

FIRST DEFIANCE FINANCIAL CORP
Form 10-K/A
February 18, 2011
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 1

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year Ended December 31, 2009

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 0-26850

FIRST DEFIANCE FINANCIAL CORP.

(Exact name of registrant as specified in its charter)

OHIO
(State or other jurisdiction of incorporation or organization)

34-1803915
(I.R.S. Employer Identification Number)

601 Clinton Street, Defiance, Ohio

43512

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(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code: (419) 782-5015

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

Common Stock, Par Value \$0.01 Per Share
(Title of Class)

The NASDAQ Stock Market
(Name of each exchange on which registered)

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

None

(Title of Class)

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

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting Company

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

As of March 2, 2010, there were issued and outstanding 8,117,520 shares of the Registrant's common stock.

The aggregate market value of the voting stock held by non-affiliates of the Registrant computed by reference to the average bid and ask price of such stock as of June 30, 2009 was approximately \$113.1 million.

Documents Incorporated by Reference

Part III of this Form 10-K incorporates by reference certain information from the registrant's definitive Proxy Statement for the 2010 Annual Shareholders Meeting.

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EXPLANATORY NOTE

First Defiance Financial Corp. (First Defiance or the Company) is filing this Amendment to Form 10-K for the fiscal year ended December 31, 2009 (this Form 10-K/A) to amend Part II, Item 8 to disclose management's determination that, as of December 31, 2009, there was a material weakness in the Company's internal control over financial reporting. There are no changes to the financial statements that are included in Item 8 of this Form 10-K/A.

When First Defiance's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009, they identified a deficiency in controls. At first, management and the Company's independent registered public accounting firm, Crowe Horwath LLP, believed that this deficiency constituted a significant deficiency. However, upon further review, management and Crowe Horwath have determined that this deficiency constituted a material weakness in the Company's internal control over financial reporting.

In accordance with the rules of the Securities and Exchange Commission, First Defiance has set forth in its entirety the text of Part II, Item 8 even though only Management's Report on Internal Control Over Financial Reporting and the Report of Independent Registered Public Accounting Firm have changed. There are no changes to the financial statements that are included in Item 8 of this Form 10-K/A. Updated certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 have been included as Exhibits 31.1 and 31.2, updated certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 have been included as Exhibits 32.1 and 32.2 and an updated Consent of Crowe Horwath LLP has been included as Exhibit 23.1 to this Form 10-K/A. Other than the change to Item 8, the Form 10-K is unchanged. This amendment is limited in scope to the portions of the Form 10-K set forth above and does not amend, update, or change any other items or disclosures contained in the Form 10-K.

This amendment continues to speak as of the date of the original filing of the Form 10-K and we have not updated the disclosures contained therein to reflect any events that occurred at any subsequent date. The filing of this amendment shall not be deemed an admission that the Form 10-K, when filed, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement therein not misleading.

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Item 8. Financial Statements and Supplementary Data
Management's Report on Internal Control Over Financial Reporting

The management of First Defiance is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of management, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

First Defiance's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009, and this assessment identified a deficiency in controls because management was considering future events in its loan grading and specific reserve allocations for loan losses. At first, management and the Company's independent registered public accounting firm, Crowe Horwath LLP, believed that this deficiency constituted a significant deficiency. However, upon further review, management and Crowe Horwath have determined that this deficiency constituted a material weakness in the Company's internal control over financial reporting. A material weakness is a control deficiency or a combination of control deficiencies that result in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected. Based on this material weakness, management believes that First Defiance did not maintain effective internal control over financial reporting as of December 31, 2009.

Crowe Horwath LLP, an independent registered public accounting firm, has issued a report on the effectiveness of the Company's internal control over financial reporting as of December 31, 2009, which is included below.

Managements Remediation Efforts

After the control deficiency was identified in January 2010, the Company made several changes in its internal controls to remediate this deficiency. These changes included, changes in internal controls associated with internal grading of loans, ongoing enhancements to processes for communication to lending personnel, and the addition of a secondary review process that is focused on accurately grading loans. We believe that the changes to our internal control processes as designed were adequate to remediate the material weakness as of September 30, 2010.

William J. Small
Chairman, President and
Chief Executive Officer

Donald P. Hileman
Executive Vice President and
Chief Financial Officer

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Report of Independent Registered Public Accounting Firm

We have audited the accompanying consolidated statements of financial condition of First Defiance Financial Corp. (the Company) as of December 31, 2009 and 2008 and the related statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2009. We also have audited First Defiance Financial Corp.'s internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. A deficiency in controls related to the allowance for loan losses was identified as a material weakness as of December 31, 2009. In particular, management placed reliance on future events in its loan grading and specific reserve allocations for loan losses. For one loan, management did not downgrade the loan, even though there was documented evidence of deterioration, because they were relying on a potential restructure of the borrower's company. For a second loan, management's calculation of the specific reserve included collateral that had not yet been secured. This material weakness has been identified and included in

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Management's Report of Internal Control over Financial Reporting. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the financial statements as of and for the year ending December 31, 2009 and does not affect our report on those financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of First Defiance Financial Corp. as of December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, because of the effects of the material weakness described above, First Defiance Financial Corp. has not maintained effective internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Crowe Horwath LLP

South Bend, Indiana

March 2, 2010

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First Defiance Financial Corp.

Consolidated Statements of Financial Condition

	December 31,	
	2009	2008
	<i>(In Thousands)</i>	
Assets		
Cash and cash equivalents:		
Cash and amounts due from depository institutions	\$ 29,613	\$ 40,980
Interest-bearing deposits	91,503	5,172
	121,116	46,152
Securities available-for-sale, carried at fair value	137,458	117,575
Securities held-to-maturity, carried at amortized cost (fair value \$1,958 and \$917 at December 31, 2009 and 2008 respectively)	1,920	886
Loans receivable, net of allowance of \$36,547 and \$24,592 at December 31, 2009 and 2008, respectively	1,580,575	1,592,643
Loans held for sale	10,346	10,960
Mortgage servicing rights	8,958	6,611
Accrued interest receivable	6,851	7,293
Federal Home Loan Bank (FHLB) stock	21,376	21,376
Bank owned life insurance	30,804	28,747
Premises and equipment	43,597	47,756
Real estate and other assets held for sale	13,527	7,000
Goodwill	56,585	56,585
Core deposit and other intangibles	6,888	8,344
Deferred taxes	3,289	336
Other assets	14,233	5,136
Total assets	\$ 2,057,523	\$ 1,957,400

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First Defiance Financial Corp

Consolidated Statements of Financial Condition (continued)

	December 31,	
	2009	2008
	<i>(In Thousands)</i>	
Liabilities and stockholders equity		
Liabilities:		
Deposits:		
Noninterest-bearing	\$ 189,132	\$ 176,063
Interest-bearing	1,391,094	1,293,849
Total	1,580,226	1,469,912
Advances from the Federal Home Loan Bank	146,927	156,067
Short term borrowings and other interest-bearing liabilities	48,398	49,454
Subordinated debentures	36,083	36,083
Advance payments by borrowers	665	652
Other liabilities	11,138	16,073
Total liabilities	1,823,437	1,728,241
Commitments and Contingent (Note 7)		
Stockholders equity:		
Preferred stock, \$.01 par value per share: 37,000 shares authorized and issued with a liquidation preference of \$37,000,000, net of discount	36,293	36,133
Preferred stock, \$.01 par value per share: 4,963,000 shares authorized; no shares issued		
Common stock, \$.01 par value per share: 25,000,000 shares authorized; 12,739,496 and 12,739,496 shares issued and 8,117,520 and 8,117,120 shares outstanding, respectively	127	127
Common stock warrant	878	878
Additional paid-in capital	140,677	140,449
Accumulated other comprehensive income (loss), net of tax of \$(85) and \$(1,025), respectively	(158)	(1,904)
Retained earnings	128,900	126,114
Treasury stock, at cost, 4,621,976 and 4,622,376 shares respectively	(72,631)	(72,638)
Total stockholders equity	234,086	229,159
Total liabilities and stockholders equity	\$ 2,057,523	\$ 1,957,400

See accompanying notes.

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FIRST DEFIANCE FINANCIAL CORP.

Consolidated Statements of Income

(Amounts in Thousands, except per share data)

	Years Ended December 31,		
	2009	2008	2007
Interest Income			
Loans	\$ 93,702	\$ 96,522	\$ 90,866
Investment securities:			
Taxable	3,976	4,357	4,475
Tax-exempt	1,797	1,399	1,260
Interest-bearing deposits	149	123	924
FHLB stock dividends	955	1,062	1,226
Total interest income	100,579	103,463	98,751
Interest Expense			
Deposits	26,102	31,354	40,356
Federal Home Loan Bank advances and other	5,114	6,375	6,889
Subordinated debentures	1,471	1,907	2,115
Notes payable	570	1,632	729
Total interest expense	33,257	41,268	50,089
Net interest income	67,322	62,195	48,662
Provision for loan losses	23,232	12,585	2,306
Net interest income after provision for loan losses	44,090	49,610	46,356
Noninterest Income			
Service fees and other charges	13,503	13,268	10,788
Mortgage banking income	9,747	2,990	3,612
Insurance commissions	5,021	5,496	5,278
Gain on sale of non-mortgage loans	264	180	226
Gain on sale or call of securities	284	22	21
Other-than-temporary impairment (OTTI) losses on investment securities			
Total impairment losses on investment securities	(2,155)	(3,182)	
Losses recognized in other comprehensive income	(1,785)		
Net impairment loss recognized in earnings	(3,940)	(3,182)	
Trust income	415	448	375
Income from bank owned life insurance	557	323	1,375
Other noninterest income	444	(476)	455
Total noninterest income	26,295	19,069	22,130
Noninterest Expense			
Compensation and benefits	27,898	28,829	25,245
Occupancy	7,852	7,484	6,100
FDIC insurance	3,350	1,082	135
Data processing	4,541	4,658	3,824
Acquisition related charges		1,117	
Other noninterest expense	16,883	14,624	12,809
Total noninterest expense	60,524	57,794	48,113

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Income before income taxes	9,861	10,885	20,373
Federal income taxes	2,667	3,528	6,469
Net Income	\$ 7,194	\$ 7,357	\$ 13,904
Dividends Accrued on Preferred Shares	\$ (1,850)	\$ (134)	\$
Accretion on Preferred Shares	(160)	(11)	
Net Income Applicable to Common Shares	\$ 5,184	\$ 7,212	\$ 13,904
Earnings per common share:			
Basic	\$ 0.64	\$ 0.91	\$ 1.96
Diluted	\$ 0.63	\$ 0.91	\$ 1.94
Dividends declared per common share	\$ 0.295	\$ 0.95	\$ 1.01

See accompanying notes

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FIRST DEFIANCE FINANCIAL CORP.

Consolidated Statement of Changes in Stockholders' Equity

(In Thousands, except number of shares)

	Preferred Stock	Common Stock	Common Stock Warrant	Treasury Stock	Additional Paid-In Capital	Stock Acquired by ESOP	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Stockholders' Equity
Balance at January 1, 2007	\$	\$ 117	\$	\$ (69,390)	\$ 110,285	\$ (628)	\$ (671)	\$ 120,112	\$ 159,825
Adjustment to initially apply FIN 48								(200)	(200)
Balance at December 31, 2006 adjusted									159,625
Comprehensive income:									
Net income								13,904	13,904
Change in net unrealized gains and losses on available-for-sale securities, net of income taxes of \$248							459		459
Change in unrealized loss on postretirement benefit, net of tax of (\$110)							(203)		(203)
Total comprehensive income									14,160
ESOP shares released					951	426			1,377
Stock option expense					260				260
36,865 shares issued under stock option plan, including income tax benefit of \$64				563	68			(46)	585
76,435 shares issued in acquisition of HHWS				1,163	1,087				2,250
196,474 common shares acquired for treasury				(5,163)					(5,163)
Dividends declared								(7,140)	(7,140)
Balance at December 31, 2007		117		(72,827)	112,651	(202)	(415)	126,630	165,954
Comprehensive income:									
Net income								7,357	7,357
Change in net unrealized gains and losses on available-for-sale securities, net of income taxes of (\$790)							(1,464)		(1,464)
Change in unrealized loss on postretirement benefit, net of tax of (\$13)							(25)		(25)
Total comprehensive income									5,868
ESOP shares released					351	202			553
Stock option expense					266				266
52,486 shares issued under stock option plan, including income tax benefit of \$72				824	63			(46)	841
1,036,861 shares issued in acquisition of Pavilion		10			27,118				27,128
31,429 common shares acquired for treasury				(635)					(635)
37,000 shares issued to U.S. Treasury CPP	36,122								36,122
Preferred stock dividends accrued								(134)	(134)

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Issuance of common stock warrant			878						878
Accretion on preferred shares	11						(11)		(11)
Common stock dividends declared							(7,682)		(7,682)
Balance at December 31, 2008	36,133	127	878	(72,638)	140,449		(1,904)	126,114	229,159
Comprehensive income:									
Net income								7,194	7,194
Change in net unrealized gains and losses on available-for-sale securities, net of income taxes of \$844							1,568		1,568
Change in unrealized gain on postretirement benefit, net of tax of \$96							178		178
Total comprehensive income									8,940
Stock option expense					228				228
400 shares issued under stock option plan, with no income tax benefit				7				(2)	5
Preferred stock dividends								(1,850)	(1,850)
Accretion on preferred shares	160							(160)	(160)
Common stock dividends declared								(2,396)	(2,396)
Balance at December 31, 2009	\$ 36,293	\$ 127	\$ 878	\$ (72,631)	\$ 140,677	\$	\$ (158)	\$ 128,900	\$ 234,086

See accompanying notes

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FIRST DEFIANCE FINANCIAL CORP.

Consolidated Statements of Cash Flows

(Amounts in Thousands)

	Years Ended December 31,		
	2009	2008	2007
Operating Activities			
Net income	\$ 7,194	\$ 7,357	\$ 13,904
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	23,232	12,585	2,306
Provision for depreciation	3,832	3,803	2,986
Net amortization of premium and discounts on loans, securities, deposits and debt obligations	170	752	140
Amortization of mortgage servicing rights	3,171	1,266	648
Net impairment (recovery) of mortgage servicing rights	(1,314)	2,676	36
Amortization of intangibles	1,456	1,458	646
Gain on sale of loans	(9,008)	(4,575)	(2,816)
Loss on sale or disposals of property, plant and equipment	563		108
Loss on sale or write-down of REO	1,627	434	805
FHLB stock dividends		(754)	
Release of ESOP shares		553	1,377
OTTI losses on investment securities	3,940	3,182	
Gain on sale of securities	(284)	(22)	(21)
Change in deferred taxes	(4,007)	(4,672)	(257)
Proceeds from sale of loans held for sale	518,747	180,072	127,674
Stock option expense	228	266	260
Origination of loans held for sale	(513,593)	(182,336)	(128,537)
Income from bank owned life insurance	(557)	(323)	(1,375)
Change in interest receivable and other assets	(8,541)	2,407	(1,615)
Change in accrued interest and other liabilities	(3,384)	(2,122)	2,444
Net cash provided by operating activities	23,472	22,007	18,713
Investing Activities			
Proceeds from maturities of held-to-maturity securities	175	230	324
Proceeds from maturities of available-for-sale securities	25,770	30,416	25,359
Proceeds from sale of available-for-sale securities	6,383		2,521
Proceeds from sale of real estate and other assets held for sale	7,076	2,796	2,923
Proceeds from sale of office properties and equipment	1,227	27	18
Purchases of available-for-sale securities	(52,645)	(31,811)	(28,946)
Purchases of held-to-maturity securities	(1,210)		
Purchases of office properties and equipment	(1,763)	(4,589)	(8,687)
Investment in bank owned life insurance	(1,500)		(2,060)
Proceed from insurance death benefit			338
Net cash received in acquisitions			190
Net cash paid in Pavilion acquisition		(23,907)	
Proceeds from sale of non-mortgage loans	8,714	10,707	12,234
Net increase in loans receivable	(35,598)	(114,816)	(67,741)
Net cash used in investing activities	(43,371)	(130,947)	(63,527)

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FIRST DEFIANCE FINANCIAL CORP.

