

TRUSTCO BANK CORP N Y
Form 10-K
March 01, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

☐ Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2009

Or

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 0-10592

TRUSTCO BANK CORP NY
(Exact name of registrant as specified in its charter)

NEW YORK
(State or other jurisdiction of incorporation or
organization)

14-1630287
(I.R.S. Employer Identification No.)

5 SARNOWSKI DRIVE, GLENVILLE, NEW YORK 12302
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (518) 377-3311

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

Title of each class
Common Stock, \$1.00 Par Value

Name of exchange on which registered
The NASDAQ Stock Market LLC

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 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. **T**

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

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-Accelerated Filer ☐ Smaller reporting company ☐

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

The aggregate market value of the common stock held by non-affiliates as of June 30, 2009 was approximately \$431,551,689 (based upon the closing price of \$5.89 on June 30, 2009, as reported on the NASDAQ Global Select Market).

The number of shares outstanding of the registrant's common stock as of March 1, 2010 was 76,761,238.

Documents Incorporated by Reference: Portions of registrant's Proxy Statement filed for its 2010 Annual Meeting of Shareholders to be filed within 120 days of the registrant's fiscal year end.

INDEX

Description	Page
<u>Use of Non-GAAP Financial Measures</u>	3
PART I	
Item 1 <u>Business</u>	4
Item 1A <u>Risk Factors</u>	15
Item 1B <u>Unresolved Staff Comments</u>	22
Item 2 <u>Properties</u>	22
Item 3 <u>Legal Proceedings</u>	22
Item 4 <u>Submission of Matters to a Vote of Security Holders</u>	22
PART II	
Item 5 <u>Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	24
Item 6 <u>Selected Financial Data</u>	25
Item 7 <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
Item 7A <u>Quantitative and Qualitative Disclosures about Market Risk</u>	25
Item 8 <u>Financial Statements and Supplementary Data</u>	25
Item 9 <u>Changes in and Disagreements with Accountants On Accounting and Financial Disclosure</u>	25
Item 9A <u>Controls and Procedures</u>	25
Item 9B <u>Other Information</u>	26
PART III	
Item 10 <u>Directors, Executive Officers and Corporate Governance</u>	26
Item 11 <u>Executive Compensation</u>	27
Item 12 <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	27
Item 13 <u>Certain Relationships and Related Transactions and Director Independence</u>	27
Item 14 <u>Principal Accounting Fees and Services</u>	27
PART IV	
Item 15 <u>Exhibits, Financial Statement Schedules</u>	27
<u>Signatures</u>	31
<u>EXHIBITS INDEX</u>	

Index

USE OF NON-GAAP FINANCIAL MEASURES

The Securities and Exchange Commission (“SEC”) has adopted Regulation G, which applies to all public disclosures, including earnings releases, made by registered companies that contain “non-GAAP financial measures.” GAAP is generally accepted accounting principles in the United States of America. Under Regulation G, companies making disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure and a statement of the company’s reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. At the same time that the SEC issued Regulation G, it also made amendments to Item 10 of Regulation S-K, requiring companies to make the same types of supplemental disclosures whenever they include non-GAAP financial measures in their filings with the SEC. The SEC has exempted from the definition of “non-GAAP financial measures” certain specific types of commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures or SEC filings, supplemental information is not required. The following measures used in this Report, which have not been specifically exempted by the SEC, may nevertheless constitute “non-GAAP financial measures” within the meaning of the SEC’s new rules, although we are unable to state with certainty that the SEC would so regard them.

Tax-Equivalent Net Interest Income and Net Interest Margin: Net interest income, as a component of the tabular presentation by financial institutions of Selected Financial Information regarding their recently completed operations, is commonly presented on a tax-equivalent basis. That is, to the extent that some component of the institution’s net interest income will be exempt from taxation (e.g., was received by the institution as a result of its holdings of state or municipal obligations), an amount equal to the tax benefit derived from that component is added back to the net interest income total. This adjustment is considered helpful in comparing one financial institution’s net interest income (pre-tax) to that of another institution, as each will have a different proportion of tax-exempt items in their portfolios. Moreover, net interest income is itself a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average earning assets. For purposes of this measure as well, tax-equivalent net interest income is generally used by financial institutions, again to provide a better basis of comparison from institution to institution. We follow these practices.

