | | | | |
| Loans (1) | $292,980 | $ 4,227 | 5.77 % | $ 318,510 | $ 4,905 | 6.16 % |
| Investment securities | 354,789 | 2,196 | 2.48 | 412,939 | 2,437 | 2.37 |
| Other (2)(5) | 130,289 | 95 | 0.29 | 97,087 | 59 | 0.24 |
| Total interest-earning assets | 778,058 | 6,518 | 3.35 | 828,536 | 7,401 | 3.57 |
| Noninterest-earning assets | 25,444 | | | 30,410 | | |
| Total Assets | $803,502 | | | $ 858,946 | | |
| INTEREST-BEARING LIABILITIES: | | | | | | |
| Interest bearing deposits | 206,309 | 122 | 0.24 % | 216,707 | 110 | 0.20 % |
| Time deposits | 333,304 | 837 | 1.00 | 366,660 | 1,116 | 1.22 |
| Other borrowings | 45,887 | 388 | 3.38 | 78,142 | 641 | 3.28 |
| Total interest-bearing liabilities | 585,501 | 1,347 | 0.92 | 661,509 | 1,867 | 1.13 |
| Demand deposits | 77,407 | | | 71,468 | | |
| Noninterest-bearing liabilities | 5,441 | | | 5,118 | | |
| Stockholders' equity (5) | 135,154 | | | 120,851 | | |
| Total liabilities and stockholders' equity | $803,502 | | | $ 858,946 | | |
| Net interest income | | $ 5,171 | | | $ 5,534 | |
| Interest-rate spread (3) | | | 2.43 % | | | 2.44 % |
| Net interest margin (4) | | | 2.66 % | | | 2.67 % |
| Ratio of average interest-earning assets to average interest bearing liabilities | 1.33 | | | 1.25 | | |

(1) Includes nonaccrual loans.

(2) Includes interest-bearing deposits, federal funds sold and securities purchased under agreements to resell.

(3) Interest-rate spread represents the difference between the average yield on interest-earning assets and the average cost of interest bearing liabilities.

(4) Net interest margin is net interest income as a percentage of average interest-earning assets.

(5) Average balances are daily average balances except for the parent company which have been calculated on a monthly basis.

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**Results of Operations**

**Results of Operations for the Three Months Ended March 31, 2013 Compared to the Three Months Ended March 31, 2012.**

**Net Income Allocated to Common Stockholders.** Net income allocated to common stockholders for the three March 31, 2013 was $1.0 million, or $0.07 per common share, compared to net income allocated to common stockholders of $2.1 million, or $0.15 per common share, for the three months ended March 31, 2012.

The Company's net income is largely dependent on interest rate levels, the demand for the Company's loan and deposit products and the strategies employed to manage the interest rate and other risks inherent in the banking business.

**Net Interest Income.** The Company's primary source of revenue is net interest income, or the difference between interest income earned on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities such as deposits and borrowings. The amount of interest income is dependent upon many factors including: (i) the amount of interest-earning assets that the Company can maintain based upon its funding sources; (ii) the relative amounts of interest-earning assets versus interest-bearing liabilities; and (iii) the difference between the yields earned on those assets and the rates paid on those liabilities. Non-performing loans adversely affect net interest income because they must still be funded by interest-bearing liabilities, but they do not provide interest income. Furthermore, when we designate an asset as non-performing, all interest which has been accrued but not actually received is deducted from current period income, further reducing net interest income.

For the quarter ended March 31, 2013, net interest income decreased by $0.3 million to $5.2 million from $5.5 million for the quarter ended March 31, 2012. The decrease in net interest income during the 2013 period compared to the 2012 period was primarily due to the decrease in the average yields earned on the average amount of interest-earning assets, partially offset by the decrease in the average amount of interest-bearing liabilities and the decrease in the average rates paid on interest-bearing liabilities.

The average yields earned on interest-earning assets declined to 3.35% during the three months ended March 31, 2013, from 3.57% during the three months ended March 31, 2012. The average rates paid on interest-bearing liabilities declined to 0.92% during the three months ended March 31, 2013, from 1.13% during the three months ended March 31, 2012. The Company's interest-rate spread, the difference between the average yield on interest-earning assets and the average cost of interest-bearing liabilities, declined to 2.43% during the three months March 31, 2013, from 2.44% during the three months ended March 31, 2012.

