CCFNB BANCORP INC
Form 10-K
March 31, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year-ended December 31, 2002

[] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 [NO FEE REQUIRED]

For the transition period from _____________to________________

Commission file Number: 0-19028

CCFNB BANCORP, INC.
(Name of small business issuer in its charter)

PENNSYLVANIA (State or other jurisdiction of incorporation or organization)	23-2254643 (I.R.S. Employer Identification Number)
232 East Street, Bloomsburg, Pennsylvania (Address of principal executive offices)	17815 (Zip Code)

Registrant's telephone number, including area code: (570) 784-4400

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $1.25 per share.

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 past 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No______

Indicate by check mark 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 amendment to this Form 10-K. [X]

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes ______ No X

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant based on the average of the bid and asked prices of $23.63 at February 28, 2003, was $30,420,435.

As of February 28, 2003, the Registrant had outstanding 1,287,365 shares of its common stock, par value $1.25 per share.

DOCUMENTS INCORPORATED BY REFERENCE

In addition, portions of the Annual Report to stockholders of the Registrant for the year-ended December 31, 2002, are incorporated by reference in Part II of this Annual Report.

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CCFNB BANCORP, INC.
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SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS

This annual report on Form 10-K, other periodic reports filed by us under the Securities Exchange Act of 1934, as amended, and any other written or oral statements made by or on behalf of us may include "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 which reflect our current views with respect to future events and financial performance. Such forward looking statements are based on general assumptions and are subject to various risks, uncertainties, and other factors that may cause actual results to differ materially from the views, beliefs and projections expressed in such statements. These risks, uncertainties and other factors include, but are not limited to:

- possible changes in economic and business conditions that may affect the prevailing interest rates, the prevailing rates of inflation, or the amount of growth, stagnation, or recession in the global, U.S., and Northcentral Pennsylvania economies, the value of investments,

collectibility of loans and the profitability of business entities;

- possible changes in monetary and fiscal policies, laws and regulations, and other activities of governments, agencies and similar organizations;

- the effects of easing of restrictions on participants in the financial services industry, such as banks, securities brokers and dealers, investment companies and finance companies, and changes evolving from the enactment of the Gramm-Leach-Bliley Act which became effective in 2000, and attendant changes in matters and effects of competition in the financial services industry;

- the cost and other effects of legal proceedings, claims, settlements and judgments; and

- our ability to achieve the expected operating results related to our operations which depends on a variety of factors, including the continued growth of the markets in which we operate consistent with recent historical experience, and our ability to expand into new markets and to maintain profit margins in the face of pricing pressures.

The words "believe," "expect," "anticipate," "project" and similar expressions signify forward looking statements. Readers are cautioned not to place undue reliance on any forward looking statements made by or on behalf of us. Any such statement speaks only as of the date the statement was made. We undertake no obligation to update or revise any forward looking statements.

PART I

ITEM 1. BUSINESS

GENERAL

We are a registered financial holding company, bank holding company, and Pennsylvania business corporation, and are headquartered in Bloomsburg, Pennsylvania. We have one wholly-owned subsidiary which is Columbia County Farmers National Bank or referred to as the Bank. A substantial part of our business consists of the management and supervision of the Bank. Our principal source of income is dividends paid by the Bank. At December 31, 2002, we had approximately:

- $229 million in total assets;

- $151 million in loans;

- $172 million in deposits; and

- $ 27 million in stockholders' equity.

The Bank is a national banking association and member of the Federal Reserve System whose deposits are insured by the Bank Insurance Fund of the FDIC. The Bank is a full-service commercial bank providing a range of services and products, including time and demand deposit accounts, consumer, commercial and mortgage loans to individuals and small to medium-sized business in its Northcentral Pennsylvania market area. The Bank also operates a full-service trust department. A third-party brokerage is also resident in the Bank's main office in Bloomsburg, Pennsylvania. At December 31, 2002, the Bank had six branch banking offices which are located in the Pennsylvania county of Columbia.

We consider our branch banking offices to be a single operating segment, because

these branches have similar:

- economic characteristics,
- products and services,
- operating processes,
- delivery system,
- customer bases, and
- regulatory oversight.

We have not operated any other reportable operating segments in the 3-year period ended December 31, 2002.

We hold a 50% interest in a local insurance agency. The name of this agency is Neighborhood Group, Inc. and trades under two fictitious names: Neighborhood Advisors (insurance agency) and Neighborhood Group Financial Services (insurance and investment). Through this joint venture, we sell insurance products and services, annuities and other investment products.

As of December 31, 2002, we had 81 employees on a full-time equivalent basis. The Company and the Bank are not parties to any collective bargaining agreement and employee relations are considered to be good.

SUPERVISION AND REGULATION

The following discussion sets forth the material elements of the regulatory framework applicable to us and the Bank and provides certain specific information. This regulatory framework is primarily intended for the protection of investors in our common stock, depositors at the Bank and the Bank Insurance Fund that insures bank deposits. To the extent that the following information describes statutory and regulatory provisions, it is qualified by reference to those provisions. A change in the statutes, regulations or regulatory policies applicable to us or the Bank may have a material effect on our business.

INTERCOMPANY TRANSACTIONS

Various governmental requirements, including Sections 23A and 23B of the Federal Reserve Act and Regulation W of the Federal Reserve Board, limit borrowings by us from the Bank and also limit various other transactions between us and the Bank. For example, Section 23A of the Federal Reserve Act limits to no more than ten percent of its total capital the aggregate outstanding amount of the Bank's loans and other "covered transactions" with any particular non-bank affiliate (including a financial subsidiary) and limits to no more than 20 percent of its total capital the aggregate outstanding amount of the Bank's covered transactions with all of its affiliates (including financial subsidiaries). At December 31, 2002, approximately $5 million was available for loans to us from the Bank. Section 23A of the Federal Reserve Act also generally requires that the Bank's loans to its non-bank affiliates (including financial subsidiaries) be secured, and Section 23B of the Federal Reserve Act generally requires that the Bank's transactions with its non-bank affiliates (including financial subsidiaries) be on arm's-length terms. Also, we, the Bank, and any financial subsidiary are prohibited from engaging in certain "tie-in" arrangements in connection with extensions of credit or provision of property or services.

SUPERVISORY AGENCIES

As a national bank and member of the Federal Reserve System, the Bank is subject to primary supervision, regulation, and examination by the Office of the Comptroller of the Currency and secondary regulation by the FDIC. The Bank is subject to extensive statutes and regulations that significantly affect its business and activities. The Bank must file reports with its regulators concerning its activities and financial condition and obtain regulatory approval to enter into certain transactions. The Bank is also subject to periodic examinations by its regulators to ascertain compliance with various regulatory requirements. Other applicable statutes and regulations relate to insurance of deposits, allowable investments, loans, leases, acceptance of deposits, trust activities, mergers, consolidations, payment of dividends, capital requirements, reserves against deposits, establishment of branches and certain other facilities, limitations on loans to one borrower and loans to affiliated persons, activities of subsidiaries and other aspects of the business of banks. Recent Federal legislation has instructed federal agencies to adopt standards or guidelines governing banks' internal controls, information systems, loan documentation, credit underwriting, interest rate exposure, asset growth, compensation and benefits, asset quality, earnings and stock valuation, and other matters. Legislation adopted in 1994 gives the federal banking agencies greater flexibility in implementing standards on asset quality, earnings, and stock valuation. Regulatory authorities have broad flexibility to initiate proceedings designed to prohibit banks from engaging in unsafe and unsound banking practices.

We and the Bank are also affected by various other governmental requirements and regulations, general economic conditions, and the fiscal and monetary policies of the federal government and the Federal Reserve Board. The monetary policies of the Federal Reserve Board influence to a significant extent the overall growth of loans, leases, investments, deposits, interest rates charged on loans, and interest rates paid on deposits. The nature and impact of future changes in monetary policies are often not predictable.

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We are subject to the jurisdiction of the SEC for matters relating to the offering and sale of our securities. We are also subject to the SEC's rules and regulations relating to periodic reporting, insider trader reports and proxy solicitation materials. Our common stock is not listed for quotation of prices on The NASDAQ Stock Market or any other nationally-recognized stock exchange. However, daily bid and asked price quotations are maintained on the interdealer electronic bulletin board system.

SUPPORT OF THE BANK

Under current Federal Reserve Board policy, we are expected to act as a source of financial and managerial strength to the Bank by standing ready to use available resources to provide adequate capital funds to the Bank during periods of financial adversity and by maintaining the financial flexibility and capital-raising capacity to obtain additional resources for assisting the Bank. The support expected by the Federal Reserve Board may be required at times when we may not have the resources or inclination to provide it.

If a default occurred with respect to the Bank, any capital loans to the Bank from us would be subordinate in right of payment to payment of the Bank depositors and certain of its other obligations.

LIABILITY OF COMMONLY CONTROLLED BANKS

The Bank can be held liable for any loss incurred, or reasonably expected to be incurred, by the FDIC in connection with:

- the default of a commonly controlled FDIC-insured depository institution or

- any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default.

"Default" generally is defined as the appointment of a conservator or receiver, and "in danger of default" generally is defined as the existence of certain conditions indicating that a default is likely to occur in the absence of regulatory assistance.

DEPOSITOR PREFERENCE STATUTE

In the "liquidation or other resolution" of the Bank by any receiver, federal legislation provides that deposits and certain claims for administrative expenses and employee compensation against the Bank are afforded a priority over the general unsecured claims against the Bank, including federal funds and letters of credit.

ALLOWANCE FOR LOAN LOSSES

There are certain risks inherent in making all loans. These risks include interest rate changes over the time period in which loans may be repaid, risks resulting from changes in our Northcentral Pennsylvania area economy, risks inherent in dealing with individual borrowers, and, in the case of a loan backed by collateral, risks resulting from uncertainties about the future value of the collateral.

Commercial loans and commercial real estate loans comprised 33% of our total consolidated loans as of December 31, 2002. Commercial loans are typically larger than residential real estate loans and consumer loans. Because our loan portfolio contains a significant number of commercial loans and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans may cause a significant increase in nonperforming loans. An increase in nonperforming loans could result in a loss of earnings from these loans, an increase in the provision for loan losses and loan charge-offs.

We maintain an allowance for loan losses to absorb any loan losses based on, among other things, our historical experience, an evaluation of economic conditions, and regular reviews of any delinquencies and loan portfolio quality. We cannot assure you that charge-offs in future periods will not exceed the allowance for loan losses or that additional increases in the allowance for loan losses will not be required. Additions to the allowance for loan losses would result in a decrease in our net income and, possibly, our capital.

In evaluating our allowance for loan losses, we divide our loans into the following categories:

- commercial,

- real estate mortgages,

- consumer, and

- unallocated.

We evaluate some loans as a group and some individually. We use the following criteria in choosing loans to be evaluated individually:

- by industry group,
- by risk profile, and
- by past due status.

After our evaluation of these loans, we allocate portions of our allowance for loan losses to categories of loans based upon the following considerations:

- historical trends,
- economic conditions, and
- any known deterioration.

We use a self-correcting mechanism to reduce differences between estimated and actual losses. We will, on a quarterly basis, weigh our loss experience among the various categories and reallocate the allowance for loan losses.

For a more in-depth presentation of our allowance for loan losses and the components of this allowance, please refer to Item 7 of this report under Management's Discussion and Analysis of Financial Condition and Results of Operations at "Non-Performing Assets," "Allowance for Loan Losses and Related Provision," and "Summary of Loan Loss Experience," as well as Note 4 at Exhibit 13 to this report.

SOURCES OF FUNDS

GENERAL. Our primary source of funds is the cash flow provided by our investing activities, including principal and interest payments on loans and mortgage-backed and other securities. Our other sources of funds are provided by operating activities (primarily net income) and financing activities, including borrowings and deposits.

DEPOSITS. We offer a variety of deposit accounts with a range of interest rates and terms. We currently offer passbook and statement savings accounts, NOW accounts, money market accounts, demand deposit accounts and certificates of deposit. The flow of deposits is influenced significantly by general economic conditions, changes in prevailing interest rates, pricing of deposits and competition. Our deposits are primarily obtained from areas surrounding our banking offices. We rely primarily on marketing, new products, service and long-standing relationships with customers to attract and retain these deposits. At December 31, 2002, our deposits totaled $172 million. Of the total deposit balance, $10 million or 6%, represent Individual Retirement Accounts and $30 million or 17% represent certificates of deposit in amounts of $100,000 or more.

When we determine the levels of our deposit rates, consideration is given to local competition, yields of U.S. Treasury securities and the rates charged for other sources of funds. We have maintained a high level of core deposits, which has contributed to our low cost of funds. Core deposits include savings, money market, NOW and demand deposit accounts, which, in the aggregate, represented 45% of total deposits at December 31, 2002 and 44% of total deposits at December 31, 2001.

For a further discussion of our deposits, please refer to Item 7 of this report under Management's Discussion and Analysis of Financial Condition and Results of Operations at "Deposits and Borrowed Funds," as well as Note 7 at Exhibit 13 to this report.

CAPITAL REQUIREMENTS

We are subject to risk-based capital requirements and guidelines imposed by the Federal Reserve Board, which are substantially similar to the capital requirements and guidelines imposed by the Comptroller of the Currency on the Bank. For this purpose, a bank's or bank holding company's assets and certain specified off-balance sheet commitments are assigned to four risk categories, each weighted differently based on the level of credit risk that is ascribed to those assets or commitments. In addition, risk-weighted assets are adjusted for low-level recourse and market-risk equivalent assets. A bank's or bank holding company's capital, in turn, includes the following tiers:

- core ("Tier 1") capital, which includes common equity, non-cumulative perpetual preferred stock, a limited amount of cumulative perpetual preferred stock, and minority interests in equity accounts of consolidated subsidiaries, less goodwill, certain identifiable intangible assets, and certain other assets; and

- supplementary ("Tier 2") capital, which includes, among other items, perpetual preferred stock not meeting the Tier 1 definition, mandatory convertible securities, subordinated debt and allowances for loan and lease losses, subject to certain limitations, less certain required deductions.