The Efficiency Ratio: Financial institutions often use an “efficiency ratio” as a measure of expense control. The efficiency ratio typically is defined as noninterest expense divided by the sum of taxable equivalent net interest income and noninterest income. As in the case of net interest income, generally, net interest income as utilized in calculating the efficiency ratio is typically expressed on a tax-equivalent basis. Moreover, most financial institutions, in calculating the efficiency ratio, also adjust both noninterest expense and noninterest income to exclude from these items (as calculated under GAAP) certain component elements, such as non-recurring charges, and other real estate expense (deducted from noninterest expense) and securities transactions and other non-recurring income items (excluded from noninterest income). We follow these practices.

Index

PART I

Item 1. Business

General

TrustCo Bank Corp NY (“TrustCo” or the “Company”) is a savings and loan holding company having its principal place of business at 5 Sarnowski Drive, Glenville, New York 12302. TrustCo was incorporated under the laws of New York in 1981 to acquire all of the outstanding stock of Trustco Bank, National Association, formerly known as Trustco Bank New York, and prior to that, The Schenectady Trust Company. The Company’s principal subsidiary, Trustco Bank, (the “Bank”) is the successor by merger to Trustco Bank, National Association.

Through policy and practice, TrustCo continues to emphasize that it is an equal opportunity employer. There were 732 full-time equivalent employees of TrustCo at year-end 2009. TrustCo had 14,127 shareholders of record as of December 31, 2009 and the closing price of the TrustCo common stock on that date was \$6.30.

Subsidiaries

Trustco Bank

Trustco Bank is a federal savings bank engaged in providing general banking services to individuals, partnerships, and corporations. The Bank operates 134 automatic teller machines and 132 banking offices in Albany, Columbia, Dutchess, Greene, Orange, Rensselaer, Rockland, Saratoga, Schenectady, Schoharie, Ulster, Warren, Washington and Westchester counties of New York, Charlotte, Hillsborough, Lake, Manatee, Orange, Osceola, Polk, Sarasota, Seminole, and Volusia counties in Florida, Bennington County in Vermont, Berkshire County in Massachusetts and Bergen County in New Jersey. The largest part of such business consists of accepting deposits and making loans and investments. The Bank provides a wide range of both personal and business banking services. The Bank is supervised and regulated by the federal Office of Thrift Supervision (“OTS”) and is a member of the Federal Reserve System. Its deposits are insured by the Federal Deposit Insurance Corporation (“FDIC”) to the extent permitted by law. The Bank’s subsidiary, Trustco Realty Corp., holds certain mortgage assets that are serviced by the Bank. The Bank accounted for substantially all of TrustCo’s 2009 consolidated net income and average assets. During 2008, the Bank dissolved and liquidated its former subsidiary Trustco Vermont Investment Company and caused the distribution of all of the assets of that subsidiary to the Bank. The Bank holds three subsidiaries, (1) Trustco Insurance Agency, Inc., which is a licensed insurance agency, (2) Trustco Realty Corp, and (3) ORE Property, Inc. None of these subsidiaries engage in any significant business activities.

The trust department of the Bank serves as executor of estates and trustee of personal trusts, provides asset and wealth management services, provides estate planning and related advice, provides custodial services, and acts as trustee for various types of employee benefit plans and corporate pension and profit sharing trusts. The aggregate market value of the assets under trust, custody, or management of the trust department of the Bank was approximately \$762 million as of December 31, 2009.

Index

The daily operations of the Bank remain the responsibility of its officers, subject to the oversight of its Board of Directors and overall supervision by TrustCo. The accounts of the Bank are included in TrustCo's consolidated financial statements.

ORE Subsidiary

In 1993, TrustCo created ORE Subsidiary Corp., a New York corporation, to hold and manage certain foreclosed properties acquired by the Bank. The accounts of this subsidiary are included in TrustCo's consolidated financial statements.

Competition

TrustCo faces strong competition in its market areas, both in attracting deposits and making loans. The Company's most direct competition for deposits, historically, has come from commercial banks, savings associations, and credit unions that are located or have branches in the Bank's market areas. The competition ranges from other locally based commercial banks, savings banks and credit unions to branch offices of the largest financial institutions in the United States. In its principal market areas, the Capital District area of New York State and Central Florida, TrustCo's principal competitors are local operations of super regional banks, branch offices of money center banks, and locally based commercial and savings banks. The Bank is the largest depository institution headquartered in the Capital District area of New York State. The Company also faces competition for deposits from national brokerage houses, short-term money market funds, and other corporate and government securities funds.

