SALISBURY BANCORP INC
Form 10-K
March 30, 2015

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, 2014

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	06-1514263
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
5 Bissell Street, Lakeville, CT	06039
(Address of principal executive offices)	(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	NASDAQ Capital Market
(Title of each class)	(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, 2014 was $51.4 million based on the closing sales price of $30.01 of such stock. The number of shares of the registrant’s Common Stock outstanding as of March 1, 2015, was 2,727,516.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for the 2015 Annual Meeting of Shareholders to be held on May 20, 2015, which will be filed within 120 days of fiscal year ended December 31, 2014, 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, 2014

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 its Subsidiary, Salisbury Bank and Trust Company ("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 its operation and control 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 thirteen banking offices and nine ATMs located in: Litchfield County, Connecticut; Dutchess and Orange County, New York; and Berkshire County, Massachusetts and through its internet website (www.salisburybank.com).

In December 2014, the Bank completed its acquisition of Riverside Bank of Poughkeepsie, New York, adding four new offices and a strong commercial lending focus to Salisbury’s New York market presence.

Abbreviations Used Herein

Bank	Salisbury Bank and Trust Company	FRA	Federal Reserve Act
BHC	Bank Holding Company	FRB	Federal Reserve Board
BHCA	Bank Holding Company Act	GAAP	Generally Accepted Accounting Principles in the United States of America
BOLI	Bank Owned Life Insurance	GLBA	Gramm-Leach-Bliley Act
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, New York’s Dutchess, Orange and Ulster Counties and Massachusetts’ Berkshire County in towns proximate to the Bank’s thirteen full service offices.

3

Real estate secured the majority of the Bank's loans as of December 31, 2014, 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. Loan portfolios acquired in business combinations include commercial loans acquired with Riverside Bank.

Residential Real Estate Loans

A principal lending activity of the Bank is to originate 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/amortizations of up to ten and twenty five years, respectively, 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 or commercial properties.

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. The typical 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, the 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 normally indexed to the prime rate as published in the Wall Street Journal.

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 second mortgages placed on one-to-four family owner-occupied properties. Home equity loans have fixed interest rates, while home equity lines of credit adjust based on the prime rate as published in the Wall Street Journal. 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: ensuring compliance with prudent written policies; 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 and risk rating 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 and 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 loan review 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, Senior Management, and the Board level Loan and Audit Committees.

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. Types of securities in the portfolio generally include U.S. Government and Agency securities, mortgage-backed securities, collateralized mortgage obligations and 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 primarily received through the Bank's banking offices. Additional depositor related services provided to customers include Landlord/Tenant Lease Security Accounts and Services, 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 with Account Aggregation 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, which 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 is 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.

Recent Acquisitions

On June 6, 2014, the Bank completed its purchase and assumption of the Sharon, Connecticut branch of Union Savings Bank, which included deposits of approximately $18 million at a premium of 2.32%. Operations of the Bank's existing Sharon, Connecticut branch were consolidated into this new location. On December 5, 2014, the Bank completed its acquisition of all shares of common stock of Riverside Bank of Poughkeepsie, New York, adding four new offices and a strong commercial loan focus to Salisbury's New York market presence. Such transaction was valued at approximately $27 million. In the merger, Riverside Bank shareholders had a right to receive 1.35 shares of Salisbury Bancorp, Inc. common stock for each share of Riverside Bank common stock.

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, 2014, the Bank had 152 full-time employees and 30 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 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 thirteen banking offices, four of which are located in Connecticut's Litchfield County; three of which are located in Massachusetts' Berkshire County; five of which are located in New York's Dutchess County, and one of which is located in New York's Orange 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 these 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.

6

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.

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 its view that, generally, 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 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.

<u>Connecticut Banking Laws and Supervision</u>

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 Authority

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.

On July 2, 2013, the Federal Reserve Bank (FRB) approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. On April 8, 2014, the FDIC adopted as final its interim final rule, which is identical in substance to the final rules issued by the FRB in July 2013. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Bank. The rules include a new common equity Tier 1 capital risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

The phase-in period for the final rules began for the Bank on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule and should be fully phased-in by January 1, 2019. Management believes that the Bank's capital levels will remain characterized as "well-capitalized" under the new rules.

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, 2014, 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 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 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 least every three (3) years. 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.

In 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 2014, the first $13.3 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 $13.3 million up to and including $89.0 million (which may be adjusted by the FRB). A 10% reserve ratio will be assessed on net transaction accounts in excess of $89.0 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 is in compliance with this requirement. At December 31, 2014, the Bank had FHLBB stock of $3.5 million and FHLBB advances of $28.8 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.

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 (CPP), 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, 2014 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 (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 Differential	19-20
II.	Investment Portfolio	25, 52-54
III.	Loan Portfolio	26-32, 55-64
IV.	Summary of Loan Loss Experience	21-23, 61-64
V.	Deposits	32, 66
VI.	Return on Equity and Assets	17
VII.	Short-Term Borrowings	32, 67

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.

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. 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 was determined to be other-than-temporarily impaired, Salisbury would recognize a material charge or its earnings and its capital ratios would be adversely impacted.

As of December 31, 2014, Salisbury had $2.1 million of after-tax unrealized gains associated with its portfolio of securities available-for-sale, compared with $0.4 million of after-tax unrealized gains at December 31, 2013. 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 2014.

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, 2014, Salisbury had $12.6 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 "Regulation and Supervision" 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
- Changes in the economic environment of the market areas the Bank serves

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 system is 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.

The risks presented by recent or future acquisitions could adversely affect our financial condition and results of operations.

Our business strategy has included, and may continue to include, growth through acquisition from time to time. Any recent and future acquisitions will be accompanied by the risks commonly encountered in acquisitions. These risks may include, among other things: our ability to realize anticipated cost savings; the difficulty of integrating operations and personnel; the loss of key employees; the potential disruption of our or the acquired company's ongoing business in such a way that could result in decreased revenues; the inability of our management to maximize our financial and strategic position; the inability to maintain uniform standards, controls, procedures and policies; and the impairment of relationships with the acquired company's employees and customers as a result of changes in ownership and management.

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 twelve full service branch offices located in Canaan, Salisbury and Sharon, Connecticut; Great Barrington, South Egremont and Sheffield, Massachusetts; and Dover Plains, Fishkill, Millerton, Newburgh, Poughkeepsie, and Red Oaks Mill, New York. 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 seven branch offices.

The Company acquired one branch in Sharon, Connecticut from Union Savings Bank on June 6, 2014, and acquired four branches from Riverside Bank on December 5, 2014.