Consolidated Statements of Cash Flows (continued)

(Amounts in Thousands)

	Years Ended December 31,		
	2009	2008	2007
Financing Activities			
Net increase in deposits	110,577	42,925	79,590
Repayment of Federal Home Loan Bank long-term advances	(25,040)	(16,408)	(873)
Net decrease in Federal Home Loan Bank short-term advances	(9,100)	(2,200)	(21,800)
Proceeds from Federal Home Loan Bank long-term advances	25,000	29,000	
Increase (decrease) in securities sold under repurchase agreements	(1,056)	7,153	(369)
Proceeds from issuance of subordinated debentures			15,464
Purchase of common stock for treasury		(635)	(4,923)
Cash dividends paid on common stock	(3,776)	(8,137)	(7,090)
Cash dividends paid on preferred stock	(1,747)		
Proceeds from issuance of preferred stock		37,000	
Proceeds from exercise of stock options	5	769	281
Excess tax benefit from exercise of stock options		72	64
Net cash provided by financing activities	94,863	89,539	60,344
Increase (decrease) in cash and cash equivalents	74,964	(19,401)	15,530
Cash and cash equivalents at beginning of period	46,152	65,553	50,023
Cash and cash equivalents at end of period	\$ 121,116	\$ 46,152	\$ 65,553

Supplemental cash flow information:

Interest paid	\$ 34,038	\$ 42,433	\$ 49,411
Income taxes paid	\$ 8,800	\$ 6,772	\$ 5,576
Stock option exercise price paid with common stock	\$	\$ 33	\$ 240
Transfers from loans to other real estate owned and other assets held for sale	\$ 14,930	\$ 6,060	\$ 3,796
Transfers from premises and equipment to other real estate owned and other assets held for sale	\$ 300	\$	\$

First Defiance acquired all of the capital stock of Pavilion Bancorp, Inc. for \$55.5 million in 2008.

In conjunction with the acquisition, liabilities were assumed as follows:

	Pavilion
Fair value of assets acquired	\$ 287,994
Purchase price	55,548
Liabilities assumed	\$ 232,446

See accompanying notes.

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Notes to the Consolidated Financial Statements

1. Basis of Presentation

First Defiance Financial Corp. (First Defiance) is a unitary thrift holding company that conducts business through its two wholly owned subsidiaries, First Federal Bank of the Midwest (First Federal) and First Insurance and Investments, Inc. (First Insurance). All significant intercompany transactions and balances are eliminated in consolidation.

First Federal is primarily engaged in attracting deposits from the general public through its offices and using those and other available sources of funds to originate loans primarily in the counties in which its offices are located. First Federal's traditional banking activities include originating and servicing residential, commercial and consumer loans and providing a broad range of depository, trust and wealth management services. First Insurance is an insurance agency that does business in the Defiance and Bowling Green, Ohio areas, offering property and casualty, and group health and life insurance products.

2. Statement of Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas where First Defiance uses estimates are the valuation of certain investment securities, the determination of the allowance for loan losses, the valuation of mortgage servicing rights and goodwill, the determination of unrecognized income tax benefits, and the determination of post-retirement benefits.

Earnings Per Common Share

Basic earnings per common share is net income applicable to common shares divided by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under stock options, warrants and stock grants. Unreleased shares held by the Company's Employee Stock Ownership Plan are not included in average shares for purposes of calculating earnings per share. As shares are released for allocation, they are included in the average shares outstanding. Also see notes 5 and 20.

Comprehensive Income

Comprehensive income (loss) consists of net income and other comprehensive income (loss). Other comprehensive income includes unrealized gains and losses on available-for-sale securities and the net unrecognized actuarial losses and unrecognized prior service costs associated with the Company's Defined Benefit Postretirement Medical Plan. All items included in other comprehensive income are reported net of tax. See also notes 3, 6 and 17.

Cash Flows

Cash and cash equivalents include amounts due from banks and overnight investments with the Federal Home Loan Bank (FHLB) and the Federal Reserve Bank (FRB). Cash and amounts due from depository

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institutions include required balances on hand or on deposit at the FHLB and Federal Reserve of approximately \$1,325,000 and \$3,290,000, respectively, at December 31, 2009 to meet regulatory reserve and clearing requirements. Net cash flows are reported for customer loan and deposit transactions, interest bearing deposits in other financial institutions and repurchase agreements.

Investment Securities

Management determines the appropriate classification of debt securities at the time of purchase and evaluates such designation as of each balance sheet date. Debt securities are classified as held-to-maturity when First Defiance has the positive intent and ability to hold the securities to maturity and are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity.

Debt securities not classified as held-to-maturity and equity securities are classified as available-for-sale. Available-for-sale securities are stated at fair value, with the unrealized gains and losses, net of tax, reported in other comprehensive income (loss) until realized. Realized gains and losses are included in gains (losses) on securities or other-than-temporary impairment losses on securities. Realized gains and losses on securities sold are recognized on the trade date based on the specific identification method.

Interest income includes amortization of purchase premiums and discounts. Premiums and discounts are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are expected. Securities with unrealized losses are reviewed quarterly to determine if value impairment is other than-temporary. In performing this review management considers the length of time and extent that fair value has been less than cost, the financial condition of the issuer, the impact of changes in market interest rates on market value and whether the Company intends to sell or it would be more than likely required to sell the securities prior to their anticipated recovery.

FHLB Stock

As a member of the FHLB System, First Federal is required to own stock of the FHLB of Cincinnati in an amount principally equal to 0.15% of total assets plus an amount of at least 2% but no more than 4% of its non-grandfathered mission asset activity (as defined in the FHLB's regulations). First Federal is permitted to own stock in excess of the minimum requirement. FHLB stock is a restricted equity security that does not have a readily determinable fair value and is carried at cost. It is evaluated for impairment based upon the ultimate recovery of par value. Both cash and stock dividends are reported as income. At December 31, 2009, the balance at FHLB of Cincinnati was \$19.4 million. First Federal acquired \$2.0 of stock from the Pavilion acquisition which is held at the FHLB of Indianapolis and is required to be held for five years from the date of acquisition of March 14, 2008.

Loans Receivable

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal amount outstanding, net of deferred loan fees and costs, purchase premiums and discounts and the allowance for loan losses. Deferred fees net of deferred incremental loan origination costs, are amortized to interest income generally over the contractual life of the loan using the interest method without anticipating prepayments.

Mortgage loans originated and intended for sale in the secondary market are classified as loans held for sale and are carried at the lower of aggregate cost or fair value, as determined by outstanding

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commitments from investors. Net unrealized losses, if any, are recorded as a valuation allowance and charged to earnings. Mortgage loans held for sale are generally sold with servicing rights retained. The carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains or losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

During 2009, the Company realized losses totaling \$281,000 pertaining to loans sold to Fannie Mae but were returned due to underwriting issues. Management does not believe there are any such matters that will have a material effect on the financial statements.

Interest receivable is accrued on loans and credited to income as earned. The accrual of interest on loans 90 days delinquent or impaired is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. For these loans, interest accrual is only to the extent cash payments are received. The accrual of interest on these loans is generally resumed after a pattern of repayment has been established and the collection of principal and interest is reasonably assured.

Acquired Loans

Valuation allowances for all acquired loans subject to FASB ASC Topic 310 reflect only those losses incurred after acquisition—that is, the present value of cash flows expected at acquisition that are not expected to be collected.

The Company acquires loans individually and in groups or portfolios. At acquisition, the Company reviews each loan to determine whether there is evidence of deterioration of credit quality since origination and if it is probable that it will be unable to collect all amounts due according to the loan's contractual terms. If both conditions exist, the Company determines whether each such loan is to be accounted for individually or whether such loans will be assembled into pools of loans based on common risk characteristics (credit score, loan type and date of origination). The Company considers expected prepayments, and estimates the amount and timing of undiscounted expected principal, interest, and other cash flows (expected at acquisition) for each loan and subsequently aggregated pool of loans.

The Company determines the excess of the loan's or pool's scheduled contractual principal and contractual interest payments over all cash flows expected at acquisition as an amount that should not be accreted (nonaccretable difference). The remaining amount—representing the excess of the loan's cash flows expected to be collected over the amount paid—is accreted into interest income over the remaining life of the loan or pool (accretable yield).

Over the life of the loan or pool, the Company continues to estimate cash flows expected to be collected, and evaluates whether the present value of its loans determined using the effective interest rates has decreased and, if so, recognizes a loss. The present value of any subsequent increase in the loan's or pool's actual cash flows or cash flows expected to be collected is used first to reverse any existing valuation allowance for that loan or pool. For any remaining increases in cash flows expected to be collected, the Company adjusts the amount of accretable yield recognized on a prospective basis over the loan's or pool's remaining life.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable incurred losses in the loan portfolio and is based on the size and current risk characteristics of

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the loan portfolio, an assessment of individual problem loans, actual loss experience, current economic events in specific industries and geographical areas and other pertinent factors, including general economic conditions. Determination of the allowance is inherently subjective as it requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience and consideration of economic trends, all of which may be susceptible to significant change. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

Loan losses are charged off against the allowance when in management's estimation it is unlikely that the loan will be collected, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan loss is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors in order to maintain the allowance for loan losses at the level deemed adequate by management. The determination of whether a loan is considered past due or delinquent is based on the contractual payment terms.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loans agreement. Loans, for which terms have been modified and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

Servicing Rights

Servicing rights are recognized separately when they are acquired through sales of loans. Servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. The Company compares the valuation model inputs and results to published industry data in order to validate the model results and assumptions. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans.

Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. Impairment is determined by stratifying rights into groupings based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual grouping, to the extent that fair value is less than the carrying amount. If the Company later determines that all or a portion of the impairment no longer exists for a particular grouping, a reduction of the allowance may be recorded as an increase to income. Changes in valuation allowances are reported with mortgage banking income on the income statement. The fair values of servicing rights are subject to significant fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses.

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Servicing fee income, which is reported on the income statement with mortgage banking income, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan, and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees, net of amortization of mortgage servicing rights (excluding valuation adjustments) totaled \$(300,000) million, \$1.3 million and \$1.1 million for the years ended December 31, 2009, 2008 and 2007. Late fees and ancillary fees related to loan servicing are not material. See Note 9.

Bank Owned Life Insurance

The Company has purchased life insurance policies on certain key employees. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Premises and Equipment and Long Lived Assets

Land is carried at cost. Premises and equipment are carried at cost less accumulated depreciation and amortization computed principally by the straight-line method over the following estimated useful lives:

Buildings and improvements	20 to 50 years
Furniture, fixtures and equipment	3 to 15 years

Long-lived assets to be held and those to be disposed of and certain intangibles are periodically evaluated for impairment. See Note 10.

Goodwill and Other Intangibles

Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected November 30 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on our balance sheet.

Other intangible assets consist of core deposit and acquired customer relationship intangible assets arising from whole bank, insurance and branch acquisitions. They are initially recorded at fair value and then amortized on an accelerated basis over their estimated lives, which range from five years for non-compete agreements to 10 to 20 years for core deposit and customer relationship intangibles. See Note 11.

Real Estate and Other Assets Held for Sale

Other assets held for sale are comprised of properties acquired through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. These properties are carried at the lower of cost or fair value,

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less estimated costs to dispose, at the time of foreclosure or insubstance foreclosure. Losses arising from the acquisition of such property are charged against the allowance for loan losses at the time of acquisition. If fair value declines subsequent to foreclosure, the property is written down against expense. Costs after acquisition are expensed.

Stock Compensation Plans

Compensation cost is recognized for stock options issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. See Note 21.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Banking Derivatives

Commitments to fund mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of these mortgage loans are accounted for as free standing derivatives. Fair values of these mortgage derivatives are estimated based on changes in mortgage interest rates from the date the interest on the loan is locked. The Company enters into forward commitments for the future delivery of mortgage loans when interest rate locks are entered into, in order to hedge the change in interest rates resulting from its commitments to fund the loans. Changes in fair values of these derivatives are included in mortgage banking income.

Operating Segments

Management considers the following factors in determining the need to disclose separate operating segments: 1) The nature of products and services, which are all financial in nature; 2) The type and class of customer for the products and services; in First Defiance's case retail customers for retail bank and insurance products and commercial customers for commercial loan, deposit, life, health and property and casualty insurance needs; 3) The methods used to distribute products or provide services; such services are delivered through banking and insurance offices and through bank and insurance customer contact representatives. Retail and commercial customers are frequently targets for both banking and insurance

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products; 4) The nature of the regulatory environment; both banking and insurance entities are subject to various regulatory bodies and a number of specific regulations.

Quantitative thresholds as stated in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 280, *Segment Reporting* are monitored. For the year ended December 31, 2009, the reported revenue for First Insurance was 5.3% of total revenue for First Defiance. Total revenue includes net interest income (before provision for loan losses) plus non-interest income. Net income for First Insurance for the year ended December 31, 2009 was 9.2% of consolidated net income. Total assets of First Insurance at December 31, 2009 were 0.4% of total assets. First Insurance does not meet any of the quantitative thresholds of FASB ASC Topic 280. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable segment.

Dividend Restriction

Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Savings bank to the holding company. See Note 18 for further details on restrictions.

Loan Commitments and Related Financial Instruments

Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and commercial letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are any such matters that will have a material effect on the financial statements.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized.

An effective tax rate of 35% is used to determine after-tax components of other comprehensive income (loss) included in the statements of stockholders' equity. See Note 19.

The Company adopted guidance issued by the FASB with respect to accounting for uncertainty in income taxes as of January 1, 2007. A tax position is recognized as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of

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being realized on examination. For tax positions not meeting the more likely than not test, no tax benefit is recorded. The Company adopted this guidance effective January 1, 2007, the effect of which resulted in \$200,000 being recorded as an adjustment to beginning retained earnings. See Note 19.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation.

Advertising Costs

Advertising costs are expensed as incurred.

Adoption of New Accounting Standards

In September 2006, the FASB issued guidance that defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This guidance also establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. The guidance was effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued guidance that delayed the effective date of this fair value guidance for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. Adoption of this guidance did not have a significant impact on the Company's financial statements.

In December 2007, the FASB issued guidance that establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The guidance is effective for fiscal years beginning on or after December 15, 2008. Adoption of this guidance did not have a significant impact on the Company's financial statements.

In March 2008, the FASB issued guidance that amends and expands the disclosure requirements for derivative instruments and hedging activities. The guidance requires qualitative disclosure about objectives and strategies for using derivative and hedging instruments, quantitative disclosures about fair value amounts of the instruments and gains and losses on such instruments, as well as, disclosures about credit-risk features in derivative agreements. The guidance was effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The new disclosures have been presented in the notes to the consolidated financial statements.

In June 2009, the FASB replaced *The Hierarchy of Generally Accepted Accounting Principles*, with the *FASB Accounting Standards Codification*TM (The Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the Securities and Exchange Commission under authority of federal securities laws are also sources of authoritative GAAP.

