SALISBURY BANCORP INC
Form 10-K
March 28, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

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

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

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

Commission file number 0-24751

**SALISBURY BANCORP, INC.**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Connecticut<br>(State or other jurisdiction of incorporation or organization) | 06-1514263<br>(I.R.S. Employer Identification No.) |
| 5 Bissell Street, Lakeville, CT<br>(Address of principal executive offices) | 06039<br>(Zip code) |

Registrant's telephone number, including area code: **(860) 435-9801**

| | |
|---|---|
| Securities registered pursuant to Section 12(b) of the Act: | |
| Common Stock, par value $.10 per share<br>(Title of each class) | NASDAQ Capital Market<br>(Name of each exchange on which registered) |

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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

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

The aggregate market value of common stock held by non-affiliates of the registrant on June 30, 2013 was $44,463,146 based on the closing sales price of $26.00 of such stock. The number of shares of the registrant’s Common Stock outstanding as of March 1, 2014, was 1,711,121.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement for the 2014 Annual Meeting of Shareholders to be held on May 14, 2014, which will be filed within 120 days of fiscal year ended December 31, 2013, are incorporated by reference into Part III (Items 10, 11, 12, 13 and 14) of this Form 10-K.

**FORM 10-K**

**SALISBURY BANCORP, INC.**

For the Year Ended December 31, 2013

**TABLE OF CONTENTS**

# PART I

## Forward-Looking Statements

This Annual Report on Form 10-K may contain and incorporates by reference statements relating to future results of Salisbury Bancorp, Inc. and Subsidiary ("Salisbury") that are considered “forward-looking” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to, among other things, expectations concerning loan demand, growth and performance, simulated changes in interest rates and the adequacy of the allowance for loan losses. Actual results may differ materially from those expressed or implied as a result of certain risks and uncertainties, including, but not limited to, changes in political and economic conditions, interest rate fluctuations, competitive product and pricing pressures within Salisbury’s markets, equity and fixed income market fluctuations, personal and corporate customers’ bankruptcies, inflation, acquisitions and integrations of acquired businesses, technological changes, changes in law and regulations, changes in fiscal, monetary, regulatory and tax policies, monetary fluctuations, success in gaining regulatory approvals when required as well as other risks and uncertainties reported from time to time in Salisbury’s filings with the Securities and Exchange Commission.

Such developments could have an adverse impact on Salisbury’s financial position and results of operations. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this Report.

## Item 1. BUSINESS

### Salisbury Bancorp, Inc.

Salisbury Bancorp, Inc., a Connecticut corporation, formed in 1998, is the bank holding company for Salisbury Bank and Trust Company (the "Bank"), a Connecticut-chartered and Federal Deposit Insurance Corporation (the "FDIC") insured commercial bank headquartered in Lakeville, Connecticut. Salisbury’s common stock is traded on the NASDAQ Capital Market under the symbol “SAL”. Salisbury's principal business consists of the business of the Bank. The Bank, formed in 1848, currently provides commercial banking, consumer financing, retail banking and trust and wealth advisory services through a network of eight banking offices and eight ATMs located in Litchfield County, Connecticut, Dutchess County, New York and Berkshire County, Massachusetts and through its internet website (www.salisburybank.com).

### Abbreviations Used Herein

| | | | |
|---|---|---|---|
| ARRA | American Recovery and Reinvestment Act of 2009 | FRA | Federal Reserve Act |
| Bank | Salisbury Bank and Trust Company | FRB | Federal Reserve Board |
| BHC | Bank Holding Company | GAAP | Generally Accepted Accounting Principles in the United States of America |
| BHCA | Bank Holding Company Act | GLBA | Gramm-Leach-Bliley Act |
| BOLI | Bank Owned Life Insurance | IOLTA | Interest on Lawyers Trust Accounts |
| CFPB | Consumer Financial Protection Bureau | LIBOR | London Interbank Offered Rate |
| CPP | Capital Purchase Program | OREO | Other Real Estate Owned |
| CRA | Community Reinvestment Act of 1977 | OTTI | Other Than Temporarily Impaired |
| CTDOB | State of Connecticut Department of Banking | PIC | Passive Investment Company |
| Dodd-Frank Act | Dodd-Frank Wall Street Reform and Consumer Protection Act | Salisbury | Salisbury Bancorp, Inc. and Subsidiary |

| | | | |
|---|---|---|---|
| ESOP | Employee Stock Ownership Plan | SBLF | Small Business Lending Fund |
| FACT Act | Fair and Accurate Credit Transactions Act | SEC | Securities and Exchange Commission |
| FASB | Financial Accounting Standards Board | SOX | Sarbanes-Oxley Act of 2002 |
| EESA | Economic Emergency Stabilization Act | TARP | Troubled Asset Relief Program |
| FDIC | Federal Deposit Insurance Corporation | Treasury | United States Department of the Treasury |
| FHLBB | Federal Home Loan Bank of Boston | | |

Lending Activities

General

The Bank originates commercial loans, commercial real estate loans, residential and commercial construction loans, residential real estate loans collateralized by one-to-four family residences, home equity lines of credit and fixed rate loans and other consumer loans predominately in Connecticut's Litchfield County, Massachusetts' Berkshire County and New York's Dutchess County in towns proximate to the Bank's eight full service offices.

Real estate secured the majority of the Bank's loans as of December 31, 2013, including some loans classified as commercial loans. Interest rates charged on loans are affected principally by the Bank's current asset/liability strategy, the demand for such loans, the cost and supply of money available for lending purposes and the rates offered by competitors. These factors are, in turn, affected by general economic and credit conditions, monetary policies of the federal government, including the FRB, federal and state tax policies and budgetary matters.

Residential Real Estate Loans

A principal lending activity of the Bank is to originate prime loans secured by first mortgages on one-to-four family residences. The Bank typically originates residential real estate loans through employees who are commissioned licensed mortgage originators (in accordance with the mortgage lending compensation guidelines issued by the CFPB). The Bank originates both fixed rate and adjustable rate mortgages.

The Bank currently sells the majority of the fixed rate 30 year residential mortgage loans it originates to the FHLBB under the Mortgage Partnership Finance program. The Bank typically retains loan servicing. The Bank retains some fixed rate residential mortgage loans and those loans originated under its first time home owner program.

The retention of adjustable rate residential mortgage loans in the portfolio and the sale of longer term, fixed rate residential mortgage loans helps reduce the Bank's exposure to interest rate risk. However, adjustable rate mortgages generally pose credit risks different from the credit risks inherent in fixed rate loans primarily because as interest rates rise, the underlying debt service payments of the borrowers rise, thereby increasing the potential for default. Management believes that these risks, which have not had a material adverse effect on the Bank to date, generally are less onerous than the interest rate risks associated with holding long-term fixed rate loans in the loan portfolio.

Commercial Real Estate Loans

The Bank makes commercial real estate loans for the purpose of allowing borrowers to acquire, develop, construct, improve or refinance commercial real estate where the property is the primary collateral securing the loan, and the income generated from the property is the primary repayment source. Office buildings, light industrial, retail facilities or multi-family income properties, normally collateralize commercial real estate loans. Among the reasons for management's continued emphasis on commercial real estate lending is the desire to invest in assets with yields, which are generally higher than yields on one-to-four family residential mortgage loans, and are more sensitive to changes in interest rates. These loans typically have terms of up to twenty five years and interest rates, which adjust over periods of three to ten years, based on one of various rate indices.

Commercial real estate lending generally poses a greater credit risk than residential mortgage lending to owner-occupants. The repayment of commercial real estate loans depends on the business and financial condition of the borrower. Economic events and changes in government regulations, which the Bank and its borrowers do not control, could have an adverse impact on the cash flows generated by properties securing commercial real estate loans and on the market value of such properties.

Construction Loans

The Bank originates both residential and commercial construction loans. Typically, loans are made to owner-borrowers who will occupy the properties as either their primary or secondary residence and to licensed and experienced developers for the construction of single-family homes.

The proceeds of commercial construction loans are disbursed in stages. Bank officers, appraisers and/or independent engineers inspect each project's progress before additional funds are disbursed to verify that borrowers have completed project phases.

Residential construction loans to owner-borrowers generally convert to a fully amortizing long-term mortgage loan upon completion of construction. Construction phase is generally for twelve months.

Construction lending, particularly commercial construction lending, poses greater credit risk than mortgage lending to owner occupants. The repayment of commercial construction loans depends on the business and financial condition of the borrower and on the economic viability of the project financed. Economic events and changes in government regulations, which the Bank and its borrowers do not control, could have an adverse impact on the value of properties securing construction loans and on the borrower's ability to complete projects financed and sell them for amounts anticipated at the time the projects commenced.

Commercial Loans

Commercial loans are generally made on a secured basis and are primarily collateralized by equipment, inventory, accounts receivable and/or leases. Commercial loans primarily provide working capital, equipment financing, financing for leasehold improvements and financing for expansion. The Bank offers both term and revolving commercial loans. Term loans have either fixed or adjustable rates of interest and, generally, terms of between two and seven years. Term loans generally amortize during their life, although some loans require a balloon payment at maturity if the amortization exceeds seven years. Revolving commercial lines of credit typically are renewable annually and have a floating rate of interest, which is normally indexed to the Wall Street Journal's prime rate of interest and occasionally indexed to the LIBOR.

Commercial lending generally poses a higher degree of credit risk than real estate lending. Repayment of both secured and unsecured commercial loans depends substantially on the success of the borrower's underlying business, financial condition and cash flows. Unsecured loans generally involve a higher degree of risk of loss than do secured loans because, without collateral, repayment is primarily dependent upon the success of the borrower's business.

Secured commercial loans are generally collateralized by equipment, inventory, accounts receivable and leases. Compared to real estate, such collateral is more difficult to monitor, its value is more difficult to validate, it may depreciate more rapidly and it may not be as readily saleable if repossessed.

Consumer Loans

The Bank originates various types of consumer loans, including home equity loans and lines of credit, auto and personal installment loans. Home equity loans and lines of credit are generally secured by one-to-four family owner-occupied properties, typically by second mortgages. Home equity loans have fixed interest rates, while home equity lines of credit adjust based on the Wall Street Journal's prime rate of interest. Consumer loans are originated through the branch network with the exception of Home Equity Lines Of Credit, which are originated by licensed Mortgage Lending Originator staff.

Credit Risk Management and Asset Quality

One of the Bank's key objectives is to maintain a high level of asset quality. The Bank utilizes the following general practices to manage credit risk: limiting the amount of credit that individual lenders may extend; establishing a process for credit approval accountability; careful initial underwriting and analysis of borrower, transaction, market and collateral risks; ongoing servicing of individual loans and lending relationships; continuous monitoring of the portfolio, market dynamics and the economy; and periodically reevaluating the Bank's strategy and overall exposure as economic, market and other relevant conditions change.

Credit Administration is responsible for determining loan loss reserve adequacy, preparing monthly and quarterly reports regarding the credit quality of the loan portfolio; which are submitted to the Loan Committee to ensure compliance with the credit policy, and managing non-performing and classified assets as well as oversight of all collection activity. On a quarterly basis, the Loan Committee reviews commercial and commercial real estate loans that are risk rated as "Special Mention" or worse, focusing on the current status and strategies to improve the credit.

The Bank's loan review activities are performed by an independent third party firm that evaluates the creditworthiness of borrowers and the appropriateness of the Bank's risk rating classifications. The firm's findings are reported to Credit Administration and the Loan and Audit Committee.

Trust and Wealth Advisory Services

The Bank provides a range of fiduciary and trust services including general investment management, wealth advisory services to individuals, families and institutions, and estate administration and settlement services.

Securities

Salisbury's securities portfolio is structured to diversify the earnings, assets and risk structure of Salisbury, provide liquidity consistent with both projected and potential needs, collateralize certain types of deposits, assist with maintaining a satisfactory net interest margin and comply with regulatory capital and liquidity requirements. Securities types include U.S. Government and Agency securities, mortgage-backed securities, collateralized mortgage obligations and bank qualified tax exempt municipal bonds.

Sources of Funds

The Bank uses deposits, proceeds from loan and security maturities, repayments and sales, and borrowings to fund lending, investing and general operations. Deposits represent the Bank's primary source of funds.

Deposits

The Bank offers a variety of deposit accounts with a range of interest rates and other terms, which are designed to meet customer financial needs. Retail and commercial deposits are received through the Bank's banking offices. Additional depositor related services provided to customers include merchant services, cash management (ACH Origination, Wire Transfers and Positive Pay), ATM, bank-by-phone, Internet Banking, Internet Bill Pay, Person to Person Payments, Bank to Bank Transfers, Mobile Banking, and Online Financial Management services.

The FDIC provides separate insurance coverage of $250,000 per depositor for each account ownership category. Deposit flows are significantly influenced by economic conditions, the general level of interest rates and the relative attractiveness of competing deposit and investment alternatives. When determining deposit pricing, the Bank considers strategic objectives, competitive market rates, deposit flows, funding commitments and investment alternatives, FHLBB advance rates and rates on other sources of funds.

National, regional and local economic and credit conditions, changes in competitor money market, savings and time deposit rates, prevailing market interest rates and competing investment alternatives all have a significant impact on the level of the Bank's deposits. Deposit generation is a key focus for the Bank as a source of liquidity and to fund continuing asset growth. Competition for deposits has been and is expected to remain strong.

Borrowings

The Bank is a member of the FHLBB that provides credit facilities for regulated, federally insured depository institutions and certain other home financing institutions. Members of the FHLBB are required to own capital stock in the FHLBB and are authorized to apply for advances on the security of their FHLBB stock and certain home mortgages and other assets (principally securities, which are obligations of, or guaranteed by, the United States Government or its agencies) provided certain creditworthiness standards have been met. Under its current credit policies, the FHLBB limits advances based on a member's assets, total borrowings and net worth. Long-term and short-term FHLBB advances are utilized as a source of funding to meet liquidity and planning needs when the cost of these funds are favorable as compared to deposits or alternate funding sources.

Additional funding sources are available through securities sold under agreements to repurchase and the Federal Reserve Bank of Boston.

Subsidiaries

Salisbury has one wholly-owned subsidiary, Salisbury Bank and Trust Company. The Bank has two wholly-owned subsidiaries, SBT Mortgage Service Corporation and S.B.T. Realty, Inc. SBT Mortgage Service Corporation is a passive investment company ("PIC") that holds loans collateralized by real estate originated or purchased by the Bank. Income of the PIC and its dividends to Salisbury are exempt from the Connecticut Corporate Business Tax. S.B.T. Realty, Inc. was formed to hold New York State real estate and is presently inactive.

Employees

At December 31, 2013, the Bank had 125 full-time employees and 22 part-time employees. None of the employees were represented by a collective bargaining group. The Bank maintains a comprehensive employee benefit program providing, among other benefits, group medical and dental insurance, life insurance, disability insurance, an ESOP plan and an employee 401(k) plan. Management considers relations with its employees to be good.

Market Area

Salisbury and the Bank are headquartered in Lakeville, Connecticut, which is located in the northwestern quadrant of Connecticut’s Litchfield County. The Bank has a total of eight banking offices, four of which are located in Connecticut's Litchfield County; two of which are located in Massachusetts’ Berkshire County; and two of which are located in New York’s Dutchess County. The Bank’s primary deposit gathering and lending area consists of the communities and surrounding towns that are served by its branch network in Litchfield, Berkshire and Dutchess counties. The Bank also has deposit, lending and trust relationships outside of these areas.

Competition

The Bank faces strong competition in attracting and retaining deposits and in making loans. The primary factors in competing for deposits are interest rates, personalized services, the quality and range of financial services, convenience of office locations, automated services and office hours. Its most direct competition for deposits and loans has come from commercial banks, savings banks and credit unions located in its market area. Competition for deposits also comes from non-banking companies such as brokerage houses that offer a range of deposit and deposit-like products. Although the Bank expects this continuing competition to have an effect upon the cost of funds, it does not anticipate any substantial adverse effect on maintaining the current deposit base. The Bank is competitive within its market area in the various deposit products it offers to depositors. Due to this fact, management believes the Bank has the ability to maintain its deposit base.

The Bank's competition for real estate loans comes primarily from mortgage banking companies, savings banks, commercial banks, insurance companies, and other institutional lenders. The primary factors in competing for loans are interest rates, loan origination fees, the quality and range of lending services and personalized service. Factors that affect competition include, among others, the general availability of funds and credit, general and local economic conditions, current interest rate levels and volatility in the mortgage markets.

The banking industry is also experiencing rapid changes in technology. In addition to improving customer services, effective use of technology increases efficiency and enables financial institutions to reduce costs. Technological advances are likely to increase competition by enabling more companies to provide cost effective products and services.

Regulation and Supervision

General

Salisbury is required to file reports and otherwise comply with the rules and regulations of the FRB, the CTDOB, the FDIC, the SEC and NASDAQ.

The Bank is subject to extensive regulation by the CTDOB, as its chartering agency, and by the FDIC, as its deposit insurer. The Bank is required to file reports with, and is periodically examined by, the FDIC and the CTDOB concerning its activities and financial condition. It must obtain regulatory approvals prior to entering into certain transactions, such as mergers.

The following discussion of the laws, regulations and policies material to the operations of Salisbury and the Bank is a summary and is qualified in its entirety by reference to such laws, regulations and policies. Such statutes, regulations and policies are continually under review by Congress and the Connecticut, New York and Massachusetts State Legislatures and federal and state regulatory agencies. Any change in such laws, regulations, or policies could have a material adverse impact on Salisbury or the Bank.

Bank Holding Company Regulation

*SEC and NASDAQ*

Salisbury is subject to the rules and regulations of the SEC and is required to comply with the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. Salisbury's common stock is listed on the NASDAQ Capital Market under the trading symbol "SAL" and, accordingly, Salisbury is also subject to the rules of NASDAQ for listed companies.

*Federal Reserve Board Regulation*

Salisbury is a registered bank holding company under the BHCA and is subject to comprehensive regulation and regular examinations by the FRB. The FRB also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

Under FRB policy, a bank holding company must serve as a source of financial and managerial strength for its subsidiary bank. Under this policy, Salisbury is expected to commit resources to support the Bank. The FRB may require a holding company to contribute additional capital to an undercapitalized subsidiary bank. Any capital loans by a bank holding company to its subsidiary bank are subordinate in right of payment to deposits and certain other indebtedness of such subsidiary bank.

Bank holding companies must obtain FRB approval before: (i) acquiring, directly or indirectly, ownership or control of another bank or bank holding company; (ii) acquiring all or substantially all of the assets of another bank or bank holding company; or (iii) merging or consolidating with another bank holding company.

The BHCA also prohibits a bank holding company, with certain exceptions, from acquiring direct or indirect ownership or control of any company, which is not a bank or bank holding company, or from engaging directly or indirectly in activities other than those of banking, managing or controlling banks, or providing services for its subsidiaries. The principal exceptions to these prohibitions involve certain non-bank activities, which, by statute or by FRB regulation or order, have been identified as activities closely related to the business of banking or managing or controlling banks. The list of activities permitted by the FRB includes, among other things: (i) operating a savings institution, mortgage company, finance company, credit card company or factoring company; (ii) performing certain data processing operations; (iii) providing certain investment and financial advice; (iv) underwriting and acting as an insurance agent for certain types of credit-related insurance; (v) leasing property on a full-payout, non-operating basis; (vi) selling money orders; (vii) real estate and personal property appraising; (viii) providing tax planning and preparation services; (ix) financing and investing in certain community development activities; and (x) subject to certain limitations, providing securities brokerage services for customers.

*Connecticut Bank Holding Company Regulation*

Salisbury is also subject to Connecticut banking law applicable to Connecticut bank holding companies. Under Connecticut banking law, no person may acquire beneficial ownership of more than 10% of any class of voting securities of a Connecticut-chartered bank, or any bank holding company of such a bank, without prior notification to, and lack of disapproval by, the CTDOB. The CTDOB will disapprove the acquisition if the bank or holding company to be acquired has been in existence for less than five years, unless the CTDOB waives this five-year restriction, or if the acquisition would result in the acquirer controlling 30% or more of the total amount of deposits in insured depository institutions in Connecticut. Similar restrictions apply to any person who holds in excess of 10% of any such class and desires to increase its holdings to 25% or more of such class.

Dividends

Salisbury’s dividends to shareholders are substantially dependent upon Salisbury’s receipt of dividends from the Bank. The FRB has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the FRB’s view that a bank holding company should be a “source of strength” to its bank subsidiary and should pay cash dividends only to the extent that the holding company’s net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the holding company’s capital needs, asset quality and overall financial condition. The FRB also indicated that it would be inappropriate for a company experiencing serious financial problems to borrow funds to pay dividends. Furthermore, the FRB may prohibit a bank holding company from paying any dividends if the holding company’s bank subsidiary is classified as “undercapitalized” or if the dividend would violate applicable law or would be an unsafe or unsound banking practice.

Financial Modernization

GLBA permits greater affiliation among banks, securities firms, insurance companies, and other companies under a type of financial services company known as a “financial holding company”. A financial holding company essentially is a bank holding company with significantly expanded powers. Financial holding companies are authorized by statute to engage in a number of financial activities previously impermissible for bank holding companies, including securities underwriting, dealing and market making; sponsoring mutual funds and investment companies; insurance underwriting and agency; and merchant banking activities. The act also permits the FRB and the Treasury to authorize additional activities for financial holding companies if they are “financial in nature” or “incidental” to financial activities. A bank holding company may become a financial holding company if each of its subsidiary banks is “well capitalized” and “well managed” as defined in the FRB’s Regulation Y, and has at least a “satisfactory” Community Reinvestment Act rating. A financial holding company must provide notice to the FRB within 30 days after commencing activities previously determined to be permissible by statute or by the FRB and the Treasury. Salisbury is a registered financial holding company.

All financial institutions are required to establish policies and procedures with respect to the ability of the Bank to share nonpublic customer data with nonaffiliated parties and to protect customer data from unauthorized access. The Bank has developed policies and procedures, and believes it is in compliance with all privacy, information sharing, and notification provisions of GLBA and the FACT Act.

Connecticut Banking Laws and Supervision

The Bank is a state-chartered commercial bank under Connecticut law and as such is subject to regulation and examination by the CTDOB. The CTDOB regulates commercial banks, among other financial institutions, for compliance with the laws and regulations of the States of Connecticut, New York and Massachusetts, as well as the appropriate rules and regulations of federal agencies. The approval of the CTDOB is required for, among other things, the establishment of branch offices and business combination transactions. The CTDOB conducts periodic examinations of Connecticut-chartered banks. The FDIC also regulates many of the areas regulated by the CTDOB, and federal law may limit some of the authority provided to Connecticut-chartered banks by Connecticut law.

Lending Activities

Connecticut banking laws grant commercial banks broad lending authority. With certain limited exceptions, total secured and unsecured loans made to any one obligor generally may not exceed 15% of the Bank's equity capital and reserves for loan and lease losses. However, if the loan is fully secured, such limitations generally may be increased by an additional 10%.