For additional information, see Note 7, “Bank Premises and Equipment,” and Note 18, “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	5 Gay Street, Sharon, CT	Leased	03/31/21
Canaan Operations	94 Main Street, Canaan, CT	Owned	-
Canaan Office	100 Main Street, Canaan, CT	Owned	-
South Egremont Office	51 Main Street, South Egremont, MA	Leased	9/10/16
Sheffield Office	640 North Main, Street, Sheffield, MA	Owned	-
Gt. Barrington Office	210 Main Street, Gt. Barrington, MA	Leased	4/30/29
Millerton Office	87 Main Street, Millerton, NY	Owned	-
Poughkeepsie Office	11 Garden Street, Poughkeepsie, NY	Owned	-
Fishkill Office	1004 Main Street, Fishkill, NY	Leased	12/31/20
Red Oaks Mill Office	2064 New Hackensack Road, Poughkeepsie, NY	Leased	7/31/23
Newburgh Office	52 Route 17K, Newburgh, NY	Leased	3/31/18
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, which are not material, arising in 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, 387,000 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 proceeded 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.

In a decision issued on June 2, 2014, the Court dismissed Erling Christophersen's special defense, and made findings as to the amount of the debt owed by Erling Christophersen and the value of the property, reserving judgment on whether to order a strict foreclosure or foreclosure by sale pending a hearing on the amount of attorneys' fees accrued, and the debt accrued since the commencement of the trial. That hearing was held on July 29, 2014. On July 25, 2014, Erling Christophersen moved to disqualify the Bank's counsel, seeking, in part, the remedy of a new trial. The Court denied that motion in a decision dated July 30, 2014. On August 5, 2014, the Court issued a Judgment of Strict Foreclosure (the "Judgment") in favor of the Bank and set September 16, 2014 as the Law Day, which is the final date fixed by the Court on which the debtor can pay off the debt or redeem the real property, with subsequent dates for subsequent encumbrances in inverse order of priority.

On September 15, 2014, Christophersen moved to open the Judgment, which motion was denied by order of the Court dated September 30, 2014. On October 3, 2014, Christophersen filed an Appeal of the Judgment and of the denial of his motion to reopen. Salisbury Bank moved to dismiss the Appeal on October 24, 2014, on grounds that Christophersen cannot represent the Trust as he is not an attorney, and that Christophersen in his individual capacity does not have any interest in this appeal. On December 17, 2014, the motion was granted in part and dismissed in part, but the decision is moot because counsel submitted an appearance on behalf of the Trust on December 29, 2014.

On January 20, 2015, Christophersen filed a motion for reconsideration, which motion was denied by order of the Appellate Court on February 10, 2015. After a pre-argument conference, which is scheduled for April 10, 2015, the parties will submit briefs to the court. The court will then schedule oral arguments and render a decision thereafter.

There are no other material pending legal proceedings, other than ordinary routine litigation incidental 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 OF EQUITY SECURITIES

Market Information

For the information required by this item see Note 24 – "Selected Quarterly Consolidated Financial Data (Unaudited)" of Notes to Consolidated Financial Statements.

Holders

There were approximately 2,131 holders of record of the common stock of Salisbury as of March 1, 2015. 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 15 – "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,	2014	2013	2012	2011	2010
Statement of Income					
Interest and dividend income	$22,855	$21,750	$22,658	$24,044	$24,656
Interest expense	2,704	3,062	4,282	5,559	7,497
Net interest and dividend income	20,151	18,688	18,376	18,485	17,159
Provision for loan losses	1,134	1,066	1,070	1,440	1,000
Gains on securities, net	—	—	279	11	16
Trust and wealth advisory	3,295	3,074	2,945	2,548	2,102
Service charges and fees	2,473	2,298	2,189	2,090	2,006
Gains on sales of mortgage loans, net	64	579	1,596	687	816
Mortgage servicing, net	94	35	(21)	65	97
Other	326	319	326	255	270
Non-interest income	6,252	6,305	7,314	5,656	5,307
Non-interest expense	22,138	18,935	19,554	17,639	17,113
Income before income taxes	3,131	4,992	5,066	5,062	4,353
Income tax provision	610	909	989	950	693
Net income	2,521	4,083	4,077	4,112	3,660
Net income available to common shareholders	2,355	3,922	3,861	3,588	3,198
Financial Condition					
Total assets	$855,427	$587,109	$600,813	$609,284	$575,470
Loans receivable, net	673,330	438,178	388,758	370,766	352,449
Allowance for loan losses	5,358	4,683	4,360	4,076	3,920
Securities	94,827	99,831	132,034	161,876	153,510
Deposits	715,426	477,369	491,215	471,306	430,289
Federal Home Loan Bank of Boston advances	28,813	30,411	31,980	54,615	72,812
Repurchase agreements	4,163	2,554	1,784	12,148	13,190
Total shareholders' equity	101,821	72,790	71,997	66,862	55,016
Non-performing assets	11,985	7,549	10,104	10,820	10,751
Per Common Share Data					
Earnings, basic and diluted	$1.32	$2.30	$2.28	$2.12	$1.90
Cash dividends paid	1.12	1.12	1.12	1.12	1.12
Tangible book value	25.83	27.12	26.85	23.69	20.81
Statistical Data					
Net interest margin (taxable equivalent)	3.64 %	3.57 %	3.45 %	3.51 %	3.37 %
Efficiency ratio (taxable equivalent)	78.41	70.70	69.38	68.16	71.51
Effective tax rate	19.49	18.21	19.49	18.80	15.92
Return on average assets	0.37	0.66	0.64	0.61	0.56
Return on average common shareholders' equity	3.88	7.01	7.22	7.26	6.93
Dividend payout ratio	81.43	48.83	49.02	52.70	59.09

Allowance for loan losses to loans receivable, gross	0.79	1.06	1.11	1.09	1.10
Non-performing assets to total assets	1.45	1.29	1.68	1.78	1.87
Tier 1 leverage capital	12.31	10.65	9.87	9.45	8.39
Total risk-based capital	14.27	16.46	16.63	15.97	13.91
Weighted average common shares outstanding, basic	1,764	1,691	1,690	1,689	1,687
Weighted average common shares outstanding, diluted	1,765	1,691	1,690	1,689	1,688

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 thirteen full-service offices in the towns of: Canaan, Lakeville, Salisbury and Sharon, Connecticut; Great Barrington, South Egremont and Sheffield, Massachusetts; and, Fishkill, Newburgh, Poughkeepsie, Red Oaks Mill, Dover Plains and Millerton, New York, and its trust and wealth advisory services from offices in Lakeville, Connecticut. In May 2014, the Bank established a new branch in Great Barrington, Massachusetts. In June 2014, the Bank acquired a branch office and related deposits from another institution in Sharon, Connecticut and consolidated its existing Sharon office with the new branch.