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for SEC registrants. The Codification was effective for financial statements issued for periods ending after September 15, 2009.

In June 2008, the FASB issued guidance which addresses whether instruments granted in share-based payment transactions are participating securities prior to vesting and, therefore, included in the earnings allocation in computing earnings per share (EPS) under the two-class method. Unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of EPS pursuant to the two-class method. This guidance was effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented were to be adjusted retrospectively (including interim financial statements, summaries of earnings and selected financial data) to conform to the provisions of this guidance. Adoption of this guidance did not have a significant impact on the Company's financial statements.

In December 2008, the FASB issued guidance on an employer's disclosures about plan assets of a defined benefit pension or other post-retirement plan. These additional disclosures include disclosure of investment policies and fair value disclosures of plan assets, including fair value hierarchy. The guidance also includes a technical amendment that requires a non-public entity to disclose net periodic benefit cost for each annual period for which a statement of income is presented. This guidance is effective for fiscal years ending after December 15, 2009. Upon initial application, provisions of the FSP are not required for earlier periods that are presented for comparative purposes. The new disclosures have been presented in the notes to the consolidated financial statements.

In April 2009, the FASB amended existing guidance for determining whether impairment is other-than-temporary for debt securities. The guidance requires an entity to assess whether it intends to sell, or it is more likely than not that it will be required to sell a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) other-than-temporary impairment (OTTI) related to other factors, which is recognized in other comprehensive income and 2) OTTI related to credit loss, which must be recognized in the income statement. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. Additionally, disclosures about other-than-temporary impairments for debt and equity securities were expanded. This guidance was effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Company elected to early-adopt this guidance as of January 1, 2009. No amounts of previously recognized impairment charges were reversed upon adoption.

In April 2009, the FASB issued guidance that emphasizes that the objective of a fair value measurement does not change even when market activity for the asset or liability has decreased significantly. Fair value is the price that would be received for an asset sold or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. When observable transactions or quoted prices are not considered orderly, then little, if any, weight should be assigned to the indication of the asset or liability's fair value. Adjustments to those transactions or prices should be applied to determine the appropriate fair value. The guidance, which was applied prospectively, was effective for interim and annual reporting periods ending after June 15, 2009 early adoption for periods ending after March 15, 2009. The Company elected to early-adopt this guidance as of January 1, 2009 and it did not have a significant impact on the Company's financial statements.

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Newly Issued Not Yet Effective Standards

In June 2009, the FASB amended previous guidance relating to transfers of financial assets and eliminates the concept of a qualifying special purpose entity. This guidance must be applied as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. This guidance must be applied to transfers occurring on or after the effective date. Additionally, on and after the effective date, the concept of a qualifying special-purpose entity is no longer relevant for accounting purposes. Therefore, formerly qualifying special-purpose entities should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. The disclosure provisions were also amended and apply to transfers that occurred both before and after the effective date of this guidance. The effect of adopting this new guidance is not expected to have a significant impact on the Company's financial statements.

Table of Contents**3. Comprehensive Income**

Comprehensive income consists of net income and other comprehensive income (loss) (OCI). Other comprehensive income (loss) includes unrealized gains and losses on securities available-for-sale and the net unrecognized actuarial losses and unrecognized prior services costs associated with the Company's Defined Benefit Postretirement Medical Plan. All items reported in other comprehensive income (loss) are reported net of tax. Following is a summary of other comprehensive income (loss) for the years ended December 31, 2009 and 2008:

	For the Year Ended December 31		
	2009	2008	2007
	(In Thousands)		
Net income	\$ 7,194	\$ 7,357	\$ 13,904
Change in securities available-for-sale:			
Other-than-temporary impairment on available-for-sale securities	(2,155)	(3,182)	
Other-than-temporary impairment on available-for-sale securities associated with credit losses realized in income	3,940	3,182	
Other-than-temporary impairment on available-for-sale securities recorded in OCI	1,785		
Unrealized holding gains (losses) on available-for-sale securities arising during the period	911	(2,232)	728
Reclassification adjustment for (gains) losses realized in income	(284)	(22)	(21)
Net unrealized gains (losses)	627	(2,254)	707
Income tax effect	(844)	(790)	(248)
Net of tax amount	1,568	(1,464)	459
Change in unrealized gain on postretirement benefit:			
Net gain (loss) on defined benefit postretirement medical plan realized during the period	218	(74)	(357)
Prior service cost added during the period		(25)	
Net amortization and deferral	56	61	44
Net gain (loss) activity during the period	274	(38)	(313)
Income tax effect	(96)	13	110
Net of tax amount	178	(25)	(203)
Total other comprehensive income (loss)	1,746	(1,489)	256
Comprehensive income	\$ 8,940	\$ 5,868	\$ 14,160

The following table summarizes the changes within each classification of accumulated comprehensive income for the years ended December 31, 2009 and 2008:

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	Unrealized gains (losses) on available for sale securities	Postretirement Benefit (In thousands)	Accumulated other comprehensive income (loss), net
Balance at December 31, 2008	\$ (1,100)	\$ (804)	\$ (1,904)
Other comprehensive income (loss), net	1,568	178	1,746
Balance at December 31, 2009	\$ 468	\$ (626)	\$ (158)

	Unrealized gains (losses) on available for sale securities	Postretirement Benefit (In thousands)	Accumulated other comprehensive income (loss), net
Balance at December 31, 2007	\$ 364	\$ (779)	\$ (415)
Other comprehensive income (loss), net	(1,464)	(25)	(1,489)
Balance at December 31, 2008	\$ (1,100)	\$ (804)	\$ (1,904)

4. Acquisitions

On March 14, 2008, First Defiance completed the acquisition of Pavilion, which was headquartered in Adrian, Michigan. Each Pavilion shareholder received 1.4209 shares of First Defiance common stock and \$37.50 in cash for each share of Pavilion stock. In connection with this transaction, 1,036,861 shares of First Defiance common stock were issued at a total value of \$27.1 million. The common shares issued were valued at \$26.117 per share, representing the average of the closing bid and ask price as of the date of the merger announcement plus two days prior and two days subsequent to the announcement. The total cost of the transaction, including legal and investment banking fees, was \$55.5 million. The assets and liabilities of Pavilion were recorded on the balance sheet at their fair value as of the acquisition date. The results of Pavilion's operations have been included in the First Defiance's consolidated statement of income from the date of acquisition. Disclosure of pro forma results of this acquisition is not material to the Company's consolidated financial statements as the transaction closed in the first quarter of 2008.

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The following tables summarize the estimated fair values of the net assets acquired and the computation of the purchase price and goodwill related to the Pavilion acquisition.

	Acquisition Date March 14, 2008 (In Thousands)
Assets	
Cash and cash equivalents	\$ 4,514
Investment securities	9,136
Loans, net of allowance for loan losses	232,499
Premises and equipment	6,992
Federal Home Loan Bank stock	2,036
Goodwill and other intangibles	26,016
Other assets	6,801
Total Assets	287,994
Liabilities	
Deposits	209,385
Borrowings	18,403
Other liabilities	4,658
Total Liabilities	232,446
Net assets acquired	\$ 55,548

	Acquisition Date March 14, 2008 (In Thousands)
Purchase price	\$ 55,548
Pavilion s carrying value of net assets acquired	(28,138)
Excess purchase price over Pavilion s carrying value of net assets acquired	27,410
Purchase accounting adjustments	
Portfolio loans	(6,632)
Premises and equipment	2,579
Mortgage servicing rights	(1,010)
Deposits	1,021
Deferred tax liabilities	2,648
Total net tangible assets	(1,394)
Core deposit and other intangibles	(6,251)
Goodwill	\$ 19,765

During the twelve months ended December 31, 2008, First Defiance recognized \$1,117,000 of acquisition-related charges, of which, \$198,000 related to retention bonuses and \$171,000 related to termination of certain contracts. The remaining \$663,000 includes items related to professional services,

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start-up costs of system conversions, supplies and other non-recurring costs associated with the completion of the acquisition and the transition of operations.

5. Earnings Per Common Share

The following table sets forth the computation of basic and diluted earnings per common share:

	2009	2008	2007
	<i>(In Thousands, Except Per Share Amounts)</i>		
Numerator for basic and diluted earnings per common share-net income applicable to common shares	\$ 5,184	\$ 7,212	\$ 13,904
Denominator:			
Denominator for basic earnings per common share-weighted-average common shares	8,117	7,889	7,085
Effect of dilutive securities:			
Employee stock options	1	22	93
Warrants	78	8	
Dilutive potential common shares	79	30	93
Denominator for diluted earnings per common share	8,196	7,919	7,178
Basic earnings per common share	\$.64	\$.91	\$ 1.96
Diluted earnings per common share	\$.63	\$.91	\$ 1.94

Shares under option of 412,150 in 2009, 327,300 in 2008 and 204,453 in 2007 were excluded from the diluted earnings per common share calculation as they were anti-dilutive.

Table of Contents**6. Investment Securities**

The following tables summarizes the amortized cost and fair value of available-for-sale securities and held-to-maturity investment securities portfolio at December 31, 2009 and 2008 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss) were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	<i>(In Thousands)</i>			
2009				
Available-for-sale				
Obligations of U.S. government corporations and agencies	\$ 14,038	\$ 252	\$ (39)	\$ 14,251
Mortgage-backed securities	30,341	1,194	(31)	31,504
REMICs	3,718	205		3,923
Collateralized mortgage obligations	40,878	824	(331)	41,371
Trust preferred stock and preferred stock	4,122		(2,446)	1,676
Obligations of state and political subdivisions	43,640	1,251	(158)	44,733
Total Available-for-Sale	\$ 136,737	\$ 3,726	\$ (3,005)	\$ 137,458
Held-to-Maturity				
Mortgage-backed Securities:				
FHLMC certificates	\$ 119	\$ 7	\$	\$ 126
FNMA certificates	304	9		313
GNMA certificates	107	3		110
Obligations of states and political subdivisions	1,390	19		1,409
Total Held-to-Maturity	\$ 1,920	\$ 38	\$	\$ 1,958

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	Amortized Cost	Gross Unrealized Gains <i>(In Thousands)</i>	Gross Unrealized Losses	Fair Value
2008				
Available-for-sale				
Obligations of U.S. government corporations and agencies	\$ 14,180	\$ 505	\$	\$ 14,685
Mortgage-backed securities	34,232	1,137	(3)	35,366
REMICs	4,041	118		4,159
Collateralized mortgage obligations	22,196	486	(252)	22,430
Trust preferred stock and preferred stock	8,038		(4,116)	3,922
Obligations of state and political subdivisions	36,581	754	(322)	37,013
Total Available-for-Sale	\$ 119,268	\$ 3,000	\$ (4,693)	\$ 117,575
Held-to-Maturity				
Mortgage-backed Securities:				
FHLMC certificates	\$ 141	\$ 5	\$	\$ 146
FNMA certificates	378	1	(2)	377
GNMA certificates	127	1		128
Obligations of states and political subdivisions	240	26		266
Total Held-to-Maturity	\$ 886	\$ 33	\$ (2)	\$ 917

The proceeds from sales of securities and the associated gains are listed below:

	2009	2008 <i>(In Thousands)</i>	2007
Proceeds	\$ 6,383	\$	\$ 2,521
Gross realized gains	284		21
Gross realized losses			
Other-than-temporary impairment charges	(3,940)	(3,182)	

Proceeds from calls were \$2.0 million, \$1.3 million, and \$0 in 2009, 2008, and 2007 with gross gains of \$0, \$22,000, and \$0, respectively. No losses on calls were recognized.

The amortized cost and fair value of the securities portfolio at December 31, 2009 and 2008 are shown below by contractual maturity. Expected maturities will differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. For purposes of the maturity table for 2009, mortgage-backed securities, collateralized mortgage obligations and REMICs, which are not due at a single maturity date, have not been allocated over maturity groupings. These securities may mature earlier than their weighted-average contractual maturities because of principal prepayments.

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	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value <i>(In Thousands)</i>	Amortized Cost	Fair Value
2009				
Due in one year or less	\$ 3,079	\$ 3,142	\$ 960	\$ 963
Due after one year through five years	11,321	11,584	120	136
Due after five years through ten years	8,102	8,319	310	310
Due after ten years	39,298	37,615		
MBS/CMO/REMIC	74,937	76,798	530	549
	\$ 136,737	\$ 137,458	\$ 1,920	\$ 1,958

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value <i>(In Thousands)</i>	Amortized Cost	Fair Value
2008				
Due in one year or less	\$ 18,383	\$ 18,764	\$ 282	\$ 286
Due after one year through five years	51,037	52,076	493	520
Due after five years through ten years	15,874	16,416	100	100
Due after ten years	33,974	30,319	11	11
	\$ 119,268	\$ 117,575	\$ 886	\$ 917

Securities pledged at year-end 2009 and 2008 had a carrying amount of \$122.8 million and \$93.0 million and were pledged to secure public deposits, securities sold under repurchase agreements and FHLB advances.

As of December 31, 2009, the Company's investment portfolio consisted of 283 securities, 41 of which were in an unrealized loss position.

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The following table summarizes First Defiance's securities that were in an unrealized loss position at December 31, 2009 and December 31, 2008:

	Duration of Unrealized Loss Position				Total	
	Less than 12 Months		12 Months or Longer		Fair Value	Unrealized Losses
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss		
At December 31, 2009						
Available-for-sale securities:						
Obligations of U.S. govt. corps. and agencies	\$ 1,961	\$ (39)	\$	\$	\$ 1,961	\$ (39)
Mortgage-backed securities	1,921	(31)			1,921	(31)
Collateralized mortgage obligations and REMICs	12,007	(287)	604	(44)	12,611	(331)
Obligations of state and political subdivisions	3,879	(55)	1,182	(103)	5,061	(158)
Trust preferred stock and preferred stock			1,651	(2,446)	1,651	(2,446)
Held to maturity securities:						
Mortgage-backed securities						
Total temporarily impaired securities	\$ 19,768	\$ (412)	\$ 3,437	\$ (2,593)	\$ 23,205	\$ (3,005)
At December 31, 2008						
Available-for-sale securities:						
Obligations of U.S. govt. corps. and agencies	\$	\$	\$	\$	\$	\$
Mortgage-backed securities	317	(3)			317	(3)
Collateralized mortgage obligations and REMICs	451		1,004	(252)	1,455	(252)
Obligations of state and political subdivisions	7,019	(192)	2,047	(130)	9,066	(322)
Trust preferred stock and preferred stock	678	(889)	2,826	(3,227)	3,504	(4,116)
Held to maturity securities:						
Mortgage-backed securities						
Total temporarily impaired securities	\$ 8,758	\$ (1,086)	\$ 5,964	\$ (3,609)	\$ 14,722	\$ (4,695)

With the exception of Trust Preferred Stock, the above securities all have fixed interest rates, and all securities have defined maturities. Their fair value is sensitive to movements in market interest rates. First Defiance has the ability and intent to hold these investments for a time necessary to recover the amortized cost without impacting its liquidity position and it is not more than likely that the Company will be required to sell the investments before anticipated recovery.

At December 31, 2009, First Defiance decided to sell four of the trust preferred collateralized debt obligations (CDOs) which are held for sale at December 31, 2009. As such, these four securities were written down to a total fair value of \$25,000 at December 31, 2009 and are discussed in more detail below. Total OTTI charges were \$(3.9) million, \$(3.2) million and \$0 for 2009, 2008, and 2007, respectively. Realized gains from the sales and calls of investment securities totaled \$284,000, \$22,000, and \$21,000 (\$185,000, \$14,000 and \$14,000 after tax) in 2009, 2008 and 2007 respectively.