Factors affecting the acquisition of deposits include pricing, office locations and hours of operation, the variety of deposit accounts offered, and the quality of customer service provided. Competition for loans has been especially keen during the last several years. Commercial banks, thrift institutions, traditional mortgage brokers affiliated with local offices and nationally franchised real estate brokers are all active and aggressive competitors. The Company competes in this environment by providing a full range of financial services based on a tradition of financial strength and integrity dating from its inception. The Company competes for loans, principally through the interest rates and loan fees it charges, and the efficiency and quality of services it provides to borrowers.

Supervision and Regulation

Banking is a highly regulated industry, with numerous federal and state laws and regulations governing the organization and operation of banks and their affiliates. As a savings and loan holding company registered under the Home Owners' Loan Act of 1934 (the "HOLA"), TrustCo is regulated and examined by the OTS. The HOLA requires TrustCo to obtain prior OTS approval for acquisitions and restricts the business operations permitted to TrustCo. The OTS is also the Bank's primary federal regulator and supervises and examines the Bank. Because the FDIC provides deposit insurance to the Bank, the Bank is also subject to its supervision and regulation even though the FDIC is not the Bank's primary federal regulator.

Index

Most of TrustCo's revenues consist of cash dividends paid to TrustCo by the Bank, payment of which is subject to various regulatory limitations. (Note 1 to the consolidated financial statements contained in TrustCo's Annual Report to Shareholders for the year ended December 31, 2009 contains information concerning restrictions on the Bank's ability to pay dividends and is hereby incorporated by reference.) Compliance with the standards set forth in the OTS rules regarding capital distribution by savings associations and savings banks could also limit the amount of dividends that TrustCo may pay to its shareholders. The banking industry is also affected by the monetary and fiscal policies of the federal government, including the Federal Reserve System, which exerts considerable influence over the cost and availability of funds obtained for lending and investing.

See Note 14 to the consolidated financial statements contained in TrustCo's Annual Report to Shareholders for the year ended December 31, 2009 for information concerning the Bank's regulatory capital requirements.

The following summary of laws and regulations applicable to the Company and the Bank is not intended to be a complete description of those laws and regulations or their effects on the Company and the Bank, and it is qualified in its entirety by reference to the particular statutory and regulatory provisions described.

Holding Company Activities

The activities of savings and loan holding companies are governed, and limited, by the HOLA. TrustCo's activities are limited to those permissible for "multiple" savings and loan holding companies (that is, savings and loan holding companies owning more than one savings association subsidiary) as of March 5, 1987, activities permitted for bank holding companies as of November 12, 1999 and activities permissible for "financial holding companies" (which are described below). "Savings associations" include federal savings banks such as the Bank. TrustCo must obtain approval from the appropriate bank regulatory agencies before acquiring control of any insured depository institution.

A savings and loan holding company is prohibited from, directly or indirectly, acquiring more than 5% of the voting stock of another financial institution or savings and loan holding company without the prior written approval of the Office of Thrift Supervision and from acquiring or retaining control of a depository institution that is not insured by the Federal Deposit Insurance Corporation. In evaluating applications by holding companies to acquire savings institutions, the Office of Thrift Supervision considers the financial and managerial resources and future prospects of the Company and institution involved, the effect of the acquisition on the risk to the deposit insurance fund, the convenience and needs of the community and competitive factors.

The Office of Thrift Supervision may not approve any acquisition that would result in a multiple savings and loan holding company controlling savings institutions in more than one state, subject to two exceptions: (i) the approval of interstate supervisory acquisitions by savings and loan holding companies and (ii) the acquisition of a savings institution in another state if the laws of the state of the target savings institution specifically permit such acquisitions. The states vary in the extent to which they permit interstate savings and loan holding company acquisitions.

Index

Although savings and loan holding companies are not currently subject to specific capital requirements or specific restrictions on the payment of dividends or other capital distributions, federal regulations do prescribe such restrictions on subsidiary savings institutions as described below. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the Office of Thrift Supervision and the agency has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of the institution.

