**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**

**FORM 10-Q**

**[√] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the quarterly period ended June 30, 2012**

**OR**

**[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the transition period from__________ to__________**

**Commission File Number: 2-94863**

# CANANDAIGUA NATIONAL CORPORATION

*(Exact name of registrant as specified in its charter)*

| **New York** | **16-1234823** |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(IRS Employer Identification Number)* |
| **72 South Main Street Canandaigua, New York** | **14424** |
| *(Address of principal executive offices)* | *(Zip code)* |

***(585) 394-4260***
*(Registrant's telephone number, including area code)*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes [√] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months.

Yes [√] No [ ]

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

Large accelerated filer [ ] Accelerated filer [√] Non-accelerated filer [ ] Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [√]

The registrant had 1,887,051 shares of common stock, par value $5.00, outstanding at July 24, 2012.

**Forward-Looking Statements**

This report, including information incorporated by reference, contains, and future filings by Canandaigua National Corporation on Forms 10-K, 10-Q and 8-K and future oral and written statements, press releases, and letters to shareholders by Canandaigua National Corporation and its management may contain, certain "forward-looking statements" intended to qualify for the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. When used or incorporated by reference in the Company's disclosures and documents, the words "anticipate," "believe," "contemplate," "estimate," "expect," "foresee," "project," "target," "goal," "budget" and similar expressions are intended to identify forward-looking statements within the meaning of Section 27A of the Securities Act. Such forward-looking statements are subject to certain risks discussed within this document and the Company's most recent Annual Report on Form 10-K, including under the heading "Risk Factors" in the Company's Annual Report on Form 10-K. These forward-looking statements are based on currently available financial, economic, and competitive data and management's views and assumptions regarding future events. These forward-looking statements are inherently uncertain, so should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated, expected, projected, targeted, or budgeted. Certain matters which management has identified, which may cause material variations are noted elsewhere herein and in the Company's other publicly filed reports. These forward-looking statements speak only as of the date of the document. We expressly disclaim any obligation or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein. We caution readers not to place undue reliance on any of these forward-looking statements.

Some examples of forward-looking statements include statements related to our expectations on the direction of interest rates, demand for our loans, changes in customer transactions types, and the payment performance of our loan portfolio. Our experience and assumptions we believe are reasonable from the basis of our stated expectations, but results can also be impacted by other factors.

As described in our public filings, factors which may cause our results to vary materiality from our expectations include, among many other, adverse changes in the global economy which may affect interest rates and as well as the stability of our local service areas, which may affect loan demand and credit quality; changes in fees related to servicing electronic transactions which may affect consumer usage, and continued focus of regulatory authorities at the state, federal and international level on bank regulation.

**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**
**INDEX TO FORM 10-Q**
**June 30, 2012**

**PART I -- FINANCIAL INFORMATION** **PAGE**


**Item 1. Financial Statements (Unaudited)**

Condensed consolidated balance sheets at June 30, 2012 and December 31, 2011 1

Condensed consolidated statements of income for the three- and six-month periods ended June 30, 2012 and 2011. 2

Condensed consolidated statements of comprehensive income for the three- and six-month periods ended June 30, 2012 and 2011. 3

Condensed consolidated statements of stockholders' equity for the six-month periods ended June 30, 2012 and 2011. 4

Condensed consolidated statements of cash flows for the six-month periods ended June 30, 2012 and 2011. 5

Notes to condensed consolidated financial statements 6

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** 27

**Item 3. Quantitative and Qualitative Disclosures about Market Risk** 35

**Item 4. Controls and Procedures** 35

**PART II -- OTHER INFORMATION**

**Item 1. Legal Proceedings** 37

**Item 1A. Risk Factors** 37

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** 37

**Item 3. Defaults Upon Senior Securities** 37

**Item 4. Mine Safety Disclosures** 37

**Item 5. Other Information** 37

**Item 6. Exhibits** 39

**SIGNATURES** 40

**PART I FINANCIAL INFORMATION**
**Item 1. Financial Statements**

**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
June 30, 2012 and December 31, 2011 (Unaudited)
(dollars in thousands, except per share data)

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 40,331 | 52,715 |
| Interest-bearing deposits with other financial institutions | 8,463 | 6,490 |
| Federal funds sold | 65,364 | 67,535 |
| Securities: | | |
| - Available for sale, at fair value | 100,087 | 114,258 |
| - Held-to-maturity (fair value of $172,548 in 2012 and $172,517 in 2011) | 168,073 | 167,225 |
| Loans - net | 1,389,053 | 1,276,426 |
| Premises and equipment – net | 15,712 | 16,101 |
| Accrued interest receivable | 6,470 | 6,627 |
| Federal Home Loan Bank stock and Federal Reserve Bank stock | 2,738 | 2,656 |
| Goodwill | 15,810 | 15,810 |
| Intangible assets – net | 6,083 | 6,787 |
| Prepaid FDIC assessment | 3,389 | 3,905 |
| Other assets | 26,798 | 24,935 |
| Total Assets | $ 1,848,371 | 1,761,470 |
| **Liabilities and Stockholders' Equity** | | |
| Deposits: | | |
| Demand | | |
| Non-interest bearing | $ 266,642 | 227,284 |
| Interest bearing | 188,863 | 175,409 |
| Savings and money market | 788,262 | 745,713 |
| Time | 385,810 | 398,204 |
| Total deposits | 1,629,577 | 1,546,610 |
| Junior subordinated debentures | 51,547 | 51,547 |
| Accrued interest payable and other liabilities | 27,540 | 27,533 |
| Total Liabilities | 1,708,664 | 1,625,690 |
| Canandaigua National Corporation stockholders' equity: | | |
| Preferred stock, $.01 par value; 4,000,000 shares authorized, no shares issued or outstanding | - | - |
| Common stock, $5.00 par value; 16,000,000 shares authorized, 1,946,496 shares issued in 2012 and 2011 | 9,732 | 9,732 |
| Additional paid-in-capital | 8,851 | 8,834 |
| Retained earnings | 125,929 | 120,675 |
| Treasury stock, at cost (60,435 shares at June 30, 2012 and 59,242 at December 31, 2011) | (5,114) | (4,912) |
| Accumulated other comprehensive income, net | (2,531) | (1,455) |
| Total Canandaigua National Corporation Stockholders' Equity | 136,867 | 132,874 |
| Non-controlling interests | 2,840 | 2,906 |
| Total Equity | 139,707 | 135,780 |
| Total Liabilities and Equity | $ 1,848,371 | 1,761,470 |

See accompanying notes to condensed consolidated financial statements.

**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**
For the three- and six-month periods ended June 30, 2012 and 2011 (Unaudited)
(dollars in thousands, except per share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Interest income: | | | | |
| Loans, including fees | $ 16,343 | 16,177 | $ 32,793 | 32,256 |
| Securities | 1,819 | 2,010 | 3,722 | 4,080 |
| Federal funds sold | 31 | 107 | 66 | 197 |
| Other | 3 | 8 | 7 | 13 |
| Total interest income | 18,196 | 18,302 | 36,588 | 36,546 |
| Interest expense: | | | | |
| Deposits | 1,456 | 2,415 | 2,959 | 5,091 |
| Junior subordinated debentures | 702 | 742 | 1,398 | 1,487 |
| Total interest expense | 2,158 | 3,157 | 4,357 | 6,578 |
| Net interest income | 16,038 | 15,145 | 32,231 | 29,968 |
| Provision for loan losses | 1,150 | 140 | 2,300 | 890 |
| Net interest income after provision for loan losses | 14,888 | 15,005 | 29,931 | 29,078 |
| Other income: | | | | |
| Service charges on deposit accounts | 2,854 | 2,722 | 5,677 | 5,307 |
| Trust and investment services income | 3,743 | 3,117 | 7,553 | 6,216 |
| Net gain on sale of mortgage loans | 970 | 440 | 1,569 | 810 |
| Loan servicing income, net | 226 | 247 | 430 | 466 |
| Loan-related fees | 171 | 56 | 243 | 165 |
| (Loss) on securities transactions, net | (85) | (96) | (91) | (97) |
| Other operating income | 879 | 433 | 1,559 | 1,244 |
| Total other income | 8,758 | 6,919 | 16,940 | 14,111 |
| Operating expenses: | | | | |
| Salaries and employee benefits | 9,417 | 7,824 | 20,172 | 15,825 |
| Occupancy, net | 2,058 | 1,883 | 4,104 | 3,716 |
| Technology and data processing | 1,342 | 1,109 | 2,552 | 2,151 |
| Professional and other services | 955 | 896 | 1,881 | 1,803 |
| Marketing and public relations | 745 | 639 | 1,354 | 1,308 |
| Office supplies, printing and postage | 425 | 362 | 846 | 776 |
| Intangible amortization | 501 | 222 | 704 | 444 |
| Other real estate operations | 137 | 178 | 455 | 406 |
| FDIC insurance | 284 | 171 | 567 | 850 |
| Other operating expenses | 1,379 | 1,551 | 2,752 | 2,877 |
| Total operating expenses | 17,243 | 14,835 | 35,387 | 30,156 |
| Income before income taxes | 6,403 | 7,089 | 11,484 | 13,033 |
| Income taxes | 1,955 | 2,045 | 3,465 | 3,650 |
| Net income attributable to noncontrolling interests and Canandaigua National Corporation | 4,448 | 5,044 | 8,019 | 9,383 |
| Less: Net income (loss) attributable to noncontrolling interests | (108) | - | (66) | - |
| Net income attributable to Canandaigua National Corporation | $ 4,556 | 5,044 | $ 8,085 | 9,383 |
| Basic earnings per share | $ 2.41 | 2.67 | $ 4.28 | 4.97 |
| Diluted earnings per share | $ 2.36 | 2.62 | $ 4.19 | 4.88 |

See accompanying notes to condensed consolidated financial statements.

**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**[WITH RESPECTIVE TAX INFORMATION PRESENTED PARENTHETICALLY]**
For the three- and six-month periods ended June 30, 2012 and 2011 (Unaudited)
(dollars in thousands)

| | | Three Months Ended June 30, | |
|---|---|---|---|
| | | **2012** | **2011** |
| Net income | $ | 4,448 | 5,044 |
| Other comprehensive income: | | | |
| Change in fair value of | | | |
| interest rate swaps, | | | |
| net of taxes of ($1,059) and ($304) | | (1,568) | (525) |
| Change in unrealized gain on | | | |
| securities available for sale, | | | |
| net of taxes of ($45) and $232 | | 37 | 460 |
| Plus reclassification adjustment | | | |
| for realized gains and losses included in | | | |
| net income on called securities, | | | |
| net of taxes of $13 and $6 | | 40 | 13 |
| Other comprehensive income | $ | (1,491) | (52) |
| Total comprehensive income | | 2,957 | 4,992 |
| Comprehensive income attributable | | | |
| to the noncontrolling interest | $ | (108) | - |
| Comprehensive income attributable to the Company | $ | 2,849 | 4,992 |

| | | Six Months Ended June 30, | |
|---|---|---|---|
| | | **2012** | **2011** |
| Net income | $ | 8,019 | 9,383 |
| Other comprehensive income: | | | |
| Change in fair value of | | | |
| interest rate swaps, | | | |
| net of taxes of ($629) and $113 | | (896) | 178 |
| Change in unrealized gain on | | | |
| on securities available for sale, | | | |
| net of taxes of ($183) and $153 | | (182) | 297 |
| Plus reclassification adjustment | | | |
| for realized gains and losses included in | | | |
| net income on called securities, | | | |
| net of taxes of $1 and $12 | | 2 | 26 |
| Other comprehensive income | $ | (1,076) | 501 |
| Total comprehensive income | | 6,943 | 9,884 |
| Comprehensive income attributable | | | |
| to the noncontrolling interest | $ | (66) | - |
| Comprehensive income attributable to the Company | $ | 7,009 | 9,884 |

See accompanying notes to condensed consolidated financial statements.

**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**
For the six-month periods ended June 30, 2012 and 2011 (Unaudited)
(dollars in thousands, except share data)

| | Number of Shares Outstanding | | Common Stock | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Non-controlling Interest | Total |
|---|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2011 | 1,887,254 | $ | 9,732 | 8,834 | 120,675 | (4,912) | (1,455) | 2,906 | 135,780 |
| Comprehensive income: | | | | | | | | | |
| Change in fair value of interest rate swaps, net of taxes of ($629) | | | - | - | - | - | (896) | - | (896) |
| Change in unrealized gain on on securities available for sale, net of taxes of ($183) | | | - | - | - | - | (182) | - | (182) |
| Plus reclassification adjustment for realized gains and losses included in net income on called securities, net of taxes of $1 | | | - | - | - | - | 2 | - | 2 |
| Net income (loss) attributable to non-controlling interest and Canandaigua National Corporation | | | - | - | 8,085 | - | - | (66) | 8,019 |
| Total comprehensive income | | | - | - | 8,085 | - | (1,076) | (66) | 6,943 |
| Purchase of treasury stock | (1,436) | | - | - | - | (222) | - | - | (222) |
| Shares issued as compensation | 243 | | - | 17 | - | 20 | - | - | 37 |
| Cash dividend - $ 1.50 per share | | | - | - | (2,831) | - | - | - | (2,831) |
| Balance at June 30, 2012 | 1,886,061 | $ | 9,732 | 8,851 | 125,929 | (5,114) | (2,531) | 2,840 | 139,707 |
| | | | | | | | | | |
| Balance at December 31, 2010 | 1,888,748 | $ | 9,732 | 8,823 | 109,768 | (4,728) | 199 | - | 123,794 |
| Comprehensive income: | | | | | | | | | |
| Change in fair value of interest rate swaps, net of taxes of $113 | | | - | - | - | - | 178 | - | 178 |
| Change in unrealized gain on on securities available for sale, net of taxes of $153 | | | - | - | - | - | 297 | - | 297 |
| Plus reclassification adjustment for realized gains and losses included in net income on called securities, net of taxes of $12 | | | - | - | - | - | 26 | - | 26 |
| Net income attributable to non-controlling interest and Canandaigua National Corporation | | | - | - | 9,383 | - | - | - | 9,383 |
| Total comprehensive income | | | - | - | 9,383 | - | 501 | - | 9,884 |
| Purchase of treasury stock | (1,048) | | - | - | - | (107) | - | - | (107) |
| Shares issued as compensation | 192 | | - | 3 | - | 16 | - | - | 19 |
| Cash dividend - $ 1.43 per share | | | - | - | (2,691) | - | - | - | (2,691) |
| Balance at June 30, 2011 | 1,887,892 | $ | 9,732 | 8,826 | 116,460 | (4,819) | 700 | - | 130,899 |

See accompanying notes to condensed consolidated financial statements.