Dividends

The Bank may pay cash dividends out of its net profits. For purposes of this restriction, "net profits" represents the remainder of all earnings from current operations. Further, the total amount of all dividends declared by the Bank in any year may not exceed the sum of its net profits for the year in question combined with its retained net profits from the preceding two years, unless the CTDOB approves the larger dividend. Federal law also prevents the Bank from paying dividends or making other capital distributions that would cause it to become "undercapitalized". The FDIC may also limit a bank's ability to pay dividends based upon safety and soundness considerations.

Powers

Connecticut law permits Connecticut banks to sell insurance and fixed and variable-rate annuities if licensed to do so by the Connecticut Insurance Department. With the prior approval of the CTDOB, Connecticut banks are also authorized to engage in a broad range of activities related to the business of banking, or that are financial in nature or that are permitted under the BHCA, other federal statutes, or the regulations promulgated pursuant to these statutes. Connecticut banks generally are also authorized to engage in any activity permitted for a federal bank or upon filing prior written notice of its intention to engage in such activity with the CTDOB, unless the CTDOB disapproves the activity.

Assessments

Connecticut banks are required to pay assessments to the CTDOB based upon a bank's asset size to fund the CTDOB's operations. The assessments are generally made annually.

Enforcement

Under Connecticut law, the CTDOB has extensive enforcement authority over Connecticut banks and, under certain circumstances, affiliated parties, insiders, and agents. The CTDOB's enforcement authority includes cease and desist orders, fines, receivership, conservatorship, removal of officers and directors, emergency closures, dissolution and liquidation.

New York and Massachusetts Banking Laws and Supervision

Federal and state laws authorize the interstate merger of banks. Among other things, banks may establish new branches on an interstate basis provided that such action is specifically authorized by the law of the host state. The Bank conducts activities and operates branch offices in New York and Massachusetts as well as Connecticut. Generally, with respect to its business in New York and Massachusetts, the Bank may conduct any activity that is authorized under Connecticut law that is permissible for either New York or Massachusetts state banks or for an out-of-state national bank, at its New York and Massachusetts branch offices, respectively. The New York State Superintendent of Banks may exercise regulatory authority with respect to the Bank's New York branch offices. The Bank is subject to certain rules related to community reinvestment, consumer protection, fair lending, establishment of intra-state branches and the conduct of banking activities with respect to its branches located in New York State. The Massachusetts Commissioner of Banks may exercise similar authority, and the Bank is subject to similar rules under Massachusetts Banking Law with respect to the Bank's Massachusetts branch offices.

Federal Regulations

Capital Requirements

Under FDIC regulations, federally insured state-chartered banks, such as the Bank, that are not members of the Federal Reserve System ("state non-member banks") are required to comply with minimum leverage capital requirements. For most institutions, the minimum leverage capital ratio is not less than 4%. Tier 1 capital is the sum of common Shareholders' equity, noncumulative perpetual preferred stock (including any related surplus) and minority investments in certain subsidiaries, less intangible assets (except for certain servicing rights and credit card relationships) and certain other specified items.

The FDIC regulations require state non-member banks to maintain certain levels of regulatory capital in relation to regulatory risk-weighted assets. The ratio of regulatory capital to regulatory risk-weighted assets is referred to as a bank's "risk-based capital ratio". Risk-based capital ratios are determined by allocating assets and specified off-balance sheet items (including recourse obligations, direct credit substitutes and residual interests) to four risk-weighted categories ranging from 0% to 100%, and in some instances 200% or assets subject to dollar-for-dollar capital requirements, with higher levels of capital being required for the categories perceived as representing greater risk.

To be considered "well capitalized", banks are generally expected to maintain a minimum ratio of total capital to risk-weighted assets of at least 8%, of which at least one-half must be Tier 1 capital. Total capital consists of Tier 1 capital plus Tier 2 or supplementary capital items, which include allowances for loan losses in an amount of up to 1.25% of risk-weighted assets, cumulative preferred stock and certain other capital instruments, and a portion of the net unrealized gain on equity securities. The includable amount of Tier 2 capital cannot exceed the amount of the institution's Tier 1 capital. Banks that engage in specified levels of trading activities are subject to adjustments in their risk based capital calculation to ensure the maintenance of sufficient capital to support market risk.

As a bank holding company, Salisbury is subject to FRB capital adequacy guidelines for bank holding companies similar to those of the FDIC for state-chartered banks.

In December 2010, the Basel Committee, a group of bank regulatory supervisors from around the world, released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as “Basel III.” Basel III, when fully implemented by the U.S. bank regulatory agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity.

In July 2013, the Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation approved final rules to implement the Basel III capital framework. The rules will be effective on January 1, 2015 and phased-in over a multiple year period through 2019. The new capital rules call for greater reliance upon equity capital with higher minimum capital level requirements. We are in the process of assessing the impact from these new regulatory requirements, and while we cannot be certain of the impact, we believe that Salisbury will exceed applicable regulatory requirements, once they become effective.

Prompt Corrective Regulatory Action

Federal law requires, among other things, that federal bank regulatory authorities take “prompt corrective action” with respect to banks that do not meet minimum capital requirements. For these purposes, the law establishes five capital categories:

- Well capitalized – at least 5% leverage capital, 6% Tier 1 risk based capital and 10% total risk based capital.
- Adequately capitalized – at least 4% leverage capital, 4% Tier 1 risk based capital and 8% total risk based capital.
- Undercapitalized – less than 4% leverage capital, 4% Tier 1 risk based capital and less than 8% total risk based capital. “Undercapitalized” banks must adhere to growth, capital distribution (including dividend) and other limitations and are required to submit a capital restoration plan. A bank’s compliance with such a plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5% of the institution’s total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized.
- Significantly undercapitalized – less than 3% leverage capital, 3% Tier 1 risk based capital and less than 6% total risk-based capital. “Significantly undercapitalized” banks must comply with one or more of a number of additional restrictions, including but not limited to an order by the FDIC to sell sufficient voting stock to become adequately capitalized, requirements to reduce total assets, cease receipt of deposits from correspondent banks or dismiss directors or officers, and restrictions on interest rates paid on deposits, compensation of executive officers and capital distributions by the parent holding company.
- Critically undercapitalized – less than 2% tangible capital. “Critically undercapitalized” institutions are subject to additional measures including, subject to a narrow exception, the appointment of a receiver or conservator within 270 days after it obtains such status.

As of December 31, 2013, the Bank was “well capitalized”.

Transactions with Affiliates

Under federal law, transactions between depository institutions and their affiliates are governed by Sections 23A and 23B of the FRA. In a holding company context, at a minimum, the parent holding company of a bank and any companies which are controlled by such parent holding company are affiliates of the bank. Generally, Sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and by requiring that such transactions be on terms that are consistent with safe and sound banking practices.

The FRA and Regulation O restrict loans to directors, executive officers, and principal shareholders ("insiders"). Loans to insiders and their related interests may not exceed, together with all other outstanding loans to such persons and affiliated entities, the institution's total capital and surplus. Loans to insiders above specified amounts must receive the prior approval of the board of directors and must be made on terms substantially the same as offered in comparable transactions to other persons. The FRA imposes additional limitations on loans to executive officers.

Enforcement

The FDIC has extensive enforcement authority over insured banks, including the Bank. This enforcement authority includes, among other things, the ability to assess civil money penalties, issue cease and desist orders and remove directors and officers. In general, these enforcement actions may be initiated in response to violations of laws and regulations and unsafe or unsound practices.

Standards for Safety and Soundness

The FDIC, together with the other federal bank regulatory agencies, prescribe standards of safety and soundness by regulations or guidelines, relating generally to operations and management, asset growth, asset quality, earnings, stock valuation and compensation. The federal bank regulatory agencies have adopted a set of guidelines prescribing safety and soundness standards, which establish general standards relating to internal controls and information systems, internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. In general, the guidelines require, among other things, appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director or principal shareholder. In addition, the federal bank regulatory agencies adopted regulations that authorize, but do not require, the agencies to order an institution that has been given notice that it is not satisfying the safety and soundness guidelines to submit a compliance plan. The federal bank regulatory agencies have also adopted guidelines for asset quality and earning standards. As a state-chartered bank, the Bank is also subject to state statutes, regulations and guidelines relating to safety and soundness, in addition to the federal requirements.

Insurance of Deposit Accounts

The Bank's deposit accounts are insured by the Deposit Insurance Fund ("DIF") of the FDIC up to applicable legal limits (generally, $250,000 per depositor for each account ownership category and $250,000 for certain retirement plan accounts) and are subject to deposit insurance assessments. The FDIC insurance coverage limit applies per depositor, per insured depository institution for each account ownership category.

The FDIC utilizes a risk-based assessment system that imposes insurance premiums based upon a risk matrix that takes into account a bank's capital level and supervisory rating. The FDIC assigns an institution to one of the following capital categories based on the institution's financial condition consisting of (1) well capitalized, (2) adequately capitalized or (3) undercapitalized, and one of three supervisory subcategories within each capital group. The supervisory subgroup to which an institution is assigned is based on a supervisory evaluation provided to the FDIC by the institution's primary federal regulator and information which the FDIC determines to be relevant to the institution's financial condition and the risk posed to the deposit insurance funds. An institution's assessment rate depends on the capital category and supervisory category to which it is assigned.

FDIC insured institutions are required to pay assessments to the FDIC to fund the DIF. The Bank's current annual assessment rate is approximately 8 basis points of total assets. Additionally, FDIC insured institutions are required to pay assessments to the FDIC to fund interest payments on bonds issued by The Financing Corporation, an agency of the federal government established to recapitalize the predecessor to the Savings Association Insurance Fund. The assessment rate is adjusted quarterly to reflect changes in the assessment bases of the fund based on quarterly Call Report and Thrift Financial Report submissions. From time to time, the FDIC may impose a supplemental special assessment in addition to other special assessments and regular premium rates to replenish the deposit insurance funds during periods of economic difficulty. The amount of an emergency special assessment imposed on a bank will be determined by the FDIC if such amount is necessary to provide sufficient assessment income to repay amounts borrowed from the Treasury; to provide sufficient assessment income to repay obligations issued to and other amounts borrowed from insured depository institutions; or for any other purpose the FDIC may deem necessary.

The FDIC may terminate insurance of deposits, after notice and a hearing, if it finds that the institution is in an unsafe or unsound condition to continue operations, has engaged in unsafe or unsound practices, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")

The Dodd-Frank Act, enacted in July 2010, significantly changed the bank regulatory landscape and has impacted lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act revised the statutory authorities governing the FDIC's management of the DIF. The Dodd-Frank Act granted the FDIC new DIF management tools: maintaining a positive Fund balance even during a banking crisis and maintaining moderate, steady assessment rates throughout economic and credit cycles.

Among other things, the Dodd-Frank Act: (1) raised the minimum Designated Reserve Ratio (DRR), which the FDIC must set each year, to 1.35% (from the former minimum of 1.15%) and removed the upper limit on the DRR (which was formerly capped at 1.5%) and therefore on the size of the DIF; (2) required that the DIF reserve ratio reach 1.35% by September 30, 2020 (rather than 1.15% by the end of 2016, as formerly required); (3) required that, in setting assessments, the FDIC offset the effect of requiring that the reserve ratio reach 1.35% by September 30, 2020 (rather than 1.15% by the end of 2016) on insured depository institutions with total consolidated assets of less than $10 billion; (4) eliminated the requirement that the FDIC provide dividends from the Fund when the reserve ratio is between 1.35% and 1.50%; and (5) continued the FDIC's authority to declare dividends when the reserve ratio at the end of a calendar year is at least 1.50%, but granted the FDIC sole discretion in determining whether to suspend or limit the declaration or payment of dividends.

The Dodd-Frank Act also required that the FDIC amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. Under the Dodd-Frank Act, the assessment base must, with some possible exceptions, equal average consolidated total assets minus average tangible equity.

The FDIC amended 12 CFR 327 to implement revisions to the Federal Deposit Insurance Act made by the Dodd-Frank Act by modifying the definition of an institution’s deposit insurance assessment base; to change the assessment rate adjustments; to revise the deposit insurance assessment rate schedules in light of the new assessment base and altered adjustments; to implement the Dodd-Frank Act’s dividend provisions; to revise the large insured depository institution assessment system to better differentiate for risk and better take into account losses from large institution failures that the FDIC may incur; and to make technical and other changes to the FDIC's assessment rules. The FDIC Board of Directors adopted the final rule, which redefined the deposit insurance assessment base as required by the Dodd-Frank Act; made changes to assessment rates; implemented the Dodd-Frank Act’s DIF dividend provisions; and revised the risk-based assessment system for all large insured depository institutions, generally, those institutions with at least $10 billion in total assets. Nearly all of the 6,700-plus institutions with assets less than $10 billion, including the Bank, have benefited from a reduction in their assessments as a result of this final rule.

The Dodd-Frank Act requires publicly traded companies to give shareholders a non-binding vote of executive compensation at, for smaller reporting companies such as Salisbury, the first annual meeting taking place after January 21, 2013 and at least every three (3) years thereafter. The legislation also authorizes the SEC to prohibit broker discretion on any voting on election of directors, executive compensation matters, and any other significant matter.

The Dodd-Frank Act also adopts various mortgage lending and predatory lending provisions and requires loan originators to retain 5% of any loan sold and securitized, unless it is a “qualified residential mortgage”, which includes standard 30 and 15-year fixed rate loans.

Consumer Protection and the Financial Protection Bureau

The Dodd-Frank Act created the Consumer Financial Protection Bureau (“CFPB”). As required by the Dodd-Frank Act, jurisdiction for all existing consumer protection laws and regulations has been transferred to the CFPB. In addition, the CFPB is granted authority to promulgate new consumer protection regulations for banks and nonbank financial firms offering consumer financial services or products to ensure that consumers are protected from “unfair, deceptive, or abusive” acts or practices.

Salisbury is subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy and population. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Truth in Lending Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, various state law counterparts, and the Consumer Financial Protection Act of 2010, which constitutes part of the Dodd-Frank Act and establishes the CFPB, as described above.

On January 10, 2013, the CFPB issued a final rule implementing the ability-to-repay and qualified mortgage (“QM”) provisions of the Truth in Lending Act, as amended by the Dodd-Frank Act (the “QM Rule”). The ability-to-repay provision requires creditors to make reasonable, good faith determinations that borrowers are able to repay their mortgages before extending the credit based on a number of factors and consideration of financial information about the borrower from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of “qualified mortgage” are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for prime loans meeting the QM requirements and a rebuttable presumption for higher-priced/subprime loans meeting the QM requirements. The definition of a “qualified mortgage” incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43% debt-to-income ratio for borrowers if the loan is to meet the QM definition.

Federal Reserve System

All depository institutions must hold a percentage of certain types of deposits as reserves. Reserve requirements currently are assessed on the depository institution's net transaction accounts (mostly checking accounts). Depository institutions must also regularly submit deposit reports of their deposits and other reservable liabilities.

For net transaction accounts in 2013, the first $12.4 million (which may be adjusted by the FRB) will be exempt from reserve requirements. A 3% reserve ratio will be assessed on net transaction accounts over $12.4 million up to and including $79.5 million (which may be adjusted by the FRB). A 10% reserve ratio will be assessed on net transaction accounts in excess of $79.5 million (which may be adjusted by the FRB). The Bank is in compliance with these requirements.

Federal Home Loan Bank System

The Bank is a member of the Boston region of the Federal Home Loan Bank System, which consists of 12 regional Federal Home Loan Banks. The FHLBB provides a central credit facility primarily for member institutions. Member institutions are required to acquire and hold shares of capital stock in the FHLBB calculated periodically based primarily on its level of borrowings from the FHLBB. The Bank was in compliance with this requirement. At December 31, 2013, the Bank had FHLBB stock of $5.3 million and FHLBB advances of $30.4 million.

No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB.

In 2008, the FHLBB announced to its members it was focusing on preserving capital in response to ongoing market volatility including the extension of a moratorium on excess stock repurchases and in 2009 announced the suspension of its quarterly dividends. On February 22, 2011, the FHLBB announced the resumption of modest quarterly cash dividends to its members through 2011 and on June 27, 2011 the FHLBB announced the discontinuation of its excess stock pool effective June 28, 2011, and designated December 28, 2011, as the required stock purchase date. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank’s FHLBB stock as of December 31, 2013. If in the future there were to be further deterioration of the FHLBB’s capital levels it might warrant the Bank to deem its restricted investment in FHLBB stock to be OTTI. If future evidence of impairment were to exist, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

Troubled Asset Relief Program and Capital Purchase Program

TARP was established as part of the Emergency Economic Stabilization Act of 2008 and gave the Treasury authority to deploy up to $700 billion into the financial system with the objective of improving liquidity in the capital markets. On October 24, 2008, the Treasury announced plans to direct $250 billion of the $700 billion authorized into preferred stock investments in banks (the “CPP”).

On March 13, 2009, Salisbury sold to the Secretary of the Treasury (i) 8,816 shares of its Series A Fixed Rate Cumulative Perpetual Preferred Stock, par value $0.01 per share, having a liquidation preference of $1,000 per share (the Series A Preferred Stock) and (ii) a ten-year warrant to purchase up to 57,671 shares of its common stock, par value $0.10 per share, at an exercise price of $22.93 per share (the “Warrant”), for an aggregate purchase price of $8,816,000 in cash. All of the proceeds from the sale of its Series A Preferred Stock were treated as Tier 1 Capital for regulatory purposes.

On August 25, 2011, Salisbury repurchased from the Secretary of the Treasury for $8,816,000 all of its 8,816 shares of Series A Fixed Rate Cumulative Perpetual Preferred Stock and on November 2, 2011, Salisbury repurchased from the Secretary of the Treasury for $205,000 the Warrant to purchase up to 57,671 shares of Salisbury’s Common Stock at a purchase price of $22.93 per share.

Small Business Lending Fund

Treasury’s SBLF program is a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion.

Salisbury elected to participate in Treasury’s SBLF program and on August 25, 2011, Salisbury sold to the Secretary of the Treasury $16 million of its Series B Preferred Stock under the SBLF program, and simultaneously repurchased all of its Series A Preferred Stock sold to the Treasury in 2009 under the Capital Purchase Program, a part of TARP. All of the proceeds from the sale of its Series B Preferred Stock are treated as Tier 1 Capital for regulatory purposes.

The Series B Preferred Stock pays noncumulative dividends. The dividend rate on the Series B Preferred Stock for the initial ten quarterly dividend periods, commencing with the period ended September 30, 2011 and ending with the period ended December 31, 2013, is determined each quarter based on the increase in the Bank’s Qualified Small Business Lending over a baseline amount. The dividend rate for the quarterly period ended December 31, 2013 was 1.0%. For the eleventh quarterly dividend payment through four and one-half years after its issuance, the dividend rate on the Series B Preferred Stock will be 1.0%. Commencing with the second quarter of 2016, four and one-half years from its issuance, the dividend rate will be fixed at 9.0% per annum. The Series B Preferred Stock is non-voting, other than voting rights on matters that could adversely affect the Series B Preferred Stock. The Series B Preferred Stock is redeemable at any time at one hundred percent of the issue price plus any accrued and unpaid dividends.

Other Regulations

*Sarbanes-Oxley Act of 2002*

The stated goals of SOX are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

SOX includes very specific disclosure requirements and corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the SEC and the Comptroller General. SOX represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

SOX addresses, among other matters, audit committees; certification of financial statements and internal controls by the Chief Executive Officer and Chief Financial Officer; the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer’s securities by directors and senior officers in the twelve-month period following initial publication of any financial statements that later require restatement; a prohibition on insider trading during pension plan black-out periods; disclosure of off-balance sheet transactions; a prohibition on certain loans to directors and officers; expedited filing requirements for Forms 4; disclosure of a code of ethics and filing a Form 8-K for significant changes or waivers of such code; “real time” filing of periodic reports; the formation of a public company accounting oversight board; auditor independence; and various increased criminal penalties for violations of securities laws. The SEC has enacted rules to implement various provisions of SOX.

*USA PATRIOT Act*

Under the USA PATRIOT Act, all financial institutions are required to take certain measures to identify their customers, prevent money laundering, monitor customer transactions and report suspicious activity to U.S. law enforcement agencies. Financial institutions also are required to respond to requests for information from federal banking regulatory authorities and law enforcement agencies. Information sharing among financial institutions for the above purposes is encouraged by an exemption granted to complying financial institutions from the privacy provisions of GLBA and other privacy laws. Financial institutions that hold correspondent accounts for foreign banks or provide private banking services to foreign individuals are required to take measures to avoid dealing with certain foreign individuals or entities, including foreign banks with profiles that raise money laundering concerns, and are prohibited from dealing with foreign “shell banks” and persons from jurisdictions of particular concern. The primary federal banking regulators and the Secretary of the Treasury have adopted regulations to implement several of these provisions. All financial institutions are also required to establish internal anti-money laundering programs. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act or the BHCA. Salisbury has in place a Bank Secrecy Act and USA PATRIOT Act compliance program, and engages in very few transactions of any kind with foreign financial institutions or foreign persons.

*Community Reinvestment Act and Fair Lending Laws*

Salisbury has a responsibility under the CRA to help meet the credit needs of our communities, including low and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. In connection with its examination, the FDIC assesses the Bank’s record of compliance with the CRA. In addition, the Equal Credit Opportunity Act and the Fair

Housing Act prohibit discrimination in lending practices on the basis of characteristics specified in those statutes. The Bank's failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on our activities. The Bank's failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions against the Bank by the FDIC as well as other federal regulatory agencies and the Department of Justice. The Bank's most recent FDIC CRA rating was "satisfactory".

The Electronic Funds Transfer Act, Regulation E and Related Laws

The Electronic Funds Transfer Act (the "EFTA") provides a basic framework for establishing the rights, liabilities, and responsibilities of consumers who use electronic funds transfer ("EFT") systems. The EFTA is implemented by the Federal Reserve's Regulation E, which governs transfers initiated through ATMs, point-of-sale terminals, payroll cards, automated clearing house ("ACH") transactions, telephone bill-payment plans, or remote banking services. Regulation E requires consumers to opt in (affirmatively consent) to participation in a bank's overdraft service program for ATM and one-time debit card transactions before overdraft fees may be assessed on the consumer's account. Notice of the opt-in right must be provided to all new customers who are consumers, and the customer's affirmative consent must be obtained, before charges may be assessed on the consumer's account for paying such overdrafts.

Regulation E also provides bank customers with an ongoing right to revoke consent to participation in an overdraft service program for ATM and one-time debit card transactions and prohibits banks from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions that overdraw the consumer's account on the consumer's opting into an overdraft service for ATM and one-time debit card transactions. For customers who do not affirmatively consent to overdraft service for ATM and one-time debit card transactions, a bank must provide those customers with the same account terms, conditions, and features that it provides to consumers who do affirmatively consent, except for the overdraft service for ATM and one-time debit card transactions. Salisbury does not allow consumers to opt in, as one time point-of-sale or ATM transactions cannot overdraw an account in which an overdraft fee is assessed.