Securities Regulation and Corporate Governance

The Company's common stock is registered with the Securities and Exchange Commission under Section 12(b) of the Securities Exchange Act of 1934, and the Company is subject to restrictions, reporting requirements and review procedures under federal securities laws and regulations. The Company is also subject to the rules and reporting requirements of The Nasdaq Stock Market LLC, on which its common stock is traded. Like other issuers of publicly traded securities, the Company must also comply with The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), which implemented legislative reforms intended to address corporate and accounting fraud and contained reforms of various business practices and numerous aspects of corporate governance. For example, Sarbanes-Oxley addresses accounting oversight and corporate governance matters, including the creation of a five-member oversight board appointed by the Securities and Exchange Commission to set and enforce auditing, quality control and independence standards for accountants and have investigative and disciplinary powers; increased responsibilities and codified requirements relating to audit committees of public companies and how they interact with a company's public accounting firm; the prohibition of accounting firms from providing various types of consulting services to public clients and requiring accounting firms to rotate partners among public client assignments every five years; expanded disclosure of corporate operations and internal controls and certification by chief executive officers and chief financial officers to the accuracy of periodic reports filed with the SEC; and prohibitions on public company insiders from trading during retirement plan "blackout" periods, restrictions on loans to company executives and enhanced controls on and reporting of insider trading.

Although the Company has and will continue to incur additional expense in complying with the provisions of Sarbanes-Oxley and the resulting regulations, management does not expect that such compliance will have a material impact on the Company's financial condition or results of operations.

Federal Savings Institution Regulation

Business Activities. Federal law and regulations govern the activities of federal savings banks such as the Bank. These laws and regulations delineate the nature and extent of the activities in which federal savings banks may engage. In particular, certain lending authority for federal savings banks, e.g., commercial, non-residential real property loans and consumer loans, is limited to a specified percentage of the institution's capital or assets.

Index

Regulatory Capital Requirements. OTS capital regulations require thrifts to satisfy three capital ratio requirements: tangible capital, Tier 1 core (leverage) capital, and risk-based capital. In general, an association's tangible capital, which must be at least 1.5% of adjusted total assets, is the sum of common shareholders' equity adjusted for the effects of other comprehensive income ("OCI"), net of the adjustment to record the previously unrecognized over funded position of employee benefit plans, less goodwill and other disallowed assets. An association's ratio of Tier 1 core capital to adjusted total assets (the "core capital" or "leverage" ratio) must be at least 3% for the most highly rated associations and 4% for others. Higher capital ratios may be required if warranted by the particular circumstances or risk profile of a given association. Under the risk-based capital requirement, a savings association must have total capital (core capital plus supplementary capital) equal to at least 8% of risk-weighted assets. Tier 1 capital must represent at least 50% of total capital and consists of core capital elements, which include common shareholders' equity, qualifying noncumulative nonredeemable perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries, but exclude goodwill and certain other intangible assets. Supplementary capital mainly consists of qualifying subordinated debt and portions of allowance for loan losses.

The above capital requirements are viewed as minimum standards by the OTS. The OTS regulations also specify minimum requirements for a savings association to be considered a "well-capitalized institution" as defined in the "prompt corrective action" regulation described below. A "well-capitalized" savings association must have a total risk-based capital ratio of 10% or greater, and a leverage ratio of 5% or greater.

Additionally, to qualify as a "well-capitalized institution," a savings association's Tier 1 risk-based capital, defined as core capital plus supplementary capital less portions of the association's allowance for loan losses, must be equal to at least 6% of risk-weighted assets. The Bank currently meets all of the requirements of a "well-capitalized institution."

The OTS regulations contain prompt corrective action provisions that require certain mandatory remedial actions and authorize certain other discretionary actions to be taken by the OTS against a savings association that falls within specified categories of capital deficiency. The relevant regulations establish five categories of capital classification for this purpose, ranging from "well-capitalized" or "adequately capitalized" through "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." In general, the prompt corrective action regulations prohibit an OTS-regulated institution from declaring any dividends, making any other capital distributions, or paying a management fee to a controlling person, such as its parent holding company, if, following the distribution or payment, the institution would be within any of the three undercapitalized categories.

Index

Insurance of Deposit Accounts. Deposits of Trustco Bank are insured by the Deposit Insurance Fund (“DIF”) of the FDIC. The FDIC determines insurance premiums based on a number of factors, primarily the risk of loss that insured institutions pose to the DIF.

The FDIC is required by statute to maintain the DIF’s “reserve ratio” (determined by dividing the DIF balance by the estimated amount of deposits insured by the DIF) within a range of 1.15 percent to 1.50 percent. If the reserve ratio falls below 1.15 percent—or is expected to within 6 months—the FDIC must adopt a restoration plan that provides that the DIF will return to 1.15 percent generally within a specified period of time.

