Harleysville NATIONAL CORPORATION

2008 ANNUAL REPORT

PEOPLE. PERFORMANCE. PERSPECTIVE.

CELEBRATING 100 YEARS OF TRADITION

Harleysville NATIONAL CORPORATION

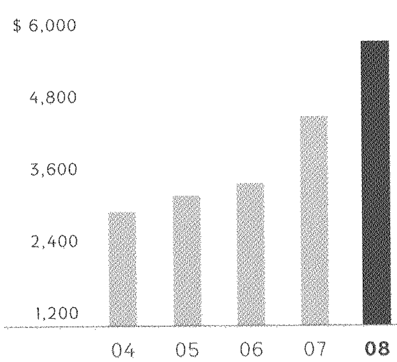
HARLEYSVILLE NATIONAL CORPORATION IS THE HOLDING COMPANY FOR HARLEYSVILLE NATIONAL BANK. FOR OVER A CENTURY, HARLEYSVILLE HAS SERVED ITS COMMUNITIES AND BUILT A REPUTATION FOR TRUST, SAFETY AND KNOWLEDGE. WITH $5.5 BILLION OF ASSETS AND 85 BRANCH OFFICES, HARLEYSVILLE CONNECTS PHILADELPHIA AND ITS SUBURBS IN MONTGOMERY, CHESTER, AND BUCKS COUNTIES WITH BERKS COUNTY, THE LEHIGH VALLEY, AND ADJACENT NORTHERN REGIONS. SINCE 1909, CONSUMERS, BUSINESS OWNERS AND MUNICIPALITIES HAVE TURNED TO HARLEYSVILLE NATIONAL BANK FOR SUPERIOR RETAIL, COMMERCIAL BANKING, INVESTMENT MANAGEMENT AND TRUST SERVICES TO HELP THEM ACHIEVE THEIR FINANCIAL GOALS.

Financial HIGHLIGHTS

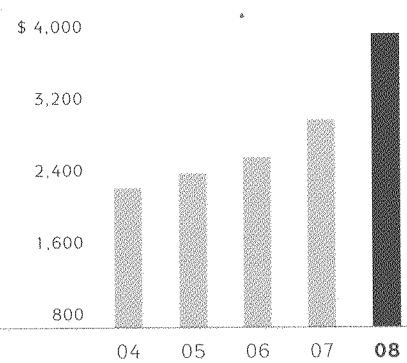
Year ended December 31 *(Dollars in Thousands)*	**2008** (1)	**2007** (2)	**2006** (3)
Total assets	$ 5,490,509	$ 3,903,001	$ 3,249,828
Loans	3,685,244	2,460,823	2,047,355
Deposits	3,938,432	2,985,058	2,516,855
Net interest income	104,140	82,434	83,173
Net income	25,093	26,595	39,415

1) The results of operations include the acquisition of Willow Financial effective December 5, 2008.
2) The results of operations include the acquisition of East Penn Financial effective November 16, 2007, and the sale lease-back of bank properties during the fourth quarter of 2007.
3) The results of operations include the acquisition of The Cornerstone Companies effective January 1, 2006, and the sale of the Bank's Honesdale branch effective November 10, 2006.

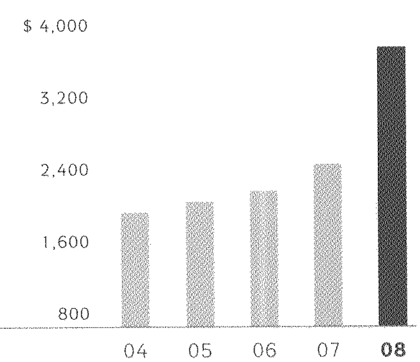
Asset Growth *(Dollars in Thousands)*



Deposit Growth *(Dollars in Thousands)*



Loan Growth *(Dollars in Thousands)*



2008 *Measurable* ACCOMPLISHMENTS

STRATEGIC ACCOMPLISHMENTS

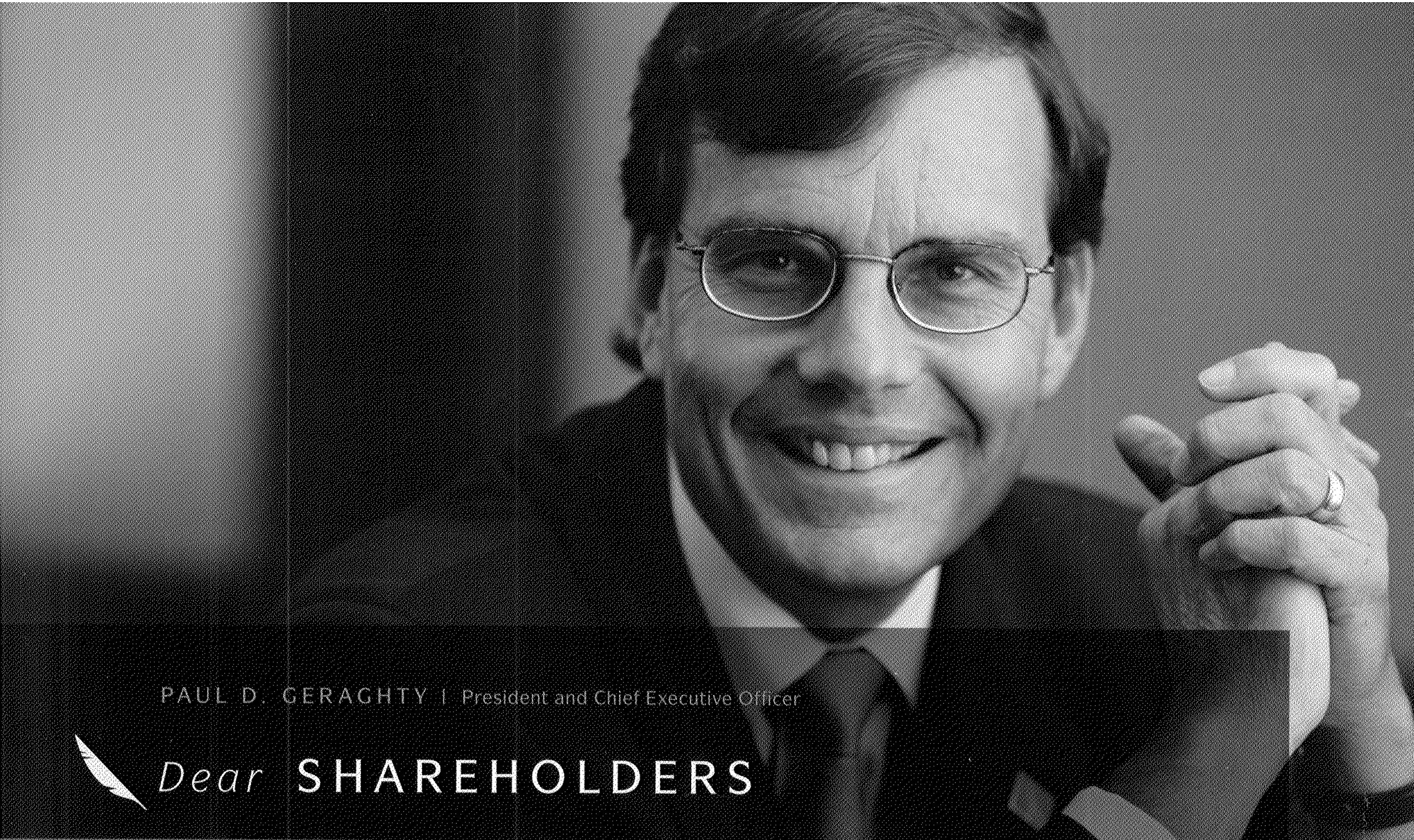
- Completed Willow Financial Bancorp acquisition, expanding our footprint, scale, product set, and customer base.
- Successfully executed the Willow Financial integration – the largest in the history of the bank – with nearly flawless execution.
- Formed executive leadership team to lead the combined bank into the future.

FINANCIAL ACCOMPLISHMENTS

- Grew assets 41%, to $5.5 billion, making us the third-largest bank headquartered in suburban Philadelphia.
- Increased net interest margin by 22 basis points.
- Boosted noninterest income by 7%.
- Experienced 5% organic loan growth.

OPERATIONAL ACCOMPLISHMENTS

- Consolidated small business lending for improved efficiency and more effective credit management.
- Implemented electronic remote deposit capture bankwide to improve efficiency and cash management.
- Strengthened credit administration.
- Managed liquidity, pricing, and credit risk in volatile credit markets.



PAUL D. GERAGHTY | President and Chief Executive Officer

Dear SHAREHOLDERS

WITH THE ACQUISITION OF WILLOW FINANCIAL COMPLETED DURING THE FOURTH QUARTER, HARLEYSVILLE IS NOW A $5.5 BILLION REGIONAL BANK THAT HAS A SIGNIFICANT SHARE OF ONE OF THE MOST ATTRACTIVE BANKING MARKETS IN THE COUNTRY: SOUTHEASTERN PENNSYLVANIA.

At the same time, we enjoy our positioning and reputation as a customer-friendly community bank with deep roots in our local markets. This is especially important at a time when consumers and commercial customers have a strong preference to do business with local financial institutions.

Without question, 2008 was one of the most challenging years that I have seen in my 30-year career in banking. I don't need to reiterate the headlines, but suffice to say, there are major changes taking place in the world's financial markets. While we see opportunity on the horizon and remain optimistic about our long-term future, indications are that there will be continued challenges in 2009 in the economic environment and credit markets. As a result, Harleysville is taking decisive action to position the bank to deliver performance and weather these storms, including improving efficiencies and managing expenses.

We earned $25.1 million or 78 cents per diluted share during the year, compared to $26.6 million, or 90 cents per share in 2007. As the year progressed, we proactively managed our credit exposures and adjusted internal credit ratings for certain borrowers as appropriate. Accordingly, in 2008, we increased our provision for loan losses

Our VISION

Be recognized as a high performing financial services company by engaging our employees to build customer wealth and shareholder value.

Our STRATEGY

Add value for our customers, manage risk and get paid appropriately, drive utilization of capital and assets, and win with people.

to $15.6 million, from $10.6 million at the end of 2007, reflecting an increase in nonperforming assets to $78.5 million, from $22.0 million at the end of 2007.

Harleysville has historically had many relationships with local homebuilders, which was a good, profitable business for us for many years. Unfortunately, the downturn in housing that accelerated during the year caused the industry to slow. Inventory sat unsold, spurring the need for us to take additional provisions for loan losses.

We continue to take proactive steps to preserve our capital position and protect our balance sheet during this challenging economic time.

We have also deployed additional resources in credit administration to improve our ability to proactively identify potential problem loans and work with borrowers toward a favorable resolution. In addition, we have centralized retail underwriting to ensure a consistent, well-managed approach.

In light of the negative economic outlook forecast by many leading economists, we reduced our dividend in the first quarter of 2009 as a strong precautionary measure to protect and strengthen our balance sheet. We believe the dividend reduction is the right thing to do, helping to safeguard our shareholders' long-term investment in Harleysville National Corporation.

We continue to scrutinize expenses. For example, in 2008 we rolled out branch remote capture, a unique technology that moves check clearing from a manual, paper-based process to real time. This reduced transportation and handling of deposited checks while improving the customer experience. As noted in our communications regarding the Willow Financial acquisition, we have identified $15–$20 million of cost savings that we believe can be realized during 2009. We expect this will make the acquisition accretive within the first full calendar year. And we are examining how changes in customer preference can drive more efficient deployment of front-line staff.

Despite the economic downturn, we remain tenacious about serving our customers. Our portfolio of products and services is robust, and enables us to compete with any financial institution in the country for new business. We have sophisticated cash management and wealth management capabilities; an 85-branch network that stretches from Northeast Philadelphia through the Lehigh Valley into the northern counties of Carbon and Monroe and west into Chester County; an engaged and talented commercial lending team that is able to benefit from an increased scale; as well as unique capabilities, such as employee benefits consulting. We believe that we can leverage this solution set to move upstream and become a financial partner to larger commercial customers in our footprint, while growing our relationship with existing customers.

Our theme for the 2008 annual report, *People*, *Performance*, *Perspective*, comes directly from our 2009 strategic plan and we believe these elements provide the foundation of our shareholder value.

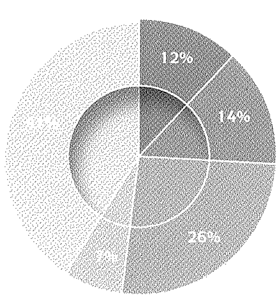
People: As a result of the Willow Financial acquisition and our presence as one of the largest banks in our region, we have had the opportunity to hand-pick the best talent to lead our company forward into the future. Today, we have playmakers up and down our lineup – from the back office operations center through our customer-facing banking professionals and our entire executive team.

Performance: Our primary performance objective going forward is to strengthen our financial results and balance sheet. To this end, we have heavy lifting ahead of us, but we also have the team, franchise, and products to make this happen. The broader footprint we enjoy as a result of the Willow Financial acquisition helps in this regard by expanding our presence in Chester and Montgomery counties.

Perspective: Our long-term perspective and 100-year history reminds us that change creates opportunity, and we believe that Harleysville National Bank is positioned to benefit from the transitions taking place in the financial markets.

Throughout our nation's current economic slowdown, Harleysville National Bank has publicly stated that the bank is open for business and willing to lend. We continue to add to our customer base and expand our relationships with local borrowers. Additionally, we remain strong supporters of our communities, donating to local outreach organizations such as United Way, Inter-Faith Housing Alliance and Montgomery County Partners for Home Ownership as well as countless local schools, chambers of commerce and health and human services organizations. We see this as a key component of our role as a community bank: to support local businesses and consumers, and to take a leadership role in protecting the financial health of our community.

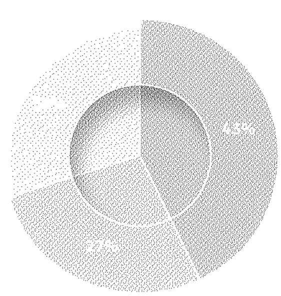
DEPOSIT PORTFOLIO



- Noninterest-bearing Checking
- Interest-bearing Checking
- Money Market
- Savings
- Time Deposits

Total Deposits = $3.9 billion

LOAN PORTFOLIO



- Real Estate
- Commercial and Industrial
- Consumer

Total Loans = $3.7 billion

CORE COMPETENCIES

Wealth Management	Commercial Banking	Retail Banking
Business and Estate Planning	Business Deposit Services	CDs, CDARS®
Custom Credit Solutions	Cash Management	Checking Accounts
Estate Settlement and Executor Services	Equipment Leasing	Credit Cards and Check Cards
Executive Management and Compensation Consulting	Government Banking Solutions	Insurance
Financial Planning	Interest Rate Risk Management	Investment Management Services
Institutional Investments	International Trade Services	Personal Loans *(Mortgages, Personal and Home Equity Lines of Credit, Installment Loans, Education Loans)*
Insurance and Annuities	Real Estate Lending and Construction Mortgages	Savings Accounts
Investment Management	Small Business and Commercial Loans	
Retirement Planning and Employee Benefit Services		
Settlement Consulting Services		
Trust and Fiduciary Services		

In closing, we are committed to enhancing shareholder value. We believe all of the pieces are in place for us to build upon Harleysville's long-term record of achievement.

The acquisition of Willow Financial is an accomplishment for which we are very proud. It furthers our stated objective to grow through disciplined in-market expansion. We gain significant scale and synergies, complementary lines of business, and 29 additional branches in attractive markets that augment the traditional Harleysville National Bank footprint. In addition, it delivers significant market share in Chester County, the fastest-growing county in Pennsylvania, and increases our market presence in Bucks, Montgomery and Philadelphia counties. In short, we believe the expanded franchise that results will be a significant driver of shareholder value in the years to come.

We thank you for your support. As always, if you have any questions, my door is open.

Thank you and best regards,

Paul D. Geraghty
President and Chief Executive Officer

Winning with PEOPLE

- Strive to hire, develop and retain the best talent.
- Engage the minds and hearts of our employees to deliver with passion.
- Manage collaboratively.
- Conduct our business with integrity.

A key tenet in the Harleysville strategic plan for 2009 and beyond is our aspiration to win with people. The banking industry remains as competitive as ever, and our team is our greatest differentiator.

In 2009, engagement is the focus for the Retail Banking group. With a keen eye on growing customer relationships, new demand deposit generation will contribute positively to the bottom line this year. We will deliver this through an enhanced customer experience; a deepening of the sales model, including sales tools and knowledge; a competitive product set; and thorough efficiencies that leverage our scale and operational strength. Our quality people, an expansion of channel opportunities and improvements within the branch offices provide us with the platform to deliver an exceptional customer experience for businesses and consumers alike.

As part of Harleysville National Bank, Millennium Wealth Management and The Cornerstone Companies enter 2009 focused on relationships, teamwork, and process to build on their market leadership among wealth advisory firms. Millennium Wealth Management strives first and foremost to build relationships of trust with its clients and prospects through service, objectivity and transparency – hallmarks of a trusted client/advisor relationship. Likewise, Cornerstone's unique approach and extensive capabilities have helped them build a strong business based on stewardship and investment risk management for their clients. With disciplined execution of their strategic plans, Millennium Wealth Management and Cornerstone can continue to achieve significant growth and provide a major contribution to the bank's profitability.

The Commercial team is committed to a full relationship approach to business owners in our market territory. This model embraces exceptional client coverage, responsiveness and considerable industry knowledge, combined with a competitive product set and direct access to senior management.

We have encouraged employees to make suggestions and propose new ways to operate more efficiently, to better serve our customers. Today, employees know that their input is welcomed, valued, and encouraged. Continuation of these initiatives is central to our achievement of expected synergies in 2009.

Financial performance is first and foremost driven by excellence at the point of contact with each and every bank customer. Shareholders expect strong performance from Harleysville National Bank, and by delivering an exceptional experience for our customers – whether they are consumers, business owners, or investors – we enable great financial performance for our shareholders.

From a service delivery standpoint, we strive to execute with 100% accuracy. In today's competitive banking environment, the smallest error can jeopardize a customer relationship for years to come. So we have built a team that is intensely focused on accuracy, effectiveness, and precision from the back office through every customer-facing salesperson.

Performance also encompasses access and convenience. Today, we have 85 branches throughout our nine county region, online banking capabilities and over 37,000 surcharge-free ATM machines worldwide through our partnership with the Allpoint Network™. Customers can access Harleysville service excellence 24x7.

To drive great performance, one needs compelling product offerings. From checking and savings accounts to cash management, credit solutions and an array of wealth management products through our Millennium Wealth Management and Cornerstone divisions, Harleysville offers a full range of products and services tailored to the needs of consumers and business owners. These services, delivered through our team of well-trained staff, position us to capture a greater share of the market in 2009.

This potent combination of accuracy, access, convenience, and compelling products enables relationship building through cross-selling, organic growth of deposit and lending relationships, and establishment of new relationships. Leveraging these competitive assets and emphasizing our commitment will be the linchpin of our turnaround efforts.

Winning with PERFORMANCE

- Drive shareholder value.
- Optimize returns through disciplined growth and improved efficiency.
- Build balance sheet strength for the long-term.
- Grow customer relationships beyond clients' expectations.

Winning with PERSPECTIVE

- Nurture long-term relationships with customers.
- Stay focused on our core business and our target markets.
- Protect interests of all stakeholders by building and maintaining an ever-stronger company.

In the current banking environment, we see opportunity amid today's challenges. We have cultivated a strong perspective on the cycles of business growth and the economy in Pennsylvania, with the benefit of 100 years of operating experience. We have steered Harleysville National Corporation through many challenging economic cycles. In short, it's hard to remember in times like these that the economy is cyclical and will rebound. But it will.

This is a time for all of us to retrench but it is also a time of great opportunity for our bank and for our customers. Our long-term perspective enables us to offer our clients the knowledge, advice and expertise to survive – and thrive – in tough times.

Our perspective enables us to build relationships with our clients beyond their expectations. From branch professionals who can help consumers navigate challenging financial waters; to a commercial lending team that stands ready to help business borrowers access the capital they need to grow; to our wealth management units that help clients make sense of the markets, we engage in deeper thinking and insight that drives long-term relationships.

For shareholders, this means that we have the know-how to protect their interests while capitalizing on the numerous growth opportunities that tough economic times provide to enhance your values over the long-term. Harleysville avoided the go-go growth opportunities of the mid 2000s when many of our peers in the banking business were aggressively pursuing deals in sub-prime lending. Accordingly, our financial results were only slightly down in 2008, largely due to credit provisions, and we did not experience those catastrophic losses that have placed many of our peers on the brink of survival.

For employees, perspective means that we make sound decisions and provide a stable career environment where they can learn and grow and sleep at night, knowing that the bank has their best interests in mind.

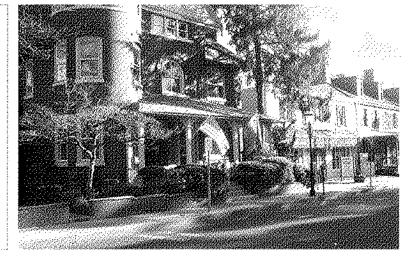
Celebrating 100 YEARS OF TRADITION

FROM BERKS COUNTY TO BUCKS COUNTY, CHESTER COUNTY TO CARBON COUNTY, WE INVEST IN OUR COMMUNITIES AND BUSINESSES EVERY DAY.

BUCKS COUNTY

With the addition of Willow Financial Bancorp, our volunteers and support can be found across the length of this county, at St. Luke's Hospital in Quakertown, in the merriment of Warminster Days in the community park each summer, and with the businesses and neighbors of Feasterville's Business Association. At the Free Clinic of Doylestown, we extend a hand to those who strive to make healthcare accessible to all, regardless of income or status.

★ *Doylestown*



CHESTER COUNTY

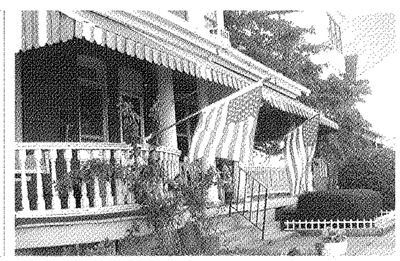
One of the fastest-growing markets in Pennsylvania, Chester County is home to 15 of our branch offices. Across the county, we're engaged in Green Valleys Association, Handi-Crafters, Community Dental, and the Brandywine Health and Wellness Foundation, through in kind and financial support for the exciting annual Strawberry Festival, to name just a few. We're delighted to share in the festivities of Downingtown's annual Community Days.

★ *Downingtown*

LEHIGH VALLEY

From the lyrical notes of Allentown's Symphony Orchestra to the heroic officers of our police departments and fire companies in Whitehall, to exciting games of Northampton football or Bethlehem's VIA All-Star Basketball Classic, we enjoy – and proudly support – the arts and organizations that make the Lehigh Valley a great place to live. East Penn Bank was founded, and remains rooted, in the heart of downtown Emmaus, which proudly recognizes its 250th anniversary this year. We are pleased to promote Emmaus' blue ribbon Main Street Program, and the year-long community celebration!

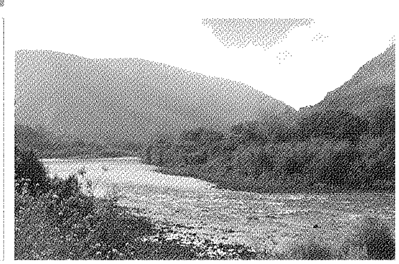
★ *Emmaus*



LEHIGH VALLEY'S ADJACENT NORTHERN REGION

From Leadership Carbon in Lehighton to Miners Memorial near Lansford, plus the West End Fair in Kresgeville, East Penn Bank recognizes the achievements of our community volunteers who make a difference every day. We proudly partner with the Lehigh Gap Nature Center, where the Center's initiatives to restore natural habitats and educate children and parents about the environment are critical to our shared future.

★ *Palmerton*



MONTGOMERY COUNTY

Montgomery County remains the heart of our nine-county footprint, and throughout, we champion initiatives to make our towns better places to live and work. Enjoy the fireworks during Horsham Days as thousands of our neighbors do each year! Limerick Community Days, Oktoberfest in Skippack and the Schuylkill River Heritage Festival are part of the culture of our region, and we're proud to help make these possible. We recognize the vision and leadership of the Willow Grove Chamber, and the many businesses across our footprint. Our stewardship extends to the Perkiomen Watershed Conservancy and the great work they do to preserve the environment for future generations.

★ *Willow Grove*

Corporate INFORMATION

FOR MORE INFORMATION ABOUT OUR SERVICES Visit us at www.harleysvillebank.com and www.eastpennbank.com, or call us at 1-888-462-2100. Millennium Wealth Management can be reached at www.millenniumwealth.com or by phone at 1-888-611-7400. Visit the Cornerstone Companies at www.cornerstone-companies.com or call 1-800-553-3232.

Copies of the Corporation's Annual Report to the Securities and Exchange Commission (Form 10-K) are available online at www.hncbank.com, or by contacting Liz Chemnitz, Senior Vice President and Assistant Corporate Secretary, Manager, Shareholder Services, 483 Main Street, P.O. Box 195, Harleysville, PA 19438.

A SPECIAL MESSAGE

It is with sincere appreciation that we thank:

William "Bill" Yocum & Walter R. Bateman, II

who together have more than 30 years of dedication and service to the Harleysville National Corporation Board of Directors. Their commitment to preserving the reputation of the bank, community involvement and customer satisfaction through service and honesty has provided a foundation of which we are very proud. They remain supportive of the company even after retirement and we value their support.

Their service and "roll-up-your-sleeves" attitude for the good of Harleysville National Corporation are something that will remain with us. We extend to them our sincere thanks and best wishes as they embark on their future endeavors.

HARLEYSVILLE NATIONAL CORPORATION BOARD OF DIRECTORS

AS OF DECEMBER 31, 2008

Walter E. Daller, Jr., *Chairman*
Retired President and Chief Executive Officer
Harleysville National Corporation

LeeAnn B. Bergey, Chief Executive Officer
BTG Holdings, LLC

Michael L. Browne, President, Chief Executive Officer and Director, Harleysville Mutual and Harleysville Group, Inc.

John J. Cunningham, III, Vice Chairman
Cozen O'Connor

Paul D. Geraghty, President and Chief Executive Officer, Harleysville National Corporation

Harold A. Herr, Partner
Albert S. Herr & Sons

Thomas C. Leamer, Retired President
Delaware Valley College

James E. McErlane, Attorney and Principal, Lamb McErlane

Stephanie S. Mitchell, Secretary, Director, R.C. Smith Industries, Inc. and Secretary/Treasurer, Director, Cole Candy & Tobacco Company, Inc.

A. Ross Myers, Chief Executive Officer
American Infrastructure

Brent L. Peters, President of East Penn Bank, a division of Harleysville National Bank and Executive Vice President and Chief Administrative Officer, Harleysville National Corporation and Harleysville National Bank

Demetra M. Takes, President and Chief Executive Officer, Harleysville National Bank, Executive Vice President, Harleysville National Corporation

James A. Wimmer, Attorney-at-Law
Philip & Wimmer

William M. Yocum*
President
W.M. Yocum Machine Company

**Director Emeritus*

EXECUTIVE OFFICERS OF HARLEYSVILLE NATIONAL CORPORATION

AS OF DECEMBER 31, 2008

Paul D. Geraghty, President and Chief Executive Officer

Donna M. Coughey, Executive Vice President

Brent L. Peters, Executive Vice President and Chief Administrative Officer, President of East Penn Bank, a division of Harleysville National Bank

George S. Rapp, CPA, Executive Vice President and Chief Financial Officer

Demetra M. Takes, Executive Vice President and President and Chief Executive Officer, Harleysville National Bank

NASDAQ MARKET MAKERS

As of December 31, 2008, the following firms made a market in the Corporation's common stock: Boenning & Scattergood Inc., UBS Securities LLC, Morgan Stanley & Co., Inc., Goldman Sachs & Co.

ANNUAL MEETING

The 2009 Annual Meeting of Shareholders of Harleysville National Corporation will be held at Presidential Caterers, Norristown, PA, at 9:30 a.m., Tuesday, April 28, 2009.

STOCK LISTING

Harleysville National Corporation common stock is traded under the symbol HNBC. The stock is commonly quoted on the NASDAQ Global Select Market®. At the close of business on December 31, 2008, there were 4,080 shareholders of record.

REGISTRAR/TRANSFER AGENT

American Stock Transfer & Trust Company, www.amstock.com, 59 Maiden Lane, New York, NY 10038, 1-800-937-5449.