**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
For the six-month periods ended June 30, 2012 and 2011 (Unaudited)
(dollars in thousands)

| | | 2012 | 2011 |
|---|---|---|---|
| Cash flow from operating activities: | | | |
| Net income attributable to Canandaigua National Corporation | $ | 8,085 | 9,383 |
| Adjustments to reconcile net income to | | | |
| Net cash provided by operating activities: | | | |
| Depreciation, amortization and accretion | | 3,502 | 2,739 |
| Provision for loan losses | | 2,300 | 890 |
| Gain on sale of premises and equipment and other real estate, net | | 95 | (21) |
| Writedown of other real estate | | 73 | 25 |
| Deferred income tax benefit | | (1,320) | (328) |
| Loss (Income) from equity-method investments, net | | (16) | (365) |
| Loss on calls of securities and write-down, net | | 91 | 97 |
| Gain on sale of mortgage loans, net | | (1,569) | (810) |
| Originations of loans held for sale | | (124,864) | (63,357) |
| Proceeds from sale of loans held for sale | | 122,227 | 72,471 |
| Increase in other assets | | (1,016) | (1,303) |
| Increase (decrease) in all other liabilities | | (1,518) | 422 |
| Net cash provided by operating activities | | 6,070 | 19,843 |
| Cash flow from investing activities: | | | |
| Securities available-for-sale: | | | |
| Proceeds from maturities and calls | | 57,108 | 27,082 |
| Purchases | | (43,391) | (31,023) |
| Securities held to maturity: | | | |
| Proceeds from maturities and calls | | 25,668 | 28,173 |
| Purchases | | (27,300) | (23,124) |
| Loan originations in excess of principal collections, net | | (111,986) | 19,622 |
| Purchase of premises and equipment, net | | (971) | (1,537) |
| Calls of FHLB stock, net of purchases of FHLB and FRB stock | | (86) | (196) |
| Other investments - net | | 75 | (3) |
| Proceeds from sale of other real estate | | 2,346 | 605 |
| Net cash (used) provided by investing activities | | (98,537) | 19,599 |
| Cash flow from financing activities: | | | |
| Net increase in demand, savings and money market deposits | | 95,361 | 57,722 |
| Net decrease in time deposits | | (12,394) | (36,464) |
| Principal repayments of term borrowings | | - | (330) |
| Proceeds from sale of treasury stock | | 37 | 19 |
| Payments to acquire treasury stock | | (222) | (107) |
| Change in noncontrolling interest, net | | (66) | - |
| Dividends paid | | (2,831) | (2,691) |
| Net cash provided by financing activities | | 79,885 | 18,149 |
| Net (decrease) increase in cash and cash equivalents | | (12,582) | 57,591 |
| Cash and cash equivalents - beginning of period | | 126,740 | 138,229 |
| Cash and cash equivalents - end of period | $ | 114,158 | 195,820 |
| Supplemental disclosure of cash flow information: | | | |
| Interest paid | $ | 4,406 | 6,825 |
| Income taxes paid | | 3,653 | 4,100 |
| Supplemental schedule of noncash investing activities | | | |
| Real estate acquired in settlement of loans | $ | 1,265 | 304 |

See accompanying notes to condensed consolidated financial statements.

### (1) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and applicable regulations of the Securities and Exchange Commission (SEC) and with generally accepted accounting principles for interim financial information. Such principles are applied on a basis consistent with those reflected in the 2011 Annual Report (defined below) of the Company filed with the SEC. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Management has prepared the financial information included herein without audit by an independent registered public accounting firm. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three- and six- month periods ended June 30, 2012, are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the “2011 Annual Report”).

Amounts in prior periods' condensed consolidated financial statements are reclassified whenever necessary to conform to the current year's presentation.

Management has evaluated the impact of subsequent events on these financial statements to the date of filing of this Form 10-Q with the Securities and Exchange Commission.

### (2) Securities

Amortized cost and fair value of available-for-sale and held-to-maturity securities at June 30, 2012 are summarized as follows:

| | | June 30, 2012 | | | |
|---|---|---|---|---|---|
| | | | Gross Unrealized | | |
| | | Amortized Cost | Gains | Losses | Fair Value |
| **Securities Available for Sale:** | | | | | |
| U.S. Treasury | $ | 501 | - | - | 501 |
| U.S. government sponsored enterprise obligations | | 51,820 | 260 | (44) | 52,036 |
| State and municipal obligations | | 42,671 | 1,490 | (16) | 44,145 |
| Corporate obligations [1] | | 1,094 | 3 | (193) | 904 |
| Equity securities | | 2,292 | 209 | - | 2,501 |
| Total Securities Available for Sale | $ | 98,378 | 1,962 | (253) | 100,087 |

[1] Amortized cost includes cumulative $360,000 write-down prior to 2010 for other-than-temporary impairment.

| | | Amortized Cost | Gains | Losses | Fair Value |
|---|---|---|---|---|---|
| **Securities Held to Maturity:** | | | | | |
| U.S. government sponsored enterprise obligations | $ | 6 | - | - | 6 |
| State and municipal obligations | | 167,248 | 4,235 | (118) | 171,365 |
| Corporate obligations | | 819 | 358 | - | 1,177 |
| Total Securities Held to Maturity | $ | 168,073 | 4,593 | (118) | 172,548 |

**(2) Securities** (continued)

The amortized cost and fair value of debt securities by years to maturity as of June 30, 2012, follow (in thousands). Maturities of amortizing securities are classified in accordance with their contractual repayment schedules. Expected maturities will differ from contractual maturities since issuers may have the right to call or prepay obligations without penalties.

| | | Available for Sale | | Held to Maturity | |
|---|---|---|---|---|---|
| | | Amortized Cost [(1)] | Fair Value | Amortized Cost | Fair Value |
| **Years** | | | | | |
| Under 1 | $ | 14,549 | 14,782 | 31,191 | 31,704 |
| 1 to 5 | | 31,686 | 32,910 | 125,802 | 129,149 |
| 5 to 10 | | 46,976 | 47,071 | 10,244 | 10,498 |
| 10 and over | | 2,875 | 2,823 | 836 | 1,197 |
| Total | $ | 96,086 | 97,586 | 168,073 | 172,548 |

[(1)]Amortized cost includes a cumulative $360,000 write-down prior to 2010 for other-than-temporary impairment.

The following table presents the fair value of securities with gross unrealized losses at June 30, 2012, aggregated by category and length of time that individual securities have been in a continuous loss position (in thousands).

| | | Less than 12 months | | Over 12 months | | Total | |
|---|---|---|---|---|---|---|---|
| **Securities Available for Sale:** | | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. government sponsored enterprise obligations | $ | 16,441 | 44 | - | - | 16,441 | 44 |
| State and municipal obligations | | 330 | 1 | 996 | 15 | 1,326 | 16 |
| Corporate obligations | | - | - | 863 | 193 | 863 | 193 |
| Total temporarily impaired securities | $ | 16,771 | 45 | 1,859 | 208 | 18,630 | 253 |
| **Securities Held to Maturity:** | | | | | | | |
| U.S. government sponsored enterprise obligations | $ | 6 | - | - | - | 6 | - |
| State and municipal obligations | $ | 18,515 | 95 | 3,870 | 23 | 22,385 | 118 |
| Total temporarily impaired securities | $ | 18,521 | 95 | 3,870 | 23 | 22,391 | 118 |

Substantially all of the unrealized losses on the Company's securities were caused by market interest rate changes from those in effect when the specific securities were purchased by the Company. The contractual terms of these securities do not permit the issuer to settle the securities at a price less than par value. Except for certain corporate obligations, all securities rated by an independent rating agency carry an investment grade rating. Because the Company does not intend to sell the securities and it believes it is not likely to be required to sell the securities before recovery of their amortized cost basis, which may be, and is likely to be, maturity, the Company does not consider these securities to be other-than-temporarily impaired at June 30, 2012, except as discussed below.

In the available-for-sale portfolio, the Company holds approximately $0.9 million of bank trust-preferred securities with an adjusted cost basis of $1.1 million. These securities are backed by debt obligations of banks, with approximately $0.8 million of the securities backed by two of the largest U.S. banks and $0.1 million backed by a pool of banks' debt in the form of a collateralized debt obligation (CDO). As a result of market upheaval, a lack of regular trading market in these securities, and bank failures, the fair value of these securities had fallen sharply in 2008 and continued to fall in the first half of 2009. The Company recognized cumulative other-than-temporary-impairment (OTTI) amounting to $0.9 million on one CDO over several years. Management sold a portion of this security in 2011 and intends to sell the remainder in whole or in part over time. If the financial condition of the underlying banks deteriorates, further write-downs could occur before a sale, which would be reflected in the statement of operations. The maximum potential write-down would be its current carrying value of less than $0.1 million.

**(2) Securities** (continued)

Amortized cost and fair value of available-for-sale and held-to-maturity securities at December 31, 2011 are summarized as follows:

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | | Gross Unrealized | | |
| | Amortized Cost | Gains | Losses | Fair Value |
| **Securities Available for Sale:** | | | | |
| U.S. Treasury | $ 502 | - | - | 502 |
| U.S. government sponsored enterprise obligations | 55,766 | 377 | (18) | 56,125 |
| State and municipal obligations | 53,531 | 1,917 | (23) | 55,425 |
| Corporate obligations | 1,093 | 2 | (296) | 799 |
| Equity securities | 1,295 | 112 | - | 1,407 |
| Total securities Available for Sale | $ 112,187 | 2,408 | (337) | 114,258 |

[(1)]Amortized cost includes cumulative write-downs of $360,000 prior to 2010 for other-than-temporary impairment.

| | Amortized Cost | Gains | Losses | Fair Value |
|---|---|---|---|---|
| **Securities Held to Maturity:** | | | | |
| U.S. government sponsored enterprise obligations | $ 1,007 | 1 | - | 1,008 |
| State and municipal obligations | 165,348 | 5,113 | (135) | 170,326 |
| Corporate obligations | 870 | 313 | - | 1,183 |
| Total Securities Held to Maturity | $ 167,225 | 5,427 | (135) | 172,517 |

The following table presents the fair value of securities with gross unrealized losses at December 31, 2011, aggregated by category and length of time that individual securities have been in a continuous loss position (in thousands).

| | Less than 12 months | | Over 12 months | | Total | |
|---|---|---|---|---|---|---|
| **Securities Available for Sale:** | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. government sponsored enterprise obligations | $ 7,610 | 18 | - | - | 7,610 | 18 |
| State and municipal obligations | 355 | 3 | 996 | 20 | 1,351 | 23 |
| Corporate obligations | - | - | 759 | 296 | 759 | 296 |
| Total temporarily impaired securities | $ 7,965 | 21 | 1,755 | 316 | 9,720 | 337 |
| **Securities Held to Maturity:** | | | | | | |
| State and municipal obligations | $ 7,886 | 80 | 4,647 | 55 | 12,533 | 135 |
| Total temporarily impaired securities | $ 7,886 | 80 | 4,647 | 55 | 12,533 | 135 |

**(3) Loans and Allowance for Loan Losses**

Loans, other than loans designated as held for sale, are stated at the principal amount outstanding net of deferred origination costs. Interest and deferred fees and costs on loans are credited to income based on the effective interest method. Loans held for sale are carried at the lower of cost or fair value.

The accrual of interest on commercial and real estate loans is generally discontinued, and previously accrued interest is reversed, when the loans become 90 days delinquent or when, in management's judgment, the collection of principal and interest is uncertain. Loans

are returned to accrual status when the doubt no longer exists about the loan's collectability and the borrower has demonstrated a sustained period of timely payment history. Specifically, the borrower will have resumed paying the full amount of scheduled interest and principal payments; all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within a reasonable period (six months); and there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms involving payments of cash or cash equivalents. Interest on consumer loans is accrued until the loan becomes 120 days past due at which time principal and interest are generally charged off.

Management, considering current information and events regarding the borrower's ability to repay its obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, and sufficient information exists to make a reasonable estimate of the inherent loss, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or as a practical expedient, at the loan's observable fair value or the fair value of underlying collateral if the loan is collateral-dependent. In the absence of sufficient, current data to make a detailed assessment of collateral values or cash flows, management measures impairment on a pool basis using historical loss factors equivalent to similarly impaired loans. Impairment reserves are included in the allowance for loan losses through a charge to the provision for loan losses. Cash receipts on impaired loans are generally applied to reduce the principal balance outstanding. In considering loans for evaluation of specific impairment, management generally excludes smaller balance, homogeneous loans: residential mortgage loans, home equity loans, and all consumer loans, unless such loans were restructured in a troubled debt restructuring. These loans are collectively evaluated for risk of loss on a pool basis.

**Loans**

The Company's market area is generally Ontario County and Monroe County of New York State. Substantially all loans are made in this market area. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio is susceptible to changes in the economic conditions in this area. The Company's concentrations of credit risk are as disclosed in the following table of loan classifications. The concentrations of credit risk in related loan commitments and letters of credit parallel the loan classifications reflected. Other than general economic risks, management is not aware of any material concentrations of credit risk to any industry or individual borrower.

The major classifications of loans at June 30, 2012 and December 31, 2011, follow (in thousands), along with a description of their underwriting and risk characteristics:

| | | 2012 | 2011 |
|---|---|---|---|
| Commercial and industrial | $ | 212,451 | 198,744 |
| Mortgages: | | | |
| Commercial | | 504,284 | 467,413 |
| Residential - first lien | | 272,165 | 256,173 |
| Residential - second lien | | 104,184 | 101,877 |
| Consumer: | | | |
| Automobile - indirect | | 275,862 | 227,541 |
| Other | | 16,430 | 25,583 |
| Loans held for sale | | 11,762 | 7,556 |
| Total loans | | 1,397,138 | 1,284,887 |
| Plus - Net deferred loan costs | | 9,188 | 7,634 |
| Less - Allowance for loan losses | | (17,273) | (16,095) |
| Loans - net | $ | 1,389,053 | 1,276,426 |

Commercial and Industrial Loans: These loans generally include term loans and lines of credit. Such loans are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition of real estate, expansion and improvements) and equipment purchases. As a general practice, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans by the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure secondary collateral, such as real estate, and obtain personal guarantees of the borrowers. To further reduce risk and enhance liquidity, these loans generally carry variable rates of interest, repricing in three- to five-year periods, and have a maturity of five years or less. Lines of credit generally have terms of one year or less and carry floating rates of interest (e.g., prime plus a margin).

Commercial Mortgages: Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may

include apartments, commercial structures housing businesses, healthcare facilities, and other non-owner occupied facilities. These loans are considered by the Company to be less risky than commercial and industrial loans, since they are secured by real estate and buildings. The loans typically have adjustable interest rates, repricing in three- to five-year periods, and require principal payments over a 10- to 25-year period. Many of these loans include call provisions within 10 to 15 years of their origination. The Company's underwriting analysis includes credit verification, independent appraisals, a review of the borrower's financial condition, and the underlying cash flows. These loans are typically originated in amounts of no more than 80% of the appraised value of the property serving as collateral.