Recent failures have significantly increased the DIF’s losses such that its reserve ratio is less than the mandated 1.15 percent. In October 2008, the FDIC established a restoration plan for the DIF that called for FDIC assessment rates designed to return the reserve ratio to 1.15 percent within five years; the FDIC amended the plan in February 2009 to extend the time period for achieving the 1.15 percent ratio to seven years. Finally, in September 2009, the FDIC further amended the restoration plan to extend the time period to eight years as permitted by amendments to the Federal Deposit Insurance Act enacted by Congress in May 2009.

On May 22, 2009, the FDIC adopted a final rule imposing a 5 basis point special assessment on each insured depository institution's assets minus Tier 1 capital as of June 30, 2009, subject to a limit that the amount of the special assessment for any institution cannot exceed 10 basis points times the institution's deposit insurance assessment base for the second quarter 2009. The Bank paid this special assessment in September, 2009.

Finally, on November 12, 2009, the FDIC adopted a final rule imposing a 13-quarter prepayment of FDIC premiums. The prepayment amount was paid in December 2009 and represented an estimated prepayment for deposit insurance assessments for the fourth quarter of 2009 through the fourth quarter of 2012. The prepayment amount will be used to offset future FDIC premiums beginning with the March 2010 payment. Other assessments to be paid to the FDIC, such as the fees for the Temporary Liquidity Guarantee Program and for the Financing Corporation (described below) are not affected by the offset.

The FDIC has indicated that it would not impose any further special deposit insurance assessments under its deposit insurance rule adopted in May 2009 and that it plans to maintain assessment rates at their current levels through the end of 2010 (although it also adopted a uniform 3 basis point increase in assessment rates effective January 1, 2011).

Future changes in insurance premiums could have an adverse effect on the operating expenses and results of operations of Trustco Bank, and the Bank cannot predict what insurance assessment rates will be in the future.

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

Index

In addition to the assessment for deposit insurance, institutions are required to make payments on bonds issued in the late 1980s by the Financing Corporation to recapitalize a predecessor deposit insurance fund.

Limitation on Capital Distributions. Office of Thrift Supervision regulations impose limitations upon all capital distributions by Trustco Bank, including cash dividends, payments to repurchase its shares and payments to stockholders of another institution in a cash-out merger. Under the regulations, an application to and the prior approval of the Office of Thrift Supervision is required prior to any capital distribution if the institution does not meet the criteria for "expedited treatment" of applications under Office of Thrift Supervision regulations (i.e., generally, examination ratings in the two top categories), the total capital distributions for the calendar year exceed net income for that year plus the amount of retained net income for the preceding two years, the institution would be undercapitalized following the distribution or the distribution would otherwise be contrary to a statute, regulation or agreement with Office of Thrift Supervision. If an application is not required, the institution must still provide prior notice to Office of Thrift Supervision of the capital distribution if, like the Bank, it is a subsidiary of a holding company. In the event the Bank's capital fell below its regulatory requirements or the Office of Thrift Supervision notified it that it was in need of more than normal supervision, the Bank's ability to make capital distributions could be restricted. In addition, the Office of Thrift Supervision could prohibit a proposed capital distribution by any institution, which would otherwise be permitted by the regulation, if the Office of Thrift Supervision determines that such distribution would constitute an unsafe or unsound practice.

Assessments. The Bank is required to pay assessments to the Office of Thrift Supervision to fund the agency's operations. The general assessments, paid on a semi-annual basis, is computed upon the Bank's total assets, including consolidated subsidiaries, as reported in the Bank's latest quarterly thrift financial report. The assessments paid by the Bank for the year ended December 31, 2009 totaled approximately \$672 thousand.

Community Reinvestment Act. The Community Reinvestment Act ("CRA") requires each savings institution, as well as commercial banks and certain other lenders, to identify the communities served by the institution's offices and to identify the types of credit the institution is prepared to extend within those communities. The CRA also requires the OTS to assess an institution's performance in meeting the credit needs of its identified communities as part of its examination of the institution, and to take such assessments into consideration in reviewing applications with respect to branches, mergers and other business combinations, including acquisitions by savings and loan holding companies. An unsatisfactory CRA rating may be the basis for denying such an application and community groups have successfully protested applications on CRA grounds. In connection with its assessment of CRA performance, the OTS assigns CRA ratings of "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance." The Bank was rated "satisfactory" in its last CRA examination. Institutions are evaluated based on (i) its record of helping to meet the credit needs of its assessment area through lending activities; (ii) its qualified investments; and (iii) the availability and effectiveness of the institution's system for delivering retail banking services. An institution that is found to be deficient in its performance in meeting its community's credit needs may be subject to enforcement actions, including cease and desist orders and civil money penalties.