Additionally, on December 5, 2014, Salisbury completed its acquisition of Riverside Bank of Poughkeepsie, New York, adding four new offices and a strong commercial loan focus to Salisbury's New York market presence.

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 which, 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.

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

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.

OVERVIEW AND HIGHLIGHTS

Selected 2014 highlights are as follows:

- On June 6, 2014, Salisbury completed its purchase and assumption of a branch of Union Savings Bank in Sharon, CT, which included the acquisition of approximately $18.2 million in deposits at a premium of 2.32%. Operations of the Bank's existing branch in Sharon, CT were then consolidated into the new Sharon, CT location.
- On December 5, 2014, Salisbury completed its acquisition of Riverside Bank of Poughkeepsie, NY. Such acquisition added four (4) additional branch offices to the Bank's branch network and approximately $211 million in deposits and $204 million in loans.
- Net income available to common shareholders was $2,355,000, or $1.32 per common share, for 2014, compared with $3,922,000, or $2.30 per common share, for 2013.
- Net interest and dividend income (tax equivalent basis) increased $1,520,000 or 7.6%. Earnings per common share excluding one-time expenses related to strategic initiatives of $1.7 million (net of taxes), or $0.94 per share, would have been $2.26 per share or a slight decrease of $0.04 compared to 2013.
- Non-interest expense increased $3,203,000, or 16.9%.

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, 2014 and 2013

Net Interest and Dividend Income

Net interest and dividend income (presented on a tax-equivalent basis) increased $1,520,000 in 2014 over 2013. The net interest margin increased 7 basis points to 3.64% from 3.57% due to an 11 basis point decline in the average cost of interest-bearing liabilities and a 2 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)	2014	2013	2012	2014	2013	2012	2014	2013	2012
Loans (a)(d)	$473,706	$419,193	$381,886	$20,041	$18,250	$18,153	4.23 %	4.35 %	4.75 %
Securities (c)(d)	86,956	106,603	134,817	3,980	4,650	5,506	4.58	4.36	4.08
FHLBB stock	4,343	5,417	5,801	71	21	30	1.63	0.39	0.51
Short term funds (b)	24,407	26,281	41,854	58	67	90	0.24	0.25	0.21
Total earning assets	589,412	557,494	564,358	24,150	22,988	23,779	4.10	4.12	4.21
Other assets	41,737	37,966	40,444						
Total assets	$631,149	$595,460	$604,802						
Interest-bearing demand deposits	$84,212	$75,185	$65,953	266	278	353	0.32	0.37	0.54
Money market accounts	130,618	128,951	128,619	299	330	420	0.23	0.26	0.33
Savings and other	116,524	106,224	99,528	204	206	281	0.18	0.19	0.28
Certificates of deposit	87,516	88,352	98,974	696	999	1,360	0.80	1.13	1.37
	418,870	398,712	393,074	1,465	1,813	2,414	0.35	0.45	0.61

Total interest-bearing deposits									
Repurchase agreements	4,598	3,035	5,879	8	6	23	0.18	0.19	0.39
Capital lease	424	—	—	47	—	—	11.08	—	—
FHLBB advances	30,214	31,176	43,605	1,184	1,243	1,845	3.92	3.99	4.23
Total interest-bearing liabilities	454,106	432,923	442,558	2,704	3,062	4,282	0.60	0.71	0.97
Demand deposits	96,199	84,416	84,385						
Other liabilities	4,058	6,162	8,391						
Shareholders' equity	76,786	71,959	69,468						
Total liabilities & shareholders' equity	$631,149	$595,460	$604,802						
Net interest income				$21,446	$19,926	$19,497			
Spread on interest-bearing funds							3.50	3.41	3.24
Net interest margin (e)							3.64	3.57	3.45

(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 $1,295,000, $1,238,000 and $1,121,000, respectively for 2014, 2013 and 2012 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.

22

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)	2014 versus 2013			2013 versus 2012		
Change in interest due to	Volume	Rate	Net	Volume	Rate	Net
Loans	$2,341	$(550)	$1,791	$1,699	$(1,602)	$97
Securities	(878)	208	(670)	(1,191)	335	(856)
FHLBB stock	(11)	61	50	(2)	(7)	(9)
Short term funds	(4)	(5)	(9)	(37)	14	(23)
Interest-earning assets	1,448	(286)	1,162	469	(1,260)	(791)
Deposits	46	(394)	(348)	(74)	(527)	(601)
Repurchase agreements	3	(1)	2	(8)	(9)	(17)
Capital lease	24	23	47	—	—	—
FHLBB advances	(37)	(22)	(59)	(511)	(91)	(602)
Interest-bearing liabilities	36	(394)	(358)	(593)	(627)	(1,220)
Net change in net interest income	$1,412	$108	$1,520	$1,062	$(633)	$429

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 increased $1.2 million, or 5.1%, to $24.2 million in 2014.

Loan income increased $1.8 million, or 9.8%, primarily due to a $54.5 million, or 13.0%, increase in average loans. This increase in volume was partially offset by a 12 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 2014.

Tax equivalent interest and dividend income from securities decreased $670,000, or 14.4%, in 2014, as a result of a $19.6 million decrease in average security balances, offset partially by a 22 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 $9,000 in 2014 as a result of a $1.9 million decrease in average short term balances and by a 1 basis point decrease in average yield.

Interest Expense

Interest expense decreased $358,000, or 11.7%, to $2.7 million in 2014.

Interest expense on interest bearing deposit accounts decreased $348,000, or 19.2%, in 2014, as a result of a 10 basis point decline in the average rate, to 0.35%, offset in part by a $20.2 million, or 5.1%, 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 expense on FHLBB advances decreased $59,000, or 4.7%, due to a $962,000, or 3.1%, decrease in average advances as a result of scheduled maturities. The average borrowing rate decreased to 3.92% from 3.99%.

Provision and Allowance for Loan Losses

The provision for loan losses was $1,134,000 for 2014, compared with $1,066,000 for 2013. Net loan charge-offs were $459,000 and $743,000, for the respective years. The higher provision for loan losses was supported by maintaining an adequate allowance to gross loans as gross loans continue to increase.