We, like other bank holding companies, are required to maintain Tier 1 and "Total Capital" (the sum of Tier 1 and Tier 2 capital, less certain deductions) equal to at least four percent and eight percent of their total risk-weighted assets (including certain off-

balance sheet items, such as unused lending commitments and standby letters of credit), respectively. At December 31, 2002, we met both requirements, with Tier 1 and Total Capital equal to 18.53 percent and 19.46 percent of total risk-weighted assets.

The Federal Reserve Board has adopted rules to incorporate market and interest rate risk components into their risk-based capital standards. Under these market-risk requirements, capital will be allocated to support the amount of market risk related to a financial institution's ongoing trading activities.

The Federal Reserve Board also requires bank holding companies to maintain a minimum "Leverage Ratio" (Tier 1 capital to adjusted total assets) of three percent if the bank holding company has the highest regulatory rating and meets certain other requirements, or of three percent plus an additional cushion of at least one to two percentage points if the bank holding company does not meet these requirements. At December 31, 2002, our leverage ratio was 11.77 percent.

The Federal Reserve Board may set capital requirements higher than the minimums noted above for holding companies whose circumstances warrant it. For example, bank holding companies experiencing or anticipating significant growth may be expected to maintain strong capital positions substantially above the minimum supervisory levels without significant reliance on intangible assets. Furthermore, the Federal Reserve Board has indicated that it will consider a "Tangible Tier 1 Leverage Ratio" (deducting all intangibles) and other indications of capital strength in evaluating proposals for expansion or new activities, or when a bank holding company faces unusual or abnormal risk. The Federal Reserve Board has not advised us of any specific minimum leverage ratio applicable to us.

The Bank is subject to similar risk-based capital and leverage requirements adopted by the Comptroller of the Currency. The Bank was in compliance with the applicable minimum capital requirements as of December 31, 2002. The Comptroller

of the Currency has not advised the Bank of any specific minimum leverage ratio applicable to the Bank.

Failure to meet capital requirements could subject the Bank to a variety of enforcement remedies, including the termination of deposit insurance by the FDIC, and to certain restrictions on its business. The Federal Deposit Insurance Corporation Improvements Act of 1991 ("FDICIA"), among other things, identifies five capital categories for insured banks - well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized - and requires federal bank regulatory agencies to implement systems for "prompt corrective action" for insured banks that do not meet minimum capital requirements based on these categories. The FDICIA imposed progressively more restrictive constraints on operations, management, and capital distributions, depending on the category in which an institution is classified. Unless a bank is well capitalized, it is subject to restrictions on its ability to offer brokered deposits, on "pass-through" insurance coverage for certain of its accounts, and on certain other aspects of its operations. FDICIA generally prohibits a bank from paying any dividend or making any capital distribution or paying any management fee to its holding company if the bank would thereafter be undercapitalized. An undercapitalized bank is subject to regulatory monitoring and may be required to divest itself of or liquidate subsidiaries. Holding companies of such institutions may be required to divest themselves of such institutions or divest themselves of or liquidate other affiliates. An undercapitalized bank must develop a capital restoration plan, and its parent bank holding company must guarantee the bank's compliance with the plan up to the lesser of five percent of the bank's assets at the time it became undercapitalized or the amount needed to comply with the plan. Critically undercapitalized institutions are prohibited from making payments of principal and interest on subordinated debt and are generally subject to the mandatory appointment of a conservator or receiver.

Rules adopted by the Comptroller of the Currency under FDICIA provide that a national bank is deemed to be well capitalized if the bank has a total risk-based capital ratio of ten percent or greater, a Tier 1 risk-based capital ratio of six percent or greater, and a leverage ratio of five percent or greater and the institution is not subject to a written agreement, order, capital directive, or prompt corrective action directive to meet and maintain a specific level of any capital measure. As of December 31, 2002, the Bank was well-capitalized, based on the prompt corrective action ratios and guidelines described above. It should be noted, however, that a bank's capital category is determined solely for the purpose of applying the Comptroller of the Currency's prompt corrective action regulations, and that the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects.

BROKERED DEPOSITS

Under FDIC regulations, no FDIC-insured bank can accept brokered deposits unless it (1) is well capitalized, or (2) is adequately capitalized and receives a waiver from the FDIC. In addition, these regulations prohibit any bank that is not well capitalized from paying an interest rate on brokered deposits in excess of three-quarters of one percentage point over certain prevailing market rates. As of December 31, 2002, the Bank held no brokered deposits.

DIVIDEND RESTRICTIONS

We are a legal entity separate and distinct from the Bank. In general, under Pennsylvania law, we cannot pay a cash dividend if such payment would render us insolvent. Our revenues consist primarily of dividends paid by the Bank. The National Bank Act

limits the amount of dividends the Bank can pay to us without regulatory approval. The Bank may declare and pay dividends to us to the lesser of:

- the level of undivided profits, and
- absent regulatory approval, an amount not in excess of net income combined with retained net income for the preceding two years.

At December 31, 2002, approximately $1 million was available for payment of dividends to us.

In addition, federal bank regulatory authorities have authority to prohibit the Bank from engaging in an unsafe or unsound practice in conducting its business. Depending upon the financial condition of the bank in question, the payment of dividends could be deemed to constitute an unsafe or unsound practice. The ability of the Bank to pay dividends in the future is currently influenced, and could be further influenced, by bank regulatory policies and capital guidelines.

DEPOSIT INSURANCE ASSESSMENTS

The deposits of the Bank are insured up to regulatory limits by the FDIC and, accordingly, are subject to deposit insurance assessments to maintain the Bank Insurance Fund ("BIF") administered by the FDIC. The FDIC has adopted regulations establishing a permanent risk-related deposit insurance assessment system. Under this system, the FDIC places each insured bank in one of nine risk categories based on the bank's capitalization and supervisory evaluations provided to the FDIC by the institution's primary federal regulator. An insured bank's insurance assessment rate is then determined by the risk category in which it is classified by the FDIC.

In the light of the recent favorable financial situation of the federal deposit insurance funds and the recent low number of depository institution failures, the annual insurance premiums on bank deposits insured by the BIF vary between $0.00 per $100 of deposits for banks classified in the highest capital and supervisory evaluation categories to $0.27 per $100 of deposits for banks classified in the lowest capital and supervisory evaluation categories. BIF assessment rates are subject to semi-annual adjustment by the FDIC within a range of up to five basis points without public comment. The FDIC also possesses authority to impose special assessments from time to time.

The Deposit Insurance Funds Act provides for assessments to be imposed on insured depository institutions with respect to deposits insured by the BIF (in addition to assessments currently imposed on depository institutions with respect to BIF-insured deposits) to pay for the cost of Financing Corporation ("FICO") funding. The FDIC established the FICO assessment rates effective for the fourth quarter 2002 and first quarter of 2003 at approximately $0.170 and $0.168, respectively, per $100 annually for BIF-assessable deposits. The FICO assessments are adjusted quarterly to reflect changes in the assessment bases of the FDIC insurance funds and do not vary depending upon a depository institution's capitalization or supervisory evaluations. In 2002, the Bank paid FICO assessments of $27,051.

INTERSTATE BANKING AND BRANCHING

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act ("Riegle-Neal"), subject to certain concentration limits and other requirements:

- bank holding companies, such as we, are permitted to acquire banks and bank holding companies located in any state;

- any bank that is a subsidiary of a bank holding company is permitted to receive deposits, renew time deposits, close loans, service loans, and receive loan payments as an agent for any other depository institution subsidiary of that bank holding company; and

- banks are permitted to acquire branch offices outside their home states by merging with out-of-state banks, purchasing branches in other states, and establishing de novo branch offices in other states.

The ability of banks to acquire branch offices through purchase or opening of other branches is contingent, however, on the host state having adopted legislation "opting in" to those provisions of Riegle-Neal. In addition, the ability of a bank to merge with a bank located in another state is contingent on the host state not having adopted legislation "opting out" of that provision of Riegle-Neal. Pennsylvania has opted in to all of these provisions upon the condition that another host state has similar or reciprocal requirements as in Pennsylvania.

As of the date of this report, we are not contemplating any interstate acquisitions of a bank or a branch office.

CONTROL ACQUISITIONS

The Change in Bank Control Act prohibits a person or group of persons from acquiring "control" of a bank holding company, unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of ten percent or more of a class of voting stock of a bank holding company with a class of securities registered under Section 12 of the Exchange Act, such as we, would, under the circumstances set forth in the presumption, constitute acquisition of control of the bank holding company.

In addition, a company is required to obtain the approval of the Federal Reserve Board under the Bank Holding Company Act before acquiring 25 percent (five percent in the case of an acquirer that is a bank holding company) or more of any class of outstanding common stock of a bank holding company, such as we, or otherwise obtaining control or a "controlling influence" over that bank holding company.

PERMITTED NON-BANKING ACTIVITIES

The Federal Reserve Board permits us or our subsidiaries to engage in nonbanking activities so closely related to banking or managing or controlling banks as to be a proper incident thereto. For a discussion of other activities that are financial in nature in which we can engage, see the caption that follows entitled "Financial Services Modernization."

The Federal Reserve Board requires us to serve as a source of financial and managerial strength to the Bank and not to conduct our operations in an unsafe and unsound manner. Whenever the Federal Reserve Board believes an activity that we are doing or our control of a nonbank subsidiary (other than a nonbank subsidiary of the Bank) constitutes a serious risk to the financial safety, soundness, or stability of the Bank and is inconsistent with sound banking principles or the purposes of the federal banking laws, the Federal Reserve Board may require us to terminate that activity or to terminate control of that subsidiary. While the types of permissible activities are subject to change by the Federal Reserve Board, the principal nonbanking activities that presently may be conducted by a bank holding company or its subsidiary without prior

approval of the Federal Reserve Board are:

- Servicing Activities. Furnishing services for, or establish or acquire a company that engages solely in servicing activities for:
  - us or the Bank in connection with activities authorized by law, such as commitments entered into by any subsidiary with third parties as long as we or our servicing company comply with published guidelines and do not act as a principal in dealing with third parties;
  - the internal operations of the Bank, such as:
    - accounting, auditing and appraising;
    - advertising and public relations;
    - data processing and transmission services, data bases or facilities;
    - personnel services;
    - courier services;
    - holding or operating property used by our subsidiaries or for their future use;
    - liquidating property acquired from the Bank; and
    - selling, purchasing or underwriting insurance, such as blanket bond insurance, group insurance for employees and property and casualty insurance.
- Safe deposit business. Conduct a safe deposit business or acquire voting securities of a company that conducts such business.
- Securities or property representing five percent or less of any company. Acquiring five percent or less of the outstanding voting securities of any company regardless of that company's activities.
- Extending credit and servicing loans. Making, acquiring, brokering, or servicing loans or other extensions of credit (including factoring, issuing letters of credit and accepting drafts) for the company's account or for the account of others.
- Activities related to extending credit. Any activity usual in connection with making, acquiring, brokering or servicing loans or other extensions of credit, as determined by the Federal Reserve Board. The Federal Reserve Board has determined that the following activities are usual in connection with making, acquiring, brokering or servicing loans or other extensions of credit:

  - Real estate and personal property appraising. Performing appraisals of real estate and tangible and intangible personal property, including securities.
  - Arranging commercial real estate equity financing. Acting as intermediary for the financing of commercial or industrial income-producing real estate by arranging for the transfer of

the title, control, and risk of such a real estate project to one or more investors, if the bank holding company and its affiliates do not have an interest in, or participate in managing or developing, a real estate project for which it arranges equity financing, and do not promote or sponsor the development of the property.

  - Check-guaranty services. Authorizing a subscribing merchant to accept personal checks tendered by the merchant's customers in payment for goods and services, and purchasing from the merchant validly authorized checks that are subsequently dishonored.

  - Collection agency services. Collecting overdue accounts receivable, either retail or commercial.

  - Credit bureau services. Maintaining information related to the credit history of consumers and providing the information to a credit grantor who is considering a borrower's application for credit or who has extended credit to the borrower.

  - Asset management, servicing, and collection activities. Engaging under contract with a third party in asset management, servicing, and collection of assets of a type that an insured depository institution may originate and own, if the company does not engage in real property management or real estate brokerage services as part of these services.

  - Acquiring debt in default. Acquiring debt that is in default at the time of acquisition under certain conditions.

  - Real estate settlement servicing. Providing real estate settlement services.

- Leasing personal or real property. Leasing personal or real property or acting as agent, broker, or adviser in leasing such property under certain conditions.

- Operating nonbank depository institutions:

  - Industrial banking. Owning, controlling, or operating an industrial bank, Morris Plan bank, or industrial loan company, so long as the institution is not a bank.

  - Operating savings association. Owning, controlling or operating a savings association, if the savings association engages only in deposit-taking activities, lending, and other activities that are permissible for bank holding companies.

- Trust company functions. Performing functions or activities that may be performed by a trust company (including activities of a fiduciary, agency, or custodial nature), in the manner authorized by federal or state law, so long as the company is not a bank for purposes of the Bank Holding Company Act.

- Financial and investment advisory activities. Acting as investment or financial advisor to any person, including (without, in any way, limiting the foregoing):

  - Serving as investment adviser (as defined in section 2(a)(20) of the Investment Company Act of 1940, 15 U.S.C. 80a-2(a)(20)), to an investment company registered under that

act, including sponsoring, organizing, and managing a closed-end investment company;

- Furnishing general economic information and advice, general economic statistical forecasting services, and industry studies;

- Providing advice in connection with mergers, acquisitions, divestitures, investments, joint ventures, leveraged buyouts, recapitalizations, capital structurings, financing transactions and similar transactions, and conducting financial feasibility studies;

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- Providing information, statistical forecasting, and advice with respect to any transaction in foreign exchange, swaps, and similar transactions, commodities, and any forward contract, option, future, option on a future, and similar instruments;

- Providing educational courses, and instructional materials to consumers on individual financial management matters; and

- Providing tax-planning and tax-preparation services to any person.

- Agency transactional services for customer investments:

  - Securities brokerage. Providing securities brokerage services (including securities clearing and/or securities execution services on an exchange), whether alone or in combination with investment advisory services, and incidental activities (including related securities credit activities and custodial services), if the securities brokerage services are restricted to buying and selling securities solely as agent for the account of customers and do not include securities underwriting or dealing.