Index

Qualified Thrift Lender Test. Like all OTS-regulated institutions, the Bank is required to meet a Qualified Thrift Lender (“QTL”) test or the Internal Revenue Code’s Domestic Building and Loan Association (“DBLA”) test to avoid certain restrictions on its operations, including restrictions on its ability to branch interstate and the Company’s mandatory registration as a savings and loan holding company under the Act. A savings association satisfies the QTL test if: (i) on a monthly average basis in at least nine months out of each twelve month period, at least 65% of a specified asset base of the savings association consists of loans to small businesses, credit card loans, educational loans, or certain assets related to domestic residential real estate, including residential mortgage loans and mortgage securities; or (ii) at least 60% of the savings association’s total assets consist of cash, U.S. government or government agency debt or equity securities, fixed assets, or loans secured by deposits, real property used for residential, educational, church, welfare, or health purposes, or real property in certain urban renewal areas. To be a QTL under the DBLA test, a savings association must meet a “business operations test” and a “60 percent of assets test.” The business operations test requires the business of a DBLA to consist primarily of acquiring the savings of the public and investing in loans. An institution meets the public savings requirement when it meets one of two conditions: (i) The institution acquires its savings accounts in conformity with OTS rules and regulations and (ii) The general public holds more than 75 percent of its deposits, withdrawable shares, and other obligations. An institution meets the investing in loans requirement when more than 75 percent of its gross income consists of interest on loans and government obligations, and various other specified types of operating income that financial institutions ordinarily earn. The 60 percent of assets test requires that at least 60 percent of a DBLA's assets must consist of assets that thrifts normally hold, except for consumer loans that are not educational loans. The Bank is currently, and expects to remain, in compliance with these standards.

Federal Reserve System

Federal Reserve Board regulations require savings institutions to maintain reserves against their transaction accounts. The reserve for transaction accounts as of December 31, 2009 was as follows:

Amount of transaction accounts	Reserve Requirement
\$0 to \$10.7 million	0 percent of amount.
Over \$10.7 million and up to \$65.9 million	3 percent of amount.
Over \$65.9 million	\$1,656,000 plus 10 percent of amount over \$65.9 million.

The Bank was in compliance with these requirements as of December 31, 2009.

Index

Legislative and Regulatory Responses to Financial Crisis

In late 2008 and early 2009, the U.S. Congress and the federal financial regulatory authorities took a number of steps to respond to the financial crises affecting the banking system and financial markets.

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the “EESA”) was signed into law. Under the EESA, the U.S. Department of the Treasury was given the authority to, among other things, purchase up to \$700 billion of securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, the Treasury Department announced a Capital Purchase Program under which it would acquire equity investments, usually preferred stock, in banks and thrifts and their holding companies. In conjunction with the purchase of preferred stock, the Treasury Department also received warrants to purchase common stock from participating financial institutions. Participating financial institutions also were required to adopt the Treasury Department’s standards for executive compensation and corporate governance for the period during which the Department holds equity issued under the Capital Purchase Program. TrustCo decided not to participate in the Capital Purchase Program.

On November 21, 2008, the FDIC adopted a final rule relating to a Temporary Liquidity Guarantee Program, which the FDIC had previously announced as an initiative to counter the financial crisis. Under the Temporary Liquidity Guarantee Program the FDIC (i) guaranteed, until the earlier of maturity or June 30, 2012, certain newly issued senior unsecured debt issued by participating institutions on or after October 14, 2008, and before June 30, 2009 (the “Debt Guarantee Program”) and (ii) guaranteed the full balance of non-interest bearing transaction deposit accounts, Negotiable Order of Withdrawal (“NOW”) accounts paying less than 0.5% interest per annum and certain other accounts held at participating FDIC- insured institutions (the “Transaction Account Guarantee Program”). TrustCo elected to participate in each of the guarantee programs.