Residential First-Lien Mortgages: We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. They are amortized over five to 30 years. Substantially all residential loans secured by first mortgage liens are originated by CNB Mortgage and sold to either the Bank or third-party investors. Generally, fixed-rate mortgage loans with a maturity or call date of ten years or less and a rate of 5% or more are retained in the Company's portfolio. For longer term, fixed-rate residential mortgages without escrow, the Company generally retains the servicing, but sells the right to receive principal and interest to Federal Home Loan Mortgage Company, also known as Freddie Mac. All loans not retained in the portfolio or sold to Freddie Mac are sold to unrelated third parties with servicing released. This practice allows the Company to manage interest rate risk, liquidity risk, and credit risk. From time to time, the Company may also purchase residential mortgage loans which are originated and serviced by third parties. In an effort to manage risk of loss and strengthen secondary market liquidity opportunities, management typically uses secondary market underwriting, appraisal, and servicing guidelines. Loans on one-to-four-family residential real estate are mostly originated in amounts of no more than 85% of appraised value or have private mortgage insurance. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including at each loan draw period.

Residential Second-Lien Mortgages: The Company originates home equity lines of credit and second mortgage loans (loans secured by a second [junior] lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position relating to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Consumer Loans: The Company funds a variety of consumer loans, including direct and indirect automobile loans, recreational vehicle loans, boat loans, aircraft loans, home improvement loans, and personal loans (collateralized and uncollateralized). Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed or a customer's deposit account. A small amount of loans are unsecured, which carry a higher risk of loss.

Loans Held for Sale: These are the Residential First-Lien Mortgages, discussed above, which are sold to Freddie Mac and other third parties. These loans are carried at their lower of cost or fair value, calculated on a loan-by-loan basis.

**Allowance for Loan Losses**

The allowance for loan losses is a valuation reserve for probable and inherent losses in the loan portfolio. Credit losses arise primarily from the loan portfolio, but may also be derived from other credit-related sources, when drawn upon, such as commitments, guarantees, and standby letters of credit. Additions are made to the allowance through periodic provisions, which are charged to expense. All losses of principal are charged to the allowance when incurred or when a determination is made that a loss is expected. Subsequent recoveries, if any, are credited to the allowance.

The Company has established a process to assess the adequacy of the allowance for loan losses and to identify the risks in the loan portfolio. This process consists of the identification of specific reserves for impaired loans and, for all other loans, pool-based general reserves, which is a formula-driven allocation.

The calculation of the general reserve involves several steps. A historical loss factor is applied to each loan by loan type and loan classification. The historical loss factors are calculated using a loan-by-loan, trailing eight-quarter net loss migration analysis for commercial loans. For all other loans, a portfolio-wide, trailing eight-quarter net loss migration analysis is used. Adjustments are then made to the historical loss factors based on current-period quantitative objective elements (delinquency, non-performing assets, classified/criticized loan trends, charge-offs, concentrations of credit, recoveries, etc.) and subjective elements (economic conditions, portfolio growth rate, portfolio management, credit policy, and others). This methodology is applied to the commercial, residential mortgage, and consumer portfolios, and their related off-balance sheet exposures. Any allowance for off-balance sheet exposures is recorded in Other Liabilities.

While management uses available information to recognize losses on loans, future additions to the allowance may be necessary. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

A summary of the changes in the allowance for loan losses follows (in thousands). Notwithstanding the estimated allocations set forth in any table, the entirety of the allowance is available to absorb losses in any portfolio:

| | | For the Three-Month Periods Ended June 30, | | For the Six-Month Periods Ended June 30, | |
|---|---|---|---|---|---|
| | | **2012** | **2011** | **2012** | **2011** |
| Balance at the beginning of period | $ | 16,841 | 15,910 | 16,095 | 15,635 |
| Loans charged off | | (955) | (581) | (1,665) | (1,286) |
| Recoveries of loans charged off | | 237 | 368 | 543 | 598 |
| Provision charged to operations | | 1,150 | 140 | 2,300 | 890 |
| Balance at end of period | $ | 17,273 | 15,837 | 17,273 | 15,837 |

The following tables, for each of the three- month periods presented, provide an analysis of the allowance for loan losses by loan type (in thousands):

| Three months ended June 30, 2012 | | Commercial and industrial | Commercial mortgage | Residential mortgage - first position | Residential mortgage - second position | Consumer - indirect | Consumer - other | Loans held for sale | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Beginning Balance | $ | 4,878 | 1,282 | 1,907 | 534 | 5,861 | 1,222 | - | 1,157 | 16,841 |
| Charge-offs | | (240) | (278) | (154) | - | (165) | (118) | - | - | (955) |
| Recoveries | | 39 | 1 | 4 | 10 | 135 | 48 | - | - | 237 |
| Provision | | (394) | 675 | 362 | (62) | 686 | (198) | - | 81 | 1,150 |
| Ending Balance | $ | 4,283 | 1,680 | 2,119 | 482 | 6,517 | 954 | - | 1,238 | 17,273 |

| Three months ended June 30, 2011 | | Commercial and industrial | Commercial mortgage | Residential mortgage - first position | Residential mortgage - second position | Consumer - indirect | Consumer - other | Loans held for sale | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Beginning Balance | $ | 5,876 | 1,671 | 1,666 | 587 | 4,141 | 811 | - | 1,158 | 15,910 |
| Charge-offs | | (196) | (43) | (16) | - | (206) | (120) | - | - | (581) |
| Recoveries | | 96 | - | 19 | 1 | 174 | 78 | - | - | 368 |
| Provision | | (1,004) | (290) | (37) | (18) | 492 | (18) | - | 1,015 | 140 |
| Ending Balance | $ | 4,772 | 1,338 | 1,632 | 570 | 4,601 | 751 | - | 2,173 | 15,837 |

The balance in the allowance for loan losses increased to $17.3 million at June 30, 2012 compared to $16.8 million at March 31, 2012 and from $15.8 million at June 30, 2011. In determining the level of allowance necessary, we considered a number of factors. The most significant factor in the second quarter of 2012 was growth in the portfolio, which amounted to an annualized rate of 13.4% for the three-month period from March 31, 2012. The balance in the allowance increased by a similar annualized rate. The allocation of the allowance changed in the second quarter generally due to the respective loan portfolio's growth rates with the exception of Commercial and industrial loans, wherein the allowance was reduced due to a reduction in the quantitative loss factor with improvements in the historical eight-quarter net loss migration factor, new loan growth receiving a lower, Pass-rated loss factor, the upgrades of previously criticized loans, and a lower level of internally classified loans and impaired loans.

In determining the level of allowance necessary as of June 30, 2012, we considered a number of factors. The most significant factor in the first half of 2012 was growth in the portfolio. In addition to the impact of loan growth, specific portfolio factors impacted the allowance, which included, (a) a reduction in the quantitative loss factor applied to Substandard-rated Commercial and Industrial Loans, (b) a decline in annualized net charge-offs, and (c) a decline in the ratio of non-performing loans to total loans. The increase in the Consumer indirect allowance for both three and six month periods is due to the portfolio's growth and not due to changes in underlying credit quality. Economic conditions were also considered in our determination of the allowance. Given improvements we have seen in our local economy, we have reduced our economic qualitative factors by two basis points.

The following tables, for each of the six- month periods presented, provide an analysis of the allowance for loan losses by loan type, including a summary, as of the period end, of the loan types individually and collectively evaluated for impairment (in thousands):

| Six months ended June 30, 2012 | | Commercial and industrial | Commercial mortgage | Residential mortgage - first position | Residential mortgage - second position | Consumer - indirect | Consumer - other | Loans held for sale | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Beginning Balance | $ | 6,393 | 994 | 1,786 | 521 | 4,839 | 916 | - | 646 | 16,095 |
| Charge-offs | | (431) | (278) | (229) | (3) | (448) | (276) | - | - | (1,665) |
| Recoveries | | 77 | 3 | 10 | 12 | 310 | 131 | - | - | 543 |
| Provision | | (1,756) | 961 | 552 | (48) | 1,816 | 183 | - | 592 | 2,300 |
| Ending Balance | $ | 4,283 | 1,680 | 2,119 | 482 | 6,517 | 954 | - | 1,238 | 17,273 |
| **of which:** | | | | | | | | | | |
| Amount for loans individually evaluated for impairment | $ | 912 | 221 | - | - | - | - | - | - | 1,133 |
| Amount for loans collectively evaluated for impairment | $ | 3,371 | 1,459 | 2,119 | 482 | 6,517 | 954 | - | 1,238 | 16,140 |
| Balance of loans individually evaluated for impairment | $ | 3,746 | 10,490 | - | 83 | - | - | - | - | 14,319 |
| Balance of loans collectively evaluated for impairment | $ | 208,705 | 493,794 | 272,165 | 104,101 | 275,862 | 16,430 | 11,762 | 9,188 | 1,392,007 |

| Six months ended June 30, 2011 | | Commercial and industrial | Commercial mortgage | Residential mortgage - first position | Residential mortgage - second position | Consumer - indirect | Consumer - other | Loans held for sale | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Beginning Balance | $ | 6,364 | 1,371 | 1,304 | 563 | 4,196 | 1,155 | - | 682 | 15,635 |
| Charge-offs | | (351) | (43) | (16) | - | (608) | (268) | - | - | (1,286) |
| Recoveries | | 111 | - | 19 | 2 | 315 | 151 | - | - | 598 |
| Provision | | (1,352) | 10 | 325 | 5 | 698 | (287) | - | 1,491 | 890 |
| Ending Balance | $ | 4,772 | 1,338 | 1,632 | 570 | 4,601 | 751 | - | 2,173 | 15,837 |
| **of which:** | | | | | | | | | | |
| Amount for loans individually evaluated for impairment | $ | 2,250 | 330 | - | - | - | - | - | - | 2,580 |
| Amount for loans collectively evaluated for impairment | $ | 2,522 | 1,008 | 1,632 | 570 | 4,601 | 751 | - | 2,173 | 13,257 |
| Balance of loans individually evaluated for impairment | $ | 2,888 | 1,376 | - | - | - | - | - | - | 4,264 |
| Balance of loans collectively evaluated for impairment | $ | 196,512 | 432,073 | 240,163 | 95,588 | 169,126 | 27,189 | 5,809 | 5,214 | 1,171,674 |

In determining the level of allowance necessary as of June 30, 2012, we considered a number of factors. The most significant factor in the first half of 2012 was growth in the portfolio. In addition to the impact of loan growth, specific portfolio factors impacted the allowance, which included, (a) a reduction in the quantitative loss factor applied to Substandard-rated Commercial and Industrial Loans, (b) a decline in annualized net charge-offs, and (c) a decline in the ratio of non-performing loans to total loans. Economic conditions were also considered in our determination of the allowance. Given improvements we have seen in our local economy, we have reduced our economic qualitative factors by two basis points.

In monitoring the credit quality of the portfolio, management applies a credit quality indicator to substantially all commercial loans. These quality indicators, as more fully described in the 2011 Annual Report, range from one through eight in increasing risk of loss. These ratings are used as inputs to the calculation of the allowance for loan losses. Loans rated 1 through 4 are generally allocated a lesser percentage allocation in the allowance for loan losses than loans rated from 5 through 8. Residential Mortgage Loans are generally rated 9, unless they are used to partially collateralize commercial loans, in which case they carry the rating of the respective commercial loan relationship, or if management wishes to recognize a well defined weakness or loss potential to more accurately reflect credit risk. Unrated loans are allocated a percentage of the allowance for loan losses on a pooled basis.

The following tables present the loan portfolio as of June 30, 2012 and December 31, 2011 by credit quality indicator (in thousands). Except for loans in the 9 and unrated categories, credit quality indicators are reassessed for each applicable loan at least annually, generally upon the anniversary of the loan's origination or receipt and analysis of the borrower's financial statements, when applicable, or in the event that information becomes available that would cause us to re-evaluate.

Loans in category 9 and unrated are evaluated for credit quality after origination based upon delinquency status. (See Aging Analysis table).

**Credit Quality Indicator Analysis as of June 30, 2012**

| | | Commercial and industrial | Commercial mortgage | Residential mortgage - first position | Residential mortgage - second position | Consumer - indirect | Consumer - other | Loans held for sale | Deferred Fees and Costs | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| 1-Superior | $ | 12,310 | - | - | - | - | 137 | - | - | 12,447 |
| 2-Good | | 12,881 | 26,246 | 1,577 | 3,492 | - | 1,054 | - | - | 45,250 |
| 3-Satisfactory | | 78,469 | 210,744 | 1,267 | 278 | - | - | - | - | 290,758 |
| 4-Watch | | 38,532 | 204,992 | 5,942 | 404 | - | - | - | - | 249,870 |
| 5-Special Mention | | 12,351 | 17,086 | 1,005 | - | - | - | - | - | 30,442 |
| 6-Substandard | | 21,693 | 22,710 | 5,888 | 254 | - | - | - | - | 50,545 |
| 7-Doubtful | | - | - | 7 | - | - | - | - | - | 7 |
| Subtotal | $ | 176,236 | 481,778 | 15,686 | 4,428 | - | 1,191 | - | - | 679,319 |
| 9 and not rated | | 36,215 | 22,506 | 256,479 | 99,756 | 275,862 | 15,239 | 11,762 | 9,188 | 727,007 |
| Total | $ | 212,451 | 504,284 | 272,165 | 104,184 | 275,862 | 16,430 | 11,762 | 9,188 | 1,406,326 |

**Credit Quality Indicator Analysis as of December 31, 2011**

| | | Commercial and industrial | Commercial mortgage | Residential mortgage - first position | Residential mortgage - second position | Consumer - indirect | Consumer - other | Loans held for sale | Deferred Fees and Costs | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| 1-Superior | $ | 9,814 | 105 | - | - | - | 913 | - | - | 10,832 |
| 2-Good | | 8,826 | 26,195 | 1,718 | 2,560 | - | - | - | - | 39,299 |
| 3 Satisfactory | | 68,246 | 177,882 | 1,409 | 576 | - | - | - | - | 248,113 |
| 4 Watch | | 43,928 | 210,901 | 6,045 | 269 | - | - | - | - | 261,143 |
| 5 Special Mention | | 7,864 | 4,645 | 1,127 | - | - | - | - | - | 13,636 |
| 6 Substandard | | 29,440 | 30,018 | 4,496 | 453 | - | 100 | - | - | 64,507 |
| 7 Doubtful | | - | - | - | 7 | - | - | - | - | 7 |
| 8 Loss | | - | - | - | - | - | - | - | - | - |
| Subtotal | $ | 168,118 | 449,746 | 14,795 | 3,865 | - | 1,013 | - | - | 637,537 |
| 9 and not rated | | 30,626 | 17,667 | 241,378 | 98,012 | 227,541 | 24,570 | 7,556 | 7,634 | 654,984 |
| Total | $ | 198,744 | 467,413 | 256,173 | 101,877 | 227,541 | 25,583 | 7,556 | 7,634 | 1,292,521 |

A summary of information regarding nonaccruing loans and other nonperforming assets as of June 30, 2012, December 31, 2011, and June 30, 2011 follows (in thousands):

| | | June 30, 2012 | December 31, 2011 | June 30, 2011 |
|---|---|---|---|---|
| Accruing loans 90 days or more delinquent | $ | 314 | 969 | 2,177 |
| Nonaccruing loans | | 20,106 | 17,307 | 20,439 |
| Total nonperforming loans | | 20,420 | 18,276 | 22,616 |
| Other real estate owned | | 3,426 | 4,632 | 3,991 |
| (less write-down of other real estate owned) | | (237) | (397) | (551) |
| Total nonperforming assets | $ | 23,609 | 22,511 | 26,056 |

The following tables present, as of June 30, 2012 and December 31, 2011, additional details about the loan portfolio in the form of an aging analysis of the loan portfolio. Amounts exclude deferred fees and costs (in thousands).