  - Riskless principal transactions. Buying and selling in the secondary market all types of securities on the order of customers as a "riskless principal" to the extent of engaging in a transaction in which the company, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security for its own account to offset a contemporaneous sale to (or purchase from) the customer. This does not include:

(A) Selling bank-ineligible securities at the order of a customer that is the issuer of the securities, or selling bank-ineligible securities in any transaction where the company has a contractual agreement to place the securities as agent of the issuer; or

(B) Acting as a riskless principal in any transaction involving a bank-ineligible security for which the company or any of its affiliates acts as underwriter (during the period of the underwriting or for 30 days thereafter) or dealer.

  - Private placement services. Acting as agent for the private placement of securities in accordance with the requirements of

the Securities Act of 1933 ("1933 Act") and the rules of the Securities and Exchange Commission, if the company engaged in the activity does not purchase or repurchase for its own account the securities being placed, or hold in inventory unsold portions of issues of these securities.

- Futures commission merchant. Acting as a futures commission merchant ("FCM") for unaffiliated persons in the execution, clearance, or execution and clearance of any futures contract and option on a futures contract traded on an exchange in the United States or abroad under certain conditions.

- Other transactional services. Providing to customers as agent transactional services with respect to swaps and similar transactions.

- Investment transactions as principal:

  - Underwriting and dealing in government obligations and money market instruments. Underwriting and dealing in obligations of the United States, general obligations of states and their political subdivisions, and other obligations that state member banks of the Federal Reserve System may be authorized to underwrite and deal in under 12 U.S.C. 24 and 335, including banker's acceptances and certificates of deposit, under the same limitations as would be applicable if the activity were performed by the bank holding company's subsidiary member banks or its subsidiary nonmember banks as if they were member banks.

  - Investing and trading activities. Engaging as principal in:

    (A) Foreign exchange;

    (B) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on any rate, price, financial asset (including gold, silver, platinum, palladium, copper, or any other metal approved by the Federal Reserve Board), nonfinancial asset, or group of assets, other than a bank-ineligible security under certain conditions.

    (C) Forward contracts, options, futures, options on futures, swaps, and similar contracts, whether traded on exchanges or not, based on an index of a rate, a price, or the value of any financial asset, nonfinancial asset, or group of assets, if the contract requires such settlement.

  - Buying and selling bullion, and related activities. Buying, selling and storing bars, rounds, bullion, and coins of gold, silver, platinum, palladium, copper, and any other metal approved by the Federal Reserve Board, for the company's own account and the account of others, and providing incidental services such as arranging for storage, safe custody, assaying, and shipment.

- Management consulting and counseling activities:

  - Management consulting. Providing management consulting advice under certain conditions.

- Employee benefits consulting services. Providing consulting services to employee benefit, compensation and insurance plans, including designing plans, assisting in the implementation of plans, providing administrative services to plans, and developing employee communication programs for plans.

- Career counseling services. Providing career counseling services to:

  (A) A financial organization and individuals currently employed by, or recently displaced from, a financial organization;

  (B) Individuals who are seeking employment at a financial organization; and

  (C) Individuals who are currently employed in or who seek positions in the finance, accounting, and audit departments of any company.

- Support services:

  - Courier services. Providing courier services for:

    (A) Checks, commercial papers, documents, and written instruments (excluding currency or bearer-type negotiable instruments) that are exchanged among banks and financial institutions; and

    (B) Audit and accounting media of a banking or financial nature and other business records and documents used in processing such media.

(ii) Printing and selling MICR-encoded items. Printing and selling checks and related documents, including corporate image checks, cash tickets, voucher checks, deposit slips, savings withdrawal packages, and other forms that require Magnetic Ink Character Recognition ("MICR") encoding.

- Insurance agency and underwriting:

  - Credit insurance. Acting as principal, agent, or broker for insurance (including home mortgage redemption insurance) that is:

    (A) Directly related to an extension of credit by the bank holding company or any of its subsidiaries; and

    (B) Limited to ensuring the repayment of the outstanding balance due on the extension of credit in the event of the death, disability, or involuntary unemployment of the debtor.

  - Finance company subsidiary. Acting as agent or broker for insurance directly related to an extension of credit by a finance company that is a subsidiary of a bank holding company under certain conditions.

  - Engaging in any general insurance agency activities.

  - Supervision of retail insurance agents. Supervising on behalf of insurance underwriters the activities of retail insurance agents who sell fidelity, property and casualty and group insurances for the operations and employees of the bank holding company or its subsidiaries.

- Community development activities:

  - Financing and investment activities. Making equity and debt investments in corporations or projects designed primarily to promote community welfare, such as the economic rehabilitation and development of low-income areas by providing housing, services, or jobs for residents.

  - Advisory activities. Providing advisory and related services for programs designed primarily to promote community welfare.

- Money orders, savings bonds, and traveler's checks. The issuance and sale at retail of money orders and similar consumer-type payment instruments; the sale of U.S. savings bonds; and the issuance and sale of traveler's checks.

- Data processing. Providing data processing data transmission services, facilities (including data processing and data transmission hardware, software, documentation, or operating personnel), data bases, advice, and access to such services, facilities, or data bases by any technological means under certain conditions.

COMMUNITY REINVESTMENT ACT

The Community Reinvestment Act of 1977, as amended (the "CRA"), and the regulations promulgated to implement the CRA are designed to create a system for bank regulatory agencies to evaluate a depository institution's record in meeting the credit needs of its community. CRA regulations establish tests for evaluating both small and large depository institutions' investment in the community. A "small bank" is defined as a bank which has total assets of less than $250 million and is independent or is an affiliate of a holding company with less than $1 billion in assets. There are streamlined procedures for evaluating small banks and the frequency of CRA examinations will occur less often based upon a bank's CRA rating. A large retail institution is one which does not meet the "small bank" definition. A large retail institution can be evaluated under one of two tests: (1) a three-part test evaluating the institution's lending, service and investment performance; or (2) a "strategic plan" designed by the institution with community involvement and approved by the appropriate federal bank regulator. A large institution must choose one of these options under which to be examined. In addition, the CRA regulations include separate rules regarding the manner in which "wholesale banks" and "limited purpose banks" will be evaluated for compliance.

For the purposes of the CRA regulations, the Bank is deemed to be a "small bank," based upon financial information as of December 31, 2002. The Bank will be examined under the streamlined procedures. The Bank received a "satisfactory" CRA rating in its last CRA examination which was held in 2002.

CONCENTRATION

We are not dependent for deposits nor exposed by loan concentrations to a single customer or to a small group of customers the loss of any one or more of which would have a materially adverse effect on our financial condition.

FINANCIAL SERVICES MODERNIZATION

The Gramm-Leach-Bliley Act (the "GLB Act"), in general, took effect on March 11, 2000. The GLB Act contains some of the most far-reaching changes governing the operations of companies doing business in the financial services industry. The GLB Act eliminates the restrictions placed on the activities of banks and bank holding companies. By creating two new structures - financial holding companies and financial subsidiaries - we and the Bank will be allowed to provide a wider array of financial services and products that were reserved only for insurance companies and securities firms. In addition, we can now affiliate with an insurance company and a securities firm.

On December 19, 2000 we became a financial holding company. A financial holding company has authority to engage in activities referred to as "financial activities" that are not permitted to bank holding companies. A financial holding company may also affiliate with companies that are engaged in financial activities. A "financial activity" is an activity that does not pose a safety and soundness risk and is:

- financial in nature,
- incidental to an activity that is financial in nature, or

- complimentary to a financial activity.

The GLB Act lists certain activities as financial in nature:

- Lending, investing or safeguarding money or securities;
- Underwriting insurance or annuities, or acting as an insurance or annuity principal, agent or broker;
- Providing financial or investment advice;
- Issuing or selling interests in pools of assets that a bank could hold;
- Underwriting, dealing in or making markets in securities;
- Engaging in any activity that the Federal Reserve Board found before the GLB Act to be related closely to banking (See the section in this report entitled "Permitted Non-banking Activities");
- Engaging within the United States in any activity that a bank holding company could engage in outside of the country, if the Federal Reserve Board determined before the GLB Act that the activity was usual in connection with banking or other financial operations internationally;
- Merchant banking - acquiring or controlling ownership interests in an entity engaged in impermissible activities, if: the interests are not held by a depository institution; the interests are held by a securities affiliate or an investment advisory affiliate of an insurance company as part of underwriting, merchant or investment banking activity; the interests are held long enough to enable their sale in a manner consistent with the financial viability of such an activity; and we do not control the entity except to the extent necessary to obtain a reasonable return on the investment; or

- Insurance portfolio investing - acquiring or controlling ownership interests in an entity engaged in impermissible activities, if: the interests are not held by a depository institution; the interests are held by an insurance or annuity company; the interests represent investments made in the ordinary course of business in accordance with state law; and we do not control the entity except to the extent necessary to obtain a reasonable return on the investment.

The GLB Act instructs the Federal Reserve Board to adopt a regulation or order defining certain additional activities as financial in nature, to the extent they are consistent with the purposes of the GLB Act. These are:

- Lending, exchanging, transferring, investing for others or safeguarding financial assets other than money or securities;

- Providing any method of transferring financial assets; and

- Arranging, effecting or facilitating financial transactions for third parties.

Other activities also may be decided by the Federal Reserve Board to be financial in nature or incidental to a financial activity if they meet specified criteria. The Federal Reserve Board is instructed to consider the purposes of the GLB Act and the Bank Holding Company Act; changes in the market in which financial holding companies compete; changes in the technology used to deliver financial services; and whether the proposed activity is necessary or appropriate to allow a financial holding company and its affiliates to compete effectively, deliver services efficiently and offer services through the most advanced technological means available.

The GLB Act gives national banks authority to use "financial subsidiaries" to engage in financial activities. This authority has some limitations. A financial subsidiary of the Bank may not, as a principal:

- underwrite insurance or annuities;

- engage in real estate development or investment;

- engage in merchant banking; or

- engage in insurance portfolio investment activities.

A bank's investment in a financial subsidiary will affect the way it calculates its capital. The bank must deduct from its assets and stockholders' equity the total of its investments in financial subsidiaries. Moreover, a bank must present its financial information in two ways: in accordance with generally accepted accounting principles, and, separately, in a manner that reflects the segregation of the bank's investments in financial subsidiaries.

PRIVACY

Title V of the GLB Act creates a minimum federal standard of privacy by limiting the instances which we and the Bank may disclose nonpublic personal information about a consumer of our products or services to nonaffiliated third parties. A state, such as Pennsylvania, can impose a greater or more restrictive standard of privacy than the GLB Act. The GLB Act distinguishes "consumers" from "customers" for purposes of the notice requirements imposed by this Act. We are required to give a "consumer" a privacy notice only if we intend to disclose nonpublic personal information about the consumer to a nonaffiliated

third party. However, by contrast, we are required to give a "customer" a notice of our privacy policy at the time of the establishment of a customer relationship and then annually, thereafter during the continuation of the customer relationship.

The term consumer is different from the term customer. A consumer means an individual who obtains or has obtained a financial product or service from the Bank that is to be used primarily for personal, family or household purposes or that individual's representative. A customer of the Bank is an individual with a continuous relationship with the Bank. The Office of the Comptroller of the Currency has regulations which give several examples of a consumer and customer relationship:

- An individual who applies to the Bank for credit for personal, family or household purposes is a consumer of a financial service, regardless of whether the credit is extended.
- An individual who provides nonpublic personal information to the Bank in order to obtain a determination about whether he or she may qualify for a loan to be used primarily for personal, family, or household purposes is a consumer of a financial service, regardless of whether the loan is extended by the Bank or another financial institution.
- An individual who provides nonpublic personal information to the Bank in connection with obtaining or seeking to obtain financial, investment or economic advisory services is a consumer regardless of whether the Bank establishes an ongoing advisory relationship.
- An individual who negotiates a workout with the Bank for a loan that the Bank owns is a consumer regardless of whether the Bank originally extended the loan to the individual.
- An individual who has a loan from the Bank is the Bank's consumer even if the Bank:
  - Hires an agent to collect on the loan;
  - Sells the rights to service the loan; or
  - Bought the loan from the financial institution that originated the loan.
- An individual is not the Bank's consumer solely because the Bank processes information about the individual on behalf of a financial institution that extended the loan to the individual.

On the other hand, several examples of a customer follow:

- A customer has a continuing relationship with the Bank if the customer:
  - Has a deposit, loan, credit, trust or investment account with the Bank;
  - Purchases an insurance product from the Bank;
  - Holds an investment product through the Bank;
    - Enters into an agreement or understanding with the Bank whereby the Bank undertakes to arrange or broker a home

mortgage loan for the customer;

- Has a loan that the Bank services where the Bank owns the servicing rights;

- Enters into a lease of personal property with the Bank; or

- Obtains financial, investment, or economic advisory services from the Bank for a fee.

- A person does not, however, have a continuing relationship with the Bank and therefore is not a customer, if:

  - The person only obtains a financial product or service in an isolated transaction, such as withdrawing cash from the Bank's ATM or purchasing a cashier's check or money order;

- The Bank sells the person's loan and does not retain the rights to service the loan; or

- The Bank sells the person airline tickets, travel insurance or traveler's checks in an isolated transaction.

In general, the Bank cannot disclose to a nonaffiliated third party any nonpublic personal information of its customers and consumers unless the Bank provides its customer or consumer with a notice that includes:

- the policies and practices of the Bank with regard to:

  - disclosing nonpublic personal information to nonaffiliated third parties;

  - the categories of persons to whom the information is or may be disclosed; and

  - the policy for disclosure to former customers;

- categories of nonpublic personal information that are collected by the Bank;

- the policies that the Bank maintains to protect the confidentiality and security of nonpublic personal information;

- the disclosure, if required, under the Fair Credit Reporting Act; and

- in addition, the Bank must provide an opt out notice to each of its consumers and customers that explains accurately the right to opt out of any disclosure by the Bank of the customer's or consumer's nonpublic personal information and the means by which the customer or consumer may exercise the opt out right.