Institutions participating in the guarantee programs pay assessments to assist in funding the FDIC’s coverage. The fee assessment under the Debt Guarantee Program ranged from 50 basis points to 100 basis points per annum, depending on the initial maturity of the debt. The FDIC has subsequently extended the Debt Guarantee Program to cover senior unsecured debt issued after April 1, 2009 and before October 31, 2009 and maturing on or before December 31, 2012. In addition, the FDIC established a limited, six-month emergency guarantee facility upon expiration of the Debt Guarantee Program. Under this emergency guarantee facility, certain participating entities can apply to the FDIC for permission to issue FDIC-guaranteed debt during the period starting October 31, 2009 through April 30, 2010. Trustco Bank has not, and does not currently intend to, seek to participate in the emergency guarantee facility. The fee for issuing debt under the emergency facility would be at least 300 basis points, which the FDIC has reserved the right to increase on a case-by-case basis, depending upon the risks presented by the issuing entity.

Index

Also, the Transaction Account Guarantee Program has been extended from its initial termination date of December 31, 2009 until June 30, 2010. Institutions participating in the Transaction Account Guarantee Program had the opportunity to opt out of the extended period, and after December 31, 2009, those institutions that have not opted out of the extension will be charged a higher annualized rate according to the institution's risk category. The fees ranged from 15 basis points for institutions in risk category I to 25 basis points for institutions in risk categories III and IV. The assessments will be paid each quarter and will be based on amounts over \$250,000 for the portion of the quarter that the institution is assigned to the risk category. TrustCo elected to continue to participate in the Transaction Account Guarantee Program. During 2009 assessments for this program were approximately \$44 thousand.

The American Recovery and Reinvestment Act of 2009 ("ARRA"), more commonly known as the economic stimulus or economic recovery package, was signed into law on February 17, 2009, by President Obama. ARRA includes a wide variety of programs intended to stimulate the economy and provide for extensive infrastructure, energy, health, and education needs. In addition, ARRA imposes certain new executive compensation and corporate expenditure limits on all current and future TARP recipients until the recipient has repaid the Treasury, which is now permitted under ARRA without penalty and without the need to raise new capital, subject to the Treasury's consultation with the recipient's appropriate regulatory agency.

Gramm-Leach-Bliley Act Privacy Requirements

The Gramm-Leach-Bliley Act of 1999 (the "GLB Act") generally provided for sweeping financial modernization for commercial banks, savings banks, securities firms, insurance companies, and other financial institutions operating in the United States. Among other matters, the GLB Act established a federal rule regarding the confidential treatment of nonpublic personal information about consumers. These provisions of the GLB Act require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. Compliance with the rules was mandatory starting on July 1, 2001. These rules affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. Because the Company does not sell customer information or give customer information to outside third parties or its affiliates except under limited circumstances (e.g., providing customer information to the Company's data processing provider), the rules have not had a significant impact on the Company's results of operations or financial condition.

Other Legislation

The USA PATRIOT Act ("Patriot Act"), which was enacted in the aftermath of the September 11, 2001 terrorist attacks, adopted numerous provisions designed to fight international money laundering and to block terrorist access to the U.S. financial system. Under Title III of the Patriot Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions, including the Company and the Bank, are required to take certain measures to identify their customers, prevent money laundering, monitor certain customer transactions and report suspicious activity to U.S. law enforcement agencies, and scrutinize or prohibit altogether certain transactions of special concern. Financial institutions also are required to respond to requests for information from federal banking regulatory agencies and law enforcement agencies concerning their customers and their transactions. Information-sharing among financial institutions concerning terrorist or money laundering activities is encouraged by an exemption provided from the privacy provisions of the GLB Act and other laws. Further, the effectiveness of a financial institution in combating money laundering activities is a factor to be considered in applications submitted by a financial institution under the Bank Merger Act. The Company has in place a Bank Secrecy Act compliance program, and it engages in very few transactions of any kind with foreign financial institutions or foreign persons.

Index

The Company operates a wholly owned real estate investment trust ("REIT") subsidiary, which was formed to acquire, hold and manage real estate mortgage assets, including, but not limited to residential mortgage loans and mortgage-backed securities. The income earned on these assets, net of expenses, is distributed in the form of dividends. Under current New York State tax law, 60% of the dividends received from the REIT are excluded from total taxable income.

Foreign Operations

Neither TrustCo nor the Bank engage in any operations in foreign countries or have outstanding loans to foreign debtors.

Statistical Information Analysis

The "Management's Discussion and Analysis of Financial Condition and Results of Ope