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**Net Interest Margin.** Net interest margin, or annualized net interest income as a percentage of average interest-earning assets, was 2.66% and 2.67% for the quarter ended March 31, 2013 and 2012, respectively. We seek to secure and retain customer deposits with competitive products and rates, while making strategic use of the prevailing interest rate environment to borrow funds at what we believe to be attractive rates. We invest such deposits and borrowed funds in a prudent mix of fixed and adjustable rate loans, investment securities and short-term interest-earning assets. The decrease in net interest margin is primarily due to the decrease in the average amounts of higher yielding loans as a percentage of the total mix of interest-earning assets.

**Interest Income.** Total interest income for the quarter ended March 31, 2013 decreased by $0.9 million to $6.5 million from $7.4 million for the quarter ended March 31, 2012. The decrease in total interest income was primarily due to the decrease in the average yield earned on the average amount of interest-earning assets to 3.35% during the 2013 quarter from 3.57% during the 2012 quarter, and the decrease in the average amount of higher yielding loans to $293.0 million during the 2013 quarter from $318.5 million during the 2012 quarter.

The following tables present the composition of interest income for the indicated periods:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | | 2012 | |
| | Interest Income | % of Total | Interest Income | % of Total |
| | (In thousands, except percentages) | | | |
| Loans | $4,227 | 64.85 % | $4,905 | 66.27 % |
| Investment Securities | 2,196 | 33.69 | 2,437 | 32.93 |
| Other | 95 | 1.46 | 59 | 0.80 |
| Total Interest Income | $6,518 | 100.00% | $7,401 | 100.00% |

Loans, which are inherently risky and therefore command a higher return than our portfolio of investment securities and other interest-earning assets, decreased to 37.7% of total average interest-earning assets during the three months ended March 31, 2013, from 38.4% of total interest-earning assets during the three months ended March 31, 2012. The average amounts of investment securities was 45.6% of total average interest-earning assets during the three months ended March 31, 2013, compared to 49.8% of total interest-earning assets during the three months ended March 31, 2012. While we actively seek to originate new loans with qualified borrowers who meet the Bank's underwriting standards, our strategy has been to maintain those standards, sacrificing some current income to avoid possible large future losses in the loan portfolio.

At March 31, 2013 and 2012, total non-performing loan assets were $1.2 million and $0.6 million, respectively, all of which were non-accrual loans. Depending upon the contractual interest rate of a loan, significant additions to non-performing loans, were such additions to occur, could have a material adverse effect on our results of operations. The effect of the decrease in non-accrual loans in 2013 from 2012 was negligible.

**Federal Home Loan Bank Stock.** The Bank owns stock of the Federal Home Loan Bank New York ("FHLB-NY") which is necessary for it to be a member of the FHLB-NY. Membership requires the purchase of stock equal to 1% of the Bank's residential mortgage loans or 5% of the outstanding borrowings, whichever is greater. The stock is redeemable at par. Therefore, its cost is equivalent to its redemption value. The Bank's ability to redeem FHLB-NY shares is dependent upon the redemption practices of the FHLB-NY. At March 31, 2013, the FHLB-NY neither placed restrictions on redemption of shares in excess of a member's required investment in stock, nor stated that it will cease paying dividends. The Bank did not consider this asset impaired at either March 31, 2013 or December 31, 2012.

**Interest Expense.** Total interest expense for the quarter ended March 31, 2013 decreased by $0.6 million to $1.3 million from $1.9 million for the quarter ended March 31, 2012. The decrease in interest expense was due to the decrease in the average amounts of interest-bearing liabilities to $585.5 million from $661.5 million during the three months ended March 31, 2013 and 2012, respectively, and the decrease in the average rates paid on interest-bearing liabilities to 0.92% during the 2013 quarter from 1.13% during the 2012 quarter.

The following tables present the components of interest expense as of the dates indicated:

| | Three Months Ended March 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2013 | | | 2012 | | |
| | Interest Expense | % of Total | | Interest Expense | % of Total | |
| | (In thousands, except percentages) | | | | | |
| Interest-Bearing Deposits | $122 | 9.06 | % | $110 | 5.89 | % |
| Time Deposits | 837 | 62.11 | | 1,116 | 59.78 | |
| Other Borrowings | 388 | 28.83 | | 641 | 34.33 | |
| Total Interest Expense | $1,347 | 100.00 | % | $1,867 | 100.00 | % |

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**Non-Interest Income.** Non-interest income consists primarily of realized gains on sales of marketable securities and service fee income. Total non-interest income for the three months ended March 31, 2013 was $527,000, compared to $523,000 for the three months ended March 31, 2012.