DIVIDEND REINVESTMENT PLAN

The Corporation has a Dividend Reinvestment and Stock Purchase Plan. Interested shareholders can obtain more information or register for this service by contacting American Stock Transfer & Trust Company.

DIVIDEND DIRECT DEPOSIT

Shareholders not participating in the Dividend Reinvestment Plan may opt to have their dividends deposited directly into their checking or savings account. To register, contact American Stock Transfer & Trust Company.

AUDITORS

Grant Thornton LLP, Two Commerce Square, 2001 Market St., Suite 3100, Philadelphia, PA 19103, 215-561-4200.

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PEOPLE | PERFORMANCE | PERSPECTIVE

Harleysville
NATIONAL CORPORATION

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON APRIL 28, 2009

Dear Harleysville National Shareholder:

On Tuesday, April 28, 2009, Harleysville National Corporation will hold its Annual Meeting of Shareholders at Presidential Caterers, 2910 DeKalb Pike, Norristown, Pennsylvania. The meeting will begin at 9:30 a.m.

Only shareholders who owned stock at the close of business on March 10, 2009 can attend and vote at the meeting or any postponement or adjournment. At the meeting, we will:

1. Elect three Class C Directors: Michael L. Browne, Paul D. Geraghty, and James A. Wimmer;
2. Consider a proposal to amend Article 5 of Harleysville's Articles of Incorporation to increase the number of authorized shares of Harleysville common stock, par value $1.00 per share, from 75,000,000 to 200,000,000;
3. Consider a proposal to ratify the Audit Committee's selection of Harleysville's independent auditors for 2009;
4. Consider a shareholder proposal requesting that the board of directors take action to declassify the terms of the board of directors, if properly presented at the meeting;
5. Consider a shareholder proposal requesting that the board of directors take action to institute a majority voting standard for the election of directors, if properly presented at the meeting; and
6. Attend to other business, if any, properly presented at the Annual Meeting or any adjournment or postponement of the meeting.

Your Board of Directors recommends that you vote <u>FOR</u> the election of directors, <u>FOR</u> the amendment to the Articles of Incorporation, <u>FOR</u> ratification of the auditors selected for 2009, and <u>AGAINST</u> the shareholder proposals if each is properly presented at the meeting.

At the meeting, we will also report on our 2008 business results and other matters of interest to shareholders.

We are enclosing with this proxy statement a copy of our 2008 Annual Report on Form 10-K. The approximate date this proxy statement and card(s) are being mailed is March 24, 2009.

BY ORDER OF THE BOARD OF DIRECTORS,

Walter E. Daller, Jr.

Walter E. Daller, Jr.
Chairman of the Board

March 24, 2009
Harleysville, Pennsylvania

Important Notice Regarding the Availability of Proxy Materials for The Shareholder Meeting to Be Held on April 28, 2009 – You can view the Annual Report and Proxy Statement on the Internet at: <u>http://materials.proxyvote.com/412850</u>

PROXY STATEMENT

Dated and to be mailed March 24, 2009

HARLEYSVILLE NATIONAL CORPORATION
483 MAIN STREET
HARLEYSVILLE, PENNSYLVANIA 19438-0195
(215) 256-8851

ANNUAL MEETING OF SHAREHOLDERS
TO BE HELD ON APRIL 28, 2009

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Proxy Statement

This Proxy Statement is furnished as part of the solicitation of proxies by the Board of Directors of Harleysville National Corporation for use at the Annual Meeting of Shareholders. This Proxy Statement and the related proxy form are being distributed to Shareholders on or about March 24, 2009.

Questions and Answers

What am I voting on?

At our annual meeting, shareholders will act upon the matters outlined in the Notice of Annual Meeting, including the election of directors, amending Harleysville's Articles of Incorporation to increase the number of authorized shares of common stock, ratification of the appointment of our independent registered public accounting firm and 2 shareholder proposals.

How does discretionary authority apply?

If you sign your proxy card and do not make any selections, you give authority to Louis P. Spinelli, Executive Vice President, and Tracie A. Young, Senior Vice President and Internal Audit Director, to vote on the proposals and any other matters that may arise at the annual meeting.

Is my vote confidential?

Yes. Only the inspector, Broadridge, and certain employees have access to your card. All comments remain confidential unless you ask that your name be disclosed.

Who is entitled to vote?

Only our shareholders of record as of the close of business on the record date for the meeting, March 10, 2009, are entitled to vote at the meeting. On the record date, we had 42,982,463 shares of common stock issued and outstanding and no other class of equity securities outstanding. For each issued and outstanding share of common stock you own on the record date, you will be entitled to one vote on each matter to be voted on at the meeting, in person or by proxy. The corporation is currently authorized to issue 75,000,000 shares of common stock, par value $1.00 per share, and 8,000,000 shares of series preferred stock, par value $1.00 per share.

How do I submit my proxy?

After you have carefully read this proxy statement, indicate on your proxy form how you want your shares to be voted. Then sign, date and mail your proxy form in the enclosed prepaid return envelope as soon as possible. Most shareholders can also vote over the Internet at **www.proxyvote.com** or by telephone at **1-800-690-6903**. If Internet or telephone voting is available to you, voting instructions are printed on the proxy card or voting information form you received. Either method of submitting your proxy will enable your shares to be represented and voted at the annual meeting.

Can I change my vote after I return my proxy card?

Yes. If you are a shareholder of record, there are three ways you can change your vote or revoke your proxy after you have sent in your proxy form.

- First, you may send a written notice to the Secretary of Harleysville National Corporation at 483 Main Street, P.O. Box 195, Harleysville, PA 19438-0195, in advance of the meeting stating that you would like to revoke your proxy.
- Second, you may complete and submit a new proxy form or resubmit your instructions via the Internet or telephone, if available, before the annual meeting. Any earlier proxies will be revoked automatically.
- Third, you may attend the annual meeting and vote in person. Any earlier proxy will be revoked. However, attending the annual meeting without voting in person will not revoke your proxy.

Should you have any questions, please call Harleysville National Corporation, Shareholder Services, (800) 423-3955, ext. 62305.

If my shares are held in "street name" by my broker, could my broker automatically vote my shares for me?

Yes. Your broker may vote in his or her discretion on the election of directors and ratification of the appointment of our independent registered public accounting firm if you do not furnish instructions.

Can I attend the meeting and vote my shares in person?

All shareholders are invited to attend the annual meeting. Shareholders of record can vote in person at the annual meeting. If your shares are held in street name, then you are not a shareholder of record and you must ask your broker or other nominee how you can vote at the annual meeting.

What constitutes a quorum?

The presence at the annual meeting, in person or by proxy, of the holders of a majority of votes that all shareholders are entitled to cast on a particular matter will constitute a quorum. Proxies received but marked as abstentions will be included in the calculation of the number of votes considered to be present at the annual meeting.

How does a shareholder communicate with the corporation's Board of Directors?

The Board of Directors does not have a formal process for shareholders to send communications to the Board. Due to the infrequency of shareholder communications to the Board of Directors, the Board does not believe that a formal process is necessary. However, only written communications received by the corporation from shareholders are shared with the full Board no later than the next regularly scheduled Board meeting.

When are the shareholder proposals due for the Year 2010 Annual Meeting?

If a shareholder wants us to include a proposal in our proxy statement for presentation at our 2010 Annual Meeting of shareholders, the proposal must be submitted in writing by Wednesday, November 25, 2009, to the Secretary of Harleysville National Corporation at 483 Main Street, P.O. Box 195, Harleysville, PA 19438-0195.

How does a shareholder nominate a director of Harleysville National Corporation?

Under our by-laws, nominations for director may be made only by the Board of Directors or the Nominating and Corporate Governance Committee of the Board of Directors, or by a shareholder of record entitled to vote. In order for a shareholder to make a nomination, the shareholder must provide a notice with information and materials required by the by-laws to the Secretary of the corporation not less than 45 days prior to the first anniversary of the record date of the preceding year's Annual Meeting. For our Annual Meeting in the year 2010, we must receive this notice on or before January 25, 2010. You can obtain a copy of the full text of the by-law provision and appropriate forms by writing to the Secretary of Harleysville National Corporation at 483 Main Street, P.O. Box 195, Harleysville, PA 19438-0195.

Who is responsible for the solicitation expenses?

Broadridge will assist in the distribution of proxy materials and solicitation of votes. The corporation is responsible for expenses related to distribution of proxy materials and solicitation of votes and will reimburse Broadridge, stockbrokers and other custodians, nominees and fiduciaries for their reasonable out-of-pocket expenses for forwarding proxy and solicitation material to the owners of the corporation's common stock.

Proposal No. 1 - Election of Class C Directors

Nominees for election this year are:

- Michael L. Browne – director since 2008
- Paul D. Geraghty – director since 2007
- James A. Wimmer – director since 2000

Each nominee has consented to serve a 4-year term and until their successors are qualified and elected.

Directors are elected by a plurality of votes cast at the meeting. "Plurality" means that the nominees receiving the largest number of votes cast are elected as directors up to the maximum number of directors to be elected at the meeting. At our meeting, the maximum number of directors to be elected is three.

The by-laws of Harleysville National Corporation provide that the Board of Directors will not have less than 5 members or more than 25 members. The Board of Directors is divided into 4 classes. Each class is elected for a 4-year term. The Board of Directors has authority to fix the number of directors in each class and the authority to change that number at any time. No person may be elected to serve as a director who is not of legal age. No person over 72 may serve as a director. The Board of Directors has fixed the number of Board members at 13, with 4 directors in Class A, and 3 directors in Classes B, C and D. Section 11.1 of the by-laws requires that a majority of the remaining members of the Board of Directors select and appoint directors to fill vacancies, even if the number of remaining members is less than a quorum. Each person who is appointed in this manner serves as a director until the expiration of the term of office of the class of directors to which he or she was appointed.

The Board of Directors recommends a vote **FOR** the election of these Class C Directors.

CORPORATE GOVERNANCE

The corporation operates within a comprehensive plan of corporate governance for the purpose of defining responsibilities, setting high standards of professional and personal conduct and assuring compliance with such responsibilities and standards. In November 2008, the corporation instituted comprehensive corporate governance guidelines. The board of directors believes that it is in the best interests of our company and its shareholders, employees and other constituents to create a framework for corporate governance that enhances the objectives and performance of the corporation and assists the board of directors in the oversight and management of the corporation. The board of directors remains committed to sound corporate governance and oversight as part of its continuing efforts to enhance long-term shareholder value. The board of directors continues to monitor and evaluate corporate governance best practices and will make future recommendations it believes are in your best interests. Information regarding our corporate governance guidelines and committee charters are available on the Corporate Governance page of our website at www.hncbank.com.

As of December 31, 2008, a majority of the members of the corporation's Board of Directors are considered "independent directors" under the listing qualifications rules for companies such as Harleysville, whose shares are traded on The NASDAQ Global Select market; namely, LeeAnn B. Bergey, Michael L. Browne, John J. Cunningham, III, Walter E. Daller, Jr., Harold A. Herr, Thomas C. Leamer, James E. McErlane, Stephanie S. Mitchell, A. Ross Myers and James A. Wimmer. Messrs. Browne and Wimmer are nominees for director at this year's annual meeting and are independent within these standards.

In determining the directors' independence, the board of directors considered loan transactions between the Bank and the directors, their family members and businesses with whom they are associated, contributions made to non-profit organizations with which the directors are associated, and payments made to businesses where the director is an executive officer, partner or controlling shareholder.

The following table includes a description of the categories or types of transactions, relationships or arrangements considered by the board (in addition to those listed above) in reaching its determination that the directors are independent.

Name	Independent	Other Transactions/Relationships/Arrangements
Ms. Bergey	Yes	Contributions to non-profit organizations
Mr. Browne	Yes	Insurance premium payments
Mr. Cunningham	Yes	Legal services
Mr. Daller	Yes	Consulting services
Mr. Herr	Yes	
Dr. Leamer	Yes	
Mr. McErlane	Yes	
Ms. Mitchell	Yes	
Mr. Myers	Yes	
Mr. Wimmer	Yes	

In each case, the board determined that none of the transactions above impaired the independence of the director. For more information regarding related party transactions, please refer to the corporation's disclosures on page 37.

Code of Ethics

We have also adopted a Code of Ethics for directors, officers and employees of the corporation. It is intended to promote honest and ethical conduct, full and accurate reporting and compliance with laws as well as other matters. The Code of Ethics is available on the Corporate Governance page of our website at www.hncbank.com.

Director Information

Three directors will be elected at the Annual Meeting to serve as Class C Directors each to serve for a 4-year term expiring in the year 2013. Former Class B Director, Walter R. Bateman, II, retired from the board on April 22, 2008. The board appointed John C. Cunningham, III as a Class A director, and James E. McErlane as a Class B director as of December 5, 2008, the effective date of the merger of Harleysville and Willow Financial Bancorp, Inc.

Name	*Age*	*Principal Occupation for Past Five Years and Position Held with the Corporation*	*Director of Corporation Since*
Class A Directors to Serve Until 2011			
John J. Cunningham, III	66	Vice Chairman of the law firm of Cozen O'Connor, Philadelphia, Pennsylvania, having previously been either the Managing Partner or Chairman of the Business Law Department of Cozen O'Connor. Mr. Cunningham previously served as a director of Willow Financial Bancorp and Willow Financial Bank and of Chester Valley Bancorp and First Financial Bank from 1998 to 2008; Director of Harleysville and Harleysville National Bank	2008
Harold A. Herr	61	Partner – Albert S. Herr & Sons; Real Estate Development; Director of Harleysville and Harleysville National Bank	1987
Stephanie S. Mitchell	60	Secretary, Director – R. C. Smith Industries, Inc; Secretary/Treasurer, Director – Cole Candy & Tobacco Co., Inc.; Director of Harleysville and Harleysville National Bank; Member of HNB's Western Regional Advisory Board	2002
Brent L. Peters	62	President, East Penn Bank Division of Harleysville National Bank; Executive Vice President, Chief Administrative Officer and Director of Harleysville and Harleysville National Bank; Former President and Chief Executive Officer of East Penn Financial Corporation; Chairman, HNB's Regional Advisory Boards: Northern and East Penn Bank Division	2007
Class B Directors to Serve Until 2012			
LeeAnn B. Bergey	55	Chief Executive Officer – BTG Holdings, LLC; Director of Harleysville and Harleysville National Bank	1999
James E. McErlane	66	Attorney and Principal of the law firm of Lamb McErlane, West Chester, Pennsylvania, since 1971. Interim President of Chester Valley Bancorp and First Financial Bank from June to November 2000. Mr. McErlane previously served as a director of Chester Valley Bancorp and First Financial Bank from 1991 to 2005 and Chairman from 2000 to 2005; and as a director of Willow Financial Bancorp from 2005 to 2008; Director of Harleysville and Harleysville National Bank	2008
Demetra M. Takes	58	President and Chief Executive Officer and Director of Harleysville National Bank; Director of Harleysville. Served as Interim President & Chief Executive Officer of Harleysville from 9/2006 to 7/2007. Member of HNB's Regional Advisory Boards: Western, Northern, and East Penn Bank Division	2005

Director Information (continued)

Name	*Age*	*Principal Occupation for Past Five Years and Position Held with the Corporation*	*Director of Corporation Since*
Class C Directors to Serve Until 2009 (Nominees for Class C Director To Serve Until 2013)			
Michael L. Browne	62	President, Chief Executive Officer and Director, Harleysville Mutual and Harleysville Group, Inc.; Former Chair, International Insurance Practice Group, Reed Smith, LLP. Current directorships: board of governors – Property Casualty Insurers Association of America; board of trustees – the American Institute for CPCU and the Insurance Information Institute of America; board of directors – the Insurance Information Institute, the Property Loss Research Bureau, the Insurance Federation of Pennsylvania, and the World Affairs Council of Philadelphia. Director of Harleysville and Harleysville National Bank	2008
Paul D. Geraghty	55	President, Chief Executive Officer and Director of Harleysville; Executive Vice President and Director of Harleysville National Bank. Executive Vice President, National City Bank	2007
James A. Wimmer	68	Attorney-at-Law – Philip & Wimmer; Director of Harleysville and Harleysville National Bank; Member of HNB's Northern Regional Advisory Board	2000
Class D Directors to Serve Until 2010			
Walter E. Daller, Jr.	69	Chairman of Harleysville and Harleysville National Bank; Member of HNB's Western Regional & Northern Regional Advisory Boards; Retired Chief Executive Officer of Harleysville and Harleysville National Bank; Chairman, President and Chief Executive Officer of Harleysville and Chairman of Harleysville National Bank from 1981 to 2004	1977
Thomas C. Leamer	67	Retired President – Delaware Valley College; Director of Harleysville and Harleysville National Bank	2003
A. Ross Myers	59	Chief Executive Officer, American Infrastructure; Director of Harleysville and Harleysville National Bank	2006

Beneficial Ownership by Directors, Officers and Nominees

The following tables set forth as of March 10, 2009, the voting record date for the Annual Meeting, certain information as to the common stock beneficially owned by (i) each person or entity, including any "group" as that term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, who or which was known to us to be the beneficial owner of more than 5% of the issued and outstanding common stock, (ii) the directors of Harleysville, (iii) certain executive officers of Harleysville; and (iv) all directors and executive officers of Harleysville as a group.

Group Name	*Common Stock Beneficially Owned(1)*	*Percent of Class*
Barclays Global Investors , NA and Barclays Global Fund Advisors 400 Howard Street San Francisco, CA 94105	2,181,921 (2)	5.08 %
Dimensional Fund Advisors LP 1299 Ocean Avenue, 11th Floor Santa Monica, CA 90401	2,270,242 (3)	5.28 %

Name	*Common Stock Beneficially Owned (4)*	*Right to Acquire within 60 days of March 10, 2009 (5)*	*Total*	*Percent of Class*
Directors				
LeeAnn B. Bergey (6)	17,652	37,547	55,199	*
Michael L. Browne (7)	1,000	-0-	1,000	*
John J. Cunningham, III (8)	10,158	21,604	31,762	*
Walter E. Daller, Jr. (9)	537,608	287,753	825,361	1.86 %
Paul D. Geraghty (10)	12,660	-0-	12,660	*
Harold A. Herr (11)	39,648	52,613	92,261	*
Thomas C. Leamer (12)	443	13,651	14,094	*
James E. McErlane (13)	341,821	21,604	363,425	*
Stephanie S. Mitchell (14)	101,833	13,651	115,484	*
A. Ross Myers (15)	2,303	-0-	2,303	*
Brent L. Peters (16)	104,161	-0-	104,161	*
Demetra M. Takes (17)	61,463	20,018	81,481	*
James A. Wimmer (18)	816,412	27,481	843,893	1.90 %
Other Named Executive Officers				
Donna M. Coughey (19)	68,362	15,377	83,739	*
George S. Rapp (20)	713	3,528	4,241	*
All Directors and Executive Officers as a Group (23 persons)	2,141,972	563,867	2,705,839	6.11 % (21)

*Less than one percent (1%) unless otherwise indicated.

(1) Based upon filings made pursuant to the Securities Exchange Act of 1934 and information furnished by the respective entities.

(2) Information obtained from a Schedule 13G, filed February 5, 2009, with the SEC with respect to shares of common stock beneficially owned by Barclays Global Investors, NA and Barclays Global Fund Advisors.

(3) Information obtained from a Schedule 13G, filed February 9, 2009, with the SEC with respect to shares of common stock beneficially owned by Dimensional Fund Advisors LP. The Schedule 13G states that Dimensional has the sole voting and dispositive power as to all of these shares. Dimensional disclaims beneficial ownership of these shares.

(4) Includes shares for which the named person:
- has sole voting and investment power,
- has shared voting and investment power with a spouse.
- This information has been provided by the directors and officers or is based upon Section 16 filings made with the SEC by the directors and officers.

(5) Shares that may be acquired upon the exercise of vested stock options through May 8, 2009.

(6) Class B Director whose term expires in 2012. 16,658 shares held solely by Ms. Bergey and 994 held jointly with her spouse.

(7) Class C Director whose term expires in 2009 and nominee for Class C Director whose term will expire in 2013. Shares held solely by Mr. Browne.

(8) Class A Director whose term expires in 2011. Shares held solely by Mr. Cunningham.

(9) Class D Director whose term expires in 2010. Ownership includes the following:
- 41,329 shares held solely by Mr. Daller's spouse, and
- 73,583 vested stock options held by an Irrevocable Trust for the benefit of Mr. Daller's 3 children.

(10) Class C Director whose term expires in 2009 and nominee for Class C Director whose term will expire in 2013. Shares held solely by Mr. Geraghty.
(11) Class A Director whose term expires in 2011. Shares held solely by Mr. Herr.
(12) Class D Director whose term expires in 2010. Shares held solely by Dr. Leamer.
(13) Class B Director whose term expires in 2012. Ownership includes the following:
- 141,696 shares held jointly with his spouse, and
- 157,113 held in the McErlane Family Trust.

(14) Class A Director whose term expires in 2011. Ownership includes the following:
- 16,100 shares held by Ms. Mitchell's spouse,
- 43,410 shares held by her company, and
- 3,180 shares held by a trust for which Ms. Mitchell acts as Co-Trustee.

(15) Class D Director whose term expires in 2010. Shares held solely by Mr. Myers.
(16) Class A Director whose term expires in 2011. Ownership includes the following:
- 27,374 shares held jointly by Mr. Peters and his spouse; and
- 42,454 shares held solely by Mr. Peters' spouse.

(17) Class B Director whose term expires in 2012.
- Ownership includes 5,542 shares held solely by parent living in Ms. Takes' home.

(18) Class C Director whose term expires in 2009 and nominee for Class C Director whose term will expire in 2013. Ownership includes the following:
- 619,696 shares held solely by Mr. Wimmer's spouse, and
- 15,887 shares held by a trust for which Mr. Wimmer acts as Co-Trustee.

(19) Executive Vice President. Ownership includes the following:
- 41,520 shares held jointly with her spouse;
- 8,824 shares held solely by Ms. Coughey's spouse.

(20) Executive Vice President and Chief Financial Officer. Shares held solely by Mr. Rapp.
(21) The percent of class assumes the exercise of all outstanding options issued to independent directors, employee directors, and officers, and therefore, on a *pro forma* basis, 44,307,187 shares of common stock outstanding.

Meetings and Committees of the Board of Directors

Board Member	*Attended 2008 Annual Meeting*	*Corporate Board*	*Audit*	*Compensation*	*Executive*	*Nominating/ Corporate Governance*
L. B. Bergey	✔	✔	✔		✔	
M. L. Browne (1)		✔	✔			✔
J. J. Cunningham (2)		✔				
W. E. Daller, Jr.	✔	✔			✔	
P. D. Geraghty	✔	✔				
H. A. Herr	✔	✔		✔	✔	
T. C. Leamer	✔	✔	✔			✔
J. E. McErlane (2)		✔				
S. S. Mitchell	✔	✔		✔	✔	
A. R. Myers		✔		✔		✔
B. L. Peters	✔	✔				
D. M. Takes	✔	✔				
J. A. Wimmer	✔	✔	✔		✔	
Meetings Held in 2008		12	10	11	6	6

(1) Appointment effective April 22, 2008
(2) Appointment effective December 5, 2008

- **Audit Committee:**

The Audit Committee held 10 meetings during 2008. All members of the committee are non-executive, independent (as independence is currently defined in Rule 4200(a)(15) of the NASD listing standards and Section 10A of the Securities Exchange Act of 1934, as amended) and possess the required level of financial literacy. Each is free from any relationship that would interfere with the exercise of his or her independent judgment.

Walter R. Bateman, II, until his retirement on April 22, 2008, was the committee's financial expert, as defined by SEC regulations, and chaired the committee. James A. Wimmer succeeded Mr. Bateman as the financial expert and chairperson of the committee. Other members of the committee include independent directors LeeAnn B. Bergey, Michael L. Browne and Thomas C. Leamer.

The Audit Committee operates under a formal charter that governs its duties and conduct. The Audit Committee Charter is available on the Investor Information/Corporate Governance page of our website at www.hncbank.com. Grant Thornton LLP, the corporation's registered public accounting firm, reports directly to the Audit Committee.

The Audit Committee, consistent with the Sarbanes-Oxley Act of 2002 and the rules adopted thereunder, meets with management and the auditors prior to the filing of officers' certifications with the SEC to receive information concerning, among other things, significant deficiencies in the design or operation of internal controls.

The Audit Committee has also adopted a Whistleblower Policy to enable confidential and anonymous reporting to the Audit Committee. The policy is also available on the Corporate Governance page of our website at www.hncbank.com.

- **Compensation Committee:**

The Compensation Committee administers executive compensation programs, policies and practices, and acts in an advisory role on employee compensation. All members of the committee are independent (as independence is currently defined in Rule 4200(a)(15) of the NASD listing standards and Section 10A of the Securities Exchange Act of 1934, as amended). The members are Harold A. Herr, Chairman, Stephanie S. Mitchell and A. Ross Myers. The committee met 11 times during 2008. The Compensation Committee operates under a formal charter that governs its duties and conduct. The Compensation Committee Charter is available on the Corporate Governance page of our website at www.hncbank.com.

At least annually, the Compensation Committee conducts a comprehensive review of the corporation's executive compensation program structure and the specific provisions for each of our highly compensated employees, including the named executive officers. It also conducts a similar review of compensation provisions for positions on the Board of Directors.

The Compensation Committee relies upon an external consultant, Strategic Compensation Planning, Inc., for information about current industry practices and programming trends, and solicits performance information on executives from the Chief Executive Officer. (The committee seeks input from other Board members on the performance of the CEO.)

After reviewing the submissions of its consultant, the CEO and other Directors, the Compensation Committee independently formulates its recommendations on changes to the executive and director compensation program structures and/or the balance among the programs' elements. It also makes recommendations on adjustments to individual executive's compensation, including: salary increases, annual incentive awards, longer-term incentive awards--usually in the form of stock options or restricted stock, special benefit provisions, perquisites and employment arrangements. These recommendations are submitted to the full Board for approval.

During the course of a year, the Compensation Committee continues to consider possible changes to executive and director compensation practices based on changing industry trends and internal corporate circumstances and objectives. It may also review and approve special compensation awards and adjustments for incumbent executives and compensation arrangements for new executives joining the organization.

- **Executive Committee:**

The Executive Committee is authorized to act on behalf of the Board during intervals between meetings of the Board and can quickly respond to time-sensitive business and legal matters when they arise. Members of the Executive Committee are Walter E. Daller, Jr., Chairman, LeeAnn B. Bergey, Harold A. Herr, Stephanie S. Mitchell and James A. Wimmer. The committee met 6 times during 2008.

- **Nominating and Corporate Governance Committee:**

  The Nominating and Corporate Governance Committee assists the Board regarding matters relating to governance, performance, and Board composition. This may include identifying qualified individuals to become Board members, recommending nominees to the Board to fill vacant Board seats, and developing and recommending corporate governance guidelines for the Board. The committee has devised a comprehensive process for considering director candidates recommended by shareholders. Though such nominations have been infrequent, the Board's policy is to give due consideration to any and all candidates. Shareholders may request the job description and prospective nominee form from the Secretary of the corporation.

  The Nominating and Corporate Governance Committee operates under a formal charter that governs its duties and standards of performance. The charter appears on the Corporate Governance page of our website at www.hncbank.com.

  Members of the committee during 2008 included Thomas C. Leamer, Chairman, Michael L. Browne, and A. Ross Myers, each of whom is a non-employee director. All members of the committee are independent (as independence is currently defined in Rule 4200(a)(15) of the NASD listing standards and Section 10A of the Securities Exchange Act of 1934, as amended). The committee met 6 times during 2008.

The members of the Board of Directors of the corporation also serve as the members of the Board of Directors of Harleysville National Bank. During 2008, the corporation held 12 regular Board meetings, the annual meeting, the annual reorganization meeting, and a special meeting concerning the merger with Willow Financial Bancorp, Inc. All of the directors attended at least 75% of the meetings of the Board of Directors of the corporation and of the committees of which they were members.

The corporation has no specific policy requiring directors to attend the Annual Meeting of Shareholders. However, criteria for determining the percentage of all meetings attended by each director include their attendance at the annual meeting. With the exception of Mr. Myers, all active members of the Board of Directors at the time were present at the 2008 Annual Meeting of Shareholders.