Management evaluates securities for OTTI at least on a quarterly basis, and more frequent when economic or market conditions warrant such an evaluation. The investment portfolio is evaluated for OTTI by segregating the portfolio into two general segments. Investment securities classified as available for sale or held-to-maturity are generally evaluated for OTTI under FASB ASC Topic 320. Certain collateralized debt obligations are evaluated for OTTI under FASB ASC Topic 325, *Investment - Other*.

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Beginning January 1, 2009, when OTTI occurs under either model, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current period credit loss. If an entity intends to sell or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current period credit loss, the OTTI shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current period loss, the OTTI shall be separated into the amount representing the credit loss and the amount related to all other factors. The amount of OTTI related to the credit loss is determined based on the present value of cash flows expected to be collected compared to the book value of the security and is recognized in earnings. The amount of OTTI related to other factors shall be recognized in other comprehensive income, net of applicable taxes. The previous amortized cost basis less the OTTI recognized in earnings shall become the new amortized cost basis of the investment.

The Company held twelve CDOs at December 31, 2009 and 2008, of which, management deemed that the value of three of those CDOs were OTTI at December 31, 2008 and an additional six were OTTI at December 31, 2009; four of the CDOs were written off in full as of December 31, 2009. The Company also holds three Fannie Mae and Freddie Mac stock investments which were also deemed OTTI at December 31, 2008. In 2009, the Company recorded OTTI write-downs of \$(3.9) million (\$2.6 million after tax) on nine CDOs.

In 2008, the Company recorded total OTTI write-downs of \$(3.2) million which consisted of \$(1.9) million (\$1.2 million after tax) of write-downs on the Fannie Mae and Freddie Mac stock and \$(1.3) million (\$833,000 after tax) of write-downs of the three CDOs.

As required under FASB ASC Topic 320, beginning January 1, 2009, declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses to the extent the impairment is related to credit losses.

Given the conditions in the debt markets today and the absence of observable transactions in the secondary and new issue markets, the Company's CDOs will be classified within Level 3 of the fair value hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

The Company's CDO valuations were prepared by an independent third party. Their approach to determining fair value involved several steps: 1) Detailed credit and structural evaluation of each piece of collateral in the CDO; 2) Collateral performance projections for each piece of collateral in the CDO (default, recovery and prepayment/amortization probabilities) and 3) Discounted cash flow modeling.

Trust Preferred CDOs Discount Rate Methodology

First Defiance uses market-based yield indicators as a baseline for determining appropriate discount rates, and then adjusts the resulting discount rates on the basis of its credit and structural analysis of specific CDO instruments. The primary focus is on the returns a fixed income investor would require in order to allocate capital on a risk adjusted basis. There is currently no active market for trust preferred CDOs, however, First Defiance looks principally to market yields for stand-alone trust preferred securities issued by banks, thrifts and insurance companies for which there is an active and liquid market. The next step is to make a series of adjustments to reflect the differences that nevertheless exist between these products (both credit and structural) and, most importantly, to reflect idiosyncratic credit performance differences

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(both actual and projected) between these products and the underlying collateral in the specific CDOs. Importantly, as part of the analysis described above, First Defiance considers the fact that structured instruments frequently exhibit leverage not present in stand-alone instruments, and make adjustments as necessary to reflect this additional risk.

Fundamental to this evaluation is an assessment of the likelihood of CDO coverage test failures that would have the effect of diverting cash flow away from the relevant CDO bond for some period of time. Generally speaking, the Company adjusts indicative credit spreads upwards in the case of CDOs that have relatively weaker collateral and/or less cushion with respect to overcollateralization and interest coverage test ratios and downwards if the reverse is true. This aspect of the Company's discount rate methodology is important because there is frequently a great difference in the risks present in CDO instruments that are otherwise very similar (i.e. CDOs with the same basic type of collateral, the same manager, the same vintage, etc., may exhibit vastly different performance characteristics). With respect to this last point, First Defiance notes that given today's credit environment, characterized by high default and deferral rates, it is typically the case that deal-specific credit performance (determined on the basis of the credit characteristics of remaining collateral) is the best indicator of what a willing market participant would pay for an instrument.

The Company uses the same methodology for all of its CDOs and believes its valuation methodology is appropriate for all of its CDOs in accordance with FASB ASC Topic 320 as well as other related guidance.

The default and recovery probabilities for each piece of collateral were formed based on the evaluation of the collateral credit and a review of historical industry default data and current/near-term operating conditions. For collateral that has already deferred, the Company assumed a recovery of 10% of par for banks, thrifts or other depository institutions and 15% for insurance companies. Although there is a possibility that the deferring collateral will become current at some point in the future, First Defiance has conservatively assumed that it will continue to defer and gradually will default.

The following table details the nine securities with other-than-temporary impairment, their lowest credit rating at December 31, 2009 and the related credit losses recognized in earnings for the four quarters ended March 31, 2009, June 30, 2009, September 30, 2009 and December 31, 2009 (In Thousands):

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	Preferred Term VI Rated Caa1	TPREF Funding II Rated CC	Alesco VIII Rated Ca	Alesco Preferred Funding XII Rated Ca	Alesco Preferred Funding XVI Rated Ca	Alesco Preferred Term Sec XVII Rated Ca	Trapeza CDO I Rated Ca	Alesco Preferred Funding VIII Not Rated	Alesco Preferred Funding IX Not Rated	Total
Amount of OTTI related to credit loss at January 1, 2009	\$	\$	\$	\$	\$	\$	\$ 488	\$ 428	\$ 440	\$ 1,356
Addition Qtr 1	15	1	212		25		369	25	25	672
Amount of OTTI related to credit loss at March 31, 2009	\$ 15	\$ 1	\$ 212	\$	\$ 25	\$	\$ 857	\$ 453	\$ 465	\$ 2,028
Addition Qtr 2		123	625		84	43				875
Amount of OTTI related to credit loss at June 30, 2009	\$ 15	\$ 124	\$ 837	\$	\$ 109	\$ 43	\$ 857	\$ 453	\$ 465	\$ 2,903
Addition Qtr 3		119	163	34	135	543				994
Amount of OTTI related to credit loss at September 30, 2009	\$ 15	\$ 243	\$ 1,000	\$ 34	\$ 244	\$ 586	\$ 857	\$ 453	\$ 465	\$ 3,897
Addition Qtr 4	2			817	171	409				1,399
Amount of OTTI related to credit loss at December 31, 2009	\$ 17	\$ 243	\$ 1,000	\$ 851	\$ 415	\$ 995	\$ 857	\$ 453	\$ 465	\$ 5,296

The four CDOs which management decided to sell were the Alesco VIII which had been fully written down to zero during 2009, the Alesco Preferred Funding XII, the Alesco Preferred Funding XVI and the Alesco Preferred Term XVII. Management decided to sell these securities in early 2010 based upon significant cash flow deterioration which had occurred during the year including the fourth quarter and were fearful that these securities would soon be worthless similar to Alesco VIII. Additionally, the December 31, 2009 valuation prepared by an independent third party estimated fair value for these securities to be less than 10% of Par which led management to conclude there would be further credit and cash flow deterioration with these securities. Based upon management having the intent to sell these securities at December 31, 2009, these securities were written down to fair value at December 31, 2009.

The following table provides additional information related to First Defiance's trust preferred securities as of December 31, 2009 (dollars in thousands):

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Deal	Class	Book Value	Fair Value	Unrealized Loss	Realized Losses 2009	Lowest Rating	Current Number of Banks and Insurance Companies	Actual Deferrals and Defaults as a % of Current Collateral	Expected Deferrals and Defaults as a % of Remaining Performing Collateral	Excess Sub-ordination as a % of Current Performing Collateral
Preferred Term VI	Mezz	\$ 243	\$ 141	\$ (102)	\$ (17)	Caa1	5	60.83%	0.00%	%
TPREF Funding II	B	751	284	(467)	(243)	CC	21	31.29%	27.16%	
Alesco VIII*	D-1	0	0		(1,000)	Ca	*	*	*	*
Alesco Preferred Funding XVI	C	5	5		(415)	Ca	39	26.45%	28.97%	
Alesco Preferred Term Sec XVII	C-1	10	10		(995)	Ca	38	31.05%	31.63%	
I-Preferred Term Sec I	B-1	1,000	496	(504)		B+	16	9.04%	20.13%	21.18%
Dekania II CDO	C-1	989	471	(518)		B	36		16.48%	28.18%
Alesco Preferred Funding XII	C-1	10	10		(851)	Ca	68	23.06%	22.43%	
Preferred Term Sec XXVII	C-1	962	172	(790)		Ca	37	21.24%	21.62%	0.52%
Trapeza CDO I*	D	0	0		(369)	Ca	*	*	*	*
Alesco Preferred Funding VIII*	D-1	0	0		(25)	Not Rated	*	*	*	*
Alesco Preferred Funding IX*	I/O	0	0		(25)	Not Rated	*	*	*	*
Total		\$ 3,970	\$ 1,589	\$ (2,381)	\$ (3,940)					

* These securities have been written down to a book value of zero and have no underlying collateral support.

The increase in OTTI in 2009 was the result of a significant deterioration in the performance of the underlying collateral. Specifically, depreciation was driven by both realized credit events (i.e. defaults and deferrals) and weakening credit fundamentals in some of the performing collateral, which led to an increased probability of default going forward. Coupled together, this collateral decay resulted in an increase in the Company's assumed average lifetime default rate from 23.7% at the end of 2008 to a rate of 36.1% at the end of 2009.

7. Commitments and Contingent Liabilities

Loan Commitments

Loan commitments are made to accommodate the financial needs of First Federal's customers; however, there are no long-term, fixed-rate loan commitments that result in market risk. Standby letters of credit commit the Company to make payments on behalf of customers when certain specified future events occur. They primarily are issued to facilitate customers' trade transactions.

Both arrangements have credit risk, essentially the same as that involved in extending loans to customers, and are subject to the Company's normal credit policies. Collateral (e.g., securities, receivables, inventory and equipment) is obtained based on Management's credit assessment of the customer.

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The Company's maximum obligation to extend credit for loan commitments (unfunded loans and unused lines of credit) and standby letters of credit outstanding on December 31 was as follows (in thousands):

	2009		2008	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	\$ 29,206	\$ 64,243	\$ 22,710	\$ 70,114
Unused lines of credit	36,772	195,692	44,535	211,291
Standby letters of credit	263	21,036	67	18,860
Total	\$ 66,241	\$ 280,971	\$ 67,312	\$ 300,265

Commitments to make loans are generally made for periods of 60 days or less.

In addition to the above commitments, at December 31, 2009 First Defiance had commitments to sell \$23.8 million of loans to Freddie Mac, Fannie Mae, Federal Home Loan Bank of Cincinnati or BB&T Mortgage.

Contingent Receivable

The Company recorded a receivable of approximately \$800,000 in 2007 relating to claims from various insurance carriers from incurred losses associated with a former employee. In 2008, \$73,000 of this receivable was recovered and \$727,000 of this receivable was recorded as an expense due to the denial of the insurance claim under the Company's fidelity bond. In 2009, an additional \$190,000 was recovered through a settlement.

Table of Contents**8. Loans Receivable**

Loans receivable consist of the following at December 31:

	December 31	
	2009	2008
	<i>(In Thousands)</i>	
Real estate loans:		
Secured by single family residential	\$ 227,592	\$ 251,807
Secured by multi-family residential	103,169	78,427
Secured by non-residential real estate	703,721	677,313
Construction	48,625	72,938
	1,083,107	1,080,485
Other loans:		
Automobile	21,661	27,490
Commercial	379,408	356,574
Home equity and improvement	147,977	161,106
Other	12,444	13,522
	561,490	558,692
Total loans	1,644,597	1,639,177
Deduct:		
Undisbursed loan funds	(26,494)	(20,892)
Net deferred loan origination fees and costs	(981)	(1,050)
Allowance for loan losses	(36,547)	(24,592)
Totals	\$ 1,580,575	\$ 1,592,643

On March 14, 2008, First Defiance acquired loans (including purchase accounting adjustments) of \$50.0 million in single family residential loans, \$6.0 million in multi-family residential loans, \$100.9 million in non-residential real estate, \$49.2 million in commercial loans, \$2.8 million in auto loans, \$25.7 million in home equity and improvement loans and \$2.2 million in other loans through the Pavilion acquisition. The associated acquired reserve of those loans was \$4.3 million.

Changes in the allowance for loan losses were as follows:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Allowance at beginning of year	\$ 24,592	\$ 13,890	\$ 13,579
Provision for credit losses	23,232	12,585	2,306
Acquired in acquisitions		4,258	
Charge-offs	(11,826)	(6,499)	(2,400)
Recoveries	549	358	405
Net charge-offs	(11,277)	(6,141)	(1,995)
Ending allowance	\$ 36,547	\$ 24,592	\$ 13,890

Individually impaired loans were as follows:

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	Years Ended December 31		
	2009	2008	
	<i>(In Thousands)</i>		
Year-end loans with no allocated allowance for loan losses	\$ 18,239	\$ 6,734	
Year-end loans with allocated allowance for loan losses	40,585	20,812	
Total	\$ 58,824	\$ 27,546	
Amount of the allowance for loan losses allocated	\$ 12,249	\$ 6,030	

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Average of individually impaired loans during the year	\$ 38,860	\$ 25,682	\$ 9,571
Interest income recognized during impairment	965	1,055	305
Cash-basis interest income recognized	913	1,067	338

Nonaccrual loans and loans past due 90 days still on accrual were as follows:

	Years Ended December 31	
	2009	2008
	<i>(In Thousands)</i>	
Non-accrual loans	\$ 41,191	\$ 28,017
Loans past due over 90 days still on accrual		
Troubled Debt Restructurings	6,715	6,250
Total Non Performing Loans	\$ 47,906	\$ 34,267
Real estate owned and other assets held for sale	13,527	7,000
Total Non Performing Assets	\$ 61,433	\$ 41,267

Impaired loans having recorded investments of \$58.8 million at December 31, 2009 and \$27.5 million at December 31, 2008, have been recognized in conformity with FASB ASC Topic 310. Loans having carrying values of \$14.9 million and \$6.1 million were transferred to real estate and other assets held for sale in 2009 and 2008, respectively. There was \$250,000 and \$119,000 of accrued interest recorded on impaired or non-performing loans at December 31, 2009 and December 31, 2008.

Specific reserves in the amount of \$3.5 million have been allocated to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2009. First Defiance is not committed to lend additional funds to customers whose loans have been modified.