The GLB Act sets forth a new requirement that this notice to a consumer or customer must be in clear and conspicuous or "plain English" language and presentation. The regulations give several examples of the rules to follow in drafting these notices:

- The Bank makes its notice reasonably understandable if, the Bank:

   - Presents the information contained in the notice in clear, concise sentences, paragraphs and sections;

   - Uses short explanatory sentences and bullet lists, whenever possible;

   - Uses definite, concrete, everyday words and active voice, whenever possible;

   - Avoids multiple negatives;

   - Avoids legal and highly technical business terminology; and

   - Avoids boilerplate explanations that are imprecise and readily subject to different interpretations.

- The Bank designs its notice to call attention to the nature and significance of the information contained in the notice if, to the extent applicable, the Bank:

   - Uses a plain-language heading to call attention to the notice;

   - Uses a typeface and type size that are easy to read; and

   - Provides wide margins and ample line spacing.

- If the Bank provides a notice on the same form as another notice or other documents, the Bank designs its notice to call attention to the nature and significance of the information contained in the notice if the Bank uses:

   - Larger type size(s), boldface or italics in the text;

   - Wider margins and line spacing in the notice; or

   - Shading or sidebars to highlight the notice, whenever possible.

The GLB Act creates certain exceptions to the prohibition on disclosure of nonpublic personal information of customers and consumers. Some of these exceptions are:

- with the consent of the customer or consumer;

- to effect, administer or enforce a transaction requested or authorized by the customer or consumer;

- the servicing or processing of a financial product or service requested or authorized by the customer or consumer;

- the maintaining or servicing of the customer's or consumer's account with the Bank or with another entity as part of a private label credit card program;

- disclosure to persons holding a legal or beneficial interest relating to the customer or consumer or to persons acting in a fiduciary or representative capacity on behalf of the customer or consumer;

- providing information to insurance rate advisory organizations, guaranty funds or agencies, rating agencies, persons assessing the Bank's compliance with industry standards and the Bank's attorneys, accountants and auditors; and

- disclosure permitted under other laws, such as the Right to Financial Privacy Act, to law enforcement agencies or under local and state laws.

The Bank cannot disclose an account number or similar form of access code for a credit card account, deposit account or transaction account of a customer or consumer to any non-affiliated third party for use in telemarketing, direct mail marketing or other marketing through electronic mail to the customer or consumer.

TERRORIST ACTIVITIES

The Office of Foreign Assets Control or OFAC of the Department of the Treasury has (and will) send our banking regulatory agencies lists of names of persons and organizations suspected of aiding, harboring or engaging in terrorist acts. If the Bank finds any name on any transaction, account or wire transfer that is on an OFAC list, the Bank must freeze such account, file a suspicious activity report and notify the FBI. The Bank has appointed an OFAC compliance officer to oversee the inspection of its accounts and the filing of any notifications.

THE USA PATRIOT ACT

In the wake of the tragic events of September 11, 2001, the President signed the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism ("USA PATRIOT") Act of 2001. Under the USA PATRIOT Act, financial institutions are subject to prohibitions against specified financial transactions and account relationships as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and foreign customers. For example, the enhanced due diligence policies, procedures, and controls generally require financial institutions to take reasonable steps:

- to conduct enhanced scrutiny of account relationships to guard against money laundering and report any suspicious transactions;

- to ascertain the identity of the nominal and beneficial owners of, and the source of funds deposited into, each account as needed to guard against money laundering and report any suspicious transactions;

- to ascertain for any foreign bank, the shares of which are not publicly traded, the identify of the owners of the foreign bank, and the nature and extent of the ownership interest of each such owner; and

- to ascertain whether any foreign bank provides correspondent accounts to other foreign banks and, if so, the identity of those foreign banks and related due diligence information.

Under the USA PATRIOT Act, the Bank had until April 25, 2002 to establish anti-money laundering programs. The USA PATRIOT Act sets forth minimum standards for these programs, including:

- the development of internal policies, procedures, and controls;

- the designation of a compliance officer;
- an ongoing employee training program; and
- and independent audit function, in order to test these programs.

In addition, the USA PATRIOT Act authorized the Secretary of the Treasury to adopt rules increasing the cooperation and information sharing between financial institutions, regulators, and law enforcement authorities regarding individuals, entities and organizations engaged in, or reasonably suspected based on credible evidence of engaging in, terrorist acts or money laundering activities. Any financial institutions complying with these rules will not be deemed to have violated the privacy provisions of the Gramm-Leach-Bliley Act, as discussed above.

SUBPRIME LENDING

Our federal banking regulatory agencies have jointly issued expanded examination and supervision guidance relating to subprime lending activities. In the guidance, "subprime" lending generally refers to programs that target borrowers with weakened credit histories or lower repayment capacity. The guidance principally applies to institutions with subprime lending programs with an aggregate credit exposure equal to or greater than 25 percent of an institution's Tier 1 capital. Such institutions would be subject to more stringent risk management standards and, in many cases, additional capital requirements. As a starting point, the guidance generally expects that such an institution would hold capital against subprime portfolios in an amount that is one and one-half to three times greater than the amount appropriate for similar types of non-subprime assets. The Bank does not engage in any subprime lending programs.

The Federal Reserve Board has issued regulations which would implement the Home Ownership and Equity Protection Act or HOEPA. This Act imposes additional disclosure requirements and certain substantive limitations on certain mortgage loans with rates or fees above specified levels. The proposed regulations would lower the rate levels that trigger the application of HOEPA and would include additional fees in the calculation of the fee amount that triggers HOEPA. The loans that the Bank currently makes are generally below the rate and fee levels that trigger HOEPA.

On June 23, 2001, the Governor of the Commonwealth of Pennsylvania signed into law Act 55 of 2001, the Mortgage Bankers and Brokers and Consumer Equity Protection Act. This law addresses what is known as "predatory lending", among other things, and is applicable to the Bank's closed-end home equity mortgage loans, involving property located in Pennsylvania, in an amount less than $100,000 made at a "high cost" which is generally the rate and point triggers in the HOEPA. Those HOEPA triggers are:

- an annual percentage rate exceeding 10 percentage points above comparable term U.S. Treasury Securities; and/or
- total points and fees payable by the consumer at or before closing that exceed the greater of 8 percent of the total loan amount or $400. The $400 is adjusted annually by the annual percentage change in the CPI, and for the years 2002 and 2003 is $480 and $488, respectively, according to the Federal Reserve Board.

These loans are called "covered loans" under this law. If HOEPA's rate or point triggers are changed, then the definition of a covered loan under this law changes automatically. Loans with an original principal amount of $100,000 or more are not subject to this law, but may be subject to HOEPA.

Certain loan terms are prohibited or conditionally restricted in connection with a covered loan, such as: balloon payments, call provisions, negative amortization, increased interest rate upon default, and prepayment fees or penalties.

Certain acts or practices are prohibited, conditionally restricted, or required in connection with a covered loan, including the following:

- a cautionary notice, in writing, is required to be provided by the Bank to the borrower at least three business days prior to consummation of the mortgage transaction;

- it is impermissible to engage in a pattern or practice of making covered loans without due regard to the consumer's ability to repay the loan;1

- there are restrictions on the Bank refinancing an existing covered loan held by it with a new covered loan such that no points may be charged to the extent the proceeds are used to refinance the existing covered loan if the most recent financing was within one year;

- the Bank may not refinance a zero interest rate or low-rate loan made by a governmental or nonprofit lender with a covered loan unless the loan is at least ten years old or the current holder of the loan consents to the refinancing;

- the Bank may not pay proceeds from a covered loan directly to a home improvement contractor but instead must disburse the loan proceeds through an instrument payable to the borrower (statutorily defined as the person obligated to repay a covered loan) individually or jointly with the contractor or, at the borrower's election through a third party escrow agent in accordance with the terms of a written agreement signed by the borrower, the Bank, and home improvement contractor prior to disbursement of funds to the contractors;

- the Bank may not sell single premium credit insurance in connection with a covered loan unless the Bank offers the borrower the option of purchasing all such credit insurance on a monthly basis (compliance with this provision is required by 18 months to 2 years after June 25, 2002);

- a credit insurance notice, in writing, must be provided to the borrower stating that his or her purchase of credit insurance is not a required condition of obtaining the covered loan, and that the borrower may cancel the credit insurance within 30 days of the date of the covered loan in order to receive a full refund (meaning a credit to the loan balance or cash, at the Bank's or insurance company's discretion);

- the Bank shall maintain records related to covered loans that will facilitate the Pennsylvania Department of Banking determining compliance;

- the Bank or its servicer shall file quarterly reports of favorable and unfavorable credit history of the borrower with a nationally recognized consumer credit reporting agency, but this requirement shall not prevent the Bank or servicer from agreeing with the

borrower not to report payment history information related to resolved or unresolved disputes with a borrower, and this provision shall not apply to covered loans held or serviced by the Bank for less than 90 days; and

- the Bank shall verify that each mortgage broker with whom it does business in connection with covered loans holds the required license to engage in business in Pennsylvania.

A borrower can institute a civil action to recover damages from the Bank if it engages in the above practices with respect to a covered loan. Moreover, the Pennsylvania Department of Banking can impose monetary penalties; revoke a license; issue a cease and desist order; and remove persons from their employment in the mortgage finance industry or in any other capacity related to these prohibited activities.

SALES OF INSURANCE

Our federal banking regulatory agencies have issued their consumer protection rules with respect to the retail sale of insurance products by the Company, the Bank, or a subsidiary or joint venture of the Company or the Bank. These rules cover generally practices, solicitations, advertising or offers of any insurance product by a depository institution or any person that performs such activities at an office of, or on behalf of, the Company or the Bank. Moreover, these rules include specific provisions relating to sales practices, disclosures and advertising, the physical separation of banking and nonbanking activities, and domestic violence discrimination.

THE BANK

The Bank's legal headquarters are located at 232 East Street, Bloomsburg, Columbia County, Pennsylvania 17815. The Bank is a locally-owned and managed community bank that seeks to provide personal attention and professional financial assistance to its customers. The Bank serves the needs of individuals and small - and medium-sized businesses. The Bank's business philosophy includes offering direct access to its President and other officers and providing friendly, informed and courteous service, local and timely decision making, flexible and reasonable operating procedures and consistently-applied credit policies.

The Bank solicits small and medium-sized businesses located primarily within the Bank's market area that typically borrow in the $25,000 to $1.0 million range. In the event that certain loan requests may exceed the Bank's lending limit to any one customer, the Bank seeks to arrange such loans on a participation basis with other financial institutions.

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1 The consumer's ability to repay applies under this law only to persons whose income is 120% or less of the median family income under the metropolitan statistical area or nonmetropolitan family income statistics. There is a statutory presumption that a consumer can repay the covered loan if the monthly payment does not exceed 50% of the consumer's monthly gross income. There is no statutory presumption that a consumer cannot make the payments even if the 50% monthly gross income level is exceeded by the required monthly loan payments.

MARKETING AREA

The Bank's primary market area is Columbia County, a 484 square mile area

located in Northcentral Pennsylvania with a population of approximately 64,157 based on 2000 census data. The Town of Bloomsburg is the County's largest municipality and its center of industry and commerce. Bloomsburg has a population of approximately 12,375 based on 2000 census data, and is the county seat. Berwick, located on the eastern boundary of the County, is the second largest municipality, with a 2000 population of approximately 10,774. The Bank currently serves its market area through six branch offices located in Bloomsburg, Benton, Lightstreet, Millville, Orangeville and South Centre, Columbia County.

The Bank competes with eight other depository institutions in Columbia County. The Bank's major competitors are: First National Bank of Berwick; PNC Bank, N.A., the largest commercial bank headquartered in Pennsylvania; and First Columbia Bank and Trust Company of Bloomsburg, Pennsylvania.

The Bank's extended market area includes the adjacent Pennsylvania counties of Luzerne, Montour, Northumberland, Schuylkill and Sullivan.

FUTURE LEGISLATION

Various legislation, including proposals to substantially change the financial institution regulatory system and to expand or contract the powers of banking institutions and bank holding companies, is from time to time introduced in the Congress. This legislation may change banking statutes and our operating environment in substantial and unpredictable ways. If enacted, such legislation could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. We can not accurately predict whether any of this potential legislation will ultimately be enacted, and, if enacted, the ultimate effect that it, or implementing regulations, would have upon our financial condition or results of operations.

ITEM 2. PROPERTIES

Our corporate headquarters are located at 232 East Street, Bloomsburg, Pennsylvania. We own this facility which has approximately 11,686 square feet. The Bank's legal or registered office is also at 232 East Street, Bloomsburg, Pennsylvania.

Our remaining banking centers, all of which we own, are described as follows:

Location	Square Footage	Approximate Use
Orangeville, PA	2,259	Banking Services
Benton, PA	4,672	Banking Services
South Centre, PA	3,868	Banking Services
Scott Township, PA	16,500	Banking Services, Corporate, Credit and Operations
Millville, PA	2,520	Banking Services

We consider our facilities to be suitable and adequate for our current and immediate future purposes.

ITEM 3. LEGAL PROCEEDINGS

We and the Bank are not parties to any legal proceedings that could have any significant effect upon our financial condition or income. In addition, we and

the Bank are not parties to any legal proceedings under federal and state environmental laws.

PART II.

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

We had 798 stockholders of record including individual participants in security position listings and 1,287,365 shares of common stock, par value of $1.25 per share, the only authorized class of common stock, outstanding as of February 28, 2003. Our common stock trades under the symbol "CCFN." As of February 28, 2003, 4 firms were identified on the interdealer electronic bulletin board system as market makers in our common stock. The following information is reported by one of our market makers: Ferris, Baker Watts, Inc., Washington, D.C. These quotations represent prices between buyers and sellers and do not include retail

makeup, markdown or commission. They may not necessarily represent actual transactions. The high and low closing sale prices and dividends per share of our common stock for the four quarters of 2002 and 2001 are summarized in the following table.