Impact of Inflation and Changing Prices

The Consolidated Financial Statements and their Notes presented within this document have been prepared in accordance with GAAP, which require the measurement of financial position and operating results in terms of historical dollar amounts without considering changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of Salisbury's operations. Unlike the assets and liabilities of industrial companies, nearly all of the assets and liabilities of Salisbury are monetary in nature. As a result, interest rates have a greater impact on Salisbury's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

Availability of Securities and Exchange Commission Filings

Salisbury makes available free of charge on its website (www.salisburybank.com) a link to its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 as soon as practicable after such reports are electronically filed with or furnished to the SEC. Such reports filed with the SEC are also available on its website (www.sec.gov). The public may also read and copy any materials filed with the SEC at the SEC's Public Reference Room, 100 F Street, NE, Washington, DC 20549. Information about accessing company filings can be obtained by calling 1-800-SEC-0330. Information on Salisbury's website is not incorporated by reference into this report. Investors are encouraged to access these reports and the other information about Salisbury's business and operations on its website. Copies of these filings may also be obtained from Salisbury free of charge upon request.

Guide 3 Statistical Disclosure by Bank Holding Companies

The following information required by Securities Act Guide 3 "Statistical Disclosure by Bank Holding Companies" is located on the pages noted below.

| | | Page |
|---|---|---|
| I. | Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differentials | 19-20 |
| II. | Investment Portfolio | 25, 47-49 |
| III. | Loan Portfolio | 25-30, 50-56 |
| IV. | Summary of Loan Loss Experience | 21-22, 54-56 |
| V. | Deposits | 30, 58 |
| VI. | Return on Equity and Assets | 17 |
| VII. | Short-Term Borrowings | 30, 58 |

Item 1A. RISK FACTORS

Salisbury is the registered bank holding company for the Bank, its wholly-owned subsidiary. Salisbury's activity is currently limited to the holding of the Bank's outstanding capital stock, and the Bank is Salisbury's primary investment.

An investment in Salisbury common stock entails certain risks. Salisbury considers the most significant factors affecting risk in Salisbury common stock as those that are set forth below. These are not the only risks of an investment in Salisbury common stock, and none of the factors set forth below relates to the personal circumstances of individual investors. Investors should read this entire Form 10-K, as well as other documents and exhibits that are incorporated by reference in the 10-K and that have been filed with the SEC, in order to better understand these risks and to evaluate investment in Salisbury common stock.

Changes in interest rates and spreads could have a negative impact on earnings.

Salisbury's earnings and financial condition are dependent to a large degree upon net interest income, which is the difference between interest earned from loans and investments and interest paid on deposits and borrowings. The narrowing of interest rate spreads, meaning the difference between interest rates earned on loans and investments, and the interest rates paid on deposits and borrowings, could adversely affect Salisbury's earnings and financial condition. Salisbury cannot predict with certainty or control changes in interest rates. Global, national, regional, and local economic conditions and the policies of regulatory authorities, including monetary policies of the FRB, affect interest income and interest expense. Salisbury has ongoing policies and procedures designed to manage the risks associated with changes in market interest rates.

However, changes in interest rates still may have an adverse effect on Salisbury's profitability. For example, high interest rates could also affect the volume of loans that Salisbury originates, because higher rates could cause customers to apply for fewer mortgages, or cause depositors to shift funds from accounts that have a comparatively lower rate, to accounts with a higher rate or experience customer attrition due to competitor pricing or disintermediation. If the cost of interest-bearing deposits increases at a rate greater than the yields on interest-earning assets increase, net interest income will be negatively affected. Changes in the asset and liability mix may also affect net interest income. Similarly, lower interest rates cause higher yielding assets to prepay and floating or adjustable rate assets to reset to lower rates. If Salisbury is not able to reduce its funding costs sufficiently, due to either competitive factors or the maturity schedule of existing liabilities, then Salisbury's net interest margin will decline.

Weakness in the markets for residential or commercial real estate, including the secondary residential mortgage loan markets, could reduce Salisbury's net income and profitability.

Declines in home prices, increases in delinquency and default rates, and constrained secondary credit markets affect the mortgage industry generally. Salisbury's financial results may be adversely affected by changes in real estate values. Decreases in real estate values could adversely affect the value of property used as collateral for loans and investments. If poor economic conditions result in decreased demand for real estate loans, Salisbury's net income and profits may decrease.

Weakness in the secondary market for residential lending could have an adverse impact upon Salisbury's profitability. The effects of ongoing mortgage market challenges, combined with the ongoing correction in residential real estate market prices and reduced levels of home sales, could result in further price reductions in single family home values, adversely affecting the value of collateral securing mortgage loans held, mortgage loan originations and gains on sale of mortgage loans. Declines in real estate values and home sales volumes, and financial stress on borrowers as a result of job losses, or other factors, could have further adverse effects on borrowers that result in higher delinquencies and greater charge-offs in future periods beyond that which is provided for in Salisbury's allowance for loan losses, which would adversely affect Salisbury's financial condition or results of operations.

Fluctuations in economic conditions and collateral values could impact the adequacy of Salisbury's allowance for loan losses may be insufficient.

Salisbury's business is subject to periodic fluctuations based on national and local economic conditions. These fluctuations are not predictable, cannot be controlled and may have a material adverse impact on Salisbury's operations and financial condition. For example, declines in housing activity including declines in building permits, housing sales and home prices may make it more difficult for Salisbury's borrowers to sell their homes or refinance their debt. Slow sales could strain the resources of real estate developers and builders. The ongoing economic uncertainty has affected employment levels and could impact the ability of Salisbury's borrowers to service their debt. Bank regulatory agencies also periodically review Salisbury's allowance for loan losses and may require an increase in the provision for credit losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses Salisbury will need additional provisions to increase the allowance for loan losses. Any increases in the allowance for loan losses will result in a decrease in net income and, possibly, capital, and may have a material adverse effect on Salisbury's financial condition and results of operations. Salisbury may suffer higher loan losses as a result of these factors and the resulting impact on its borrowers.

Credit market conditions may impact Salisbury's investments.

Significant credit market anomalies may impact the valuation and liquidity of Salisbury's investment securities. The problems of numerous financial institutions have reduced market liquidity, increased normal bid-asked spreads and increased the uncertainty of market participants. Such illiquidity could reduce the market value of Salisbury's investments, even those with no apparent credit exposure. The valuation of Salisbury's investments requires judgment and as market conditions change investment values may also change.

If all, or a significant portion, of the unrealized losses in Salisbury's portfolio of investment securities were determined to be other-than-temporarily impaired, Salisbury would recognize a material charge to its earnings and its capital ratios would be adversely impacted.

As of December 31, 2013, Salisbury had $0.4 million of after-tax unrealized gains associated with its portfolio of securities available-for-sale, compared with $2.9 million of after-tax unrealized gains at December 31, 2012. Fair values of securities are supplied by third-party sources.

Management must assess whether unrealized losses are other-than-temporary and relies on data supplied by third-party sources to do so. The determination of whether a decline in fair value is other-than-temporary considers numerous factors, many of which involve significant judgment.

To the extent that any portion of the unrealized losses in Salisbury's portfolio of investment securities is determined to be other-than-temporarily impaired, Salisbury will recognize a charge to its earnings in the quarter during which such determination is made and its earnings and capital ratios will be adversely impacted. Salisbury did not recognize any other-than-temporary impairment losses in 2013.

If the goodwill that Salisbury has recorded in connection with its acquisitions becomes impaired, it could have a negative impact on Salisbury's profitability.

Applicable accounting standards require that the purchase method of accounting be used for all business combinations. Under purchase accounting, if the purchase price of an acquired company exceeds the fair value of the acquired company's net assets, the excess is carried on the acquirer's balance sheet as goodwill. At December 31, 2013, Salisbury had $9.8 million of goodwill on its balance sheet. Salisbury must evaluate goodwill for impairment at least annually. Write-downs of the amount of any impairment, if necessary, are to be charged to the results of operations in the period in which the impairment occurs. There can be no assurance that future evaluations of goodwill will not result in findings of impairment and related write-downs, which may have a material adverse effect on Salisbury's financial condition and results of operations.

Salisbury's ability to pay dividends substantially depends upon its receipt of dividends from the Bank.

Cash dividends from the Bank and Salisbury's liquid assets are the principal sources of funds for paying cash dividends on Salisbury's common stock and preferred stock. Unless Salisbury receives dividends from the Bank or chooses to use its liquid assets, it may not be able to pay dividends. Salisbury must pay dividends on its preferred stock before it may pay dividends on its common stock. The Bank's ability to pay dividends to Salisbury is subject to its condition and profitability as well as its regulatory requirements.

Strong competition within Salisbury's market areas may limit growth and profitability.

Competition in the banking and financial services industry is intense. Salisbury competes with commercial banks, savings institutions, mortgage brokerage firms, credit unions, finance companies, mutual funds, insurance companies, and brokerage and investment banking firms operating locally and elsewhere. As Salisbury grows, it may expand into contiguous market areas where it may not be as well-known as other institutions that have been operating in those areas for some time. In addition, larger banking institutions may become increasingly active in Salisbury's market areas, may have substantially greater resources and lending limits and may offer certain services that Salisbury does not, or cannot efficiently, provide. Salisbury's profitability depends upon its continued ability to successfully compete in its market areas. The greater resources and deposit and loan products offered by some competitors may limit its ability to grow profitably.

**Salisbury and the Bank are subject to extensive federal and state regulation and supervision.**

Salisbury and the Bank are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole, not Shareholders. These regulations affect Salisbury's lending practices, capital structure, investment practices, and dividend policy and growth, among other things. State and federal legislatures and regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect Salisbury in substantial and unpredictable ways. Such changes could subject Salisbury to additional costs, limit the types of financial services and products it may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on Salisbury's business, financial condition and results of operations. While Salisbury has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur. See the section captioned "Supervision and Regulation" in Item 1 of this report for further information.

Salisbury's stock price may be volatile.

Salisbury's stock is inactively traded and its stock price may fluctuate widely in response to a variety of factors including:

- Actual or anticipated variations in quarterly operating results
- Recommendations by securities analysts
- New technology used, or services offered, by competitors
- Significant acquisitions or business combinations, strategic partnerships, joint ventures or capital commitments by or involving Salisbury or Salisbury's competitors
- Failure to integrate acquisitions or realize anticipated benefits from acquisitions
- Operating and stock price performance of other companies that investors deem comparable to Salisbury
- News reports relating to trends, concerns and other issues in the financial services industry
- Changes in government regulations
- Geopolitical conditions such as acts or threats of terrorism or military conflicts
- Extended recessionary environment

General market fluctuations, industry factors and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes, credit loss trends or currency fluctuations could also cause Salisbury's stock price to decrease regardless of Salisbury's operating results.

Salisbury's ability to attract and retain skilled personnel may impact its success.

Salisbury's success depends, in large part, on its ability to attract and retain key people. Competition for people with specialized knowledge and skills can be intense and Salisbury may not be able to hire people or to retain them. The unexpected loss of services of one or more of Salisbury's key personnel could have a material adverse impact on the business because of their skills, knowledge of the market, years of industry experience and the difficulty of promptly finding qualified replacement personnel.

Salisbury continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology can increase efficiency and enable financial institutions to better serve customers and to reduce costs. However, some new technologies needed to compete effectively result in incremental operating costs. Salisbury's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in operations. Many of Salisbury's competitors have substantially greater resources to invest in technological improvements. Salisbury may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on Salisbury's business and, in turn, its financial condition and results of operations.

A failure involving controls and procedures may have an adverse effect on Salisbury.

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

If customer information was to be misappropriated and used fraudulently, Salisbury could be exposed to potential liability and reputation risk.

Risk of theft of customer information resulting from security breaches by third parties exposes banks to reputation risk and potential monetary loss. Like other financial institutions, Salisbury has exposure to fraudulent misuse of its customers' personal information resulting from its general business operations through loss or theft of the information and through misappropriation of information by third parties in connection with customer use of financial instruments, such as debit cards.

In addition, Salisbury relies upon a variety of computing platforms and networks over the internet for the purposes of data processing, communications and information exchange. Despite the safeguards instituted by Salisbury, any systems are susceptible to a breach of security. In addition, Salisbury relies on the services of a variety of third party vendors to meet Salisbury's data processing and communication needs. The occurrence of any failures, interruptions or security breaches of Salisbury's information systems or that of its vendors could damage Salisbury's reputation, result in a loss of customer business or expose Salisbury to civil litigation and possible financial loss. Such costs and/or losses could materially impact Salisbury's earnings.

Changes in accounting standards can materially impact Salisbury's financial statements.

Salisbury's accounting policies and methods are fundamental to how Salisbury records and reports its financial condition and results of operations. From time to time, the Financial Accounting Standards Board or regulatory authorities change the financial accounting and reporting standards that govern the preparation of Salisbury's financial statements. These changes can be hard to predict and can materially impact how it records and reports its financial condition and results of operations. In some cases, it could be required to apply a new or revised standard retroactively, resulting in Salisbury restating prior period financial statements.

Changes and interpretations of tax laws and regulations may adversely impact Salisbury's financial statements.

Local, state or federal tax authorities may interpret tax laws and regulations differently than Salisbury and challenge tax positions that Salisbury has taken on its tax returns. This may result in the disallowance of deductions or differences in the timing of deductions and result in the payment of additional taxes, interest or penalties that could materially affect Salisbury's performance.

Unprecedented disruption and significantly increased risk in the financial markets may impact Salisbury.

The banking industry has experienced unprecedented turmoil over recent years as some of the world's major financial institutions collapsed, were seized or were forced into mergers as the credit markets tightened and the economy headed into a recession. Measures taken by the Government in an effort to stabilize the economy may have unintended consequences, and there can be no assurance that Salisbury will not be impacted by current market uncertainty in a way it cannot currently predict or mitigate.

Item 1B. UNRESOLVED SEC STAFF COMMENTS

None.

Item 2. PROPERTIES
Salisbury does not own or lease any properties. The properties described below are owned or leased by the Bank.

The Bank conducts its business at its main office, located at 5 Bissell Street, Lakeville, Connecticut, and through seven full service branch offices located in Canaan, Salisbury and Sharon, Connecticut, Sheffield and South Egremont, Massachusetts, and Dover Plains and Millerton, New York. The Bank recently took steps to establish a new branch in Great Barrington, Massachusetts which will be a leased facility and is expected to open in mid-2014. In addition, the Bank signed an agreement to acquire a branch office (leased facility) and related deposits from another institution in Sharon, Connecticut. The Bank expects to consolidate our existing Sharon office with the new branch following receipt of regulatory approvals and consummation of the transaction later this year. The Bank's trust and wealth advisory services division is located in a separate building adjacent to the main office of the Bank in Lakeville, Connecticut. The Bank owns its main office and five of its branch offices and currently leases three branch offices.

For additional information, see Note 6, "Bank Premises and Equipment," and Note 17, "Commitments and Contingent Liabilities" to the Consolidated Financial Statements.

The following table includes all property owned or leased by the Bank, but does not include Other Real Estate Owned.

| Offices | Location | Owned/Leased | Lease expiration |
|---|---|---|---|
| Main Office | 5 Bissell Street, Lakeville, CT | Owned | — |
| Trust and Wealth Advisory Services Division | 19 Bissell Street, Lakeville, CT | Owned | — |
| Salisbury Office | 18 Main Street, Salisbury, CT | Owned | — |
| Sharon Office | 29 Low Road, Sharon, CT | Owned | — |
| Canaan Operations | 94 Main Street, Canaan, CT | Owned | — |
| Canaan Office | 100 Main Street, Canaan, CT | Owned | — |
| Millerton Office | 87 Main Street, Millerton, NY | Owned | — |
| South Egremont Office | 51 Main Street, South Egremont, MA | Leased | 9/10/14 |
| Sheffield Office | 640 North Main, Street, Sheffield, MA | Owned | — |
| Gt. Barrington Office | 210 Main Street, Gt. Barrington, MA | Leased | 4/30/29 |
| Dover Plains Office | 5 Dover Village Plaza, Dover Plains, NY | Leased | 8/01/17 |

Item 3. LEGAL PROCEEDINGS

The Bank is involved in various claims and legal proceedings arising out of the ordinary course of business.

As previously disclosed, the Bank, individually and in its capacity as a former Co-Trustee of the Erling C. Christophersen Revocable Trust (the "Trust"), was named as a defendant in litigation filed in the Connecticut Complex Litigation Docket in Stamford, captioned John Christophersen v. Erling Christophersen, et al., X08-CV-08-5009597S (the "First Action"). The Bank also was a counterclaim-defendant in related mortgage foreclosure litigation in the Connecticut Complex Litigation Docket in Stamford, captioned Salisbury Bank and Trust Company v. Erling C. Christophersen, et al., X08-CV-10-6005847-S (the "Foreclosure Action," together with the First Action, the "Actions"). The other parties to the Actions were John R. Christophersen; Erling C. Christophersen, individually and as Co-Trustee of the Trust; Bonnie Christophersen and Elena Dreiske, individually and as Co-Trustees of the Mildred B. Blount Testamentary Trust; People's United Bank; Law Offices of Gary Oberst, P.C.; Rhoda Rudnick; and Hinckley Allen & Snyder LLP.

The Actions involved a dispute over title to certain real property located in Westport, Connecticut that was conveyed by Erling Christophersen, as grantor, to the Trust on or about August 8, 2007. Subsequent to this conveyance, the Bank loaned $3,386,609 to the Trust, which was secured by a commercial mortgage in favor of the Bank on the

Westport property. This mortgage is the subject of the Foreclosure Action brought by the Bank.

As previously disclosed, John R. Christophersen claimed an interest in the Westport real property transferred to the Trust and sought to quiet title to the property and to recover money damages from the defendants for the alleged wrongful divestiture of his claimed interest in the property.

On June 25, 2012, the Bank and John R. Christophersen entered into a Settlement Agreement which resolved all differences between John R. Christophersen and the Bank, and resulted in the withdrawal (with prejudice) of the claims made by John R. Christophersen. All claims against the Bank have been withdrawn and the Bank is no longer a defendant or counterclaim defendant in any litigation involving the Actions. As an additional consequence of the Settlement Agreement, Bonnie Christophersen, Elena Dreiske and People's United Bank are no longer parties to any of the litigation referenced above.

On July 27, 2012, Erling Christophersen filed a Motion to Restore the First Action, and on October 15, 2012 filed a Motion to Stay the Foreclosure Action pending resolution of the Motion to Restore. The Bank opposed both motions. On February 1, 2013, the Court issued orders denying both motions. On February 14, 2013, Erling Christophersen appealed the orders denying his Motion to Restore the First Action, and Motion to Stay the Foreclosure Action.

The Appellate Court dismissed the appeal of the Foreclosure Action in May 2013, and later denied Erling Christophersen's motion for reconsideration of its decision. The Bank continues to proceed in its Foreclosure Action against Erling Christophersen. Erling Christophersen asserted two special defenses and set-off claims alleging (1) that the Bank failed to defend the title claims against the properties, and (2) that the Bank took certain trustee fees without approval. The Bank moved to strike the special defenses and set off claims. In a decision issued on November 6, 2013, the court granted the motion to strike as to the second special defense and set off, but denied the motion as to the first special defense and set off. Trial began on February 4, 2014, and concluded on February 14, 2014. Post-trial briefs are due in mid-April, 2014, and a decision is expected thereafter.

Erling Christophersen's appeal of the order denying his Motion to Restore the First Action remains pending, and was heard by the Appellate Court on March 10, 2014. The Court has now taken the matter under advisement and next it will write an opinion disposing of the appeal.

There are no other material pending legal proceedings, other than ordinary routine litigation incident to the registrant's business, to which Salisbury is a party or of which any of its property is subject.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

Item 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASED ON EQUITY SECURITIES

Market Information

For the information required by this item see “Note 22 - Selected Quarterly Consolidated Financial Data (Unaudited)” of Notes to Consolidated Financial Statements.

Holders

There were approximately 1,713 holders of record of the common stock of Salisbury as of March 1, 2014. This number includes brokerage firms and other financial institutions that hold stock in their name, but which is actually beneficially owned by third parties.

Equity Compensation Plan Information

For the information required by this item see “Note 14 – Directors Stock Retainer Plan and Long Term Incentive Plan” of Notes to Consolidated Financial Statements.

Recent Sales of Unregistered Securities

None.

Dividends

For a discussion of Salisbury's dividend policy and restrictions on dividends see "Management’s Discussion and Analysis of Financial Condition and Results of Operations" under the caption "Dividends”.

Item 6. SELECTED FINANCIAL DATA

The following table contains certain information concerning the financial position and results of operations of Salisbury at the dates and for the periods indicated. This information should be read in conjunction with the Consolidated Financial Statements and related notes.