**Non-Interest Expense.** Non-interest expense includes salaries and employee benefits, occupancy and equipment expenses, legal and professional fees and other operating expenses associated with the day-to-day operations of the Company. Total non-interest expense for the three months ended March 31, 2013 was $4.5 million, compared to $4.2 million for the three months ended March 31, 2012.

The following tables present the components of non-interest expense as of the dates indicated:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2013 | | 2012 | |
| | Non-Interest Expense | % of Total | Non-Interest Expense | % of Total |
| | (In thousands, except percentages) | | | |
| Salaries and Employee Benefits | $2,702 | 60.54 % | $2,480 | 59.19 % |
| Net Occupancy Expense | 593 | 13.29 | 584 | 13.94 |
| Equipment Expense | 89 | 1.99 | 78 | 1.86 |
| FDIC Assessment | 300 | 6.72 | 300 | 7.16 |
| Data Processing Expense | 127 | 2.85 | 112 | 2.67 |
| Other | 652 | 14.61 | 636 | 15.18 |
| Total Non-Interest Expense | $4,463 | 100.00% | $4,190 | 100.00% |

**Provision for Income Tax.** During the three-month period ended March 31, 2013, the Company recorded an income tax provision of $587,000, compared to income tax benefit of $269,000 for three-month period ended March 31, 2012.

**Issuer Purchases of Equity Securities**

On May 15, 2003, The Company's Board of Directors authorized the purchase of up to an additional 450,000 shares of its Common Stock in the open market, from time to time, depending upon prevailing market conditions, thereby increasing the maximum number of shares which may be purchased by the Company from 1,950,000 shares of Common Stock to 2,400,000 shares of Common Stock. Since 1990 through March 31, 2013, the Company has purchased a total of 1,898,909 shares of its Common Stock. We did not repurchase shares of the Company's Common Stock during the first quarter of 2013. At March 31, 2013, there were 501,091 shares of Common Stock which may yet be purchased under our stock repurchase plan.

**Provision for Loan Losses.** The allowance for loan losses is the estimated amount considered necessary to cover credit losses inherent in the loan portfolio at the balance sheet date. The allowance is established through the provision for loan losses that is charged against income. In determining the allowance for loan losses, management makes significant estimates which involve a high degree of judgment, subjectivity of the assumptions utilized, and potential for changes in the economic environment that could result in changes to the amount of the recorded allowance for loan losses.

The allowance for loan losses has been determined in accordance with U.S. GAAP, principally FASB ASC 450, "Contingencies", ("ASC 450") and FASB ASC 310, "Receivables", ("ASC 310"). Under the above accounting principles, we are required to maintain an allowance for probable losses at the balance sheet date. We are responsible for the timely and periodic determination of the amount of the allowance required. Management believes that the allowance for loan losses is adequate to cover specifically identifiable losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

Management performs a monthly evaluation of the adequacy of the allowance for loan losses. The analysis of the allowance for loan losses has two components: specific and general reserves. Specific reserves are made for loans determined to be impaired. Impairment is measured by determining the present value of expected future cash flows or, as a practical expedient for collateral-dependent loans, the fair value of the collateral adjusted for market conditions and selling expenses. The Bank considers its investment in one-to-four family real estate loans and consumer loans to be smaller balance homogeneous loans and therefore excluded from separate identification for evaluation of impairment. These homogeneous loan groups are evaluated for impairment on a collective basis under FASB ASC 310.

The general reserve is determined by segregating the remaining loans by type of loan, risk weighting (if applicable) and payment history. Management also analyzes historical loss experience, delinquency trends, general economic conditions, geographic concentrations, and industry and peer comparisons. This analysis establishes factors that are applied to the loan segments to determine the amount of the general reserves. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses management has established which could have a material negative effect on the Company's financial results.

On a monthly basis, the Bank's management committee reviews the current status of various loan assets in order to evaluate the adequacy of the allowance for loan losses. In this evaluation process, specific loans are analyzed to determine their potential risk of loss. This process includes all loans, concentrating on non-accrual and classified loans. Each non-accrual or classified loan is evaluated for potential loss exposure. Any shortfall results in a recommendation of a specific allowance if the likelihood of loss is evaluated as probable. To determine the adequacy of collateral on a particular loan, an estimate of the fair market value of the collateral is based on the most current appraised value available. This appraised value is then reduced to reflect estimated liquidation expenses.