2002:	High ($)	Low ($)	Dividends Declared ($)
First quarter	23.45	21.12	.15
Second quarter	21.60	21.00	.16
Third quarter	24.00	20.36	.16
Fourth quarter	24.25	23.00	.16

2001:	High ($)	Low ($)	Dividends Declared ($)
First quarter	17.88	16.50	.14
Second quarter	21.00	19.00	.15
Third quarter	24.50	23.00	.15
Fourth quarter	23.75	23.05	.15

We have paid cash dividends since 1983. It is our present intention to continue the dividend payment policy, although the payment of future dividends must necessarily depend upon earnings, financial position, appropriate restrictions under applicable law and other factors relevant at the time the Board of Directors considers any declaration of dividends.

ITEM 6. SELECTED FINANCIAL DATA

CCFNB BANCORP, INC.
SELECTED CONSOLIDATED FINANCIAL SUMMARY

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA AND RATIOS)

	2002	2001	2000
INCOME STATEMENT DATA:			
Total interest income	$ 12,780	$ 13,720	$ 13,552
Total interest expense	5,741	6,924	6,859
Net interest income	$ 7,039	$	6,796 $
Provision for possible loan losses	309	163	54
Other operating income	1,210	1,149	1,053
Other operating expenses	5,479	5,104	4,967
Federal income taxes	539	621	671
Net income	$ 1,922	$ 2,057	$ 2,054
PER SHARE DATA:			
Earnings per share (1)	$ 1.47	$ 1.54	$ 1.51
Cash dividends declared per share	0.63	0.59	0.56
Book value per share	20,76	19.64	18.61
Average shares outstanding	1,309,084	1,338,007	1,355,624
BALANCE SHEET DATA:			
Total assets	$ 229,032	$ 214,238	$ 203,054
Total loans	151,338	142,990	137,360
Total securities	53,538	57,121	47,311
Total deposits	172,127	155,666	143,169
FHLB advances - long-term	11,347	11,357	13,368
Total stockholders' equity	26,840	26,042	25,050
PERFORMANCE RATIOS:			
Return on average assets	0.86%	0 .99	1.04
Return on average stockholders' equity	7.22%	7.92%	8.59
Net interest margin (2)	3.58%	3.68%	3..88%
Total non-interest expense as a percentage of average assets	2.45%	2.45	2.52
ASSET QUALITY RATIOS:			
Allowance for possible loan losses as a percentage of loans, net	.87%	0.72%	0.74
Allowance for possible loan losses as a percentage of non-performing loans (3)	57.95%	60.54%	341.27
Non-performing loans as a percentage of total loans, net (3)	1.49%	1.19	0.25
Non-performing assets as a percentage of total assets (3)	0.98%	0.79%	0.17
Net charge-offs as a percentage of average net loans (4)	0.03%	0.10%	0.02

LIQUIDITY AND CAPITAL RATIOS:			
Equity to assets	11.72%	12.16%	12.34
Tier 1 Capital to risk-weighted assets (5)	20.36%	19.06%	20.94
Leverage ratio (5)(6)	11.77%	12.44%	13.02
Total capital to risk-weighted assets (5)	18.53%	19.82%	21.79

Dividend payout ratio	42.86%	38.31%	37.09

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(1) Based upon average shares and common share equivalents outstanding.

(2) Represents net interest income as a percentage of average total interest-earning assets, calculated on a tax-equivalent basis.

(3) Non-performing loans are comprised of (i) loans which are on a non-accrual basis, (ii) accruing loans that are 90 days or more past due, and (iii) restructured loans. Non-performing assets are comprised of non-performing loans and foreclosed real estate (assets acquired in foreclosure), if applicable.

(4) Based upon average balances for the respective periods.

(5) Based on the Federal Reserve Bank's risk-based capital guidelines, as applicable to the Corporation. The Bank is subject to similar requirements imposed by the Comptroller of the Currency.

(6) The leverage ratio is defined as the ratio of Tier 1 Capital to average total assets less intangible assets, if applicable.

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

The following discussion and analysis should be read in conjunction with the detailed information and financial statements, including notes thereto, included elsewhere in this Annual Report. Our consolidated financial condition and results of operations are essentially those of our subsidiary, the Bank. Therefore, the analysis that follows is directed to the performance of the Bank.

FACTORS THAT MAY AFFECT FUTURE RESULTS

General. Banking is affected, directly and indirectly, by local, domestic and international economic and political conditions, and by government monetary and fiscal policies. Conditions such as inflation, recession, unemployment, volatile interest rates, tight money supply, real estate values, international conflicts and other factors beyond our control may adversely affect the future results of operations. We do not expect any one particular factor to affect our results of operations. A downward trend in several areas, however, including real estate, construction and consumer spending, could have an adverse impact on our ability to maintain or increase profitability. Therefore, there is no assurance that we will be able to continue our current rates of income and growth.

Interest Rates. Our earnings depend, to a large extent, upon net interest income, which is primarily influenced by the relationship between the cost of funds (deposits and borrowings) and the yield on interest-earning assets (loans and investments). This relationship, known as the net interest spread, is subject to fluctuation and is affected by regulatory, economic and competitive factors which influence interest rates, the volume, rate and mix of interest-earning assets and interest-bearing liabilities, and the level of non-performing assets. As part of our interest rate risk management strategy comprised of interest rate risk, mortgage risk, and deposit pricing risk components, we seek to control our exposure to interest rate changes by managing the maturity and repricing characteristics of interest-earning assets and interest-bearing liabilities.

As of December 31, 2002, total interest-earning assets maturing or repricing within one year were more than total interest-bearing liabilities

maturing or repricing in the same period by $16,704,000, representing a cumulative one-year interest rate sensitivity gap as a percentage of positive 7.29%. This condition suggests that the yield on the our interest-earning assets should adjust to changes in market interest rates at a faster rate than the cost of the our interest-bearing liabilities. Consequently, our net interest income could increase during periods of rising interest rates. See "Interest Rate Sensitivity".

Local Economic Conditions. Our success is dependent, to a certain extent, upon the general economic conditions in the geographic market in which we conduct our business. Although we expect that economic conditions will continue to be favorable in this market, no assurance can be given that these economic conditions will continue. Adverse changes in economic conditions in the geographic market that we serve would likely impair our ability to collect loans and could otherwise have a material adverse effect on our results of operations and financial condition.

Competition. The banking industry is highly competitive, with rapid changes in product delivery systems and in consolidation of service providers. Many of our competitors are bigger than us in terms of assets and have substantially greater technical, marketing and financial resources. Because of their size, many of these competitors can (and do) offer products and services that we do not offer. We are constantly striving to meet the convenience and needs of our customers and to enlarge our customer base. No assurance can be given that these efforts will be successful in maintaining and expanding our customer base.

RESULTS OF OPERATIONS

Our net income decreased by 6.6% from $2,057,000 in 2001 to $1,922,000 in 2002. Earnings per share decreased by 4.5% from $1.54 in 2001 to $1.47 in 2002. Our return on average assets (ROAA) decreased to 0.86% in 2002, compared to 0.99% in 2001. Our return on average equity (ROAE) decreased to 7.22% in 2002, compared to 7.92% in 2001.The primary reasons for these declines in our performance ratios were: the decreasing interest rate environment; unstable economic conditions; a significant increase to our loan loss reserve; the downward repricing of our large concentration of adjustable rate mortgages; the

adjustment to the funding of deferred compensation plans and the funding of deferred health benefits for retiring Senior Management; an increase in non-accrual loans; and interest expense on long term debt.

Loans increased by 5.8% in 2002 to $151,338,000 from $142,900,000 in 2001. This increase was in the real estate lending area.

We instituted, in 1995, a dividend reinvestment plan and an employees stock purchase plan. Moreover, in 1999, we commenced a strategy to purchase and cancel up to 10% of our outstanding shares of common stock through open market purchases. This repurchase program resulted in the purchase and cancellation of the following numbers of shares of our common stock for the years indicated: 41,500 shares (2002); 27,501 shares (2001); and 30,100 shares (2000). The net effect of the stock plans and the repurchase program resulted in weighted average shares of common stock outstanding as follows: 1,309,084 (2002); 1,338,007 (2001); and 1,355,624 (2000).

Tax-equivalent net interest income increased 2.7% to $7.5 million in 2002 from $7.3 million in 2001. Average earning assets increased 6.3% from $198.2 million in 2001 to $210.6 million in 2002. Along with the increase in interest earning assets, net interest income also increased 2.9% from $6.8 million in

2001 to $7 million in 2002. This increased net interest income is a result of strategies in the loan and deposit areas during 2002. One strategy consisted of closely monitoring all deposit pricing to minimize interest expense. Other strategies were the marketing of a 7 year convertible rate and a 15 year fixed rate mortgage product.

TABLE OF NON-INTEREST INCOME
(Dollars in Thousands)

	Years Ended December 31,		
	2002	2001	2000
Service charges and fees	$ 651	$ 606	$ 595
Gain on sale of loans	1	0	0
Trust department income	215	238	219
Investment securities gains - net	137	99	0
Other	207	206	239
Total non-interest income	$1,211	$1,149	$1,053

Total non-interest income increased slightly during 2002 from $1,149,000 in 2001 to $1,211,000 in 2002. The decline in Trust income in the amount of $23,000 was primarily due to the decline in market value of the accounts. This loss offset the increases in fee income of $45,000 and Gain on sale investment securities of $38,000; making the increase in non-interest income $62,000 for the year. The amount of Trust income decreased 9.7% from $238,000 in 2001 to $215,000 in 2002. Service fees and charges increased from $606,000 in 2001 to $651,000 in 2002 or 7.4%. Other income remained at $207,000 for 2002 compared to $206,000 in 2001. The increase in the non-interest area is reflected in the gain on sale of investment securities, which increased $38,000 from $99,000 in 2001 to $137,000 in 2002. During 2002, we began a fixed-rate mortgage sales program with the Federal Home Loan Bank of Pittsburgh (FHLB-Pgh), in which fixed-rate mortgages are sold to FHLB-Pgh with servicing rights maintained by us and some recourse retained by us. During 2002, one such loan was placed on the books reflecting approximate income of $1,000. Many more loan sales are expected in 2003 due to the low interest rate environment.

TABLE OF NON-INTEREST EXPENSE
(Dollars in Thousands)

	Years Ended December 31,		
	2002	2001	2000
Salaries and wages	$2,224	$2,050	$2,016
Employee benefits	730	692	645
Net occupancy expense	335	366	328
Furniture and equipment expense	587	544	601
State shares tax	254	243	219
Other expense	1,329	1,209	1,158

Total non-interest expense	$5,479	$5,104	$4,967

Total non-interest expense increased to $5,479,000 in 2002 from $5,104,000 in 2001 or an increase of 7.3%. An 7.7% increase in salaries and benefits was attributable to normal merit and cost of living increases as well as increased health insurance costs. Additionally, two deferred compensation plans for senior officers were modified and the cost attributed to these increases was 35.1% of the $212,000 increase. Furniture and equipment expense increased 7.9% from $544,000 in 2001 compared to $587,000 in 2002. The main factor contributing to this increase was a systems upgrade during 2002 of the wide area network (WAN) computer system, including hardware and software, loan and deposit software and telephone system upgrades. Net occupancy expense decreased $11,000 from $366,000 in 2001 to $355,000 in 2002 or 3%. The mild winter enjoyed in 2002 was the contributing factor in this decrease. State Shares tax increased 4.5% from $243,000 in 2001 to $254,000 in 2002.

A 9.9% increase in other expenses from $1,209,000 in 2001 to $1,329,000 in 2002 was attributable to the following increases:

Other Professional	$ 25,000
Accounting	20,000
Other Real Estate Expense	17,000
Deferred Health Benefits	15,000
Third Party Loss of 2001	15,000
Telephone	13,000
Data processing	12,000
Other	3,000
Total	$120,000

One standard to measure non-interest expense is to express non-interest expense as a percentage of average total assets. In 2002, this percentage was 2.5% compared to 2.4% in 2001.

Loan delinquencies increased 51.6% from $2,647,000 in 2001 to $4,013,000 in 2002. The increase in these delinquencies was attributed to the current economic conditions, which resulted in less profitability for many local companies. This further impacted the local job market and the associated wages. The provision for loan losses for 2002 increased in response to this rise in delinquencies from $162,500 in 2001 to $309,000 in 2002. Our management has been diligent in its efforts to reduce these delinquencies and has increased monitoring and review of current loans to foresee future delinquency occurrences and react to them quickly.

NET INTEREST INCOME

Tax-equivalent net interest income for 2002 equaled $7,529,000 compared to $7,290,000 in 2001, an increase of 3.3%.

The decrease in the overall net interest margin from 3.68% in 2001 to 3.58% in 2002 is a result of interest rate changes with adjustable loan rates repricing downward throughout 2002 in this continuing downward interest rate environment. Income received on one-day investments fell from an average of 4.09% for 2001 to an average of 1.22% for 2002. This "squeeze" caused by interest rates is keeping the net interest spread in a declining mode; however,

the change in net interest margin is gradual and slight. Our "asset" sensitive position places us in a position to have an increase in our net interest margin when rates rise. The cost of long-term debt averaged 5.99% for the year which contributed to the declining net interest margin. This long-term debt will remain a deterrent to us in a declining interest rate environment. This is due to the fact that the Federal Home Loan Bank has the option to reprice these loans at their discretion. Until interest rates would rise to make the current 5.99% average rate unattractive, this in all probability will not occur. We will continue to use the following strategies to mitigate this decline in our net interest margin: Pricing of deposits will continue to be monitored and lowered, if necessary, to meet current market conditions; large deposits over $100,000 will continue to be priced conservatively; and in this low interest rate environment the majority of new investments will be kept short term in anticipation of rising rates.

TAX-EQUIVALENT NET INTEREST INCOME
(Dollars in Thousands)

	Years Ended December 31,		
	2002	2001	2000
Interest income	$12,780	$13,719	$13,55
Interest expense..	5,741	6,924	6,85
Net interest income.....................................	7,039	6.795	6,69
Tax-equivalent adjustment...............................	490	495	44
Net interest income (fully taxable equivalent)...........	$ 7,529	$ 7,290	$7,13

The following Average Balance Sheet and Rate Analysis table presents the average assets, actual income or expense and the average yield on assets, liabilities and stockholders' equity for the years 2002, 2001 and 2000.