SELECTED CONSOLIDATED FINANCIAL DATA

(in thousands, except ratios and per share amounts)

| At or for the years ended December 31, | 2013 | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|---|
| Statement of Income | | | | | |
| Interest and dividend income | $21,750 | $22,658 | $24,044 | $24,656 | $25,866 |
| Interest expense | 3,062 | 4,282 | 5,559 | 7,497 | 9,032 |
| Net interest and dividend income | 18,688 | 18,376 | 18,485 | 17,159 | 16,834 |
| Provision for loan losses | 1,066 | 1,070 | 1,440 | 1,000 | 985 |
| Trust and wealth advisory | 3,074 | 2,945 | 2,548 | 2,102 | 1,978 |
| Service charges and fees | 2,298 | 2,189 | 2,090 | 2,006 | 1,725 |
| Gains on sales of mortgage loans, net | 579 | 1,596 | 687 | 816 | 488 |
| Mortgage servicing, net | 35 | (21) | 65 | 97 | 80 |
| Gains on securities, net | — | 279 | 11 | 16 | 473 |
| Other-than-temporary impairment losses, net | — | — | — | — | (1,128) |
| Other | 319 | 326 | 255 | 270 | 459 |
| Non-interest income | 6,305 | 7,314 | 5,656 | 5,307 | 4,075 |
| Non-interest expense | 18,935 | 19,554 | 17,639 | 17,113 | 17,506 |
| Income before income taxes | 4,992 | 5,066 | 5,062 | 4,353 | 2,418 |
| Income tax provision (benefit) | 909 | 989 | 950 | 693 | (49) |
| Net income | 4,083 | 4,077 | 4,112 | 3,660 | 2,467 |
| Net income available to common shareholders | 3,922 | 3,861 | 3,588 | 3,198 | 2,102 |
| Financial Condition | | | | | |
| Total assets | $587,109 | $600,813 | $609,284 | $575,470 | $562,347 |
| Loans receivable, net | 438,178 | 388,758 | 370,766 | 352,449 | 327,257 |
| Allowance for loan losses | 4,683 | 4,360 | 4,076 | 3,920 | 3,473 |
| Securities | 99,831 | 132,034 | 161,876 | 153,510 | 151,125 |
| Deposits | 477,369 | 491,215 | 471,306 | 430,289 | 418,203 |
| Federal Home Loan Bank of Boston advances | 30,411 | 31,980 | 54,615 | 72,812 | 76,364 |
| Repurchase agreements | 2,554 | 1,784 | 12,148 | 13,190 | 11,415 |
| Total shareholders' equity | 72,790 | 71,997 | 66,862 | 55,016 | 52,355 |
| Non-performing assets | 7,549 | 10,104 | 10,820 | 10,751 | 7,720 |
| Per Common Share Data | | | | | |
| Earnings, diluted and basic | $2.30 | $2.28 | $2.12 | $1.90 | $1.25 |
| Cash dividends paid | 1.12 | 1.12 | 1.12 | 1.12 | 1.12 |
| Tangible book value | 27.12 | 26.85 | 23.69 | 20.81 | 19.12 |
| Statistical Data | | | | | |
| Net interest margin (taxable equivalent) | 3.57 % | 3.45 % | 3.51 % | 3.37 % | 3.51 % |
| Efficiency ratio (taxable equivalent) | 70.70 | 69.38 | 68.16 | 71.51 | 74.38 |
| Effective tax rate | 18.21 | 19.49 | 18.80 | 15.92 | (2.03) |
| Return on average assets | 0.66 | 0.64 | 0.61 | 0.56 | 0.39 |
| Return on average common shareholders' equity | 7.01 | 7.22 | 7.26 | 6.93 | 5.18 |
| Dividend payout ratio | 48.83 | 49.02 | 52.70 | 59.09 | 89.60 |

| | | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses to loans receivable, gross | 1.06 | 1.11 | 1.09 | 1.10 | 1.05 |
| Non-performing assets to total assets | 1.29 | 1.68 | 1.78 | 1.87 | 1.37 |
| Tier 1 leverage capital | 10.65 | 9.87 | 9.45 | 8.39 | 8.39 |
| Total risk-based capital | 16.46 | 16.63 | 15.97 | 13.91 | 12.86 |
| Weighted average common shares outstanding, diluted | 1,691 | 1,690 | 1,689 | 1,687 | 1,686 |
| Common shares used to calculate diluted earnings per common share | 1,691 | 1,690 | 1,689 | 1,688 | 1,687 |

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

BUSINESS

Salisbury, a Connecticut corporation, formed in 1998, is the bank holding company for the Bank, a Connecticut-chartered and FDIC insured commercial bank headquartered in Lakeville, Connecticut. Salisbury's principal business consists of the business of the Bank. The Bank, formed in 1848, is engaged in customary banking activities, including general deposit taking and lending activities to both retail and commercial markets, and trust and wealth advisory services. The Bank conducts its banking business from eight full-service offices in the towns of Canaan, Lakeville, Salisbury and Sharon, Connecticut, South Egremont and Sheffield, Massachusetts, and, Dover Plains and Millerton, New York, and its trust and wealth advisory services from offices in Lakeville, Connecticut. The Bank recently took steps to establish a new branch in Great Barrington, Massachusetts. In January 2014 the Bank signed an agreement to acquire a branch office and related deposits from another institution in Sharon, Connecticut and expects to consolidate its existing Sharon office with such new branch following receipt of regulatory approvals and consummation of the transaction later this year.

Additionally on March 19, 2014, Salisbury announced the execution of a definitive agreement and plan of merger with Riverside Bank, headquartered in Poughkeepsie, New York with three offices in Dutchess County and a branch office in Orange County, New York, in an all-stock transaction pursuant to which Riverside Bank will merge into Salisbury Bank and Trust Company. Upon consummation of such transaction, the combined organization expected to have approximately $850 million in total assets, $630 million in total loans and $730 million in total deposits with 13 branch locations in Connecticut, Massachusetts and New York. The transaction is subject to approval by the shareholders of Salisbury and Riverside, as well as regulatory approvals. The transaction is expected to close in the third or fourth calendar quarter of 2014. (Please refer to the note at the conclusion of this Management Discussion and Analysis for "Additional Information and Where to Find it" regarding this matter.)

Critical Accounting Policies and Estimates

Salisbury's consolidated financial statements follow GAAP as applied to the banking industry in which it operates. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements. These estimates, assumptions and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event.

Salisbury's significant accounting policies are presented in Note 1 of Notes to Consolidated Financial Statements and, along with this Management's Discussion and Analysis, provide information on how significant assets are valued in the financial statements and how those values are determined. Management believes that the following accounting estimates are the most critical to aid in fully understanding and evaluating Salisbury's reported financial results, and they require management's most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain.

The allowance for loan losses represents management's estimate of credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheet. Note 1 describes the methodology used to determine the allowance for loan losses. A discussion of the factors driving changes in the amount of the allowance for loan losses are included in the "Provision and Allowance for Loan Losses" section of Management's Discussion and Analysis.

Management evaluates goodwill and identifiable intangible assets for impairment annually using valuation techniques that involve estimates for discount rates, projected future cash flows and time period calculations, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates, which are used to determine the carrying value of goodwill and identifiable intangible assets or which otherwise adversely affects their value or estimated lives could have a material adverse impact on the results of operations.

Management evaluates securities for other-than-temporary impairment giving consideration to the extent to which the fair value has been less than cost, estimates of future cash flows, delinquencies and default severity, and the intent and ability of Salisbury to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The consideration of the above factors is subjective and involves estimates and assumptions about matters that are inherently uncertain. Should actual factors and conditions differ materially from those used by management, the actual realization of gains or losses on investment securities could differ materially from the amounts recorded in the financial statements.

The determination of the obligation and expense for pension and other postretirement benefits is dependent on certain assumptions used in calculating such amounts. Key assumptions used in the actuarial valuations include the discount rate, expected long-term rate of return on plan assets and rates of increase in compensation and health care costs. Actual results could differ from the assumptions and market driven rates may fluctuate. Significant differences in actual experience or significant changes in the assumptions may materially affect the future pension and other postretirement obligations and expense.

OVERVIEW

Net income available to common shareholders was $3,922,000, or $2.30 per common share, for 2013, compared with $3,861,000 or $2.28 per common share for 2012. Selected 2013 highlights are as follows:

- Earnings per common share increased $0.02, or 0.9%, to $2.30.
- Earnings per common share excluding one-time fourth quarter expenses related to strategic initiatives of $202,000 (net of taxes), or $0.12 per share, would have been $2.42 per share or an increase of $0.14 (+6%) compared to 2012.
- Tax equivalent net interest income increased $429,000, or 2.2%.
- Non-interest expense decreased $619,000, or 3.2%. Preferred stock dividends were $161,000, versus $240,000 for 2012.

The following discussion and analysis of Salisbury's consolidated results of operations should be read in conjunction with the Consolidated Financial Statements and footnotes.

RESULTS OF OPERATIONS

Comparison of the Years Ended December 31, 2013 and 2012

Net Interest and Dividend Income

Net interest and dividend income (presented on a tax-equivalent basis) increased $429,000 in 2013 over 2012. The net interest margin increased 12 basis points to 3.57% from 3.45%, due to a 26 basis point decline in the average cost of interest-bearing liabilities, offset partially by a 9 basis point decline in the average yield on interest-earning assets. The net interest margin is affected by changes in the mix of interest-earning assets and funding liabilities, asset and liability growth, and the effects of changes in market interest rates on the pricing and re-pricing of assets and liabilities. The following table sets forth the components of Salisbury's net interest income and yields on average interest-earning assets and interest-bearing funds. Income and yields on tax-exempt securities are presented on a fully taxable equivalent basis.

| Years ended December 31, | Average Balance | | | Income / Expense | | | Average Yield / Rate | | |
|---|---|---|---|---|---|---|---|---|---|
| (dollars in thousands) | 2013 | 2012 | 2011 | 2013 | 2012 | 2011 | 2013 | 2012 | 2011 |
| Loans (a)(d) | $419,193 | $381,886 | $367,342 | $18,250 | $18,153 | $18,666 | 4.35 % | 4.75 % | 5.08 % |
| Securities (c)(d) | 106,603 | 134,817 | 144,021 | 4,650 | 5,506 | 6,258 | 4.36 | 4.08 | 4.35 |
| FHLBB stock | 5,417 | 5,801 | 6,032 | 21 | 30 | 24 | 0.39 | 0.51 | 0.40 |
| Short term funds (b) | 26,281 | 41,854 | 39,185 | 67 | 90 | 127 | 0.25 | 0.21 | 0.32 |
| Total earning assets | 557,494 | 564,358 | 556,580 | 22,988 | 23,779 | 25,075 | 4.12 | 4.21 | 4.51 |
| Other assets | 37,966 | 40,444 | 35,360 | | | | | | |
| Total assets | $595,460 | $604,802 | $591,940 | | | | | | |
| Interest-bearing demand deposits | $75,185 | $65,953 | $64,625 | 278 | 353 | 437 | 0.37 | 0.54 | 0.68 |
| Money market accounts | 128,951 | 128,619 | 108,983 | 330 | 420 | 530 | 0.26 | 0.33 | 0.49 |
| Savings and other | 106,224 | 99,528 | 96,317 | 206 | 281 | 379 | 0.19 | 0.28 | 0.39 |
| Certificates of deposit | 88,352 | 98,974 | 111,042 | 999 | 1,360 | 1,819 | 1.13 | 1.37 | 1.64 |
| Total interest-bearing deposits | 398,712 | 393,074 | 380,967 | 1,813 | 2,414 | 3,165 | 0.45 | 0.61 | 0.83 |
| Repurchase agreements | 3,035 | 5,879 | 12,510 | 6 | 23 | 63 | 0.19 | 0.39 | 0.50 |
| FHLBB advances | 31,176 | 43,605 | 57,126 | 1,243 | 1,845 | 2,331 | 3.93 | 4.16 | 4.08 |
| Total interest-bearing liabilities | 432,923 | 442,558 | 450,603 | 3,062 | 4,282 | 5,559 | 0.71 | 0.97 | 1.23 |
| Demand deposits | 84,416 | 84,385 | 77,577 | | | | | | |
| Other liabilities | 6,162 | 8,391 | 3,569 | | | | | | |
| Shareholders' equity | 71,959 | 69,468 | 60,191 | | | | | | |
| Total liabilities & shareholders' equity | $595,460 | $604,802 | $591,940 | | | | | | |
| Net interest income | | | | $19,926 | $19,497 | $19,516 | | | |
| Spread on interest-bearing funds | | | | | | | 3.41 | 3.25 | 3.27 |
| Net interest margin (e) | | | | | | | 3.57 | 3.45 | 3.51 |

*(a) Includes non-accrual loans.*

*(b) Includes interest-bearing deposits in other banks and federal funds sold.*

*(c) Average balances of securities are based on amortized cost.*

*(d) Includes tax exempt income of $1,238,000, $1,121,000 and $1,031,000, respectively for 2013, 2012 and 2011 on tax-exempt securities and loans whose income and yields are calculated on a tax-equivalent basis.*

*(e) Net interest income divided by average interest-earning assets.*

The following table sets forth the changes in net interest income (presented on a tax-equivalent basis) due to volume and rate.

| Years ended December 31, (in thousands) | 2013 versus 2012 | | | 2012 versus 2011 | | |
|---|---|---|---|---|---|---|
| Change in interest due to | Volume | Rate | Net | Volume | Rate | Net |
| Loans | $1,699 | $(1,602) | $97 | $715 | $(1,228) | $(513) |
| Securities | (1,191) | 335 | (856) | (388) | (364) | (752) |
| FHLBB stock | (2) | (7) | (9) | (1) | 7 | 6 |
| Short term funds | (37) | 14 | (23) | 7 | (44) | (37) |
| Interest-earning assets | 469 | (1,260) | (791) | 333 | (1,629) | (1,296) |
| Deposits | (74) | (527) | (601) | (83) | (668) | (751) |
| Repurchase agreements | (8) | (9) | (17) | (30) | (10) | (40) |
| FHLBB advances | (511) | (91) | (602) | (562) | 76 | (486) |
| Interest-bearing liabilities | (593) | (627) | (1,220) | (675) | (602) | (1,277) |
| Net change in net interest income | $1,062 | $(633) | $429 | $1,008 | $(1,027) | $(19) |

Net interest and dividend income represents the difference between interest and dividends earned on loans and securities and interest expense incurred on deposits and borrowings. The level of net interest income is a function of volume, rates and mix of both earning assets and interest-bearing liabilities. Net interest income can be affected by changes in interest rate levels, changes in the volume of assets and liabilities that are subject to re-pricing within different future time periods, and in the level of non-performing assets.

Interest and Dividend Income

Tax equivalent interest and dividend income decreased $0.8 million, or 3.3%, to $23.0 million in 2013. Loan income increased $97,000, or 0.5%, primarily due to a $37.3 million, or 9.8%, increase in average loans. This increase in volume was partially offset by a 40 basis point decline in average yield, due to lower market interest rates and their effect on new loan rates, loan re-pricing and loan re-financing activity in 2013.

Tax equivalent interest and dividend income from securities decreased $856,000, or 15.5%, in 2013, as a result of a $28.2 million decrease in average security balances, offset partially by a 28 basis point increase in average yield. Contributing factors to the higher yield includes the maturity, call or pay down of lower yielding securities resulting in a remaining mix of higher yielding securities in the portfolio. Interest from short term funds decreased $23,000 in 2013 as a result of a $15.6 million decrease in average short term balances, which was offset partially by a 4 basis points increase in average yield.

Interest Expense

Interest expense decreased $1.2 million, or 28.5%, to $3.1 million in 2013 primarily as a result of decreases in deposit rates and maturities, and prepayments in the prior period of FHLBB advances, offset in part by higher average balances of interest bearing deposits.

Interest expense on interest bearing deposit accounts decreased $601,000, or 24.9%, in 2013, as a result of a 16 basis point decline in the average rate, to 0.45%, offset in part by a $5.6 million, or 1.4%, increase in average interest bearing deposits. The decline in average rate was due to the decline in interest rates and changes in product mix. Interest on retail repurchase agreements decreased $17,000, or 73.9%, as a result of a 20 basis point decline in average rate, to 0.19%, while the average balance decreased $2.8 million.

Interest expense on FHLBB advances decreased $602,000, or 32.6%, due to a $12.4 million, or 28.5%, decrease in average advances as a result of scheduled maturities in the current period and prepayment of an advance at the end of 2012. The average borrowing rate decreased to 3.93% from 4.16%.

20

Provision and Allowance for Loan Losses

The provision for loan losses was $1,066,000 for 2013, compared with $1,070,000 for 2012. Net loan charge-offs were $743,000 and $786,000, for the respective years. The lower provision for loan losses was supported by lower net charge-offs of non-performing loans. The following table sets forth changes in the allowance for loan losses and other statistical data:

| Years ended December 31, (dollars in thousands) | 2013 | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|---|
| Balance, beginning of period | $4,360 | $4,076 | $3,920 | $3,473 | $2,724 |
| Provision (benefit) or loan losses | 1,066 | 1,070 | 1,440 | 1,000 | 985 |
| Real estate mortgages | (700) | (573) | (985) | (437) | (106) |
| Commercial & industrial | (4) | (222) | (180) | (95) | (82) |
| Consumer | (70) | (91) | (201) | (50) | (78) |
| Charge-offs | (774) | (886) | (1,366) | (582) | (266) |
| Real estate mortgages | 6 | 36 | 26 | — | — |
| Commercial & industrial | 1 | 38 | 29 | — | 4 |
| Consumer | 24 | 26 | 27 | 29 | 26 |
| Recoveries | 31 | 100 | 82 | 29 | 30 |
| Net (charge-offs) recoveries | (743) | (786) | (1,284) | (553) | (236) |
| Balance, end of period | $4,683 | $4,360 | $4,076 | $3,920 | $3,473 |
| Loans receivable, gross | $441,679 | $392,086 | $373,838 | $355,547 | $330,144 |
| Non-performing loans | 7,172 | 9,860 | 8,076 | 10,141 | 7,445 |
| Accruing loans past due 30-89 days | 5,374 | 5,629 | 2,460 | 1,917 | 4,098 |
| Ratio of allowance for loan losses: | | | | | |
| to loans receivable, gross | 1.06 % | 1.11 % | 1.09 % | 1.10 % | 1.05 % |
| to non-performing loans | 65.30 | 44.22 | 50.47 | 38.65 | 46.65 |
| Ratio of non-performing loans: | | | | | |
| to loans receivable, gross | 1.62 | 2.51 | 2.16 | 2.84 | 2.25 |
| Ratio of accruing loans past due 30-89 days: | | | | | |
| to loans receivable, gross | 1.22 | 1.44 | 0.66 | 0.54 | 1.24 |

The reserve coverage at December 31, 2013, as measured by the ratio of allowance for loan losses to gross loans, was 1.06%, as compared with 1.11% at December 31, 2012. Non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) decreased $2.7 million to $7.2 million, or 1.62% of gross loans receivable, at December 31, 2013, down from 2.51% at December 31, 2012, while accruing loans past due 30-89 days decreased $0.2 million to $5.4 million, or 1.22% of gross loans receivable at December 31, 2013. See “Financial Condition – Loan Credit Quality” below for further discussion and analysis.

The credit quality segments of loans receivable and the allowance for loan losses are as follows:

| | December 31, 2013 | | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|---|---|
| (in thousands) | Loans | Allowance | Loans | Allowance | Loans | Allowance |
| Performing loans | $416,734 | $2,835 | $364,594 | $2,567 | $346,302 | $2,436 |
| Potential problem loans | 8,687 | 282 | 8,345 | 246 | 7,289 | 234 |
| Collectively evaluated | 425,421 | 3,117 | 372,939 | 2,813 | 353,591 | 2,670 |
| Performing loans | 157 | 69 | 121 | 52 | 819 | 35 |
| Potential problem loans | 429 | 19 | 2,464 | 131 | 6,750 | 255 |
| Impaired loans | 15,672 | 1,053 | 16,562 | 924 | 12,678 | 874 |
| Individually evaluated | 16,258 | 1,141 | 19,147 | 1,107 | 20,247 | 1,164 |
| Unallocated allowance | — | 425 | — | 440 | — | 242 |
| Totals | $441,679 | $4,683 | $392,086 | $4,360 | $373,838 | $4,076 |

The following table sets forth the allocation of the allowance for loan losses among the broad categories of the loan portfolio and the percentage of loans in each category to total loans. Although the allowance has been allocated among loan categories for purposes of the table, it is important to recognize that the allowance is applicable to the entire portfolio. Furthermore, future charge-offs may not necessarily occur in these amounts or proportions.

| Years ended December 31, | 2013 | | 2012 | | 2011 | | 2010 | | 2009 | |
|---|---|---|---|---|---|---|---|---|---|---|
| (dollars in thousands)(a) | Allowance | Loans | Allowance | Loans | Allowance | Loans | Allowance | Loans | Allowance | Loans |
| Residential | $ I,545 | 54.34 % | $ 1,477 | 52.87 % | $ 1,097 | 52.47 % | $ I,115 | 50.56 % | $ L88 | 50.91 % |
| Commercial | 1,385 | 23.04 | 1,059 | 23.45 | 1,139 | 23.81 | 1,152 | 22.83 | 1,428 | 20.65 |
| Construction, land & land development | 226 | 2.11 | 300 | 2.71 | 409 | 4.75 | 400 | 7.39 | 233 | 8.61 |
| Home equity credit | 393 | 7.92 | 457 | 9.03 | 382 | 9.27 | 361 | 9.61 | 397 | 10.18 |
| Real estate secured | 3,549 | 87.41 | 3,293 | 88.06 | 3,027 | 90.30 | 3,028 | 90.39 | 2,546 | 90.35 |
| Commercial & industrial | 561 | 10.72 | 499 | 9.94 | 704 | 7.85 | 592 | 8.29 | 630 | 7.97 |
| Consumer | 105 | 0.87 | 92 | 1.09 | 79 | 1.20 | 164 | 1.32 | 117 | 1.38 |
| Municipal | 43 | 1.00 | 36 | 0.91 | 24 | 0.65 | — | — | — | — |
| General unallocated | 425 | — | 440 | — | 242 | — | 136 | — | 180 | — |
| Total allowance | $ 4,683 | 100.00 % | $ 4,360 | 100.00 % | $ 4,076 | 100.00 % | $ 3,920 | 100.00 % | $ K,473 | 100.00 % |

(a) Percent of loans in each category to total loans.

The allowance for loan losses represents management’s estimate of the probable credit losses inherent in the loan portfolio as of the reporting date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by loan charge-offs. Loan charge-offs are recognized when management determines a loan, or portion of a loan, to be uncollectible. The allowance for loan losses is computed by segregating the portfolio into three components: (1) loans collectively evaluated for impairment: general loss allocation factors for non-impaired loans are segmented into pools of loans based on similar risk characteristics such as loan product, collateral type and loan-to-value, loan risk rating, historical loss experience, delinquency factors and other similar economic indicators, (2) loans individually evaluated for impairment: individual loss allocations for loans deemed to be impaired based on discounted cash flows or collateral value, and (3) unallocated: general loss allocations for other environmental factors.

Impaired loans and certain potential problem loans, where warranted, are individually evaluated for impairment. Impairment is measured for each individual loan, or for a borrower’s aggregate loan exposure, using either the fair value of the collateral, if the loan is collateral dependent, or the present value of expected future cash flows discounted at the loan’s effective interest rate. An allowance is established when the collateral value or discounted cash flows of the loan is lower than the carrying value of that loan.

The component of the allowance for loan losses for loans collectively evaluated for impairment is estimated by stratifying loans into segments and credit risk ratings and then applying management’s general loss allocation factors. The general loss allocation factors are based on expected loss experience adjusted for historical loss experience and other qualitative factors, including levels or trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff; and national and local economic trends and conditions. The qualitative factors are determined based on the various risk characteristics of each loan segment. There were no significant changes in Salisbury’s policies or methodology pertaining to the general component of the allowance for loan losses during 2013.

The unallocated component of the allowance is maintained to cover uncertainties that could affect management’s estimate of probable losses. It reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

Determining the adequacy of the allowance at any given period is difficult, particularly during deteriorating or uncertain economic periods, and management must make estimates using assumptions and information that are often subjective and changing rapidly. The review of the loan portfolio is a continuing event in light of a changing economy and the dynamics of the banking and regulatory environment. Should the economic climate deteriorate, borrowers could experience difficulty and the level of non-performing loans, charge-offs and delinquencies could rise and require increased provisions. In management's judgment, Salisbury remains adequately reserved both against total loans and non-performing loans at December 31, 2013.

Management’s loan risk rating assignments, loss percentages and specific reserves are subjected annually to an independent credit review by an external firm. In addition, the Bank is examined annually on a rotational process by one of its two primary regulatory agencies, the FDIC and CTDOB. As an integral part of their examination process, the FDIC and CTDOB review the Bank's credit risk ratings and allowance for loan losses.