Director Compensation

In 2008, each director who was not an employee of the corporation earned or was paid certain fees, including annual retainer fees, committee and/or chairmanship fees, and meeting fees. Directors were not compensated for committee meetings of less than 15 minutes in duration or for committee meetings held prior to, or immediately following a Board meeting. Directors Emeriti are generally not eligible to receive annual retainers, bonuses, stock option awards or sit on committees of the Board. They receive half of the prevailing board fee for each Board meeting attended. Directors who are also salaried officers of Harleysville or Harleysville subsidiaries do not receive any fees for Board or committee meetings. In 2008, Directors of Harleysville received $439,250 in the aggregate. This compensation included the following:

- $1,750 for each Board meeting attended,
- $1,750 for Annual Meeting attendance,
- $600 for each Board committee meeting attended, except for Audit Committee which receives $750,
- an annual retainer of $16,500, and
- an annual retainer of $3,000 to committee chairpersons, except for the chairperson of the Audit Committee who receives $4,500.

For 2009, in light of the current economic environment and levels of company performance, the Board of Directors has decided to reduce its director fees by ten percent (10%) from 2008 levels.

The following table provides information about the compensation of directors during 2008.

Director Compensation Table

Name	*Fees Earned or Paid in Cash ($)*	*Option Awards ($)(1)(2)*	*Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(3)*	*All Other Compensation ($)*	*Total ($)*
LeeAnn B. Bergey	$55,350	-0-	--	--	$ 55,350
Michael L. Browne	$28,225	-0-	--	--	$ 28,225
John J. Cunningham, III	-0-	-0-	$ 54,033 (a)(b)	--	$ 54,033
Walter E. Daller, Jr.	$46,400	-0-	--	$508,843 (4)	$555,243
Harold A. Herr	$56,500	-0-	--	--	$ 56,500
Thomas C. Leamer	$58,200	-0-	--	--	$ 58,200
James E. McErlane	-0-	-0-	$195,635 (a)(b)	--	$195,635
Stephanie S. Mitchell	$54,150 (5)	-0-	--	--	$ 54,150
A. Ross Myers	$47,000	-0-	--	--	$ 47,000
James A. Wimmer	$62,050 (6)	-0-	--	$75,205 (7)	$137,255

(1) No options were awarded to Harleysville non-employee directors during 2008.

(2) At December 31, 2008, each non-employee director held the following amount of outstanding, aggregate stock option awards:

Name	Option Awards (a)	Name	Option Awards (a)
LeeAnn B. Bergey	37,547	Thomas C. Leamer	13,651
Michael L. Browne	-0-	James E. McErlane (b)	21,604
John J. Cunningham, III (b)	21,604	Stephanie S. Mitchell	13,651
Walter E. Daller, Jr. (c)	287,753	A. Ross Myers	-0-
Harold A. Herr	52,613	James A. Wimmer	27,481

a. All outstanding options awarded to non-employee directors, with the exception of Messrs. Cunningham, Daller and McErlane, were annual grants between 1999 and 2006. All grants were made under substantially the same terms, with 100% vesting after 6 months from date of grant and expiration 10 years from date of grant. The grant prices were based on either of the following criteria: (i) the average of the high and low prices of the corporation's common stock on the date of grant; (ii) the closing price of the corporation's common stock on the date of grant; or (iii) the closing price of the corporation's common stock on the last trading day immediately preceding the date of grant.

b. Mr. Cunningham's and Mr. McErlane's options resulted from the conversion of their outstanding Willow Financial Bancorp stock options into Harleysville options on December 5, 2008, the effective date of the merger of Harleysville and Willow Financial Bancorp. Willow stock options and grant prices were converted according to the terms of the merger agreement.

c. With the exception of the January 3, 2006 grant, as awarded to all non-employee directors, Mr. Daller's outstanding option grants were awarded pursuant to his employment with the corporation; all are fully vested and will expire 10 years from their respective dates of grant.

(3) The sum of (i) the aggregate change in the actuarial present value of the director's benefit under all defined benefit and actuarial pension plans from the pension plan measurement date used for financial statement reporting purposes with respect to Harleysville's audited financial statements for 2007 to the pension plan measurement date used for financial statement reporting purposes with respect to Harleysville's audited financial statements for 2008 and (ii) above-market or preferential earnings on non-tax-qualified deferred compensation.

a. As a result of the merger of Harleysville and Willow Financial, Willow's non-qualified retirement plan was assumed by Harleysville. As of December 31, 2008, the vested benefits accrued under the plan, including reimbursement of self-employment taxes under the plan, are $2,179 for each of Messrs. Cunningham and McErlane, with such amounts representing the aggregate payments to be received for a period of 10 years following retirement.

b. Additionally, as of December 31, 2008, Messrs. Cunningham and McErlane had accrued $51,854 and $193,456, respectively, under Willow's deferred compensation plans, as assumed by Harleysville at the time of merger.

(4) Includes $107,000 consulting fees paid under terms of Mr. Daller's consulting contract which became effective upon his retirement as President and CEO of Harleysville and $401,843 annual payout under Supplemental Executive Retirement Benefit Plan, pursuant to Mr. Daller's previous employment.

(5) Includes fees paid in connection with service on the corporation's Western Regional Advisory Board.

(6) Includes fees paid in connection with service on the corporation's Northern Regional Advisory Board.

(7) Mr. Wimmer received payouts under 2 separate deferred compensation plans assumed by Harleysville pursuant to the merger and acquisition of Citizens Bank and Trust Company of Palmerton. During 2007, he received $31,326 payout under the Citizens Bank and Trust Company of Palmerton 1983 Deferred Compensation Plan and $43,879 payout under the Citizens Bank and Trust Company of Palmerton 1987 Deferred Compensation Plan.

1998 Independent Directors' Stock Option Plan, as amended

The corporation maintains a stock option plan to advance the development, growth and financial condition of the corporation and its subsidiaries; and, to secure, retain and motivate non-employee directors. The Plan provides that retiring directors who are appointed to emeritus status may, during their lifetime, have the full term of each respective option to exercise any options that are outstanding as of the date of their retirement.

During 2008, there were no options granted under the plan; 2,500 options were exercised, and 258,564 options remain outstanding under the plan. The plan expired on October 8, 1998. No further options may be awarded under the plan.

East Penn Financial Corporation 1999 Independent Directors Stock Option Plan Converted to Harleysville Stock Options

In connection with the acquisition of East Penn Financial Corporation in 2007, Harleysville assumed all obligations under the East Penn Financial 1999 Independent Directors Stock Option Plan. The change in control accelerated the vesting of all outstanding stock options to 100%. At the effective time of the merger, 28,000 East Penn Independent Directors stock options were converted into 23,548 options to purchase the corporation's common stock according to proration parameters outlined in the merger agreement. During 2008, 2,523 options were exercised, and 21,025 options remain outstanding and exercisable under the plan. No further stock options may be granted under the plan.

Willow Financial Bancorp Stock Options Converted to Harleysville Stock Options

In connection with the acquisition of Willow Financial Bancorp in 2008, Harleysville assumed all obligations under Willow's 1999 and 2002 Stock Option Plans, as well as obligations that remained open under the Willow Grove Bank and Chester Valley stock option plans at the effective time of the merger. The Plans provided option grants to non-employee directors, as well as employees. The change in control accelerated the vesting of all outstanding stock options to 100%. At the effective time of the merger, 761,795 stock options were converted into 556,506 options to purchase the corporation's common stock according to proration parameters outlined in the merger agreement. During 2008, 4,700 options were exercised, 153 were cancelled and 551,653 options remain outstanding and exercisable under the plans. No further stock options may be granted under the plans.

Deferred Compensation Plans for the Directors of Harleysville National Corporation

The corporation maintains deferred compensation plans for its directors; the 1985 Plan and the 1989 Plan. In the past, certain directors elected to defer, with interest, all or part of their compensation for future distribution. Under the terms of the plan, benefits can be paid out to the respective directors over a 10-year period. Should the director die before age 70 or before receiving all of the benefits, the remaining benefit would be paid to his or her beneficiary until age 70 or for ten years, whichever is greater. This plan is an unfunded plan, which is subject to substantial risk of forfeiture, and the director is not deemed vested in the plan, according to the terms of the plan. Currently, Mr. Daller participates in the plans.

Additionally, Mr. Wimmer, as a former director of the former Citizens Bank and Trust Company of Palmerton, Pennsylvania, acquired by Harleysville on April 28, 2000, continues to accrue benefits and receive payouts under 2 separate deferred compensation plans in effect at that time, and as agreed under terms of the Agreement and Plan of Reorganization.

Willow Financial Directors' Non-Qualified Retirement Plan

In connection with the acquisition of Willow Financial Bancorp in 2008, Harleysville assumed obligations under a non-qualified retirement plan adopted in 1998 for the non-employee members of Willow Financial Bank's Board of Directors which was frozen in November 2005. Participating directors became 100% vested in the benefits accrued in such plan on the date the plan was frozen. The retirement plan provides for fixed annual payments at retirement for a period of ten years. As of December 31, 2008, the vested benefits accrued for each of the remaining non-employee directors, including reimbursement of self-employment taxes under the plan, are $2,179 for each of Messrs. Cunningham and McErlane, with such amounts representing the aggregate payments that each director would receive for a period of 10 years following retirement.

Walter E. Daller, Jr. - Supplemental Executive Retirement Plan

Harleysville Management Services maintains a Supplemental Executive Retirement Plan for Walter E. Daller, Jr., Chairman of the Board of Directors of the corporation and the bank. The plan provides for payment to the covered employee of an annual supplemental retirement benefit equal to 70% of his final five year average compensation, reduced by the employer's share of social security, defined benefit pension and available employer's 401(k) matching contribution. There is a lifetime payout in retirement benefits with a minimum payout of 10 years.

Walter E. Daller, Jr. - Consulting Agreement

Mr. Daller's employment agreement ended at the time that he retired from active management as Chief Executive Officer of the corporation on March 31, 2005. Mr. Daller, Chairman of the Board of Directors of the corporation and the bank, entered into a Consulting Agreement and General Release with the corporation and the bank effective April 1, 2005. Pursuant to the Consulting Agreement and under the terms of the Daller Employment Agreement, the corporation paid Mr. Daller a lump sum equal to 1.5 times his "Agreed Compensation," as defined in the Daller Employment Agreement, on the date of his retirement.

Among the terms of the Consulting Agreement: (1) Mr. Daller agreed to a general release to the corporation and the bank from any potential claims he could assert pursuant to his employment or his employment agreement, dated October 26, 1998, entered into by and among Mr. Daller, the corporation and the bank; (2) Mr. Daller will continue to serve as Chairman of the Board of Directors of the corporation and the bank; (3) from April 1, 2005, through March 31, 2008, Mr. Daller will provide consulting advice to the corporation and bank; (4) the term of the agreement will automatically extend for one additional year at the end of the initial three years and on every anniversary of the Consulting Agreement, unless notice to terminate is given 180 days prior to renewal; (5) Mr. Daller will receive $107,000 per year; (6) Mr. Daller will receive continuation of all life, disability, medical insurance and other normal health and welfare benefits for a period of 5 years after the date of retirement; and (7) Mr. Daller will receive dues and other expenses for membership at a country club. Upon retirement, he received an automobile, and continues to receive office space and reimbursement of certain business expenses. The Consulting Agreement contains a restrictive covenant precluding Mr. Daller from engaging in competitive activities in a certain area and a provision preventing Mr. Daller from disclosing proprietary information about the corporation.

EXECUTIVE OFFICERS

The following table provides information, as of March 10, 2009, about the corporation's executive officers.

Name	*Age*	*Years in Position*	*Principal Occupation for the Past Five Years and Position Held with Harleysville and Subsidiaries*
Donna M. Coughey	58	2008 – present	Executive Vice President, Harleysville and Harleysville National Bank
		2005– 2008	President and Chief Executive Officer, Willow Financial Bancorp and Willow Financial Bank
		2000 – 2005	President and Chief Executive Officer, Chester Valley Bancorp Inc. and First Financial Bank
Paul D. Geraghty	55	2007 – present	President and Chief Executive Officer and Director, Harleysville, Executive Vice President and Director, Harleysville National Bank
		2004 – 2007	Executive Vice President, National City Corporation
		1999 – 2004	Executive Vice President, National City Bank
Brent L. Peters	62	2008 – present	Executive Vice President, Chief Administrative Officer and Director, Harleysville and Harleysville National Bank
		2007 – present	Executive Vice President and Director, Harleysville and Harleysville National Bank
		2007 – present	President, East Penn Bank Division of Harleysville National Bank
		2003 – 2007	President and Chief Executive Officer, East Penn Financial Corporation
		1991 – 2007	President and Chief Executive Officer, East Penn Bank
George S. Rapp	56	2006 – present	Executive Vice President and Chief Financial Officer, Harleysville and Harleysville National Bank
		2005 – 2006	Senior Vice President, Chief Financial Officer and Treasurer, Harleysville and Harleysville National Bank
		2004 – 2005	Executive Vice President, Chief Financial Officer, Astea International
Demetra M. Takes	58	2005 – present	Executive Vice President and Director, Harleysville and Harleysville National Bank
		9/26/06 – 7/23/07	Interim President and Chief Executive Officer, Harleysville
		2000 – present	President and Chief Executive Officer, Harleysville National Bank

EQUITY COMPENSATION PLANS

1993 Stock Incentive Plan

The corporation maintains the 1993 Stock Incentive Plan. The plan's purpose is to advance the development, growth and financial condition of the corporation. The plan provides that shares of our common stock be issued to certain employees of the corporation and banking subsidiaries.

A disinterested committee of the corporation's Board of Directors administers the plan. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock as the disinterested committee deems appropriate. No stock options remain available for grant under the 1993 Stock Incentive Plan. During 2008, 13,226 options were exercised, and 7,855 options remain outstanding under the plan. No further options may be awarded under the plan.

1998 Stock Incentive Plan

The corporation maintains the 1998 Stock Incentive Plan. The plan's purpose is to advance the development, growth and financial condition of the corporation. The plan provides that shares of our common stock be issued to certain employees of the corporation and banking subsidiaries.

A disinterested committee of the corporation's Board of Directors administers the plan. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock as the disinterested committee deems appropriate. No stock options were granted during 2008. The plan expired on October 8, 2008; therefore, no future options may be awarded under the plan. A total of 136,660 stock options were exercised, 69,223 were cancelled and 561,377 option awards remain outstanding under this plan.

2004 Omnibus Stock Incentive Plan, as amended

The corporation maintains the 2004 Omnibus Stock Incentive Plan. The plan's purpose is to advance the development, growth and financial condition of the corporation. The plan provides that shares of our common stock be issued to certain employees and/or directors of the corporation and banking subsidiaries.

A disinterested committee of the corporation's Board of Directors administers the plan. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock as the disinterested committee deems appropriate.

During 2008, 210,082 options were granted under the 2004 Omnibus Stock Incentive Plan. There were no options exercised during 2008, however 825 were cancelled. 247,157 stock option awards were outstanding and 910,468 stock options remain available for grant under this plan.

Millennium Bank Stock Compensation Program Converted to Harleysville Stock Options

In connection with the acquisition of Millennium Bank in 2004, Harleysville assumed all obligations under the Millennium Bank Stock Compensation Program. The change in control accelerated the vesting of all outstanding stock options to 100%. Upon consummation of the merger, outstanding stock options were converted according to proration parameters outlined in the merger agreement. 328,327 stock options were assumed on the effective date of the merger. Since the effective date, 292,118 stock options have been exercised and 36,209 were cancelled. No stock option awards remain outstanding and exercisable under the program. No further stock options may be granted under the program.

Equity Compensation Plans (continued)

East Penn Financial Corporation 1999 Stock Incentive Plan Converted to Harleysville Stock Options

In connection with the acquisition of East Penn Financial Corporation in 2007, Harleysville assumed all obligations under the East Penn Financial 1999 Stock Incentive Plan. The change in control accelerated the vesting of all outstanding stock options to 100%. On the effective date of the merger, 2,300 East Penn stock options were converted into 1,932 options to acquire the corporation's common stock according to proration parameters outlined in the merger agreement. During 2008, 840 options were exercised and 1,092 options remain outstanding and exercisable under the plan. No further stock options may be granted under the plan.

Willow Financial Bancorp Stock Options Converted to Harleysville Stock Options

In connection with the acquisition of Willow Financial Bancorp in 2008, Harleysville assumed all obligations under Willow's 1999 and 2002 Stock Option Plans, as well as obligations that remained open under the Willow Grove Bank and Chester Valley stock option plans at the effective time of the merger. The Plans provided option grants to non-employee directors, as well as employees. The change in control accelerated the vesting of all outstanding stock options to 100%. At the effective time of the merger, 761,795 stock options were converted into 556,506 options to purchase the corporation's common stock according to proration parameters outlined in the merger agreement. During 2008, 4,700 options were exercised, 153 were cancelled and 551,653 options remain outstanding and exercisable under the plan. No further stock options may be granted under the plans.

Willow Financial Bank Amended and Restated 2005 Executive Deferred Compensation Plan

Formerly the First Financial Bank 2005 Deferred Compensation Plan, the plan was frozen to new participants and deferrals as of August 31, 2005, and there is no change in control provision in the plan. Deferrals into the plan are invested in company stock and mutual funds. Subsequent to the acquisition of Willow by Harleysville, the accounts of active participants will continue and terminated participants will receive payouts per their original election beginning in July 2009.

First Financial Bank 2003 Executive Deferred Compensation Plan

This plan was frozen to new participants and deferrals as of August 31, 2005. There is no change in control provision in the plan. Deferrals into the plan are invested in company stock and mutual funds. The plan provides a guaranteed rate of return equal to the average 3 month LIBOR rate for the year plus 3.6%. Subsequent to the acquisition, the accounts of active participants will continue and terminated participants began receiving payouts per their original election beginning in December 2008.

Harleysville National Corporation Stock Bonus Plan

The corporation maintains the Harleysville National Corporation Stock Bonus Plan to recognize employees who have:

- a strong interest in the successful operation of the business;
- loyalty to the corporation and banking subsidiaries; and
- visible evidence of increased efficiency.

The Stock Bonus Plan is administered by the Compensation Committee of the corporation. The committee annually determines, in its sole discretion, the amount of shares the corporation awards.

The corporation awarded 129 shares on April 1, 2008, to certain employees for exemplary service throughout 2007. As of December 31, 2008, a total of 22,695 shares remain available for awards under the plan.

COMPENSATION DISCUSSION AND ANALYSIS

Compensation Philosophy and Program Objectives

Our compensation program balances the need for competitive pay opportunities at the executive level with shareholders' expectations for reasonable return on their investment. The Compensation Committee believes that the compensation program for executives should directly support the achievement of strategic goals of the business and, thereby, align the interests of executives with the interests of the corporation's shareholders. The executives must contribute as a member of a team to the corporation's success rather than focusing upon specific goals within that executive's specific area of responsibility. The current program is intended to provide sufficient levels of fixed income, in the forms of base salary and benefits, and to attract high caliber executive talent to the organization. It also is intended to provide incentive opportunities to encourage specific performance and to reward the successful efforts of executives.

Program Management

The Compensation Committee has primary responsibility for the design and administration of the executive compensation program. It reviews the program throughout the year in light of changing organizational needs, operating conditions, changing trends in industry practice, and the general economic and business environment.

The committee currently consists of three (3) directors, all of whom qualify as independent members of the Board: Harold A. Herr, Chairperson of the Committee, Stephanie S. Mitchell and A. Ross Myers.

Role of Executive Management in the Pay Decision Process

The Compensation Committee regularly seeks information about the performance levels of executives from the Chief Executive Officer. The Compensation Committee also seeks recommendations regarding salaries, performance targets and bonus awards for other executives as well as updates on industry trends from the Chief Executive Officer. The Compensation Committee considers the information provided carefully, especially the recommendations of the Chief Executive Officer on decisions affecting subordinate executives, in conjunction with the information provided by the independent compensation consultant. Although the Chief Executive Officer and compensation consultant make recommendations, the Compensation Committee ultimately decides upon its recommendations for executive compensation independently. The performance of the Chief Executive Officer is reviewed and appraised by the Compensation Committee in the Chief Executive Officer's absence.

Role of Compensation Consultant

In evaluating program effectiveness, the Compensation Committee chose and engaged the services of an outside consultant, Strategic Compensation Planning, Inc. The Compensation Committee assigned the consultant the task of reviewing survey reports on the compensation practice within the corporation's industry group, focusing on pay levels and practices among a selected group of community banking and diversified financial services institutions based in the Mid-Atlantic Region and Northeast Region and having between $3.0 billion and $7.0 billion of assets, a grouping more consistent with Harleysville's circumstances following the acquisition of Willow Financial. The peer organizations are identified below in Benchmarking: The Basis for Defining Competitive Compensation Levels and Practices. The consultant's analysis and assessment relied heavily upon compensation program and practice information obtained from the target organizations' proxy statements. The review covered all aspects of executive compensation programming: base salary levels, annual, intermediate and long-term incentive practices, as well as use of special benefits and perquisites and employment arrangements of the selected peer group and the corporation.

Generally, the consultant found that the corporation's executive compensation program structure was sound but that base salary levels for some of Harleysville's executive positions and its use of longer-term incentives in the total rewards strategy were lagging the practices of the selected peer group.

Benchmarking: The Basis for Defining Competitive Compensation Levels and Practices

For the 2009 program planning review, the outside consultant reviewed executive compensation information from the following institutions in Delaware, New Jersey, New York, Ohio and Pennsylvania:

Community Bank System, Inc.	Investors Bancorp	S&T Bancorp, Inc.
Dime Community Bancshares	National Penn Bancshares	Signature Bank
First Commonwealth Financial	NBT Bancorp, Inc.	Sun Bancorp, Inc.
First Financial Bancorp	Northwest Bancorp, Inc.	Trustco Bank Corp.
First Place Financial Corp.	Park National Corp.	WSFS Financial Corp.
F.N.B. Corp.	Provident Financial Services	

These institutions were chosen because of their similarities in size, geography, and markets served to the corporation. The results of the consultant's review were submitted to the Compensation Committee for its consideration in assessing the corporation's program structure and practices.

Program Review and Pay Decision Process

In December 2008, the merger between Harleysville National Corporation and Willow Financial Corporation was completed. Beginning in 2008, the Compensation Committee began a comprehensive review of the corporation's program structures and provisions as well as those implemented at Willow Financial Corporation prior to the merger. The Compensation Committee intends to continue the review of the program structures to determine which plans best further the objectives of the corporation and the corporation's overall pay philosophy.

In the fall of 2008, the Compensation Committee received information regarding the current executive compensation levels from the Chief Executive Officer and the outside consultant. Using this information, the Compensation Committee examined the current compensation and benefit levels of the named executive officers in light of their changing roles in the business, the assessments of their individual performances, industry practice trends, current economic situation, the effectiveness of the executive officers as a team and the corporation's overall performance. In 2008, the Compensation Committee began the use of tally sheets, as further discussed in tally sheets below.

At the conclusion of the process, the Compensation Committee establishes individual and executive compensation proposals and recommendations for the Board of Directors. The recommendations are presented to the full Board of Directors for consideration, usually in January of the new calendar year. As incentive awards for the year ending are calculated, the Compensation Committee works with the Chief Executive Officer to construct executive performance plans for the next calendar year (the new fiscal year) using the previous year's incentive goals as the basis for the following year's incentive goals adjusted accordingly.

The Compensation Committee is called upon to consider pay related decisions throughout the calendar year as executives are reassigned or promoted and new executives join the organization. In these instances, the Compensation Committee will review all aspects of the executive's compensation including base salary level, annual incentive opportunities, longer-term incentive awards, participation in special benefit plans, and employment contract provisions, if applicable.

Tally Sheets

In October 2008, when reviewing executive compensation in anticipation of determining executive compensation for 2009, the Compensation Committee reviewed tally sheets for each named executive officer prepared by the compensation consultant. The tally sheets contained information regarding base salaries, guaranteed bonuses, current outstanding option grants, and payments upon termination. The tally sheets also showed:

1. Executives did not receive any or received very modest salary increases over the past two years (2007-2008).
2. Executives had not received any performance incentive awards for 2007.
3. Executives had not received any equity grants, other than time of hire commitments, over the preceding two years (2007-2008).

Although the tally sheets did not drive specific executive compensation decisions, the Compensation Committee used the information to understand the total compensation being awarded to each named executive officer.

Program Components

There are six (6) elements in the current executive compensation program:

Base Salary

Prior to the completion of the merger with Willow Financial Corporation, base salary opportunities were set at the median level of industry practice for comparable jobs in similar community banking and financial service organizations. Due to the increase in size of the corporation and the additional responsibilities associated with this increase, the Compensation Committee continues to believe that the median level for base salaries for executives at financial institutions of similar size is appropriate. The Committee reviewed the median benchmarks for comparable positions from the selected peer group, referenced under Benchmarking above, as one of the factors in determining salary for individual and executive compensation. The Compensation Committee also took into consideration the future job duties and responsibilities of the executive, the executive's past performance against organizational expectations, industry trends, and the specific amount of the increase in base salary necessary to take the executive to the new median level.

Discretionary Bonus

The Compensation Committee retains the authority to recommend to the Board of Directors that named executive officers, executives, or all employees receive a discretionary bonus. The Compensation Committee bases its recommendation upon employee performance in general, employee performance relative to the management team, as well as their individual business judgment.

The Compensation Committee generally believes that the reward opportunity for executives should match the performance expectations of the corporation. Top performance warrants top level rewards. Given the current economic conditions and the attendant affect upon the corporation, the Compensation Committee believes that the named executive officers should not be penalized for that over which they have no control and that they should be rewarded for exceptional performance when appropriate. The Compensation Committee is aware that the named executive officers may have worked harder this year than any in the recent past; however, the results of this hard work may not yet appear on the income statement and balance sheet of the corporation. As such, the Compensation Committee recommended discretionary bonuses of 4.2% of salary for those named executive officers who the Compensation Committee believes exhibited commendable 2008 individual performance and contributions to the team as documented in a list of accomplishments provided for and validated by the Compensation Committee.

Benefits

Executives participate in the corporation's qualified health & welfare and pension (401(k) plan) benefits program on the same terms and conditions as all other employees of the corporation. Health & welfare benefit programs and pension benefit programs are expected by all employees and are the minimum of which must be offered to attract most employees. Because benefit plans are standard throughout most industries, the costs of providing such plans are not taken into consideration in determining the other components of executive compensation.

Annual Performance Incentives

The annual performance incentive award plan provides participating executives with opportunities to earn additional cash compensation in a given year when corporate and business unit operating results and individual performance contributions meet or exceed established thresholds of acceptable achievement. We believe that by providing this incentive, we are creating long-term shareholder value.

For the year 2008, the Compensation Committee approved the following target bonuses for the named executive officers:

Named Executive Officer	*Target Bonus Percent of Base Salary*
Paul D. Geraghty	60%
Demetra M. Takes	50%
Michael B. High	45%
George S. Rapp	35%
Brent L. Peters	50%

For 2008, each executive's annual incentive opportunity was based on attainment of a corporate performance objective, ROE. For 2008, the threshold percentage was 9.75% with the target being 10.5%. As the corporation did not meet these objectives, no bonus was paid under this portion of the annual performance incentive award plan.

Equity Grant Plans

Currently, the corporation has a 1993 Stock Incentive Plan, 1998 Stock Incentive Plan, a 2004 Omnibus Stock Incentive Plan and a Stock Bonus Plan. For more information on the specific details of each Equity Incentive Plan, see Equity Compensation Plan Information.

The Compensation Committee recommends to the Board and the Board authorizes the awarding of stock options and/or restricted stock to executives and certain employees. The equity grant plans are established to focus the executive's efforts on the strategic directions and goals of the business and to reward them for their successes in these areas even though the successes may not be readily apparent. These awards are designed to provide incentives for long-term positive performance by the executives and to align their financial interests with those of our stockholders by providing the opportunity to participate in any appreciation in the stock price of our common stock which may occur after the date of grant of stock options.

There is a service time vesting schedule associated with all options which encourages the executive to remain with the corporation. The options, if not exercised, are forfeited upon being terminated for cause; therefore, we do not reward an executive whose conduct has risen to the level of being terminated for cause. Stock option grants were awarded in December 2008 to named executive officers. These options contained a three-year graded vesting feature with a seven-year life, as opposed to the typical 10-year life. The shortened life of the awards requires the executives to produce target results more quickly in order to realize an increase in stock prices.