Certain loans acquired in the Pavilion, ComBanc and Genoa acquisitions had evidence that the credit quality of the loan had deteriorated since its origination and in management's assessment at the acquisition date it was probable that First Defiance would be unable to collect all contractually required payments due. In accordance with FASB ASC Topic 310 Subtopic 30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, these loans have been recorded based on management's estimate of the fair value of the loans. Details of these loans are as follows:

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	Contractual Amount Receivable	Impairment Discount <i>(in thousands)</i>	Recorded Loan Receivable
Balance at January 1, 2007	\$ 4,110	\$ 1,683	\$ 2,427
Principal payments received	(908)		(908)
Loans charged off	(97)	(97)	
Additional provision for loan loss	(95)		(95)
Loan accretion recorded		(233)	233
Balance at December 31, 2007	3,010	1,353	1,657
Amount recorded for Pavilion Bancorp	6,362	2,002	4,360
Principal payments received	(274)		(274)
Loans charged off	(234)	(234)	
Loan accretion recorded		(53)	53
Balance at December 31, 2008	8,864	3,068	5,796
Principal payments received	(2,633)		(2,633)
Loans charged off	(1,110)	(1,110)	
Additional provision for loan loss	(115)		(115)
Loan accretion recorded		(340)	340
Balance at December 31, 2009	\$ 5,006	\$ 1,618	\$ 3,388

Interest income on loans is as follows:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Commercial and non-residential real estate loans	\$ 73,504	\$ 73,973	\$ 68,419
Mortgage loans	9,446	10,115	9,693
Other loans	10,752	12,434	12,754
Totals	\$ 93,702	\$ 96,522	\$ 90,866

First Defiance's loan portfolio is concentrated geographically in its northwest Ohio market area. Management has also identified lending for income-generating rental properties as an industry concentration. Total loans for income generating property totaled \$444.8 million at December 31, 2009, which represents 27% of the Company's loan portfolio. The Company's loans receivable are primarily to borrowers in the northwest Ohio, northeast Indiana or southeast Michigan areas.

Loans to executive officers, directors, and their affiliates are as follows (in thousands):

	Years Ended December 31	
	2009	2008
Beginning balance	\$ 5,041	\$ 5,610
New loans	3,405	4,623
Effect of changes in composition of related parties	(216)	656
Repayments	(3,418)	(5,848)
Ending Balance	\$ 4,812	\$ 5,041

Table of Contents**9. Mortgage Banking**

Net revenues from the sales and servicing of mortgage loans consisted of the following:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Gain from sale of mortgage loans	\$ 8,744	\$ 4,395	\$ 2,590
Mortgage loan servicing revenue (expense):			
Mortgage loan servicing revenue	2,860	2,537	1,706
Amortization of mortgage servicing rights	(3,171)	(1,266)	(648)
Mortgage servicing rights valuation adjustments	1,314	(2,676)	(36)
	1,003	(1,405)	1,022
Net revenue from sale and servicing of mortgage loans	\$ 9,747	\$ 2,990	\$ 3,612

The unpaid principal balance of residential mortgage loans serviced for third parties was \$1.2 billion at December 31, 2009 compared to \$1.1 billion at December 31, 2008.

Activity for capitalized mortgage servicing rights and the related valuation allowance follows:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Mortgage servicing assets:			
Balance at beginning of period	\$ 9,403	\$ 6,089	\$ 5,609
Loans sold, servicing retained	4,204	1,450	1,128
Servicing assets acquired		3,130	
Amortization	(3,171)	(1,266)	(648)
Carrying value before valuation allowance at end of period	10,436	9,403	6,089
Valuation allowance:			
Balance at beginning of period	(2,792)	(116)	(80)
Impairment recovery (charges)	1,314	(2,676)	(36)
Balance at end of period	(1,478)	(2,792)	(116)
Net carrying value of MSR's at end of period	\$ 8,958	\$ 6,611	\$ 5,973
Fair value of MSR's at end of period	\$ 8,958	\$ 6,611	\$ 7,000

Amortization of mortgage servicing rights is computed based on payments and payoffs of the related mortgage loans serviced. Estimates of future amortization expense are not easily estimable.

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The Company's servicing portfolio is comprised of the following:

Investor	December 31			
	2009 Number of Loans	Principal Outstanding (Dollars in Thousands)	2008 Number of Loans	Principal Outstanding
Fannie Mae	5,071	\$ 520,959	4,275	\$ 413,078
Freddie Mac	7,760	656,680	7,959	678,485
Federal Home Loan Bank	310	41,903	61	7,905
Other	38	2,013	42	1,852
Totals	13,179	\$ 1,221,555	12,337	\$ 1,101,320

Significant assumptions at December 31, 2009 used in determining the value of MSR's include a weighted average prepayment rate of 245 PSA and a weighted average discount rate of 9.00%. Significant assumptions at December 31, 2008 used in determining the value of MSR's include a weighted average prepayment rate of 422 PSA and a weighted average discount rate of 9.00%.

A sensitivity analysis of the current fair value to immediate 10% and 20% adverse changes in those assumptions as of December 31, 2009 is presented below. These sensitivities are hypothetical. Changes in fair value based on a 10% variation in assumptions generally cannot be extrapolated because the relationship of the change in the assumption to the change in fair value may not be linear. Also, the effect of a variation in a particular assumption on the fair value of the MSR is calculated independently without changing any other assumption. In reality, changes in one factor may result in changes in another (for example, changes in mortgage interest rates, which drive changes in prepayment rate estimates, could result in changes in the discount rates), which might magnify or counteract the sensitivities.

	10% Adverse Change	20% Adverse Change
<i>(Dollars in Thousands)</i>		
Assumption:		
Decline in fair value from increase in prepayment rate	\$ 398	\$ 760
Declines in fair value from increase in discount rate	278	519

10. Premises and Equipment

Premises and equipment are summarized as follows:

	December 31	
	2009	2008
<i>(In Thousands)</i>		
Cost:		
Land	\$ 6,836	\$ 6,936
Land improvements	1,269	1,248
Buildings	38,529	38,926
Leasehold improvements	582	808
Furniture, fixtures and equipment	23,987	22,474

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Construction in process	63	1,655
	71,266	72,047
Less allowances for depreciation and amortization	27,669	24,291
	\$ 43,597	\$ 47,756

Depreciation expense was \$3.8 million, \$3.8 million and \$3.0 million for the years ended December 31, 2009, 2008 and 2007, respectively.

Lease Agreements

The Company has entered into lease agreements covering First Insurance's main office and Bowling Green, Ohio office, four banking center locations, three land leases for which the Company owns the banking centers, one land lease which is primarily used for parking, one land lease for future branch development and numerous stand-alone Automated Teller Machine sites with varying terms and options to renew.

Future minimum commitments under non-cancelable operating leases are as follows (in thousands):

2010	\$ 482
2011	426
2012	241
2013	189
2014	192
Thereafter	3,670
Total	\$ 5,200

Rentals under operating leases amounted to \$504,000, \$444,000 and \$446,000, in 2009, 2008, and 2007, respectively.

11. Goodwill and Intangible Assets**Goodwill**

The change in the carrying amount of goodwill for the year is as follows:

	December 31	
	2009	2008
	<i>(In Thousands)</i>	
Beginning balance	\$ 56,585	\$ 36,820
Goodwill acquired or adjusted during the year		19,765
Ending balance	\$ 56,585	\$ 56,585

Impairment exists when a reporting unit's carrying value of goodwill exceeds its fair value, which is determined through a two-step impairment test. Step 1 includes the determination of the carrying value of our reporting units, including the existing goodwill and intangible assets, and estimating the fair value of the reporting unit. We determined the fair value of our reporting units and compared it to its carrying value.

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Our annual impairment analysis as of November 30, 2009, indicated that the Step 2 analysis was not necessary as the fair values of the reporting units exceeded the carrying amounts.

Acquired Intangible Assets

Acquired intangibles consist of core deposit intangibles, customer relationship intangibles and non-compete agreements from previous Bank and Insurance acquisitions.

Activity in acquired intangibles for the years ended December 31, 2009 and 2008 was as follows:

	Gross Carrying Amount	Accumulated Amortization <i>(In Thousands)</i>	Net Value
Balance as of January 1, 2008	\$ 5,851	\$ (2,300)	\$ 3,551
Intangible assets acquired	6,251		6,251
Amortization of intangible assets		(1,458)	(1,458)
Balance as of December 31, 2008	12,102	(3,758)	8,344
Amortization of intangible assets		(1,456)	(1,456)
Balance as of December 31, 2009	\$ 12,102	\$ (5,214)	\$ 6,888

Aggregate amortization expense was \$1,456,000, \$1,458,000 and \$646,000 for 2009, 2008 and 2007 respectively.

Estimated amortization expense for each of the next five years and thereafter (in thousands) is as follows:

2010	\$ 1,284
2011	1,150
2012	1,009
2013	872
2014	767
Thereafter	1,806
Total	\$ 6,888

12. Deposits

The following schedule sets forth interest expense by type of deposit:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Checking and money market accounts	\$ 3,439	\$ 4,876	\$ 8,273
Savings accounts	460	1,376	1,404
Certificates of deposit	22,203	25,102	30,786
	26,102	31,354	40,463
Less interest capitalized			(107)

Totals		\$ 26,102	\$ 31,354	\$ 40,356
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Accrued interest payable on deposit accounts amounted to \$713,000 and \$1,387,000 at December 31, 2009 and 2008, respectively, which was comprised of \$665,000 and \$48,000 for certificates of deposit and checking and money market accounts, respectively, at December 31, 2009 and \$1,327,000 and \$60,000 for certificates of deposit and checking and money market accounts, respectively, at December 31, 2008.

A summary of deposit balances is as follows:

	December 31	
	2009	2008
	<i>(In Thousands)</i>	
Non-interest bearing checking accounts	\$ 189,132	\$ 176,063
Interest bearing checking and money market accounts	499,575	374,488
Savings deposits	130,156	132,146
Retail certificates of deposit less than \$100,000	550,710	578,244
Retail certificates of deposit greater than \$100,000	163,300	170,485
Brokered or national certificates of deposit	47,353	38,486
	\$ 1,580,226	\$ 1,469,912

On March 14, 2008, \$45.6 million of non-interest-bearing checking accounts, \$39.7 million of interest-bearing checking accounts, \$26.2 million of savings accounts and \$97.9 million of certificates of deposit were acquired in the Pavilion acquisition.

Scheduled maturities of certificates of deposit at December 31, 2009 are as follows (in thousands):

2010	\$ 511,118
2011	220,725
2012	24,983
2013	2,312
2014	824
2015 and thereafter	1,401
Total	\$ 761,363

At December 31, 2009 and 2008, deposits of \$543.3 million and \$429.7 million, respectively, were in excess of the \$100,000 FDIC insurance limit. Of these same deposits at December 31, 2009 and 2008, deposits of \$229.5 million and \$175.1 million, respectively, were in excess of the \$250,000 FDIC insurance limit per the Temporary Liquidity Guarantee Program. At December 31, 2009 and 2008, \$56.2 million and \$40.3 million, respectively, in investment securities were pledged as collateral against public deposits for certificates in excess of \$100,000 and an additional \$66.6 million and \$52.7 million of securities were pledged at December 31, 2009 and December 31, 2008, respectively, as collateral against deposits from private entities in excess of \$100,000.

13. Advances from Federal Home Loan Bank

First Federal has the ability to borrow funds from the FHLB. First Federal pledges its single-family residential mortgage loan portfolio, certain investment securities, certain first mortgage home equity loans, and certain multi-family or non-residential real estate loans as security for these advances. Advances secured by investment securities must have collateral of at least 105% of the borrowing. Advances secured by residential mortgages must have collateral of at least 125% of the borrowings. Advances secured by multi-family or non-residential real estate loans securities must have 300% collateral coverage. The total level of borrowing is also limited to 50% of total assets and at least 50% of

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the borrowings must be secured by either one-to-four family residential mortgages or investment securities. Total loans pledged to the FHLB at December 31, 2009 and December 31, 2008 were \$662.9 million and \$677.8 million, respectively. First Federal may obtain advances of up to approximately \$202.3 million from the FHLB at December 31, 2009.

At year-end, advances from the FHLB were as follows:

Principal Terms	Advance Amount <i>(in Thousands)</i>	Range of Maturities	Weighted Average Interest Rate
December 31, 2009			
Short-term borrowings	\$ 0	Overnight	0.00%
Single maturity fixed rate advances	35,000	January 2011 to October 2013	2.39%
Single maturity LIBOR based advances	20,000	March 2011	0.26%
Putable advances	64,000	September 2010 to March 2018	4.50%
Strike-rate advances	27,000	March 2011 to February 2013	4.18%
Amortizable mortgage advances	927	December 2015	4.10%
	\$ 146,927		

December 31, 2008			
Short-term borrowings	\$ 9,100	Overnight	0.54%
Single maturity fixed rate advances	10,000	October 2013	2.60%
Single maturity LIBOR based advances	45,000	January 2011 to March 2011	3.49%
Putable advances	64,000	September 2010 to March 2018	4.50%
Strike-rate advances	27,000	March 2011 to February 2013	4.18%
Amortizable mortgage advances	967	December 2015	4.10%
	\$ 156,067		

Putable advances are callable at the option of the FHLB on a quarterly basis. Strike rate advances are callable at the option of the FHLB only when three-month LIBOR rates exceed the agreed upon strike rate in the advance contract. Such strike rates range from 7.5% to 8.0%. When called, First Defiance has the option of paying off these advances or converting them to variable rate advances at the three month LIBOR rate. First Defiance has one advance totaling \$20 million outstanding at December 31, 2009 that was converted from callable advances. This advance can be paid in full without penalty at any quarterly repricing date.

Estimated future minimum payments by fiscal year based on maturity date and current interest rates are as follows (in thousands):

2010	\$ 14,850
2011	58,256
2012	15,023
2013	53,886
2014	554
Thereafter	18,119
Total minimum payments	160,688
Less amounts representing interest	13,761
Totals	\$ 146,927

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First Defiance also utilizes short-term advances from the FHLB to meet cash flow needs and for short-term investment purposes. First Defiance borrows short-term advances under a variety of programs at

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FHLB. At December 31, 2008, \$9.1 million was outstanding under First Defiance's Cash Management Advance line of credit. At December 31, 2009, there was no amounts outstanding under that line of credit. The total available under this line is \$15.0 million. In addition, First Defiance has a \$100.0 million REPO Advance line of credit available. There were no borrowings against this line at December 31, 2009 and December 31, 2008. Amounts are generally borrowed under the Cash Management and REPO lines on an overnight basis.

Amounts available under the various lines are also subject to the Company's overall borrowing limitations. Information concerning short-term advances is summarized as follows:

	Years Ended December 31	
	2009	2008
	<i>(In Thousands, Except Percentages)</i>	
Average daily balance during the year	\$ 33	\$ 14,004
Maximum month-end balance during the year	0	44,900
Average interest rate during the year	0.84%	2.17%

14. Junior Subordinated Debentures Owed to Unconsolidated Subsidiary Trust

In March 2007, the Company sponsored an affiliated trust, First Defiance Statutory Trust II (Trust Affiliate II) that issued \$15 million of Guaranteed Capital Trust Securities (Trust Preferred Securities). In connection with the transaction, the Company issued \$15.5 million of Junior Subordinated Deferrable Interest Debentures (Subordinated Debentures) to Trust Affiliate II. The Company formed Trust Affiliate II for the purpose of issuing Trust Preferred Securities to third-party investors and investing the proceeds from the sale of these capital securities solely in Subordinated Debentures of the Company. The Subordinated Debentures held by Trust Affiliate II are the sole assets of that trust. The Company is not considered the primary beneficiary of this Trust (variable interest entity), therefore the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability. Distributions on the Trust Preferred Securities issued by Trust Affiliate II are payable quarterly at a fixed rate equal to 6.441% for the first five years and a floating interest rate based on three-month LIBOR plus 1.5%, repricing quarterly, thereafter.

The Trust Preferred Securities issued by Trust Affiliate II are subject to mandatory redemption, in whole or part, upon repayment of the Subordinated Debentures. The Company has entered into an agreement that fully and unconditionally guarantees the Trust Preferred Securities subject to the terms of the guarantee. The Trust Preferred Securities and Subordinated Debentures mature on June 15, 2037, but may be redeemed at the Company's option at any time on or after June 15, 2012, or at any time upon certain events.