Non-Interest Income

The following table details the principal categories of non-interest income.

| Years ended December 31, (dollars in thousands) | 2013 | 2012 | 2011 | 2013 vs. 2012 | | 2012 vs. 2011 | |
|---|---|---|---|---|---|---|---|
| Trust and wealth advisory | $3,074 | $2,945 | $2,548 | $129 | 4.4 % | $397 | 15.6 % |
| Service charges and fees | 2,298 | 2,189 | 2,090 | 109 | 5.0 | 99 | 4.7 |
| Gains on sales of mortgage loans, net | 579 | 1,596 | 687 | (1,017) | (63.7 ) | 909 | 132.3 |
| Mortgage servicing, net | 35 | (21 ) | 65 | 56 | 266.7 | (86 ) | (132.3 ) |
| Gains on securities, net | — | 279 | 11 | (279 ) | (100.0) | 268 | 2,436.4 |
| Bank-owned life insurance | 234 | 258 | 183 | (24 ) | (9.3 ) | 75 | 41.0 |
| Other | 85 | 68 | 72 | 17 | 25.0 | (4 ) | (5.6 ) |
| Total non-interest income | $6,305 | $7,314 | $5,656 | $(1,009) | (13.8 )% | $1,658 | 29.3 % |

Non-interest income decreased $1.0 million, or 13.8%, in 2013 versus 2012. Trust and Wealth Advisory revenues increased $129,000 primarily due to growth in managed assets; partially offset by decreased estate fee income. Service charges and fees increased $109,000 due to increased interchange and deposit fees. Gains on sales of mortgage loans decreased $1.0 million due to significantly lower mortgage volume of loans sold to the FHLBB Mortgage Partnership Finance Program. Mortgage loans sales totaled $18.4 million in 2013 versus $60.2 million in 2012. Income from servicing of mortgage loans increased $56,000 due primarily to higher servicing fees and periodic impairment benefit posted for 2013. Loans serviced under the FHLBB Mortgage Partnership Finance Program (MPF) program totaled $146.3 million and $145.9 million at December 31, 2013 and 2012, respectively. Gains on securities in 2012 resulted from the sale of a treasury bond. BOLI income decreased $24,000 due to a decrease in the nominal credit rate on the policies.

Non-Interest Expense

The following table details the principal categories of non-interest expense.

| Years ended December 31, (dollars in thousands) | 2013 | 2012 | 2011 | 2013 vs. 2012 | | 2012 vs. 2011 | |
|---|---|---|---|---|---|---|---|
| Salaries | $7,467 | $7,149 | $6,970 | $318 | 4.4 % | $179 | 2.6 % |
| Employee benefits | 2,804 | 2,912 | 2,493 | (108) | (3.7 ) | 419 | 16.8 |
| Premises and equipment | 2,398 | 2,408 | 2,330 | (10 ) | (0.4 ) | 78 | 3.3 |
| Data processing | 1,514 | 1,569 | 1,410 | (55 ) | (3.5 ) | 159 | 11.3 |
| Professional fees | 1,524 | 1,212 | 1,099 | 312 | 25.7 | 113 | 10.3 |
| Collections and OREO | 519 | 709 | 590 | (190) | (26.8 ) | 119 | 20.2 |
| Litigation settlement | — | 400 | — | (400) | (100.0) | 400 | 100.0 |
| FDIC insurance | 470 | 486 | 596 | (16 ) | (3.3 ) | (110 ) | (18.5 ) |
| Marketing and community contributions | 393 | 356 | 343 | 37 | 10.4 | 13 | 3.8 |
| Printing and stationery | 205 | 230 | 215 | (25 ) | (10.9 ) | 15 | 7.0 |
| Amortization of intangible assets | 222 | 222 | 222 | — | — | — | — |
| FHLBB advance prepayment fee | — | 450 | — | (450) | (100.0) | 450 | 100.0 |
| Other | 1,419 | 1,451 | 1,371 | (32 ) | (2.2 ) | 80 | 5.8 |
| Non-interest expense | $18,935 | $19,554 | $17,639 | $(619) | (3.2 )% | $1,915 | 10.9 % |

Non-interest expense decreased $619,000, or 3.2%, in 2013 versus 2012. Salaries increased $318,000 due to changes in staffing levels and mix, and merit increases. Employee benefits decreased $108,000 mainly due to decreased pension plan expense of $786,000, which was mostly offset by higher 401(k) expense and new compensation plan expenses implemented to compensate for the hard freeze placed on the defined benefit pension plan as of December 31, 2012. Premises and equipment decreased $10,000 due primarily to lower equipment, software maintenance and depreciation, offset in part by the disposal of assets related to the renovations to the Millerton drive-up. Data processing decreased $55,000 mostly due to decreased trust data processing / trust tax preparation fees. Professional fees increased $312,000 primarily due to non-recurring expenses related to strategic initiatives and increased investment management fees due to higher volumes of assets under management. Collections and OREO expenses decreased $190,000 due to a change in the accounting for delinquent property taxes, lower collection costs and fewer OREO properties to maintain. FDIC insurance decreased $16,000. The 2012 FHLBB advance prepayment fee of $450,000 resulted from the early prepayment of a $10 million advance due 12/16/2013 with a 4.88% coupon. All other operating expenses decreased $20,000.

Income Taxes

The effective income tax rates for 2013 and 2012 were 18.21% and 19.49%, respectively. Fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Salisbury’s effective tax rate was less than the 34% federal statutory rate due to tax-exempt income, primarily from municipal bonds, tax advantaged loans and bank-owned life insurance. For further information on income taxes, see Note 11 of Notes to Consolidated Financial Statements.

Salisbury did not incur Connecticut income tax in 2013 or 2012, other than minimum state income tax, as a result of its utilization of Connecticut tax legislation that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a PIC. In 2004 Salisbury availed itself of this legislation by forming a PIC, SBT Mortgage Service Corporation. Salisbury's income tax provision reflects the full impact of the Connecticut legislation. Salisbury does not expect to pay other than minimum state income tax in the foreseeable future unless there is a change in Connecticut tax law.

Comparison of the Years Ended December 31, 2012 and 2011

Net Interest and Dividend Income

Net interest and dividend income (presented on a tax-equivalent basis) decreased $19,000 in 2012 over 2011. The net interest margin decreased 6 basis points to 3.45% from 3.51%, due to a 30 basis point decline in the average yield on interest-earning assets and a 26 basis points decline in the average cost of interest-bearing liabilities. The net interest margin is affected by changes in the mix of interest-earning assets and funding liabilities, asset and liability growth, and the effects of changes in market interest rates on the pricing and re-pricing of assets and liabilities. Income and yields on tax-exempt securities and loans are presented on a fully taxable equivalent basis.

Interest and Dividend Income

Tax equivalent interest and dividend income decreased $1.3 million, or 5.2%, to $23.8 million in 2012. Loan income decreased $513,000, or 2.7%, primarily due to a 33 basis point decline in average yield, due to lower market interest rates and their effect on new loan rates, loan re-pricing and loan re-financing activity in 2012. This decline in rate was partially offset by a $14.5 million, or 3.9%, increase in average loans.

Tax equivalent interest and dividend income from securities decreased $752,000, or 12.0%, in 2012, as a result of a $9.2 million decrease in average securities, and a 27 basis points decline in average yield, due to lower market interest rates and their effect on new bond yields, bond re-pricing and bond calls in 2012. Interest from short term funds decreased $37,000 in 2012 as a result of an 11 basis points decline in average yield, offset in part by a $2.7 million increase in average short term funds.

Interest Expense

Interest expense decreased $1.3 million, or 23.0%, to $4.3 million in 2012 as a result of decreases in deposit rates and maturities of FHLBB advances, offset in part by higher average interest bearing deposits.

Interest on interest bearing deposit accounts decreased $751,000, or 23.7%, in 2012, as a result of a 22 basis point decline in average rate, to 0.61%, offset in part by a $12.1 million, or 3.2%, increase in average interest bearing deposits. The decline in average rate was due to the decline in interest rates and changes in product mix, as the proportion represented by time deposits decreased to 25.2% from 29.2%, while non-maturity deposits increased to 74.8% from 70.6%. Interest on retail repurchase agreements decreased $40,000, or 63.5%, as a result of an 11 basis point decline in average rate, to 0.39%, while the average balance decreased $6.6 million.

Interest expense on FHLBB advances decreased $486,000, or 20.8%, due to a $13.5 million, or 23.7%, decrease in average advances as a result of scheduled maturities and the early prepayment of a $10 million advance due 12/16/2013 with a 4.88% coupon. The average borrowing rate increased slightly to 4.16%.

Provision and Allowance for Loan Losses

The provision for loan losses was $1,070,000 for 2012, compared with $1,440,000 for 2011. Net loan charge-offs were $786,000 and $1,284,000, for the respective years. Reserve coverage at December 31, 2012, as measured by the ratio of allowance for loan losses to gross loans of 1.11%, was substantially unchanged as compared with 1.09% at December 31, 2011. Non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) increased $1.8 million to $9.9 million, or 2.51% of gross loans receivable, at December 31, 2012, up from 2.16% at December 31, 2011, while accruing loans past due 30-89 days increased $3.2 million to $5.6 million, or 1.44% of gross loans receivable at December 31, 2012. See “Financial Condition – Loan Credit Quality” below for further discussion and analysis.

Non-Interest Income

Non-interest income increased $1.7 million, or 29.3%, in 2012 versus 2011. Trust and Wealth Advisory revenues increased $397,000 due to growth in managed assets, higher asset valuations and increased estate fee income. Service charges and fees increased $99,000. Gains on sales of mortgage loans increased $909,000 due to significantly higher loan volume and higher pricing. Mortgage loans sales totaled $60.2 million in 2012 versus $30.9 million in 2011. Income from servicing of mortgage loans decreased $86,000 due primarily to increased mortgage servicing rights amortization expense and lower credit enhancement fees, both attributable to increased loan refinancing activity, offset in part by higher servicing fees. Loans serviced under the FHLBB MPF program totaled $145.9 million and $114.8 million at December 31, 2012 and 2011, respectively. Gains on securities in 2012 resulted from the sale of a treasury bond. BOLI cash surrender value increased $75,000.

Non-Interest Expense

Non-interest expense increased $1.9 million, or 10.9%, in 2012 versus 2011. Salaries increased $179,000 due to changes in staffing levels and mix, and merit increases. Employee benefits increased $419,000 due to increased pension plan expense, up $406,000, that included a curtailment charge of $342,000 for lump sum benefit payments, and higher payroll taxes, while benefit costs remained relatively unchanged. Premises and equipment increased $78,000 due primarily to higher equipment and software maintenance and depreciation, offset in part by lower facilities maintenance and utilities, and the inclusion in 2011 of an expense related to the disposal of assets related to the reorganization of several Bank departments to gain efficiencies. Data processing increased $159,000 mostly due to increased ATM/debit card network processing fees, of $123,000 due to increased transactions volume and to vendor rebates in 2011. Professional fees increased $113,000 primarily due to increased audit and compliance and trust client related investment management services. Collections and OREO expenses increased $119,000 due to increased borrower real estate tax delinquencies, collection related legal fees and OREO carrying costs, offset in part by lower OREO write-downs, which were $123,000 and $231,000, respectively, for 2012 and 2011. The 2012 litigation settlement of $400,000 has enabled Salisbury to proceed with a foreclosure action against a non-performing loan. FDIC insurance decreased $110,000 as a result of the change in the assessment method in mid-2011. The 2012 FHLBB advance prepayment fee of $450,000 resulted from the early prepayment of a $10.0 million advance due 12/16/2013 with a 4.88% coupon. All other operating expenses increased $108,000.

Income Taxes

The effective income tax rates for 2012 and 2011 were 19.49% and 18.80%, respectively. Fluctuations in the effective tax rate result from changes in the mix of taxable and tax exempt income. Salisbury's effective tax rate was less than the 34% federal statutory rate due to tax-exempt income, primarily from municipal bonds and bank-owned life insurance. Salisbury did not incur Connecticut income tax in 2012 or 2011, other than minimum state income tax, as a result of its utilization of Connecticut tax legislation that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a PIC. In 2004 Salisbury availed itself of this legislation by forming a PIC, SBT Mortgage Service Corporation.

Overview

During 2013, Salisbury's assets decreased by $13.7 million to $587.1 million at December 31, 2013, as a result of decreases in cash and securities which funded net deposit outflows. Net loans receivable grew $49.4 million, or 12.7%, to $438.2 million. Deposits and repurchase agreements declined by $13.1 million, or 2.7%, to $479.9 million at December 31, 2013 as higher yielding, and more volatile, deposits left the balance sheet. At December 31, 2013, Salisbury's tangible book value per common share was $27.12 and Tier 1 leverage and total risk-based capital ratios were 10.65% and 16.46%, respectively. Both Salisbury and the Bank are categorized as "well capitalized".

Securities and Short Term Funds

During 2013, securities decreased $31.8 million to $94.5 million, while short-term funds (interest-bearing deposits with other banks) decreased to $6.8 million, in order to fund loan growth. The carrying values of securities are as follows:

| Years ended December 31, (dollars in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Available-for-Sale | | | |
| U.S. Treasury bills | $2,657 | $2,733 | $5,528 |
| U.S. Government agency notes | 2,590 | 7,726 | 14,924 |
| Municipal bonds | 40,437 | 47,365 | 50,796 |
| Mortgage backed securities | 33,892 | 48,729 | 58,300 |
| Collateralized mortgage obligations | 11,888 | 16,704 | 21,320 |
| SBA pools | 2,230 | 2,863 | 3,706 |
| Other | 797 | 167 | 1,220 |
| Held-to-Maturity | | | |
| Mortgage backed security | — | — | 50 |
| Non-Marketable | | | |
| FHLBB stock | 5,340 | 5,747 | 6,032 |
| Total Securities | $99,831 | $132,034 | $161,876 |

Salisbury evaluates securities for OTTI where the fair value of a security is less than its amortized cost basis at the balance sheet date. As part of this process, Salisbury considers its intent to sell each debt security and whether it is more likely than not that it will be required to sell the security before its anticipated recovery. If either of these conditions is met, Salisbury recognizes an OTTI charge to earnings equal to the entire difference between the security's amortized cost basis and its fair value at the balance sheet date. For securities that meet neither of these conditions, an analysis is performed to determine if any of these securities are at risk for OTTI.

Salisbury evaluates securities for strategic fit and may reduce its position in securities, although it is not more likely than not that Salisbury will be required to sell securities before recovery of their cost basis, which may be maturity. Therefore, management does not consider any of its securities, other than four non-agency CMO securities reflecting OTTI, to be OTTI at December 31, 2013.

In 2009 Salisbury determined that five non-agency CMO securities reflected OTTI and recognized losses for deterioration in credit quality of $1,128,000. Salisbury judged the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of December 31, 2013. It is possible that future loss assumptions could change necessitating Salisbury to recognize future OTTI for further deterioration in credit quality. Salisbury does not intend to sell these securities and it is not more likely than not that Salisbury will be required to sell these securities before recovery of their cost basis. The carrying value of such securities judged to be OTTI are as follows:

| Available-for-Sale (dollars in thousands) | Par value | Carrying value | Fair value |
|---|---|---|---|

| | | | |
|---|---|---|---|
| Non-agency CMO | | | |
| December 31, 2013 | $3,093 | $2,534 | $2,724 |
| December 31, 2012 | 4,446 | 3,748 | 3,817 |
| December 31, 2011 | 5,158 | 4,385 | 4,144 |

Accumulated other comprehensive gain at December 31, 2013 included net unrealized holding gains, net of tax, of $0.4 million, which is a reduction of $2.5 million from December 31, 2012.

Loans

During 2013, net loans receivable increased $49.4 million, or 12.7%, to $438.2 million at December 31, 2013, compared with loan growth of $18.0 million, or 4.9% in 2012.

Salisbury's retail lending department originates residential mortgage, home equity loans and lines of credit, and consumer loans for the portfolio. During 2013, Salisbury originated $78.7 million of residential mortgage loans and $6.5 million of home equity loans for the portfolio, compared with $44.1 million and $6.8 million, respectively, in 2012. During 2013, total residential mortgage and home equity loans receivable grew by $33.0 million to $272.0 million at December 31, 2013, and represent 61.6% of loans receivable, substantially unchanged from 2012. During 2013, Salisbury's residential mortgage lending department also originated and sold $18.4 million of residential mortgage loans, compared with $60.2 million during 2012. All loans were sold through the FHLBB Mortgage Partnership Finance Program with servicing retained by Salisbury. Consumer loans, amounting to $3.9 million at December 31, 2013, and representing 0.9% of loans receivable, were down slightly from 2012.

Salisbury's commercial lending department specializes in lending to small and mid-size companies, businesses and municipalities. More specifically we meet our client's credit need by providing short-term and long-term financing, construction loans, commercial mortgages, equipment, working capital, property improvement loans and municipal financing. The department also works with both the SBA and USDA Government Guaranteed Lending Programs; however, such loans represent a very small percent of the commercial loan portfolio. Salisbury originated $46.2 million of commercial loans during 2013. During 2013, total commercial real estate, commercial and industrial and municipal loans increased $18.6 million to $153.3 million at December 31, 2013, and represent 34.7% of loans receivable, substantially unchanged from December 31, 2012.

The principal categories of loans receivable and loans held-for-sale are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|---|
| Residential 1-4 family | $231,113 | $198,552 | $187,676 | $173,932 | $165,249 |
| Residential 5+ multifamily | 4,848 | 3,889 | 3,187 | 2,889 | 2,643 |
| Construction of residential 1-4 family | 1,876 | 2,379 | 5,305 | 8,948 | 2,817 |
| Home equity credit | 34,139 | 34,162 | 34,621 | 34,164 | 33,569 |
| Residential real estate | 271,976 | 238,982 | 230,789 | 219,933 | 204,278 |
| Commercial | 91,853 | 87,382 | 81,958 | 75,495 | 68,085 |
| Construction of commercial | 10,948 | 5,823 | 7,069 | 7,312 | 8,706 |
| Commercial real estate | 102,801 | 93,205 | 89,027 | 82,807 | 76,791 |
| Farm land | 3,402 | 4,320 | 4,925 | 5,690 | 5,577 |
| Vacant land | 9,067 | 9,926 | 12,828 | 12,979 | 11,656 |
| Real estate secured | 387,246 | 346,433 | 337,569 | 321,409 | 298,302 |
| Commercial and industrial | 46,292 | 38,094 | 29,358 | 25,123 | 24,014 |
| Municipal | 4,252 | 3,378 | 2,415 | 4,338 | 2,284 |
| Consumer | 3,889 | 4,181 | 4,496 | 4,677 | 5,544 |
| Loans receivable, gross | 441,679 | 392,086 | 373,838 | 355,547 | 330,144 |
| Deferred loan origination costs, net | 1,182 | 1,032 | 1,004 | 822 | 586 |
| Allowance for loan losses | (4,683 ) | (4,360 ) | (4,076 ) | (3,920 ) | (3,473 ) |
| Loans receivable, net | $438,178 | $388,758 | $370,766 | $352,449 | $327,257 |
| Loans held-for-sale | | | | | |
| Residential 1-4 family | $173 | $1,879 | $948 | $1,184 | $665 |

The composition of loans receivable by forecasted maturity distribution is as follows:

| December 31, 2013 (in thousands) | Within 1 year | Within 1-5 years | After 5 years | Total |
|---|---|---|---|---|
| Residential | $92 | $3,150 | $234,595 | $237,837 |
| Home equity credit | 54 | 441 | 33,644 | 34,139 |
| Commercial | 612 | 2,592 | 88,649 | 91,853 |
| Commercial construction | 500 | 123 | 10,325 | 10,948 |
| Land | 2,821 | 376 | 9,272 | 12,469 |
| Real estate secured | 4,079 | 6,682 | 376,485 | 387,246 |
| Commercial and industrial | 2,788 | 10,338 | 33,166 | 46,292 |
| Municipal | 119 | 709 | 3,424 | 4,252 |
| Consumer | 498 | 2,719 | 672 | 3,889 |
| Loans receivable, gross | $7,484 | $20,448 | $413,747 | $441,679 |

The composition of loans receivable due after one year with fixed and variable or adjustable interest rates is as follows:

| December 31, 2013 (in thousands) | Fixed interest rates | Adjustable interest rates |
|---|---|---|
| Residential | $127,804 | $109,941 |
| Home equity credit | — | 34,085 |
| Commercial | 13,217 | 78,024 |
| Commercial construction | 1,882 | 8,566 |
| Land | 75 | 9,573 |
| Real estate secured | 142,978 | 240,189 |
| Commercial and industrial | 31,037 | 12,467 |
| Municipal | 3,587 | 546 |
| Consumer | 3,073 | 318 |
| Loans receivable, gross | $180,675 | $253,520 |

Loan Credit Quality

The persistent weakness in the local and regional economies continues to impact the credit quality of Salisbury's loans receivable. During 2013 total impaired and potential problem loans remained elevated, however decreased slightly, by $0.9 million to $24.8 million, or 5.6% of gross loans receivable at December 31, 2013, from $27.3 million, or 7.0% of gross loans receivable at December 31, 2012.

The credit quality segments of loans receivable and their credit risk ratings are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 |
|---|---|---|
| Pass | $378,689 | $327,928 |
| Special mention | 38,203 | 36,785 |
| Performing loans | 416,892 | 364,713 |
| Substandard | 9,116 | 10,810 |
| Doubtful | — | — |
| Potential problem loans | 9,116 | 10,810 |
| Pass | | |
| Troubled debt restructured loans, accruing | 137 | 1,318 |
| Special mention | | |
| Troubled debt restructured loans, accruing | 2,109 | 1,568 |
| Substandard | | |
| Troubled debt restructured loans, accruing | 6,159 | 3,818 |
| Troubled debt restructured loans, non-accrual | 1,753 | 2,181 |
| All other non-accrual loans | 5,419 | 7,579 |
| Doubtful | | |
| Troubled debt restructured loans, accruing | 95 | — |
| Troubled debt restructured loans, non-accrual | — | 99 |
| Impaired loans | 15,672 | 16,563 |
| Loans receivable, gross | $441,679 | $392,086 |

Changes in impaired and potential problem loans are as follows:

| | 2013 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|
| | Impaired loans | | Potential | | Impaired loans | | Potential | |
| Year ended December 31, (in thousands) | Non-accrual | Accruing | problem loans | Total | Non-accrual | Accruing | problem loans | Total |
| Net loans placed on non-accrual status | $1,652 | $833 | $(1,227) | $1,258 | $5,201 | $(103) | $(1,415) | $3,683 |
| Loan risk rating downgrades to substandard | — | — | 3,636 | 3,636 | — | — | 1,680 | 1,680 |
| Loan risk rating upgrades from substandard | — | — | (1,350) | (1,350) | — | — | (1,259) | (1,259) |
| Loan repayments | (3,004) | 259 | (2,700) | (5,445) | (1,623) | (706) | (405) | (2,734) |
| Loan charge-offs (less charge offs for delinquent taxes) | (364) | — | (4) | (368) | (783) | — | — | (783) |
| Increase (decrease) in troubled debt restructuring | — | 1,422 | (50) | 1,372 | 35 | 2,910 | (1,830) | 1,115 |
| Real estate acquired in settlement of loans | (971) | (717) | — | (1,688) | (1,047) | — | — | (1,047) |
| Increase (decrease) in loans | $(2,687) | $1,797 | $(1,695) | $(2,585) | $1,783 | $2,101 | $(3,229) | $655 |

Credit risk remained a focus of management's attention during 2013; however there was a slight decrease in total impaired and potential problem loans, down $0.9 million in 2013. Similarly, net loans placed on non-accrual status, due to payment and financial performance, decreased to $1.3 million in 2013 from $3.7 million in 2012. Downgrades in loan risk ratings to substandard increased to $3.6 million in 2013 from $1.7 million in 2012. Upgrades in loan risk ratings from substandard increased slightly to $1.4 million in 2013 from $1.3 million in 2012. Loan repayments increased to $5.4 million in 2013 from $2.7 million in 2012. Loan charge-offs, primarily due to collateral deficiencies, remained elevated, though declined to $0.4 million in 2013 from $0.8 million in 2012. Troubled debt restructures increased to $1.4 million in 2013 from $1.1 million in 2012. Real estate acquired in settlement of loans increased to $1.7 million in 2013 from $1.0 million in 2012.