AVERAGE BALANCE SHEET AND RATE ANALYSIS
THREE YEARS ENDED DECEMBER 31,
(Dollars in thousands)

	2002			2001		
	Average Balance	Interest Inc./Exp	Average Yd/Rate	Average Balance	Interest Inc./Exp	Avera Yd/Ra
ASSETS:	(1)	(2)		(1)	(2)	
Interest Bearing Deposits With						
Other Financial Institutions	$ 5,309	$ 65	1.22%	$ 6,569	$ 269	4.0
Investment Securities:						
U.S. Government Securities..	32,180	1,548	4.81%	29,908	$ 1,727	5.

State and Municipal Obligations (3)	16,965	799	7.14%	17,162	815	7.
Other Securities	5,052	221	4.37%	3,523	196	5.
Total Investment Securities	$ 54,197	$ 2,568	4.74%	$ 50,593	$ 2,738	5.
Federal Funds Sold	3,503	51	1.46%	1,771	67	3.
Consumer	8,767	742	8.46%	11,436	959	8.
Dealer Floor Plan	4,543	181	3.98%	4,522	290	6.
Mortgage	122,434	8,450	6.90%	111,715	8,523	7.
Commercial	8,941	570	6.38%	8,733	726	8.
Municipal Leases (3)	1,863	98	7.97%	230	10	6.
Tax Free (3)	997	55	8.36%	2,543	137	8.
Total Loans	$147,545	$10,096	6.84%	$139,219	$10,645	7.6
Total Interest-Earning Assets	210,554	12,780	6.07%	198,152	13,719	6.9
Reserve for Loan Losses	(1,167)			(1,015)		
Cash and Due from Banks	5,328			2,373		
Other Assets	8,761			9,120		
Total Assets	$223,476			$208,630		
LIABILITIES AND CAPITAL:						
NOW Deposits	$ 24,575	$ 133	0.54%	$ 22,188	$ 217	.9
IRA's under $100,000	8,636	240	2.78%	8,326	368	4.4
Money Market Deposits	10,858	112	1.03%	8,337	173	2.0
Savings Deposits	24,040	266	1.11%	21,335	396	1.8
Time Deposits including IRA's over $100,000	29,143	1,419	4.87%	24,272	1,493	6.1
Other Time Deposits under $100,000	53,631	2,555	4.76%	51,121	2,827	5.5
Total Interest-Bearing Deposits	$150,883	$ 4,725	3.13%	$135,579	$5,474	4.0
U.S. Treasury Short-Term Borrowings	511	6	1.17%	485	17	3.5
Short-Term Borrowings - Other	0	0	0.00%	0	0	.0
Long-Term Borrowings	11,351	680	5.99%	12,179	731	6.0
Repurchase Agreements	17,494	330	1.89%	18,965	702	3.7
Total Interest-Bearing Liabilities	$180,239	$55,741	3.19%	$167,208	$6,924	4.1
Demand Deposits	15,224			14,022		
Other Liabilities	1,398			1,420		
Stockholders' Equity	26,615			25,980		
Total Liabilities and Capital	$223,476			$208,630		
NET INTEREST INCOME/NET INTEREST MARGIN (4)		$ 7,039	3.34%		$6,795	3.4
TAX-EQUIVALENT NET INTEREST INCOME/NET INTEREST MARGIN (5)		$ 7,529	3.58%		$7,290	3.6

(1) Average volume information was compared using daily (or monthly) averages.
(2) Interest on loans includes fee income.
(3) Yield on tax-exempt obligations has been computed on a tax-equivalent basis.
(4) Net interest margin is computed by dividing net interest income by total interest-earning assets. (5) Interest and yield are presented on a tax-equivalent basis using 34% for 2002, 2001 & 2000.

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COMPONENTS OF NET INTEREST INCOME

To enhance the understanding of the effects of volumes (the average balance of earning assets and costing liabilities) and average interest rate fluctuations on the balance sheet as it pertains to net interest income, the table below reflects these changes for 2002 versus 2001, 2001 versus 2000, and 2000 versus 1999:

TABLE OF NET INTEREST INCOME COMPONENTS ON A TAX-EQUIVALENT BASIS
For the twelve months ended December 31, 2002
(Dollars in thousands)

	2002 Versus 2001 Increase (Decrease) Due to Changes In			2001 Versus 2000 Increase (Decrease) Due to Changes In		
	Average Volume	Average Rate	Total	Average Volume	Average Rate	Total
Interest Income:						
Interest-Bearing Deposits with Other Financial Institutions	$ (52)	$ (189)	$ (241)	$ 337	$ (30)	$ 307
U.S. Government Securities	131	(287)	(156)	(66)	(124)	(190
State and Municipal Obligations ..	(14)	(9)	(23)	183	(50)	133
Other Securities	85	(42)	43	169	(26)	143
Federal Funds Sold	65	(41)	24	105	(1)	104
Consumer Loans	(224)	8	(216)	(88)	34	(54
Dealer Floor Plan	1	(110)	(109)	(79)	(127)	(206
Mortgage Loans(1)	818	(816)	2	576	(209)	367
Commercial Loans	14	(167)	(153)	(71)	(144)	(215
Int. Municipal Leases-Lehigh-Tax Exempt	108	3	111	7	(3)	4
Tax Free Loans	(126)	5	(121)	13	5	18
Total Earning Assets	$ 806	$(1,645)	$ (839)	$1,086	$(675)	$ 411
Interest Expense:						
SUPER NOW Deposits	$ 23	$ (98)	$ (75)	$ 7	$ (67)	$ (60
IRA	14	(137)	(123)	10	(73)	(63
Money Market Deposits	52	(88)	(36)	(27)	(61)	(88
Savings Deposits	50	(160)	(110)	(3)	(150)	(153
Time Deposits over $100,000	300	(311)	(11)	441	(10)	431
Other Time Deposits	139	(394)	(255)	193	43	236
U.S. Treasury - Short-Term Borrowings	1	(11)	(10)	3	(13)	(10
Short-Term Borrowings - Other	0	0	0	(202)	(202)	(404
Long-Term Borrowings	(50)	(1)	(51)	70	81	151
Repurchase Agreements	(54)	(343)	(397)	135	(280)	(145

Total Interest-Bearing Deposits ..	$ 475	$(1,543)	$(1,068)	$ 627	$(732)	$(105
NET INTEREST INCOME	$ 331	$ (102)	$ 229	$ 459	$ 57	$ 516

(1) Includes non-accrual loans.

FINANCIAL CONDITION

Our consolidated assets at December 31, 2002 were $229 million which represented an increase of $14.8 million or 6.9% over $214.2 million at December 31, 2001. The comparable increase for 2001 over 2000 was 5.5% or $11.1 million.

Capital increased 3.1% from $26 million in 2001 to $26.8 million in 2002. The adjustment for the fair market value of securities was a positive $500,000 for 2002 compared to a positive $75,000 for 2001. Additionally, a strategy to purchase and retire up to 10% of our outstanding shares of common stock was in place and resulted in common stock and surplus decreasing to $5.6 million in 2002 from $6.4 million in 2001, or a decrease of 12.5%.

Total average assets grew 7.1% from 2001 at $208.6 million to 2002 at $223.5 million. Average earning assets grew 6.3% from 2001 at $198.2 million to 2002 at $210.6 million.

Loans grew 5.8% from $143 million at December 31, 2001 to $151.3 million at December 31, 2002.

Non-interest bearing deposits grew 3.4% to $15.2 million at December 31, 2002 from $14.7 million at December 31, 2001. Interest bearing deposits grew 11.3% from $141 million in 2001 to $156.9 million in 2002.

The loan-to-deposit ratio is a key measurement of liquidity. Our loan-to-deposit ratio decreased during 2002 to 87.9% compared to 91.9% during 2001.

It is our opinion that the balance sheet mix and the interest rate risk associated with the balance sheet is within manageable parameters. Constant monitoring using asset/liability reports and interest rate risk scenarios are in place along with quarterly asset/liability management meetings on the committee level by the Bank's Board of Directors. Additionally, the Board's Asset/Liability Committee meets with the investment consultants quarterly.

INVESTMENTS
(Dollars in thousands)

	Outstanding Balance at December 31,					
	2002		2001		2000	
	Available-For-Sale	Held-To Maturity	Available-For-Sale	Held-To Maturity	Available-For-Sale	He Ma
	(2)	(1)	(2)	(1)	(2)	

Federal Agency Obligations.....	$ 10,104	$0	$12,553	$0	$15,810
Mortgage-backed Securities.....	22,690	0	21,001	0	13,294
Obligations of State and Political Subdivisions........	15,751	0	17,525	0	16,104
Corporate Securities...........	3,419	0	4,589	0	725
Marketable Equity Securities...	363	0	327	0	252
Restricted Equity Securities...	1,198	0	1,126	0	1,126
Total Investment Securities....	$ 53,528	$0	$57,121	$0	$47,311

(1) Carried at amortized cost.

(2) Carried at estimated fair value.

The following table sets forth the maturity distribution of the investment portfolio's Available-for-Sale securities, the weighted average yield for each type of Available-for-Sale security and ranges of maturity at December 31, 2002. Yields are presented on a tax-equivalent basis, are based upon carrying value and are weighted for the scheduled maturity. At December 31, 2002, our investment securities portfolio had an average maturity of approximately 6.11 years.

	(Dollars in Thousands					
	Within One Year		After One Year But Within Five Years		After Five Years But Within Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield
AVAILABLE-FOR-SALE SECURITIES AT FAIR VALUE						
Federal Agency Obligations..........	$1,335	5.61%	$22,604	5.15%	$5,836	5.22%
Obligations of State and Political Subdivisions.....................	0	0.00%	413	6.70%	3,363	6.84%
Corporate Securities................	1,007	4.18%	1,032	3.02%	0	0.00%
Marketable Equity Securities........	0	0.00%	0	0.00%	0	0.00%
Restricted Equity Securities........	0	0.00%	0	0.00%	0	0.00%
TOTAL	$2,342	4.99%	$24,049	5.12%	$9,199	5.81%

Available-for-Sale securities are reported on the balance sheet at fair value. An adjustment to capital, net or deferred taxes, is the offset for this entry. The possibility of material price volatility in a falling interest rate environment is offset by the availability to us of restructuring the portfolio for gap positioning at any time through the securities classed as Available-for-Sale. All of our securities are Available-for-Sale. The impact of the fair value accounting was an unrealized gain, net of tax, on December 31, 2002 of $537,000 compared to an unrealized gain, net of tax, on December 31, 2001 of $75,000.

Available-for-Sale securities total $53.5 at year-end 2002 compared

to $57.1 at year-end 2001, or a decrease of 6.3%.

The mix of securities in the portfolio is 61.3% Federal Agency Obligations, 29.4% Municipal Securities, 6.4% Corporate Securities and 2.9% Other. We do not engage in derivative investment products.

LOANS

LOAN PORTFOLIO
LOANS OUTSTANDING
(Dollars in thousands)

	2002	2001	2000
Commercial	$ 15,033	$ 13,091	$ 14,412
Tax-Exempt	3,535	1,947	2,747
Real Estate - Construction...............	1,185	2,538	1,648
Real Estate	123,746	115,716	106,604
Personal	7,902	9,962	12,317
	$151,401	$143,254	$137,850
Unamortized Loan Fees, Net of Costs.......	76	15	(4)
Unearned Discount........................	(139)	(279)	(486)
Loans, Net	$151,338	$142,990	$137,360

The loan portfolio grew 5.8% from $143 million in 2001 to $151.3 million in 2002. The percentage distribution in the loan portfolio was 82.5% in real estate loans at $124,931,000; 10% in commercial loans at $15,033,000; 5.2% in consumer loans at $7,902,000; and 2.3% in tax exempt loans at $3,535,000. Variable rate real estate loans were comprised of 1.7% with 5-year adjustable rates; 46.9% with 3-year adjustable rates; 14.9% with 1-year adjustable rates; and 3% with one-day to 3-month adjustable rates. Many 3-year and one-year adjustable rate loans have bi-weekly payments. The remaining 33.5% of real estate loans are fixed rates.

DEPOSITS AND BORROWED FUNDS

TABLE OF DISTRIBUTION OF AVERAGE DEPOSITS
(Dollars in thousands)

		December 31,	
	2002	2001	2000
Demand deposits....................	$ 39,799	$ 36,210	$ 36,107
Savings deposits...................	34,898	29,672	30,772

Time deposits......................	62,267	59,447	55,726
Time deposits, $100,000 and over....	29,143	24,272	17,169
Total..............................	$166,107	$149,601	$139,774

TABLE OF MATURITY DISTRIBUTION OF TIME DEPOSITS OVER $100,000
(Dollars in thousands)

	December 31,		
	2002	2001	2000
Three months or less..................	$ 9,236	$ 6,446	$ 4,648
Over three months to six months........	5,769	4,225	1,960
Over six months to twelve months.......	8,123	7,493	5,889
Over twelve months....................	8,063	7,895	9,419
Total................................	$31,191	$26,059	$21,916

Total average deposits increased by 11% from $149.6 million at year-end 2001 to $166.1 million at year-end 2002. Average savings deposits increased to $34.9 million at year-end 2002 from $29.7 million at year-end 2001. Average time deposits increased 9.2% from $83.7 million at year-end 2001 to $91.4 million at year-end 2002. Average non-interest bearing demand deposits increased to $15.2 million for 2002 from $14.7 million for 2001. Average interest bearing NOW accounts increased 10.8% from $22.2 million for 2001 to $24.6 million for 2002.

Short-term borrowings, securities sold under agreements to repurchase and day-to-day borrowings from the FHLB-Pgh decreased 12.6% from $19.8 million at year-end 2001 to $17.3 million at year-end 2002. Treasury Tax and Loan deposits held by us for the U.S. Treasury averaged $511,000 for 2002. One-day borrowings did not occur in 2002 and repurchase agreements averaged $17.5 million for 2002. Long-term borrowings, namely borrowings from the FHLB-Pgh, averaged $11.4 million for 2002.