Continuing studies of longer-term incentive award practices provided to the Compensation Committee by the compensation consultant suggest that the corporation should shift its award practice from use of time vested stock options to performance-based restricted stock grants. The Compensation Committee believes that the use of restricted stock will be perceived positively by executives and will allow them to achieve tangible recognition for achievements within their direct control. Where restricted stock is granted to executives, the corporation typically will use performance based vesting requirements, i.e. the corporation or the individual must achieve certain results in order for the grant to vest, which requirements have not yet been determined. Failure to achieve stated vested requirements within expected time frames will result in loss (forfeiture) of the grant. No restricted stock was awarded in 2008.

After beginning its consideration and review in 2007, the Compensation Committee is initiating a three-year performance plan, which is associated with the 2004 Omnibus Plan, for a number of executives, including the named executive officers, in early 2009. The plan provides an opportunity for participants to earn corporation common stock, but only if executives are successful in producing a return on equity in line with Board expectations. The combination of the increase in the size of annual incentive opportunities and a performance-based restricted stock plan will maintain a healthy, results-based total rewards program for executives.

The timing of restricted stock or option grants is not tied to the release of negative or positive material information about the corporation. Past recommendations are not made on a set or regular schedule, and the corporation does not have a policy of making awards on a set or regular schedule or at specific times a year. In 2009, the corporation intends to establish a policy regarding executive ownership of corporation stock and/or retention guidelines applicable to equity awards to executives.

Nonqualified Benefits and Perquisites

Some named executive officers participate in a nonqualified retirement income benefit plan that supplements benefits from the corporation's qualified pension and 401(k) plans for all employees. The supplemental plan is designed to make-up benefits lost under the qualified plans because of the Federal restrictions on pension plans and is used to encourage longevity with executives. In some instances, the benefit is vested over service time or by agreement, but for most executives today, the benefit is contingent on active employment with the corporation at the time of retirement.

Named executive officers are provided with a car allowance and Messrs. Geraghty and Peters, as well as Ms. Takes are provided company vehicles. Provision of a company vehicle and for car allowance is standard in the financial services industry as the named executive officers frequently meet clients and business associates offsite.

Employment Contracts and Change of Control Agreements

In line with current banking industry norms, and as most top banking executives require an employment contract as a condition of employment, our top executives are employed under formal contracts which define their roles in the business and the terms and conditions under which they are compensated during and after employment with the corporation. The Compensation Committee only awards contracts when it determines that it is desirable for the corporation to obtain a measure of assurance as to the executive's continued employment in light of prevailing market competition and in light of past practices of the corporation with respect to similarly situated employees.

The contracts are designed to compensate the executive if the executive is terminated without cause, is terminated after a change of control, or terminates employment for good reason. The contracts give the executive the security of knowing that if he or she is terminated in one of those scenarios that the executive will receive some form of compensation during the transition phase from working for the corporation to finding another position. In addition, the contracts contain a noncompetition provision, whereby the executive is not allowed to compete with the corporation or solicit customers of the corporation for a specific period of time. Frequently, the time period in which the executive receives compensation is the same time period that the noncompetition provision is in effect.

The contracts contain change of control provisions whereby the executive is compensated upon a termination after a change of control in order to ensure that decisions regarding potential change of controls are made in the best interests of the shareholders and that personal concerns regarding subsequent employment are minimized.

Tax Gross-up Provision. None of the named executive officers have a tax gross-up provision in their respective employment contracts. In the event that severance payments exceed the deduction limits under IRS Code Section 4999, the company may reduce the payments to the executive by an amount necessary to avoid the excise tax.

Difference in Compensation among the Named Executive Officers

The named executive officers receive base salaries commensurate with their positions and responsibilities and with the executive's past performance.

Generally, the employment contracts entered into between the corporation and the top executives are similar in form to each other in an effort to be consistent and fair among the top executives with the differences among the amount of compensation being attributed to the differences among the responsibilities of the positions or negotiations between the parties at the time of hire.

However, the employment contract entered into between the corporation and the Chief Executive Officer of the corporation is somewhat different from the others to reflect his past experience and to incorporate specific incentives offered to him through his contract negotiations. The Chief Executive Officer received stock options upon the signing of his agreement which will vest upon the stock price of the corporation reaching a particular price over a period of thirty (30) consecutive days. This benefit awarded to the Chief Executive Officer will encourage him to perform in such a manner that will benefit the shareholders as his interests are now aligned with theirs.

Furthermore, the structure of Chief Executive Officer's payments upon a change of control differ from the other named executive officers in that the payment is structured to give the Chief Executive Officer two times his base salary if the change of control occurs prior to the second anniversary of his agreement and two times his base salary plus highest bonus if the change of control occurs after the second anniversary of his agreement. The Chief Executive Officer is in the position to most directly influence whether or not a change of control occurs. Therefore, it was incumbent upon the Compensation Committee to structure the arrangement such that the Chief Executive Officer's fears of being terminated upon a change of control were balanced with the Compensation Committee's desire not to give him an incentive to effectuate a change of control if it was not in the best interests of the corporation.

The differences in the Supplemental Executive Retirement Plan payments available to the named executive officers upon retirement age vary depending upon the executive's monthly compensation and the time of the vesting of benefits may differ based upon the negotiation between the parties.

While most of the differences in the employment agreements are a result of the time of hire or promotion, the Compensation Committee is concerned that some may detract from the corporation's goal of providing internally equitable compensation for all of its executives. It continues to review the employment agreements and will strive for greater consistency as current contracts reach their renewal dates and contracts are initiated with new hires.

Recent Actions: First Quarter 2009

The Chief Executive Officer was awarded an increase in salary by the Board of Directors due to Mr. Geraghty's 2008 performance which included the successful closing and integration of the Willow acquisition. Mr. Geraghty declined the increase for purposes of current remuneration because of the corporation's continuing effort to contain and reduce costs.

No merit increases in base salary will be given to the named executives. However, the chief financial officer will receive a market adjustment to position his salary more competitively, especially in light of the corporation's increased size and the increased responsibilities associated therewith.

Status of the Program and Likely Practices Going Forward

The Compensation Committee will continue to monitor practice changes and trends in the financial services and community banking industries throughout the year and will conduct a comprehensive assessment of the corporation again in the Fall of 2009 and may recommend changes during 2009, as appropriate.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management, and based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in the Proxy Statement.

COMPENSATION COMMITTEE
Harold A. Herr, Chairman
Stephanie S. Mitchell
A. Ross Myers

Compensation Committee Interlocks and Insider Participation

During 2008, no current or former officer or employee of the corporation or of any of its banking subsidiaries served on the Compensation Committee. In addition, none of the members of the committee had any relationship with the corporation or any of its subsidiaries that would require disclosure under Item 404 of the Securities and Exchange Commission's Regulation S-K relating to insider transactions and indebtedness of management.

EXECUTIVE COMPENSATION

The following table shows compensation to the current Chief Executive Officer, the Chief Financial Officer, the other two most highly compensated executive officers who were serving as executive officers at the end of 2008 and whose total annual compensation exceeded $100,000 in 2008, and one additional individual, Michael B. High, who would have been among the three other highest paid executive officers had he been serving as an executive officer at December 31, 2008. These were our "named executive officers" for 2008.

Summary Compensation Table

Name & Principal Position	Year	*Salary* $	*Bonus (1)* $	*Option Awards* $	*Change in Pension Value and Non-qualified Deferred Compensation Earnings* $	*All Other Compensation (7)* $	*Total Compensation* $
Paul D. Geraghty	2008	$375,000	$15,750	$50,348 (2a,b)	$153,549	$ 15,075	$609,722
President & CEO	2007	$154,327	$0	$21,212 (2b)	$0	$ 670	$176,209
	2006	n/a	n/a	n/a	n/a	n/a	n/a
George S. Rapp	2008	$187,250	$ 7,865	$ 7,081 (3a,b)	$0	$ 54,184	$256,380
Executive Vice President &	2007	$187,250	$0	$ 6,437 (3b)	$ 24,549	$ 10,703	$228,939
CFO	2006	$171,192	$40,444	$ 7,719 (3b)	$ 17,289	$ 9,017	$245,661
Demetra M. Takes	2008	$309,960	$13,018	$34,643 (4a,b)	$ 70,878	$494,988	$923,487
President & CEO	2007	$377,460	$0	$33,591 (4b)	$ 170,232	$ 5,516	$586,799
Harleysville National Bank	2006	$295,200	$80,728	$33,404 (4b)	$ 124,986	$ 8,485	$542,803
Brent L. Peters	2008	$296,000	$12,432	$ 1,019 (5)	$ 1,049	$20,322	$330,822
Executive Vice President &	2007	n/a	n/a	n/a	n/a	n/a	n/a
CAO; President, East Penn	2006	n/a	n/a	n/a	n/a	n/a	n/a
Bank Division							
Michael B. High - Former	2008	$279,587	$0	$ 1,421 (6a)	$0	$858,768	$1,139,776
Executive Vice President &	2007	$296,100	$0	$39,426 (6b)	$133,122	$ 10,478	$ 479,126
COO	2006	$282,000	$71,381	$39,132 (6b)	$112,495	$ 14,608	$ 519,616

(1) Cash bonus earned in 2008 was paid in December 2008. No bonuses were paid for services performed in 2007. Cash bonus earned in 2006 was paid in the first quarter of 2007.

(2) Mr. Geraghty's equity compensation awards:

   a. Represents the value of equity compensation recognized in 2008 for options granted 12/17/2008: 50,000 options granted, 7-year term, 3-year vesting, FAS 123(R) value = $3.5387.

   b. Represents the value of equity compensation awarded to Mr. Geraghty in 2007. 25,000 options granted 7/23/2007, special vesting as follows: within 5 years from date of grant, 12,500 options will vest when the corporation's stock price equals or exceeds $20/share for 30 consecutive trading days; and 12,500 will vest when the corporation's stock price equals or exceeds $22.50/share for 30 consecutive days. FAS 123(R) value = $3.08. Refer to 2008 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

(3) Mr. Rapp's equity compensation awards:

   a. Represents the value of equity compensation recognized in 2008 for options granted 12/17/2008: 13,318 options granted, 7-year term, 3-year vesting, FAS 123(R) value = $3.5387.

   b. Represents the value of equity compensation awarded to Mr. Rapp prior to 2008, with service periods extending into 2008, and recognized for financial reporting purposes in each respective year: 2,205 options granted 5/18/2005, 5-year vesting, FAS 123(R) value = $5.2451; and, 3,675 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = $5.6104. Refer to 2008 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

(4) Ms. Takes' equity compensation awards:

   a. Represents the value of equity compensation recognized in 2008 for options granted 12/17/2008: 22,046 options granted, 7-year term, 3-year vesting, FAS 123(R) value = $3.5387.

   b. Represents the value of equity compensation awarded to Ms. Takes prior to 2008, with service periods extending into 2008, and recognized for financial reporting purposes in each respective year: 6,945 options granted 12/30/2003, 5-year vesting, FAS 123(R) value = $7.4941; 8,269 options granted 12/30/2004, 5-year vesting, FAS 123(R) value = $6.7192; and, 10,762 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = $5.6104. Refer to 2008 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

(5) Represents the value of equity compensation recognized in 2008 for options granted to Mr. Peters on 12/17/2008: 21,053 options granted, 7-year term, 3-year vesting, FAS 123(R) value = $3.5387. Refer to 2008 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

(6) Mr. High's equity compensation awards:

a. As a result of Mr. High's termination, 5,820 unvested option awards were forfeited. The value of Mr. High's equity compensation for 2008 has been reduced by $36,350 of previously recognized expense. The 12/31/2008 balance of 4,620 options under this award expired and was forfeited on 2/28/2009. Any adjustment for previously recognized expense for such forfeiture will occur in 2009.

b. Represents the value of equity compensation awarded to Mr. High prior to 2008, with service periods extending into 2008, and recognized for financial reporting purposes in each respective year: 11,576 options granted 2/23/2004, 5-year vesting, FAS 123(R) value = $6.6316; 8,269 options granted 12/30/2004, 5-year vesting, FAS 123(R) value = $6.7192; and, 11,550 options granted 12/8/2005, 5-year vesting, FAS 123(R) value = $5.6104. Refer to 2008 Form 10-K, Item 8, footnote #14 regarding stock-based compensation.

(7) All Other Compensation

Name	***Year***	***Car Allowance (a) ($)***	***Country Club Membership ($)***	***Harleysville's 401(k) Plan Contribution ($)***	***Health Benefits ($)***	***Contract Payouts ($)***
P. Geraghty	2008	$3,575	$0*(b)*	$11,500	--	--
	2007	$ 670	$0*(b)*	--	--	--
	2006	n/a	n/a	n/a	n/a	n/a
G. Rapp	2008	$1,708	--	$ 9,756	--	$42,720 *(e)*
	2007	$5,086	--	$ 5,617	--	--
	2006	$3,881	--	$ 5,136	--	--
D. Takes	2008	--	--	$11,500	--	$483,488 *(f)*
	2007	--	--	$ 5,516	--	--
	2006	--	--	$ 6,600	$1,885 *(c)*	--
B. Peters	2008	--	$8,822	$11,500	--	--
	2007	n/a	n/a	n/a	n/a	n/a
	2006	n/a	n/a	n/a	n/a	n/a
M. High	2008	$4,573	--	$11,500	$30,832 *(d)*	$811,863 *(g)*
	2007	$4,937	--	$ 5,541	--	--
	2006	$3,469	$4,539	$ 6,600	--	--

(a) Taxable benefit calculation of personal use of company provided vehicle or car allowance, if applicable.

(b) While Mr. Geraghty is entitled to country club membership under terms of his employment agreement, he chooses not to accept the provision at this time.

(c) Benefit under Exec-u-care Health Benefit Plan which was discontinued in 2007.

(d) The value of benefits paid to or on behalf of Mr. High includes the value of insurance and a medical plan payment paid directly to COBRA.

(e) Distribution paid to Mr. Rapp as a result of termination of Harleysville's pension plan.

(f) Distribution paid to Ms. Takes as a result of termination of Harleysville's pension plan.

(g) Includes distribution of $87,955 paid to Mr. High during 2008 as a result of termination of Harleysville's pension plan; and Mr. High's payment on termination of employment pursuant to the terms of either employment and/or severance agreements; a salary payment of $14,134 which will be paid bi-weekly for one year; and payout of his accrued benefit under Harleysville's Supplemental Executive Retirement Plan - $356,424.

Grants of Plan-Based Awards

The table below shows equity-based awards granted to named executive officers during the fiscal year ended December 31, 2008 or during 2009 prior to the date of this Proxy Statement.

Grants of Plan-Based Awards Table

Name	*Grant date*	*All other option awards: Number of Securities Underlying options (#)* (1)	*Exercise or Base Price of Option Awards ($/Sh)*	*Grant date fair value of stock and option awards* **(2)**
P. Geraghty	12/17/2008	50,000	$14.06	$176,935
G. Rapp	12/17/2008	13,318	$14.06	$ 47,128
D. Takes	12/17/2008	22,046	$14.06	$ 78,014
B. Peters	12/17/2008	21,053	$14.06	$ 74,500
M. High	--	--	--	--

(1) On 12/15/2008, the Compensation Committee of the Board of Directors approved the grant of option awards with a grant date of 12/17/2008. The options are for a term of 7-years; vesting in 3 annual installments on the anniversary of grant. The exercise price of the awards, $14.06, is the closing price of Harleysville common stock on the date of grant.

(2) All options granted on December 17, 2008 have a 7-year term, 3-year vesting and FAS 123(R) value = $3.5387.

Option Exercises and Stock Vested

No options were exercised by named executive officers during 2008. No restricted stock, stock appreciation rights or other equity-based awards have been granted to any named executive officers.

Outstanding Equity Awards

The following table shows information about outstanding equity awards held by named executive officers at December 31, 2008.

Outstanding Equity Awards at Fiscal Year-End

	Option Awards			
Name	*Number of Securities Underlying Unexercised Options (#) Exercisable*	*Number of Securities Underlying Unexercised Options (#) Unexercisable*	*Option Exercise Price ($)*	*Option Expiration Date*
Paul D. Geraghty	-0- (1)	25,000	$14.49	07/23/2017
	-0- (6)	50,000	$14.06	12/17/2015
George S. Rapp	1,323 (5)	882	$19.54	05/18/2015
	2,205 (4)	1,470	$20.10	12/08/2015
	-0- (6)	13,318	$14.06	12/17/2015
Demetra M. Takes	6,945 (2)	-0-	$27.37	12/30/2013
	6,615 (3)	1,654	$24.54	12/30/2014
	6,457 (4)	4,305	$20.10	12/08/2015
	-0- (6)	22,046	$14.06	12/17/2015
Brent L. Peters	-0- (6)	21,053	$14.06	12/17/2015
Michael B. High	4,620 (4)	-0-	$20.10	02/28/2009 (7)

(1) Incentive stock option granted July 23, 2007, subject to ISO limitation under Section 422(d) of the Internal Revenue Code. Special vesting: within 5 years from date of grant, 12,500 options will vest when the corporation's stock price equals or exceeds $20/share for 30 consecutive trading days; and 12,500 will vest when the corporation's stock price equals or exceeds $22.50/share for 30 consecutive days.

(2) Incentive stock option granted December 30, 2003, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.

(3) Incentive stock option granted December 30, 2004, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
(4) Incentive stock option granted December 8, 2005, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
(5) Incentive stock option granted May 18, 2005, vesting in 5 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
(6) Incentive stock option granted December 17, 2008, vesting in 3 equal annual installments on the anniversary of grant, subject to ISO limitation under Section 422(d) of the Internal Revenue Code.
(7) Early expiration due to termination of employment on November 28, 2008.

Pension Benefits

The following table shows information about retirement payments and benefits for named executive officers as of December 31, 2008.

Pension Benefits

Name	*Plan Name*	*Number of Years Credited Service (#)*	*Present Value of Accumulated Benefit ($)*	*Payments During Last Fiscal Year ($)*
Paul D. Geraghty	HNC Pension Plan	--	-0-	-0-
	Supplemental Employee Retirement Plan	--	$153,549	-0-
George S. Rapp	HNC Pension Plan	3	-0-	$ 42,720 (1)
	Supplemental Employee Retirement Plan	--	-0-	-0-
Demetra M. Takes	HNC Pension Plan	25	-0-	$483,488 (1)
	Supplemental Employee Retirement Plan	--	$950,834	-0-
Brent L. Peters	HNC Pension Plan	--	-0-	-0-
	Supplemental Employee Retirement Plan	--	$593,566	-0-
Michael B. High	HNC Pension Plan	4	-0-	$ 87,955 (1)
	Supplemental Employee Retirement Plan	--	-0-	$356,424 (2)

(1) Distribution as a result of termination of Harleysville's Pension Plan.
(2) Distribution of accrued Supplemental Executive Retirement Plan benefit.

Pension Plan. As of December 31, 2007, all pension plan accruals were frozen. The corporation terminated its non-contributory defined-benefit pension plan in May 2008, and began to distribute accrued benefits to participants. Active participants who were partially vested at the time the plan was terminated became fully vested. Participants elected from lump sum, rollover or annuity options as the form of their distribution. Total contributions by Harleysville National Bank to the pension plan for the years ending December 31, 2008, 2007, and 2006, were $1,250,000, $1,250,000, and $1,250,000, respectively. As of December 31, 2008, there was approximately $405,300 benefit liability remaining in the plan.

Supplemental Executive Retirement Plan. Harleysville Management Services maintains a Supplemental Executive Retirement Plan for certain officers and key employees. The plan provides for payment to the covered employee of an annual supplemental retirement benefit of up to 50% of their average annual compensation upon retirement, offset by 50% of the employee's social security retirement income, defined pension benefit, and projected income from the employer's 401(k) matching contributions. There is a lifetime payout in retirement benefits with a minimum payout of 10 years (15 years for Geraghty). There is a pre-retirement death benefit, payable for 10 years, of 100% of the average annual compensation for the first year, and up to 50% of the average annual compensation for the next 9 years.

Supplemental Executive Retirement Plan for Brent L. Peters. The SERP agreement for Mr. Peters provides a benefit of $60,000 per year for 15 years. The benefit was fully vested upon Mr. Peters' attainment of age 62 in 2008, and becomes payable upon his separation from service for reasons other than death. In the event of Mr. Peters' death prior to beginning his retirement benefits, his beneficiary will receive a lump sum payment from a split life insurance policy acquired for this purpose. The agreement restricts Mr. Peters from competitive activity after his employment and until age 65 except in the event of a change in control.

Non-Qualified Deferred Compensation

None of the named executive officers received any non-qualified deferred compensation during 2008.

401(k) Plan

The corporation maintains a 401(k) plan. It is a tax-exempt profit-sharing plan, qualified under section 401(a) of the Internal Revenue Code. All employees are eligible to participate on the first day of the calendar quarter following 3 months of service, if they are 21 years of age. They may contribute a percentage (up to IRS dollar limits) of their compensation on a pre-tax basis, with a 50% employer match, up to a maximum of 3% of salary. In addition, the corporation contributes 2% of compensation to each eligible employee as a Basic Contribution. The plan assets, which include the corporation's stock and other investment options, are managed by an independent investment manager. Distributions are made upon normal retirement at age 65, early retirement at age 55 with a minimum of 15 years of service, or upon disability, death, termination or hardship. A participant may elect distributions in a lump sum or in installments.

Potential Payments Upon Termination Or Change In Control

Payments under each named executive's contract as detailed below would be triggered by termination of executive's employment for cause (misconduct for example), good reason, disability, death, voluntary separation absent good reason (as in the case of retirement), involuntary termination absent cause (as in the case of poor performance), and also in the event of a change in control. Good reason is defined as (i) the assignment of duties and responsibilities inconsistent with executive's contracted position, (ii) a reduction in salary or benefits, or (iii) a reassignment that requires executive to move his/her principal office more than 50 miles from the corporation's principal office. The Compensation Committee of the Board shall confirm the reason for separation. All payments are contingent upon the execution of a release, and are made by either lump sum or monthly installment, except for pension payments which shall be made according to the executive's election under the pension plan.

Post-termination, each executive is prohibited from competing directly or indirectly with the corporation for a period of one year, or two years depending on the contract, within a non-competition area that includes all counties in which the corporation is located, or any county contiguous to such a county, including contiguous counties located outside of the Commonwealth of Pennsylvania. Each executive is also prohibited from soliciting corporation customers or employees, and from disclosing confidential or privileged information obtained in the course of employment with the corporation. Each executive acknowledges that all work product belongs to the corporation, and agrees to return any company property or documents obtained in the course of employment with the corporation. Both the corporation and each executive agree to the use of arbitration as the means for resolving contract disputes other than those concerning these restrictions and acknowledgements, which may be litigated.

The following table shows the potential payments and benefits payable to **Paul D. Geraghty**, the corporation's President and Chief Executive Officer, upon a separation of employment under terms of his employment agreement, assuming the event giving rise to such payment occurred on December 31, 2008.

Element	Voluntary Resignation with Good Reason	Voluntary Resignation, absent Good Reason	Involuntary For Cause	Involuntary Without Cause	Death (1)	Disability (2)	Retirement	Change in Control
Paul D. Geraghty								
Accelerated Cash, Equity, Enhanced Severance and Benefits								
Cash Severance								
Base Salary + Bonus	$593,750	$0	$0	$593,750	$0	$172,500	$0	$750,000
Pro-rata Target Bonus (as applicable)								
Total Cash Severance	*$593,750*	*$0*	*$0*	*$593,750*	*$0*	*$172,500*	*$0*	*$750,000*
Pension Benefit Enhancements								
Pension (3)	$0	$0	$0	$0	$0	$0	$0	$0
SERP (4)	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Enhanced Pension Benefits	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
Other Benefits & Perquisites								
Health and Welfare Benefit Continuation	$30,581	$0	$0	$30,581	$0	$19,314	$0	$61,161
Executive Benefits & Perquisites Continuation	$3,575	$0	$0	$3,575	$0	$3,575	$0	$0
Subtotal Benefits & Perquisites	*$34,156*	*$0*	*$0*	*$34,156*	*$0*	*$22,889*	*$0*	*$61,161*
280G Tax Gross-up	$0	$0	$0	$0	$0	$0	$0	$0
Total Severance, Pension Enhancements, Benefits	*$627,906*	*$0*	*$0*	*$627,906*	*$0*	*$195,389*	*$0*	*$811,161*
Long-Term Incentives Values								
In-the-Money Value of Stock Options (5)	$0	$0	$0	$0	$0	$0	$0	$19,000
Value of Restricted Stock	$0	$0	$0	$0	$0	$0	$0	$0
Total Value of Equity Grants	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$19,000*
Full "Walk-Away" Value	***$627,906***	***$0***	***$0***	***$627,906***	***$0***	***$195,389***	***$0***	***$830,161***

(1) Does not include the proceeds from any employer-paid life insurance policies.

(2) Disability salary payment is 70% times base salary, offset by amounts payable under any disability plan, calculated as follows: 70% x Good Reason amount, minus 9 months only of base salary x 60% (disability plan has a 3 month elimination period). The long term disability benefit is capped at $10,000 per month, so salaries over $200,000 are capped.

(3) The corporation terminated its non-contributory defined-benefit pension plan in May 2008.

(4) Under executive's employment agreement, the corporation shall enter into a Supplemental Executive Retirement Plan with executive, but the agreement has not yet been executed. Subject to the terms of the anticipated plan, the executive shall not vest in any benefit for the first five years of service, and then 20% per year for the next five years of service. Upon age 65, Mr. Geraghty will receive a retirement benefit equal to 60% of the sum of (i) his previous year's annual base salary and (ii) an average of the last three years' bonuses reduced by any qualified retirement or Social Security benefits, and continuing for fifteen (15) years.

(5) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2008, $14.44.

a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one-year from the date of disability or death, as applicable, of the optionee. As of December 31, 2008, Mr. Geraghty had no vested options.

b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2008, Mr. Geraghty had no vested options.

c. Upon a change in control, vesting accelerates and all outstanding options become immediately exercisable. As of December 31, 2008, the intrinsic value of all outstanding options held by Mr. Geraghty, presumed to vest on such event, was $19,000.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Mr. Geraghty equal one (1) times his then annual base salary plus continuation of basic health & welfare and retirement benefits for a period of twelve months. Under terms of Mr. Geraghty's employment agreement, "agreed compensation" equals his annual base salary. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death. In the event of a termination related to a change of control, severance benefits are increased to 2.0 times his then annual base salary plus continuation of health & welfare benefits for a corresponding period of months. There is no provision for payment in the event of his death.

The following table shows the potential payments and benefits payable to **George S. Rapp**, Executive Vice President and Chief Financial Officer, upon a separation of employment under terms of his employment agreement, assuming the event giving rise to such payment occurred on December 31, 2008.

Element	Voluntary Resignation with Good Reason	Voluntary Resignation, absent Good Reason	Involuntary For Cause	Involuntary Without Cause	Death (1)	Disability (2)	Retirement	Change in Control
George S. Rapp								
Accelerated Cash, Equity, Enhanced Severance and Benefits								
Cash Severance								
Base Salary + Bonus	$187,250	$0	$0	$187,250	$0	$46,817	$0	$374,500
Pro-rata Target Bonus (as applicable)								
Total Cash Severance	*$187,250*	*$0*	*$0*	*$187,250*	*$0*	*$46,817*	*$0*	*$374,500*
Pension Benefit Enhancements								
Pension (3)	$0	$0	$0	$0	$0	$0	$0	$0
SERP (4)	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Enhanced Pension Benefits	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*
Other Benefits & Perquisites								
Health and Welfare Benefit Continuation	$22,097	$0	$0	$22,097	$0	$22,097	$0	$44,194
Executive Benefits & Perquisites Continuation	$0	$0	$0	$0	$0	$0	$0	$0
Subtotal Benefits & Perquisites	*$22,097*	*$0*	*$0*	*$22,097*	*$0*	*$22,097*	*$0*	*$44,194*
280G Tax Gross-up	$0	$0	$0	$0	$0	$0	$0	$0
Total Severance, Pension Enhancements, Benefits	***$209,347***	***$0***	***$0***	***$209,347***	***$0***	***$68,914***	***$0***	***$418,694***
Long-Term Incentives Values								
In-the-Money Value of Stock Options (5)	$0	$0	$0	$0	$0	$0	$0	$5,061
Value of Restricted Stock	$0	$0	$0	$0	$0	$0	$0	$0
Total Value of Equity Grants	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$5,061*
Full "Walk-Away" Value	***$209,347***	***$0***	***$0***	***$209,347***	***$0***	***$68,914***	***$0***	***$423,755***

(1) Does not include the proceeds from any employer-paid life insurance policies.
(2) Disability salary payment is 70% times Agreed Compensation, offset by amounts payable under any disability plan, calculated as follows: 70% x Good Reason amount, minus 9 months only of base salary x 60% (disability plan has a 3 month elimination period). The long term disability benefit is capped at $10,000 per month, so salaries over $200,000 are capped.
(3) The corporation terminated its non-contributory defined-benefit pension plan in May 2008.
(4) Currently not applicable to Mr. Rapp.
(5) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2008, $14.44.
   a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one year from the date of disability or death, as applicable, of the optionee. As of December 31, 2008, intrinsic value of all outstanding exercisable options held by Mr. Rapp was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2008.
   b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2008, the intrinsic value of all outstanding exercisable options held by Mr. Rapp was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2008.
   c. Upon a change in control, vesting accelerates and all outstanding options become immediately exercisable. As of December 31, 2008, the intrinsic value of all outstanding options held by Mr. Rapp, presumed to vest on such event, was $5,061.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Mr. Rapp equal 1 times annual agreed compensation ("agreed compensation for Mr. Rapp equals the highest annual base salary under terms of his employment agreement") plus continuation of basic health & welfare benefits for a period of 12 months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death; one year is illustrated. There is no provision for payment in the event of his death. In the event of a termination related to a change of control, severance benefits are increased to 2 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months.