Salisbury has cooperative relationships with the vast majority of its non-performing loan customers. Substantially all non-performing loans are collateralized with real estate and the repayment of such loans is largely dependent on the return of such loans to performing status or the liquidation of the underlying real estate collateral. Salisbury pursues the resolution of all non-performing loans through collections, restructures, voluntary liquidation of collateral by the borrower and, where necessary, legal action. When attempts to work with a customer to return a loan to performing status, including restructuring the loan, are unsuccessful, Salisbury will initiate appropriate legal action seeking to acquire property by deed in lieu of foreclosure or through foreclosure, or to liquidate business assets.

Credit Quality Segments

Salisbury categorizes loans receivable into the following credit quality segments.

- Impaired loans consist of all non-accrual loans and troubled debt restructured loans, and represent loans for which it is probable that Salisbury will not be able to collect all principal and interest amounts due according to the contractual terms of the loan agreements.
- Non-accrual loans, a sub-set of impaired loans, are loans for which the accrual of interest has been discontinued because, in the opinion of management, full collection of principal or interest is unlikely.
- Non-performing loans consist of non-accrual loans, and accruing loans past due 90 days and over that are well collateralized, in the process of collection and where full collection of principal and interest is assured. Non-performing assets consist of non-performing loans plus real estate acquired in settlement of loans.
- Troubled debt restructured loans are loans for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower’s financial condition. Loan restructuring is employed when management believes the granting of a concession will increase the probability of the full or partial collection of principal and interest.
- Potential problem loans consist of performing loans that have been assigned a substandard credit risk rating and that are not classified as impaired.

Credit Risk Ratings

Salisbury assigns credit risk ratings to loans receivable in order to manage credit risk and to determine the allowance for loan losses. Credit risk ratings categorize loans by common financial and structural characteristics that measure the credit strength of a borrower. Salisbury’s rating model has eight risk rating grades, with each grade corresponding to a progressively greater risk of default. Grades 1 through 4 are pass ratings and 5 through 8 are ratings (special mention, substandard, doubtful, and loss) defined by the bank’s regulatory agencies, the FDIC and CTDOB. Risk ratings are assigned to differentiate risk within the portfolio and are reviewed on an ongoing basis and revised, if needed, to reflect changes in the borrowers' current financial position and outlook, risk profiles and the related collateral and structural positions.

- Loans risk rated as "special mention" possess credit deficiencies or potential weaknesses deserving management’s close attention that if left uncorrected may result in deterioration of the repayment prospects for the loans at some future date.
- Loans risk rated as "substandard" are loans where the Bank’s position is clearly not protected adequately by borrower current net worth or payment capacity. These loans have well defined weaknesses based on objective evidence and include loans where future losses to the Bank may result if deficiencies are not corrected, and loans where the primary source of repayment such as income is diminished and the Bank must rely on sale of collateral or other secondary sources of collection.
- Loans risk rated as "doubtful" have the same weaknesses as substandard loans with the added characteristic that the weakness makes collection or liquidation in full, given current facts, conditions, and values, to be highly improbable. The possibility of loss is high, but due to certain important and reasonably specific pending factors, which may work to strengthen the loan, its reclassification as an estimated loss is deferred until its exact status can be determined.
- Loans risk rated as "loss" are considered uncollectible and of such little value that continuance as Bank assets is unwarranted. This classification does not mean that the loan has absolutely no recovery or salvage value, but rather, it is not practical or desirable to defer writing off this loan even though partial recovery may be made in the future.

Management actively reviews and tests its credit risk ratings against actual experience and engages an independent third-party to annually validate its assignment of credit risk ratings. In addition, the Bank’s loan portfolio and risk ratings are examined annually on a rotating basis by its two primary regulatory agencies, the FDIC and CTDOB.

Impaired Loans

Impaired loans decreased $0.9 million during 2013 to $15.7 million, or 3.55% of gross loans receivable at December 31, 2013, from $16.6 million, or 4.22% of gross loans receivable at December 31, 2012. The components of impaired loans are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Troubled debt restructurings, accruing | $8,500 | $6,703 | $4,602 |
| Troubled debt restructurings, non-accrual | 1,753 | 2,280 | 1,753 |
| All other non-accrual loans | 5,419 | 7,579 | 6,323 |
| Impaired loans | $15,672 | $16,562 | $12,678 |

Non-Performing Assets

Non-performing assets decreased $2.6 million to $7.5 million at December 31, 2013, or 1.29% of assets, as compared with December 31, 2012, after peaking at $15.1 million, or 2.55% of total assets, at June 30, 2011. The components of non-performing assets are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|---|
| Commercial | $1,857 | $2,235 | $2,337 | $2,923 | $2,226 |
| Vacant land | 2,870 | 3,995 | 3,658 | 4,018 | 3,535 |
| Farm land | 384 | — | — | — | — |
| Residential 1-4 family | 1,525 | 3,024 | 1,240 | 2,534 | 765 |
| Home equity credit | 402 | 442 | 173 | 362 | 367 |
| Real estate secured | 7,038 | 9,696 | 7,408 | 9,837 | 6,893 |
| Commercial and industrial | 134 | 164 | 668 | 208 | 546 |
| Non-accrual loans | 7,172 | 9,860 | 8,076 | 10,045 | 7,439 |
| Accruing loans past due 90 days and over | — | — | — | 96 | 6 |
| Non-performing loans | 7,172 | 9,860 | 8,076 | 10,141 | 7,445 |
| Real estate acquired in settlement of loans, net | 377 | 244 | 2,744 | 610 | 275 |
| Non-performing assets | $7,549 | $10,104 | $10,820 | $10,751 | $7,720 |

Reductions in interest income associated with non-accrual loans are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Income in accordance with original terms | $551 | $301 | $811 |
| Income recognized | 64 | 195 | 111 |
| Reduction in interest income | $487 | $106 | $700 |

The past due status of non-performing loans is as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Current | $1,274 | $1,798 | $734 |
| Past due 1-29 days | 241 | 75 | 138 |
| Past due 30-59 days | 134 | 701 | 134 |
| Past due 60-89 days | 254 | 445 | — |
| Past due 90-179 days | 588 | 1,983 | 1,095 |
| Past due 180 days and over | 4,681 | 4,858 | 5,975 |
| Total non-performing loans | $7,172 | $9,860 | $8,076 |

At December 31, 2013, 17.76% of non-accrual loans were current with respect to loan payments, compared with 18.23% at December 31, 2012. Loans past due 180 days include a $2.8 million loan secured by vacant land (residential) where Salisbury has initiated a foreclosure action that is referred to in Item 3 of Part I, Legal Proceedings.

Troubled Debt Restructured Loans

Troubled debt restructured loans increased $1.3 million in 2013 to $10.3 million, or 2.32% of gross loans receivable, from $9.0 million, or 2.29% of gross loans receivable at December 31, 2012. The components of troubled debt restructured loans are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Residential 1-4 family | $4,956 | $3,097 | $2,163 |
| Home equity credit | 48 | — | — |
| Personal | 22 | — | — |
| Vacant land | 225 | — | — |
| Commercial | 2,691 | 2,774 | 1,970 |
| Real estate secured | 7,942 | 5,871 | 4,133 |
| Commercial and industrial | 558 | 832 | 469 |
| Accruing troubled debt restructured loans | 8,500 | 6,703 | 4,602 |
| Residential 1-4 family | 999 | 1,041 | 52 |
| Home equity credit | 40 | — | — |
| Commercial | 608 | 1,159 | 1,132 |
| Vacant land | — | — | 461 |
| Real estate secured | 1,647 | 2,200 | 1,645 |
| Commercial and Industrial | 106 | 80 | 108 |
| Non-accrual troubled debt restructured loans | 1,753 | 2,280 | 1,753 |
| Troubled debt restructured loans | $10,253 | $8,983 | $6,355 |

The past due status of troubled debt restructured loans is as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Current | $6,559 | $5,353 | $3,375 |
| Past due 1-29 days | 1,490 | 445 | 1,072 |
| Past due 30-59 days | 95 | 905 | 155 |
| Past due 60-89 days | 356 | — | — |

| | | | |
|---|---|---|---|
| Accruing troubled debt restructured loans | 8,500 | 6,703 | 4,602 |
| Current | 999 | 1,333 | 251 |
| Past due 1-29 days | 241 | — | — |
| Past due 30-59 days | 64 | 301 | 98 |
| Past due 60-89 days | — | 194 | — |
| Past due 90-179 days | 449 | — | 493 |
| Past due 180 days and over | — | 452 | 911 |
| Non-accrual troubled debt restructured loans | 1,753 | 2,280 | 1,753 |
| Total troubled debt restructured loans | $10,253 | $8,983 | $6,355 |

At December 31, 2013, 73.72% of troubled debt restructured loans were current with respect to loan payments, as compared with 74.43% at December 31, 2012.

Past Due Loans

Loans past due 30 days or more decreased $2.6 million during 2013 to $11.0 million, or 2.50% of gross loans receivable at December 31, 2013, compared with $13.6 million, or 3.47% of gross loans receivable at December 31, 2012. The components of loans past due 30 days or greater are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Past due 30-59 days | $2,535 | $4,309 | $1,999 |
| Past due 60-89 days | 2,840 | 1,317 | 461 |
| Past due 90-179 days | — | — | — |
| Accruing loans | 5,375 | 5,626 | 2,460 |
| Past due 30-59 days | 133 | 701 | 134 |
| Past due 60-89 days | 254 | 445 | — |
| Past due 90-179 days | 588 | 1,983 | 1,095 |
| Past due 180 days and over | 4,681 | 4,859 | 5,975 |
| Non-accrual loans | 5,656 | 7,988 | 7,204 |
| Total loans past due 30 days and over | $11,031 | $13,614 | $9,664 |

Potential Problem Loans

Potential problem loans decreased $1.7 million during 2013 to $9.1 million, or 2.06% of gross loans receivable at December 31, 2013, compared with $10.8 million, or 2.76% of gross loans receivable at December 31, 2012. The components of potential problem loans are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Residential 1-4 family | $1,528 | $3,108 | $3,367 |
| Residential 5+ multifamily | 975 | — | — |
| Construction of residential 1-4 family | — | — | — |
| Home equity credit | 890 | 892 | 1,154 |
| Residential real estate | 3,393 | 4,000 | 4,521 |
| Commercial | 4,036 | 4,624 | 7,391 |
| Construction of commercial | 589 | 450 | 450 |
| Commercial real estate | 4,625 | 5,074 | 7,841 |
| Farm land | 751 | 1,180 | 830 |
| Vacant land | 44 | 183 | 249 |
| Real estate secured | 8,813 | 10,437 | 13,441 |
| Commercial and Industrial | 288 | 345 | 534 |
| Consumer | 15 | 28 | 64 |
| Other classified loans receivable | $9,116 | $10,810 | $14,039 |

The past due status of potential problem loans is as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Current | $7,646 | $7,992 | $10,771 |
| Past due 1-29 days | 189 | 452 | 2,837 |
| Past due 30-59 days | 298 | 2,065 | 385 |
| Past due 60-89 days | 983 | 301 | 46 |
| Past due 90-179 days | — | — | — |
| Total potential problem loans | $9,116 | $10,810 | $14,039 |

At December 31, 2013, 83.87% of potential problem loans were current with respect to loan payments, as compared with 73.93% at December 31, 2012.

Management cannot predict the extent to which economic or other factors may impact such borrowers' future payment capacity, and there can be no assurance that such loans will not be placed on nonaccrual status, restructured, or require increased provision for loan losses.

Deposits and Borrowings

Deposits during 2013 decreased $13.8 million, or 2.82%, to $477.4 million at December 31, 2013, compared with $491.2 million at December 31, 2012. Retail repurchase agreements increased $0.8 million during 2013 to $2.6 million at December 31, 2013, compared with $1.8 million at December 31, 2012. Included in deposits at December 31, 2013 is a single relationship totaling $27.1 million, or 5.68% of total deposits.

Scheduled maturities of time certificates of deposit in denominations of $100,000 or more were as follows:

| December 31, 2013 (in thousands) | Within 3 months | Within 3-6 months | Within 6-12 months | Over 1 year | Total |
|---|---|---|---|---|---|
| Certificates of deposit over $100,000 | $6,279 | $5,834 | $7,450 | $14,804 | $34,367 |

FHLBB advances decreased $1.6 million during 2013 to $30.4 million at December 31, 2013, compared with $32.0 million at December 31, 2012. The decrease in advances was due to scheduled maturities and principal re-payments.

30

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL CASH OBLIGATIONS

In the normal course of business, Salisbury enters into various contractual obligations that may require future cash payments. Contractual obligations at December 31, 2013 include leases, capital lease, contractual purchases and certain pension and other benefit plans. For further discussion regarding leases see Note 17 to the Consolidated Financial Statements.

The accompanying table summarizes Salisbury's off-balance sheet lending-related financial instruments and significant cash obligations, by remaining maturity, at December 31, 2013. Salisbury's lending-related financial instruments include commitments that have maturities over one year. Contractual purchases include commitments for future cash expenditures, primarily for services and contracts that reflect the minimum contractual obligation under legally enforceable contracts with contract terms that are both fixed and determinable. Excluded from the following table are a number of obligations to be settled in cash, primarily in under one year. These obligations are reflected in Salisbury's Consolidated Balance Sheets and include deposits, FHLBB advances and repurchase agreements that settle within standard market timeframes.

| December 31, 2013 (in thousands) By Remaining Maturity | Within 1 year | Within 1-3 years | Within 4-5 years | After 5 years | Total |
|---|---|---|---|---|---|
| Residential | $25 | $— | $20 | $269 | $314 |
| Home equity credit | — | 1,126 | 175 | 27,076 | 28,377 |
| Commercial | 1,114 | 1,594 | 368 | 6,824 | 9,900 |
| Land | — | — | — | 10 | 10 |
| Real estate secured | 1,139 | 2,720 | 563 | 34,179 | 38,601 |
| Commercial and industrial | 2,541 | 2,907 | 749 | 11,091 | 17,288 |
| Municipal | 200 | — | — | 75 | 275 |
| Consumer | — | — | — | 1,321 | 1,321 |
| Unadvanced portions of loans | 3,880 | 5,627 | 1,312 | 46,666 | 57,485 |
| Commitments to originate loans | 9,730 | — | — | — | 9,730 |
| Standby letters of credit | — | 53 | — | — | 53 |
| Total | $13,610 | $5,680 | $1,312 | $46,666 | $67,268 |

LIQUIDITY

Salisbury manages its liquidity position to ensure it has sufficient funding availability at all times to meet both anticipated and unanticipated deposit withdrawals, loan originations and advances, securities purchases and other operating cash outflows. Salisbury's primary source of liquidity is deposits and though its preferred funding strategy is to attract and retain low cost deposits, its ability to do so is affected by competitive interest rates and terms in its marketplace, and other financial market conditions. Other sources of funding include cash flows from loan and securities principal payments and maturities, funds provided by operations, and discretionary use of national market certificates of deposit and FHLBB advances. Liquidity can also be provided through sales of securities and loans.

Salisbury manages its liquidity in accordance with a liquidity funding policy, and also maintains a contingency funding plan that provides for the prompt and comprehensive response to unexpected demands for liquidity. At December 31, 2013, Salisbury's liquidity ratio, as represented by cash, short term available-for-sale securities and marketable assets to net deposits and short term unsecured liabilities, was 16.33%, down from 30.55% at December 31, 2012. Management believes Salisbury's funding sources will meet anticipated funding needs.

Operating activities for 2013 provided net cash of $9.7 million. Investing activities utilized net cash of $23.8 million, principally from net loan advances and sales of OREO of $50.6 million, partially offset by calls and maturities of securities of $27.7 million. Financing activities utilized net cash of $16.7 million, principally from a net deposit and repurchase agreement decline of $13.1 million, repayment and maturities of FHLBB advances of $1.6 million and cash dividend payments, on common and preferred stock, of $2.1 million.

Operating activities for 2012 provided net cash of $7.1 million. Investing activities provided net cash of $14.8 million, principally from calls, sales and maturities of securities of $37.8 million, offset in part by net loan advances and sales of OREO of $16.7 million, and securities purchases of $6.3 million. Financing activities utilized net cash of $15.2 million, principally, from repayment and maturities of FHLBB advances of $22.6 million and cash dividend payments, on common and preferred stock, of $2.1 million, offset in part by a net deposit and repurchase agreement growth of $9.5 million.

Operating activities for 2011 provided net cash of $6.8 million. Investing activities utilized net cash of $23.3 million, principally for securities purchases of $45.8 million and net loan advances of $22.6 million, offset in part by securities repayments and maturities of $43.1 million and the maturity of an interest bearing time deposit with other banks of $5.0 million. Financing activities provided net cash of $26.5 million, principally, from net deposit and repurchase agreement growth of $40.0 million and proceeds from issuance of preferred stock of $16.0 million, offset in part by a net decrease in FHLBB advances of $18.2 million, redemption of preferred stock of $8.8 million and cash dividend payments, on common and preferred stock, of $2.3 million.

CAPITAL RESOURCES

Shareholders’ Equity

Book value and tangible book value per common share increased $0.08 and $0.27, respectively, in 2013 to $33.21 and $27.12, respectively, at December 31, 2013, compared with $33.13 and $26.85, respectively, at December 31, 2012.

Shareholders’ equity increased $0.8 million in 2013 to $72.8 million at December 31, 2013. Contributing to the increase in shareholders’ equity for 2013 was net income of $4.1 million and common stock issuance of $0.2 million, less common and preferred stock dividends of $1.9 million and $0.2 million, respectively and other comprehensive loss of $1.4 million. Accumulated other comprehensive income as of December 31, 2013 included unrealized gains on securities available-for-sale, net of tax, of $0.4 million and a pension plan gain, net of tax, of $0.6 million.

Preferred Stock

In August 2011, Salisbury issued to the Treasury $16 million of its Series B Preferred Stock under the SBLF program. The SBLF program is a $30 billion fund established under the Small Business Jobs Act of 2010 to encourage lending to small businesses by providing Tier 1 capital to qualified community banks with assets of less than $10 billion. The Preferred Stock qualifies as Tier 1 capital for regulatory purposes and ranks senior to the Common Stock.

The Series B Preferred Stock pays noncumulative dividends. The dividend rate on the Series B Preferred Stock for the initial quarterly dividend period ended September 30, 2011 and each of the next nine quarterly dividend periods the Series B Preferred Stock is outstanding is determined each quarter based on the increase in the Bank's Qualified Small Business Lending. The dividend rate for the quarterly dividend period ended December 31, 2013, was 1.0%. For the eleventh quarterly dividend period through four and one-half years after its issuance, the dividend rate on the Series B Preferred Stock will be 1.0% and after four and one-half years from its issuance the dividend rate will be fixed at 9.0% per annum. On December 21, 2013, Salisbury declared a Series B Preferred Stock dividend of $40,000, payable on January 2, 2014. The Series B Preferred Stock is non-voting, other than voting rights on matters that could adversely affect the Series B Preferred Stock. The Series B Preferred Stock is redeemable at any time at one hundred percent of the issue price plus any accrued and unpaid dividends.

Simultaneously with the receipt of the SBLF capital in 2011, Salisbury repurchased for $8.8 million all of its Series A Preferred Stock sold to the Treasury in 2009 under the CPP, a part of TARP, and made a payment for accrued dividends. The transaction resulted in net capital proceeds to Salisbury of $7.2 million, of which Salisbury invested $6.5 million, or 90%, in the Bank as Tier 1 Capital.

As part of the CPP, Salisbury had issued to the Treasury a 10-year Warrant to purchase 57,671 shares of Common Stock at an exercise price of $22.93 per share. The Warrant was repurchased for $205,000 on November 2, 2011 and simultaneously cancelled.

Capital Requirements

Salisbury and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Under current regulatory definitions, Salisbury and the Bank are considered to be "well capitalized" for capital adequacy purposes. As a result, the Bank pays lower federal deposit insurance premiums than those banks that are not "well capitalized." Salisbury's and the Bank's regulatory capital ratios are as follows:

| | Well capitalized | December 31, 2013 Salisbury | December 31, 2013 Bank | December 31, 2012 Salisbury | December 31, 2012 Bank |
|---|---|---|---|---|---|
| Total Capital (to risk-weighted assets) | 10.00 % | 16.46 % | 13.87% | 16.63 % | 13.77% |
| Tier 1 Capital (to risk-weighted assets) | 6.00 | 15.20 | 12.63 | 15.46 | 12.62 |
| Tier 1 Capital (to average assets) | 5.00 | 10.65 | 8.96 | 9.87 | 8.15 |

A well-capitalized institution, which is the highest capital category for an institution as defined by the Prompt Corrective Action regulations issued by the FDIC and the FRB, is one which maintains a Total Risk-Based ratio of 10% or above, a Tier 1 Risk-Based ratio of 6% or above and a Leverage ratio of 5% or above, and is not subject to any written order, written agreement, capital directive, or prompt corrective action directive to meet and maintain a specific capital level. Maintaining strong capital is essential to Salisbury and the Bank's safety and soundness. However, the effective management of capital resources requires generating attractive returns on equity to build value for shareholders while maintaining appropriate levels of capital to fund growth, meet regulatory requirements and be consistent with prudent industry practices.

In December 2010, the Basel Committee, a group of bank regulatory supervisors from around the world, released its final framework for strengthening international capital and liquidity regulation, now officially identified by the Basel

Committee as “Basel III.” Basel III, when fully implemented by the U.S. bank regulatory agencies and fully phased-in, will require bank holding companies and their bank subsidiaries to maintain substantially more capital, with a greater emphasis on common equity.

In July 2013, the Federal Reserve Board, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation approved final rules to implement the Basel III capital framework. The rules will be effective on January 1, 2015 and phased-in over a multiple year period through 2019. The new capital rules call for higher quality capital with higher minimum capital level requirements. We are still in the process of assessing the impact from these new complex regulatory requirements, and while we cannot be certain of the impact, we believe that we will exceed the requirements of adequately capitalized plus the capital conservation buffer, once they become effective.