The following table sets forth changes in the allowance for loan losses and other statistical data:

Business Activities Loans

Years ended December 31, (dollars in thousands)	2014	2013	2012	2011	2010
Balance, beginning of period	$4,683	$4,360	$4,076	$3,920	$3,473
Provision for loan losses	1,113	1,066	1,070	1,440	1,000
Real estate mortgages	(512)	(700)	(573)	(985)	(437)
Commercial and industrial	(19)	(4)	(222)	(180)	(95)
Consumer	(28)	(70)	(91)	(201)	(50)
Unallocated	—	—	—	—	—
Charge-offs	(559)	(774)	(886)	(1,366)	(582)
Real estate mortgages	60	6	36	26	—
Commercial and industrial	16	1	38	29	—
Consumer	24	24	26	27	29
Unallocated	—	—	—	—	—
Recoveries	100	31	100	82	29
Net (charge-offs) recoveries	(459)	(743)	(786)	(1,284)	(553)
Balance, end of period	$5,337	$4,683	$4,360	$4,076	$3,920

Acquired Loans

Years ended December 31, (dollars in thousands)	2014
Balance, beginning of period	$—
Provision for loan losses	21
Real estate mortgages	—
Commercial and industrial	—
Unallocated	—
Charge-offs	—
Real estate mortgages	—
Commercial and industrial	—
Unallocated	—
Recoveries	—
Net (charge-offs) recoveries	—
Balance, end of period	$21

	2014	2013	2012	2011	2010
Loans receivable, gross	$677,485	$441,679	$392,086	$373,838	$355,547
Non-performing loans	9,890	7,172	9,860	8,076	10,141
Accruing loans past due 30-89 days	4,128	5,374	5,629	2,460	1,917
Ratio of allowance for loan losses:					
to loans receivable, gross	0.79 %	1.06 %	1.11 %	1.09 %	1.10 %
to non-performing loans	54.18	65.30	44.22	50.47	38.65
Ratio of non-performing loans					
to loans receivable, gross	1.46	1.62	2.51	2.16	2.84
Ratio of accruing loans past due 30-89 days					
to loans receivable, gross	0.61	1.22	1.44	0.66	0.54

The reserve coverage at December 31, 2014, as measured by the ratio of allowance for loan losses to gross loans, was 0.79%, as compared with 1.06% at December 31, 2013. Non-performing loans (non-accrual loans and accruing loans past-due 90 days or more) increased $2.7 million to $9.9 million, or 1.46% of gross loans receivable, at December 31, 2014, down from 1.62% at December 31, 2013, while accruing loans past due 30-89 days decreased $1.2 million to $4.1 million, or 0.61% of gross loans receivable at December 31, 2014. 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:

Business Activities Loans

(in thousands)	December 31, 2014		December 31, 2013		December 31, 2012	
	Loans	Allowance	Loans	Allowance	Loans	Allowance
Performing loans	$457,744	$3,283	$416,734	$2,835	$364,594	$2,567
Potential problem loans	9,423	509	8,687	282	8,345	246
Unallocated	—	409	—	425	—	440
Collectively evaluated	467,167	4,201	425,421	3,542	372,939	3,253
Performing loans	—	—	157	69	121	52
Potential problem loans	11	—	429	19	2,464	131
Impaired loans	16,569	1,136	15,672	1,053	16,562	924
Individually evaluated	$16,580	$1,136	16,258	1,141	19,147	1,107
Totals	$483,747	$5,337	$441,679	$4,683	$392,086	$4,360

Acquired Loans

(in thousands)	December 31, 2014	
	Loans	Allowance
Performing loans	$187,966	$21
Potential problem loans	2,708	—
Unallocated	—	—
Collectively evaluated	190,674	21
Performing loans	—	—
Potential problem loans	—	—
Impaired loans	3,064	—
Individually evaluated	$3,064	$—
Totals	$193,738	$21

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.

December 31,	2014		2013		2012		2011		2010
(dollars in thousands)(a)	Allowance	Loans	Allowance	Loans	Allowance	Loans	Allowance	Loans	Allowance
Residential	$1,947	53.12 %	$1,545	54.34 %	$1,477	52.87 %	$1,097	52.47 %	$1,115
Commercial	1,704	24.37	1,385	23.04	1,059	23.45	1,139	23.81	1,152
Construction, land & land development	164	1.91	226	2.11	300	2.71	409	4.75	400
Home equity credit	359	7.20	393	7.92	457	9.03	382	9.27	361
Real estate secured	4,174	86.60	3,549	87.41	3,293	88.06	3,027	90.30	3,028
Commercial and industrial	597	11.25	561	10.72	499	9.94	704	7.85	592
Consumer	117	0.87	105	0.87	92	1.09	79	1.20	164
Municipal	61	1.28	43	1.00	36	0.91	24	0.65	—
General unallocated	409	—	425	—	440	—	242	—	136
	$5,358	100.00%	$4,683	100.00%	$4,360	100.00%	$4,076	100.00%	$3,920

Total
allowance
(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.

25

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 2014.

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 requiring increased provisions. In management's judgment, Salisbury remains adequately reserved both against total loans and non-performing loans at December 31, 2014.

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 adequacy and methodology of 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)	2014	2013	2012	2014 vs. 2013		2013 vs. 2012	
Gains on securities, net	$—	$—	$279	$—	0.0 %	$(279)	(100.0)%
Trust and wealth advisory	3,295	3,074	2,945	221	7.2	129	4.4
Service charges and fees	2,473	2,298	2,189	175	7.6	109	5.0
Gains on sales of mortgage loans, net	64	579	1,596	(515)	(88.9)	(1,017)	(63.7)
Mortgage servicing, net	94	35	(21)	59	168.6	56	266.7
Bank-owned life insurance	245	234	258	11	4.7	(24)	(9.3)
Other	81	85	68	(4)	(4.7)	17	25.0
Total non-interest income	$6,252	$6,305	$7,314	$(53)	(0.85)%	$(1,009)	(13.8)%

Non-interest income decreased $53,000, or 0.8%, in 2014 versus 2013. Trust and Wealth Advisory revenues increased $221,000 primarily due to increased market values and slightly higher estate fee income. Service charges and fees increased $175,000 due to increased interchange, deposit and loan servicing fees. Gains on sales of mortgage loans decreased $515,000 due to significantly lower mortgage volume of loans sold to the FHLBB Mortgage Partnership Finance Program. Mortgage loans sales totaled $4.4 million in 2014 versus $18.7 million in 2013. Income from servicing of mortgage loans increased $59,000 due primarily to a slow-down in amortization. Loans serviced under the FHLBB Mortgage Partnership Finance Program totaled $138.1 million and $146.3 million at December 31, 2014 and 2013, respectively. BOLI income increased $11,000 due to an increase in coverage held by the Bank.