During the first half of 2012, we experienced an increase in past-due commercial and residential mortgages, particularly in non-accrual loans. Based upon available appraisals, we believe loans underlying the relationship are secured by collateral with values exceeding our carrying value. In accordance with our internal policy, we are in the process of re-appraising the collateral.

**Aging Analysis as of June 30, 2012**

| | | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days Or Greater | Total Past Due | Current | Total Loans | > 90 Days and Accruing | Non-Accrual Loans |
|---|---|---|---|---|---|---|---|---|---|
| Commercial and industrial | $ | 348 | 217 | 3,756 | 4,321 | 208,130 | 212,451 | 10 | 3,746 |
| Commercial mortgages | | 2,361 | - | 10,491 | 12,852 | 491,432 | 504,284 | - | 10,491 |
| Residential - first lien | | 2,206 | 513 | 5,677 | 8,396 | 263,769 | 272,165 | 96 | 5,581 |
| Residential - junior lien | | 183 | 249 | 288 | 720 | 103,464 | 104,184 | - | 288 |
| Consumer: | | | | | | | | | |
| Automobile - Indirect | | 1,878 | 882 | 199 | 2,959 | 272,903 | 275,862 | 199 | - |
| Other | | 234 | 78 | 9 | 321 | 16,109 | 16,430 | 9 | - |
| Loans held-for-sale | | - | - | - | - | 11,762 | 11,762 | - | - |
| | $ | 7,210 | 1,939 | 20,420 | 29,569 | 1,367,569 | 1,397,138 | 314 | 20,106 |

**Aging Analysis as of December 31, 2011**

| | | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days Or Greater | Total Past Due | Current | Total Loans | > 90 Days and Accruing | Non-Accrual Loans |
|---|---|---|---|---|---|---|---|---|---|
| Commercial and industrial | $ | 395 | 432 | 3,992 | 4,819 | 193,925 | 198,744 | 75 | 3,917 |
| Commercial mortgages | | 2,184 | - | 9,078 | 11,262 | 456,151 | 467,413 | - | 9,078 |
| Residential - first lien | | 633 | 55 | 4,453 | 5,141 | 251,032 | 256,173 | 652 | 3,801 |
| Residential - junior lien | | 444 | 91 | 419 | 954 | 100,923 | 101,877 | 8 | 411 |
| Consumer: | | | | | | | | | |
| Automobile - indirect | | 1,766 | 653 | 165 | 2,584 | 224,957 | 227,541 | 165 | - |
| Other | | 257 | 88 | 169 | 514 | 25,069 | 25,583 | 69 | 100 |
| Loans held-for-sale | | - | - | - | - | 7,556 | 7,556 | - | - |
| Total | $ | 5,679 | 1,319 | 18,276 | 25,274 | 1,259,613 | 1,284,887 | 969 | 17,307 |

A summary of information regarding impaired loans follows (in thousands):

| | | As of and for the six-month period ended June 30, 2012 | As of and for the year ended December 31, 2011 | As of and for the six-month period ended June 30, 2011 |
|---|---|---|---|---|
| Recorded investment at period end | $ | 20,106 | 17,307 | 20,439 |
| Impaired loans with specific related allowance at period end | $ | 3,823 | 2,453 | 4,264 |
| Amount of specific related allowance at period end | $ | 1,133 | 1,138 | 2,580 |
| Average investment during the period | $ | 19,461 | 20,394 | 21,618 |
| Interest income recognized on a cash basis during the period | $ | 138 | 127 | - |

The details of impaired loans as of June 30, 2012 and December 31, 2011 follow (in thousands)

**June 30, 2012**

| | | Recorded Investment | Unpaid principal balance | Specific Related Allowance | Average Recorded Investment | Interest income Recognized |
|---|---|---|---|---|---|---|
| **With no specific allowance** | | | | | | |
| Commercial and industrial | $ | 1,702 | 2,230 | - | 1,940 | - |
| Commercial mortgage | | 8,711 | 9,524 | - | 8,878 | 105 |
| Residential mortgage - first position | | 5,581 | 5,769 | - | 4,450 | 31 |
| Residential mortgage - second position | | 289 | 300 | - | 356 | - |
| Consumer - other | | - | - | - | 50 | 2 |
| **Subtotal** | | 16,283 | 17,823 | - | 15,674 | 138 |
| **With specific allowance** | | | | | | |
| Commercial and industrial | | 2,043 | 2,160 | 912 | 2,292 | - |
| Commercial mortgage | | 1,780 | 2,569 | 221 | 1,495 | - |
| **Subtotal** | | 3,823 | 4,729 | 1,133 | 3,787 | - |
| **Total** | $ | 20,106 | 22,552 | 1,133 | 19,461 | 138 |
| **Summary by portfolio:** | | | | | | |
| Commercial | $ | 14,236 | 16,483 | 1,133 | 14,605 | 105 |
| Residential | | 5,870 | 6,069 | - | 4,806 | 31 |
| Consumer and other | | - | - | - | 50 | 2 |
| **Total** | $ | 20,106 | 22,552 | 1,133 | 19,461 | 138 |

**December 31, 2011**

| **With no specific allowance** | | Recorded Investment | Unpaid principal balance | Specific Related Allowance | Average Recorded Investment | Interest income Recognized |
|---|---|---|---|---|---|---|
| Commercial and industrial | $ | 2,541 | 3,048 | - | 1,401 | - |
| Commercial mortgage | | 8,001 | 9,440 | - | 6,578 | 114 |
| Residential mortgage - first position | | 3,801 | 3,968 | - | 3,366 | 13 |
| Residential mortgage - second position | | 411 | 439 | - | 390 | - |
| Consumer - other | | 100 | 102 | - | 76 | - |
| **Subtotal** | | 14,854 | 16,997 | - | 11,811 | 127 |
| **With specific allowance** | | | | | | |
| Commercial and industrial | | 1,376 | 1,454 | 895 | 3,079 | - |
| Commercial mortgage | | 1,077 | 1,153 | 243 | 3,988 | - |
| Residential mortgage - first position | | - | - | - | 1,265 | - |
| Residential mortgage - second position | | - | - | - | 201 | - |
| **Subtotal** | | 2,453 | 2,607 | 1,138 | 8,583 | - |
| **Total** | $ | 17,307 | 19,604 | 1,138 | 20,394 | 127 |
| **Summary by portfolio:** | | | | | | |
| Commercial | $ | 12,995 | 15,095 | 1,138 | 15,046 | 114 |
| Residential | | 4,212 | 4,407 | - | 5,222 | 13 |
| Consumer and other | | 100 | 102 | - | 126 | - |
| **Total** | $ | 17,307 | 19,604 | 1,138 | 20,394 | 127 |

**Troubled Debt Restructurings**

In the process of resolving nonperforming loans, we may choose to restructure the contractual terms of certain loans and attempt to work out alternative payment schedules with the borrower in order to avoid foreclosure of collateral. Any loans that are modified are evaluated to determine if they are "troubled debt restructurings" (TDR) and if so determined, are evaluated for impairment. A TDR is defined as a loan restructure where for legal or economic reasons related to a borrower's financial difficulties, the creditor grants one or more concessions to the borrower that it would not otherwise consider. Terms of loan agreements may be modified to fit the ability of the borrower to repay in respect of its current financial status and restructuring of loans may include the transfer of assets from the borrower to satisfy debt, a modification of loan terms, or a combination of the two. If a satisfactory restructure and payment arrangement cannot be reached, the loan may be referred to legal counsel for foreclosure.

As of June 30, 2012, there was one commercial relationship totaling $4.5 million that was considered a TDR due to the nature of the concessions granted to the borrower. We have established no impairment reserve for the relationship in light of the value of underlying collateral and management's recovery expectations. The balances of the underlying loans are included in non-performing loans. For this relationship, we renegotiated certain terms of their loans in 2010. The significant term modified was the monthly principal and interest payment amount. We agreed to forbear our rights under default provisions in the loan agreements on the condition that the borrower made monthly payments which were significantly less than those required under the terms of the original loan agreements. The customer was in compliance with the terms of the forbearance agreement which expired in March 2011. At that time, we renewed the forbearance agreement for an additional 24 months with higher monthly payments than under the previous agreement. The borrower has paid as agreed.

A loan totaling $0.3 million, previously classified as a TDR was liquidated in the second quarter of 2012.

## (4) Loan Servicing Assets

The Company services first-lien, residential loans for the Federal Home Loan Mortgage Company (FHLMC), also known as Freddie Mac, and certain commercial loans as lead participant. The associated servicing rights (assets) entitle the Company to a future stream of cash flows based on the outstanding principal balance of the loans and contractual servicing fees. Failure to service the loans in accordance with contractual requirements may lead to a termination of the servicing rights and the loss of future servicing fees.

The Company services all loans for FHLMC on a non-recourse basis; therefore, its credit risk is limited to temporary advances of funds to FHLMC, while FHLMC retains all credit risk associated with the loans. Commercial loans are serviced on a non-recourse basis, whereby the Company is subject to credit losses only to the extent of the proportionate share of the loan's principal balance owned. The Company's contract to sell loans to FHLMC and to the Federal Housing Administration (FHA) via third-parties contain certain representations and warranties that if not met by the Company would require the repurchase of such loans. The Company has not historically been subject to a material volume of repurchases.

Gross servicing fees earned by the Company for the six-month periods ended June 30, 2012 and 2011, respectively, amounted to $712,000 and $704,000. Gross servicing fees for the three-month periods ended June 30, 2012 and 2011, respectively, amounted to $366,000 and $361,000. These fees are included in net mortgage servicing income on the statements of income.

The following table presents the changes in loan servicing assets for the six-month periods ended June 30, 2012 and 2011, respectively, as well as the estimated fair value of the assets at the beginning and end of the period (in thousands).

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Book Value | Estimated Fair Value | Book Value | Estimated Fair Value |
| Balance at January 1, | $ 2,489 | $ 3,244 | $ 2,222 | $ 3,418 |
| Originations | 572 | | 253 | |
| Amortization | (282) | | (244) | |
| Balance at June 30, | $ 2,779 | $ 3,425 | $ 2,231 | $ 3,460 |

## (5) Capital Changes

At a special meeting of the Company's shareholders held on September 14, 2011, the Company's shareholders approved (a) a 4-for-1 forward stock split of the Company's common stock (the "Stock Split") and (b) a corresponding amendment to the Company's Certificate of Incorporation that would affect the stock split by increasing the Company's total number of authorized shares from 8,000,000 to 20,000,000 shares, increasing the authorized number of shares of common stock from 4,000,000 to 16,000,000 shares, including changing the par value per share from $20.00 to $5.00, and implementing the Stock Split. The amendment to the Company's

Certificate of Incorporation effecting the Stock Split was filed with New York State on September 20, 2011. All share data presented in the Company's financial statements and this Form 10-Q has been adjusted retroactively to reflect the Stock Split.

At the Company's April 2011 Annual Meeting, shareholders authorized a class of 4,000,000 shares of preferred stock, $.01 par value. No shares of preferred stock have been issued.

### (6) Dividend

On July 11, 2012, the Board of Directors declared a semi-annual $1.61 per share dividend on common stock to shareholders of record on July 21, 2012. The dividend was paid on August 1, 2012. This is in addition to the semi-annual $1.50 per share paid on February 1, 2012.

### (7) Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the period. Diluted earnings per share includes the maximum dilutive effect of stock issuable upon conversion of stock options. Calculations for the three- and six- month periods ended June 30, 2012 and 2011 follow (dollars in thousands, except per share data):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| Basic Earnings Per Share: | | | | |
| Net income applicable to common shareholders | $ 4,556 | 5,044 | $ 8,085 | 9,383 |
| Weighted average common shares outstanding | 1,887,035 | 1,888,548 | 1,887,145 | 1,888,559 |
| Basic earnings per share | $ 2.41 | 2.67 | $ 4.28 | 4.97 |
| Diluted Earnings Per Share: | | | | |
| Net income applicable to common shareholders | $ 4,556 | 5,044 | $ 8,085 | 9,383 |
| Weighted average common shares outstanding | 1,887,035 | 1,888,548 | 1,887,145 | 1,888,559 |
| Effect of assumed exercise of stock options | 46,622 | 35,281 | 42,693 | 34,683 |
| Total | 1,933,657 | 1,923,829 | 1,929,838 | 1,923,242 |
| Diluted earnings per share | $ 2.36 | 2.62 | $ 4.19 | 4.88 |

## (8) Segment Information

The Company is organized into four reportable segments: the Company and its banking and Florida trust subsidiaries (Bank), CNB Mortgage Company (CNBM), Genesee Valley Trust Company (GVT), and WBI OBS Financial, LLC and its subsidiaries (OBS). These have been segmented due to differences in their distribution channels, the volatility of their earnings, and internal and external financial reporting requirements. The interim period reportable segment information for the three- and six-month periods ended June 30, 2012 and 2011 follows (dollars in thousands). The Company acquired a majority interest in OBS in November 2011; therefore, OBS segment information is only presented for the three- and six-month period ended June 30, 2012.