NON-PERFORMING ASSETS
PAST DUE AND NON-ACCRUAL LOANS
(Dollars in thousands)

2002	Real Estate	Installment Loans	Commercial	Lease Financing Receivables	Total
Days 30-89...........	$1,216	$112	$ 513	$0	$1,814
Days 90 Plus..........	40	10	0	0	50
Non-accrual...........	1,279	6	837	0	2,122
Total................	$2,535	$128	$1,350	$0	$4,013

2001	Real Estate	Installment Loans	Commercial	Lease Financing Receivables	Total
Days 30-89...........	$ 798	$142	$ 9	$0	$ 949
Days 90 Plus.........	915	28	26	0	969
Non-accrual..........	429	15	285	0	729
Total................	$2,142	$185	$320	$0	$2,647

2000	Real Estate	Installment Loans	Commercial	Lease Financing Receivables	Total
Days 30-89...........	$1,053	$205	$ 82	$0	$1,340
Days 90 Plus.........	336	8	0	0	344
Non-accrual..........	282	0	30	0	312
Total................	$1,671	$213	$112	$0	$1,996

At year-end 2002, loans 30-89 days past due totaled $1,841,000 compared to $949,000 at year-end 2001. Past due loans 90 days plus totaled $50,000 at year-end 2002 compared to $969,000 at year-end 2001. Non-accrual loans at year-end 2002 totaled $2,122,000 compared to $729,000 at year-end 2001. Overall, past due and non-accrual loans increased 51.6% from $2,647,000 at year-end 2001 to $4,013,000 at year-end 2002. During this same period of time, the ratio of net charge offs during the period to average loans outstanding during the period was .03%. (See Summary of Loan Loss Experience). We do not consider these percentages to be significant or material.

Loans were stated at their outstanding principal balances, net of any deferred fees or costs, unearned income, and the allowance for loan losses. Interest on loans was accrued on the principal amount outstanding, primarily on the actual day basis. Non-renewable loan fees and certain direct costs were deferred and amortized over the life of the loans using the interest method. The amortization was reflected on an interest yield adjustment, and the deferred portion of the net fees and costs was reflected as a part of the loan balance.

Generally, a loan is classified as non-accrual, and the accrual of interest on such a loan is discontinued when the contractual payment of principal or interest becomes 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan may be performing.

A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed

on non-accrual status, unpaid interest credited to income in the current year is reversed, and unpaid interest accrued in prior years is charged against the allowance for loan losses. Potential problem loans are identified by management as part of its loan review process.

Certain non-accrual loans may continue to perform, that is, payments were still being received generally, and the payments were applied to principal. These loans remain under constant scrutiny and if performance continues, interest income may be recorded on a cash basis based on management's judgment as to collectibility of principal.

ALLOWANCE FOR LOAN LOSSES AND RELATED PROVISION
(Dollars in Thousands)

	Outstanding Balance at December 31,					
	2002		2001		2000	
	Amount	% of Loans in Category to Total Loans	Amount	% of Loans in Category to Total Loans	Amount	% o in C to L
Commercial	$ 406	13.00%	$ 372	13%	$ 173	
Real estate mortgages	723	82.00%	464	78%	318	
Consumer	66	5.00%	94	7%	79	
Unallocated	103	N/A	98	N/A	438	
	$1,298	100.00%	$1,028	100%	$1,008	

The allowance for loan losses was $1,298,000 at December 31, 2002, compared to $1,028,000 at December 31, 2001. This allowance equaled .87% and .72% of total loans, net of unearned income, at the end of

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2002 and 2001. This allowance was considered adequate based on delinquency trends and actual loans written as it relates to the loan portfolio.

The loan loss reserve is analyzed quarterly and reviewed by the Bank's Board of Directors. The assessment of the loan policies and procedures during 2002 revealed no anticipated loss on any loans considered "significant". No concentration or apparent deterioration in classes of loans or pledged collateral was evident. Monthly loan meetings with the Bank Board's Credit Administration Committee reviewed new loans, delinquent loans and loan exceptions to determine compliance with policies.

The schedule below presents a history of actual charge-offs and recoveries by category and related balances and ratios.

SUMMARY OF LOAN LOSS EXPERIENCE
(Dollars in thousands)

Years Ended Decemb

	2002	2001
Loans outstanding at end of year	$151,338	$142,990
Average loans outstanding	$147,545	$139,219
Allowance for loan losses:		
Balance, beginning of year	$ 1,028	$ 1,008
Loans Charged-off:		
Commercial and industrial	(29)	(94)
Real estate mortgages	(17)	(13)
Consumer	(54)	(82)
Credit cards	0	0
Total loans charged-off	(100)	(189)
Recoveries:		
Commercial and industrial	19	14
Real estate mortgages	0	0
Consumer	42	29
Municipal leases	0	0
Credit cards	0	3
Total recoveries	61	46
Net loans charged-off	(39)	(143)
Provision charged to expense	309	163
Balance, end of year	$ 1,298	$ 1,028
Ratio of net charge-offs during the year to average loans outstanding during year	0.03%	0.10%

The allowance for loan losses is established through provisions for loan losses charged against income. Loans deemed to be uncollectible were charged against income. Loans deemed to be uncollectible were charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance.

On January 1, 1995, we adopted Statement of Financial Accounting Standards No. 114, "Accounting for Creditors for Impairment of a Loan - Income Recognition and Disclosure." Under these standards, the allowance for loan losses related to loans that were identified for evaluation in accordance with Statement No. 114 which was based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain collateral dependent loans. Prior to 1995, the allowance for loan losses related to these loans was based on undiscounted cash flows or the fair value of the collateral for collateral dependent loans. Statement No. 118 allowed the continued use of existing methods for income recognition on impaired loans and amends disclosure requirements to require information about the recorded investment in certain impaired loans and related income recognition on those loans. The allowance for loan losses was maintained at a level to be adequate to absorb estimated potential loan losses. Our periodic evaluations of the adequacy of the allowance for loan losses were based on past loan loss experience; known and inherent risks in the portfolio; adverse situations that may affect

the borrower's ability to repay (including the timing of future payments); and other relevant factors. These evaluations were inherently subjective as they required material estimates, including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant change. See "Factors That May Affect Future Results".

No additional charge to operations was required to provide for the impaired loans since the total allowance for loan losses is estimated by management to be adequate to provide for the loan loss allowance required by SFAS No. 114 along with any other potential losses.

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LIQUIDITY

Liquidity management is required to ensure that adequate funds will be available to meet anticipated and unanticipated deposit withdrawals, debt service payments, investment commitments, commercial and consumer loan demand, and ongoing operating expenses. Funding sources include principal repayments on loans, sales of assets, growth in core deposits, short and long-term borrowings, investment securities coming due, loan prepayments and repurchase agreements. Regular loan payments are a dependable source of funds, while the sale of investment securities, deposit growth and loan prepayments are significantly influenced by general economic conditions and the level of interest rates.

We manage liquidity on a daily basis. We believe that our liquidity is sufficient to meet present and future financial obligations and commitments on a timely basis. However, see "Factors That May Affect Future Results".

At December 31, 2002, cash and cash equivalents totaled $16,020,677 compared to $8,517,616 at December 31, 2001. Changes in cash were measured by changes in the three major classifications of cash flows known as operating, investing and financing activities.

At December 31, 2002, net cash provided by operating activities equaled $2,643,687 which consisted mainly of net income adjusted for non-cash items such as depreciation, provision for loan losses, premium amortization on investment securities and deferred income tax.

Net cash used for investing activities totaled $7,498,901 which was principally the result of $8,454,934 increase in loans and $4,215,746 excess of proceeds on sale and redemption of Available-for-Sale securities over the purchases of Available-for-Sale securities.

Net cash provided by financing activities totaled $12,358,255 and consisted mainly of an increase in deposits of $16,461,354 and a decrease in short-term borrowings of $2,506,672.

CAPITAL RESOURCES

Capital continues to be a strength for us.

Capital is critical as it must provide growth, payment to shareholders, and absorption of unforeseen losses. The federal regulators provide standards that must be met. We are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory - and possibly additional discretionary - actions by regulators that, if undertaken, could have a direct material impact on our consolidated

financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines that involve quantitative measures of our assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Our capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by federal banking regulation are to ensure capital adequacy require that we maintain minimum amounts and ratios (set forth in the following table) of Total and Tier I Capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I Capital (as defined) to average assets (as defined).

As of December 31, 2002, the most recent notification from the Comptroller of the Currency, the Bank's primary federal regulator, categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the Table. There are no conditions or events since that notification that management believes have changed the institution's category.

The Bank's actual capital amounts are ratios in the following table:

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
As of December 31, 2002:				
Total Capital				
(To risk-weighted assets).......	$27,615	19.46%	$11,352	8.00%
Tier I Capital				
(To risk-weighted assets).......	$26,303	18.53%	$ 5,682	4.00%
Tier I Capital				
(To average assets)............	$26,303	11.77%	$ 8,939	4.00%

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	Amount	Ratio	Amount	Ratio
As of December 31, 2001:				
Total Capital				
(To risk-weighted assets).......	$26,989	19.82%	$10,894	8.00%
Tier I Capital				
(To risk-weighted assets).......	$25,961	19.06%	$ 5,447	4.00%
Tier I Capital				
(To average assets)............	$25,961	12.44%	$ 8,346	4.00%

Our capital ratios are not materially different from those of the Bank.

Dividend payouts are restricted by the Pennsylvania Business Corporation Law of 1988, as amended (the BCL). The BCL operates generally

to preclude dividend payments if the effect thereof would render us unable to meet our obligations as they become due. As a practical matter, our payment of dividends is contingent upon our ability to obtain funding in the form of dividends from the Bank. Payment of dividends to us by the Bank is subject to the restrictions set forth in the National Bank Act. Generally, the National Bank Act would permit the Bank to declare dividends in 2003 of approximately $1,080,224 plus additional amounts equal to the net income earned in 2003 for the period January 1, 2003 through the date of declaration, less any dividends which may be paid in 2003.

INTEREST RATE RISK MANAGEMENT

Interest rate risk management involves managing the extent to which interest-sensitive assets and interest-sensitive liabilities are matched. Interest rate sensitivity is the relationship between market interest rates and earnings volatility due to the repricing characteristics of assets and liabilities. The Bank's net interest income is affected by changes in the level of market interest rates. In order to maintain consistent earnings performance, the Bank seeks to manage, to the extent possible, the repricing characteristics of its assets and liabilities.

One major objective of the Bank when managing the rate sensitivity of its assets and liabilities is to stabilize net interest income. The management of and authority to assume interest rate risk is the responsibility of the Bank's Asset/Liability Committee ("ALCO"), which is comprised of senior management and Board members. ALCO meets quarterly to monitor the ratio of interest sensitive assets to interest sensitive liabilities. The process to review interest rate risk management is a regular part of management of the Bank. Consistent policies and practices of measuring and reporting interest rate risk exposure, particularly regarding the treatment of noncontractual assets and liabilities, are in effect. In addition, there is an annual process to review the interest rate risk policy with the Board of Directors which includes limits on the impact to earnings from shifts in interest rates.

The ratio between assets and liabilities repricing in specific time intervals is referred to as an interest rate sensitivity gap. Interest rate sensitivity gaps can be managed to take advantage of the slope of the yield curve as well as forecasted changes in the level of interest rate changes.

To manage the interest sensitivity position, an asset/liability model called "gap analysis" is used to monitor the difference in the volume of the Bank's interest sensitive assets and liabilities that mature or reprice within given periods. A positive gap (asset sensitive) indicates that more assets reprice during a given period compared to liabilities, while a negative gap (liability sensitive) has the opposite effect. The Bank employs computerized net interest income simulation modeling to assist in quantifying interest rate risk exposure. This process measures and quantifies the impact on net interest income through varying interest rate changes and balance sheet compositions. The use of this model assists the ALCO to gauge the effects of the interest rate changes on interest sensitive assets and liabilities in order to determine what impact these rate changes will have upon the net interest spread.

STATEMENT OF INTEREST SENSITIVITY GAP
(Dollars in thousands)
DECEMBER 31, 2002

	90 Days Or Less	> 90 Days But <1 Year	1 to 5 Years	5 to Years
Short-term investments	$ 16,021	$ 0	$ 0	$
Securities Available-for-Sale (1)	13,839	19,126	17,434	1,
Loans (1)	35,529	37,800	66,090	11,
Rate Sensitive Assets	65,389	56,926	83,524	13,
Deposits:				
Interest-bearing demand deposits (2)	$ 4,029	$ 3,751	$ 20,005	$
Savings (2)	5,376	5,584	24,041	
Time	31,245	35,656	27,202	
Borrowed funds	17,274	0	0	
Long-term debt	3	9	199	11,
Shareholders' equity	671	2,013	8,857	8,
Rate Sensitive Liabilities and Shareholders' Equity	$ 58,598	$ 47,013	$ 80,304	$ 19,
Interest Sensitivity Gap	$ 6,791	$ 9,913	$ 3,220	$ (6,
Cumulative Gap	$ 6,791	$ 16,704	$ 19,924	$ 13,

(1) Investments and loans are included at the earlier of repricing or maturity adjusted for the effects of prepayments.

(2) Interest bearing demand and savings accounts are included based on historical experience and managements' judgment about the behavior of these deposits in changing interest rate environments.

At December 31, 2002, our cumulative gap positions and the potential earnings change resulting from a 200 basis point change in rates were within the internal risk management guidelines.

Upon reviewing the current interest sensitivity scenario, declining interest rates could negatively affect net income because the Bank is asset-sensitive. In an increasing interest rate environment, net income could be positively affected because more assets than liabilities will reprice during a given period.

Certain shortcomings are inherent in the method of analysis presented in the above table. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react in different degrees to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities may lag behind changes in market interest rates. Certain assets, such as adjustable-rate mortgages, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. In the event of a change in interest rates, prepayment and early withdrawal levels may deviate significantly from those assumed in calculating the table. The ability of many borrowers to service their adjustable-rate debt may decrease in the event of an interest rate

increase.

In addition to gap analysis, the Bank uses earnings simulation to assist in measuring and controlling interest rate risk.

The following table provides information about our financial instruments. The table presents the financial instruments including the expected cash flow over the next five years. In addition the average interest rate is shown for each period presented. The table also includes the fair market value for each category of financial instruments as of December 31, 2002. This presentation differs from the above gap report primarily due to presenting the financial instruments based on a contractual maturity as opposed to a repricing scenario as reflected in the above gap report.