The Company also sponsors an affiliated trust, First Defiance Statutory Trust I (Trust Affiliate I), that issued \$20 million of Trust Preferred Securities in 2005. In connection with this transaction, the Company issued \$20.6 million of Subordinated Debentures to Trust Affiliate I. Trust Affiliate I was formed for the purpose of issuing Trust Preferred Securities to third-party investors and investing the proceeds from the sale of these capital securities solely in Subordinated Debentures of the Company. The Junior Debentures held by Trust Affiliate I are the sole assets of the trust. The Company is not considered the primary beneficiary of this Trust (variable interest entity), therefore the trust is not consolidated in the Company's financial statements, but rather the subordinated debentures are shown as a liability. Distributions on the Trust Preferred Securities issued by Trust Affiliate I are payable

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quarterly at a variable rate equal to the three-month LIBOR rate plus 1.38%. The Coupon rate payable on the Trust Preferred Securities issued by Trust Affiliate I was 1.63% and 3.38% as of December 31, 2009 and 2008 respectively.

The Trust Preferred Securities issued by Trust Affiliate I are subject to mandatory redemption, in whole or in part, upon repayment of the Subordinated Debentures. The Company has entered into an agreement that fully and unconditionally guarantees the Trust Preferred Securities subject to the terms of the guarantee. The Trust Preferred Securities and Junior Debentures mature December 15, 2035 but may be redeemed by the issuer at par after October 28, 2010.

Due to the Company's participation in the U.S. Treasury's Capital Purchase Program, permission must be obtained from the U.S. Treasury in order to call these securities.

A summary of all junior subordinated debentures issued by the Company to affiliates follows. These amounts represent the par value of the obligations owed to these affiliates, including the Company's equity interest in the trusts. Junior subordinated debentures owed to the following affiliates were as follows:

	December 31	
	2009	2008
First Defiance Statutory Trust I due December 2035	\$ 20,619	\$ 20,619
First Defiance Statutory Trust II due June 2037	15,464	15,464
Total junior subordinated debentures owed to unconsolidated subsidiary Trusts	\$ 36,083	\$ 36,083

Interest on both issues of Trust Preferred Securities may be deferred for a period of up to five years at the option of the issuer.

15. Notes Payable and Other Short-term Borrowings

Total short-term borrowings, revolving and term debt is summarized as follows:

	Years Ended December 31	
	2009	2008
	<i>(In Thousands, Except Percentages)</i>	
Securities sold under agreement to repurchase		
Amounts outstanding at year-end	\$ 48,398	\$ 49,454
Year-end interest rate	1.05%	1.79%
Average daily balance during year	44,287	36,926
Maximum month-end balance during the year	50,920	50,679
Average interest rate during the year	1.29%	2.69%
Revolving line of credit facilities to financial institutions		
Average daily balance during year	\$	\$ 14,416
Maximum month-end balance during the year		23,200
Average interest rate during the year	%	4.45%

As of December 31, 2009, First Defiance had no line of credit facilities available for short-term borrowing purposes; all previous lines of credit have expired.

During 2009, First Defiance had the following line of credit facilities expire:

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A \$20 million fed funds line of credit with a financial institution. The line was unsecured and had an interest rate of the institution's fed funds rate. The line of credit had no activity in 2009 and there were no amounts outstanding on the line at December 31, 2008. The maximum borrowed at any point in time under the line was \$0 million in 2009 and \$20.0 million in 2008, and the average balance outstanding was \$0 and \$339,000 in 2009 and 2008, respectively. The line of credit expired on January 31, 2009.

During 2008, First Defiance had the following line of credit facilities *expire*:

A \$15 million revolving line of credit facility with a financial institution. The facility was unsecured and has an interest rate of fed funds rate plus 0.45%. This facility was not used in 2008.

A \$15 million fed funds line of credit with a financial institution. The line was unsecured and has an interest rate of the institution's fed funds rate. This facility was not used in 2008.

A \$22.0 million revolving line of credit with a financial institution. There was no amount outstanding on the line at December 31, 2008. The line was secured by the stock of First Federal Bank and the interest rate was the lender's prime rate or LIBOR plus 1.50%, whichever was selected by First Defiance. The maximum borrowed at any point in time under the line was \$22,000,000 in 2008, and the average balance outstanding was \$14,077,000 in 2008. This line of credit was paid off in December 2008.

Further, the Company has agreed with its primary regulator not to incur, issue, renew or roll-over any debt, increase any current lines of credit, or guarantee the debt of any entity without OTSprior approval.

16. Other Non-Interest Expense

The following is a summary of other non-interest expense:

	Years Ended December 31,		
	2009	2008	2007
	<i>(In Thousands)</i>		
Legal and other professional fees	\$ 2,486	\$ 1,933	\$ 1,840
Marketing	1,293	1,896	1,729
State franchise taxes	1,994	1,951	1,579
REO expenses and write-downs	2,245	583	831
Printing and office supplies	569	776	679
Amortization of intangibles	1,456	1,459	646
Postage	650	768	643
Check charge-offs and fraud losses	128	1,120	549
Overdraft protection expense	15	123	492
Credit and collection expense	1,117	676	274
Other	4,930	3,339	3,547
Total other non-interest expense	\$ 16,883	\$ 14,624	\$ 12,809

Table of Contents**17. Postretirement Benefits**

First Defiance sponsors a defined benefit postretirement plan that is intended to supplement Medicare coverage for certain retirees who meet minimum age requirements. First Federal employees who retired prior to April 1, 1997 who completed 20 years of service after age 40 receive full medical coverage at no cost. Such coverage continues for surviving spouses of those participants for one year, after which coverage may be continued provided the spouse pays 50% of the average cost. First Federal employees retiring after April 1, 1997 are provided medical benefits at a cost based on their combined age and years of service at retirement. Surviving spouses are also eligible for continued coverage after the retiree is deceased at a subsidy level that is 10% less than what the retiree is eligible for. First Federal employees retiring before July 1, 1997 receive dental and vision care in addition to medical coverage. First Federal employees who retire after July 1, 1997 are not eligible for dental or vision care, but those retirees and their spouses each receive up to \$200 annually in a medical spending account. Funds in that account may be used for payment of uninsured medical expenses.

First Federal employees who were born after December 31, 1950 are not eligible for the medical coverage described above at retirement. Rather, a medical spending account of up to \$10,000 (based on the participant's age and years of service) will be established to reimburse medical expenses for those individuals. First Insurance employees who were born before December 31, 1950 can continue coverage until they reach age 65, or in lieu of continuing coverage, can elect the medical spending account option, subject to eligibility requirements. Employees hired or acquired after January 1, 2003 are eligible only for the medical spending account option.

Included in accumulated other comprehensive income at December 31, 2009 and 2008 are the following amounts that have not yet been recognized in net periodic benefit cost:

	December 31	
	2009	2008
	<i>(In Thousands)</i>	
Unrecognized prior service cost	\$ 66	\$ 76
Unrecognized actuarial losses	898	1,161
Total recognized in Accumulated Other Comprehensive Income	964	1,237
Income tax effect	(337)	(433)
Net amount recognized in Accumulated Other Comprehensive Income	\$ 627	\$ 804

The prior service cost and actuarial loss included in other comprehensive income and expected to be recognized in net postretirement benefit cost during the fiscal year-ended December 31, 2010 is \$10,000 (\$6,500 net of tax) and \$40,000 (\$26,000 net of tax), respectively.

Table of Contents**Reconciliation of Funded Status and Accumulated Benefit Obligation**

The plan is not currently funded. The following table summarizes benefit obligation and plan asset activity for the plan measured as of December 31 each year:

	December 31	
	2009	2008
	<i>(In Thousands)</i>	
Change in benefit obligation:		
Benefit obligation at beginning of year	\$ 2,853	\$ 2,393
Service cost	60	57
Interest cost	166	159
Participant contribution	27	37
Plan amendments		25
Actuarial (gains) / losses	(218)	74
Acquisition		271
Benefits paid	(154)	(163)
Benefit obligation at end of year	2,734	2,853
Change in fair value of plan assets:		
Balance at beginning of year		
Employer contribution	127	126
Participant contribution	27	37
Benefits paid	(154)	(163)
Balance at end of year		
Funded status at end of year	\$ (2,734)	\$ (2,853)

Net periodic postretirement benefit cost includes the following components:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Service cost-benefits attributable to service during the period	\$ 60	\$ 57	\$ 49
Interest cost on accumulated postretirement benefit obligation	166	159	125
Net amortization and deferral	56	61	44
Net periodic postretirement benefit cost	282	277	218
Net (gain) / loss during the year	(218)	74	357
Prior service cost added during the year		25	
Amortization of prior service cost and actuarial losses	(56)	(61)	(44)
Total recognized in comprehensive income	(274)	38	313
Total recognized in net periodic postretirement benefit cost and other comprehensive income	\$ 8	\$ 315	\$ 531

The following assumptions were used in determining the components of the postretirement benefit obligation:

	2009	2008
Weighted average discount rates:		
Used to determine benefit obligations at December 31	5.70%	6.00%
Used to determine net periodic postretirement benefit cost for years ended December 31	6.00%	6.00%
Assumed health care cost trend rates at December 31:		
Health care cost trend rate assumed for next year	8.50%	9.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	4.00%	4.00%
Year that rate reaches ultimate trend rate	2019	2019

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The following benefits are expected to be paid over the next five years and in aggregate for the next five years thereafter. Because the plan is unfunded, the expected net benefits to be paid and the estimated Company contributions are the same amount.

	Expected to be Paid <i>(In Thousands)</i>
2010	\$ 154
2011	146
2012	162
2013	161
2014	183
2015 through 2019	1,002

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effect:

	One-Percentage-Point Increase		One-Percentage-Point Decrease	
	Year Ended December 31		Year Ended December 31	
	2009	2008	2009	2008
	<i>(In Thousands)</i>			
Effect on total of service and interest cost	\$ 34	\$ 29	\$ (29)	\$ (24)
Effect on postretirement benefit obligation	351	301	(299)	(259)

The Company expects to contribute \$150,000 before reflecting expected Medicare retiree drug subsidy payments in 2010.

18. Regulatory Matters

First Federal is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, First Federal must meet specific capital guidelines that involve quantitative measures of First Federal's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. First Federal's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require First Federal to maintain minimum amounts and ratios of Tier I and total capital to risk-weighted assets and of Tier I capital to average assets. As of December 31, 2009 and 2008, First Federal meets all capital adequacy requirements to which it is subject and the most recent notification from the Office of Thrift Supervision (OTS) categorized First Federal as well-capitalized under the regulatory framework. There are no conditions or events since these notifications that management believes have changed any of the well-capitalized categorizations of First Federal. The following schedule presents First Federal's regulatory capital ratios:

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	Actual		Required for Capital Adequacy Purposes		Required to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2009						
Tangible Capital	\$ 207,554	10.40%	\$ 29,937	1.50%	N/A	N/A
Tier 1 (Core) Capital	207,554	10.40%	79,831	4.00%	\$ 99,789	5.00%
Tier 1 Capital to risk-weighted assets	207,554	11.78%	70,455	4.00%	105,683	6.00%
Risk-Based Capital	229,649	13.04%	140,910	8.00%	176,138	10.00%
As of December 31, 2008						
Tangible Capital	\$ 202,616	10.70%	\$ 28,416	1.50%	N/A	N/A
Tier 1 (Core) Capital	202,616	10.70%	75,777	4.00%	\$ 94,721	5.00%
Tier 1 Capital to risk-weighted assets	202,616	12.03%	67,356	4.00%	101,034	6.00%
Risk-Based Capital	219,290	13.02%	134,712	8.00%	168,390	10.00%

First Defiance is a unitary thrift holding company and is regulated by the OTS. The OTS does not have defined capital requirements for unitary thrift holding companies.

Dividend Restrictions Dividends paid by First Federal to First Defiance are subject to various regulatory restrictions. First Federal paid \$5.4 million in dividends in 2009 and \$10.0 million in dividends in 2008. First Federal can initiate dividend payments equal to its net profits (as defined by statute) for 2008 and 2009 plus 2010 net profits. During 2010, the Bank could declare dividends of approximately \$2.6 million plus 2010 net profits to First Defiance. First Federal must receive approval from the OTS prior to the payment of any such dividend, and it may apply to the OTS to pay total dividends that exceed an amount equal to its 2008 to 2010 net profits. First Insurance paid dividends of \$700,000 to First Defiance in 2009 and \$1.8 million in dividends in 2008.

As a result of its participation in the CPP, First Defiance is prohibited without prior approval of the U.S. Treasury, from paying a quarterly cash dividend of more than \$0.26 per share until the earlier of December 5, 2011 or the date the U.S. Treasury's preferred stock is redeemed or transferred to an unaffiliated third party. Further, First Defiance has agreed with its primary regulator to obtain approval of cash dividends prior to declaration.

19. Income Taxes

The components of income tax expense are as follows:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Current:			
Federal	\$ 6,590	\$ 7,534	\$ 6,636
State and local	84	45	90
Deferred	(4,007)	(4,051)	(257)
	\$ 2,667	\$ 3,528	\$ 6,469

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The provision for income taxes differs from that computed at the statutory corporate tax rate as follows:

	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Tax expense at statutory rate (35%)	\$ 3,451	\$ 3,810	\$ 7,130
Increases (decreases) in taxes from:			
State income tax net of federal tax benefit	55	29	59
ESOP adjustments		(30)	152
Tax exempt interest income, net of TEFRA	(673)	(530)	(472)
Bank owned life insurance	(311)	130	(511)
Stock option expense under FAS 123(R)	76	90	89
Other	69	29	22
Totals	\$ 2,667	\$ 3,528	\$ 6,469

Deferred federal income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

Significant components of First Defiance's deferred federal income tax assets and liabilities are as follows:

	December 31	
	2009	2008
	<i>(In Thousands)</i>	
Deferred federal income tax assets:		
Allowance for loan losses	\$ 12,648	\$ 8,423
Postretirement benefit costs	952	998
Deferred compensation	810	645
Impaired loans	1,227	1,074
Capital loss carry-forward	621	
Impaired investments	756	1,140
Accrued vacation	432	428
Allowance for real estate held for sale losses	200	56
Deferred loan origination fees and costs	326	337
Net unrealized losses on available-for-sale securities		708
Other	311	565
Total deferred federal income tax assets	18,283	14,374
Deferred federal income tax liabilities:		
FHLB stock dividends	3,284	3,284
Goodwill	2,684	2,284
Mortgage servicing rights	3,000	2,072
Fixed assets	1,432	975
Other intangible assets	2,329	2,815
Loan mark to market	1,800	2,274
Net unrealized gains on available-for-sale securities	252	
Other	213	334
Total deferred federal income tax liabilities	14,994	14,038
Net deferred federal income tax asset (liability)	\$ 3,289	\$ 336

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The realization of the Company's deferred tax assets is dependent upon the Company's ability to generate taxable income in future periods and the reversal of deferred tax liabilities during the same

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period. The Company has evaluated the available evidence supporting the realization of its deferred tax assets and determined it is more likely than not that the assets will be realized and thus no valuation allowance was required at December 31, 2009.

At year-end 2009, the Company had capital loss carry-forwards of \$1.8 million which will expire on December 31, 2014. No valuation allowance has been recorded as management has evaluated evidence supporting the realization of this asset and determining it was more likely than not.