| **Three Months Ended June 30,** | | **2012** | | | | | |
|---|---|---|---|---|---|---|---|
| | | **Bank** | **CNBM** | **GVT** | **OBS** | **Intersegment** | **Total** |
| Net interest income | $ | 16,038 | 1 | 2 | - | (3) | 16,038 |
| Non-interest income | | 5,927 | 1,766 | 927 | 727 | (589) | 8,758 |
| Total revenues | | 21,965 | 1,767 | 929 | 727 | (592) | 24,796 |
| Provision for loan losses | | 1,150 | - | - | - | - | 1,150 |
| Intangible amortization | | 45 | - | 158 | 298 | - | 501 |
| Other operating expenses | | 14,891 | 617 | 767 | 738 | (271) | 16,742 |
| Total expenses | | 16,086 | 617 | 925 | 1,036 | (271) | 18,393 |
| Income (loss) before tax | | 5,879 | 1,150 | 4 | (309) | (321) | 6,403 |
| Income tax | | 1,955 | 456 | (3) | - | (453) | 1,955 |
| Net income (loss) attributable to noncontrolling interests and Canandaigua National Corporation | | 3,924 | 694 | 7 | (309) | 132 | 4,448 |
| Less: Net income (loss) attributable to noncontrolling interests | | - | - | - | (108) | - | (108) |
| Net income (loss) attributable to Canandaigua National Corporation | $ | 3,924 | 694 | 7 | (201) | 132 | 4,556 |
| Total identifiable assets | $ | 1,825,096 | 10,831 | 17,031 | 12,434 | (17,021) | 1,848,371 |

| **Three Months Ended June 30,** | | **2011** | | | | |
|---|---|---|---|---|---|---|
| | | **Bank** | **CNBM** | **GVT** | **Intersegment** | **Total** |
| Net interest income | $ | 15,145 | 2 | 3 | (5) | 15,145 |
| Non-interest income | | 5,685 | 784 | 1,013 | (563) | 6,919 |
| Total revenues | | 20,830 | 786 | 1,016 | (568) | 22,064 |
| Provision for loan losses | | 140 | - | - | - | 140 |
| Intangible amortization | | 50 | - | 172 | - | 222 |
| Other operating expenses | | 13,400 | 630 | 805 | (222) | 14,613 |
| Total expenses | | 13,590 | 630 | 977 | (222) | 14,975 |
| Income before tax | | 7,240 | 156 | 39 | (346) | 7,089 |
| Income tax | | 2,045 | 69 | (18) | (51) | 2,045 |
| Net income | $ | 5,195 | 87 | 57 | (295) | 5,044 |
| Total identifiable assets | $ | 1,675,216 | 8,229 | 16,716 | (10,267) | 1,689,894 |

| Six Months Ended June 30, | | 2012 | | | | | |
|---|---|---|---|---|---|---|---|
| | | **Bank** | **CNBM** | **GVT** | **OBS** | **Intersegment** | **Total** |
| Net interest income | $ | 32,231 | 3 | 5 | - | (8) | 32,231 |
| Non-interest income | | 11,687 | 3,050 | 1,812 | 1,318 | (927) | 16,940 |
| Total revenues | | 43,918 | 3,053 | 1,817 | 1,318 | (935) | 49,171 |
| Provision for loan losses | | 2,300 | - | - | - | - | 2,300 |
| Intangible amortization | | 91 | - | 315 | 298 | - | 704 |
| Other operating expenses | | 31,039 | 1,358 | 1,528 | 1,208 | (450) | 34,683 |
| Total expenses | | 33,430 | 1,358 | 1,843 | 1,506 | (450) | 37,687 |
| Income (loss) before tax | | 10,488 | 1,695 | (26) | (188) | (485) | 11,484 |
| Income tax | | 3,465 | 671 | (10) | - | (661) | 3,465 |
| Net income (loss) attributable to noncontrolling interests and Canandaigua National Corporation | | 7,023 | 1,024 | (16) | (188) | 176 | 8,019 |
| Less: Net income (loss) attributable to noncontrolling interests | | - | - | - | (66) | - | (66) |
| Net income (loss) attributable to Canandaigua National Corporation | $ | 7,023 | 1,024 | (16) | (122) | 176 | 8,085 |
| Total identifiable assets | $ | 1,825,096 | 10,831 | 17,031 | 12,434 | (17,021) | 1,848,371 |

| Six Months Ended June 30, | | 2011 | | | | |
|---|---|---|---|---|---|---|
| | | **Bank** | **CNBM** | **GVT** | **Intersegment** | **Total** |
| Net interest income | $ | 29,968 | 5 | 6 | (11) | 29,968 |
| Non-interest income | | 11,707 | 1,520 | 2,050 | (1,166) | 14,111 |
| Total revenues | | 41,675 | 1,525 | 2,056 | (1,177) | 44,079 |
| Provision for loan losses | | 890 | - | - | - | 890 |
| Intangible amortization | | 100 | - | 344 | - | 444 |
| Other operating expenses | | 27,356 | 1,201 | 1,549 | (394) | 29,712 |
| Total expenses | | 28,346 | 1,201 | 1,893 | (394) | 31,046 |
| Income before tax | | 13,329 | 324 | 163 | (783) | 13,033 |
| Income tax | | 3,650 | 133 | 27 | (160) | 3,650 |
| Net income | $ | 9,679 | 191 | 136 | (623) | 9,383 |
| Total identifiable assets | $ | 1,675,216 | 8,229 | 16,716 | (10,267) | 1,689,894 |

## (9) Interest Rate Swap Agreements

The Company is exposed to interest rate risk as a result of both the timing of changes in interest rates of assets and liabilities, and the magnitude of those changes. In order to reduce this risk for the Company's $30.9 million floating-rate junior subordinated debenture, the Company entered into an interest rate swap agreement in 2007, which expired on June 15, 2011. This interest rate swap agreement modified the repricing characteristics of the debentures from a floating-rate debt (LIBOR +1.40%) to a fixed-rate debt (5.54%). For this swap agreement, amounts receivable or payable were recognized as accrued under the terms of the agreement, and the net differential was recorded as an adjustment to interest expense of the related debentures. The interest rate swap agreement was

designated as a cash flow hedge. Therefore, the effective portion of the swap's unrealized gain or loss was recorded as a component of other comprehensive income. The ineffective portion of the unrealized gain or loss, if any, was immediately reported in other operating income. The swap agreement was carried at fair value in Other Liabilities on the Condensed Consolidated Statement of Condition.

In consideration of the expiration of the aforementioned agreement, the Company entered into a forward interest rate swap agreement on July 1, 2010. This swap became effective on June 15, 2011 and expires on June 15, 2021. This interest rate swap agreement modifies the repricing characteristics of the Company's $30.9 million floating-rate junior subordinated debenture from a floating-rate debt (LIBOR +1.40%) to a fixed-rate debt (4.81%). The accounting for this is the same as the expired swap agreement.

In December 2012, the Company will be exposed to interest rate risk as a result of the timing of changes in interest rates associated with the $20.6 million fixed-to-floating junior subordinated debentures issued in June 2006. In consideration of the end of the fixed-rate period, the Company entered into a forward interest rate swap agreement on December 22, 2011. The Company designated the swap as a cash flow hedge, and it is intended to protect against the variability of cash flows associated with this debenture. This swap becomes effective on December 15, 2012 and expires on December 15, 2022. This interest rate swap agreement will modify the repricing characteristics of the debenture from a floating-rate debt (LIBOR +1.44%) to a fixed-rate debt (3.859%).

**(10) Fair Values of Financial Instruments**

Current accounting pronouncements require disclosure of the estimated fair value of financial instruments. Fair value is generally defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly, non-distressed sale between market participants at the measurement date. With the exception of certain marketable securities and one-to-four-family residential mortgage loans originated for sale, the Company's financial instruments are not readily marketable and market prices do not exist. The Company, in attempting to comply with accounting disclosure pronouncements, has not attempted to market its financial instruments to potential buyers, if any exist. Since negotiated prices in illiquid markets depend upon the then present motivations of the buyer and seller, it is reasonable to assume that actual sales prices could vary widely from any estimate of fair value made without the benefit of negotiations. Additionally, changes in market interest rates can dramatically impact the value of financial instruments in a short period of time. Finally, the Company expects to retain substantially all assets and liabilities measured at fair value to their maturity or call date. Accordingly, the fair values disclosed herein are unlikely to represent the instruments' liquidation values, and do not, with the exception of securities, consider exit costs, since they cannot be reasonably estimated by management.

Accounting principles establish a three-level valuation hierarchy for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows.

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 – inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The estimated fair values and the valuation hierarchy of the Company's financial instruments are as follows (in thousands):

| | | | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|---|---|
| Financial Assets: | **Fair Value Hierarchy** | | **Carrying Amount** | **Fair Value** | **Carrying Amount** | **Fair Value** |
| Cash and equivalents | 1 | $ | 114,158 | 114,158 | 126,740 | 126,740 |
| Securities, available-for-sale | 1, 2, 3 | $ | 100,087 | 100,087 | 114,258 | 114,258 |
| Securities, held-to-maturity | 2 | $ | 168,073 | 172,548 | 167,225 | 172,517 |
| FHLB stock and Federal Reserve Bank stock | 3 | $ | 2,738 | 2,738 | 2,656 | 2,656 |
| Loans-net | 3 | $ | 1,389,053 | 1,446,438 | 1,276,426 | 1,308,531 |
| Loan servicing assets | 3 | $ | 2,779 | 3,425 | 2,489 | 3,244 |
| Financial Liabilities: | | | | | | |
| Deposits: | | | | | | |
| Demand, savings and money market accounts | 3 | $ | 1,243,767 | 1,243,767 | 1,148,406 | 1,148,406 |
| Time deposits | 3 | $ | 385,810 | 388,105 | 398,204 | 393,583 |
| Borrowings | 2 | $ | - | - | - | - |
| Junior subordinated debentures | 2 | $ | 51,547 | 52,172 | 51,547 | 52,185 |
| Other financial instruments: | | | | | | |
| Interest rate swap agreements | 2 | $ | (5,940) | (5,940) | (4,415) | (4,415) |
| Letters of credit | 2 | $ | (177) | (177) | (233) | (233) |

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

**Cash and Equivalents**

For these short-term instruments that generally mature in 90 days or less, or carry a market rate of interest, the carrying value approximates fair value.

**Securities**

Fair values for securities are determined using independent pricing services and market-participating brokers, or matrix models using observable inputs. The pricing service and brokers use a variety of techniques to arrive at fair value including market maker bids, quotes and pricing models. Inputs to their pricing models include recent trades, benchmark interest rates, spreads, and actual and projected cash flows. Management obtains a single market quote or price estimate for each security. None of the quotes or estimates is considered a binding quote, as management would only request a binding quote if management had the positive intent to sell the securities in the foreseeable future and management believed the price quoted represented one from a market participant with the intent and the ability to purchase. Management evaluates the supplied price quotes against expectations of general price trends associated with changes in the yield curve and by comparing prices to the last period's price quote. Management employs an internal matrix model for non-traded municipal securities. The matrix model considers observable inputs, such as benchmark interest rates and spreads.

Certain securities' fair values are determined using unobservable inputs and include bank-debt-based CDOs. There is a very limited market and limited demand for these CDOs due to imbalances in marketplace liquidity and the uncertainty in evaluating the credit risk in these securities. In determining fair value for these securities, management considered various inputs. Management considered fair values from brokerage firms which were determined using assumptions as to expected cash flows and approximate risk-adjusted discount rates.

There is no market for stock issued by the Federal Home Loan Bank and the Federal Reserve Bank. Member banks are required to hold this stock. Shares can only be sold to the issuer at par. Fair value is estimated to equal book value.

**Loans**

Fair values are estimated for portfolios of loans with similar financial characteristics. Loans are segregated by interest type such as floating, adjustable, and fixed-rate, and by portfolios such as commercial, mortgage, and consumer.

The fair value of performing loans is calculated by discounting scheduled cash flows through the loans' estimated maturity using estimated market discount rates that reflect the credit and interest rate risk inherent in the loan category. The estimate of maturity is based on the average maturity for each loan classification.

Delinquent loans (not in foreclosure) are valued using the method noted above, and also consider the fair value of collateral for collateral-dependent loans. While credit risk is a component of the discount rate used to value loans, delinquent loans are presumed to possess additional risk. Therefore, the calculated fair value of loans is reduced by the allowance for loan losses.

The fair value of loans held for sale is estimated based on outstanding investor commitments or in the absence of such commitments, is based on current yield requirements or quoted market prices.

**Loan Servicing Assets**

Fair value is determined through estimates provided by a third party. To estimate the fair value, the third party considers market prices for similar assets and the present value of expected future cash flows associated with the servicing assets calculated using assumptions that market participants would use in estimating future servicing income and expense. Such assumptions include estimates of the cost of servicing loans, loan default rates, an appropriate discount rate, and prepayment speeds. The key economic assumptions used to determine the fair value of mortgage servicing rights at June 30, 2012 and 2011, and the sensitivity of such values to changes in those assumptions are summarized in the 2011 Annual Report and are substantially unchanged.

**Deposits**

The fair value of demand deposits, savings accounts, and money market accounts is the amount payable on demand at the reporting date. The fair value of fixed maturity time deposits is estimated using a discounted cash flow approach that applies current market rates to a schedule of aggregated expected maturities of time deposits.

**Junior Subordinated Debentures**

There is no trading market for the Company’s debentures. Therefore the fair value of junior subordinated debentures is determined using an expected present value technique. The fair value of the adjustable-rate debentures approximates their face amount, while the fair value of fixed-rate debentures is calculated by discounting scheduled cash flows through the debenture’s estimated maturity using current market rates.

**Interest Rate Swap Agreements (Swaps)**

The fair value of swaps is the amount the Company would expect to pay to terminate the agreements and is based upon the present value of expected future cash flows using the LIBOR swap curve, the basis for the underlying interest rates.

**Other Financial Instruments**

The fair values of letters of credit and unused lines of credit approximate the fee charged to make the commitments.

## (11) Fair Values Measurements

The following table presents for each of the fair-value hierarchy levels the Company's assets and liabilities that are measured at fair value on a recurring and non-recurring basis at June 30, 2012, by caption on the Condensed Consolidated Balance Sheet (dollars in thousands).

| | | Quoted market prices in active markets (Level 1) | Internal models with significant observable market parameters (Level 2) | Internal models with significant unobservable market parameters (Level 3) | Total carrying value in the Consolidated Balance Sheet |
|---|---|---|---|---|---|
| **Measured on a recurring basis:** | | | | | |
| **Assets** | | | | | |
| Securities available-for-sale: | | | | | |
| U.S. Treasury | $ | 501 | - | - | 501 |
| U.S. government sponsored enterprise obligations | | - | 52,036 | - | 52,036 |
| State and municipal obligation | | - | 44,145 | - | 44,145 |
| All other | | - | 3,285 | 120 | 3,405 |
| Total assets | $ | 501 | 99,466 | 120 | 100,087 |
| **Liabilities** | | | | | |
| Interest rate swap agreement | $ | - | 5,940 | - | 5,940 |
| Letters of credit | | - | 177 | - | 177 |
| Total liabilities | $ | - | 6,118 | - | 6,118 |
| **Measured on a non-recurring basis:** | | | | | |
| **Assets** | | | | | |
| Loans | | | | | |
| Loans-held-for-sale | $ | - | 11,762 | - | 11,762 |
| Collateral dependent impaired loans | | - | - | 3,823 | 3,823 |
| Other real estate owned | | - | - | 3,189 | 3,189 |
| Loan servicing assets | | - | - | 2,779 | 2,779 |
| Total assets | $ | - | 11,762 | 9,791 | 21,553 |

The Company values impaired loans and other real estate owned at the time the loan is identified as impaired or when title to the property passes to the Company. The fair values of such loans and real estate owned are estimated using Level 3 inputs in the fair value hierarchy. Each loan's collateral and real estate property has a unique appraisal and management's consideration of any discount of the value is based on factors unique to each impaired loan and real estate property. The significant unobservable input in determining the fair value is management's subjective discount on appraisals of the collateral securing the loan or real estate property, which ranges from 10%-50%. Collateral for impaired loans may consist of real estate and/or business assets including equipment, inventory and/or accounts receivable and the value of these assets is determined based on appraisals by qualified licensed appraisers hired by the Company. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, estimated costs to sell, and/or management's expertise and knowledge of the client and the client's business.