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As a substantial amount of our loan portfolio is collateralized by real estate, appraisals of the underlying value of property securing loans are critical in determining the amount of the allowance required for specific loans. Assumptions for appraisal valuations are instrumental in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly impact the valuation of a property securing a loan and the related allowance determined. The assumptions supporting such appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable on the related loans. Based on the composition of our loan portfolio, management believes the primary risks are increases in interest rates, a decline in the economy, generally, and a decline in real estate market values in the New York metropolitan area. Any one or combination of these events may adversely affect our loan portfolio resulting in increased delinquencies, loan losses and future levels of loan loss provisions. Management believes the allowance for loan losses reflects the inherent credit risk in our portfolio, the level of our non-performing loans and our charge-off experience.

A loan is considered nonperforming when it becomes delinquent ninety days or when other adverse factors become known to us. We generally order updated appraisals from independent third party licensed appraisers at the time the loan is identified as nonperforming. Depending upon the property type, we receive appraisals within thirty to ninety days from the date the appraisals are ordered. Upon receipt of the appraisal, which is discounted by us to take account of estimated selling and other holding costs, we compare the adjusted appraisal amount to the carrying amount of the real estate dependent loan and record any impairment through the allowance for loan loss at that time.

The majority of our real estate dependent loans are concentrated in the New York City metropolitan area, we do not make adjustments to the appraisals for this concentration. We do not increase the appraised value of any property. Any adjustments we make to the appraisals are to decrease the appraised value due to selling and other holding costs.

Although management believes that we have established and maintained the allowance for loan losses at adequate levels, additions may be necessary if future economic and other conditions differ substantially from the current operating environment. Although management uses what it believes is the best information available, the level of the allowance for loan losses remains an estimate that is subject to significant judgment and short-term change. In addition, the Federal Deposit Insurance Corporation, the New York State Department of Financial Services, and other regulatory bodies, as an integral part of their examination process, will periodically review our allowance for loan losses. Such agencies may require us to recognize adjustments to the allowance based on its judgments about information available to them at the time of their examination.

The following table sets forth information with respect to activity in the Company's allowance for loan losses during the periods indicated (in thousands, except percentages):

| | Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 |
| Average loans outstanding | $292,980 | $318,510 |
| Allowance at beginning of period | $11,008 | $17,720 |
| Charge-offs: | | |
| Commercial and other loans | — | — |
| Real estate loans | — | — |
| Total loans charged-off | — | — |
| Recoveries: | | |
| Commercial and other loans | — | — |
| Real estate loans | — | — |
| Total loans recovered | — | — |
| Net recoveries (charge-offs) | — | — |
| Provision for loan losses charged to operating expenses | (303) | — |
| Allowance at end of period | $10,705 | 17,720 |
| Ratio of net recoveries (charge-offs) to average loans outstanding | 0.00% | 0.00% |
| Allowance as a percent of total loans | 3.59% | 5.49% |
| Total loans at end of period | $298,215 | $322,574 |

**Loan Portfolio.**

**Loan Portfolio Composition.** The Company's loans consist primarily of mortgage loans secured by residential and non-residential properties as well as commercial loans which are either unsecured or secured by personal property collateral. Most of the Company's loans are either made to individuals or personally guaranteed by the principals of the business to which the loan is made. At March 31, 2013 and December 31, 2012, the Company had loans, net of unearned income, of $297.6 million and $295.2 million, respectively, and an allowance for loan losses of $11.0 million and $11.0 million, respectively. From time to time, the Bank may originate residential mortgage loans, sell them on the secondary market, normally recognizing fee income in connection with the sale.

Interest rates on loans are affected by the demand for loans, the supply of money available for lending, credit risks, the rates offered by competitors and other conditions. These factors are in turn affected by, among other things, economic conditions, monetary policies of the federal government, and legislative tax policies.

In order to manage interest rate risk, the Bank focuses its efforts on loans with interest rates that adjust based upon changes in the prime rate or changes in United States Treasury or similar indices. Generally, credit risks on adjustable-rate loans are somewhat greater than on fixed-rate loans primarily because, as interest rates rise, so do borrowers' payments, increasing the potential for default. The Bank seeks to impose appropriate loan underwriting standards in order to protect against these and other credit related risks associated with its lending operations.