The following table shows the potential payments and benefits payable to **Demetra M. Takes**, the President and Chief Executive Officer of Harleysville National Bank, upon a separation of employment under terms of her employment agreement, assuming the event giving rise to such payment occurred on December 31, 2008.

Element	Voluntary Resignation with Good Reason	Voluntary Resignation, absent Good Reason	Involuntary For Cause	Involuntary Without Cause	Death (1)	Disability (2)	Retirement	Change in Control
Demetra M. Takes								
Accelerated Cash, Equity, Enhanced Severance and Benefits								
Cash Severance								
Base Salary + Bonus	$309,960	$0	$0	$309,960	$0	$126,972	$0	$619,920
Pro-rata Target Bonus (as applicable)								
Total Cash Severance	*$309,960*	*$0*	*$0*	*$309,960*	*$0*	*$126,972*	*$0*	*$619,920*
Pension Benefit Enhancements								
Pension (3)	$0	0	$0	$0	$0	$0	$0	$0
SERP (4)	$950,834	$950,834	$0	$950,834	$1,932,552	$0	$950,834	$950,834
Subtotal Enhanced Pension Benefits	*$950,834*	*950,834*	*$0*	*$950,834*	*$1,932,552*	*$0*	*$950,834*	*$950,834*
Other Benefits & Perquisites								
Health and Welfare Benefit Continuation	$22,958	$0	$0	$22,958	$0	$22,958	$0	$45,916
Executive Benefits & Perquisites Continuation	$11,500	$0	$0	$11,500	$0	$0	$0	$23,000
Subtotal Benefits & Perquisites	*$34,458*	*$0*	*$0*	*$34,458*	*$0*	*$22,958*	*$0*	*$68,916*
280G Tax Gross-up	$0	$0	$0	$0	$0	$0	$0	
Total Severance, Pension Enhancements, Benefits	*$1,295,252*	*$950,834*	*$0*	*$1,295,252*	*$1,932,552*	*$149,930*	*$950,834*	*$1,639,670*
Long-Term Incentives Values								
In-the-Money Value of Stock Options (5)	$0	$0	$0	$0	$0	$0	$0	$8,377
Value of Restricted Stock	$0	$0	$0	$0	$0	$0	$0	$0
Total Value of Equity Grants	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$8,377*
Full "Walk-Away" Value	***$1,295,252***	***$950,834***	***$0***	***$1,295,252***	***$1,932,552***	***$149,930***	***$950,834***	***$1,648,047***

(1) Does not include the proceeds from any employer-paid life insurance policies.

(2) Disability salary payment is 70% times Agreed Compensation, offset by amounts payable under any disability plan, calculated as follows: 70% x Good Reason amount, minus 9 months only of base salary x 60% (disability plan has a 3 month elimination period). The long term disability benefit is capped at $10,000 per month, so salaries over $200,000 are capped.

(3) The corporation terminated its non-contributory defined-benefit pension plan in May 2008.

(4) Under the corporation's Supplemental Executive Retirement Plan, the executive is entitled to monthly benefits as follows:

a. Death before retirement: Represents annualized first year benefit. The benefit is paid monthly to survivors in the amount of $29,281 per month for the first 12 months following executive's death; then $14,640 monthly from month 13 until the date that would have been the executive's 65th birthday, but not less than 120 months.

b. Good Reason: Represents annualized benefit. The executive is entitled to the accrued benefit, which was $950,834 as of December 31, 2008. The executive would be paid monthly, for life, an amount that represents the present value of the accrued benefit, but not less than 120 months.

c. Retirement: Not eligible at this time. Monthly retirement benefit is equal to 50% times 1/60th of Ms. Takes' total annual compensation (including salary, overtime and bonus) from the company for her last 5 consecutive full calendar years of employment immediately preceding her retirement at or after age 65, less ½ of her monthly social security benefit, less the monthly income from the company's defined benefit pension plan, and less the projected monthly retirement income derived from the company's matching contributions to her 401(k). If she dies before receiving a minimum of 120 monthly retirement payments, the remaining payments will be paid to her beneficiary.

d. Change in control – Represents annualized benefit. Ms. Takes would be entitled to the accrued benefit, which was $950,834 as of December 31, 2008. The executive would be paid monthly, for life, an amount that represents the present value of the accrued benefit, but not less than 120 months.

(5) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2008, $14.44.

a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one year from the date of disability or death, as applicable, of the optionee. As of December 31, 2008, the intrinsic value of all outstanding exercisable options held by Ms. Takes was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2008.

b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2008, the intrinsic value of all outstanding exercisable options held by Ms. Takes was zero since the exercise price was greater than the market price of the corporation's common stock as of December 31, 2008.

c. Upon a change in control, vesting accelerates and all outstanding options become immediately exercisable. As of December 31, 2008, the intrinsic value of all outstanding options held by Ms. Takes, presumed to vest on such event, was $8,377.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Ms. Takes equal one (1) times annual agreed compensation ("agreed compensation for Ms. Takes equals the highest annual base salary under terms of her employment agreement") plus continuation of basic health & welfare and retirement benefits for a period of 12 months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death. In the event of a termination related to a change of control, severance benefits are increased to 2.0 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months. There is no provision for payment in the event of her death.

The following table shows the potential payments and benefits payable to **Brent L. Peters**, the President, East Penn Division of Harleysville National Bank, upon a separation of employment under terms of his employment agreement, assuming the event giving rise to such payment occurred on December 31, 2008.

Element	Voluntary Resignation with Good Reason	Voluntary Resignation, absent Good Reason	Involuntary For Cause	Involuntary Without Cause	Death (1)	Disability (2)	Retirement	Change in Control
Brent L. Peters								
Accelerated Cash, Equity, Enhanced Severance and Benefits								
Cash Severance								
Base Salary + Bonus	$567,333	$0	$0	$567,333	$0	$117,200	$0	$592,000
Pro-rata Target Bonus (as applicable)								
Total Cash Severance	*$567,333*	*$0*	*$0*	*$567,333*	*$0*	*$117,200*	*$0*	*$592,000*
Pension Benefit Enhancements								
Pension (3)	$0	$0	$0	$0	$0	$0	$0	$0
SERP (4)	$900,000	$900,000	$0	$900,000	$337,077	$900,000	$900,000	$900,000
Subtotal Enhanced Pension Benefits	*$900,000*	*$900,000*	*$0*	*$900,000*	*$337,077*	*$900,000*	*$900,000*	*$900,0000*
Other Benefits & Perquisites								
Health and Welfare Benefit Continuation	$19,409	$0	$0	$19,409	$0	$19,409	$0	$19,409
Executive Benefits & Perquisites Continuation	$0	$0	$0	$0	$0	$0	$0	
Subtotal Benefits & Perquisites	*$19,409*	*$0*	*$0*	*$19,409*	*$0*	*$19,409*	*$0*	*$19,409*
280G Tax Gross-up	$0	$0	$0	$0	$0	$0	$0	
Total Severance, Pension Enhancements, Benefits	$1,486,742	$900,000	$0	$1,486,742	$337,077	$1,036,609	$900,000	$1,511,409
Long-Term Incentives Values								
In-the-Money Value of Stock Options (5)	$0	$0	$0	$0	$0	$0	$0	$8,000
Value of Restricted Stock	$0	$0	$0	$0	$0	$0	$0	
Total Value of Equity Grants	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$0*	*$8,000*
Full "Walk-Away" Value	**$1,486,742**	**$900,000**	**$0**	**$1,486,742**	**$337,077**	**$1,036,609**	**$900,000**	**$1,519,409**

(1) Does not include the proceeds from any employer-paid life insurance policies.
(2) Disability salary payment is 70% times Agreed Compensation, offset by amounts payable under any disability plan, calculated as follows: 70% x Good Reason amount, minus 9 months only of base salary x 60% (disability plan has a 3 month elimination period.) The long term disability benefit is capped at $10,000 per month, so salaries over $200,000 are capped.
(3) Not applicable to Mr. Peters.
(4) Under Mr. Peters' Supplemental Executive Retirement Plan, the executive is entitled to monthly benefits as follows:
  a. Death before retirement: The benefit is determined by a schedule derived from the proceeds of a split dollar life insurance policy.
  b. Good Reason: The executive will receive $60,000 per year for 15 years.
  c. Retirement: The executive will receive $60,000 per year for 15 years.
  d. Change in control: The executive will receive $60,000 per year for 15 years.
(5) Based on the closing price of Harleysville National Corporation common stock as of December 31, 2008, $14.44.
  a. Vesting of stock options does not accelerate upon death or disability. The optionee or the optionee's estate, as applicable, may exercise the vested portion of any outstanding awards for a period of one year from the date of disability or death, as applicable, of the optionee. As of December 31, 2008, Mr. Peters had no vested options.
  b. Vesting of stock options does not accelerate for any reason, except change in control. In the case of normal retirement, the optionee may exercise the vested portion of any outstanding awards for a period of 3 months from the date of retirement. As of December 31, 2008, Mr. Peters had no vested options.
  c. Upon a change in control, vesting accelerates and all outstanding options become immediately exercisable. As of December 31, 2008, the intrinsic value of all outstanding options held by Mr. Peters, presumed to vest on such event, was $8,000.

In the event of a termination for good reason or involuntary termination absent cause, severance benefits to Mr. Peters equal one (1) times annual agreed compensation ("agreed compensation for Mr. Peters equals the highest annual base salary under terms of his employment agreement") plus continuation of basic health & welfare and retirement benefits for a period of twelve months. Payments for disability include 70% of agreed compensation, less amounts payable under any disability plan of the corporation, plus benefit continuation until the earliest of (i) return to work, (ii) attainment of age 65, or (iii) death. In the event of a termination related to a change of control, severance benefits are increased to 2.0 times annual agreed compensation plus continuation of health & welfare benefits for a corresponding period of months. There is no provision for payment in the event of his death.

EXECUTIVE EMPLOYMENT AGREEMENTS

Paul D. Geraghty

In 2007, Harleysville Management Services, LLC entered into an employment agreement with Paul D. Geraghty, President and Chief Executive Officer, Harleysville National Corporation (the "Geraghty Employment Agreement").

The Geraghty Employment Agreement is for a term of 2 years, renewing automatically on the first anniversary of the Agreement and extended for an additional one year, such that the employment period shall end two (2) years from each renewal date. Either party must provide at least 90 days written notice prior to an annual renewal date in the event this agreement shall terminate at the end of the then existing employment period. The agreement specifies position, title and duties, compensation and benefits, and indemnification and termination provisions. The executive will be entitled to participate in annual and long-term incentive plans, employee benefit plans, and a Supplemental Executive Retirement Plan, receive annual vacation in accordance with the policies established by the Board of Directors of the corporation, and receive an automobile and maintenance of such automobile. The Geraghty Employment Agreement will automatically terminate upon the executive's disability, as defined in the agreement, and he will receive employee benefits and an amount no greater than 70% of his compensation less amounts payable under any disability plan until he (i) returns to work, (ii) reaches 65, or (iii) dies. If the executive is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreement, he may receive up to 2.0 times his agreed compensation and may continue participation in employee benefit plans. The Geraghty Employment Agreement also contains a non-competition provision and a confidentiality provision.

George S. Rapp

Harleysville Management Services LLC entered into an employment agreement with George S. Rapp, effective May 2005 and amended December 15, 2006, pursuant to his employment as Executive Vice President and Chief Financial Officer of the bank and the corporation.

The agreement is for a term of 2 years, renewing automatically at the end of the two year period for an additional one-year term. The employment agreement renews automatically at the end of each one-year extension. Either party must provide at least 90 days written notice prior to an annual renewal date in the event this agreement shall terminate at the end of the then existing employment period. The agreement specifies position title and duties, compensation and benefits, and indemnification and termination provisions. The executive will be entitled to participate in annual and long-term incentive plans and employee benefit plans and to receive annual vacation in accordance with the policies established by the Board of Directors of Harleysville. According to the agreement, the executive's employment will automatically terminate upon the executive's disability, as defined in the agreement, and he will receive employee benefits and an amount no greater than 70% of his compensation less amounts payable under any disability plan until he (i) returns to work, (ii) reaches 65, or (iii) dies. If he is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreement, Mr. Rapp may receive up to 2.0 times his agreed compensation and may continue participation in employee benefit plans. The agreement also contains a non-competition provision and a confidentiality provision.

Demetra M. Takes

In 1998, the corporation and Harleysville National Bank entered into an employment agreement with Demetra M. Takes, Executive Vice President, Harleysville and President and Chief Executive Officer, Harleysville National Bank (the "Takes Employment Agreement").

The Takes Employment Agreement is for a term of 3 years, renewing automatically at the end of the three year period for an additional one-year term. The employment agreement renews automatically at the end of each one year extension. The employment agreement is in the renewal period. Either party must provide at least 180 days written notice prior to an annual renewal date in the event this agreement shall terminate at the end of the then existing employment period. The agreement specifies position title and duties, compensation and benefits, and indemnification and termination provisions. The executive will be entitled to participate in annual and long-term incentive plans and employee benefit plans, receive annual vacation in accordance with the policies established by the Board of Directors of the corporation, and receive an automobile and maintenance of such automobile. The Takes Employment Agreement will automatically terminate upon the executive's disability, as defined in the agreement, and she will receive employee benefits and an amount no greater than 70% of her compensation less amounts payable under any disability plan until she (i) returns to work, (ii) reaches 65, or (iii) dies. If the executive is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreement, she may receive up to 2.0 times her agreed compensation and may continue participation in employee benefit plans. The Takes Employment Agreement also contains a non-competition provision and a confidentiality provision.

Brent L. Peters

In 2007, the corporation and Harleysville National Bank entered into an employment agreement with Brent L. Peters, Executive Vice President of Harleysville and Harleysville National Bank, Chief Administrative Officer of Harleysville National Bank, and President of the East Penn Bank Division of Harleysville National Bank ("the Peters Employment Agreement").

The Peters Employment Agreement is for a term of 3 years, renewing automatically on the third anniversary of the Agreement and extended for an additional one year. Either party must provide at least 90 days written notice prior to an annual renewal date in the event this agreement shall terminate at the end of the then existing employment period. The agreement specifies position title and duties, compensation and benefits, and indemnification and termination provisions. The executive will be entitled to participate in annual and long-term incentive plans, employee benefit plans, and receive annual vacation in accordance with the policies established by the Board of Directors of the corporation, and receive an automobile and maintenance of such automobile. If the executive is terminated or upon occurrence of other events following a "Change in Control," as defined in the agreement, he may receive up to 2.0 times his agreed compensation (annual base salary) and may continue participation in employee benefit plans. The Peters Employment Agreement also contains a non-competition provision and a confidentiality provision.

EXECUTIVE SEPARATION AGREEMENTS

Michael B. High

Effective November 28, 2008, Harleysville National Corporation, Harleysville National Bank and Trust Company and Harleysville Management Services LLC entered into a Complete Settlement Agreement and General Release (the "Agreement") with Michael B. High dated October 17, 2008.

The material terms of the Agreement are summarized as follows:

- Mr. High received as his severance package amounts equal to $367,481 minus all appropriate withholdings and/or deductions. Additionally, a lump sum amount equal to $13,050, minus all appropriate withholdings and deductions, representing the amount of money it would have cost the Corporation to provide non-COBRA eligible employee benefits to Mr. High. Mr. High also received $6,000 reimbursement of his country club dues for one year. A lump sum payment equal to $356,424 minus all appropriate withholdings and deductions, representing the accrued value of his Supplemental Executive Retirement Benefit Agreement, was also paid to Mr. High.

- Mr. High agreed to release the corporation and its affiliates and all other releasees as identified in the Agreement from all claims and rights including but not limited to those arising from or based upon his employment or the termination of his employment and any related statute or law.

- The corporation agrees to indemnify Mr. High from any legal process in any actions or suits arising out of his service as an officer or employee of the corporation subject to certain limitations.

- Mr. High agrees not to disclose any confidential information of the corporation and return any confidential documents and information to the corporation.

RELATED PARTY TRANSACTIONS

Certain directors and officers of the corporation, their immediate family members and companies with which they are associated, are customers of the corporation's banking subsidiary, Harleysville National Bank. During 2008, these individuals, family members and companies had banking transactions with Harleysville National Bank in the ordinary course of business. Similar transactions are expected to occur in the future. All loans and loan commitments involved in such transactions were made in the ordinary course of business under substantially the same terms, including interest rates, collateral, and repayment terms, as those prevailing at the time for comparable transactions with other persons. In the opinion of the corporation's management, these transactions do not involve more than the normal risk of collection, nor do they present other unfavorable features. Each of these transactions was made in compliance with applicable law, including Section 13(k) of the Securities and Exchange Act of 1934 and Federal Board Regulation O. As of December 31, 2008, loans to executive officers, directors, and their affiliates represented 5.2% of total shareholders' equity in the corporation.

Harleysville National Bank has established written policy and procedures for the review, approval and/or ratification of all related party transactions. These transactions are reported to and reviewed by Risk Management and the Audit Committee.

Section 16(a) Beneficial Ownership Reporting Compliance

The rules of the Securities and Exchange Commission require that the corporation disclose late filings of reports of stock ownership (and changes in stock ownership) by its directors and executive officers. Due to delayed availability of certain share information following Harleysville's merger with Willow Financial Bancorp, each of the following individuals were late in filing one Form 4 with the Securities and Exchange Commission in connection with the exchange of Willow shares for Harleysville shares: Messrs. Cunningham and McErlane, as well as Ammon J. Baus, Donna M. Coughey and James F. McGowan, Jr.

<u>Proposal No. 2</u> - Amendment to the Corporation's Articles of Incorporation to Increase the Authorized Number of Shares of Common Stock

The corporation's Articles of Incorporation currently authorizes seventy-five million (75,000,000) shares of common stock, par value $1.00 per share and eight million (8,000,000) shares of series preferred stock, par value $1.00 per share. As of March 10, 2009, there were 42,982,463 shares of common stock issued and outstanding and no shares of series preferred stock issued and outstanding. Of the remaining 32,017,537 authorized but unissued shares of common stock, 2,277,385 shares were reserved for issuance upon the exercise of outstanding stock options under the corporation's stock option plans and in connection with the corporation's Dividend Reinvestment and Stock Purchase Plan, as well. In the future, the corporation may need additional authorized but unissued shares available for issuance, from time to time, as may be necessary in connection with future financings, capital enhancement, investment opportunities, acquisitions of other companies, the declaration of stock dividends, stock splits or other distributions, or for other corporate purposes.

The Board of Directors approved and adopted resolutions to amend Article 5 of the corporation's Articles of Incorporation to increase the number of authorized shares of common stock from 75,000,000 shares to 200,000,000 shares. This increase in the number of authorized shares of common stock requires that shareholders adopt the amendment to the corporation's Articles of Incorporation. A true and correct copy of the amended and restated articles of incorporation is set forth in Annex A to this proxy statement.

The corporation is currently evaluating certain capital raising alternatives including participation in the United States Treasury Department's Capital Purchase Program and/or the Capital Assistance Program. However, the corporation has no definitive present plans, undertakings, arrangements or agreements for issuing additional shares of common stock or preferred stock as of the date of this proxy statement. However, the board of directors believes that it is advisable to have the ability to issue additional shares of common stock to enable corporation, as the need may arise, to take prompt advantage of market conditions and favorable opportunities in connection with capital raising options and/or participation in the United States Treasury Department's programs without the delay and expense of holding a special meeting of shareholders. The future issuance of shares of stock may dilute the present equity ownership position of current holders. However, since the corporation has not developed plans as of this time the corporation cannot determine the impact of any future issuances as of this date. The proposed amendment is not intended to have an anti-takeover effect. The issuance, however, of any of the shares may potentially have an anti-takeover effect by making it more difficult to obtain shareholder approval of actions, such as certain business combinations or removal of management.

Unissued shares of common stock and series preferred stock are available for issuance at the discretion of the board of directors, from time to time, for any proper corporate purpose, generally without further action of the shareholders, upon the affirmative vote of a majority of the members of the board of directors. However, if the proposed amendment is adopted by the shareholders, the board of directors is not likely to solicit shareholder approval to issue the additional authorized shares, except to the extent that approval may be required by law, regulation or any agreement governing the trading of the corporation's stock.

To provide sufficient shares for the future needs, the board of directors believes that it is in the best interest of the corporation for the shareholders to approve and adopt the amendment to Article 5 of the Articles of Incorporation. The board of directors believes that the increase in the number of authorized shares of common stock is necessary to provide the corporation with as much flexibility as possible to issue additional shares for proper purposes, including financing, capital enhancement, participation in United States Treasury Department programs, acquisitions, stock splits, stock dividends, employee incentive plans, and other similar purposes.

As a result, the board of directors proposes that the corporation's Articles of Incorporation be amended and restated to revise Article 5(a) of the Articles of Incorporation to read as follows:

"5. (a) The aggregate number of shares that the corporation shall have authority to issue is two hundred million (200,000,000) shares of Common Stock of the par value of one dollar ($1.00) per share (the

"Common Stock"), and eight million (8,000,000) shares of shares of series preferred stock of the par value of one dollar ($1.00) per share (the "Preferred Stock")."

The affirmative vote of a majority of the votes cast by all of the corporation's shareholders entitled to vote thereon is required to approve and adopt this amendment.

The corporation's board of directors recommends a vote FOR the proposal to amend the corporation's Articles of Incorporation.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee ("Committee") oversees the corporation's financial reporting process on behalf of the Board of Directors. In that connection, the Committee, along with the Board of Directors, has formally adopted an audit committee charter setting forth its responsibilities. In addition, appropriate policies have been established to further strengthen disclosure procedures required under Sarbanes-Oxley Act of 2002.

Management has the primary responsibility for the financial statements and the reporting process including the systems of internal control. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements in the Annual Report with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in the financial statements.

The Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of the corporation's accounting principles and such other matters as are required to be discussed with the Committee under generally accepted auditing standards. In addition, the committee has received the written disclosures and letter from the independent accountant required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence, and the Committee has discussed with the independent auditors the auditors' independence from management and the corporation including the matters in the written disclosures required by the Independence Standards Board and considered the compatibility of non-audit services with the auditors' independence.

The Committee discussed with the corporation's internal and independent auditors the overall scope and plans for their respective audits. The Committee meets with the internal and independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the corporation's internal controls and the overall quality of the corporation's financial reporting. During fiscal year 2008, the Committee held 10 meetings which included 4 conference calls to review earnings prior to their public release.

In reliance on the reviews and discussions referred to above, the Committee recommended to the Board of Directors (and the Board has approved) that the audited financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2008 for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE
James A. Wimmer, Chairman
LeeAnn B. Bergey
Michael L. Browne
Thomas C. Leamer

Independent Registered Public Accounting Firm

Grant Thornton LLP, Certified Public Accountants, a registered public accounting firm, of Philadelphia, Pennsylvania, served as Harleysville National Corporation's independent Registered Public Accounting Firm for the 2008 fiscal year. Grant Thornton LLP assisted the corporation and its subsidiaries with:

- preparation of federal and state tax returns, and
- assistance in connection with regulatory matters,

charging the banking subsidiaries for such service at its customary hourly billing rates. Aggregate fees billed to Harleysville National Corporation and subsidiaries by the independent accountants for services rendered during the fiscal year ending December 31, 2008, were as follows:

Types of Fees	2008	2007
Audit Fees: (1)	$766,412	$452,841
Audit Related Fees: (2)	$ 55,624	$ 51,488
Tax Fees: (3)	$173,805	$184,640
All Other Fees: (4)	-0-	-0-
TOTAL	$995,841	$688,969

(1) Audit fees consisted of audit work performed in the preparation of financial statements, Sarbanes-Oxley Sec. 404 certification work, as well as work generally only the independent registered public accounting firm can reasonably be expected to provide, such as statutory audit and registration statements.
(2) Audit related fees consisted principally of audits of employee benefit plans.
(3) Tax fees consisted principally of assistance with matters related to tax compliance and reporting.
(4) No other fees in 2008.

The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent certified public accountants. These services may include audit services, audit related services, tax services, and other services. The Audit Committee has adopted a policy for the pre-approval of services provided by the independent certified public accountants. Under the policy, pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of particular services on a case-by-case basis. The Audit Committee approved all services provided by Grant Thornton during 2008 and 2007.

Proposal No. 3 - Ratification of Selection of Independent Auditors

The Audit Committee has approved and appointed Grant Thornton LLP, Certified Public Accountants, a registered public accounting firm, as the corporation's auditors for the fiscal year ended December 31, 2009, subject to shareholder ratification. The Board of Directors of Harleysville National Corporation has ratified this appointment. Grant Thornton has advised the corporation that none of its members has any financial interests in Harleysville National Corporation.

Representatives of Grant Thornton will be present at the annual meeting. They will be given the opportunity to make a statement, if they desire to do so, and will be available to respond to appropriate questions after the meeting.

The Board of Directors recommends that the shareholders vote **FOR** ratification of the selection of Grant Thornton LLP as the corporation's auditors for the fiscal year ended, December 31, 2009.

SHAREHOLDER PROPOSALS

Proposal No. 4

Gerald R. Armstrong, a shareholder of Harleysville who owns 799 shares of Common Stock, has notified Harleysville of his intention to propose a resolution at the Annual Meeting of Shareholders. Mr. Armstrong's address is 910 Sixteenth Street, No. 412, Denver, Colorado 80202-2917. The resolution and statement provided by Mr. Armstrong are set forth below.

RESOLUTION

That the shareholders of HARLEYSVILLE NATIONAL CORPORATION request its Board of Directors to take the steps necessary to eliminate classification of terms of the Board of Directors to require that all Directors stand for election annually. The Board declassification shall be completed in a manner that does not affect the unexpired terms of the previously-elected Directors.

STATEMENT

The proponent believes the election of directors is the strongest way that shareholders influence the directors of any corporation. Currently, our board of directors is divided into four classes with each class serving four-year terms. Because of this structure, shareholders may only vote for one-fourth of the directors each year. This is not in the best interest of shareholders because it reduces accountability.

Xcel Energy Inc., Devon Energy Corporation, ConocoPhillips, ONEOK, Inc., CenterPoint Energy, Inc., Hess Corporation have adopted this practice and it has been approved by shareholders at CH Energy Group, Inc., Central Vermont Public Service Corporation, Black Hills Corporation, Spectra Energy Corp., and several others, upon presentation of a similar resolution by the proponent during 2008. The proponent is a professional investor who has studied this issue carefully.

The performance of our management and our Board of Directors is now being more strongly tested due to economic conditions and the accountability for performance must be given to the shareholders whose capital has been entrusted in the form of share investments.

A study by researchers at Harvard Business School and the University of Pennsylvania's Wharton School titled "Corporate Governance and Equity Prices" (Quarterly Journal of Economics, February, 2003), looked at the relationship between corporate governance practices (including classified boards) and firm performance. The study found a significant positive link between governance practices favoring shareholders (such as annual director's election) and firm value.

While management may argue that directors need and deserve continuity, management should become aware that continuity and tenure may be best assured when their performance as directors is exemplary and is deemed beneficial to the best interests of the corporation and its shareholders.