As more fully described in the prior note, the Company evaluates and values loan servicing assets on a quarterly basis at their lower of amortized cost or fair value. The fair values of these assets are estimated using Level 3 inputs in the fair value hierarchy. Fair value is determined through estimates provided by a third party or by management by reference to rights sold on similar loans during the quarter. When values are estimated by management using market prices for similar servicing assets, certain discounts may be applied to reflect the differing rights underlying the loan servicing contract. These discounts may range from 25 to 75 basis points of the principal balance of the underlying loan. Such discounts represent the significant unobservable input.

The following table shows a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three- and six-month periods ended June 30, 2012 (in thousands). During the first quarter of 2012 certain securities were transferred to Level 2 classification. These securities show an active trading market, which resulted in fair values with significant observable elements.

| | Three Months Ended June 30, 2012 | Six Months Ended June 30, 2012 |
|---|---|---|
| Securities available for sale, beginning of period | $ 97 | $ 799 |
| Securities transferred to Level 2 during period | - | (730) |
| Unrealized gain included in other comprehensive income | 23 | 51 |
| Securities available for sale, end of period | $ 120 | $ 120 |

The following table presents for each of the fair-value hierarchy levels the Company's assets and liabilities that were measured at fair value on a recurring and non-recurring basis at December 31, 2011, by caption on the Consolidated Balance Sheet (dollars in thousands).

| | | Quoted market prices in active markets (Level 1) | Internal models with significant observable market parameters (Level 2) | Internal models with significant unobservable market parameters (Level 3) | Total carrying value in the Consolidated Balance Sheet |
|---|---|---|---|---|---|
| **Measured on a recurring basis:** | | | | | |
| **Assets** | | | | | |
| Securities available-for-sale: | | | | | |
| U.S. Treasury | $ | 502 | - | - | 502 |
| U.S. government sponsored enterprise obligations | | - | 56,125 | - | 56,125 |
| State and municipal obligation | | - | 55,425 | - | 55,425 |
| All other | | - | 1,407 | 799 | 2,206 |
| Total assets | $ | 502 | 112,957 | 799 | 114,258 |
| **Liabilities** | | | | | |
| Interest rate swap agreement | $ | - | 4,415 | - | 4,415 |
| Letters of credit | | - | 233 | - | 233 |
| Total liabilities | $ | - | 4,648 | - | 4,648 |
| **Measured on a non-recurring basis:** | | | | | |
| **Assets** | | | | | |
| Loans | | | | | |
| Loans-held-for-sale | $ | - | 7,556 | - | 7,556 |
| Collateral dependent impaired loans | | - | - | 2,453 | 2,453 |
| Other assets | | | | | |
| Other real estate owned | | - | - | 4,235 | 4,235 |
| Loan servicing assets | | - | - | 2,489 | 2,489 |
| Total assets | $ | - | 7,556 | 9,177 | 16,733 |

The following table shows a reconciliation of the beginning and ending balances for assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three- and six-month periods ended June 30, 2011 (in thousands).

| | | Three Months Ended June 30, 2011 | | Six Months Ended June 30,2011 |
|---|---|---|---|---|
| Securities available for sale, beginning of period | $ | 995 | $ | 958 |
| Unrealized gain included in other comprehensive income | | 4 | | 41 |
| Securities available for sale, end of period | $ | 999 | $ | 999 |

**(12) Accounting Pronouncements Implemented in the Current Year**

We implemented the following Accounting Standards Updates (ASU) as of January 1, 2012 with no impact to our financial condition or results of operations. However, some footnote disclosures were revised:

ASU 2011-03. *Reconsideration of Effective Control for Repurchase Agreements*, issued April 2011. The main objective in developing this Update was to improve the accounting for repurchase agreements (repos) and other agreements that both entitle and obligate a transferor to repurchase or redeem financial assets before their maturity. The amendments in this Update removed from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control were not changed by the amendments in this Update. Since the Company does not currently engage in these types of transactions, the Update had no impact on the Company's financial condition or results of operations upon implementation.

*ASU 2011-04 Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, issued May 2011. The amendments were intended to converge fair value measurement and disclosure guidance in U.S. GAAP with the guidance in the International Accounting Standards Board's concurrently issued IFRS 13, *Fair Value Measurement*. The amendments in ASU 2011-04 did not modify the requirements for when fair value measurements apply; rather, they generally represented clarifications on how to measure and disclose fair value under ASC 820, *Fair Value Measurement*. In implementing this ASU, we expanded relevant disclosures for fair values of financial instruments and fair value measurements.

*ASU 2011-05 Presentation of Comprehensive Income*, issued June 2011. The objective of this Update was to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. The amendments required that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. We used the two statement report by including a consolidated statement of comprehensive income.

In *ASU 2011-12 Deferral of the Effective Date for Amendments to the Presentation of Reclassification of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*, the FASB indefinitely deferred certain reporting requirements for reclassifications out of accumulated other comprehensive income on a components basis.

*ASU 2011-08 Testing Goodwill for Impairment*, issued September 2011. The objective of this Update was to simplify how entities, both public and non-public, test goodwill for impairment. The amendments in the Update permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance required an entity to test goodwill for impairment, on at least an annual basis, by comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. Under the amendments in this Update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. Although this ASU became effective on January 1, 2012, we will not implement its provisions until the fourth quarter of 2012 when we perform our annual goodwill assessment.

**(13) Acquisition**

As more fully discussed in the 2011 Annual Report, in November 2011, the Company acquired a majority interest in WBI OBS Financial, LLC (WBI), a company formed to concurrently acquire OBS Holdings, Inc. (OBS). As of June 30, 2012, the Company had not completed its comprehensive analysis of the fair value of assets acquired and liabilities assumed. The Company is in the process accumulating additional internal and market data not available at the time of the acquisition. The Company expects to complete its analysis in 2012. There has been no change to the acquisition-related financial information presented in the 2011 Annual Report.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following is our discussion and analysis of certain significant factors which have affected the Company's financial position and operating results during the periods included in the accompanying condensed consolidated financial statements. This discussion and analysis supplements our *Management's Discussion and Analysis of Financial Condition and Results of Operations* in our 2011 Annual Report. Further, we remind you to consider our Forward-Looking Statements disclosure when reading this discussion and analysis.

**Critical Accounting Estimates**

We are instructed, pursuant to SEC guidance, to evaluate and disclose those accounting estimates that we judge to be critical - those most important to the portrayal of the Company's financial condition and results, and that require our most difficult, subjective and complex judgments. We consider the Allowance for Loan Losses (allowance) as critical given the inherent uncertainty in evaluating the levels of the allowance required to reflect credit losses in the portfolio. We also consider the valuation of investment securities for Other-Than-Temporary-Impairment (OTTI) as critical in the current market environment given the lack of an active and liquid market for a small number of our holdings. There has been no change in our methodology for estimating the allowance or securities' valuation, which is fully described within the 2011 Annual Report.

**Financial Overview**

Total assets at June 30, 2012 were $1,848.4 million compared to $1,761.5 million at December 31, 2011 and $1,799.4 million at March 31, 2012. With this growth came higher revenues and higher operating expenses, the net of which negatively impacted net income. Diluted earnings per common share for the second quarter of 2012 was down 9.9% to $2.36 from $2.62 in the same quarter of 2011. Net income in these periods was $4.6 million and $5.0 million, respectively. For the year to date, diluted earnings per common share for the first half of 2012 declined 14.1% to $4.19 from $4.88 in the same half of 2011. Net income in these periods was $8.1 million and $9.4 million, respectively.

Earnings for the first half of 2012, as compared with the first half of 2011, were down, but reflected a strong 11.9% increase in total revenues (net interest income and other income) driven by business growth, offset by a higher provision for loan losses, and higher operating expenses. Despite a general decline in asset yields, net interest income grew due to higher volumes of earning assets and a decline in interest costs. The higher provision for loan losses was driven by increased net new loans. Reflecting continued organic growth and the impact of the OBS acquisition, total operating expenses increased in many major categories. As anticipated, FDIC premiums were down due to changes in assessment rates.

We were encouraged by the substantial increase in average interest earnings assets, particularly since it occurred in the higher-yielding loan portfolio. We experienced a planned decrease in federal funds sold, which were used to fund the loan growth. Average interest bearing liabilities grew slower than assets, and importantly, their cost fell significantly. Off-balance sheet, both the book value and fair value of Assets under Administration grew since the beginning of the year, reflecting new customer accounts and an overall improvement in stock market performance.

**Financial Condition (*three months ended June 30, 2012*)**

At June 30, 2012, total assets were $1,848.4 million, up $49.0 million or 2.7% from $1,799.4 million at March 31, 2012.

Cash and cash equivalents (cash, balances with other financial institutions, and federal funds sold) were $114.2 million at June 30, 2012, falling $8.6 million, impacted by an increase in loan originations.

The securities portfolio fell to $268.2 million, a $4.6 million decrease from March 31, 2012. Similar to the first quarter of 2012 and most of 2011 we experienced a relatively high level of security calls (i.e., issuers repaid debt obligations before their stated maturities). Market interest rates have declined through most of this year. This decline made it beneficial for issuers to call outstanding higher cost obligations and replace them with lower cost obligations. With this lower rate environment we found fewer investments with attractive terms (rate, maturity, credit quality) in which to invest. With low rates and little inventory in the market, our purchases did not keep pace with maturities and calls. We will continue to pursue the purchase of securities to replace the volume called. However, our ability to do so will be restricted by the low supply of high-quality US government sponsored enterprise obligations and municipal obligations, our preferred investment choices.

The securities portfolio consists principally of New York State municipal obligations (79% of total at June 30, 2012) with the remainder mostly in US government sponsored enterprise obligations. The total fair value of both the available-for-sale and the held-to-maturity securities portfolios exceeded amortized cost as a result of a decrease in mid- and long-term market rates since the securities' purchase. In both portfolios we hold some securities with fair values below their amortized cost and we concluded at June 30, 2012, that there are none considered to be other than temporarily impaired.

During the weak economic cycle that began in late 2008, a handful of non-New York State municipalities have declared bankruptcy. Much continues to be written about high debt loads and unrecorded liabilities of many municipalities and other government entities and concern remains about the possibility of additional defaults given the budget pressures, including structural deficits that many municipalities face. Our Company is an investor in state and municipal obligations. We invest only in New York State based obligors.

These investments are used to re-cycle the deposits of our local municipalities, and since we invest in New York State obligations, the money stays local and earns a tax-advantaged return. Prior to purchasing an investment, our Treasury team performs a financial analysis of the obligor or the obligation using such tools as internal models, particularly for non-rated issuances, third-party analyses, and rating agency guidance. At June 30, 2012, 95% of the portfolio was rated A or better, 2% BBB, and 3% was unrated. In addition, 96% of the obligations were backed by third-party credit support, and 98% were general obligations of the municipalities with unlimited taxing authority. We found no evidence of credit deterioration in the portfolio at June 30, 2012.

Loans, exclusive of loans held for sale, grew $45.2 million during the second quarter of 2012 with the gross portfolio totaling $1,397.1 million compared to $1,352.1 million at March 31, 2012. This continues four quarters' trend of net portfolio growth. During this quarter, as expected, we saw an increase in commercial loans given the strength in our pipeline, and in mortgage loans due to low rates and the spring buying season. Conversely, we expected, and a saw,slowed growth in the indirect automobile portfolio to allow the other loan portfolios to grow. Looking to the third quarter, we expect to see continued intense competition from banks, finance companies, and credit unions. With respect to our balance sheet, we expect both the commercial and residential portfolios to show continued increases, and limited growth of the indirect portfolio.

Please see the section entitled “Impaired Loans and Non-Performing Assets” for a discussion of loan credit quality.

Total deposits at June 30, 2012, were $1,629.6 million and were up $46.1 million from March 31, 2012. Growth occurred in all lower interest cost categories. Net growth was seen in consumer and commercial deposits while municipal deposits were down, which is typical for the second quarter of the year. Although the pace has been slowing from recent past quarters, we continued to experience declines in time deposits, both consumer and business, and expect that to trend throughout 2012 as a result of the generally low interest rate environment in which depositors prefer to keep excess funds liquid, awaiting higher rates and investment returns. Since most of these matured time deposits were redeposited in other deposit types, there was no impact on overall liquidity. However, the total cost of deposits (interest expense) did fall due to lower reinvestment rates available to depositors. Looking to the coming quarter, we expect all deposit types to grow modestly.

As expected, there was no change in total borrowings. We do not expect to incur new long-term borrowings or need to access overnight borrowings for the foreseeable future, because the balance of federal funds sold and the strength of deposit inflows should be sufficient to fund the increases we expect in earning assets.

**Results of Operations (*three months ended June 30, 2012)***

Net interest income grew $0.9 million or 5.9% for the quarter compared to the same quarter in 2011, reflecting stability in net interest margin and a widening of spread. Average earning asset balances grew and were invested in higher-yielding loans, replacing lower yielding Federal Funds Sold. With general interest rates remaining low we have seen both asset yields and liability costs fall year over year as maturing products are replaced at lower interest rates. Given the length of this very low interest rate environment, we are not likely to find opportunities to significantly lower rates on deposit products, yet falling rates on earning assets will eventually lead to lower interest rate spread and margin.

On a tax-equivalent basis, compared to the same quarter in 2011, the overall net growth in interest-earning assets and interest-bearing liabilities had a $2.4 million positive impact on net interest income, and the change in rates had a $1.3 million negative impact. Net interest margin was 4.00% for the second quarter of 2012, unchanged from the same quarter in 2011. Net interest spread improved four basis points from 2011. As we discussed in our 2011 Annual Report, we expect full-year net interest income (revenue) to increase year-on-year due to expected balance sheet growth, but we expect little positive impact from rate changes given the current interest rate environment and our anticipation of continued low interest rates for the remainder of the year.

Summary tax-equivalent net interest income information for the three-month periods ended June 30, 2012 and 2011 follows (dollars in thousands).

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest | Annualized Average Rate | Average Balance | Interest | Annualized Average Rate |
| Interest-bearing deposits and fed funds sold | $ 53,385 | $ 34 | 0.25 % | $ 178,414 | $ 115 | 0.26 % |
| Securities | 272,914 | 2,593 | 3.80 | 275,951 | 2,855 | 4.14 |
| Loans, net | 1,353,689 | 16,343 | 4.83 | 1,145,756 | 16,177 | 5.65 |
| Total interest-earning assets | 1,679,988 | $ 18,970 | 4.52 % | 1,600,121 | $ 19,147 | 4.79 % |
| Non interest-earning assets | 111,728 | | | 94,357 | | |
| Total assets | $ 1,791,716 | | | $ 1,694,478 | | |
| Total deposits | $ 1,337,149 | $ 1,456 | 0.44 % | $ 1,301,941 | $ 2,415 | 0.74 % |
| Total debt | 51,547 | 702 | 5.45 | 51,547 | 742 | 5.76 |
| Total interest-bearing liabilities | 1,388,696 | $ 2,158 | 0.62 % | 1,353,488 | $ 3,157 | 0.93 % |
| Non-interest bearing liabilities | 267,358 | | | 213,757 | | |
| Equity | 135,662 | | | 127,233 | | |
| Total liabilities and equity | $ 1,791,716 | | | $ 1,694,478 | | |
| Interest rate spread | | | 3.90 % | | | 3.86 % |
| Net interest margin | | $ 16,812 | 4.00 % | | $ 15,990 | 4.00 % |

The provision for loan losses was $1.2 million for the quarter, higher than the $0.1 million for the same quarter last year. The higher provision in the second quarter of 2012 was driven by a higher overall loan portfolio balance coupled with stable asset quality and lower net charge-offs. Details of the allowance for loan losses and net charge-offs for the year to date is presented in Footnote 3 to the Condensed Consolidated Financial Statements.