Dividends

During 2013 and 2012, Salisbury declared and paid four quarterly common stock dividends of $0.28 per common share each quarter, totaling $1,915,000 and $1,892,000, respectively. The Board of Directors of Salisbury declared a common stock dividend of $0.28 per common share payable on February 28, 2014 to shareholders of record on February 14, 2014. Common stock dividends, when declared, will generally be paid the last business day of February, May, August and November, although Salisbury is not obligated to pay dividends on those dates or at any other time.

During 2013 Salisbury declared Preferred Stock Series B dividends of $161,000 to the Treasury.

Salisbury's ability to pay cash dividends is dependent on the Bank's ability to pay cash dividends to Salisbury. There are certain restrictions on the payment of cash dividends and other payments by the Bank to Salisbury. Under Connecticut law, the Bank cannot declare a cash dividend except from net profits, defined as the remainder of all earnings from current operations. The total of all cash dividends declared by the Bank in any calendar year shall not, unless specifically approved by the Banking Commissioner, exceed the total of its net profits of that year combined with its retained net profits of the preceding two years.

FRB Supervisory Letter SR 09-4, February 24, 2009, revised March 27, 2009, states that, as a general matter, the Board of Directors of a Bank Holding Company ("BHC") should inform the Federal Reserve and should eliminate, defer, or significantly reduce dividends if (1) net income available to shareholders for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends; (2) the prospective rate of earnings retention is not consistent with capital needs and overall current and prospective financial condition; or (3) the BHC will not meet, or is in danger of not meeting, its minimum regulatory capital adequacy ratios. Moreover, a BHC should inform the Federal Reserve reasonably in advance of declaring or paying a dividend that exceeds earnings for the period (e.g., quarter) for which the dividend is being paid or that could result in a material adverse change to the BHC capital position.

Salisbury believes that the payment of common stock cash dividends is appropriate, provided that such payment considers Salisbury's capital needs, asset quality, and overall financial condition and does not adversely affect the financial stability of Salisbury or the Bank. The continued payment of common stock cash dividends by Salisbury will be dependent on Salisbury's future core earnings, financial condition and capital needs, regulatory restrictions, and other factors deemed relevant by the Board of Directors of Salisbury.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

See Note 1 to the Consolidated Financial Statements for details of recently issued accounting pronouncements and their expected impact on Salisbury's financial statements.

IMPACT OF INFLATION AND CHANGING PRICES

Salisbury's consolidated financial statements are prepared in conformity with GAAP that require the measurement of financial condition and operating results in terms of historical dollars without considering changes in the relative purchasing power of money, over time, due to inflation. Unlike most industrial companies, virtually all of the assets and liabilities of Salisbury are monetary and as a result, interest rates have a greater impact on Salisbury's performance than do the effects of general levels of inflation, although interest rates do not necessarily move in the same direction or with the same magnitude as the prices of goods and services. Although not a material factor in recent years, inflation could impact earnings in future periods.

ADDITIONAL INFORMATION AND WHERE TO FIND IT

In connection with the proposed merger, Salisbury will file with the SEC a Registration Statement on Form S-4 that will include a proxy statement of Salisbury and Riverside Bank and a prospectus of Salisbury, as well as other relevant documents concerning the proposed transaction. SHAREHOLDERS OF SALISBURY AND RIVERSIDE BANK ARE URGED TO READ CAREFULLY THE REGISTRATION STATEMENT AND JOINT PROXY STATEMENT/PROSPECTUS REGARDING THE PROPOSED TRANSACTION IN ITS ENTIRETY WHEN IT BECOMES AVAILABLE AND ANY OTHER DOCUMENTS FILED WITH THE SEC, AS WELL AS ANY AMENDMENTS OR SUPPLEMENTS TO THOSE DOCUMENTS, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION. Investors and shareholders of Salisbury and Riverside Bank will be able to obtain a free copy of the joint proxy statement/prospectus (when available) containing information about Salisbury and Riverside Bank, as well as other filings containing information about Salisbury, at the SEC's website at www.sec.gov. The joint proxy statement/prospectus (when available) and other filings may also be obtained free of charge at Salisbury's website at www.salisburybank.com.

PARTICIPANTS IN THE SOLICITATION

Salisbury and Riverside Bank and certain of their respective directors, executive officers and other members of management and employees, under the SEC's rules, may be deemed to be "participants" in the solicitation of proxies from the shareholders of Salisbury and Riverside Bank in connection with the proposed merger and related matters. Information regarding the directors and executive officers of Salisbury and their ownership of Salisbury common stock is set forth in the proxy statements for Salisbury's 2013 annual meeting of shareholders, as filed with the SEC on Schedule 14A on April 30, 2013. Information regarding the directors and executive officers of Riverside Bank and their ownership of Riverside Bank common stock, and additional information regarding the interests of the Salisbury and Riverside Bank participants, may be obtained by reading the joint proxy statement/prospectus when it becomes available. Free copies of this document may be obtained as described in the preceding paragraph.

This communication does not constitute an offer to sell or the solicitation of an offer to buy any securities or a solicitation of any vote or approval, nor shall there be any sale of securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of such jurisdiction.

## Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Salisbury manages its exposure to interest rate risk through its Asset/Liability Management Committee ("ALCO") using risk limits and policy guidelines to manage assets and funding liabilities to produce financial results that are consistent with Salisbury's liquidity, capital adequacy, growth, risk and profitability targets. Interest rate risk is the risk of a negative impact to future earnings due to changes in interest rates.

The ALCO manages interest rate risk using income simulation to measure interest rate risk inherent in Salisbury's financial instruments at a given point in time by showing the effect of interest rate shifts on net interest income over a 24-month horizon. In management's December 31, 2013 analysis, three of the simulations incorporate management's growth assumptions over the simulation horizons, with allowances made for loan, deposit and security product mix shifts in selected interest rate scenarios, such as movements between lower rate savings and money market deposit accounts and higher rate time deposits, and changes in the reinvestment of loan and securities cash flows. The fourth simulation incorporates management's balance sheet growth assumptions. Additionally, the simulations take into account the specific re-pricing, maturity and prepayment characteristics of differing financial instruments that may vary under different interest rate scenarios.

The ALCO reviews the simulation results to determine whether Salisbury's exposure to change in net interest income remains within established tolerance levels over the simulation horizons and to develop appropriate strategies to manage this exposure. Salisbury's tolerance levels for changes in net interest income in its income simulations varies depending on the magnitude of interest rate changes and level of risk-based capital. All changes are measured in comparison to the projected net interest income that would result from an "unchanged" rate scenario where interest rates remain stable over the forecast horizon. The ALCO also evaluates the directional trends of net interest income, net interest margin and other financial measures over the forecast horizon for consistency with its liquidity, capital adequacy, growth, risk and profitability targets.

ALCO uses four interest rate scenarios to evaluate interest risk exposure and may vary these interest rate scenarios to show the effect of steepening or flattening changes in yield curves as well as parallel changes in interest rates. At December 31, 2013 ALCO used the following interest rate scenarios: (1) unchanged interest rates; (2) immediately rising interest rates – immediate non-parallel upward shift in market interest rates ranging from 300 basis points for short term rates to 300 basis points for the 10-year Treasury; (3) immediately falling interest rates – immediate non-parallel downward shift in market interest rates ranging from 25 basis points for short term rates to 135 basis points for the 10-year Treasury; and (4) two step shock rising interest rates – ranging from 400 basis points for short term rates (200 basis points each year) to 315 basis points for the 10-year Treasury (150 basis points for year one and 165 basis points for year two). Deposit rates are assumed to shift by lesser amounts due to their relative historical insensitivity to market interest rate movements. Further, deposits are assumed to have certain minimum rate levels below which they will not fall. Income simulations do not reflect adjustments in strategy that the ALCO could implement in response to rate shifts.

As of December 31, 2013 net interest income simulations indicated that Salisbury's exposure to changing interest rates over the simulation horizons remained within its tolerance levels. The following table sets forth the estimated change in net interest income from an unchanged interest rate scenario over the periods indicated for changes in market interest rates using Salisbury's financial instruments as of December 31, 2013.

| December 31, 2013 (in thousands) | Months 1-12 | | Months 13-24 | |
|---|---|---|---|---|
| Immediately rising interest rates (management's growth assumptions) | (12.19 | )% | (4.67 | )% |
| Immediately falling interest rates (management's growth assumptions) | (1.26 | ) | (3.92 | ) |
| Two step shock rising interest rates (management's growth assumptions) | (3.94 | ) | (8.99 | ) |

The negative exposure of net interest income to immediately and gradually rising rates as compared to the unchanged rate scenario results from a faster projected rise in the cost of funds versus income from earning assets, as relatively rate-sensitive money market and time deposits re-price faster than longer duration earning assets. The negative exposure of net interest income to immediately falling rates as compared to an unchanged rate scenario results from a greater decline in earning asset yields compared to rates paid on funding liabilities, as a result of faster prepayments on existing assets and lower reinvestment rates on future loans originated and securities purchased.

While the ALCO reviews simulation assumptions and back-tests simulation results to ensure that they are reasonable and current, income simulation may not always prove to be an accurate indicator of interest rate risk or future net interest margin. Over time, the re-pricing, maturity and prepayment characteristics of financial instruments and the composition of Salisbury's balance sheet may change to a different degree than estimated. Simulation modeling assumes Salisbury's expectation for future balance sheet growth, which is a function of the business environment and customer behavior. Another significant simulation assumption is the sensitivity of core savings deposits to fluctuations in interest rates. Income simulation results assume that changes in both core savings deposit rates and balances are related to changes in short-term interest rates. The assumed relationship between short-term interest rate changes and core deposit rate and balance changes used in income simulation may differ from the ALCO's estimates. Lastly, mortgage-backed securities and mortgage loans involve a level of risk that unforeseen changes in prepayment speeds may cause related cash flows to vary significantly in differing rate environments. Such changes could affect the level of reinvestment risk associated with cash flow from these instruments, as well as their market value. Changes in prepayment speeds could also increase or decrease the amortization of premium or accretion of discounts related to such instruments, thereby affecting interest income.

Salisbury also monitors the potential change in market value of its available-for-sale debt securities in changing interest rate environments. The purpose is to determine market value exposure that may not be captured by income simulation, but which might result in changes to Salisbury's capital and liquidity position. Results are calculated using industry-standard analytical techniques and securities data. Available-for-sale equity securities are excluded from this analysis because the market value of such securities cannot be directly correlated with changes in interest rates. The following table summarizes the potential change in market value of available-for-sale debt securities resulting from immediate parallel rate shifts:

| December 31, 2013 (in thousands) | Rates up 100bp | Rates up 200bp |
|---|---|---|
| U.S. Treasury notes | $(70) | $(138) |
| U.S. Government agency notes | (95) | (263) |
| Municipal bonds | (2,467) | (5,029) |
| Mortgage backed securities | (1,215) | (2,475) |
| Collateralized mortgage obligations | (335) | (697) |
| SBA pools | (8) | (15) |
| Total available-for-sale debt securities | $(4,190) | $(8,617) |

34

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**Index to Consolidated Financial Statements**

To the Board of Directors

Salisbury Bancorp, Inc.

Lakeville, Connecticut

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We have audited the accompanying consolidated balance sheets of Salisbury Bancorp, Inc. and Subsidiary as of December 31, 2013 and 2012 and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2013. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Salisbury Bancorp, Inc. and Subsidiary as of December 31, 2013 and 2012, and the consolidated results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

SHATSWELL, MacLEOD & COMPANY, P.C.

West Peabody, Massachusetts

March 19, 2014

Salisbury Bancorp, Inc. and Subsidiary

**CONSOLIDATED BALANCE SHEETS**

| Years ended December 31, (dollars in thousands, except par value) | 2013 | 2012 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $5,926 | $9,545 |
| Interest bearing demand deposits with other banks | 6,785 | 34,029 |
| Total cash and cash equivalents | 12,711 | 43,574 |
| Interest bearing time deposits with other banks | 738 | — |
| Securities | | |
| Available-for-sale at fair value | 94,491 | 126,287 |
| Federal Home Loan Bank of Boston stock at cost | 5,340 | 5,747 |
| Loans held-for-sale | 173 | 1,879 |
| Loans receivable, net (allowance for loan losses: $4,683 and $4,360) | 438,178 | 388,758 |
| Other real estate owned | 377 | 244 |
| Bank premises and equipment, net | 11,611 | 11,520 |
| Goodwill | 9,829 | 9,829 |
| Intangible assets (net of accumulated amortization: $1,967 and $1,745) | 576 | 798 |
| Accrued interest receivable | 1,760 | 1,818 |
| Cash surrender value of life insurance policies | 7,529 | 7,295 |
| Deferred taxes | 260 | — |
| Other assets | 3,536 | 3,064 |
| Total Assets | $587,109 | $600,813 |
| LIABILITIES and SHAREHOLDERS' EQUITY | | |
| Deposits | | |
| Demand (non-interest bearing) | $84,677 | $98,850 |
| Demand (interest bearing) | 81,932 | 65,991 |
| Money market | 120,550 | 128,501 |
| Savings and other | 107,171 | 103,985 |
| Certificates of deposit | 83,039 | 93,888 |
| Total deposits | 477,369 | 491,215 |
| Repurchase agreements | 2,554 | 1,784 |
| Federal Home Loan Bank of Boston advances | 30,411 | 31,980 |
| Capital lease liability | 425 | — |
| Deferred taxes | — | 590 |
| Accrued interest and other liabilities | 3,560 | 3,247 |
| Total Liabilities | 514,319 | 528,816 |
| Shareholders' Equity | | |
| Preferred stock - $.01 per share par value | | |
| Authorized: 25,000; issued: 16,000 (Series B); | | |
| Liquidation preference: $1,000 per share | 16,000 | 16,000 |
| Common stock - $.10 per share par value | | |
| Authorized: 3,000,000; | | |
| Issued: 1,710,121 and 1,689,691 | 171 | 169 |
| Paid-in capital | 13,668 | 13,158 |
| Retained earnings | 42,240 | 40,233 |
| Unearned compensation – restricted stock awards | (335) | — |

| | | |
|---|---|---|
| Accumulated other comprehensive income, net | 1,046 | 2,437 |
| Total Shareholders' Equity | 72,790 | 71,997 |
| Total Liabilities and Shareholders' Equity | $587,109 | $600,813 |

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

37

Salisbury Bancorp, Inc. and Subsidiary

**CONSOLIDATED STATEMENTS OF INCOME**

| Years ended December 31, (in thousands except per share amounts) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Interest and dividend income | | | |
| Interest and fees on loans | $17,978 | $18,054 | $18,666 |
| Interest on debt securities | | | |
| Taxable | 1,757 | 2,454 | 3,041 |
| Tax exempt | 1,948 | 2,030 | 2,210 |
| Other interest and dividends | 67 | 120 | 127 |
| Total interest and dividend income | 21,750 | 22,658 | 24,044 |
| Interest expense | | | |
| Deposits | 1,813 | 2,414 | 3,165 |
| Repurchase agreements | 6 | 23 | 63 |
| Federal Home Loan Bank of Boston advances | 1,243 | 1,845 | 2,331 |
| Total interest expense | 3,062 | 4,282 | 5,559 |
| Net interest and dividend income | 18,688 | 18,376 | 18,485 |
| Provision for loan losses | 1,066 | 1,070 | 1,440 |
| Net interest and dividend income after provision for loan losses | 17,622 | 17,306 | 17,045 |
| Non-interest income | | | |
| Gains on securities, net | — | 279 | 11 |
| Trust and wealth advisory | 3,074 | 2,945 | 2,548 |
| Service charges and fees | 2,298 | 2,189 | 2,090 |
| Gains on sales of mortgage loans, net | 579 | 1,596 | 687 |
| Mortgage servicing, net | 35 | (21 ) | 65 |
| Other | 319 | 326 | 255 |
| Total non-interest income | 6,305 | 7,314 | 5,656 |
| Non-interest expense | | | |
| Salaries | 7,467 | 7,149 | 6,970 |
| Employee benefits | 2,804 | 2,912 | 2,493 |
| Premises and equipment | 2,398 | 2,408 | 2,330 |
| Data processing | 1,514 | 1,569 | 1,410 |
| Professional fees | 1,524 | 1,212 | 1,099 |
| Collections and OREO | 519 | 709 | 590 |
| Litigation settlement | — | 400 | — |
| FDIC insurance | 470 | 486 | 596 |
| Marketing and community support | 393 | 356 | 343 |
| Amortization of intangibles | 222 | 222 | 222 |
| FHLBB advance prepayment fee | — | 450 | — |
| Other | 1,624 | 1,681 | 1,586 |
| Total non-interest expense | 18,935 | 19,554 | 17,639 |
| Income before income taxes | 4,992 | 5,066 | 5,062 |
| Income tax provision | 909 | 989 | 950 |
| Net income | $4,083 | $4,077 | $4,112 |
| Net income available to common shareholders | $3,922 | $3,861 | $3,588 |
| Basic and diluted earnings per common share | $2.30 | $2.28 | $2.12 |

| | | | |
|---|---|---|---|
| Common dividends per share | 1.12 | 1.12 | 1.12 |

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

38

**Salisbury Bancorp, Inc. and Subsidiary**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Net income | $4,083 | $4,077 | $4,112 |
| Other comprehensive (loss) income | | | |
| Net unrealized (losses) gains on securities available-for-sale | (3,743) | 2,632 | 5,973 |
| Reclassification of net realized gains in net income | — | (279) | (11) |
| Unrealized (losses) gains on securities available-for-sale | (3,743) | 2,353 | 5,962 |
| Income tax benefit (expense) | 1,273 | (800) | (2,027) |
| Unrealized (losses) gains on securities available-for-sale, net of tax | (2,470) | 1,553 | 3,935 |
| Pension plan income (loss) | 1,635 | 2,407 | (1,319) |
| Income tax (expense) benefit | (556) | (818) | 448 |
| Pension plan income (loss), net of tax | 1,079 | 1,589 | (871) |
| Other comprehensive (loss) income, net of tax | (1,391) | 3,142 | 3,064 |
| Comprehensive income | $2,692 | $7,219 | $7,176 |

Salisbury Bancorp, Inc. and Subsidiary

**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

| | Common Stock | | Preferred | | Paid-in | Retained | Unearned compensation restricted stock | Accumu other compreh |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Stock | Warrants | capital | earnings | awards | income ( |
| Balances at December 31, 2010 | 1,687,661 | $168 | $8,738 | $112 | $13,200 | $36,567 | $— | $(3,769 |
| Net income for year | — | — | — | — | — | 4,112 | — | — |
| Other comprehensive income, net of tax | — | — | — | — | — | — | — | 3,064 |
| Amortization (accretion) of preferred stock | — | — | 78 | — | — | (78) | — | — |
| Issuance of Series B preferred stock | — | — | 16,000 | — | — | — | — | — |
| Redemption of Series A preferred stock | — | — | (8,816) | — | — | — | — | — |
| Repurchase of Common Stock Warrants | — | — | — | (112) | (93) | — | — | — |
| Common stock dividends declared | — | — | — | — | — | (1,891) | — | — |
| Preferred stock dividends declared | — | — | — | — | — | (446) | — | — |
| | 1,070 | 1 | — | — | 27 | — | — | — |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Issuance of common stock for director fees | | | | | | | | |
| Balances at December 31, 2011 | 1,688,731 | $169 | $16,000 | $— | $13,134 | $38,264 | $— | $(705 |
| Net income for year | — | — | — | — | — | 4,077 | — | — |
| Other comprehensive income, net of tax | — | — | — | — | — | — | — | 3,142 |
| Common stock dividends declared | — | — | — | — | — | (1,892) | — | — |
| Preferred stock dividends declared | — | — | — | — | — | (216) | — | — |
| Issuance of common stock for director fees | 960 | — | — | — | 24 | — | — | — |
| Balances at December 31, 2012 | 1,689,691 | $169 | $16,000 | $— | $13,158 | $40,233 | $— | $2,437 |
| Net income for year | — | — | — | — | — | 4,083 | — | — |
| Other comprehensive loss, net of tax | — | — | — | — | — | — | — | (1,391 |
| Common stock dividends declared | — | — | — | — | — | (1,915) | — | — |
| Preferred stock dividends declared | — | — | — | — | — | (161) | — | — |
| Issuance of restricted common stock | 19,600 | 2 | — | — | 488 | — | (490) | — |
| Forfeiture of restricted common stock | (500) | — | — | — | (12) | — | 12 | — |
| Stock based compensation-restricted stock awards | — | — | — | — | — | — | 143 | — |
| Issuance of common stock for director fees | 1,330 | — | — | — | 34 | — | — | — |
| Balances at December 31, 2013 | 1,710,121 | $171 | $16,000 | $— | $13,668 | $42,240 | $(335) | $1,046 |

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

39

Salisbury Bancorp, Inc. and Subsidiary

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Operating Activities | | | |
| Net income | $4,083 | $4,077 | $4,112 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| (Accretion), amortization and depreciation | | | |
| Securities | 365 | 611 | 369 |
| Bank premises and equipment | 856 | 883 | 850 |
| Core deposit intangible | 222 | 222 | 222 |
| Mortgage servicing rights | 389 | 379 | 240 |
| Fair value adjustment on loans | 32 | 33 | 42 |
| (Gains) and losses | | | |
| Sales and calls of securities available-for-sale, net | — | (279) | (11) |
| Gain on sales of loans, excluding capitalized servicing rights | (285) | (915) | (358) |
| Other real estate owned | 133 | 123 | 231 |
| Loss on sale/disposals of premises and equipment | 34 | — | — |
| Provision for loan losses | 1,066 | 1,070 | 1,440 |
| Proceeds from loans sold | 18,693 | 61,109 | 31,260 |
| Loans originated for sale | (16,702) | (61,125) | (30,666) |
| Increase in deferred loan origination fees and costs, net | (150) | (28) | (182) |
| Mortgage servicing rights originated | (294) | (682) | (329) |
| (Decrease) increase in mortgage servicing rights impairment reserve | (23) | 16 | 12 |
| Decrease in interest receivable | 58 | 308 | 6 |
| Deferred tax (benefit) expense | (134) | (199) | 130 |
| Decrease in prepaid expenses | 706 | 207 | 576 |
| Increase in cash surrender value of life insurance policies | (234) | (258) | (183) |
| Decrease in income tax receivable | 311 | 242 | 147 |
| (Increase) decrease in other assets | (637) | (26) | 41 |
| Increase (decrease) in accrued expenses | 734 | 927 | (442) |
| Decrease in interest payable | (55) | (75) | (164) |
| Increase (decrease) in other liabilities | 346 | 473 | (587) |
| Issuance of shares for directors' fees | 34 | 24 | 28 |
| Stock based compensation-restricted stock awards | 143 | — | — |
| Net cash provided by operating activities | 9,691 | 7,117 | 6,784 |
| Investing Activities | | | |
| Proceeds from maturities of interest-bearing time deposits with other banks | — | — | 5,000 |
| Purchase of interest-bearing time deposits with other banks | (738) | — | — |
| Redemption of Federal Home Loan Bank of Boston stock | 407 | 285 | — |
| Purchases of securities available-for-sale | — | (6,288) | (45,831) |
| Proceeds from sales of securities available-for-sale | — | 2,771 | — |
| Proceeds from calls of securities available-for-sale | 3,800 | 12,625 | 27,565 |
| Proceeds from maturities of securities available-for-sale | 23,888 | 22,420 | 15,498 |
| Proceeds from maturities of securities held-to-maturity | — | 50 | 6 |
| Loan originations and principal collections, net | (52,088) | (18,888) | (22,556) |
| Recoveries of loans previously charged-off | 31 | 100 | 82 |

| | | | |
|---|---|---|---|
| Proceeds from sales of other real estate owned | 1,423 | 2,098 | 492 |
| Purchase of life insurance policies | — | — | (3,000 ) |
| Proceeds from sales/disposals of premises and equipment | — | — | 200 |
| Capital expenditures | (556 ) | (380 ) | (821 ) |
| Proceeds from sales of investment in real estate | — | — | 75 |
| Net cash (utilized) provided by investing activities | (23,833) | 14,793 | (23,290) |