Non-Interest Expense

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

Years ended December 31, (dollars in thousands)	2014	2013	2012	2014 vs. 2013		2013 vs. 2012	
Salaries	$8,029	$7,467	$7,149	$562	7.5 %	$318	4.4 %
Employee benefits	3,136	2,804	2,912	332	11.8	(108)	(3.7)
Premises and equipment	2,831	2,398	2,408	433	18.1	(10)	(0.4)
Data processing	1,502	1,514	1,569	(12)	(0.8)	(55)	(3.5)
Professional fees	1,331	1,212	1,212	119	9.8	—	—
Collections and OREO	458	519	709	(61)	(11.9)	(190)	(26.8)
Litigation settlement	—	—	400	—	—	(400)	(100.0)
FDIC insurance	461	470	486	(9)	(1.9)	(16)	(3.3)
Marketing and community support	396	393	356	3	0.8	37	10.4
Printing and stationery	240	205	230	35	17.1	(25)	(10.9)
Amortization of intangible assets	291	222	222	69	31.1	—	—
FHLBB advance prepayment fee	—	—	450	—	—	(450)	(100.0)
Merger and acquisition related expenses	1,974	312	—	1,662	532.7	312	100.0
Other	1,489	1,419	1,451	70	4.9	(32)	(2.2)
Non-interest expense	$22,138	$18,935	$19,554	$3,203	16.9 %	$(619)	(3.2)%

Non-interest expense increased $3.2 million, or 16.9%, in 2014 versus 2013. Salary expense increased $562,000 due to changes in staffing levels and mix, merit increases, and expenses related to the Riverside Bank acquisition. Employee benefit expense increased $332,000 primarily as a result of incurring $208,000 (pre-tax) of expenses related to the termination of the Bank's previously frozen defined benefit pension plan. Premises and equipment expense increased $433,000 primarily as a result of the opening of the Great Barrington, Massachusetts branch as well as the relocation, consolidation and renovation of the Sharon, Connecticut branch as a result of the acquisition of the Union Savings Bank branch in Sharon, Connecticut. Data processing expense decreased $12,000. Professional fees increased $119,000 primarily due to increased consulting, legal and other professional services. Collections and OREO expenses decreased $61,000 due to lower appraisal costs and lower OREO write-downs, offset partially by higher collection costs. Amortization of intangible assets increased $69,000 reflecting the increased intangible asset related to the Sharon branch acquisition and the Riverside Bank merger. Printing supplies increased $35,000 for the additional supplies needed at our new and acquired branches. Merger and acquisition related expenses were primarily related to legal fees, consulting, and data conversion expenses. All other operating expenses increased $64,000.

Income Taxes

The effective income tax rates for 2014 and 2013 were 19.49% and 18.21%, 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 12 of Notes to Consolidated Financial Statements.

Salisbury did not incur Connecticut income tax in 2014 or 2013, other than minimum state income tax, as a result of a Connecticut law that permits banks to shelter certain mortgage income from the Connecticut corporation business tax through the use of a special purpose entity called a Passive Investment Company or PIC. In 2004, Salisbury availed itself of this benefit 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, 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.

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 3.99% from 4.23%.

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 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.

Non-Interest Income

Non-interest income decreased $1.0 million, or 13.8%, in 2013 versus 2012. Trust and Wealth Advisory revenues for 2013 increased $129,000 from 2012 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

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.

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 benefit 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.

Overview

Assets

During 2014, Salisbury's assets increased by $268.3 million to $855.4 million at December 31, 2014. The acquisition of Riverside Bank, which closed on December 5, 2014, contributed $235.0 million in total asset growth, $196.3 million total loan growth and $211.2 million total deposit growth. Additionally, equity increased $27.3 million as result of the transaction. Additional details relating to the transaction may be found in Note 2 to the Consolidated Financial Statements. In addition to the balance sheet growth provided by the Riverside Bank acquisition, loans, deposits and equity grew $37.9 million, $8.8 million and $1.8 million, respectively. At December 31, 2014, Salisbury's tangible book value per common share was $25.83 and Tier 1 leverage and total risk-based capital ratios were 12.31% and 14.27%, respectively. Both Salisbury and the Bank are categorized as "well capitalized."

Securities and Short Term Funds

During 2014, securities decreased $5.0 million to $94.8 million, while short-term funds (interest-bearing deposits with other banks) increased to $22.8 million. The carrying values of securities are as follows:

Years ended December 31, (dollars in thousands)	2014	2013	2012
Available-for-Sale			
U.S. Treasury notes	$2,806	$2,657	$2,733
U.S. Government agency notes	5,874	2,590	7,726
Municipal bonds	40,352	40,437	47,365
Mortgage-backed securities	27,709	33,892	48,729
Collateralized mortgage obligations	9,275	11,888	16,704
SBA bonds	4,465	2,230	2,863
Other	831	797	167
Non-Marketable			
FHLBB stock	3,515	5,340	5,747
Total Securities	$94,827	$99,831	$132,034

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 are 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, 2014.

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 deemed the four remaining securities not to have additional OTTI and all other CMO securities not to be OTTI as of December 31, 2014. It is possible that future loss assumptions could change necessitating Salisbury to recognize future 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. 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, 2014	$2,452	$1,968	$2,369
December 31, 2013	3,093	2,534	2,724
December 31, 2012	4,446	3,748	3,817

Accumulated other comprehensive income at December 31, 2014 included net unrealized holding gains, net of tax, of $2.1 million, which is an increase of $1.7 million from December 31, 2013.

29

Loans

During 2014, net loans receivable increased $235.2 million, or 53.7%, to $673.3 million at December 31, 2014. Of this growth the acquisition of Riverside Bank contributed $196.3 million. Portfolio growth of $37.9 million during 2014, while lower than 2013's growth of $49.4 million, reflects Salisbury's strong market presence.

Salisbury's retail lending department originates residential mortgage, home equity loans and lines of credit, and consumer loans for the portfolio. During 2014, Salisbury originated $52.1 million of residential mortgage loans and $6.1 million of home equity loans for the portfolio, compared with $78.7 million and $6.5 million, respectively, in 2013. During 2014, total residential mortgage and home equity loans receivable grew by $40.4 million to $312.4 million at December 31, 2014, and represent 46.1% of loans receivable. Of the growth in residential mortgages, $18.0 million is attributable to the merger with Riverside Bank. During 2014, Salisbury's residential mortgage lending department also originated and sold $4.4 million of residential mortgage loans, compared with $18.4 million during 2013. All such sold loans were sold through the FHLBB Mortgage Partnership Finance Program with servicing retained by Salisbury. Consumer loans, amounting to $4.5 million at December 31, 2014, represent 0.7% of loans receivable. Of the growth in consumer loans, $0.1 million is attributable to the merger with Riverside Bank.