The proponent regards as unfounded the concern expressed by some that annual election of all directors could leave companies without experienced directors in the event that all incumbents are voted out by shareholders. In the unlikely event that shareholders do vote to replace all directors, such a decision would express dissatisfaction with the incumbent directors and reflect the need for change.

If you agree that shareholders may benefit from greater accountability afforded by annual election of <u>all</u> directors, please vote "FOR" this proposal.

HARLEYSVILLE NATIONAL CORPORATION
RESPONSE TO THE GERALD R. ARMSTRONG SHAREHOLDER PROPOSAL

The Board recommends a vote "AGAINST" this proposal.
The Board has carefully considered the proposal and the arguments in favor and against a classified board. Our review included consideration of the present state of financial services industry, the history of the classified board system, and current regional and national corporate governance best practices relating to classified boards. After our review, we concluded that the present classified board system remains in the best interests of the corporation and its shareholders.

Since 1982, Harleysville National Corporation's Board has been divided into four classes with members of each class serving four-year terms. The classified board system was designed to and continues to balance: (1) the need for shareholders to express their opinion on a director's performance and (2) the need for Harleysville National Corporation's directors to focus on long-term business performance and long-term strategy. Harleysville National Corporation's long-term success and long-term strategy is achieved by having stability, continuity, accountability and independence of its Board.

Stability and Continuity. We believe that a classified board system enhances the stability and continuity of the Board. Our Board puts great emphasis on strategic long-term planning. By electing approximately one-fourth of the directors each year, it ensures that approximately three-fourths of the directors remaining have the requisite experience and knowledge of the company's ongoing business and affairs to implement and focus on strategic long-term planning, goals, and performance. Also, as a result of the acquisition of Willow Financial Corporation, the Board has two new directors who served as directors of Willow Financial Corporation and who will make a valuable contribution towards the execution of our combined business strategy. Consequently, a sudden change in the board structure could jeopardize our long-term plans as well as the execution of our combined business strategy.

Accountability. While our directors hold four-year terms on a classified board, they have the same fiduciary and legal duties to the shareholders of Harleysville National Corporation as directors elected on a yearly basis. It is the manner in which directors conduct themselves on the board that drives corporate governance and not the frequency to which they are elected. Furthermore, the Board's effectiveness depends in large part on how well its members work together to identify and address issues important to its shareholders and Harleysville National Corporation's future. Finally, as engaged community members and business leaders, directors are available to be contacted by any shareholder to discuss issues throughout the year.

Independence. We believe that a classified board enhances director independence. By electing approximately one-fourth of the Board each year, our directors are insulated from pressure by management and special interest groups that may have interests which are contrary to the best interests of all shareholders.

Value Protection. A classified board also protects your company against unfriendly or unfavorable takeover proposals. If persons or entities of questionable intent or hostile to the long-term shareholder interests took a position in the company which permitted them to determine the outcome of an election of directors in a yearly election regime, they could abruptly change the composition of the Board in a single year and thereby diminish shareholder value protections. However, a classified board would slow any change in board composition over the span of a couple of years. This would encourage any influences of questionable intent to negotiate with the Board and permit the Board to consider various alternatives, if available, and maximize shareholder value.

Vote Required and Board Recommendation.

Assuming a quorum is present: the affirmative vote of a majority of the votes cast on the proposal at the annual meeting, whether in person or by proxy, is required for the approval of the proposal presented above. However, because this proposal is only a request, approval of the proposal will not automatically repeal the classified board. Eliminating the classified board would require further action by the Board.

The Board recommends a vote "AGAINST" this proposal. Proxies solicited by the Board will be voted "AGAINST" this proposal unless otherwise instructed on the proxy card.

Proposal No. 5

CalPERS, whose official address is P.O. Box 942708, Sacramento, California 94229-2708, is the owner of approximately 53,000 shares of Harleysville Common Stock. The resolution and statement provided by CalPERS are set forth below.

RESOLUTION

RESOLVED, that the shareowners of Harleysville National Corporation (Company) hereby request that the Board of Directors initiate the appropriate process to amend the Company's articles of incorporation and/or bylaws to provide that director nominees shall be elected by the affirmative vote of the majority of votes cast at an annual meeting of shareholders, with a plurality vote standard retained for contested director elections, that is, when the number of director nominees exceeds the number of board seats.

STATEMENT

Is accountability by the Board of Directors important to you? As a long-term shareowner of the Company, CalPERS thinks accountability is of paramount importance. This is why we are sponsoring this proposal which would remove a plurality vote standard for uncontested elections that effectively disenfranchises shareowners and eliminates a meaningful shareowner role in uncontested director elections.

Under the Company's current voting system, a director nominee may be elected with as little as his or her own affirmative vote because "withheld" votes have no legal effect. This scheme deprives shareowners of a powerful tool to hold directors accountable, because it makes it impossible to defeat director nominees who run unopposed. Conversely, a majority voting standard allows shareowners to actually vote "against" candidates and to defeat reelection of a management nominee unsatisfactory to the majority of shareowner votes cast.

For these reasons, a substantial number of companies already have adopted this form of majority voting. In fact, more than 66% of the companies in the S&P 500 have adopted majority voting for uncontested director elections. We believe the Company should join the growing number of companies that have adopted a majority voting standard requiring incumbent directors who do not receive a favorable majority vote to submit a letter of resignation and not continue to serve unless the Board declines the resignation and publicly discloses its reasons for doing so.

Majority voting in director elections empowers shareowners to clearly say "no" to unopposed directors who are viewed as unsatisfactory by a majority of votes cast. Incumbent board members serving in a majority vote system are aware the shareowners have the ability to determine whether the director remains in office. The power of majority voting, therefore, is not just the power to effectively remove poor directors, but to heighten director accountability by raising the threat of a loss of majority support. That is what accountability is all about.

CalPERS believes that corporate governance procedures and practices, and the level of accountability they impose, are closely related to financial performance. It is intuitive that, when directors are accountable for their actions, they perform better. We, therefore, ask you to join us in requesting that the Board of Directors promptly adopt the majority voting standard. We believe the Company's shareowners will substantially benefit from the increased accountability of incumbent directors and the power to reject directors shareowners believe are not acting in their best interests.

Please vote FOR this proposal.

HARLEYSVILLE NATIONAL CORPORATION
RESPONSE TO THE CalPERS SHAREHOLDER PROPOSAL

The Board recommends a vote "AGAINST" this proposal.
The Board has carefully considered the proposal and the arguments in favor and against instituting a majority voting standard for the election of our directors. Our analysis included a thorough review of the research and trends associated with majority voting, the history of majority voting, consideration of the present state of the financial services industry, appropriate state and national laws, and current regional and national corporate governance best practices concerning majority voting.

Until recently, virtually all directors of the largest U.S. public companies were elected under a "plurality" vote standard. Furthermore, plurality voting remains the default voting standard for corporations under Pennsylvania law. Under a plurality standard, the nominees with the largest number of votes are elected as directors, up to the maximum number of directors to be chosen at the election, without regard to votes cast as "withheld" or "against". While the trend among the largest U.S. public companies appears to be moving in support of majority voting, there is little research, data or guidance available to determine the impact of majority voting on long-term shareholder value for institutions, such as Harleysville National Corporation, that are significantly smaller than the largest U.S. public companies. Thus, it is premature to conclude that majority voting will have a positive impact on the short-term or long-term performance of Harleysville National Corporation. However, we will continue to monitor developments in corporate governance practices, including majority voting, with a focus towards building shareholder value.

Commitment. We believe maintaining a plurality voting standard is prudent given the current economic environment and firmly believe that this position does not imply a lower standard of corporate governance. In fact, we have recently established our Corporate Governance Guidelines which address director performance, qualifications, and competencies and provide for an annual Board self-evaluation. These guidelines demonstrate our belief that sound corporate governance is a strategic process. We believe that our corporate governance practices protect the interests of all investors – even individual investors who stand at a relative disadvantage to larger institutional shareholders in the voting process. Harleysville National Corporation and its Board are vigilant and proactive in seeking to balance short-term initiatives with long-term growth and value, navigating procedural and compliance requirements, and critically evaluating all shareholder concerns to determine what will further the best interests of Harleysville National Corporation and its shareholders. We believe that these guidelines will serve to impact the long-term performance of Harleysville National Corporation. We invite you to review these Corporate Governance Guidelines on our website.

Accountability. Accountability of directors and the Board is of paramount importance to Harleysville National Corporation. It is because of this reason that we established our Corporate Governance Guidelines focusing on the performance of directors individually and the Board as a whole. We believe these guidelines will be a more effective method of ensuring director and Board accountability because, in a majority vote system, a campaign to withhold votes for the election of a director could be based on factors other than performance. Accordingly, we believe the plurality vote system, as specified by state statute, remains in the best interests of Harleysville National Corporation and its shareholders.

Vote Required and Board Recommendation.

Assuming a quorum is present: the affirmative vote of a majority of the votes cast on the proposal at the annual meeting, whether in person or by proxy, is required for the approval of the proposal presented above. However, because this proposal is only a request, approval of the proposal will not automatically repeal the plurality vote standard. Eliminating the plurality vote standard would require further action by the Board.

The Board recommends a vote "AGAINST" this proposal. Proxies solicited by the Board will be voted "AGAINST" this proposal unless otherwise instructed on the proxy card.

Electronic Distribution

You may choose to receive future distributions of Harleysville's material (quarterly reports, proxy statements, annual reports, etc.) via e-mail. Please follow your broker instructions to receive Harleysville's material electronically or you may go to **www.hncbank.com** and subscribe to our E-Mail Alert service. After appropriately completing and submitting the form, you will be notified each time new information is released and becomes available on this website. You will be able to view the documents by clicking on "Documents" and following instructions, as prompted. If you need help with this, please call us at (215) 256-8851 and ask for Shareholder Services.

Annual Report

A copy of the corporation's annual report for the fiscal year ended December 31, 2008, accompanies this proxy statement. We furnish the annual report for your information only. We have not incorporated the annual report, or any part of the annual report, in this proxy statement.

Householding

We have adopted a procedure approved by the SEC called "householding." Under this procedure, multiple shareholders who share the same last name and address and do not participate in electronic delivery will receive only one copy of the proxy materials, unless they notify us that they wish to continue receiving multiple copies. We have undertaken householding to reduce our printing costs and postage fees.

If you wish to continue to receive multiple copies of the proxy materials at the same address, additional copies will be provided promptly to you upon request. You may request multiple copies by notifying us in writing or by telephone at:

Harleysville National Corporation
ATTN: Shareholder Services
483 Main Street
P. O. Box 195
Harleysville, PA 19438-0195
Telephone (215) 256-8851 or toll-free @ (800) 423-3955

You may opt-out of householding at any time prior to thirty days before the mailing of proxy materials in March of each year by notifying us at the address above.

If you share an address with another shareholder and currently are receiving multiple copies of the proxy materials, you may request householding by notifying us at the above-referenced address or telephone number.

Discretionary Voting Authority

In connection with Harleysville's 2009 annual meeting and pursuant to SEC Rule 14a-4 under the Securities Exchange Act of 1934, if the shareholder's notice is not received by Harleysville on or before February 6, 2009, the corporation (through management proxy holders) may exercise discretionary voting authority when the proposal is raised at the annual meeting without any reference to the matter in the proxy statement.

Additional Information

Any shareholder may obtain a copy of Harleysville National Corporation's Annual Report on Form 10-K for the fiscal year ended December 31, 2008, including the financial statements and the schedules thereto, required to be filed with the Securities and Exchange Commission, without charge, by submitting a written request to Liz Chemnitz, Senior Vice President and Assistant Secretary of the corporation, Harleysville National Corporation, 483 Main Street, P.O. Box 195, Harleysville, Pennsylvania 19438-0195, telephone (800) 423-3955. You may also view these documents on our website at **www.hncbank.com** under the heading, "Financial Information & Filings."

Other Matters

The Board of Directors does not know of any matters to be presented for consideration other than the matters described in the accompanying Notice of Annual Meeting of Shareholders, but, if any matters are properly presented, persons named in the accompanying proxy intend to vote on such matters in accordance with their best judgment.

By Order of the Board of Directors,

Walter E. Daller, Jr.

Walter E. Daller, Jr.
Chairman of the Board

Date: March 24, 2009

Harleysville National Corporation
Amended and Restated Articles of Incorporation

1. The name of the corporation is:

   Harleysville National Corporation

2. The location and post office address of the registered office of the corporation in this Commonwealth is:

   483 Main Street
   Harleysville, Pennsylvania 19438

3. The corporation is incorporated under the Business Corporation Law of the Commonwealth of Pennsylvania for the following purpose or purposes:

   To have unlimited power to engage in and do any lawful act concerning any or all lawful business for which corporations may be incorporate under the provisions of the Business Corporation Law of the Commonwealth of Pennsylvania. The corporation is incorporated under the provisions of the Business Corporation Law of the Commonwealth of Pennsylvania (Act of May 5, 1933, P. L. 364) (15 P.S. Section 1204, as amended).

4. The term for which the corporation is to exist is: Perpetual

5. (a) The aggregate number of shares that the corporation shall have authority to issue is two hundred million (200,000,000) shares of Common Stock of the par value of one dollar ($1.00) per share (the "Common Stock"), and eight million (8,000,000) shares of shares of series preferred stock of the par value of one dollar ($1.00) per share (the "Preferred Stock").

   (b) The Preferred Stock may be issued from time to time by the Board of Directors as herein provided in one or more series. The designations, relative rights, preferences and limitations of the Preferred Stock, and particularly of the shares of each series thereof, may, to the extent permitted by law, be similar to or may differ from those of any other series. The Board of Directors of the Corporation is hereby expressly granted authority, subject to the provisions of this Article 5, to issue from time to time Preferred Stock in one or more series and to fix from time to time before issuance thereof, by filing a certificate pursuant to the Business Corporation Law, the number of shares in each such series of such class and all designations, relative rights (including the right, to the extent permitted by law, to convert into shares of any class or into shares of any series of any class), preferences and limitations of the shares in each such series, including, but without limiting the generality of the foregoing, the following:

      (i) The number of shares to constitute such series (which number may at any time, or from time to time, be increased or decreased by the Board of Directors, notwithstanding that shares of the series may be outstanding at the time of such increase or decrease, unless the Board of Directors shall have otherwise provided in creating such series) and the distinctive designation thereof;

(ii) The dividend rate on the shares of such series, whether or not dividends on the shares of such series shall be cumulative, and the date or dates, if any, from which dividends thereon shall be cumulative;

(iii) Whether or not the shares of such series shall be redeemable, and, if redeemable, the date or dates upon or after which they shall be redeemable and the amount or amounts per share (which shall be, in the case of each share, not less than its preference upon involuntary liquidation, plus an amount equal to all dividends thereon accrued and unpaid, whether or not earned or declared) payable thereon in the case of the redemption thereof, which amount may vary at different redemption dates or otherwise as permitted by law;

(iv) The right, if any, of holders of shares of such series to convert the same into, or exchange the same for, Common Stock or other stock as permitted by law, and the terms and conditions of such conversion or exchange, as well as provisions for adjustment of the conversion rate in such events as the Board of Directors shall determine;

(v) The amount per share payable on the shares of such series upon the voluntary and involuntary liquidation, dissolution or winding up of the Corporation;

(vi) Whether the holders of shares of such series shall have voting power, full or limited, in addition to the voting powers provided by law, and, in case additional voting powers are accorded, to fix the extent thereof; and

(vii) Generally to fix the other rights and privileges and any qualifications, limitations or restrictions of such rights and privileges of such series, provided, however, that no such rights, privileges, qualifications, limitations or restrictions shall be in conflict with the Articles of Incorporation of the Corporation or with the resolution or resolutions adopted by the Board of Directors providing for the issue of any series of which there are shares then outstanding.

(c) All shares of Preferred Stock of the same series shall be identical in all respects, except that shares of any one series issued at different times may differ as to dates, if any, from which dividends thereon may accumulate. All shares of Preferred Stock of all series shall be of equal rank and shall be identical in all respects, except that to the extent not otherwise limited in this Article 5 any series may differ from any other series with respect to any one or more of the designations, relative rights, preferences and limitations described or referred to in subparagraphs (b)(i) to (vii) inclusive of this Article 5.

(d) Dividends on the outstanding Preferred Stock of each series shall be declared and paid or set apart for payment before any dividends shall be declared and paid or set apart for payment on the Common Stock with respect to the same quarterly dividend period. Dividends on any shares of Preferred Stock shall be cumulative only if and to the extent set forth in a certificate filed pursuant to law. After dividends on all shares of Preferred Stock (including cumulative dividends if and to the extent any such shares shall be entitled thereto) shall have been declared and paid or set apart for payment with respect to any quarterly dividend period, then and not otherwise as long as any shares of Preferred Stock shall remain outstanding, dividends may be declared and paid or set apart for payment with respect to the same quarterly dividend period on the Common Stock out of the assets or funds of the Corporation legally available therefor.

(e) All shares of Preferred Stock of all series shall be of equal rank, preference and priority as to dividends irrespective of whether or not the rates of dividends to which the particular series of Preferred Stock shall be entitled shall be the same and when the stated dividends are not paid in full, the shares of all series of Preferred Stock shall share ratably in the payment thereof in accordance with the sums which would be payable on such shares if all dividends were paid in full, provided, however, that any two or more series of Preferred Stock may differ from each other as to the existence and extent of the right to cumulative dividends, as aforesaid.

(f) Except as otherwise specifically provided in the certificate filed pursuant to law with respect to any series of Preferred Stock or as otherwise provided by law, the Preferred Stock shall not have any right to vote for the election of directors or for any other purpose and the Common Stock shall have the exclusive right to vote for the election of directors and for all other purposes. Each holder of Common Stock shall be entitled to one vote for each share thereof held. In all instances in which voting rights are granted to the Preferred Stock or any series thereof, such Preferred Stock or series shall vote with the Common Stock as a single class, except with respect to any vote for the approval of any merger, consolidation, liquidation or dissolution of the Corporation and except as otherwise provided in the certificate filed pursuant to law with respect to any series of the Preferred Stock or as otherwise provided by law.

(g) In the event of any liquidation, dissolution or winding up of the Corporation, whether voluntary or involuntary, each series of Preferred Stock shall have preference and priority over the Common Stock for payment of the amount to which each outstanding series of Preferred Stock shall be entitled in accordance with the provisions thereof and each holder of Preferred Stock shall be entitled to be paid in full such amount, or have a sum sufficient for the payment in full set aside, before any payments shall be made to the holders of Common Stock. If, upon liquidation, dissolution or winding up of the Corporation, the assets of the Corporation or the proceeds thereof, distributable among the holders of the shares of all series of Preferred Stock shall be insufficient to pay in full the preferential amount aforesaid, then such assets, or the proceeds thereof, shall be distributed among such holders ratably in accordance with the respective amounts which would be payable if all amounts payable thereon were paid in full. After the holders of the Preferred Stock of each series shall have been paid in full the amounts to which they respectively shall be entitled, or a sum sufficient for the payment in full set aside, the remaining net assets of the Corporation shall be distributed pro rata to the holders of the Common Stock in accordance with their respective rights and interests, to the exclusion of the holders of the Preferred Stock. A Consolidation or merger of the Corporation with or into another corporation or corporations, or a sale, whether for cash, shares of stock, securities or properties, of all or substantially all of the assets of the Corporation, shall not be deemed or construed to be a liquidation, dissolution or winding up of the Corporation within the meaning of this Article 5.

(h) In the event that Preferred Stock of any series shall be made redeemable as provided in subparagraph (b)(iii) of this Article 5, the Corporation, at the option of the Board of

Directors, may redeem at any time or times, from time to time, all or any part of any one or more series of Preferred Stock outstanding by paying for each share the then applicable redemption price fixed by the Board of Directors as provided herein, plus an amount equal to accrued and unpaid dividends to the date fixed for redemption, upon such notice and terms as may be specifically provided in the certificate filed pursuant to law with respect to such series of Preferred Stock.

(i) No holder of Preferred Stock of the Corporation shall be entitled, as such, as a matter of right, to subscribe for or purchase any part of any new or additional issue of stock of any class or series whatsoever, any rights or options to purchase stock of any class or series whatsoever or any securities convertible into, exchangeable for or carrying rights or options to purchase stock of any class or series whatsoever, whether now or hereafter authorized, and whether issued for cash or other consideration or by way of dividend.

6. Intentionally Omitted.

7. No merger, consolidation, liquidation or dissolution of the Corporation, nor any action that would result in the sale or other disposition of all or substantially all of the assets of the Corporation shall be valid unless first approved by the affirmative vote of:

(a) the holders of at least eighty percent (80%) of the outstanding shares of the voting stock of the Corporation; or

(b) the holders of at least a majority of the outstanding shares of voting stock of the Corporation, provided that such transaction has received the prior approval of at least seventy-five percent (75%) of all of the members of the Board of Directors.

8. Cumulative voting rights shall not exist with respect to the election of directors.

9. (a) The Board of Directors may, if it deems it advisable, oppose a tender or other offer for the corporation's securities, whether the offer is in cash or in the securities of a corporation or otherwise. When considering whether to oppose an offer, the Board of Directors may, but is not legally obligated to, consider any pertinent issue; by way of illustration, but not of limitation, the Board of Directors may, but shall not be legally obligated to, consider any or all of the following:

(i) Whether the offer price is acceptable based on the historical and present operating results or financial condition of the corporation;

(ii) Whether a more favorable price could be obtained for the corporation's securities in the future;

(iii) The impact which an acquisition of the corporation would have on the employees, depositors and customers of the corporation and its subsidiaries and the communities which they serve;

(iv) The reputation and business practices of the offeror and its management and affiliates as they would affect the employees, depositors and customers of the corporation and its subsidiaries and the future value of the corporation's stock;

(v) The value of the securities (if any) which the offeror is offering in exchange for the corporation's securities based on an analysis of the worth of the corporation as compared to the corporation or other entity whose securities are being offered; and

(vi) any antitrust or other legal and regulatory issues that are raised by the offer.

(b) If the Board of Directors determines that an offer should be rejected, it may take any lawful action to accomplish its purpose, including, but not limited to, any or all of the following: advising shareholders not to accept the offer; litigation against the offeror; filing complaints with all governmental and regulatory authorities; acquiring the corporation's securities; selling or otherwise issuing authorized but unissued securities or treasury stock or granting options with respect thereto; acquiring a company to create an antitrust or other regulatory problem for the offeror and obtaining a more favorable offer from another individual or entity.

Harleysville
NATIONAL CORPORATION

Harleysville
NATIONAL CORPORATION

2008 ANNUAL REPORT
ON FORM 10-K

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

Form 10-K

(Mark One)

☒ **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2008.**

OR

☐ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to .**

Commission file number 0-15237

Harleysville National Corporation
(Exact name of registrant as specified in its charter)

Pennsylvania (State or other jurisdiction of incorporation or organization)	**23-2210237** (I.R.S. Employer Identification No.)
483 Main Street, Harleysville, Pennsylvania (Address of principal executive offices)	**19438** (Zip Code)

Registrant's telephone number, including area code: **(215) 256-8851**

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1.00 par value	The NASDAQ Stock Market LLC

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ☐ No ☒

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

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

Yes ☐ No ☒

The aggregate market value of the Registrant's Common Stock held by non-affiliates is $317,118,196 based on the June 30, 2008 closing price of the Registrant's Common Stock of $11.16 per share.

As of March 10, 2009, there were 42,982,463 outstanding shares of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

1. Portions of the Registrant's Definitive Proxy Statement relating to the Annual Meeting of Shareholders to be held April 28, 2009 are incorporated by reference into Part III, Items 10-14 of this report.

HARLEYSVILLE NATIONAL CORPORATION

FORM 10-K

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Forward-Looking Statements

In addition to historical information, this report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We have made forward-looking statements in this report, and in documents that we incorporate by reference, that are subject to risks and uncertainties. Forward-looking statements include the information concerning possible or assumed future results of operations of Harleysville National Corporation (the Corporation) and its subsidiaries. When we use words such as "believes," "expects," "anticipates," "may," "estimates," or "intends" or similar expressions, we are making forward-looking statements. Forward-looking statements are representative only as of the date they are made, and the Corporation undertakes no obligation to update any forward-looking statement.

Shareholders should note that many factors, some of which are discussed elsewhere in this report and in the documents that we incorporate by reference, could affect the future financial results of the Corporation and its subsidiaries and could cause those results to differ materially from those expressed or implied in our forward-looking statements contained or incorporated by reference in this document. These factors include but are not limited to those described in Item 1A, "Risk Factors."

PART I

Item 1. Business

Harleysville National Corporation (the Corporation), a Pennsylvania corporation, was incorporated June 1, 1982. On January 1, 1983, the Corporation became the parent bank holding company of Harleysville National Bank and Trust Company (the Bank or Harleysville National Bank), established in 1909, a wholly owned subsidiary of the Corporation. The Corporation is registered as a bank holding company under the Bank Holding Company Act of 1956.

Since commencing operations, the Corporation's business has consisted primarily of providing financial services through its subsidiaries and has acquired nine financial institutions since 1991 including the recent acquisitions of Willow Financial Bancorp, Inc. (Willow Financial) and its banking subsidiary, Willow Financial Bank in December 2008 and East Penn Financial Corporation (East Penn Financial) and its banking subsidiary, East Penn Bank in November 2007. Additionally, the Corporation completed the acquisition of the Cornerstone Companies (registered investment advisors) in January 2006. The Corporation is also the parent holding company of HNC Financial Company and HNC Reinsurance Company. HNC Financial Company was incorporated on March 17, 1997 as a Delaware Corporation and its principal business function is to expand the investment opportunities of the Corporation. HNC Reinsurance Company was incorporated on March 30, 2001 as an Arizona Corporation and reinsures consumer loan credit life and accident and health insurance.

The Bank is a national banking association under the supervision of the Office of the Comptroller of the Currency (the OCC). The Corporation's and the Bank's legal headquarters are located at 483 Main Street, Harleysville, Pennsylvania 19438. HNC Financial Company's legal headquarters is located at 2751 Centerville Road, Suite 3164, Wilmington, Delaware 19808. HNC Reinsurance Company's legal headquarters is located at 101 North First Avenue, Suite 2460, Phoenix, AZ 85003.

The Bank provides a full range of banking services including loans and deposits, investment management and trust and investment advisory services to individual and corporate customers located primarily in eastern Pennsylvania. The Bank engages in the full-service commercial banking and trust business, including accepting time and demand deposits, making secured and unsecured commercial and consumer loans, financing commercial transactions, making construction and mortgage loans and performing corporate pension and personal investment and trust services. Deposits are insured by the Federal Deposit Insurance Corporation (FDIC) to the extent provided by law. As of December 31, 2008, the Bank had 85 branch offices located in Montgomery, Bucks, Chester, Berks, Carbon, Lehigh, Monroe, Northampton and Philadelphia counties, Pennsylvania.

The Bank has maintained a stable base of core deposits and is a leading community bank in its service areas. The Bank believes it has gained its position as a result of strategic acquisitions, a customer-oriented philosophy and a strong commitment to service. Senior management has made the development of a sales orientation throughout the Bank one of their highest priorities and emphasizes this objective with extensive training and sales incentive programs. The Bank maintains close contact with the local business community to monitor commercial lending needs and believes it responds to customer requests quickly and with flexibility.

The Bank opened new branches in Flourtown, Montgomery County and Whitehall, Lehigh County and relocated its Pottstown East End branch in Montgomery County during 2008. The Conshohocken branch in Montgomery County was opened in February 2009. The Bank continues to evaluate potential new branch sites that are contiguous to our current service area and will expand the Bank's market area and market share of loans and deposits.

Acquisitions

Effective after the market close on December 5, 2008, the Corporation completed its acquisition of Willow Financial Bancorp, Inc. and its subsidiary, Willow Financial Bank, a $1.6 billion bank with 29 banking offices in Southeastern Pennsylvania. Headquartered in Wayne, PA, Willow Financial Bank branch offices were located in Philadelphia, Montgomery, Chester, and Bucks Counties. On the acquisition date, Willow Financial had approximately $1.6 billion in assets, $1.1 billion in loans and $946.7 million in deposits. The acquisition of

Willow Financial is consistent with the Corporation's plan to strategically grow through disciplined in-market expansion. The merger delivers a significant market share in Chester County, one of the fastest growing counties in Pennsylvania, increases the Corporation's market presence in Bucks and Montgomery counties and establishes a new market presence in Philadelphia county. The combined company establishes a stronger presence in eastern Pennsylvania, including becoming the third largest financial institution headquartered in suburban Philadelphia. The Corporation also acquired BeneServ, Inc., a respected provider of employee benefits services from Willow Financial. The merger drives shareholder value by providing the opportunity to deliver synergies and accretion to earnings.