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

Salisbury Bancorp, Inc. and Subsidiary

**CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)**

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Financing Activities | | | |
| (Decrease) increase in deposit transaction accounts, net | (2,997) | 29,724 | 62,367 |
| Decrease in time deposits, net | (10,849) | (9,815) | (21,350) |
| Increase (decrease) in securities sold under agreements to repurchase, net | 770 | (10,364) | (1,042) |
| Principal payments on Federal Home Loan Bank of Boston advances | (1,569) | (22,635) | (18,197) |
| Proceeds from issuance of Series B preferred stock | — | — | 16,000 |
| Redemption of Series A preferred stock | — | — | (8,816) |
| Redemption of common stock warrants | — | — | (205) |
| Common stock dividends paid | (1,915) | (1,892) | (1,891) |
| Series A and Series B preferred stock dividends paid | (161) | (240) | (382) |
| Net cash (utilized) provided by financing activities | (16,721) | (15,222) | 26,484 |
| Net (decrease) increase in cash and cash equivalents | (30,863) | 6,688 | 9,978 |
| Cash and cash equivalents, beginning of year | 43,574 | 36,886 | 26,908 |
| Cash and cash equivalents, end of year | $12,711 | $43,574 | $36,886 |
| Cash paid during year | | | |
| Interest | $3,117 | $4,357 | $5,723 |
| Income taxes | 732 | 946 | 673 |
| Non-cash transfers | | | |
| From loans to other real estate owned | 1,689 | 1,047 | 3,057 |
| From other real estate owned to loans | — | (1,326) | 200 |
| The Company recorded a capital lease asset and incurred a capital lease obligation in connection with the lease of a building | 425 | — | — |

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

41

**Salisbury Bancorp, Inc. and Subsidiary**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Salisbury is the bank holding company for Salisbury Bank, a State chartered commercial bank. Salisbury's activity is currently limited to the holding of the Bank's outstanding capital stock and the Bank is Salisbury's only subsidiary and its primary investment. The Bank is a Connecticut chartered and Federal Deposit Insurance Corporation (the "FDIC") insured commercial bank headquartered in Lakeville, Connecticut. The Bank's principal business consists of attracting deposits from the public and using such deposits, with other funds, to make various types of loans and investments. The Bank conducts its business through eight full-service offices located in Litchfield, Berkshire and Dutchess Counties in Connecticut, Massachusetts and New York, respectively, and recently took steps to establish a new branch in Great Barrington, Massachusetts. The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles. The following is a summary of significant accounting policies:

Principles of Consolidation

The consolidated financial statements include those of Salisbury and its subsidiary after elimination of all inter-company accounts and transactions.

Basis of Financial Statement Presentation

The financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America. In preparing the financial statements, management is required to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the statement of condition, and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains independent appraisals for significant properties.

Certain reclassifications have been made to the 2011 and 2012 financial statements to make them consistent with the 2013 presentation.

**Securities**

Securities that may be sold as part of Salisbury's asset/liability or liquidity management or in response to or in anticipation of changes in interest rates and resulting prepayment risk, or for other similar factors, are classified as available-for-sale and carried at their fair market value. Unrealized holding gains and losses on such securities are reported net of related taxes, if applicable, as a separate component of shareholders' equity. Securities that Salisbury has the ability and positive intent to hold to maturity are classified as held-to-maturity and carried at amortized cost. Realized gains and losses on the sales of all securities are reported in earnings and computed using the specific identification cost basis. Securities are reviewed regularly for other-than-temporary impairment (“OTTI”). Premiums and discounts are amortized or accreted utilizing the interest method over the life or call of the term of the investment security. For any debt security with a fair value less than its amortized cost basis, Salisbury will determine whether it has the intent to sell the debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, Salisbury will recognize a full impairment charge to earnings. For all other debt securities that are considered OTTI and do not meet either condition, the credit loss portion of impairment will be recognized in earnings as realized losses. The OTTI related to all other factors will be recorded in other comprehensive income. Declines in marketable equity securities below their cost that are deemed other than temporary are reflected in earnings as realized losses.

**Federal Home Loan Bank of Boston Stock**

The Bank is a member of the Federal Home Loan Bank of Boston (“FHLBB”). The FHLBB is a cooperative that provides services, including funding in the form of advances, to its member banking institutions. As a requirement of membership, the Bank must own a minimum amount of FHLBB stock, calculated periodically based primarily on its level of borrowings from the FHLBB. No market exists for shares of the FHLBB and therefore, they are carried at par value. FHLBB stock may be redeemed at par value five years following termination of FHLBB membership, subject to limitations which may be imposed by the FHLBB or its regulator, the Federal Housing Finance Board, to maintain capital adequacy of the FHLBB. While the Bank currently has no intentions to terminate its FHLBB membership, the ability to redeem its investment in FHLBB stock would be subject to the conditions imposed by the FHLBB. In 2008, the FHLBB announced to its members that it is focusing on preserving capital in response to ongoing market volatility including the extension of a moratorium on excess stock repurchases and in 2009 announced the suspension of its quarterly dividends. On February 22, 2011, the FHLBB declared a modest cash dividend payable to its members on March 2, 2011. The FHLBB continued to declare modest cash dividends through 2013. Based on the capital adequacy and the liquidity position of the FHLBB, management believes there is no impairment related to the carrying amount of the Bank’s FHLBB stock as of December 31, 2013. Further deterioration of the FHLBB’s capital levels may require the Bank to deem its restricted investment in FHLBB stock to be OTTI. If evidence of impairment exists in the future, the FHLBB stock would reflect fair value using either observable or unobservable inputs. The Bank will continue to monitor its investment in FHLBB stock.

**Loans**

Loans receivable consist of loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off. Loans receivable are reported at their principal outstanding balance, net of unamortized deferred loan origination fees and costs. Interest income is accrued on the unpaid principal balance. Deferred loan origination fees and costs are amortized as an adjustment to yield over the lives of the related loans.

Loans held-for-sale consist of residential mortgage loans that management has the intent to sell. Loans held-for-sale are valued at the lower of cost or market as determined by outstanding commitments from investors or current investor yield requirements calculated on the aggregate loan basis, net of deferred loan origination fees and costs. Changes in the carrying value, deferred loan origination fees and costs, and realized gains and losses on sales of loans held-for-sale are reported in earnings as gains and losses on sales of mortgage loans, net, when the proceeds are received from investors.

The accrual of interest on loans, including troubled debt restructured loans, is generally discontinued when principal or interest is past due by 90 days or more, or earlier when, in the opinion of management, full collection of principal or interest is unlikely, except for loans that are well collateralized, in the process of collection and where full collection of principal and interest is assured. When a loan is placed on non-accrual status, interest previously accrued but not collected is reversed against current income. Income on such loans, including impaired loans, is then recognized only to the extent that cash is received and future collection of principal is probable. Loans, including troubled debt restructured loans, are restored to accrual status when principal and interest payments are brought current and future payments are reasonably assured, following a sustained period of repayment performance by the borrower in accordance with the loan's contractual terms.

Troubled debt restructured loans include those for which concessions such as reduction of interest rates, other than normal market rate adjustments, or deferral of principal or interest payments, extension of maturity dates, or reduction of principal balance or accrued interest, have been granted due to a borrower's financial condition. The decision to restructure a loan, versus aggressively enforcing the collection of the loan, may benefit Salisbury by increasing the ultimate probability of collection.

Troubled debt restructured loans are classified as accruing or non-accruing based on management's assessment of the collectability of the loan. Loans which are already on non-accrual status at the time of the troubled debt restructuring generally remain on non-accrual status for approximately six months before management considers such loans for return to accruing status. Accruing troubled debt restructured loans are generally placed into non-accrual status if and when the borrower fails to comply with the restructured terms.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of the probable credit losses inherent in the loan portfolio as of the reporting date. The allowance is increased by provisions charged to earnings and by recoveries of amounts previously charged off, and is reduced by loan charge-offs. Loan charge-offs are recognized when management determines a loan or portion of a loan to be uncollectible.

The determination of the adequacy of the allowance is based on management's ongoing review of numerous factors, including the growth and composition of the loan portfolio, historical loss experience over an economic cycle, probable credit losses based upon internal and external portfolio reviews, credit risk concentrations, changes in lending policy, current economic conditions, analysis of current levels and asset quality, delinquency levels and trends, estimates of the current value of underlying collateral, the performance of individual loans in relation to contract terms, and other pertinent factors.

While management believes that the allowance for loan losses is adequate, the allowance is an estimate, and ultimate losses may vary from management's estimate. Future additions to the allowance may also be necessary based on changes in assumptions and economic conditions. In addition, various regulatory agencies periodically review the allowance for loan losses. Such agencies may require additions to the allowance based on their judgments about information available to them at the time of their examination.

Changes in the estimate are recorded in the results of operations in the period in which they become known, along with provisions for estimated losses incurred during that period.

The allowance for loan losses is computed by segregating the portfolio into three components: (1) loans collectively evaluated for impairment: general loss allocation factors for non-impaired loans based on loan product, collateral type and abundance, loan risk rating, historical loss experience, delinquency factors and other similar economic indicators, (2) loans individually evaluated for impairment: individual loss allocations for loans deemed to be impaired based on discounted cash flows or collateral value, and (3) unallocated: general loss allocations for other environmental factors.

Loans collectively evaluated for impairment

This component of the allowance for loan losses is stratified by the following loan segments: residential real estate secured (residential 1-4 family and 5+ multifamily, construction of residential 1-4 family, and home equity credit), commercial real estate secured (commercial and construction of commercial), secured by land (farm and vacant land), commercial and industrial, municipal and consumer. Management's general loss allocation factors are based on expected loss experience adjusted for historical loss experience and other qualitative factors, including levels/trends in delinquencies; trends in volume and terms of loans; effects of changes in risk selection and underwriting standards and other changes in lending policies, procedures and practices; experience/ability/depth of lending management and staff;

and national and local economic trends and conditions. There were no changes in Salisbury's policies or methodology pertaining to the general component of the allowance for loan losses during 2013.

The qualitative factors are determined based on the various risk characteristics of each loan segment. Risk characteristics relevant to each portfolio segment are as follows:

Residential real estate - Salisbury generally does not originate loans with a loan-to-value ratio greater than 80 percent and does not grant subprime loans. All loans in this segment are collateralized 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 segment.

Commercial real estate - Loans in this segment are primarily income-producing properties throughout Salisbury's market area. The underlying cash flows generated by the properties are adversely impacted by a downturn in the economy as evidenced by increased vacancy rates which, in turn, will have an effect on the credit quality in this segment. For commercial loans management annually obtains business and personal financial statements, tax returns, and, where applicable, rent rolls, and continually monitors the repayment of these loans.

Construction loans - Loans in this segment are primarily residential construction loans which typically roll into a permanent residential mortgage loan when construction is completed, or commercial construction which consist primarily of owner occupied commercial construction projects.

Commercial loans - Loans in this segment are made to businesses and are generally secured by assets of the business. Repayment is expected from the cash flows of the business. A weakened economy, and resultant decreased consumer spending, has an effect on the credit quality in this segment.

Consumer loans - Loans in this segment are generally unsecured and repayment is dependent on the credit quality of the individual borrower.

Loans individually evaluated for impairment

This component relates to loans that are classified as impaired. Impairment is measured on a loan by loan basis for all portfolio loans except consumer loans, by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value) of the impaired loan is lower than the carrying value of that loan.

A loan is considered impaired when, based on current information and events, it is probable that Salisbury will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Salisbury periodically may agree to modify the contractual terms of loans. When a loan is modified and a concession is made to a borrower experiencing financial difficulty, the modification is considered a troubled debt restructuring ("TDR"). All TDRs are classified as impaired.

Unallocated

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating allocated and general reserves in the portfolio.

Other Real Estate Owned ("OREO")

Salisbury's loans collateralized by real estate and all other real estate owned ("OREO") are located principally in northwestern Connecticut and nearby New York and Massachusetts towns, which constitute Salisbury's service area. Accordingly, the collectability of a substantial portion of the loan portfolio and OREO is particularly susceptible to changes in market conditions in Salisbury's service area. While management uses available information to recognize losses on loans and OREO, future additions to the allowance or write-downs of OREO may be necessary based on changes in local economic conditions, particularly in Salisbury's service area. In addition, various regulatory agencies, as an integral part of their examination process, periodically review Salisbury's allowance for loan losses and valuation of OREO. Such agencies may require Salisbury to recognize additions to the allowance or write-downs based on their judgments of information available to them at the time of their examination.

OREO consists of properties acquired through foreclosure or a deed in lieu of foreclosure. These properties are carried at the lower of cost or fair value less estimated costs to sell. Any write-down from cost to estimated fair value required at the time of foreclosure is charged to the allowance for loan losses. A valuation allowance is maintained for declines in market value and for estimated selling expenses. Increases to the valuation allowance, expenses associated with ownership of these properties, and gains and losses from their sale are included in OREO expense.

Income Taxes

Deferred income taxes are provided for differences arising in the timing of income and expenses for financial reporting and for income tax purposes using the asset/liability method of accounting for income taxes. Deferred income taxes and tax benefits are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Salisbury provides deferred taxes for the estimated future tax effects attributable to temporary differences and carry-forwards when realization is assured beyond a reasonable doubt.

Bank Premises and Equipment

Bank premises, furniture and equipment are carried at cost, less accumulated depreciation and amortization computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized on the straight-line basis over the shorter of the estimated useful lives of the improvements or the term of the related leases.

Intangible Assets

Intangible assets consist of core deposit intangibles and goodwill. Intangible assets equal the excess of the purchase price over the fair value of the tangible net assets acquired in acquisitions accounted for using the acquisition method of accounting. Salisbury's assets at December 31, 2013, and 2012, include goodwill of $2,358,000 arising from the purchase of a branch office in 2001, $7,152,000 arising from the 2004 acquisition of Canaan National Bancorp, Inc. and $319,000 arising from the 2007 purchase of a branch office in New York State. See Note 7.

On an annual basis management assesses intangible assets for impairment, and for the year ending December 31, 2013, concluded there was no impairment. If a permanent loss in value is indicated, an impairment charge to income will be recognized.

Statement of Cash Flows

For the purpose of the Consolidated Statements of Cash Flows, cash and cash equivalents include cash and due from banks and interest-bearing demand deposits with other financial institutions.

Computation of Earnings per Share

Basic earnings per share are computed using the weighted-average common shares outstanding during the year. The computation of diluted earnings per share is similar to the computation of basic earnings per share except the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. See Note 21.

Recent Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board (FASB) issued ASU 2011-11, "Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities." The objective of this ASU is to enhance current disclosures. Entities are required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement. The amendments in this ASU are effective for annual periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In October 2012, the FASB issued ASU 2012-06, "Business Combinations (Topic 805): Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution." The amendments in this update clarify the applicable guidance for subsequently measuring an indemnification asset recognized as a result of a government-assisted acquisition of a financial institution. The amendments in this update are effective for fiscal years, and interim periods within those years beginning on or after December 15, 2012. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income." The amendments in this update 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. Early adoption is permitted. The required disclosures have been reflected in the accompanying footnotes to the consolidated financial statements.

In February 2013, the FASB issued ASU 2013-04, "Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date." The objective of the amendments in this ASU is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, except for obligations addressed within existing guidance in U.S. generally accepted accounting principles (GAAP). Examples of obligations within the scope of this ASU include debt arrangements, other contractual obligations, and settled litigation and judicial rulings. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013; and should be applied retrospectively to all prior periods presented for those obligations resulting from joint and several liability arrangements within the ASU scope that exist at the beginning of an entity's fiscal year of adoption. The Company anticipates that the adoption of this guidance will not have a material impact on its consolidated financial statements.

In April 2013, the FASB issued ASU 2013-07, "Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting." The amendments in this ASU are being issued to clarify when an entity should apply the liquidation basis of accounting. The guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting. Additionally, the amendments require disclosures about an entity's plan for liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process. The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. The Company anticipates that the adoption of this guidance will not have an impact on its consolidated financial statements.

In July 2013, the FASB issued ASU 2013-10, "Derivatives and Hedging (Topic 815) – Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes." The amendments in this ASU permit the Fed Funds Effective Swap Rate (OIS) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to Treasury Obligations of the U.S.

government (UST) and the London Interbank Offered Rate (LIBOR). The amendments also remove the restriction on using different benchmark rates for similar hedges. The amendments apply to all entities that elect to apply hedge accounting of the benchmark interest rate under Topic 815. The amendments are effective prospectively for qualifying new or redesignated hedging relationships entered into on or after July 17, 2013. The adoption of this ASU did not have an impact on the Company's results of operations or financial position.

In July 2013, the FASB issued ASU 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." The amendments in this ASU provide guidance for the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amendments in this ASU are expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments apply to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this guidance is not expected to have an impact on the Company's results of operations or financial position.

In January 2014, the FASB issued ASU 2014-01, "Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects." The amendments in this ASU apply to all reporting entities that invest in qualified affordable housing projects through limited liability entities that are flow-through entities for tax purposes as follows:

1. For reporting entities that meet the conditions for and that elect to use the proportional amortization method to account for investments in qualified affordable housing projects, all amendments in this ASU apply.
2. For reporting entities that do not meet the conditions for or that do not elect the proportional amortization method, only the amendments in this ASU that are related to disclosures apply.

The amendments in this ASU permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). For those investments in qualified affordable housing projects not accounted for using the proportional amortization method, the investment should be accounted for as an equity method investment or a cost method investment in accordance with Subtopic 970-323. The amendments in this ASU should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The amendments in this ASU are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2014. Early adoption is permitted. The Company does not expect that the adoption of this ASU will have an impact on the Company's consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, “Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure.” The objective of the amendments in this ASU is to reduce diversity by clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments in this ASU clarify that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. An entity can elect to adopt the amendments in this ASU using either a modified retrospective transition method or a prospective transition method. The Company is reviewing this ASU to determine if there will be a material impact on its consolidated financial statements.

NOTE 2 - SECURITIES

The composition of securities is as follows:

| (in thousands) | Amortized cost (1) | Gross un-realized gains | Gross un-realized losses | Fair value |
|---|---|---|---|---|
| December 31, 2013 | | | | |
| Available-for-sale | | | | |
| U.S. Treasury notes | $ 2,497 | $ 160 | $— | $ 2,657 |
| U.S. Government Agency notes | 2,507 | 83 | — | 2,590 |
| Municipal bonds | 41,775 | 782 | (2,120) | 40,437 |
| Mortgage-backed securities | | | | |
| U.S. Government Agencies | 33,522 | 442 | (72) | 33,892 |
| Collateralized mortgage obligations | | | | |
| U.S. Government Agencies | 3,545 | 35 | — | 3,580 |
| Non-agency | 7,923 | 401 | (16) | 8,308 |
| SBA bonds | 2,042 | 188 | — | 2,230 |
| Preferred Stock | 20 | 777 | — | 797 |
| Total securities available-for-sale | $ 93,831 | $ 2,868 | $ (2,208) | $ 94,491 |
| Non-marketable securities | | | | |
| Federal Home Loan Bank of Boston stock | $ 5,340 | $— | $— | $ 5,340 |

(1) Net of other-than-temporary impairment write-downs recognized in earnings.

| (in thousands) | Amortized cost (1) | Gross un-realized gains | Gross un-realized losses | Fair value |
|---|---|---|---|---|
| December 31, 2012 | | | | |
| Available-for-sale | | | | |
| U.S. Treasury notes | $ 2,496 | $ 237 | $ — | $ 2,733 |
| U.S. Government Agency notes | 7,515 | 211 | — | 7,726 |
| Municipal bonds | 45,395 | 2,138 | (168) | 47,365 |
| Mortgage-backed securities | | | | |
| U.S. Government Agencies | 47,465 | 1,284 | (20) | 48,729 |
| Collateralized mortgage obligations | | | | |
| U.S. Government Agencies | 5,131 | 66 | — | 5,197 |
| Non-agency | 11,081 | 494 | (68) | 11,507 |
| SBA bonds | 2,781 | 82 | — | 2,863 |
| Preferred Stock | 20 | 147 | — | 167 |
| Total securities available-for-sale | $ 121,884 | $ 4,659 | $ (256) | $ 126,287 |
| Non-marketable securities | | | | |
| Federal Home Loan Bank of Boston stock | $ 5,747 | $ — | $ — | $ 5,747 |

Sales of securities available-for-sale and gains realized are as follows:

| Years ended December 31, (in thousands) | 2013 | 2012 | 2011 |
|---|---|---|---|
| Proceeds | $— | $ 2,771 | $— |
| Gains realized | — | 267 | — |
| Losses realized | — | — | — |

| | | | |
|---|---|---|---|
| Net gains realized | — | 267 | — |
| Income tax provision | — | 91 | — |

47

The following table summarizes, for all securities, including debt securities for which a portion of other-than-temporary impairment has been recognized in other comprehensive income, in an unrealized loss position, the aggregate fair value and gross unrealized loss of securities that have been in a continuous unrealized loss position as of the dates presented:

| (in thousands) | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair Value | Unrealized losses |
| December 31, 2013 | | | | | | |
| Available-for-sale | | | | | | |
| Municipal bonds | $19,714 | $ 1,428 | $2,323 | $ 692 | $22,037 | $ 2,120 |
| Mortgage-backed securities | 15,096 | 20 | 2,132 | 52 | 17,228 | 72 |
| Collateralized mortgage obligations | | | | | | |
| Non-agency | 398 | 2 | 294 | 10 | 692 | 12 |
| Total temporarily impaired securities | 35,208 | 1,450 | 4,749 | 754 | 39,957 | 2,204 |
| Other-than-temporarily impaired securities | | | | | | |
| Collateralized mortgage obligations | | | | | | |
| Non-agency | | | | | | |