Salisbury's commercial lending department specializes in lending to small and mid-size companies, businesses and municipalities. More specifically, we meet our clients' credit needs 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 $68.5 million of commercial loans during 2014. During 2014, total commercial real estate, commercial and industrial and municipal loans increased $194.8 million to $360.6 million at December 31, 2014, and represent 53.2% of loans receivable. Growth in commercial real estate, commercial and industrial and municipal loans of $175.7 million are attributable to the merger with Riverside Bank.

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

Business Activities Loans

December 31, (in thousands)	2014	2013	2012	2011	2010
Residential 1-4 family	$252,258	$231,113	$198,552	$187,676	$173,932
Residential 5+ multifamily	5,556	4,848	3,889	3,187	2,889
Construction of residential 1-4 family	2,004	1,876	2,379	5,305	8,948
Home equity credit	34,627	34,139	34,162	34,621	34,164
Residential real estate	294,445	271,976	238,982	230,789	219,933
Commercial	98,498	91,853	87,382	81,958	75,495
Construction of commercial	18,602	10,948	5,823	7,069	7,312
Commercial real estate	117,100	102,801	93,205	89,027	82,807
Farm land	3,239	3,402	4,320	4,925	5,690
Vacant land	9,342	9,067	9,926	12,828	12,979
Real estate secured	424,126	387,246	346,433	337,569	321,409
Commercial and industrial	49,204	46,292	38,094	29,358	25,123
Municipal	6,083	4,252	3,378	2,415	4,338
Consumer	4,334	3,889	4,181	4,496	4,677
Loans receivable, gross	483,747	441,679	392,086	373,838	355,547
Deferred loan origination fees and costs, net	1,203	1,182	1,032	1,004	822
Allowance for loan losses	(5,337)	(4,683)	(4,360)	(4,076)	(3,920)
Loans receivable, net	$479,613	$438,178	$388,758	$370,766	$352,449
Loans held-for-sale					
Residential 1-4 family	$568	$173	$1,879	$948	$1,184

Acquired Loans	
December 31, (in thousands)	2014
Residential 1-4 family	$9,223
Residential 5+ multifamily	8,735
Construction of residential 1-4 family	—
Home equity credit	—
Residential real estate	17,958
Commercial	97,899
Construction of commercial	9,045
Commercial real estate	106,944
Farm land	—
Vacant land	—
Real estate secured	124,902
Commercial and industrial	68,714
Municipal	—
Consumer	122
Loans receivable, gross	193,738
Deferred loan origination fees and costs, net	—
Allowance for loan losses	(21)
Loans receivable, net	$193,717
Loans held-for-sale	
Residential 1-4 family	$—

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

December 31, 2014 (in thousands)	Within 1 year	Within 1-5 years	After 5 years	Total
Residential	$4,071	$16,668	$257,037	$277,776
Home equity credit	963	313	33,351	34,627
Commercial	11,333	63,035	122,029	196,397
Construction of commercial	7,416	4,300	15,931	27,647
Land	3,318	621	8,642	12,581
Real estate secured	27,101	84,937	436,990	549,028
Commercial and industrial	39,058	32,653	46,207	117,918
Municipal	247	552	5,284	6,083
Consumer	833	2,978	645	4,456
Loans receivable, gross	$67,239	$121,120	$489,126	$677,485

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

December 31, 2014 (in thousands)	Fixed interest rates	Adjustable interest rates
Residential	$127,926	$145,779
Home equity credit	—	33,664
Commercial	103,607	81,457
Construction of commercial	6,443	13,788
Land	63	9,200
Real estate secured	238,039	283,888
Commercial and industrial	44,495	34,365
Municipal	3,254	2,582
Consumer	3,292	331
Loans receivable, gross	$289,080	$321,166

Loan Credit Quality

During 2014, total impaired and potential problem loans decreased by $7.0 million to $31.8 million, or 4.7% of gross loans receivable at December 31, 2014, from $24.8 million, compared to 5.6% of gross loans receivable at December 31, 2013.

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

Business Activities Loans

December 31, (in thousands)	2014	2013
Pass	$430,316	$378,689
Special mention	27,428	38,203
Performing loans	457,744	416,892
Substandard	9,434	9,116
Doubtful	—	—
Potential problem loans	9,434	9,116
Pass		
Troubled debt restructured loans, accruing	442	137
Special mention		

Troubled debt restructured loans, accruing	2,610	2,109
Substandard		
Troubled debt restructured loans, accruing	6,044	6,159
Troubled debt restructured loans, non-accrual	628	1,753
All other non-accrual loans	6,752	5,419
Doubtful		
Troubled debt restructured loans, accruing	93	95
Troubled debt restructured loans, non-accrual	—	—
Impaired loans	16,569	15,672
Loans receivable, gross	$483,747	$441,680

Acquired Loans

December 31, (in thousands)	2014
Pass	$182,455
Special mention	5,511
Performing loans	187,966
Substandard	2,708
Potential problem loans	2,708
Pass	
Troubled debt restructured loans, accruing	—
Special mention	
Troubled debt restructured loans, accruing	—
Substandard	
Troubled debt restructured loans, accruing	571
Troubled debt restructured loans, non-accrual	—
All other non-accrual loans	1,967
Doubtful	
Troubled debt restructured loans, accruing	—
Troubled debt restructured loans, non-accrual	—
All other non-accrual loans	526
Impaired loans	3,064
Loans receivable, gross	$193,738

Changes in impaired and potential problem loans are as follows:

Years ended December 31, (in thousands)	2014 Impaired loans		Potential		2013 Impaired loans		Potential	
	Non-accrual	Accruing	problem loans	Total	Non-accrual	Accruing	problem loans	Total
Net loans placed on non-accrual status	$6,356	$(378)	$(1,176)	$4,802	$1,652	$833	$(1,227)	$1,258
Loans restored to accrual status	(856)	739	—	(117)	—	—	—	—
Loan risk rating downgrades to substandard	—	—	5,941	5,941	—	—	3,636	3,636
Loan risk rating upgrades from substandard	—	—	—	—	—	—	(1,350)	(1,350)
Loan repayments	(1,745)	(593)	(1,235)	(3,573)	(3,004)	259	(2,700)	(5,445)
Loan charge-offs (less charge offs for delinquent taxes)	(291)	(6)	(24)	(321)	(364)	—	(4)	(368)
Increase (decrease) in troubled debt restructuring	—	1,499	(480)	1,019	—	1,422	(50)	1,372
Real estate acquired in settlement of loans	(764)	—	—	(764)	(971)	(717)	—	(1,688)
Increase (decrease) in loans	$2,700	$1,261	$3,026	$6,987	$(2,687)	$1,797	$(1,695)	$(2,585)

Credit risk remained a focus of management's attention during 2014. There was an increase in total impaired and potential problem loans, up $7.0 million in 2014. However, such amount represents a lower percentage of gross loans when compared to 2013. Net loans placed on non-accrual status, due to payment and financial performance, increased to $4.8 million in 2014 from $1.3 million in 2013. Loans restored to accrual status increased to $0.1 million compared to $0 in 2013. Downgrades in loan risk ratings to substandard increased to $5.9 million in 2014 from $3.6 million in 2013. Upgrades in loan risk ratings from substandard did not change in 2014 compared to $1.3 million in 2013. Loan repayments decreased to $3.6 million in 2014 from $5.4 million in 2013. Loan charge-offs, primarily due to collateral deficiencies declined to $0.3 million in 2014 from $0.4 million in 2013. Troubled debt restructures decreased to $1.0 million in 2014 from $1.4 million in 2013. Real estate acquired in settlement of loans decreased to $0.8 million in 2014 from $1.7 million in 2013.

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 increased $4.0 million during 2014 to $19.6 million, or 2.89% of gross loans receivable at December 31, 2014, from $15.7 million, or 3.55% of gross loans receivable at December 31, 2013. The components of impaired loans are as follows:

December 31, (in thousands)	2014	2013	2012
Troubled debt restructurings, accruing	$9,760	$8,500	$6,703
Troubled debt restructurings, non-accrual	628	1,753	2,280
All other non-accrual loans	9,245	5,419	7,579
Impaired loans	$19,633	$15,672	$16,562

Non-Performing Assets

Non-performing assets increased $3.3 million to $10.9 million at December 31, 2014, or 1.27% of assets, from $7.5 million or 1.29% of assets at December 31, 2013. The components of non-performing assets are as follows:

December 31, (in thousands)	2014	2013	2012	2011	2010
Commercial	$3,150	$1,857	$2,235	$2,337	$2,923
Vacant land	2,862	2,870	3,995	3,658	4,018
Farm land	384	384	—	—	—
Residential 1-4 family	3,096	1,525	3,024	1,240	2,534
Home equity credit	348	402	442	173	362
Real estate secured	9,840	7,038	9,696	7,408	9,837
Commercial and industrial	33	134	164	668	208
Non-accrual loans	9,873	7,172	9,860	8,076	10,045
Accruing loans past due 90 days and over	17	—	—	—	96
Non-performing loans	9,890	7,172	9,860	8,076	10,141
Real estate acquired in settlement of loans, net	1,002	377	244	2,744	610
Non-performing assets	$10,892	$7,549	$10,104	$10,820	$10,751

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

Years ended December 31, (in thousands)	2014	2013	2012
Income in accordance with original terms	$680	$551	$301
Income recognized	48	64	195
Reduction in interest income	$632	$487	$106

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

December 31, (in thousands)	2014	2013	2012
Current	$1,268	$1,274	$1,798
Past due 1-29 days	586	241	75
Past due 30-59 days	54	134	701
Past due 60-89 days	214	254	445
Past due 90-179 days	1,464	588	1,983
Past due 180 days and over	6,304	4,681	4,858
Total non-performing loans	$9,890	$7,172	$9,860

At December 31, 2014, 12.82% of non-accrual loans were current with respect to loan payments, compared with 17.76% at December 31, 2013. Loans past due 180 days include one loan of $2.8 million 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 $0.1 million in 2014 to $10.4 million, or 1.54% of gross loans receivable, from $10.3 million, or 2.32% of gross loans receivable at December 31, 2013. The components of troubled debt restructured loans are as follows:

December 31, (in thousands)	2014	2013	2012
Residential 1-4 family	$4,748	$4,956	$3,097
Home equity credit	48	48	—
Personal	—	22	—
Vacant land	235	225	—
Commercial	4,065	2,691	2,774

Real estate secured	9,096	7,942	5,871
Commercial and industrial	664	558	832
Accruing troubled debt restructured loans	9,760	8,500	6,703
Residential 1-4 family	295	999	1,041
Home equity credit	88	40	—
Commercial	235	608	1,159
Vacant land	—	—	—
Real estate secured	618	1,647	2,200
Commercial and Industrial	10	106	80
Non-accrual troubled debt restructured loans	628	1,753	2,280
Troubled debt restructured loans	$10,388	$10,253	$8,983

35

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

December 31, (in thousands)	2014	2013	2012
Current	$6,514	$6,559	$5,353
Past due 1-29 days	2,704	1,490	445
Past due 30-59 days	542	95	905
Past due 60-89 days	—	356	—
Accruing troubled debt restructured loans	9,760	8,500	6,703
Current	49	999	1,333
Past due 1-29 days	—	241	—
Past due 30-59 days	—	64	301
Past due 60-89 days	10	—	194
Past due 90-179 days	333	449	—
Past due 180 days and over	236	—	452
Non-accrual troubled debt restructured loans	628	1,753	2,280
Total troubled debt restructured loans	$10,388	$10,253	$8,983

At December 31, 2014, 63.18% of troubled debt restructured loans were current with respect to loan payments, as compared with 73.72% at December 31, 2013.