PRINCIPAL / NOTIONAL AMOUNTS MATURING IN:
(Dollars in millions)

	2003	2004	2005	2006	2007
Rate sensitive assets:					
Fixed interest loans (1)	$ 9,955	$ 6,767	$ 5,389	$4,222	$ 3,872
Average interest rate	7.71%	7.62%	7.36%	7.26%	7.21%
Variable interest rate loans (2)	$56,989	$21,497	$18,485	$ 973	$ 262
Average interest rate	5.53%	6.97%	5.91%	7.36%	7.13%
Fixed interest rate securities (1)	$ 1,335	$ 5,722	$ 2,180	$4,828	$10,287
Average interest rate	5.61%	5.44%	3.20%	4.52%	5.20%
Variable interest rate securities (1)	$ 1,007	$ 492	$ 540	$ 0	$ 0
Average interest rate	4.18%	2.56%	2.35%	0.00%	0.00%
Other interest-bearing assets	$10,068	$ 0	$ 0	$ 0	$ 0
Average interest rate	1.22%	0.00%	0.00%	0.00%	0.00%
Rate sensitive liabilities:					
Non-interest-bearing checking (2)	$ 6,094	$ 2,286	$ 2,286	$2,286	$ 2,286
Average interest rate	0.00%	0.00%	0.00%	0.00%	0.00%
Savings & interest-bearing checking (2)	$21,387	$ 8,020	$ 8,020	$8,020	$ 8,020
Average interest rate	0.75%	0.75%	0.75%	0.75%	0.75%
Money market accounts (2)	$ 3,727	$ 1,398	$ 1,398	$1,398	$ 1,398
Average interest rate	0.97%	0.97%	0.97%	0.97%	0.97%
Time deposits (under $100,000)	$49,506	$ 5,081	$ 2,952	$1,011	$ 4,362
Average interest rate	4.81%	3.80%	3.61%	5.15%	4.58%
Time deposits (over 100,000)	$23,129	$ 3,402	$ 3,260	$ 451	$ 949'
Average interest rate	4.45%	4.45%	6.30%	5.75%	5.37%
Fixed interest rate borrowings	$ 0	$ 0	$ 0	$ 0	$ 0
Average interest rate	0.00%	0.00%	0.00%	0.00%	0.00%
Variable interest rate borrowings	$17,274	$ 0	$ 0	$ 0	$11,000
Average interest rate	1.89%	0.00%	0.00%	5.91%	5.91%

(1) Investments and loans are included at contractual maturity.

(2) Non interest-bearing checking, interest-bearing checking, savings and money market accounts are reflecting historical experience and management's judgment about the duration of these deposits.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by this item can be found at Item 7 of this Annual Report under the caption "Interest Rate Risk Management" and is incorporated in its entirety by reference under this Item 7A.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our consolidated financial statements and notes to these statements are filed at Exhibit 13 to this report and are incorporated in their entirety by reference under this Item 8.

Our supplementary data is filed at Exhibit 13 to this report and is incorporated in its entirety by reference under this Item 8.

PART III.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

DIRECTORS

At February 28, 2003, we had nine directors.

Our directors are divided into three classes: three directors are in Class 1; three directors are in Class 2; and three directors are in Class 3. Each director holds office for a three-year term. The terms of the classes are staggered, so that the term of office of one class expires each year.

The following information includes the age of each of our current directors, a recently-resigned director, and those persons who have been nominated to become a director upon their election at our 2003 annual meeting of stockholders. All directors of the Corporation are also directors of the Bank.

NAME	AGE	PRINCIPAL OCCUPATION
Don E. Bangs	71	Secretary of the Corporation and the Bank. Former owner of Bangs Insurance Agency and former agent fo The Thrush Insurance Agency.
Robert M. Brewington, Jr.	52	Owner of Sutliff Motors and Brewington Transportati (sales and service of cars and trucks; school bus contractor).
Edward L. Campbell	64	President of ELC Enterprises, Inc. and the sole proprietor of Heritage Acres Christmas tree sales.
Lance O. Diehl	37	President of the Corporation and the Bank and Direc since February 13, 2003; Chief Executive Officer of the Corporation and the Bank since January 1, 2003. Former Executive Vice President of the Bank for Bra Operations and Marketing.
Elwood R. Harding, Jr.	56	Attorney-at-Law and President of Premier Real Estat Settlement Services, Inc. (title insurance) and sin January 1, 2003, Vice Chairman of the Corporation a the Bank.
William F. Hess	69	Former Chairman of the

		Corporation and the Bank. Dairy farmer.
Rodney B. Keller	52	Community Development Director for PPL Electric Utilities. Resigned as Director on February 13, 200
Willard H. Kile, Jr., D.M.D.	48	Partner of Kile & Robinson LLC (dentists); Partner Kile & Kile Real Estate.
Charles E. Long	67	Retired. Former President of Long Supply Co., Inc. wholesaler and retailer of hardware and masonry products).
Paul E. Reichart	65	Chairman of the Corporation and the Bank since Janu 1, 2003. Former Vice Chairman of the Corporation a the Bank. President of the Corporation and the Bank until February 13, 2003. Former Chief Executive Officer until January 1, 2003.

PRINCIPAL OFFICERS

Our principal officers are appointed by the Board of Directors and serve at the will of the Board of Directors, subject to certain change in control agreements discussed later in this report. The following information is presented for those persons who were principal officers at December 31, 2002:

NAME & POSITION	HELD SINCE	EMPLOYEE SINCE	AGE
William F. Hess, Chairman	1998	*	69
Don E. Bangs, Secretary	1993	*	71
Paul E. Reichart, President and Chief Executive Officer, and Vice Chairman	1985	1960	65
Virginia D. Kocher Treasurer and Assistant Secretary	1991	1972	55

* Not an employee of the Company and the Bank.

COMPLIANCE WITH SECTION 16(A) OF THE SECURITIES EXCHANGE ACT OF 1934

Executive officers and directors and "beneficial owners" of more than ten percent of our common stock must file initial reports of ownership and reports of changes in ownership with the SEC pursuant to Section 16(a).

We have reviewed the reports and written representations from the executive officers and directors. Based on this review, we believe that all filing requirements were met during 2002.

ITEM 11. EXECUTIVE COMPENSATION

This section of the report contains charts that show the amount of compensation earned by our executive officers whose salary and bonus exceeded $100,000 for

2002. It also contains the performance graph comparing our performance relative to a peer group and the report of our human resource committee explaining the compensation philosophy for our most highly paid officers.

SUMMARY COMPENSATION TABLE(1)

NAME AND PRINCIPAL POSITION	FISCAL YEAR	ANNUAL COMPENSATION SALARY($)	BONUS($)	OTHER ANNUAL COMPENSATION(2)($
Paul E. Reichart	2002	100,211	31,470(4)	10,200
President and Chief	2001	98,302	31,333(5)	9,600
Executive Officer(7)	2000	94,439	31,598(6)	9,600

(1) From January 1, 2000 through December 31, 2002, the Corporation did not pay any long-term compensation in the form of stock options, stock appreciation rights, restricted stock or any other long-term compensation, nor did it make any long-term incentive plan payments. Accordingly, no such information is presented in the summary compensation table set forth above. No such arrangements are currently in effect.

(2) Represents the payment of directors' fees by the bank for the years presented. Mr. Reichart did not receive perquisites and other personal benefits, securities and property that totaled in the aggregate for the years presented either $50,000 or 10% of the total of the amounts reported under the salary and bonus columns. Therefore, the amounts for such perquisites and other personal benefits, securities and property are not reported.

(3) These figures represent annual term insurance premium payments on the life of Mr. Reichart.

(4) Includes $15,000 as a life insurance premium payment for a deferred compensation plan; $4,101 as a cash bonus representing 4% of base salary; $4,764 as a contribution to the bank's profit sharing plan; $1,572 representing 50% up to 3% matching contribution to Mr. Reichart's 401K plan; $325 representing car expense; and $5,708 representing cafeteria plan benefits.

(5) Includes $15,000 as a life insurance premium payment for a deferred compensation plan; $3,513 as a cash bonus representing 3 -1/2 % of base salary; $5,349 as a contribution to the bank's profit sharing plan; $1,538 representing 50% up to 3% matching contribution to Mr. Reichart's 401K plan; $704 representing car expense; and $5,229 representing cafeteria plan benefits.

(6) Includes $15,000 as a life insurance premium payment for a deferred compensation plan; $4,212 as a cash bonus representing 4% of base salary; $5,430 as a contribution to the bank's profit sharing plan; $1,300

representing 50% up to 3% matching contribution to Mr. Reichart's 401K plan; $718 representing car expense; and $4,938 representing cafeteria plan benefits.

(7) Mr. Reichart retired from this position in January 2003.

EXECUTIVE COMPENSATION

HUMAN RESOURCE COMMITTEE REPORT

Executive compensation for the officers of the Company and the Bank is determined by the Human Resource Committee of the Company's Board of Directors. Salaries and bonuses for the executive officers are reviewed annually. All executive compensation is paid by the Bank to the applicable executive.

COMPENSATION PHILOSOPHY

Our executive compensation philosophy is designed to attract, retain, and motivate the best managerial talent available in line with three central themes: alignment, accountability, and attraction.

- Alignment with the long-term interests of our stockholders;

- Accountability for results by linking executives to the Company and individual performance; and

- Attraction, motivation and retention of critical talent.

The Human Resource Committee annually conducts a full review of our executives and their performance in determining compensation levels. For 2002, the Human Resource Committee considered various qualitative and quantitative indicators of the Company and individual performance in determining the level of compensation for President and Chief Executive Officer and other executive officers. The review included an evaluation of the Company's performance both on a short- and long-term basis. This review included an analysis of quantitative measures, such as Return on Equity. The Human Resource Committee considered also qualitative measures such as leadership, experience, strategic direction, community representation and social responsibility. The Human Resource Committee has been sensitive to management's maintaining a balance between actions that foster long-term value creation and short-term performance. In addition, the Human Resource Committee evaluates total executive compensation in light of the operational and financial performance and compensation practices of the commercial banking industry in the Pennsylvania region.

Base salaries are reviewed each year and generally adjusted relative to individual performance and competitive salaries with the commercial banking industry in the Pennsylvania region.

A base salary increase of 3.63% was made to all executives in 2002. Actual salaries will continue to be set according to the scope of the responsibilities of each executive officer's position.

DEFERRED COMPENSATION AGREEMENTS FOR EXECUTIVE OFFICERS

Paul E. Reichart has served as the Corporation's and the Bank's President and Chief Executive Officer from 1985 to 2003. Mr. Reichart was named Vice Chairman in 1998. J. Jan Girton has served as the Executive Vice President, Chief Operating Officer and Assistant Secretary of the Bank since 1987. As a result of Messrs. Reichart's and Girton's active involvement and experience in the affairs of the Bank, the Bank has depended upon, and continues to depend upon, their

continued employment. The Bank does not maintain employment agreements or keyman insurance, other than the deferred compensation agreements described below, with respect to Messrs. Reichart and Girton. In 1992, the Bank entered into agreements with Paul E. Reichart, the former President and Chief Executive Officer of the Corporation and the Bank, and J. Jan Girton, Executive Vice President, Chief Operating Officer and Assistant Secretary of the Bank, to establish a non-qualified deferred compensation plan for these officers.

Each officer is deferring compensation in order to participate in his deferred compensation plan. If the officer continues to serve as an officer of the Bank until he attains 65 years of age, the Bank has agreed to pay him 120 guaranteed consecutive monthly payments commencing on the first day of the month following the officer's 65th birthday. Each officer's guaranteed monthly payment is based upon the future value of life insurance purchased with the compensation the officer has deferred. If the officer attains 65 years of age but dies before receiving all of the guaranteed monthly payments, then the Bank will make the remaining payments to the officer's designated beneficiary or to the representative of his estate. In the event that the officer dies while serving as an officer, but prior to age 65 years of age, then the Bank will remit the guaranteed monthly payments to the officer's designated beneficiary or to the representative of his estate. The Bank has obtained life insurance (designating the bank as the beneficiary) on the life of each participating officer in an amount which is intended to cover the Bank's obligations under the deferred compensation plan, based upon certain actuarial assumptions. In 2002 the Bank accrued $87,139 as an expense for the deferred compensation plan.

During 2002, the agreements with the two executive officers were modified. Under one agreement, Mr. Reichart will receive $225,000 payable monthly over a 10 year period commencing in February 2003. Under the other agreement, Mr. Girton will receive $175,000 payable monthly over a 10 year period commencing in April 2003. This second agreement will also provide post employment health care benefits to the executive officer until the attainment of age 65. As of December 31, 2002 and 2001, the net cash value of insurance policies was $292,515 and $254,936, respectively, and the total accrued liability, equal to the present value of these obligations, was $314,674 and $227,535, respectively, relating to these executive officers' deferred compensation agreements and the accrued liability related to the post employment health care benefit was $14,668 as of December 31, 2002.

Additionally, during December 2002, the Bank purchased $3,000,000 of bank-owned life insurance policies covering certain of its employees. The amount of net cash values of insurance policies and total accrued liabilities are included in other assets and accrued interest and other expenses, respectively, on the consolidated balance sheets.

FIVE YEAR PERFORMANCE GRAPH

The following graph and table compare the cumulative total stockholder return on our common stock during the five-year period ending on December 31, 2002, with (i) the cumulative total return on the SNL Securities Corporation Performance Index (1) for 35 publicly-traded banks with under $250 million in total assets in the Middle Atlantic area (2), and (ii) the cumulative total return for all United States stocks traded on the NASDAQ Stock market. The comparison assumes the value of the investment in our common stock and each index was $100 on December 31, 1997, and assumes further the reinvestment of dividends into the applicable securities. The stockholder return shown on the graph and table below is not necessarily indicative of future performance.

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[BANCORP LINE CHART]

INDEX	PERIOD ENDING 12/31/97	12/31/98	12/31/99	12/31/00	12/31/01	1
CCFNB Bancorp, Incorporated	100.00	111.33	88.65	75.67	108.70	
NASDAQ - Total US*	100.00	140.99	261.48	157.42	124.89	
SNL						