Effective November 16, 2007, the Corporation completed its acquisition of East Penn Financial and its subsidiary, East Penn Bank. On the acquisition date, East Penn Financial had approximately $451.1 million in assets, $337.7 million in loans and $382.7 million in deposits with nine banking offices located in Lehigh, Northampton and Berks Counties, Pennsylvania. The acquisition expanded the branch network of the Corporation in the Lehigh Valley and its opportunity to provide East Penn customers with a broader mix of products and services. As part of the merger agreement, East Penn Bank continues to operate under the East Penn name and logo, and has become a division of the Bank. Nine of the Bank's existing branches were transferred to the East Penn division including those in Lehigh, Carbon, Monroe, and Northampton Counties.

On March 1, 2007, the Cornerstone Companies, a subsidiary of the Bank, completed a selected asset purchase of McPherson Enterprises and related entities (McPherson), registered investment advisors specializing in estate and succession planning and life insurance for high-net-worth construction and aggregate business owners and families throughout the United States. McPherson became a part of the Cornerstone Companies, a component of the Bank's Millennium Wealth Management division. The acquisition was part of the Corporation's plan to continue to build its fee-based services businesses. The consideration for the transaction was $1.5 million in cash.

Effective January 1, 2006, the Bank completed its acquisition of the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Located in the Lehigh Valley, Pennsylvania, the firm serves clients throughout Pennsylvania and other mid-Atlantic states. The purchase price consisted of $15.0 million in cash paid at closing and a contingent payment of up to $7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of $7.0 million over this period. For 2006 through 2008, the minimum operating results were met resulting in earn-out payments totaling $3.6 million which were recorded as additional goodwill. At December 31, 2008, the remaining maximum payout is $3.4 million through 2010.

Dispositions

The Corporation completed a sale-leaseback transaction involving fifteen bank properties as well as a separate sale of office space during the fourth quarter of 2007. Under the leases, the Bank continues to utilize the properties in the normal course of business. The Corporation received net proceeds of $39.7 million and recorded a pre-tax gain of $2.8 million. The remaining gain of $17.1 million was deferred and is being amortized through a reduction of occupancy expense over the term of the leases.

Segments

The Corporation has two reportable operating segments: Community Banking and Wealth Management, as well as certain other non-reportable segments. As of December 31, 2008, the Wealth Management segment had assets under management of $2.6 billion. Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information" establishes standards for the way public business enterprises report information about operating segments. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision-maker in deciding how to allocate and assess resources and performance. The Corporation's chief operating decision-maker is the President and Chief Executive Officer. For more detailed financial information pertaining to operating segments, see Item 8— Note 17 of the Consolidated Financial Statements which is herein incorporated by reference.

As of December 31, 2008, the Corporation had total assets of $5.5 billion, total shareholders' equity of $474.7 million and total deposits of $3.9 billion.

As of December 31, 2008, the Corporation and the Bank employed approximately 1,169 full-time equivalent employees. The Corporation provides a variety of employment benefits and considers its relationships with its employees to be satisfactory.

Competition

The Bank competes actively with other eastern Pennsylvania financial institutions as well as with financial and non-financial institutions, many larger than the Bank, headquartered elsewhere. Commercial banks, savings banks, savings and loan associations, credit unions, and money market funds actively compete for deposits and loans. Such institutions, as well as consumer finance, insurance companies and brokerage firms, may be considered competitors with respect to one or more services they render. The Bank is generally competitive with all competing institutions in its service areas with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, interest rates charged on loans and fees for trust and investment advisory services. At December 31, 2008, the Bank's legal lending limit to a single customer was $55.6 million. Many of the institutions with which the Bank competes are able to lend significantly more than this amount to a single customer.

Concentrations/Seasonality

The Corporation and its subsidiaries do not have any portion of their businesses dependent on a single or limited number of customers, the loss of which would have a material adverse effect on the Corporation's business. No substantial portion of investments is concentrated within a single industry or group of related industries. The Corporation had no concentrations of credit extended to any specific industry that exceeded 10% of total loans at December 31, 2008. The businesses of the Corporation and its subsidiaries are not typically seasonal in nature.

Supervision and Regulation—The Registrant

The Gramm-Leach-Bliley Financial Modernization Act of 1999 (Modernization Act) allows bank holding companies meeting management, capital, and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than permissible before enactment, including underwriting insurance and making merchant banking investments in commercial and financial companies. It allows insurers and other financial services companies to acquire banks, removes various restrictions that currently apply to bank holding company ownership of securities firms and mutual fund advisory companies, and establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

The Modernization Act also modified law related to financial privacy and community reinvestment. The privacy provisions generally prohibit financial institutions, including the Corporation, from disclosing nonpublic financial information to nonaffiliated third parties unless customers have the opportunity to "opt out" of the disclosure.

Pending Legislation

Other than the FDIC insurance increase for 2009 and other regulatory matters as discussed subsequently, management is not aware of any other current specific recommendations by regulatory authorities or proposed legislation which, if they were implemented, would have a material adverse effect upon the liquidity, capital resources, or results of operations, although the general cost of compliance with numerous federal and state laws and regulations does have, and in the future may have, a negative impact on the Corporation's results of operations.

Effects of Inflation

Inflation has some impact on the Corporation's and the Bank's operating costs. Unlike many industrial companies, however, substantially all of the Bank's assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on the Corporation's and the Bank's performance than the general level of inflation. Over short periods of time, interest rates may not necessarily move in the same direction or in the same magnitude as prices of goods and services.

Effect of Government Monetary Policies

The earnings of the Corporation are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. An important function of the Federal Reserve is to regulate the money supply and interest rates. Among the instruments used to implement those objectives are open market operations in United States government securities and changes in reserve requirements to member bank deposits. These instruments are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may also affect rates charged on loans or paid for deposits.

The Bank is a member of the Federal Reserve and, therefore, the policies and regulations of the Federal Reserve have a significant effect on its deposits, loans and investment growth, as well as the rate of interest earned and paid, and are expected to affect the Bank's operations in the future. The effect of such policies and regulations upon the future business and earnings of the Corporation and the Bank cannot be predicted.

Environmental Regulations

There are several federal and state statutes which regulate the obligations and liabilities of financial institutions pertaining to environmental issues. In addition to the potential for attachment of liability resulting from its own actions, a bank may be held liable under certain circumstances for the actions of its borrowers, or third parties, when such actions result in environmental problems on properties that collateralize loans held by the bank. Further, the liability has the potential to far exceed the original amount of a loan issued by the bank. Currently, neither the Corporation nor the Bank are a party to any pending legal proceeding pursuant to any environmental statute, nor are the Corporation and the Bank aware of any circumstances that may give rise to liability under any such statute.

Supervision and Regulation—Bank

The operations of the Bank are subject to federal and state statutes applicable to banks chartered under the banking laws of the United States, to members of the Federal Reserve and to banks whose deposits are insured by the FDIC. The Bank's operations are also subject to regulations of the OCC, the Securities and Exchange Commission (SEC), the Federal Reserve and the FDIC. The primary supervisory authority of the Bank is the OCC, who regularly examines the Bank. The OCC has authority to prevent a national bank from engaging in unsafe or unsound practices in conducting its business.

Federal and state banking laws and regulations govern, among other things, the scope of a bank's business, the investments a bank may make, the reserves against deposits a bank must maintain, loans a bank makes and collateral it takes, the activities of a bank with respect to mergers and consolidations and the establishment of branches.

The Corporation and the Bank are subject to regulations of certain state and federal agencies and, accordingly, these regulatory authorities periodically examine the Corporation and the Bank. As a consequence of the extensive regulation of commercial banking activities, the Corporation's and the Bank's business is susceptible to being affected by state and federal legislation and regulations.

As a subsidiary bank of a bank holding company, the Bank is subject to certain restrictions imposed by the Federal Reserve Act on any extensions of credit to the bank holding company or its subsidiaries, or investments in the stock or other securities as collateral for loans. The Federal Reserve Act and Federal Reserve regulations also place certain limitations and reporting requirements on extensions of credit by a bank to principal shareholders of its parent holding company, among others, and to related interests of such principal shareholders. In addition, such legislation and regulations may affect the terms upon which any person becoming a principal shareholder of a holding company may obtain credit from banks with which the subsidiary bank maintains a correspondent relationship.

Under the Federal Deposit Insurance Act, the OCC possesses the power to prohibit institutions regulated by it (such as the Bank) from engaging in any activity that would be an unsafe and unsound banking practice or would otherwise be in violation of the law.

Community Reinvestment Act

Under the Community Reinvestment Act, the OCC is required to assess the record of all financial institutions regulated by it to determine if these institutions are meeting the credit needs of the community, including low and moderate income neighborhoods which they serve and to take this record into account in its evaluation of any application made by any of such institutions for, among other things, approval of a branch or other deposit facility, office relocation, a merger or an acquisition of bank shares. The Financial Institutions Reform, Recovery and Enforcement Act amended the CRA to require, among other things, that the OCC make publicly available the evaluation of a bank's record of meeting the credit needs of its entire community, including low and moderate income neighborhoods. This evaluation will include a descriptive rating like "outstanding," "satisfactory," "needs to improve" or "substantial noncompliance" and a statement describing the basis for the rating. These ratings are publicly disclosed.

Bank Secrecy Act

Under the Bank Secrecy Act, banks and other financial institutions are required to report to the Internal Revenue Service currency transactions of more than $10,000 or multiple transactions of which a bank is aware in any one day that aggregate in excess of $10,000 and to report suspicious transactions under specified criteria. Civil and criminal penalties are provided under the Bank Secrecy Act for failure to file a required report, for failure to supply information required by the Bank Secrecy Act or for filing a false or fraudulent report.

Capital Requirements / FDICIA

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires that institutions be classified, based on their risk-based capital ratios into one of five defined categories, as illustrated below: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. Under these guidelines, the Bank was considered well capitalized for the Tier 1 risk-based and Tier 1 leverage ratios and adequately capitalized for total risk based capital as of December 31, 2008. Unprecedented upheaval in the economy that has negatively impacted the credit and capital markets caused substantial "mark to market" discounts in connection with the acquisition of Willow Financial in December 2008. The Corporation does not believe that these "mark to market" valuations reflect a reduction in the realizable value of Willow Financial's assets and expects to recover the discount through amortization in 2009 and beyond. Purchase accounting adjustments related to the Willow Financial acquisition caused the Bank's total risk-based capital ratio to fall below the regulatory threshold for a well capitalized bank holding company. The Bank has instituted a plan targeted to return to "well capitalized" before the end of 2009.

	Total Risk Based Ratio	Tier 1 Risk Based Ratio	Tier 1 Leverage Ratio	Under a Capital Order or Directive
Capital category				
Well capitalized	≥10.0%	≥6.0%	≥5.0%	NO
Adequately capitalized	≥8.0%	≥4.0%	≥4.0%(1)	
Undercapitalized	<8.0%	<4.0%	<4.0%(1)	
Significantly undercapitalized	<6.0%	<3.0%	<3.0%	
Critically undercapitalized	Tangible equity capital ratio that is ≤ 2%			

(1) 3.0% for those banks having the highest available regulatory rating.

In the event an institution's capital deteriorates to the undercapitalized category or below, FDICIA prescribes an increasing amount of regulatory intervention, including: the institution of a capital restoration plan and a guarantee of the plan by a parent institution; and the placement of a hold on increases in assets, number of branches or lines of business. If capital has reached the significantly or critically undercapitalized levels, further material restrictions can be imposed, including restrictions on interest payable on accounts, dismissal of management and, in critically undercapitalized situations, appointment of a receiver. For well capitalized institutions, FDICIA provides authority for regulatory intervention where the institution is deemed to be engaging in unsafe or unsound practices or receives a less than satisfactory examination report rating for asset quality, management, earnings or liquidity. All but well capitalized institutions are prohibited from accepting brokered deposits without prior regulatory approval.

Under FDICIA, financial institutions are subject to increased regulatory scrutiny and must comply with certain operational, managerial and compensation standards developed by Federal Reserve Board regulations. As required by FDICIA, the regulators have adopted guidelines prescribing safety and soundness standards relating to internal controls, loan documentation, credit underwriting, interest rate exposure, asset growth and compensation, fees and benefits.

Annual full-scope, on site regulatory examinations are required for all FDIC-insured institutions except institutions with assets under $500 million that meet certain other criteria may qualify for an 18 month on site examination cycle. Banks with total assets of $500 million or more are required to have an annual audit of their consolidated financial statements in accordance with generally accepted auditing standards by an independent public accountant. The independent accountants of banks with total assets of $1 billion or more are required to attest to the accuracy of management's report regarding the internal controls of the bank. In addition, such banks also are required to have an independent audit committee composed of outside directors who are independent of management, to review with management and the independent accountants, the reports that must be submitted to the bank regulatory agencies. If the independent accountants resign or are dismissed, written notification must be given to the bank's supervising government banking agencies.

A separate subtitle within FDICIA, called the "Bank Enterprise Act of 1991," requires "truth-in-savings" on consumer deposit accounts so that consumers can make meaningful comparisons between the competing claims of banks with regard to deposit accounts and products. Under this provision, a bank is required to provide information to depositors concerning the terms of their deposit accounts, and in particular, to disclose the annual percentage yield.

Capital Distributions

The Corporation is a legal entity separate and distinct from its banking and other subsidiaries. The majority of the Corporation's revenue is from dividends paid to the Corporation by the Bank. The Bank is subject to various regulatory policies and requirements relating to the amount and frequency of dividend declarations. Future dividend payments to the Corporation by the Bank will be dependent on a number of factors, including the earnings and financial condition of the Bank, and are subject to limitations and other statutory powers of bank regulatory agencies.

The National Banking Laws require the approval of the OCC if the total of all dividends declared by a national bank in any calendar year exceed the net profits of the bank for that year combined with its retained net profits for the preceding two calendar years. An insured depository institution is prohibited from making any capital distributions to its owner, including any dividend, if, after making such distribution, the depository institution fails to meet the required minimum level for any relevant capital measure, including the risk-based capital adequacy and leverage standards previously discussed in the capital requirements section.

Deposit Insurance and Premiums

The Bank's deposits are insured by the Deposit Insurance Fund (DIF) which is administered by the FDIC. The basic insurance limit is $250,000 per depositor per insured institution through December 31, 2009. Certain retirement accounts, such as Individual Retirement Accounts are insured up to $250,000 per depositor per insured institution. The FDIC is authorized to consider inflation adjustments to increase the insurance limits for all deposit accounts every five years, beginning in 2010. The insurance is backed by the full faith and credit of the United States government.

As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the insurance fund. The FDIC also has the authority to terminate an institution's deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

On November 2, 2006, the FDIC set the designated reserve ratio for the deposit insurance fund at 1.25% of estimated insured deposits and adopted final regulations to implement the risk-based deposit insurance assessment system mandated by the Deposit Insurance Reform Act of 2005, which more closely ties each bank's deposit insurance assessments to the risk it poses to the deposit insurance fund. Under the new risk-based assessment system, the FDIC evaluates each institution's risk based on three primary factors -- supervisory ratings for all insured institutions, financial ratios for most institutions, and long-term debt issuer ratings for large institutions that have them and places the institution into one of four risk categories. Effective January 1, 2007, the rates range from 5 to 43 basis points. However, the Deposit Insurance Reform Act of 2005 provided credits to institutions that paid high premiums in the past to bolster the FDIC's insurance reserves, as a result of which a majority of banks had assessment credits to initially offset all of their premiums in 2007. The assessment credits for the Bank were fully utilized by December 31, 2008. The Bank was classified in the strongest risk category for 2008 and its assessment rate was approximately 6.3 basis points. The Bank paid FDIC premiums of $2.1 million in 2008, including $248,000 for Willow Financial.

In December 2008, the FDIC approved a final rule which will raise assessment rates uniformly by seven basis points for the first quarter of 2009 only. The FDIC proposes to establish new assessment rates effective April 1, 2009. The Bank expects that the assessment rates subsequent to the first quarter of 2009 will continue to be significantly higher than in 2008. The Bank estimates that its FDIC assessment for the first quarter of 2009 will be approximately $1.3 million.

In addition, all insured institutions are required to pay a Financing Corporation (FICO) assessment. FICO is a government agency-sponsored entity that was formed to borrow money necessary to carry out the closing and disposition of failed thrift institutions in the 1980's. The annual FICO rate for all insured institutions as of December 31, 2008 was 1.14 basis points. These assessments are revised quarterly and will continue until the bonds mature in the year 2019. The Bank paid FICO premiums of $364,000 in 2008.

Any significant increases in assessment rates or additional special assessments by the FDIC could have an adverse impact on the results of operations and capital of the Bank and the Corporation.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 implemented a broad range of corporate governance, accounting and reporting measures for companies that have securities registered under the Exchange Act, including publicly-held bank holding companies. The more significant reforms of the Sarbanes-Oxley Act of 2002 included: (1) new requirements for audit committees, including independence, expertise, and responsibilities; (2) certification of financial statements by the Chief Executive Officer and Chief Financial Officer of the reporting company; (3) new standards for auditors and regulation of audits, including independence provisions that restrict non-audit services that accountants may provide to their audit clients; (4) increased disclosure and reporting obligations for the reporting company and their directors and executive officers, including accelerated reporting of stock transactions and a prohibition on trading during pension blackout periods; (5) a range of new and increased civil and criminal penalties for fraud and other violations of the securities laws.

USA Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act) imposes additional obligations on financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. In addition, provisions of the USA Patriot Act require the federal financial institution regulatory agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing bank mergers and bank holding company acquisitions.

Supervision and Regulation - Cornerstone Companies

The Cornerstone Companies (Cornerstone Financial Consultants, Ltd. (CFC), Cornerstone Institutional Investors, Inc. (CII) and Cornerstone Advisors Asset Management, Inc. (CAAM)) are subject to regulation by a number of federal regulatory agencies that are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets. The SEC is the federal agency that is primarily responsible for the regulation of broker-dealers and investment advisers doing business in the United States. The Federal Reserve Board promulgates regulations applicable to securities credit transactions involving broker-dealers and certain other institutions. Much of the regulation of CII, as a registered broker-dealer, however, has been delegated to self-regulatory organizations (SROs), principally FINRA (Financial Industry Regulatory Authority, formerly known as the NASD), its subsidiaries and the national securities exchanges. These SROs, which are subject to oversight by the SEC, adopt rules (which are subject to approval by the SEC) that govern the industry, monitor daily activity and conduct periodic examinations of member broker-dealers.

CII, CFC and CAAM are registered investment advisers with the SEC and are subject to the requirements of the Investment Advisers Act of 1940 and the SEC's regulations, as well as certain state securities laws and regulations. These requirements relate to limitations on the ability of an investment adviser to charge performance-based or non-refundable fees to clients, record-keeping and reporting requirements, disclosure requirements, limitations on principal transactions between an adviser or its affiliates and advisory clients, as well as general anti-fraud prohibitions. CII, as a broker-dealer registered with the SEC and as a member firm of FINRA, is subject to capital requirements of the SEC and the FINRA. These capital requirements specify minimum levels of capital that CII is required to maintain and also limit the amount of leverage that it is able to obtain in its respective business.

In the event of non-compliance with an applicable regulation, governmental regulators and FINRA, if concerning CII, may institute administrative or judicial proceedings that may result in censure, fine, civil penalties, the issuance of cease-and-desist orders or the deregistration or suspension of the non-compliant broker-dealer or investment adviser or other adverse consequences. The imposition of any such penalties or orders on the Cornerstone Companies could have a material adverse effect on the Cornerstone Companies' (and therefore the Corporation's) operating results and financial condition.

CII is a member of the Securities Investor Protection Corporation (SIPC), which is a non-profit corporation that was created by the United States Congress under the Securities Protection Act of 1970. SIPC protects customers of member broker-dealers against losses caused by the financial failure of the broker-dealer but not against a change in the market value of securities in customers' accounts at the broker-dealer. In the event of the inability of a member broker-dealer to satisfy the claims of its customers in the event of its failure, the SIPC's funds are available to satisfy the remaining claims up to maximum of $500,000 per customer, including up to $100,000 on claims for cash. In addition, CII's clearing firm, Pershing LLC, carries private insurance that provides unlimited account protection in excess of SIPC's protection.

Changes in Regulations

From time to time, various types of federal and state legislation have been proposed that could result in additional regulation of, and restriction on, the business of the Corporation and the Bank. It cannot be predicted whether any such legislation will be adopted or, if adopted, how such legislation would affect the business of the Corporation or the Bank. As a consequence of the extensive regulation of commercial banking activities in the United States, the Corporation and the Bank are particularly susceptible to being affected by federal legislation and regulations that may increase the costs of doing business.

Additional Information

The Corporation's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge on the Corporation's website (*www.hncbank.com* under "Financial Information & Filings—Documents") as soon as reasonably practicable after the Corporation electronically files such material with, or furnishes it to the Securities and Exchange Commission. These filings are also accessible on the Securities and Exchange Commission's website (*www.sec.gov*). You may also read and copy any materials the Corporation files with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the Corporation makes available on *www.hncbank.com* under "Corporate Governance" the following: 1) Audit Committee Charter, 2) Code of Ethics, which applies to all directors and all employees, 3) Whistleblower Policy, 4) Nominating and Corporate Governance Committee Charter and 5) Compensation Committee Charter.

Item 1A. Risk Factors

The business of the Corporation and the Bank involve significant risks as described below. Additional risks may arise in the future or risks that are currently not considered significant may also impact the operations of the Corporation and the Bank. The Corporation may amend or supplement the risk factors described below from time to time by reports filed with the SEC in the future. Management's ability to analyze and manage these and other risks could affect the future financial results of the Corporation. If any of the events or circumstances described in the following risks occurs, the financial condition or results of operations of the Corporation could suffer and the trading price of the Corporation's common stock could decline.

Interest rate movements impact the earnings of the Corporation.

The Corporation is exposed to interest rate risk, through the operations of its banking subsidiary, since substantially all of the Bank's assets and liabilities are monetary in nature. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and value of financial instruments. The Bank's earnings, like that of most financial institutions, largely depends on net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and investments, and the interest expense paid on interest-bearing liabilities, such as deposits and borrowings. In an increasing interest rate environment, the cost of funds is expected to increase more rapidly than the interest earned on the loans and securities because the primary source of funds are deposits with generally shorter maturities than the maturities on loans and investment securities. This causes the net interest rate spread to compress and negatively impacts the Bank's profitability. Changes in interest rates may also adversely affect the Corporation's loan and deposit growth and the quality of its loan portfolio. The Corporation actively manages its interest rate sensitivity positions. The objectives of interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve consistent growth in net interest income. Continued aggressive pricing by competitors for loans and deposits may adversely affect the Corporation's profitability.

The Corporation is exposed to risks in connection with loans the Bank makes and if the allowance for loan losses is not sufficient to cover actual loan losses, the Corporation's earnings could decrease.

A significant source of risk for the Corporation arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. The Corporation has underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that are believed to be adequate to minimize this risk by assessing the likelihood of nonperformance, tracking loan performance and diversifying loan portfolios. Such policies and procedures, however, may not prevent unexpected losses that could adversely affect the Corporation's results of operations.

The Corporation maintains an allowance for loan losses at a level management believes is sufficient to absorb estimated probable credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires significant estimates by management. Consideration is given to a variety of factors in establishing these estimates including historical losses, current and anticipated economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' perceived financial and management strengths, the adequacy of underlying collateral, the dependence on collateral, or the strength of the present value of future cash flows and other relevant factors. These factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required which may adversely affect the Corporation's results of operations in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgment of information available to them at the time of their examination. If economic conditions weaken in the geographic region served by the Corporation, the allowance may not be sufficient to cover actual loan losses, which could adversely affect our profitability.

The Corporation's ability to pay dividends is subject to limitations.

The Corporation is a bank holding company and its operations are conducted by direct and indirect subsidiaries, each of which is a separate and distinct legal entity. Substantially all of the Corporation's assets are held by its direct and indirect subsidiaries.

The Corporation's ability to pay dividends depends on its receipt of dividends from its direct and indirect subsidiaries. Its principal banking subsidiary, Harleysville National Bank, is its primary source of dividends. Dividend payments from its banking subsidiaries are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by the various banking regulatory agencies. The ability of banking subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements. There is no assurance that the Corporation's subsidiaries will be able to pay dividends in the future or that the Corporation will generate adequate cash flow to pay dividends in the future. The Corporation's failure to pay dividends on its common stock could have a material adverse effect on the market price of its common stock.

The Corporation may fail to realize the anticipated benefits from mergers.

The success of mergers will depend, in part, on the Corporation's ability to realize the estimated cost savings or revenue enhancements from combining the businesses of the merged companies. If the Corporation's estimates are incorrect or the Corporation is unable to combine acquired companies successfully, the anticipated benefits may not be realized fully or at all, or may take longer to realize than expected. The integration process could result in the loss of key employees, the disruption of ongoing business, inconsistencies in standards, controls, procedures and policies that adversely affect the Corporation's ability to maintain relationships with clients and employees or achieve the anticipated benefits of the merger. As with any merger of financial institutions, there also may be disruptions that cause the Bank to lose customers or cause customers to withdraw their deposits from the Bank, or other unintended consequences that could have a material adverse effect on the Corporation's results of operations or financial condition.

Future acquisitions by the Corporation could dilute shareholder ownership of the Corporation and may cause the Corporation to become more susceptible to adverse economic events.

The Corporation has acquired other companies with its common stock in the past and may acquire or make investments in banks and other complementary businesses in the future. The Corporation may issue shares of its common stock in connection with these potential acquisitions and other investments, which would dilute shareholder ownership interest in the Corporation in the event that shareholders receive consideration in the form of the Corporation's common stock. While there is no assurance that these transactions will occur, or that they will occur on terms favorable to the Corporation, future business acquisitions could be material to the Corporation, and the degree of success achieved in acquiring and integrating these businesses into the Corporation could have a material effect on the value of Corporation's common stock. In addition, any such acquisition could require the Corporation to expend substantial cash or other liquid assets or to incur debt, which could cause the Corporation to become more susceptible to economic downturns and competitive pressures.

An economic downturn in eastern Pennsylvania or a general decline in economic conditions could adversely affect the Corporation's financial results.

The Bank's operations are concentrated in eastern Pennsylvania and to a lesser degree central and southern New Jersey and Delaware. As a result of this geographic concentration, the Corporation's financial results may correlate to the economic conditions in this area. Deterioration in economic conditions in this market area, particularly in the industries on which this geographic areas depend, or a general decline in economic conditions may adversely affect the quality of the loan portfolio (including the level of non-performing assets, charge offs and provision expense) and the demand for products and services, and accordingly, the Corporation's results of operations. Inflation has some impact on the Corporation's and the Bank's operating costs.

The soundness of other financial institutions may adversely affect the Corporation.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. The Corporation has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry, including commercial banks, brokers and dealers, investment banks, and other institutional clients. Many of these transactions expose the Corporation to credit risk in the event of a default by a counterparty or client. In addition, the Corporation's credit risk may be exacerbated when the collateral held by the Corporation cannot be realized upon or is liquidated at prices not sufficient to recover the full amount of the credit or derivative exposure due to the Corporation. Such losses could have a material adverse affect on the Corporation's financial condition and results of operations.

Current levels of market volatility may have materially adverse effects on the Corporation's liquidity, financial condition and/or profitability.

The capital and credit markets have been experiencing volatility and disruption for more than twelve months. In some cases, the markets have exerted downward pressure on stock prices, security prices and credit capacity for certain issuers without regard to those issuers' underlying financial strength. If the current levels of market disruption and volatility continue or worsen, there can be no assurance that the Corporation will not experience adverse effects, which may be material, on its liquidity, financial condition and/or profitability.

Strong competition within the Corporation's market area may limit its growth and profitability.

Competition in the banking and financial services industry is intense. The Bank competes actively with other eastern Pennsylvania financial institutions as well as with financial and non-financial institutions, many larger than the Bank, headquartered elsewhere. Commercial banks, savings banks, savings and loan associations, credit unions, and money market funds actively compete for deposits and loans. Such institutions, as well as consumer finance, insurance companies and brokerage firms, may be considered competitors with respect to one or more services they render. The Bank is generally competitive with all competing institutions in its service areas with respect to interest rates paid on time and savings deposits, service charges on deposit accounts, interest rates charged on loans and fees for trust and investment advisory services. Many of the institutions with which the Bank competes have substantially greater resources and lending limits and may offer certain services that the Bank does not or cannot provide. The Corporation's profitability depends upon the Bank's ability to successfully compete in its market area.