Total other income for the quarter ended June 30, 2012 increased 28.8% to $8.9 million from $6.9 million in 2011. Service charges on deposit accounts increased approximately $0.1 million due to higher revenues from both account activities fees and from electronic banking services. Account maintenance service charges (included in service charges) were flat year-on-year due to higher customer balances offsetting their periodic fees. Electronic banking services (debit and ATM card revenues) continued to increase with consumers shifting from cash and checks to electronic transactions. We expect these trends to continue through the remainder of the year.

Trust and investment services income grew 25.1% to $3.9 million for the second quarter of 2012 compared to $3.1 million for the same quarter in 2011. Included in 2012's revenue is $0.8 million from OBS. Total assets under administration (see table) have grown year to year due to both organic growth in underlying accounts and higher fair value of assets within the accounts resulting from improved equity and bond markets. We anticipate book value growth to continue into the coming quarters with year-over-year growth rates expected to be in the 5% range. For the remainder of the year we anticipate fair value growth in the low single digits.

The following table presents information about period-end book value and fair value of assets under administration (dollars in thousands).

**Assets Under Administration (excluding OBS)**
**as of**
**(in thousands)**

| | June 30, 2012 | March 31, 2012 | December 31, 2011 | June 30, 2011 |
|---|---|---|---|---|
| Book value | $ 1,756,492 | 1,748,111 | 1,726,172 | 1,705,644 |
| Fair value | $ 1,965,219 | 1,991,810 | 1,858,130 | 1,909,411 |

The net gain on sale of mortgages was 120.5% higher in the second quarter of 2012 compared to the same quarter in 2011. The total volume of closed loans was up 126.3% year over year (See table below). As seen in the table, the pace of activity is significantly higher in 2012. This is due to a combination of our competitive success, and the impact of lower market interest rates. The coming quarter is usually our heaviest period for home sales and mortgage closings in our region. We expect volumes to be slightly higher than this past quarter's. Notwithstanding the increased volume, if originations for the year are similar to 2011's, we expect the net gain on sale of mortgages might be lower than last year, because we anticipate holding more loans in portfolio.

**CNB Mortgage Closed Loans by Type**
**For the three-month periods ended June 30,**
**(dollars in thousands)**

| | 2012 | 2011 |
|---|---|---|
| Purchase money mortgages | $ 46,753 | 29,769 |
| Refinance mortgages | 48,603 | 12,368 |
| Total mortgage originations | $ 95,356 | 42,137 |
| Percentage of loans retained in portfolio | 22.7 % | 32.8 % |

Loan servicing fee income was down slightly year over year. Higher gross revenue was offset by higher amortization of servicing rights caused by a higher year-over-year amortizable balance. We expect this historical level of income for the Company to remain as long as rates stay low and we sell loans with servicing retained. The heavy mortgage refinance activity during the past few years had led us to sell more originations to third parties rather than add these low-rate, long-term assets to our portfolio. We service many of these originated loans on behalf of Freddie Mac. The balance of loans serviced for Freddie Mac stood at $488.2 million at June 30, 2012 compared to $468.9 million at March 31, 2012, and $444.4 million at June 30, 2011. We also earn servicing fees from sold commercial loan participations. The total balance of participations sold was $115.7 million at June 30, 2012 compared to $ 115.4 million at March 31, 2012, and $112.0 million at June 30, 2011.

Other operating income grew for the quarter compared to the same quarter in 2011, and can fluctuate from time to time depending upon earnings from our nonmarketable investments. In the second quarter of 2012, we recognized approximately $0.5 million from our investments in Cephas, while in the second quarter of 2011, the amount recognized was less than $0.1 million. We expect to record earnings from this and other investments in the coming quarters, however the extent and timing cannot be determined.

Total operating expenses grew $2.6 million for the quarter ended June 30, 2012 compared to the same three-month period in 2011. Of this, $1.0 million was associated with OBS with $0.7 million in operating expenses, and $0.3 million in intangible amortization. With the exception of other operating expenses, all major categories of expenses generally increased, and were consistent with the growth in our franchise: loans, deposits, assets under administration, etc. The largest component increase was in salaries and employee benefits reflecting the addition of new staff and raises for incumbents. Except for FDIC insurance, we expect all categories to continue to increase for the remainder of the year consistent with our business growth goals and the inclusion of OBS.

The quarterly effective tax rate was 30.5% in 2012 and 28.8% in 2011. The increase in the effective rate is attributable to the ratio of tax-exempt income to total income. It is likely this rate will settle in the 29% - 31% range through 2012 due to lower tax-exempt income from declining interest rates on tax-exempt bonds.

***Financial Condition and Results of Operations (six months ended June 30, 2012)***

At June 30, 2012, total assets of the Company were up $86.9 million or 4.9% from December 31, 2011. Cash and equivalents (cash, balances and federal funds sold) decreased as a result of strong loan growth in excess of securities and net deposit growth. Securities fell $13.3 million as calls and maturities nearly outpaced purchases of new investments. Loans grew $113.8 million or 8.8%. Increases were seen in all categories with the largest increase in commercial loans followed by indirect automobile loans. Total deposits at June 30, 2012, were up $83.0 million or 5.4% with growth in depositor types.

Compared to the same period in 2011, net interest income was up $2.3 million or 7.6% in the first six-months of 2012. Net interest margin was positively impacted by a net increase in balances, but this was offset by the negative impact of falling rates in interest-earning assets. Summary tax-equivalent net interest income information for the six-month periods ended June 30, 2012 and 2011 follows:

| | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|
| | Average Balance | Interest | Annualized Average Rate | Average Balance | Interest | Annualized Average Rate |
| Interest-bearing deposits and fed funds sold | $ 59,022 | $ 73 | 0.25 % | $ 163,770 | $ 210 | 0.26 % |
| Securities | 276,227 | 5,303 | 3.84 | 274,879 | 5,792 | 4.22 |
| Loans, net | 1,322,521 | 32,793 | 4.96 | 1,154,709 | 32,256 | 5.59 |
| Total interest-earning assets | 1,657,770 | $ 38,169 | 4.60 % | 1,593,358 | $ 38,258 | 4.80 % |
| Non interest –earning assets | 113,243 | | | 93,708 | | |
| Total assets | $ 1,771,013 | | | $ 1,687,066 | | |
| Total deposits | $ 1,322,108 | $ 2,959 | 0.45 % | $ 1,301,690 | $ 5,091 | 0.78 % |
| Total debt | 51,547 | 1,398 | 5.42 | 51,604 | 1,487 | 5.76 |
| Total interest-bearing liabilities | 1,373,655 | $ 4,357 | 0.63 % | 1,353,294 | $ 6,578 | 0.97 % |
| Non-interest bearing liabilities | 261,697 | | | 208,450 | | |
| Equity | 135,661 | | | 125,322 | | |
| Total liabilities and equity | $ 1,771,013 | | | $ 1,687,066 | | |
| Interest rate spread | | | 3.97 % | | | 3.83 % |
| Net interest margin | | $ 33,812 | 4.08 % | | $ 31,680 | 3.98 % |

The provision for loan losses was $1.4 million higher for the first six months of 2012 compared to the first six months of 2011. The reasons are discussed in the three-month section above.

Other income for the six months ended June 30, 2012, increased 21.2% to $17.1 million from $14.1 million in 2011. Similar factors impacting the three-month period impacted the six month period results. OBS revenues accounted for $1.3 million of the increase, and income from our investments in Cephas accounted for $0.2 million of the increase

Mortgage closings grew 90.7% for the six month period ended June 30, 2012 compared to the same period in 2011 due to our market competitiveness in the purchase money mortgage arena, and general market interest rate declines which spurred refinance activity. Along with the overall increase in volume was the $1.5 million increase in net gain on the sale of mortgage loans. A summary of originations follows (dollars in thousands):

**CNB Mortgage Closed Loans by Type**
**For the six-month period ended June 30,**
**(dollars in thousands)**

| | 2012 | 2011 |
|---|---|---|
| Purchase money mortgages | $ 75,248 | 47,631 |
| Refinance mortgages | 90,117 | 39,068 |
| Total mortgage originations | $ 165,365 | 86,699 |
| Percentage of loans retained in portfolio | 24.5 % | 26.9 % |

Operating expenses increased 17.9% or $5.4 million for the six months ended June 30, 2012, over the same period in 2011. Operating expenses of OBS accounted for $1.5 million of the increase, and approximately $1.8 million of the increase was due to higher accruals for stock appreciation rights due to the higher market price of our common stock. Other categories increase for same reasons as those discussed in the three-month section above.

The Company's effective tax rate for the year to date in 2012 increased to 30.2% from 28.0% in 2011. The change in the effective rate is attributable to the ratio of tax-exempt income to total income.

## Liquidity

There has been no material change from December 31, 2011 in our available sources of wholesale liquidity from either the Federal Home Loan Bank of New York (FHLB) or the Federal Reserve Bank of New York. At June 30, 2012 we had no overnight or short-term borrowings outstanding, and during the quarter we did not utilize any overnight or short-term borrowings. Given our high level of federal funds sold and continued deposit inflows, we foresee no borrowings in the coming quarter; though we might consider raising medium- or long-term borrowings for interest rate risk management purposes.

For the six months ended June 30, 2012, cash flows from all activities used $12.6 million in net cash and cash equivalents versus providing $57.6 million for the same period in 2011. In both years the principal source of cash inflows was deposits.

Net cash provided by operating activities was $6.1 million in 2012 versus $19.8 million in 2011. Both the largest source and use of operating cash in the first half of 2012 and 2011 were loans held for sale with origination and sales activity, which, for 2012, nearly doubled 2011. Excluding the effect of loans held for sale, operating activities provided $10.3 million and $11.5 million cash for each of the six-month periods in 2012 and 2011, respectively.

During the first half of 2012, investing activities used $98.5 million in cash and equivalents compared to providing $19.6 million during the same period of 2011. Securities activities provided cash in 2012, while in 2011 these activities were nearly breakeven. Loan activities used significant amounts of cash in 2012, while in 2011 loan activities provided cash. For the remainder of the year we expect both securities and loan activities to utilize cash.

Cash provided by financing activities was $79.9 million in the first half of 2012 versus $18.1 million in the same period of 2011. The main contributor in both periods was deposit activity.

For the remainder of 2012, cash for growth is expected to come primarily from operating activities and customer deposits. Customer deposit growth is expected to come from all depositor types.

## Contractual obligations and commitments

Less material, but a part of our ongoing operations, and expected to be funded through normal operations, are liquidity uses such as lease obligations, long-term debt repayments, and other funding commitments. There has been no material change from the information disclosed in our 2011 Annual Report. During the second quarter of 2012, the Company made a required $2.5 million installment purchase payment for the OBS acquisition.

Also, as discussed more fully in our 2011 Annual Report, in the normal course of business, various commitments and contingent liabilities are outstanding. Because many commitments and almost all letters of credit expire without being funded in whole or in part, the notional amounts are not estimates of future cash flows. The following table presents the notional amount of the Company's significant commitments. Most of these commitments are not included in the Company's consolidated balance sheet (in thousands).

| | | June 30, 2012 | December 31, 2011 |
|---|---|---|---|
| | | Notional Amount | Notional Amount |
| Commitments to extend credit: | | | |
| Commercial lines of credit | $ | 140,581 | 138,072 |
| Commercial real estate and construction | $ | 46,855 | 37,174 |
| Residential real estate at fixed rates | $ | 5,873 | 5,269 |
| Home equity lines of credit | $ | 204,111 | 186,902 |
| Unsecured personal lines of credit | $ | 17,118 | 16,326 |
| Standby and commercial letters of credit | $ | 11,820 | 15,563 |
| Commitments to sell real estate loans | $ | 11,762 | 7,556 |

## Capital Resources

Under the regulatory framework for prompt corrective action, as of June 30, 2012, the Company and Bank are categorized as "well-capitalized." This is unchanged from December 31, 2011, and management anticipates no change in this classification for the foreseeable future.

On September 12, 2010, the Basel Committee on Banking Supervision released its proposal for revising capital requirements for internationally active financial institutions. These new standards are called Basel III. On June 7, 2012, the US banking regulators published their Notice of Proposed Rule Making to implement changes in capital rules. In two different actions, both the Federal Reserve and the Federal Deposit Insurance Corporation have proposed new capital requirements for all banks that essentially accept all recommendations from the Basel III accord. While we had anticipated some changes for community banks, we were surprised that non-international banks, banks like us, would be within the scope of much of the proposal. The proposal will increase required capital and change risk-weightings for many assets. We are still evaluating the proposed rule, but are generally disappointed as to its scope and its broad-based application across all institutions regardless of their systematic risk profile. While the rule would be effective as of January 1, 2013, full compliance with most aspects of the rule would not be required until January 1, 2019.

The key features that generally relate to banks like ours are:

- New minimum regulatory capital ratio requirements
  - A newly-introduced "common equity" tier 1 ratio of 4.5%,
  - Tier 1 capital ratio of 6% (increased from the current requirement of 4%),
  - Total capital ratio of 8% of risk-weighted assets (unchanged from the current requirement), and
  - Tier 1 leverage ratio of 4%.

- New capital conservation buffer: To avoid restrictions on capital distributions (e.g. distributing dividends) and discretionary bonus payments to executive officers, a bank will be required to hold an additional buffer of common equity Tier 1 capital in an amount above 2.5% of total risk-weighted assets in addition to the minimum common equity Tier 1, Tier 1, and total capital risk-based capital ratios.

- Capital is redefined: What is included in Tier 1 capital will change:
  - Cumulative preferred and trust preferred instruments would be excluded from Tier 1 capital.
  - Regulatory capital deductions would be stricter than those currently required. Examples of the more stringent requirements for common equity Tier 1 capital are:
    - Unrealized gains and losses on all available-for-sale securities and gains and losses associated with certain cash flow hedges will now flow through to common equity Tier 1 capital. Currently, these gains and losses are neutralized when calculating regulatory capital.
    - Goodwill and net defined benefit pension plan assets will be deducted;
    - Deferred tax assets (DTAs) arising from operating losses and tax credit carry forwards will be deducted;
    - Mortgage servicing assets, deferred tax assets arising from temporary differences that an organization could not realize through net operating loss carry backs, and the common stock of unconsolidated financial institutions each would be individually limited to 10% of common equity Tier 1 capital, and, in the aggregate, to 15% of common equity Tier 1 capital;
    - The amount of minority interests permitted in capital would be more limited;

- Asset risk-weighting: The most significant changes to the calculation of risk-weighted assets are:
  - The treatment of exposures to the U.S. government, U.S. public sector entities (such as states and municipalities), U.S. government-sponsored entities, and U.S. depository institutions would be unchanged from the current rules. However, the risk weight for an exposure to a foreign bank or public-sector entity (PSE), such as a state or municipality, would be assigned based on the rating of its home country.
  - Residential mortgage exposures would be assigned to a range of risk weight categories (between 35 and 200%) based upon the loan-to-value (LTV) ratio of the mortgage and certain mortgage product features. Currently, most residential mortgages are assigned a 50% risk weight despite the broad range of risk profiles associated with mortgage exposures.
  - Certain commercial real estate loans are assigned a 150% risk weight.
  - Nonaccrual loans and loans greater than 90 days past due are assigned a 150% risk weight.