In addition to analyzing the income and assets of its borrowers when underwriting a loan, the Bank obtains independent appraisals on all material real estate in which the Bank takes a mortgage. The Bank generally obtains title insurance in order to protect against title defects on mortgaged property.

**Commercial Mortgage Loans.** The Bank originates commercial mortgage loans secured by office buildings, retail establishments, multi-family residential real estate and other types of commercial property. Substantially all of the properties are located in the New York City metropolitan area.

The Bank generally makes commercial mortgage loans with loan to value ratios not to exceed 75% and with terms to maturity that do not exceed 15 years. Loans secured by commercial properties generally involve a greater degree of risk than one-to four-family residential mortgage loans. Because payments on such loans are often dependent on successful operation or management of the properties, repayment may be subject, to a greater extent, to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks through its underwriting policies. The Bank evaluates the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the underlying property. The factors considered by the Bank include net operating income; the debt coverage ratio (the ratio of cash net income to debt service); and the loan to value ratio. When evaluating the borrower, the Bank considers the financial resources and income level of the borrower, the borrower's experience in owning or managing similar property and the Bank's lending experience with the borrower. The Bank's policy requires borrowers to present evidence of the ability to repay the loan without having to resort to the sale of the mortgaged property. The Bank also seeks to focus its commercial mortgage loans on loans to companies with operating businesses, rather than passive real estate investors.

**Commercial Loans and Finance Leases.** The Bank makes commercial loans to businesses for inventory financing, working capital, machinery and equipment purchases, expansion, and other business purposes. These loans generally have higher yields than mortgage loans, with maturities of one year, after which the borrower's financial condition and the terms of the loan are re-evaluated. At March 31, 2013 and December 31, 2012, $25.8 million and $23.2 million, respectively, or 8.6% and 7.8%, respectively, of the Company's total loan portfolio consisted of such loans.

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Commercial loans tend to present greater risks than mortgage loans because the collateral, if any, tends to be rapidly depreciable, difficult to sell at full value and is often easier to conceal. In order to limit these risks, the Bank evaluates these loans based upon the borrower's ability to repay the loan from ongoing operations. The Bank considers the business history of the borrower and perceived stability of the business as important factors when considering applications for such loans. Occasionally, the borrower provides commercial or residential real estate collateral for such loans, in which case the value of the collateral may be a significant factor in the loan approval process.

**Residential Mortgage Loans (1 to 4 family loans).** The Bank makes residential mortgage loans secured by first liens on one-to-four family owner-occupied or rental residential real estate. At March 31, 2013 and December 31, 2012, $80.2 million and $84.2 million, respectively, or 26.9% and 28.5%, respectively, of the Company's total loan portfolio consisted of such loans. The Bank offers both adjustable rate mortgages ("ARMS") and fixed-rate mortgage loans. The relative proportion of fixed-rate loans versus ARMs originated by the Bank depends principally upon current customer preference, which is generally driven by economic and interest rate conditions and the pricing offered by the Bank's competitors. At March 31, 2013, 14% of the Bank's residential one-to-four family owner-occupied first mortgage portfolio were ARMs and 86% were fixed-rate loans. At December 31, 2012, approximately 40% of the Bank's residential one-to-four family owner-occupied first mortgage portfolio were ARMs and 60% were fixed-rate loans. The percentage represented by fixed-rate loans tends to increase during periods of low interest rates. The ARMs generally carry annual caps and life-of-loan ceilings, which limit interest rate adjustments.

The Bank's residential loan underwriting criteria are generally comparable to those required by Fannie Mae and other major secondary market loan purchasers. Generally, ARM credit risks are somewhat greater than fixed-rate loans primarily because, as interest rates rise, the borrowers' payments rise, increasing the potential for default. The Bank's teaser rate ARMs (ARMs with low initial interest rates that are not based upon the index plus the margin for determining future rate adjustments) were underwritten based on the payment due at the fully-indexed rate.

In addition to verifying income and assets of borrowers, the Bank obtains independent appraisals on all residential first mortgage loans and title insurance is required at closing. Private mortgage insurance is required on all loans with a loan-to-value ratio in excess of 80% and the Bank requires real estate tax escrows on such loans. Real estate tax escrows are voluntary on residential mortgage loans with loan-to-value ratios of 80% or less.