Retained earnings at December 31, 2009 include approximately \$11.0 million for which no tax provision for federal income taxes has been made. This amount represents the tax bad debt reserve at December 31, 1987, which is the end of the Company's base year for purposes of calculating the bad debt deduction for tax purposes. If this portion of retained earnings is used in the future for any purpose other than to absorb bad debts, the amount used will be added to future taxable income. The unrecorded deferred tax liability on the above amount at December 31, 2009 was approximately \$3.85 million.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Balance at January 1, 2007	\$ 588
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	
Reductions for tax positions of prior years	
Reductions due to the statute of limitations	(90)
Settlements	
Balance at December 31, 2007	\$ 498
Balance at January 1, 2008	\$ 498
Additions based on tax positions related to the current year	86
Additions for tax positions of prior years	
Reductions for tax positions of prior years	
Reductions due to the statute of limitations	(140)
Settlements	
Balance at December 31, 2008	\$ 444
Balance at January 1, 2009	\$ 444
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	
Reductions for tax positions of prior years	
Reductions due to the statute of limitations	(98)
Settlements	
Balance at December 31, 2009	\$ 346

The Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next twelve months.

The total amount of interest and penalties recorded in the income statement, net of the related federal tax benefit, for the year ended December 31, 2009 was \$28,000, and the amount accrued for interest and penalties (net of the related federal tax benefit) at December 31, 2009 was \$122,000.

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The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax in the state of Indiana. The Company is no longer subject to examination by taxing authorities for years before 2006. The Company currently operates primarily in the states of Ohio and Michigan, which tax financial institutions based on their equity rather than their income.

20. Employee Benefit Plans**ESOP Plan**

First Defiance has established an Employee Stock Ownership Plan (ESOP) covering all employees of First Defiance age 21 or older who have at least one year of credited service. Contributions to the ESOP are made by First Defiance and are determined by First Defiance's Board of Directors at their discretion. The contributions may be made in the form of cash or First Defiance common stock. The annual contributions may not be greater than the amount deductible for federal income tax purposes and cannot cause First Federal to violate regulatory capital requirements.

To fund the plan, the ESOP borrowed funds from First Defiance for the purpose of purchasing shares of First Defiance common stock. The ESOP acquired a total of 863,596 shares in 1993 and 1995. The loan outstanding was paid off in June 2008. Principal and interest payments on the loan were due in equal quarterly installments. The loan was collateralized by the shares of First Defiance's common stock and was repaid by the ESOP with funds from the Company's contributions to the ESOP, dividends on allocated and unallocated shares and earnings on ESOP assets.

As principal and interest payments on the loan were paid, shares were released from collateral and committed for allocation to active employees, based on the proportion of debt service paid in the year. Shares held by the ESOP which had not been released for allocation were reported as stock acquired by the ESOP plan in the statement of financial condition. As shares were released, First Defiance recorded compensation expense equal to the average fair value of the shares over the period in which the shares were earned. Also, the shares released for allocation were included in the average shares outstanding for earnings per share computations. Dividends on allocated shares were recorded as a reduction of retained earnings and dividends on unallocated shares reduce debt and accrued interest. ESOP compensation expense was \$0, \$116,000, and \$859,000, for 2009, 2008 and 2007, respectively.

Shares held by the ESOP at December 31 were as follows:

	Year Ended December 31, 2009			Year Ended December 31, 2008		
	Allocated	Unallocated	Total	Allocated	Unallocated	Total
Beginning Balance	527,723		527,723	515,618	34,828	550,446
Allocation of shares to participants				34,828	(34,828)	
Distribution of shares to former participants	(4,777)		(4,777)	(22,723)		(22,723)
Ending Balance	522,946		522,946	527,723		527,723

There were no unallocated shares at December 31, 2009 and December 31, 2008.

401(k) Plan

Employees of First Defiance are eligible to participate in the First Defiance Financial Corp. 401(k) Employee Savings Plan (First Defiance 401(k)) if they meet certain age and service requirements. Beginning in 2009, under the First Defiance 401(k), First Defiance matches 100% of the participants

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contributions up to 3% of compensation and then 50% of the participants' contributions for the next 2% of compensation. Previously, matching contributions were 50% of the first 3% of participants' contributions. The First Defiance 401(k) also provides for a discretionary First Defiance contribution in addition to the First Defiance matching contribution. First Defiance matching contributions totaled \$719,000, \$474,000 and \$409,000 for the years ended December 31, 2009, 2008 and 2007, respectively. There were no discretionary contributions in any of those years.

21. Stock Option Plans

First Defiance has established incentive stock option plans for its directors and its employees and has reserved 1,727,485 shares of common stock for issuance under the plans. A total of 1,467,204 shares are reserved for employees and 260,281 shares are reserved for directors. As of December 31, 2009, 467,500 options (445,500 for employees and 22,000 for directors) have been granted and remain outstanding at option prices based on the market value of the underlying shares on the date the options were granted. Options granted under all plans vest 20% per year except for the 2009 grant to the Company's five most-highly compensated employees, which vest 40% in 2011 and then 20% annually, subject to certain other limitations. There are 13,200 options granted under the 1996 plan of which 13,100 are fully vested and currently exercisable, 188,950 options granted under the 2001 plan of which 182,150 are fully vested and currently exercisable and 265,350 options granted under the 2005 plan of which 89,600 are fully vested and currently exercisable. All options expire ten years from date of grant. Vested options of retirees expire on the earlier of the scheduled expiration date or three months after the retirement date.

The fair value of each option award is estimated on the date of grant using the Black-Scholes model using the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses historical data to estimate option exercise and post-vesting termination behavior. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding, which takes into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of options granted was determined using the following weighted-average assumptions as of grant date.

	Year Ended December 31		
	2009	2008	2007
Risk-free interest rate	3.38%	4.26%	4.84%
Expected term	6.4 years	6.5 years	6.6 years
Expected stock price volatility	26.1%	22.5%	21.8%
Dividend yield	3.62%	6.08%	3.67%

The following table summarizes stock option activity for 2009:

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	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in \$000s)
Outstanding at January 1, 2009	439,800	\$ 20.58		
Granted	64,350	9.43		
Exercised	(400)	11.75		
Forfeited/Expired	(36,250)	15.92		
Outstanding at December 31, 2009	467,500	\$ 19.41	5.47	\$ 117
Vested or expected to vest at December 31, 2009	449,207	\$ 19.54	6.70	\$ 102
Exercisable at December 31, 2009	284,850	\$ 20.75	3.71	\$ 0

Information related to the stock option plans follows:

	Year Ended December 31.		
	2009	2008	2007
	<i>(in thousands, except per share amounts)</i>		
Intrinsic value of options exercised	\$ 1	\$ 290	\$ 509
Cash received from option exercises*	5	768	522
Tax benefit realized from option exercises		72	64
Weighted average fair value of options granted	\$ 1.88	\$ 1.98	\$ 5.27

* - Includes \$33,000 and \$240,000 of option exercises paid by optionees in First Defiance common stock in 2008 and 2007, respectively. There were no such amounts for 2009.

As of December 31, 2009, there was \$424,000 of total unrecognized compensation cost related to non-vested stock options granted under the Company Stock Option Plans. The cost is expected to be recognized over a weighted-average period of 2.9 years.

As of December 31, 2009 and 2008, 98,750 and 146,850 shares, respectively, were available for grant under the Company's stock option plans. Options forfeited or cancelled under the 1996 plan are no longer available for grant to other participants.

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Condensed parent company financial statements, which include transactions with subsidiaries, follow:

<i>Statements of Financial Condition</i>	December 31		
	2009	2008	
	<i>(In Thousands)</i>		
Assets			
Cash and cash equivalents	\$ 1,891	\$ 2,023	
Investment securities, available for sale, carried at fair value		419	
Investment in subsidiaries	268,505	263,562	
Other assets	1,280	1,101	
 Total assets	 \$ 271,676	 \$ 267,105	
Liabilities and stockholders' equity:			
Subordinated debentures	\$ 36,083	\$ 36,083	
Accrued liabilities	1,507	1,863	
Stockholders' equity	234,086	229,159	
 Total liabilities and stockholders' equity	 \$ 271,676	 \$ 267,105	
 <i>Statements of Income</i>	 Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Dividends from subsidiaries	\$ 6,050	\$ 11,750	\$
Interest on loan to ESOP		10	64
Interest expense	(1,471)	(2,545)	(2,124)
Other-than-temporary impairment on investment securities	(419)	(1,281)	
Other income	(3)	35	222
Noninterest expense	(881)	(785)	(698)
 Income (loss) before income taxes and equity in earnings of subsidiaries	 3,276	 7,184	 (2,536)
Income tax credit	(950)	(1,650)	(867)
 Income (loss) before equity in earnings of subsidiaries	 4,226	 8,834	 (1,669)
Undistributed equity in (distributions in excess of) earnings of subsidiaries	2,968	(1,477)	15,573
 Net income	 \$ 7,194	 \$ 7,357	 \$ 13,904

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<i>Statements of Cash Flows</i>	Years Ended December 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Operating activities:			
Net income	\$ 7,194	\$ 7,357	\$ 13,904
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Distribution in excess of (undistributed equity in) earnings of subsidiaries	(2,968)	1,477	(15,573)
OTTI on investment securities	419	1,281	
Change in other assets and liabilities	741	115	(435)
Net cash provided by (used in) operating activities	5,386	10,230	(2,104)
Investing activities:			
Investment in unconsolidated trust subsidiary			(464)
Cash paid for Pavilion Bancorp		(27,964)	
Cash paid for Huber Harger Welt & Smith			(175)
Principal payments received on ESOP loan		493	641
Maturities of available-for-sale securities		29	156
Net cash (used in) provided by investing activities		(27,442)	158
Financing activities:			
Proceeds from issuance of subordinated debt securities			15,464
Capital contribution to subsidiary		(13,000)	
Stock options exercised	5	768	281
Excess tax benefit from exercise of stock options		72	64
Purchase of common stock for treasury		(635)	(4,923)
Cash dividends paid	(5,523)	(8,137)	(7,090)
Proceeds from issuance of preferred stock		37,000	
Net cash used in financing activities	(5,518)	16,068	3,796
Net increase (decrease) in cash and cash equivalents	(132)	(1,144)	1,850
Cash and cash equivalents at beginning of year	2,023	3,167	1,317
Cash and cash equivalents at end of year	\$ 1,891	\$ 2,023	\$ 3,167

23. Fair Value

FASB ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

FASB ASC Topic 820 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation

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techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on the best information available. In that regard, FASB ASC Topic 820 established a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by a correlation or other means.

Level 3: Unobservable inputs for determining fair value of assets and liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

A description of the valuation methodologies used for instruments measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Available for sale securities - Securities classified as available for sale are generally reported at fair value utilizing Level 2 inputs where the Company obtains fair value measurements from an independent pricing service which uses matrix pricing, which is a mathematical technique widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows and the bonds' terms and conditions, among other things. Securities in Level 1 include other federal agency securities. Securities in Level 2 include U.S. Government agencies, mortgage-backed securities and municipal securities. The Company classifies its pooled trust preferred collateralized debt obligations as Level 3. The portfolio consists of collateralized debt obligations backed by pools of trust preferred securities issued by financial institutions and insurance companies. Based on the lack of observable market data, the Company estimated fair values based on the observable data available and reasonable unobservable market data. The Company estimated fair value based on a discounted cash flow model which used appropriately adjusted discount rates reflecting credit and liquidity risks. The Company used an independent third party which is described further in Note 6.

Impaired loans - The fair value of impaired loans with specific allocations of the allowance for loan loss is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences

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between the comparable sales and income data available. Such adjustments are typically significant and result in impaired loans being valued using Level 3 inputs.

Mortgage servicing rights - Mortgage servicing rights are reported at fair value utilizing Level 2 inputs. MSR's are valued by a third party consultant using a proprietary cash flow valuation model.

Mortgage banking derivative - The fair value of mortgage banking derivatives are based on derivative valuation models using market data inputs as of the valuation date (Level 2).

Real estate held for sale - Real estate held for sale is determined using Level 3 inputs which include current and prior appraisals and estimated costs to sell.

The following table summarizes the financial assets measured at fair value on a recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

Assets and Liabilities Measured on a Recurring Basis

December 31, 2009	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
	(In Thousands)			
Available for sale securities:				
Obligations of U.S. Government corporations and agencies	\$	\$	14,251	\$ 14,251
Mortgage-backed securities			31,504	31,504
REMICs			3,923	3,923
Collateralized mortgage obligations			41,371	41,371
Trust preferred stock				1,589
Preferred stock	87			87
Obligations of state and political subdivisions			44,733	44,733
Mortgage banking derivative - asset			380	380
Mortgage banking derivative - liability				

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December 31, 2008	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs (In Thousands)	Total Fair Value
Available for sale securities:				
Obligations of U.S. Government corporations and agencies	\$	\$ 14,685	\$	\$ 14,685
Mortgage-backed securities		35,366		35,366
REMICs		4,159		4,159
Collateralized mortgage obligations		22,430		22,430
Trust preferred stock			3,873	3,873
Preferred stock	49			49
Obligations of state and political subdivisions		37,013		37,013
Mortgage banking derivative - asset		1,264		1,264
Mortgage banking derivative - liability		(166)		(166)

The table below presents a reconciliation and income classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2009 and December 31, 2008:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) (In Thousands)
Beginning balance, January 1, 2009	\$ 3,873
Total gains or losses (realized/unrealized)	
Included in earnings	(3,940)
Included in other comprehensive income (presented gross of taxes)	1,785
Purchases, issuances, and settlements	(130)
Transfers in and/or out of Level 3	
Ending balance, December 31, 2009	\$ 1,588
	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) (In Thousands)
Beginning balance, January 1, 2008	\$ 8,642
Total gains or losses (realized/unrealized)	
Included in earnings	(1,281)
Included in other comprehensive income (presented gross of taxes)	(3,281)
Purchases, issuances, and settlements	(207)
Transfers in and/or out of Level 3	
Ending balance, December 31, 2008	\$ 3,873

The following table summarizes assets measured at fair value on a non-recurring basis segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value:

Table of ContentsAssets and Liabilities Measured on a Non-Recurring Basis

December 31, 2009	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs (In Thousands)	Total Fair Value
Impaired loans	\$	\$	\$ 28,336	\$ 28,336
Mortgage servicing rights		8,958		8,958
Real estate held for sale			935	935

December 31, 2008	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs (In Thousands)	Total Fair Value
Impaired loans	\$	\$	\$ 14,782	\$ 14,782
Mortgage servicing rights		6,611		6,611
Real estate held for sale			90	90

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a fair value of \$28,336,000, with a valuation allowance of \$12,249,000 at December 31, 2009. A provision expense of \$11,985,000 for year ended December 31, 2009 was included in earnings.

Mortgage servicing rights which are carried at lower of cost or fair value had a fair value of \$8,958,000 at December 31, 2009, resulting in a valuation allowance of \$1,478,000. A recovery of \$1,314,000 was included in the earnings for the year ended December 31, 2009.

Real estate held for sale is determined using Level 3 inputs which include current and prior appraisals and estimated costs to sell. The change in fair value of real estate held for sale was \$1,295,000 for the year ended December 31, 2009 was recorded directly as an adjustment to current earnings through non-interest expense.

In accordance with FASB ASC Topic 825, the following table is a comparative condensed consolidated statement of financial condition based on carrying amount and estimated fair values of financial instruments as of December 31, 2009 and December 31, 2008. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of First Defiance.

Much of the information used to arrive at fair value is highly subjective and judgmental in nature and therefore the results may not be precise. Subjective factors include, among other things, estimated cash flows, risk characteristics and interest rates, all of which are subject to change. With the exception of investment securities, the Company's financial instruments are not readily marketable and market prices do not exist. Since negotiated prices for the instruments, which are not readily marketable depend greatly on the motivation of the buyer and seller, the amounts that will actually be realized or paid per settlement or maturity of these instruments could be significantly different.