**Credit-Related Information**

**Allowance for Loan Losses , Net Charge-offs, and Non-performing Loans**

Credit-related statistics follow:

| | June 30, 2012 | March 31, 2012 | December 31, 2011 | June 30, 2011 |
|---|---|---|---|---|
| Allowance as a percentage of total period end loans | 1.24 % | 1.25 % | 1.25 % | 1.35 % |
| Allowance as a percentage of non-performing loans | 84.59 % | 84.58 % | 88.07 % | 70.03 % |
| Net charge-offs to average loans (annualized) | 0.17 % | 0.12 % | 0.28 % | 0.12 % |
| Non-performing loans to total period-end loans | 1.46 % | 1.47 % | 1.42 % | 1.93 % |
| Non-performing assets to total period-end loans and other real estate | 1.69 % | 1.70 % | 2.25 % | 2.22 % |

The provision for loan losses for the six-month period ended June 30, 2012 was higher than the same period in 2011, due to substantially higher net loan growth offset by improved credit quality compared to 2011. The balance in the allowance for loan losses also increased during the quarter and was impacted by growth and higher quantitative factors from the eight-quarter loss migration applied to the residential mortgage and the consumer indirect portfolio. Conversely the allowances associated with commercial loans were reduced due to lower quantitative factors. As discussed more fully in the 2011 Annual Report, we determine the amount necessary in the allowance for loan losses based upon a number of factors. Based on our current assessment of the loan portfolio, we believe the amount of the allowance for loan losses at June 30, 2012 is appropriate at $17.3 million. However, should non-performing and non-accrual loans increase, or should we experience declines in customers' credit quality measured through loan impairment or internal loan classifications, we may need to establish a higher allowance for loan losses as a percentage of total loans, which would necessitate an increase to the provision for loan losses.

Net charge-offs in the first half of 2012 were $1.1 million, compared to $0.5 million in the first half of 2011. Net charge-offs to average loans for the first six months increased in 2012 to 17 basis points compared to 12 basis points in 2011, but remained well below 2011's full year figure. In the coming quarters, we anticipate annualized net charge-offs in the 20-25 basis points range if we experience no significant portfolio deterioration.

Total non-performing loans were $20.4 million at June 30, 2012, up from $18.3 million at December 31, 2011, but down from $22.6 million at June 30, 2011. The general decline in non-performing loans since June 30, 2011 came mainly in commercial-related loans.

Other real-estate owned has fallen $0.8 million since December 31, 2011 to $3.2 million at June 30, 2012, due to property liquidations, and is also down slightly from the second quarter of 2011. Given the current economic climate and overall growth in non-performing loans, we can expect additional foreclosures in the coming periods.

**Impaired Loans**

Total impaired loans have exhibited a positive trend during the past twelve months, having declined to $20.1 million at June 30, 2012 from $20.4 million at June 30, 2011 due to improvements in commercial and industrial loans. However, since year end 2011, total impaired loans increased $2.8 million mostly due to one commercial real-estate relationship for which we could incur an impairment charge in the coming quarter depending upon the results of re-appraisals.

At June 30, 2012 we identified 100 loans totaling $20.1 million that were considered impaired. Of these, 52, with an aggregate balance outstanding of $14.3 million were analyzed on a loan-by-loan basis, 11 of which, with an aggregate balance of $3.8 million, had specific reserves calculated amounting to $1.1 million. The remaining 48 loans totaling $5.8 million were evaluated for impairment on a collective basis.

Regional economic conditions continue to improve slowly. Despite this, as in all economic cycles, we can anticipate more loans, though we know of no material ones, which will become impaired in the coming quarters. Concurrently, we expect some loans, which are currently impaired, to improve over this same period, and we will likely see some impaired loans decline to loss status. Accordingly we do not expect the level of impaired loans to substantially change throughout the rest of 2012.

**Impact of Financial Regulation Legislation**

Management continues to navigate the myriad regulations and pronouncements resulting from the July 21, 2010 passing of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* ("Financial Reform Act"). Most of the major regulations have yet to be enacted, but planning and managing their implementation requires considerable forethought. Our employees are working tirelessly to develop cost-effective solutions. The provisions expected to most significantly impact us are more fully described in the 2011 Annual Report, and in the Capital Resources section above.

**Recent Accounting Standards to be implemented in Future Periods**

The following presents a summary of Accounting Standards Updates (ASU's), exclusive of technical correction ASU's that will be subject to implementation in future periods.

*ASU 2011-11 Disclosures about Offsetting Assets and Liabilities*, issued December 2011. The amendments in this Update require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are intended to bring closer convergence of US GAAP with International Financial Reporting Standards (IFRS). The amendments are effective for us beginning in 2013. We do not anticipate any material impact to our financial statements.

*ASU 2012-02 Testing Indefinite-Lived Intangible Assets for Impairment*, issued July 2012. The amendments in this update permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other than Goodwill. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Previous guidance in Subtopic 350-30 required an entity to test indefinite-lived intangible assets for impairment, on at least an annual basis, by comparing the fair value of the asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an entity should recognize an impairment loss in the amount of that excess. In accordance with the amendments in this Update, an entity will have an option not to calculate annually the fair value of an indefinite-lived intangible asset if the entity determines that it is not more likely than not that the asset is impaired. Permitting an entity to assess qualitative factors when testing indefinite-lived intangible assets for impairment results in guidance that is similar to the goodwill impairment testing guidance in Update 2011-08

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

*Interest Rate Sensitivity and Asset / Liability Management Review*

As set forth in our 2011 Annual Report, we expected market interest rates for 2012 would remain fairly steady for most of the year at current historic lows with no measurable increase expected until 2014. We have no reason at this time to change that expectation.

We measure net interest income at-risk by estimating the changes in net interest income resulting from instantaneous and sustained parallel shifts in interest rates of plus- or minus- 200 basis points over a twelve-month period. This provides a basis or benchmark for our Asset/Liability Committee to manage our interest rate risk profile. Presented below is a table showing our interest rate risk profile at June 30, 2012 and December 31, 2011.

| Changes in Interest Rates (basis points) | Estimated Percentage Change in Future Net Interest Income | |
|---|---|---|
| | 2012 | 2011 |
| 200 | (3)% | (4)% |
| 100 | (4) | (6) |
| No change | - | - |
| -100 | - | - |
| -200 | - | - |

Our model suggests our interest rate risk has decreased slightly from year end for upward changes in rates, and is unchanged for downward changes in rates. Our exposure to smaller increases in rates has declined, because we have more earning assets in higher yielding loans relative to the year-end 2011 balance sheet. Our exposure to downward rate movements has stabilized due to the very low cost of deposits. Deposit rates have little room to move lower, and, despite the magnitude of market rate changes, asset yields declines have moderated somewhat due to interest rate floors in many of our variable-rate loan contracts.

**Item 4. Controls and Procedures**

The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of June 30, 2012, that the Company's disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-14(c) and 15d-14(c)) are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act

of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Also, there have been no changes in the Company's internal control over financial reporting identified in connection with that evaluation, or that occurred during the second quarter of 2012, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II -- OTHER INFORMATION**
**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**

**Item 1. Legal proceedings**

The Company and its subsidiaries are, from time to time, parties to or otherwise involved in legal proceedings arising in the normal course of business as either plaintiffs or defendants. Management does not believe that there is any pending or threatened proceeding against the Company or its subsidiaries which, if determined adversely, would have a material effect on the Company's business, results of operations, or financial condition.

**Item 1A. Risk Factors**

There has been no material change to the risk factors disclosed in the 2011 Annual Report.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

From time to time, shares of our common stock are purchased by The Canandaigua National Bank and Trust Company (Bank) for the Arthur S. Hamlin Award, the Canandaigua National Corporation Employee Stock Ownership Plan (ESOP) and the Canandaigua National Corporation for treasury. Each of these entities is considered an affiliated purchaser of the Company under Item 703 of Regulation S-K. Shares repurchased by Company are not part of a publicly announced plan or program. The Bank, ESOP, and Company purchase prices per share are determined based on the most recent price established at the sealed-bid auction immediately preceding the purchase. Purchases occur on an ad-hoc basis when shares become available in the marketplace and the Company is interested in purchasing these shares for the corporate purposes discussed above. Sales occur when corporate needs require the use of shares and there are none available in the market at the time.

The following table sets forth, for the monthly periods in 2012, a summary of these transactions.

| Date | Total Shares Purchased (Sold) (#) | Average Price Per Share ($) | Purpose |
|---:|---:|---:|---:|
| April | 100 | $ 152.56 | Treasury |
| June | (243) | $ 153.53 | Compensation |
| June | 1,336 | $ 154.86 | Treasury |

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

Not Applicable

**Item 5. Other information**

**Unresolved Staff Comments**

None

**Common Stock Trades**

All share and per share information in all tables has been adjusted to reflect the four-for-one forward stock split approved by the Company's shareholders at a special meeting on September 14, 2011, and effected pursuant to an amendment to the Company's Certificate of Incorporation, which was filed with New York State on September 20, 2011.

While the Company's stock is not actively traded, from time to time, shareholders sell shares to interested persons in sealed-bid public auctions administered by the Bank's Trust Department at the request of selling shareholders. Our stock is not listed with a national securities exchange. Due to the limited number of transactions, the quarterly high, low and weighted average sale prices may not be indicative of the actual market value of the Company's stock. The following table sets forth a summary of transactions by selling shareholders and bidders in the Company's common stock during each period for transactions that were administered by the Bank's Trust Department:

| Date of Transaction | Number of Shares Sold | Average Price Per Share | Highest Accepted Bid | Lowest Accepted Bid |
|---|---|---|---|---|
| March 8, 2012 | 1,926 | $ 147.48 | $ 165.78 | $ 141.93 |
| April 5, 2012 | 4,233 | $ 152.56 | $ 179.96 | $ 145.00 |
| May 24, 2012 | 3,049 | $ 154.86 | $ 185.00 | $ 145.01 |
| June 21, 2012 | 3,353 | $ 149.24 | $ 185.00 | $ 137.51 |

Although the Company's common stock is not listed with a national securities exchange, it trades sporadically on the Over-the-Counter Bulletin Board System under the symbol CNND or CNND.OB. The following table sets forth a summary of information about these trades. Due to the limited number of transactions, the quarterly high, low and weighted average bid/ask prices may not be indicative of the actual market value of the Company's stock.

The OTC Bulletin Board® (OTCBB) is a regulated quotation service that displays real-time quotes, last-sale prices, and volume information in over-the-counter (OTC) equity securities. An OTC equity security generally is any equity that is not listed or traded on NASDAQ® or a national securities exchange. The OTCBB is a quotation medium for subscribing members, not an issuer listing service, and should not be confused with The NASDAQ Stock Market℠. Investors must contact a broker/dealer to trade OTCBB securities. Investors do not have direct access to the OTCBB service. The Securities and Exchange Commission's (SEC's) Order-Handling Rules which apply to NASDAQ-listed securities do not apply to OTCBB securities. The OTCBB market quotations set forth below reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

| Period | Number of Shares Transacted | Quarterly Average Sales Price | Quarterly High Sales Price | Quarterly Low Sales Price |
|---|---|---|---|---|
| 1st Quarter, 2012 | 5,603 | $ 93.56 | $ 105.00 | $ 87.50 |
| 2nd Quarter, 2012 | 1,897 | $ 112.01 | $ 135.00 | $ 105.00 |

**Item 6. Exhibits**

| | Exhibit | Where exhibit may be found (incorporated by reference to the extent not filed herewith): |
|---|---|---|
| (2.1) | Stock purchase Agreement, dated September 6, 2007, by and among Canandaigua National Corporation, Genesee Valley Trust Company | Filed as Exhibit 2.1 to Form 10-Q for the period ended June 30, 2010* |
| (2.2) | Asset Purchase Agreement, dated December 22, 2008, by and among The Canandaigua National Bank and Trust Company, Greentree Capital Management, LLC, Peter J Gaess, and T.C. Lewis | Filed as Exhibit 2.2 to Form 10-Q for the period ended June 30, 2010* |
| (2.3) | Amendment to Asset Purchase Agreement, dated December 31, 2008, by and among The Canandaigua National Bank and Trust Company, Greentree Capital Management, LLC, Peter J. Gaess, and T.C. Lewis | Filed as Exhibit 2.3 to Form 10-Q for the period ended June 30, 2010* |
| (3.i) | Certificate of Incorporation of the Registrant, as amended | Filed as Exhibit 3.i to Form 10-Q for the period ended March 31, 2011 |
| (3.ii.) | By-laws of the Registrant, as amended | Filed as Exhibit 3.ii to Form 10-Q for the period ended March 31, 2011 |
| (10.10) | Canandaigua National Corporation Omnibus Incentive Plan, as amended | Filed as Exhibit 3.ii to Form 10-Q for the period ended March 31, 2012 |
| (11) | Calculations of Basic Earnings Per Share and Diluted Earnings Per Share | Note 7 to the Condensed Consolidated Financial Statements |
| (31.1) | Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002 | Filed Herewith |
| (31.2) | Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002 | Filed Herewith |
| (32) | Certification of Chief Executive Officer and Chief Financial Officer under 18 U.S.C. Section 1350 pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Filed Herewith |

(101)** The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Condition as of June 30, 2012 and December 31, 2011; (ii) Condensed Consolidated Statements of Income for the three- and six-months ended June 30, 2012 and 2011; (iii) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011; (iv) Condensed Consolidated Statements of Comprehensive Income for the six months ended June 30, 2012 and 2011; (v) Condensed Consolidated Statements of Changes in Shareholders' Equity for the six months ended June 30, 2012 and 2011; and, (vi) Notes to Unaudited Condensed Consolidated Financial Statements.

Notes

*Certain portions of these agreements have been granted confidential treatment by the Securities and Exchange Commission. Confidential information is omitted from these agreements and filed separately with the Commission

****** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections

**SIGNATURES**

**CANANDAIGUA NATIONAL CORPORATION AND SUBSIDIARIES**
Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CANANDAIGUA NATIONAL CORPORATION
(Registrant)

| | |
|---|---|
| August 6, 2012 | /s/ George W. Hamlin, IV |
| Date | George W. Hamlin, IV<br>Chairman and Chief Executive Officer |
| August 6, 2012 | /s/ Lawrence A. Heilbronner |
| Date | Lawrence A. Heilbronner<br>Executive Vice President and<br>Chief Financial Officer |