Fixed-rate residential mortgage loans are generally originated by the Bank for terms of 15 to 30 years. Although 30 year fixed-rate mortgage loans may adversely affect our net interest income in periods of rising interest rates, the Bank originates such loans to satisfy customer demand. Such loans are generally originated at initial interest rates which exceed the fully indexed rate on ARMs offered at the same time. Fixed-rate residential mortgage loans originated by the Bank generally include due-on-sale clauses, which permit the Bank to demand payment in full if the borrower sells the property without the Bank's consent.

Due-on-sale clauses are an important means of adjusting the rates on the Bank's fixed-rate mortgage loan portfolio, and the Bank will generally exercise its rights under these clauses if necessary to maintain market yields.

ARMs originated in recent years have interest rates that adjust annually based upon the movement of the one year treasury bill constant maturity index, plus a margin of 2.00% to 2.75%. These loans generally have a maximum interest rate adjustment of 2% per year, with a lifetime maximum interest rate adjustment, measured from the initial interest rate, of 5.5% or 6.0%.

The Bank offers a variety of other loan products including residential single family construction loans to persons who intend to occupy the property upon completion of construction, home equity loans secured by junior mortgages on one-to-four family owner-occupied residences, and short-term fixed-rate consumer loans either unsecured or secured by monetary assets such as bank deposits and marketable securities or personal property. At March 31, 2013 and December 31, 2012, $192.2 million and $188.4 million, respectively, or 64.4% and 63.7%, respectively, of the Company's total loan portfolio consisted of such other loan products.

**Origination of Loans.** Loan originations can be attributed to depositors, retail customers, phone inquiries, advertising, the efforts of the Bank's loan officers, and referrals from other borrowers, real estate brokers and builders. The Bank originates loans primarily through its own efforts, occasionally obtaining loan opportunities as a result of referrals from loan brokers.

The Bank’s lending limit generally restricts extensions of credit to one borrower to 15% of the Bank’s capital stock, surplus fund and undivided profits, but allow such extensions of credit to one borrower of up to 25% of the Bank’s capital stock, surplus fund and undivided profits, if the additional 10% is secured by collateral that can be adequately valued. This means that as of March 31, 2013, the Bank could lend $18.9 million to one borrower, and this amount may be increased up to $31.5 million, if the loan is secured by collateral that can be adequately valued.

**Delinquency Procedures.** When a borrower fails to make a required payment on a loan, the Bank attempts to cause the deficiency to be cured by contacting the borrower. The Bank reviews past due loans on a case by case basis, taking the action it deems appropriate in order to collect the amount owed. Litigation may be necessary if other procedures are not successful. Judicial resolution of a past due loan can be delayed if the borrower files a bankruptcy petition because collection action cannot be continued unless the Bank first obtains relief from the automatic stay provided by the Bankruptcy Code.

If a non-mortgage loan becomes delinquent and satisfactory arrangements for payment cannot be made, the Bank seeks to realize upon any personal property collateral to the extent feasible and collect any remaining amount owed from the borrower through legal proceedings, if necessary.

It is the Bank's policy to discontinue accruing interest on a loan when it is 90 days past due or if management believes that continued interest accruals are unjustified. The Bank may continue interest accruals if a loan is more than 90 days past due if the Bank determines that the nature of the delinquency and the collateral are such that collection of the principal and interest on the loan in full is reasonably assured. When the accrual of interest is discontinued, all accrued but unpaid interest is charged against current period income. Once the accrual of interest is discontinued, the Bank records interest as and when received until the loan is restored to accruing status. If the Bank determines that collection of the loan in full is in reasonable doubt, then amounts received are recorded as a reduction of principal until the loan is returned to accruing status.

**Capital Adequacy**

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets, and of Tier I capital to average assets. Management believes that, as of March 31, 2013, the Bank meets all capital adequacy requirements to which it is subject.

As of March 31, 2013, the Bank met all regulatory requirements for classification as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that date that management believes have changed the institution's category.