The carrying amount of cash and cash equivalents, warehouse and term notes payable, and advance payments by borrowers for taxes and insurance, and accrued interest receivable and payable as a result of their short-term nature, is considered to be equal to fair value.

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As disclosed in more detail in Note 6, investment securities fair value has been based on current market quotations. If market prices are not available, fair value has been estimated based upon the quoted price of similar instruments. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability.

The fair value of loans which reprice within 90 days is equal to their carrying amount. For other loans, the estimated fair value is calculated based on discounted cash flow analysis, using interest rates currently being offered for loans with similar terms. The allowance for loan losses is considered to be a reasonable adjustment for credit risk.

FASB ASC Topic 825 requires that the fair value of demand, savings, NOW and certain money market accounts be equal to their carrying amount. The Company believes that the fair value of these deposits may be greater or less than that prescribed by FASB ASC Topic 825.

The carrying value of Subordinated Debentures and deposits with fixed maturities is estimated based on interest rates currently being offered on instruments with similar characteristics and maturities. FHLB advances with maturities greater than 90 days are valued based on discounted cash flow analysis, using interest rates currently being quoted for similar characteristics and maturities. The cost or value of any call or put options is based on the estimated cost to settle the option at December 31, 2009.

	December 31, 2009		December 31, 2008	
	Carrying Value	Estimated Fair Values	Carrying Value	Estimated Fair Values
	<i>(In Thousands)</i>			
Assets:				
Cash and cash equivalents	\$ 121,116	\$ 121,116	\$ 46,152	\$ 46,152
Investment securities	139,378	139,416	118,461	118,492
Federal Home Loan Bank Stock	21,376	N/A	21,376	N/A
Loans, net, including loans held for sale	1,590,921	1,586,101	1,603,603	1,619,409
Accrued interest receivable	6,851	6,851	7,293	7,293
	1,879,642	\$ 1,874,860	1,796,885	\$ 1,812,722
Other assets	177,881		160,515	
Total assets	\$ 2,057,523		\$ 1,957,400	
Liabilities and stockholders' equity:				
Deposits	\$ 1,580,226	\$ 1,586,466	\$ 1,469,912	\$ 1,476,135
Advances from Federal Home Loan Bank	146,927	152,643	156,067	162,776
Securities sold under repurchase agreements	48,398	48,398	49,454	49,454
Subordinated debentures	36,083	32,057	36,083	26,299
Accrued interest payable	1,234	1,234	2,015	2,015
Advance payments by borrowers for taxes and insurance	665	665	652	652
	1,813,533	\$ 1,821,463	1,714,183	\$ 1,717,331
Other liabilities	9,904		14,058	
Total liabilities	1,823,437		1,728,241	
Stockholders' equity	234,086		229,159	
Total liabilities and stockholders' equity	\$ 2,057,523		\$ 1,957,400	

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24. Derivative Financial Instruments

Commitments to fund certain mortgage loans (interest rate locks) to be sold into the secondary market and forward commitments for the future delivery of mortgage loans to third party investors are considered derivatives. It is the Company's practice to enter into forward commitments for the future delivery of residential mortgage loans when interest rate lock commitments are entered into in order to economically hedge the effect of changes in interest rates resulting from its commitments to fund the loans. These mortgage banking derivatives are not designated in hedge relationships. First Federal had approximately \$18.7 million and \$63.6 million of interest rate lock commitments at December 31, 2009 and 2008, respectively. There were \$23.8 million and \$72.2 million of forward commitments for the future delivery of residential mortgage loans at December 31, 2009 and 2008, respectively.

The fair value of these mortgage banking derivatives are reflected by a derivative asset and a derivative liability. The table below provides data about the carrying values of these derivative instruments:

	December 31, 2009			December 31, 2008		
	Assets Carrying Value	(Liabilities) Carrying Value	Derivative Net Carrying Value (In Thousands)	Assets Carrying Value	(Liabilities) Carrying Value	Derivative Net Carrying Value
Derivatives not designated as hedging instruments						
Mortgage Banking Derivatives	\$ 380	\$	\$ 380	\$ 1,264	\$ (166)	\$ 1,098

The table below provides data about the amount of gains and losses recognized in income on derivative instruments not designated as hedging instruments:

	Twelve Months Ended December 31,	
	2009	2008
Derivatives not designated as hedging instruments		
Mortgage Banking Derivatives Gain (Loss)	\$ (718)	\$ 1,098

The above amounts are included in mortgage banking income.

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The following is a summary of the quarterly consolidated results of operations:

	March 31	Three Months Ended		December 31
		June 30	September 30	
<i>(In Thousands, Except Per Share Amounts)</i>				
2009				
Interest income	\$ 25,122	\$ 24,822	\$ 25,487	\$ 25,148
Interest expense	9,085	8,643	7,914	7,615
Net interest income	16,037	16,179	17,573	17,533
Provision for loan losses	2,746	3,965	8,051	8,470
Net interest income after provision for loan losses	13,291	12,214	9,522	9,063
Gain (loss) on sale, call or write-down of securities	(672)	(750)	(840)	(1,394)
Noninterest income	7,476	9,109	6,396	6,970
Noninterest expense	14,996	16,133	14,786	14,609
Income before income taxes	5,099	4,440	292	30
Income taxes	1,691	1,539	(37)	(526)
Net income	\$ 3,408	\$ 2,901	\$ 329	\$ 556
Dividends declared on Preferred Shares	(463)	(468)	(473)	(446)
Accretion on Preferred Shares	(38)	(40)	(40)	(42)
Net income applicable to common shares	\$ 2,907	\$ 2,393	\$ (184)	\$ 68
Earnings per common share:				
Basic	\$ 0.36	\$ 0.29	\$ (0.02)	\$ 0.01
Diluted	\$ 0.36	\$ 0.29	\$ (0.02)	\$ 0.01
Average shares outstanding:				
Basic	8,117	8,117	8,117	8,117
Diluted	8,117	8,182	8,117	8,265

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	Three Months Ended			
	March 31	June 30	September 30	December 31
<i>(In Thousands, Except Per Share Amounts)</i>				
2008				
Interest income	\$ 24,639	\$ 26,237	\$ 26,643	\$ 25,945
Interest expense	11,048	9,991	10,277	9,952
Net interest income	13,591	16,246	16,366	15,993
Provision for loan losses	1,058	2,797	4,907	3,824
Net interest income after provision for loan losses	12,533	13,449	11,459	12,169
Gain on sale of securities	(81)	(432)	(2,051)	(596)
Noninterest income	6,096	6,582	6,191	3,360
Noninterest expense	13,476	15,515	15,233	13,571
Income before income taxes	5,072	4,084	366	1,362
Income taxes	1,653	1,349	44	482
Net income	\$ 3,419	\$ 2,735	\$ 322	\$ 880
Dividends declared on Preferred Shares				(134)
Accretion on Preferred Shares				(11)
Net income applicable to common shares	\$ 3,419	\$ 2,735	\$ 322	\$ 735
Earnings per common share:				
Basic	\$ 0.48	\$ 0.34	\$ 0.04	\$ 0.09
Diluted	\$ 0.47	\$ 0.34	\$ 0.04	\$ 0.09
Average shares outstanding:				
Basic	7,195	8,094	8,113	8,117
Diluted	7,241	8,126	8,123	8,117

26. Preferred Stock

On December 5, 2008, as part of the Troubled Asset Relief Program (TARP) Capital Purchase Program, the Company entered into a Letter Agreement and Securities Purchase Agreement (collectively, the Purchase Agreement) with the United States Department of the Treasury (U.S. Treasury), pursuant to which the Company sold \$37.0 million shares of newly authorized Fixed Rate Cumulative Perpetual Preferred Stock, par value \$0.01 per share and liquidation value \$1,000 per share (Senior Preferred Shares) and also issued warrants (the Warrants) to the U.S. Treasury to acquire an additional 550,595 of common shares having an exercise price of \$10.08 per share. The warrant has a term of 10 years.

The Senior Preferred Shares qualify as Tier 1 capital and will pay cumulative dividends at a rate of 5% per annum for the first five years, and 9% per annum thereafter. The Senior Preferred Shares may be redeemed by the Company after three years. The Senior Preferred Shares are not subject to any contractual restrictions on transfer, except that the U.S. Treasury or any its transferees may affect any transfer that, as a result of such transfer, would require the Company to become subject to the periodic reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934.

Pursuant to the terms of the Purchase Agreement, the ability of the Company to declare or pay dividends or distributions on, or purchase, redeem or otherwise acquire for consideration, shares of its Common Stock will be subject to restrictions, including a restriction against increasing dividends from the last quarterly cash dividend per share of \$0.26 declared on the Common Stock prior to October 14, 2008. The redemption, purchase or other acquisition of trust preferred securities of the Company or its affiliates also will be restricted. These restrictions will terminate on the earlier of (a) the third anniversary of the

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date of issuance of the Senior Preferred Shares and (b) the date on which the Senior Preferred Shares have been redeemed in whole or the U.S. Treasury has transferred all of the Senior Preferred Shares to third parties, except that, after the third anniversary of the date of issuance of the Senior Preferred Shares, if the Senior Preferred Shares remain outstanding at such time, the Company may not increase its common dividends per share without obtaining consent of the U.S. Treasury.

The Purchase Agreement also subjects the Company to certain of the executive compensation limitations included in the Emergency Economic Stabilization Act of 2008 (the "EESA"). In this connection, as a condition to the closing of the transaction, the Company's Senior Executive Officers (as defined in the Purchase Agreement) (the "Senior Executive Officers"), (i) voluntarily waived any claim against the U.S. Treasury or the Company for any changes to such officer's compensation or benefits that are required to comply with the regulation issued by the U.S. Treasury under the TARP Capital Purchase Program and acknowledged that the regulation may require modification of the compensation, bonus, incentive and other benefit plans, arrangements and policies and agreements as they relate to the period the U.S. Treasury owns the Preferred Stock of the Company; and (ii) entered into a letter with the Company amending the Benefit Plans with respect to such Senior Executive Officers as may be necessary, during the period that the Treasury owns the Preferred Stock of the Company, as necessary to comply with Section 111(b) of the EESA.

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PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) Financial Statements

The following documents are filed as Item 8 of this Form 10-K.

- (A) Report of Independent Registered Public Accounting Firm (Crowe Horwath LLP)
- (B) Consolidated Statements of Financial Condition as of December 31, 2009 and 2008
- (C) Consolidated Statements of Income for the years ended December 31, 2009, 2008 and 2007
- (D) Consolidated Statements of Stockholders' Equity for the years ended December 31, 2009, 2008 and 2007
- (E) Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007
- (F) Notes to Consolidated Financial Statements

- (1) We are not filing separate financial statement schedules because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements or the related notes.
- (2) The exhibits required by this item are listed in the Exhibit Index of this Form 10-K. The management contracts and compensation plans or arrangements required to be filed to this Form 10-K are listed as Exhibits 10.1 through 10.19.

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SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST DEFIANCE FINANCIAL CORP.

February 18, 2011

By: /s/ Donald P. Hileman
Donald P. Hileman Chief Financial Officer

(Principal Financial Officer)

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This report incorporates by reference the documents listed below that we have previously filed with the SEC. The SEC allows us to incorporate by reference information in this document. The information incorporated by reference is considered to be part of this document.

This information may be read and copied at the Public Reference Room of the SEC at 100 F Street, N.E., Washington D.C. 20549. The SEC also maintains an internet web site that contains reports, proxy statements, and other information about issuers, like First Defiance, who file electronically with the SEC. The address of the site is <http://www.sec.gov>. The reports and other information filed by First Defiance with the SEC are also available at the First Defiance Financial Corp. web site. The address of the site is <http://www.fdef.com>. Except as specifically incorporated by reference into this Annual Report on Form 10-K, information on those web sites is not part of this report.

Exhibit Number	Description	
3.1	Articles of Incorporation	(1)
3.2	Code of Regulations	(1)
3.3	Bylaws	(1)
3.4	Amendment to Articles of Incorporation	(11)
4.1	Agreement to furnish instruments and agreements defining rights of holders of long-term debt	(19)
4.2	Form of Warrant for Purchase of Shares of Common Stock	(15)
10.1	1996 Stock Option Plan	(2)
10.2	Form of Incentive Stock Option Award Agreement	(3)
10.3	Form of Nonqualified Stock Option Award Agreement	(3)
10.4	1996 Management Recognition Plan and Trust	(2)
10.5	2001 Stock Option and Incentive Plan	(5)
10.6	1993 Stock Incentive Plan	(1)
10.7	Employment Agreement with William J. Small	(6)
10.8	Employment Agreement with James L. Rohrs	(7)
10.9	Employment Agreement with Donald P. Hileman	(18)
10.10	Employment Agreement with Gregory R. Allen	(9)
10.11	Description of Annual Bonus	(16)
10.12	2005 Stock Option and Incentive Plan	(10)
10.13	Letter Agreement, dated December 5, 2008, between First Defiance and the U.S. Treasury	(12)
10.14	2008 Long Term Incentive Compensation Plan	(13)
10.15	Form of Contingent Award Agreement	(14)
10.16	Form of Stock Option Award Agreement	(4)
10.17	Amendment to all Employment Agreements for CPP	(4)
10.18	Form of Agreement for CPP Compensation Standards	(19)
10.19	Form of Option Award Agreement	(19)
14	Code of Ethics	(16)
21	List of Subsidiaries of the Company	(16)

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23.1	Consent of Crowe Horwath LLP	(17)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	(17)
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	(17)
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	(17)
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	(17)
99.1	PEO TARP Capital Purchase Program Certification	(19)
99.2	PFO TARP Capital Purchase Program Certification	(19)

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- (1) Incorporated herein by reference to the like numbered exhibit in the Registrant's Form S-1 (File No. 33-93354).
- (2) Incorporated herein by reference to like numbered exhibit in Registrant's 2001 Form 10-K
- (3) Incorporated herein by reference to like numbered exhibit in Registrant's 2004 Form 10-K
- (4) Incorporated herein by reference to like numbered exhibit in Registrant's 2008 Form 10-K
- (5) Incorporated herein by reference to Appendix B to the 2001 Proxy Statement
- (6) Incorporated herein by reference to exhibit 10.1 in Form 8-K filed October 1, 2007
- (7) Incorporated herein by reference to exhibit 10.2 in Form 8-K filed October 1, 2007
- (8) Incorporated herein by reference to exhibit 10.3 in Form 8-K filed October 1, 2007
- (9) Incorporated herein by reference to exhibit 10.4 in Form 8-K filed October 1, 2007
- (10) Incorporated herein by reference to Appendix A to the 2005 Proxy Statement
- (11) Incorporated herein by reference to exhibit 3 in Form 8-K filed December 8, 2008
- (12) Incorporated herein by reference to exhibit 10 in Form 8-K filed December 8, 2008
- (13) Incorporated herein by reference to exhibit 10.1 in Form 8-K filed December 12, 2008
- (14) Incorporated herein by reference to exhibit 10.2 in Form 8-K filed December 12, 2008
- (15) Incorporated herein by reference to exhibit 4 in Form 8-K filed December 8, 2008
- (16) Incorporated herein by reference to like numbered exhibit in Registrant's 2007 Form 10-K
- (17) Included herein

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(18) Incorporated herein by reference to exhibit 10.1 in Form 8-K filed December 16, 2009

(19) Previously included in Registrant's 2009 Form 10-K filed March 3, 2010

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