Past Due Loans

Loans past due 30 days or more increased $1.1 million during 2014 to $12.1 million, or 1.80% of gross loans receivable at December 31, 2014, compared with $11.0 million, or 2.50% of gross loans receivable at December 31, 2013. The components of loans past due 30 days or greater are as follows:

December 31, (in thousands)	2014	2013	2012
Past due 30-59 days	$2,295	$2,535	$4,309
Past due 60-89 days	1,834	2,840	1,317
Past due 90-179 days	17	—	—
Accruing loans	4,146	5,375	5,626
Past due 30-59 days	54	133	701
Past due 60-89 days	214	254	445
Past due 90-179 days	1,447	588	1,983
Past due 180 days and over	6,305	4,681	4,859
Non-accrual loans	8,020	5,656	7,988
Total loans past due 30 days and over	$12,166	$11,031	$13,614

Potential Problem Loans

Potential problem loans increased $3.0 million during 2014 to $12.1 million, or 1.79% of gross loans receivable at December 31, 2014, compared with $9.1 million, or 2.06% of gross loans receivable at December 31, 2013. The components of potential problem loans are as follows:

December 31, (in thousands)	2014	2013	2012
Residential 1-4 family	$2,829	$1,528	$3,108
Residential 5+ multifamily	975	975	—
Construction of residential 1-4 family	—	—	—
Home equity credit	786	890	892
Residential real estate	4,590	3,393	4,000
Commercial	5,139	4,036	4,624
Construction of commercial	450	589	450

Commercial real estate	5,589	4,625	5,074
Farm land	723	751	1,180
Vacant land	66	44	183
Real estate secured	10,968	8,813	10,437
Commercial and industrial	1,146	288	345
Consumer	28	15	28
Other classified loans receivable	$12,142	$9,116	$10,810

36

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

December 31, (in thousands)	2014	2013	2012
Current	$8,302	$7,646	$7,992
Past due 1-29 days	2,416	189	452
Past due 30-59 days	100	298	2,065
Past due 60-89 days	1,324	983	301
Total potential problem loans	$12,142	$9,116	$10,810

At December 31, 2014, 68.08% of potential problem loans were current with respect to loan payments, as compared with 83.87% at December 31, 2013.

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 2014 increased $238.0 million, or 49.9%, to $715.4 million at December 31, 2014, compared with $477.4 million at December 31, 2013. 2014 deposit growth was mainly influenced by the acquisition of a Union Savings Bank branch in Sharon, Connecticut from another institution with deposits of $18.2 million and the acquisition of Riverside Bank which included deposits of $211.2 million. Non-acquisition deposit activity resulted in deposit growth of $8.8 million in 2014. Retail repurchase agreements increased $1.6 million during 2014 to $4.2 million at December 31, 2014, compared with $2.6 million at December 31, 2013. Total deposits at December 31, 2014 include a single relationship totaling $30.3 million, or 4.24% of total deposits.

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

December 31, 2014 (in thousands)	Within 3 months	Within 3-6 months	Within 6-12 months	Over 1 year	Total
Certificates of deposit over $100,000	$9,175	$10,705	$14,738	$35,375	$69,993

FHLBB advances decreased $1.6 million during 2014 to $28.8 million at December 31, 2014, compared with $30.4 million at December 31, 2013. The decrease in advances was due to scheduled maturities and principal re-payments.

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, 2014 include operating leases, a capital lease, contractual purchases and certain other benefit plans. For further discussion regarding leases see Note 18 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, 2014. 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, 2014 (in thousands) By Remaining Maturity	Within 1 year	Within 1-3 years	Within 4-5 years	After 5 years	Total
Residential	$—	$1,449	$500	$1,081	$3,030
Home equity credit	1,138	8	198	24,538	25,882
Commercial	5,684	6,375	887	3,805	16,751
Land	—	—	—	5	5
Real estate secured	6,822	7,832	1,585	29,429	45,668
Commercial and industrial	40,065	2,926	721	13,083	56,795
Municipal	660	200	—	250	1,110
Consumer	—	25	—	1,512	1,537
Unadvanced portions of loans	47,547	10,983	2,306	44,274	105,110
Commitments to originate loans	20,953	—	—	—	20,953
Standby letters of credit	3,339	82	—	1	3,422
Total	$71,839	$11,065	$2,306	$44,275	$129,485

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, 2014, 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 17.95%, up from 16.33% at December 31, 2013. Management believes Salisbury’s funding sources will meet anticipated funding needs.

Operating activities for 2014 provided net cash of $4.5 million. Investing activities provided net cash of $12.2 million, principally from cash acquired, calls and maturities of securities of $53.9 million, offset by net loan originations and purchases of $40.6 million. Financing activities provided net cash of $6.7 million, principally from a net deposit and repurchase agreement increase of $10.4 million, offset by 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 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 net deposit and repurchase agreement growth of $9.5 million.

CAPITAL RESOURCES

Shareholders’ Equity

Shareholders’ equity increased $29.0 million in 2014 to $101.8 million at December 31, 2014. Contributing to the increase in shareholders’ equity for 2014 was net income of $2.5 million, other comprehensive income increase of $1.1 million, and common stock issuance as a result of the Riverside Bank acquisition of $27.3 million, less common and preferred stock dividends of $1.9 million and $0.2 million, respectively. Accumulated other comprehensive income as of December 31, 2014 included unrealized gains on securities available-for-sale, net of tax, of $2.1 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 was 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, 2014, 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 29, 2014, Salisbury declared a Series B Preferred Stock dividend of $40,000, payable on January 2, 2015. 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.

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 meet all capital adequacy requirements to which they are subject and are considered to be well-capitalized. As a result, the Bank pays lower federal deposit insurance premiums than those banks that are not “well capitalized.” Requirements for classification as a well-capitalized institution and for minimum capital adequacy along with Salisbury’s and the Bank's regulatory capital ratios are as follows:

	Minimum for		December 31, 2014		December 31, 2013	
	Capital Adequacy	Well Capitalized	Salisbury	Bank	Salisbury	Bank
Total Capital (to risk-weighted assets)	8.00 %	10.00 %	14.27 %	12.75 %	16.46 %	13.87 %
Tier 1 Capital (to risk-weighted assets)	4.00	6.00	13.38	11.86	15.20	12.63
Tier 1 Capital (to average assets)	4.00	5.00	12.31	10.95	10.65	8.96

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.

On July 2, 2013, the Federal Reserve Bank (FRB) approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. On April 8, 2014, the FDIC adopted as final its interim final rule, which is identical in substance to the final rules issued by the FRB in July 2013. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Bank. The rules include a new common equity Tier 1 capital risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio of Total capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer will be phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules.

The phase-in period for the final rules will begin for the Bank on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule and should be fully phased-in by January 1, 2019. Management believes that the Bank's capital levels will remain characterized as "well-capitalized" under the new rules.

Dividends

During 2014 and 2013, Salisbury declared and paid four quarterly common stock dividends of $0.28 per common share each quarter, totaling $1,918,000 and $1,915,000, respectively. The Board of Directors of Salisbury declared a common stock dividend of $0.28 per common share payable on February 27, 2015 to shareholders of record on February 13, 2015. 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 2014, Salisbury declared Preferred Stock Series B dividends of $166,000 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.

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 pr