The following table set forth the actual and required regulatory capital amounts and ratios of the Company and the Bank as of March 31, 2013 (dollars in thousands):

| | Actual | | **For capital** adequacy purposes | | **To be well capitalized under prompt corrective action provisions** | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| March 31, 2013 | | | | | | |
| Total Capital (to Risk-Weighted Assets) | | | | | | |
| Company | 139,636 | 37.7% | 29,601 | ≥8.0% | $— | N/A |
| Bank | 129,596 | 35.6% | 29,118 | ≥8.0% | 36,397 | ≥10.0 % |
| Tier I Capital (to Risk-Weighted Assets) | | | | | | |
| Company | 134,936 | 36.5% | 14,800 | ≥4.0% | — | N/A |
| Bank | 124,970 | 34.3% | 14,559 | ≥4.0% | 21,838 | ≥6.0 % |
| Tier I Capital (to Average Assets) | | | | | | |
| Company | 135,936 | 16.9% | 31,915 | ≥4.0% | — | N/A |
| Bank | 124,970 | 15.8% | 31,647 | ≥4.0% | 39,559 | ≥5.0 % |

**Liquidity**

The management of the Company's liquidity focuses on ensuring that sufficient funds are available to meet loan funding commitments, withdrawals from deposit accounts, the repayment of borrowed funds, and ensuring that the Bank and the Company comply with regulatory liquidity requirements. Liquidity needs of the Bank have historically been met by deposits, investments in federal funds sold, principal and interest payments on loans, and maturities of investment securities. Additional liquidity, up to approximately $359.9 million is available from the Federal Reserve Bank and the FHLB-NY.

The current uncertainties in the credit markets have negatively impacted our ability to liquidate, if necessary, investments in auction rate securities. We are not certain as to when the liquidity issues relating to these investments will improve; however, we have the intent to hold these available for sale securities to maturity, and do not believe we will be required to sell these securities prior to maturity.

Based on our expected operating cash flows and our other sources of cash, we do not expect the potential lack of liquidity in these auction rate securities to affect our capital, liquidity or our ability to execute our current business plan.  We have cash and cash equivalents totaling $132.6 million, or 16.6% of total assets at March 31, 2013.  In addition, we have the capacity to borrow up to approximately $226.2 million from the Federal Reserve Bank and approximately $133.7 million from the FHLB-NY if the need should arise.

For the parent company, Berkshire Bancorp Inc., liquidity means having cash available to fund its normal operating expenses and to pay stockholder dividends on its common stock, when and if declared by the Company's Board of Directors.  On November 28, 2012, the Company's Board of Directors declared a cash dividend in respect of the common stock of the Company in the amount of $.08 per share. Such dividend was paid on December 20, 2012 to the holders of record of its common stock as of the close of business on December 10, 2012. This was the first dividend payment since the Company announced in March 2009 that it would temporarily suspend its stated policy of paying a regular cash dividend on its common stock. The declaration, payment and amount of dividends in the future are within the discretion of the Board of Directors and will depend upon our earnings, capital requirements, financial condition and other relevant factors including possibly requiring regulatory approval.

The ability of the Company to fund its normal operating expenses is not currently dependent upon the receipt of dividends from the Bank.  At March 31, 2013, the Company had cash of approximately $5.7 million.  However, the payment of dividends on its common stock when and if declared by the Board of Directors, will be dependent upon the receipt of dividends from the Bank.

The Bank maintains financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers.  These financial instruments, $15.5 million at March 31, 2013, include commitments to extend credit, stand-by letters of credit and loan commitments.

At March 31, 2013, the Bank had outstanding commitments of $337.2 million; including $0.6 million of borrowings, $5.1 million of operating leases, and $331.5 million of time deposits.  These commitments include $198.2 million that mature or renew within one year, $137.4 million that mature or renew after one year and within three years, $0.6 million that mature or renew after three years and within five years and commitments of $1.0 million that mature or renew after five years.

**Impact of Inflation and Changing Prices**

The Company's financial statements measure financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increasing cost of the Company's operations. The assets and liabilities of the Company are largely monetary. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. In addition, interest rates do not necessarily move in the direction, or to the same extent, as the price of goods and services. However, in general, high inflation rates are accompanied by higher interest rates, and vice versa.

## ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

**Interest Rate Risk.** Fluctuations in market interest rates can have a material effect on the Bank's net interest income because the yields earned on loans and investments may not adjust to market rates of interest with the same frequency, or with the same speed, as the rates paid by the Bank on its deposits.

Most of the Bank's deposits are either interest-bearing demand deposits or short term certificates of deposit and other interest-bearing deposits with interest rates that fluctuate as market rates change. Management of the Bank seeks to reduce the risk of interest rate fluctuations by concentrating on loans and securities investments with either short terms to maturity or with adjustable rates or other features that cause yields to adjust based upon interest rate fluctuations. In addition, to cushion itself against the potential adverse effects of a substantial and sustained increase in market interest rates, the Bank has from time to time purchased off balance sheet interest rate cap contracts which generally provide that the Bank will be entitled to receive payments from the other party to the contract if interest rates exceed specified levels. These contracts are entered into with major financial institutions.

The Company seeks to maximize its net interest margin within an acceptable level of interest rate risk. Interest rate risk can be defined as the amount of the forecasted net interest income that may be gained or lost due to favorable or unfavorable movements in interest rates. Interest rate risk, or sensitivity, arises when the maturity or repricing characteristics of assets differ significantly from the maturity or repricing characteristics of liabilities.

## ITEM 4 - CONTROLS AND PROCEDURES

**Disclosure Controls and Procedures.**

As of the end of the period covered by this Quarterly Report on Form 10-Q, the Company evaluated the effectiveness of the design and operation of its "disclosure controls and procedures" as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended ("Disclosure Controls"). The Disclosure Controls are designed to allow the Company to reach a reasonable level of assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time period specified in the SEC's rules and forms and that any information relating to the Company is accumulated and communicated with management, including its principal executive/financial officer to allow timely decisions regarding required disclosure. The evaluation of the Disclosure Controls ("Controls Evaluation") was done under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO"), who is also the Chief Financial Officer ("CFO"). Based upon the Controls Evaluation, and as a result of management's identification of the material weaknesses described below, the CEO/CFO has concluded that as of March 31, 2013, the Disclosure Controls were not effective at the reasonable assurance level.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis.

As disclosed in more detail in the Company's Form 10-K for the year ended December 31, 2012 (the "Form 10-K"), management previously identified the material weaknesses related to income taxes computations, financial statement closing process and allowance for loan losses.

**Remediation of Material Weaknesses**

As a result of management's identification of the material weaknesses described above, the Company is implementing the following changes in its internal control over financial reporting:

- *Material weakness related to income taxes computations* - The Company is enhancing its oversight procedures to review its tax consultant's work product and recommendations.

- *Material weakness related to financial statement closing process* - Management has implemented additional review controls over the financial statement closing process, including previously identified unrecorded adjustments, omitted disclosures and investment pricing.

- *Material weakness related to allowance for loan losses* - The Company no longer utilizes the services of the third party specialist or the allowance methodology recommended by such third party specialist in calculating its allowance for loan losses. The company has engaged a reputable national firm to review its ALLL methodology on a quarterly basis. In addition, the Company has enhanced the documentation that supports its ALLL assumptions and inputs.

**Changes in Internal Control over Financial Reporting.**

There were no changes in the Company's internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the fiscal quarter ended March 31, 2013, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Limitations on the Effectiveness of Controls**

The Company's management, including the CEO/CFO, does not expect that its Disclosure Controls and/or its internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

**PART II. OTHER INFORMATION**

**Item 6. Exhibits**

| Exhibit Number | Description |
|---|---|
| 10.1 | Amendment No. 6, dated as of March 25, 2013, to Employment Agreement, dated as of May 1, 1999, by and between The Berkshire Bank and Moses Krausz (incorporated by reference to Exhibit 10.9 to the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2012).+ |
| 10.2 | Letter Agreement, dated as of March 25, 2013, between the Company and Steven Rosenberg. + |
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| 31 | Certification of Principal Executive and Financial Officer pursuant to Section 302 Of The Sarbanes-Oxley Act of 2002. |
| 32 | Certification of Principal Executive and Financial Officer pursuant to Section 906 Of The Sarbanes-Oxley Act of 2002. |
| 101. | The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, formatted in Extensible Business Reporting Language (XBRL), pursuant to Rule 406T of Regulation S-T: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Stockholders' Equity, (v) Consolidated Statements of Cash Flows and (vi) related notes to consolidated financial statements. Users of this data are advised that the information contained in the XBRL documents is unaudited and these are not the official publicly filed financial statements of the Company. |
| | Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections. |

+ Denotes a management compensation plan or arrangement.

**SIGNATURES**

Pursuant to the requirements 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.

**BERKSHIRE BANCORP INC.**
**(Registrant)**

Date: May 15, 2013 By: /s/ Joseph Fink
**Joseph Fink**
**President and Chief**
**Financial Officer**

EXHIBIT INDEX

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