The Corporation operates in a highly regulated environment and may be adversely affected by changes in laws and regulations.

The Corporation and the Bank are subject to extensive regulation, supervision and examination by certain state and federal agencies including the Federal Deposit Insurance Corporation, as insurer of the Bank's deposits, the Board of Governors of the Federal Reserve System, as regulator of the holding company and the Office of the Comptroller of Currency. Such regulation and supervision governs the activities in which an institution and its holding company may engage, and are intended primarily to ensure the safety and soundness of financial institutions. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on operations, the classification of assets and determination of the level of the allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on the Bank's and the Corporation's operations. There are also several federal and state statutes which regulate the obligation and liabilities of financial institutions pertaining to environmental issues. In addition to the potential for attachment of liability resulting from its own actions, a bank may be held liable under certain circumstances for the actions of its borrowers, or third parties, when such actions result in environmental problems on properties that collateralize loans held by the bank. Further, the liability has the potential to far exceed the original amount of a loan issued by the bank.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

The principal executive offices of the Corporation and of the Bank are located in Harleysville, Pennsylvania in two, two-story office buildings leased by the Bank, one built in 1929 and the other in 2007. The Bank owns the buildings in which twenty-four of its branches are located (one branch opened in February 2009) and leases space for the other sixty-four branches from unaffiliated third parties under leases expiring at various times through 2037.

Office	Office Location	Owned/Leased
Airport Village	102 Airport Road, Coatesville, PA	Leased
Allentown	1602 Allen Street, Allenton, PA	Leased
Audubon	2624 Egypt Road, Norristown, PA	Owned(2)
Avondale	119 Pennsylvania Avenue, Avondale, PA	Owned
Bethlehem	4510 Bath Pike, Bethlehem, PA	Leased
Blue Bell	20 West Skippack Pike, Ambler PA	Owned(2)
Boyertown	Rt. 100 and Bause Road, Boyertown, PA	Leased
Brandywine Square	82 Quarry Road, Downingtown, PA	Leased
Busleton	9869 Bustleton Avenue, Philadelphia, PA	Leased
Cedar Crest	1251 S Cedar Crest Blvd, Allentown, PA	Leased
Chalfont	251 West Butler Avenue, Chalfont, PA	Leased
Coatesville	112 East Lincoln Highway, Coatesville, PA	Leased
Collegeville	364 East Main Street, Collegeville, PA	Owned
Conshohocken(3)	101 Ridge Pike, Conshohocken, PA	Owned(2)
Devon	414 Lancaster Avenue, Devon, PA	Leased
Dorneyville	3570 Hamilton Boulevard, Allentown, PA	Leased
Douglassville	1191 West Ben Franklin Highway, Douglassville, PA	Leased
Downingtown	100 E. Lancaster Avenue, Downingtown, PA	Leased
Doylestown	500 East Farm Lane, Doylestown, PA	Owned(2)
Dresher	701 Twining Road, Dresher, PA	Leased
Eagle	300 Simpson Drive, Chester Springs, PA	Leased
East Norriton	450 East Germantown Pike, East Norriton, PA	Owned(2)
Emmaus	731 Chestnut St, Emmaus, PA	Owned
Emmaus	502 State Ave, Emmaus, PA	Owned
Emmaus High School	500 Macungie Ave, Emmaus, PA	Leased
Exton	601 N. Pottstown Pike, Exton, PA	Leased
Feasterville	220 East Street Road, Feasterville, PA	Leased
Flourtown	1851 Bethlehem Pike, Flourtown, PA	Leased
Fogelsville	861 N. Rt. 100, Fogelsville, PA	Owned
Foulkeways	1120 Meetinghouse Road, Gwynedd, PA	Leased
Frazer	200 West Lancaster Avenue, Frazer, PA	Leased(4)
Gilbertsville	1050 East Philadelphia Avenue, Gilbertsville, PA	Leased
Harleysville Campus	483 Main Street, Harleysville, PA	Leased
Harleysville-Meadowbrook	278 Main Street, Harleysville, PA	Owned(2)
Hatboro	2 North York Road, Hatboro, PA	Leased
Hatfield	1632 Cowpath Road, Hatfield, PA	Leased
Horsham	955 Horsham Road, Horsham, PA	Leased
Huntington Valley	761 Huntingdon Pike, Huntingdon Valley, PA	Leased
Kennett Square	838 East Baltimore Pike, Kennett Square, PA	Owned(6)
King of Prussia	170 S. Warner Road, Suite 100, Wayne, PA	Leased
Kresgeville	Route 209, Kresgeville, PA	Leased
Lansdale-Marketplace	1551 Valley Forge Road, Lansdale, PA	Owned(2)
Lansdale-North Broad	1804 North Broad Street, Lansdale, PA	Leased
Lansford	13-15 West Ridge Street, Lansford, PA	Leased
Lehigh Township	4421 Lehigh Drive, Walnutport, PA	Leased

Office	Office Location	Owned/Leased
Lehighton	904 Blakeslee Blvd, Lehighton, PA	Leased
Limerick	260 West Ridge Pike, Limerick, PA	Leased
Macungie	201 W Main St, Macungie, PA	Owned(2)
Malvern(1)	30 Valley Stream Parkway, Malvern, PA	Leased
Maple Glen	732 Norristown Road, Maple Glen, PA	Leased
Meadowood	3205 Skippack Pike, Worcester, PA	Leased
Mertztown	951 State Street, Mertztown, PA	Leased
Normandy Farms	Morris Road & Route 202, Blue Bell, PA	Leased
North Wales (North Penn)	1498 North Wales Road, North Wales, PA	Leased
North Wales	122 N. Main Street, North Wales, PA	Leased
Oxford	499 North 3rd Street, Oxford, PA	Leased
Palmerton	372 Delaware Avenue, Palmerton, PA	Leased
Peter Becker Community	815 Maplewood Drive, Harleysville, PA	Leased
Pottstown Center	Rt. 100 and Shoemaker Road, Pottstown, PA	Owned(2)
Pottstown-Coventry	2 Glocker Way, Pottstown, PA	Owned(2)
Pottstown-East End	1450 East High Street, Pottstown, PA	Owned(2)
Pottstown-North End	930 North Charlotte Street, Pottstown, PA	Leased
Pottstown-Train Station	One Security Plaza, Pottstown, PA	Leased
Quakertown Main	224 West Broad Street, Quakertown, PA	Owned
Red Hill	400 Main Street, Red Hill, PA	Leased
Rhawnhurst	8200 Castor Avenue, Philadelphia, PA	Leased
Roslyn Valley	1331 Easton Road, Roslyn, PA	Leased
Royersford	440 W. Linfield-Trappe Road, Royersford, PA	Owned(2)
Sellersville	209 North Main Street, Sellersville, PA	Leased
Skippack	3893 Skippack Pike, Skippack, PA	Leased
Slatington	502 Main Street, Slatington, PA	Leased
Slatington Handi-Bank	701-705 Main Street, Slatington, PA	Leased
Somerton	11730 Bustleton Avenue, Philadelphia, PA	Leased
Souderton	702 Route 113, Souderton, PA	Owned(2)
Southampton	735 Davisville Road, Southampton, PA	Leased
Spring House(1)	1017 North Bethlehem Pike, Spring House, PA	Leased
Summit Hill	2 East Ludlow Street, Summit Hill, PA	Leased
Thorndale	3909 Lincoln Highway, Downingtown, PA	Leased
Trainers Corner	120 North West End Boulevard, Quakertown, PA	Leased
Trexlertown	6890 Hamilton Blvd, Trexlertown, PA	Owned
Warminster	190 Veterans Way, Warminster, PA	Owned(2)
Warminster Kmart Plaza	1141 Ivyland Road, Warminster, PA	Leased
Warminster Square	1555 West Street Road, Warminster, PA	Leased
West Chester	16 E. Market Street, West Chester, PA	Leased
Westtown	1197 Wilmington Pike, West Chester, PA	Leased
Whitehall	2985 MacArthur Rd, Whitehall, PA	Owned
Willow Grove	9 Easton Road, Willow Grove, PA	Owned(5) (6)
Wyomissing(1)	2800 State Hill Road, Wyomissing, PA	Leased
Additional Office Space		
Commercial Business Development	650 Sentry Parkway, Blue Bell, Pa	Leased
Harleysville National Bank Trust Department(1)	1690 Sumneytown Pike, Lansdale, PA	Leased
Cornerstone Financial Consultants	1802 Hamilton, Allentown PA	Leased
Cornerstone Financial	8320 Bellona Ave, Towson, MD	Leased

Office	Office Location	Owned/Leased
Consultants - McPherson		
Cornerstone Institutional Investments	74 West Broad St, Bethlehem, PA	Leased
Cornerstone Advisor Asset Management	74 West Broad St., Bethlehem, PA	Leased
HNC Financial Company	2751 Centerville Rd, Wilmington, DE	Leased
HNC Reinsurance Company	101 North First Avenue, Phoenix, AZ	Leased
Harleysville Management Services	474 Main St, Harleysville, Pa	Owned
BeneServ, Inc.	453 Baltimore Pike, Springfield, Pa	Leased

(1) Locations include Millennium Wealth Management and Private Banking offices.
(2) Branch buildings are owned by the Bank and the land is leased.
(3) Branch opened for business in February 2009.
(4) The branch facility at this location is owned. There is also a drive-up facility at this location that is leased.
(5) Includes the lease of an easement at this location.
(6) Branch buildings are rented but land is owned.

In management's opinion, all of the above properties are in good condition and are adequate for the Registrant's and the Bank's purposes.

Item 3. Legal Proceedings

As a result of the acquisition of Willow Financial, the Corporation recorded a liability in purchase accounting of $2.7 million in connection with certain legal contingencies which existed prior to the acquisition. The amount accrued represents estimated settlement and legal costs on ongoing litigation assumed from Willow Financial. There can be no assurance that any of the outstanding legal proceedings to which the Corporation is a party as a successor in interest to Willow Financial will not be decided adversely to the Corporation's interests and have a material effect on the financial condition and operations of the Corporation.

Management, based on consultation with the Corporation's legal counsel, is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Corporation. Except as noted above, there are no proceedings pending other than the ordinary routine litigation incident to the business of the Corporation and its subsidiaries—the Bank, HNC Financial Company and HNC Reinsurance Company. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation and the Bank by government authorities.

Item 4. Submission of Matters to a Vote of Security Holders

No matter was submitted during the fourth quarter of 2008 to a vote of holders of the Corporation's Common Stock.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The following table sets forth high and low closing sales prices for the Corporation's common stock and quarterly cash dividends paid per share for 2008 and 2007. The Corporation's stock is traded under the symbol "HNBC" on the NASDAQ Global Select Market. All share information has been restated to reflect stock dividends and splits. For certain limitations on the Bank's ability to pay dividends to the Corporation, see Item 1, "Supervision and Regulation—Bank" and Item 8, Note 20, "Notes to Consolidated Financial Statements—Regulatory Capital."

Price of Common Stock and Cash Dividends

2008	High Price	Low Price	Cash dividends per share
First Quarter	**$15.84**	**$12.50**	**$0.20**
Second Quarter	**15.24**	**11.16**	**0.20**
Third Quarter	**19.65**	**10.77**	**0.20**
Fourth Quarter	**16.86**	**11.27**	**0.20**

2007	High Price	Low Price	Cash dividends per share
First Quarter	$20.25	$17.11	$0.20
Second Quarter	18.13	15.54	0.20
Third Quarter	18.58	14.03	0.20
Fourth Quarter	17.17	13.15	0.20

At December 31, 2008, there were 4,080 shareholders of record, not including the number of persons or entities whose stock is held in nominee or "street" name through various brokerage firms and banks.

The Corporation has a stock repurchase program that permits the repurchase of up to five percent of its outstanding common stock. The repurchased shares will be used for general corporate purposes. The Corporation did not repurchase any shares of its stock under the Corporation's stock repurchase programs during 2008. The maximum number of share that may yet be purchased under the plans was 731,761 as of December 31, 2008. The repurchased shares are used for general corporate purposes. On May 12, 2005, the Board of Directors authorized a plan to purchase up to 1,416,712 shares (restated for five percent stock dividend paid on September 15, 2006 and September 15, 2005) or 4.9% of its outstanding common stock.

Equity Compensation Plan Information

The following table provides information about shares of the Corporation's stock that may be issued under existing equity compensation plans as of December 31, 2008:

Plan Category	Number Of Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants And Rights (A) (#)	Weighted-Average Exercise Price Of Outstanding Options, Warrants And Rights (B) ($)	Number Of Securities Remaining Available For Future Issuance Under Equity Compensation Plans, Excluding Securities Reflected In Column (A) (C)(#)
Equity Compensation Plans Approved by Stockholders	1,648,723[(1)]	$15.28 per share	1,157,625
Equity Compensation Plans Not Approved by Stockholders	-0-[(2)]	-0-	22,695
TOTAL	1,648,723	$15.28 per share	1,180,320

(1) Includes options issued under the Corporation's 1993 and 1998 Stock Incentive Plans, 1998 Independent Director's Stock Option Plan, 2004 Omnibus Stock Incentive Plan, options assumed pursuant to the merger & acquisition of Millennium Bank on April 30, 2004, options assumed pursuant to acquisition of East Penn Financial on November 16, 2007 and options assumed pursuant to the acquisition of Willow Financial on December 5, 2008.

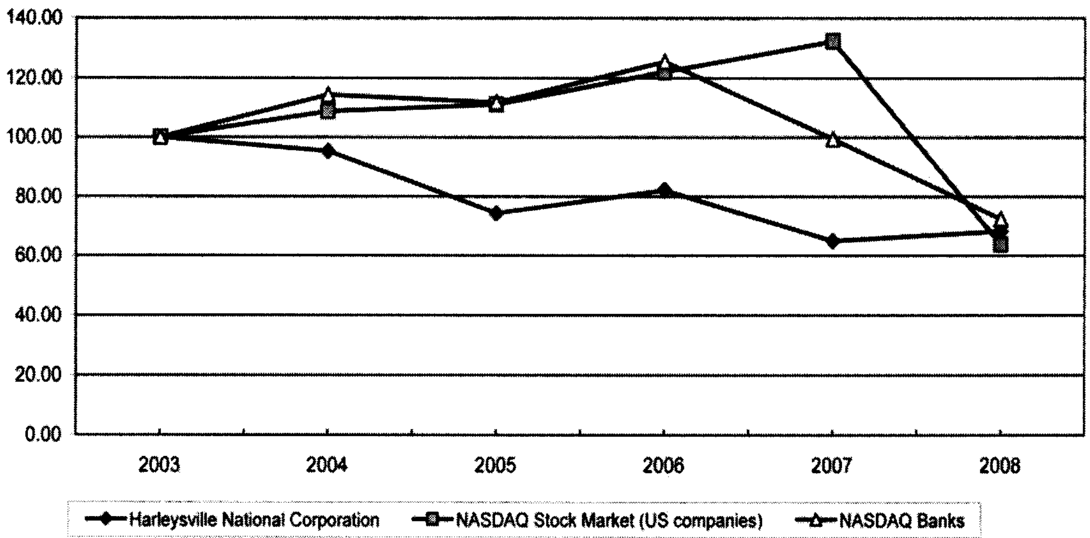
(2) On December 13, 1996, the Board of Directors authorized the registration of 70,354 shares of common stock for issuance under the Corporation's Employee Stock Bonus Plan. On December 24, 1996, in celebration of the Corporation reaching $1 billion in total assets, 41,685 shares were issued to full and part-time employees of the Corporation's subsidiaries. Annually, since 1996, a total of 5,974 shares in the aggregate, have been awarded under this Plan to employees in recognition of exemplary service during each calendar year. When awarded, the value of shares is based on the closing price of the Corporation's common stock as of the close of business on the last business day of the most recently completed calendar quarter. Registered shares and available shares under the Plan reflect adjustment for stock dividends.

Additional information on the Corporation's equity compensation plans included under Item 8, Note 1, "Notes to Consolidated Financial Statements—Stock-Based Compensation and Note 14, "Stock-Based Compensation," is incorporated herein by reference.

Performance Graph

The following graph contains a comparison of the cumulative total returns on Harleysville National Corporation's common stock against the cumulative total returns of the NASDAQ Stock Market (U.S. companies) Index and the NASDAQ Bank Stocks Index for the period of five fiscal years commencing December 31, 2003, and ending December 31, 2008. The graph assumes that $100 was invested on December 31, 2003 in the Corporation's common stock, the NASDAQ Stock Market (US companies) and NASDAQ Banks. The cumulative returns assume the reinvestment of dividends. The shareholder return shown on the graph below is not necessarily indicative of future performance.

Comparison of Five-Year Cumulative Total Returns*



Zack's Total Return Annual Comparison
Five-Year Cumulative Total Return Summary

	2003	2004	2005	2006	2007	2008
Harleysville National Corporation	100.00	95.41	74.47	82.13	65.01	68.27
NASDAQ Stock Market (US companies)	100.00	108.84	111.16	122.11	132.42	63.80
NASDAQ Banks	100.00	114.45	111.80	125.48	99.46	72.51

Notes:
Corporate Performance Graph with peer group uses peer group only performance (excludes only company).
Peer group indices use beginning of period market capitalization weighting.

* Source: Zack's Investment Research, Inc.

Item 6. Selected Financial Data

	Year Ended December 31,				
	2008(1)	2007(2)	2006(3)	2005	2004(4)
	(Dollars in thousands, except per share information)				
Income and expense					
Interest income	**$ 206,294**	$ 194,561	$ 178,941	$ 151,739	$ 127,729
Interest expense	**102,154**	112,127	95,768	64,618	42,638
Net interest income	**104,140**	82,434	83,173	87,121	85,091
Provision for loan losses	**15,567**	10,550	4,200	3,401	2,555
Net interest income after provision for loan losses	**88,573**	71,884	78,973	83,720	82,536
Noninterest income	**46,217**	43,338	45,348	29,990	28,158
Noninterest expense	**104,622**	81,355	70,830	62,479	59,561
Income before income tax expense	**30,168**	33,867	53,491	51,231	51,133
Income tax expense	**5,075**	7,272	14,076	12,403	12,566
Net income	**$ 25,093**	$ 26,595	$ 39,415	$ 38,828	$ 38,567
Per share information(5)					
Basic earnings	**$ 0.78**	$ 0.91	$ 1.36	$ 1.34	$ 1.35
Diluted earnings	**0.78**	0.90	1.34	1.32	1.31
Cash dividends paid	**0.80**	0.80	0.75	0.72	0.65
Book value (at year-end)	**11.05**	10.83	10.18	9.48	9.34
Basic average common shares outstanding	**32,201,150**	29,218,671	28,946,847	28,891,412	28,505,392
Diluted average common shares outstanding	**32,364,137**	29,459,898	29,353,128	29,490,216	29,465,613
Average balance sheet					
Loans	**$2,585,101**	$2,123,170	$2,014,420	$1,900,023	$1,625,419
Investments	**1,037,112**	944,464	925,635	903,063	941,910
Other interest-earning assets	**48,474**	72,087	79,670	51,740	41,064
Total assets	**3,997,972**	3,371,304	3,229,224	3,039,186	2,773,405
Deposits	**3,004,070**	2,557,546	2,469,514	2,259,831	2,094,998
Borrowed funds	**586,088**	471,296	434,938	456,599	372,141
Shareholders' equity	**336,654**	298,393	281,847	272,974	251,963
Balance sheet at year-end					
Loans	**$3,685,244**	$2,460,823	$2,047,355	$1,985,493	$1,845,802
Investments	**1,231,661**	982,915	911,889	901,208	943,563
Other interest-earning assets	**27,221**	135,473	62,975	37,455	56,291
Total assets	**5,490,509**	3,903,001	3,249,828	3,117,359	3,024,515
Deposits	**3,938,432**	2,985,058	2,516,855	2,365,457	2,212,563
Borrowed funds	**990,498**	508,285	389,495	439,168	488,182
Shareholders' equity	**474,707**	339,310	294,751	273,232	270,532
Performance ratios					
Return on average assets	**0.63%**	0.79%	1.22%	1.28%	1.39%
Return on average equity	**7.45**	8.91	13.98	14.22	15.31
Average equity to average assets	**8.42**	8.85	8.73	8.98	9.08
Dividend payout ratio	**100.06**	88.82	55.26	53.41	48.16
Net interest margin	**3.04**	2.82	2.95	3.27	3.55

(1) The results of operations include the acquisition of the Willow Financial effective December 5, 2008.
(2) The results of operations include the acquisition of the East Penn Financial effective November 16, 2007 and the sale lease-back of bank properties during the fourth quarter of 2007.
(3) The results of operations include the acquisition of the Cornerstone Companies effective January 1, 2006 and the sale of the Bank's Honesdale branch effective November 10, 2006.
(4) The results of operations include the acquisition of Millennium Bank effective April 30, 2004.
(5) Adjusted for a five percent stock dividend effective September 15, 2006, September 15, 2005 and September 15, 2004.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following is management's discussion and analysis of the significant changes in the results of operations, capital resources and liquidity presented in its accompanying consolidated financial statements for Harleysville National Corporation (the Corporation), and its wholly owned subsidiaries—Harleysville National Bank (the Bank), HNC Financial Company and HNC Reinsurance Company. The Corporation's consolidated financial condition and results of operations consist almost entirely of the Bank's financial condition and results of operations. Current performance does not guarantee, and may not be indicative of, similar performance in the future. The information in Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Corporation's consolidated financial statements and the accompanying footnotes under Item 8 and the Forward-Looking Statements on page 3 of this report on Form 10-K.

Critical Accounting Estimates

The accounting and reporting policies of the Corporation and its subsidiaries conform to accounting principles generally accepted in the United States and general practices with the financial services industry. The Corporation's significant accounting policies are described in Note 1 of the consolidated financial statements and are essential in understanding Management's Discussion and Analysis of Results of Operations and Financial Condition. In applying accounting policies and preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. Therefore, actual results could differ significantly from those estimates. Judgments and assumptions required by management, which have, or could have a material impact on the Corporation's financial condition or results of operations are considered critical accounting estimates. The following is a summary of the policies the Corporation recognizes as involving critical accounting estimates: Allowance for Loan Loss, Goodwill and Other Intangible Asset Impairment, Stock-Based Compensation, Unrealized Gains and Losses on Securities Available for Sale, and Deferred Taxes.

Allowance for Loan Losses: The Corporation maintains an allowance for loan losses at a level management believes is sufficient to absorb estimated probable credit losses. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires significant estimates by management. Consideration is given to a variety of factors in establishing these estimates including historical losses, current and anticipated economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, borrowers' perceived financial and management strengths, the adequacy of underlying collateral, the dependence on collateral, or the strength of the present value of future cash flows and other relevant factors. These factors may be susceptible to significant change. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required which may adversely affect the Corporation's results of operations in the future.

Goodwill and Other Intangible Asset Impairment: Goodwill and other intangible assets are reviewed for potential impairment on an annual basis, or more often if events or circumstances indicate that there may be impairment, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. The Corporation employs general industry practices in evaluating the fair value of its goodwill and other intangible assets. The Corporation calculates the fair value, with the assistance of a third party specialist, using a combination of the following valuation methods: dividend discount analysis under the income approach, which calculates the present value of all excess cash flows plus the present value of a terminal value and market multiples (pricing ratios) under the market approach. Management performed its annual review of goodwill and other identifiable intangibles at June 30, 2008 and determined there was no impairment of goodwill or other identifiable intangibles. No assurance can be given that future impairment tests will not result in a charge to earnings.

Stock-based Compensation: The Corporation recognizes compensation expense for stock options in accordance with SFAS 123 (revised 2004), "Share-Based Payment" (SFAS 123(R)) adopted at January 1, 2006 under the modified prospective application method of transition. The expense of the option is generally measured at fair value at the grant date with compensation expense recognized over the service period, which is usually the vesting period. For grants subject to a service condition, the Corporation utilizes the Black-Scholes option-pricing model (as used under SFAS 123) to estimate the fair value of each option on the date of grant. The Black-Scholes model takes into consideration the exercise price and expected life of the options, the current price of the underlying stock and its expected volatility, the expected dividends on the stock and the current risk-free interest rate for the expected life of the option. For grants subject to a market condition, the Corporation utilizes a Monte Carlo simulation to estimate the fair value and determine the derived service period. Compensation is recognized over the derived service period with any unrecognized compensation cost immediately recognized when the market condition is met. The Corporation's estimate of the fair value of a stock option is based on expectations derived from historical experience and may not necessarily equate to its market value when fully vested. In accordance with SFAS 123(R), the Corporation estimates the number of options for which the requisite service is expected to be rendered.

Unrealized Gains and Losses on Securities Available for Sale: The Corporation receives estimated fair values of debt securities from independent valuation services and brokers. In developing these fair values, the valuation services and brokers use estimates of cash flows based on historical performance of similar instruments in similar rate environments. Debt securities available for sale are mostly comprised of mortgage-backed securities as well as tax-exempt municipal bonds and U.S. government agency securities. The Corporation uses various indicators in determining whether a security is other-than-temporarily impaired, including for equity securities, if the market value is below its cost for an extended period of time with low expectation of recovery or for debt securities, when it is probable that the contractual interest and principal will not be collected. The debt securities are monitored for changes in credit ratings. Adverse changes in credit ratings would affect the estimated cash flows of the underlying collateral or issuer. The Bank recognized an other-than-temporary impairment charge of $1.9 million during the fourth quarter of 2008 as a result of deterioration in the individual credits of a collateralized debt obligation investment in a pool of trust preferred securities. The unrealized losses associated with the securities portfolio, that management has the ability and intent to hold, are not considered to be other-than temporary as of December 31, 2008 because the unrealized losses are primarily related to changes in interest rates and current market conditions, however, we do not see any negative effect on the expected cash flows of the underlying collateral or issuer. The unrealized losses are affecting all portfolio sectors with collateralized mortgage obligation securities and preferred securities having the largest reductions.

Deferred Taxes: The Corporation recognizes deferred tax assets and liabilities for the future effects of temporary differences, net operating loss carryforwards, and tax credits. Deferred tax assets are subject to management's judgment based upon available evidence that future realizations are likely. If management determines that the Corporation may not be able to realize some or all of the net deferred tax asset in the future, a charge to income tax expense may be required to reduce the value of the net deferred tax asset to the expected realizable value.

The Corporation has not substantively changed its application of the foregoing policies, and there have been no material changes in assumptions or estimation techniques used as compared to prior periods.

Financial Overview

For the year ended December 31, 2008, the Corporation's diluted earnings per share were $0.78 compared to $0.90 for 2007. Net income in 2008 was $25.1 million compared to $26.6 million in 2007. The year-to-date financial results include the impact on operations from the acquisition of the Willow Financial Corporation effective December 5, 2008 and the related issuance of 11,515,366 shares of the Corporation common stock. In addition, the Corporation's 2008 year-to-date results include a full year of income and expense resulting from the acquisition of East Penn Financial and its subsidiary, East Penn Bank, effective November 16, 2007. The following is an overview of the key financial highlights for 2008:

Consolidated total assets were $5.5 billion at December 31, 2008, an increase of 40.7% or $1.6 billion over $3.9 billion in total assets reported at December 31, 2007. Effective December 5, 2008, the Corporation completed its acquisition of Willow Financial. At the acquisition date, Willow Financial had approximately $1.6 billion in assets, $1.1 billion in gross loans and $946.7 million in deposits.

The return on average shareholders' equity was 7.45% in 2008 compared to 8.91% in 2007. The return on average assets was 0.63% in 2008 compared to 0.79% in 2007. The decrease in these ratios during 2008 was primarily the result of increases in average assets and average equity coupled with lower net income.

Loans increased $1.2 billion and deposits increased $953.4 million. Adjusted for the Willow Financial acquisition, organic loan growth was approximately $125.7 million or 5.1% and deposit growth was approximately $6.7 million or 0.2%.

Net interest income on a tax-equivalent basis increased $23.2 million, or 26.2%, for the year ending December 31, 2008, over the prior year. The net interest margin for 2008 increased to 3.04% compared to 2.82% for 2007. The net interest margin increased as a 56 basis point decrease in the yield on average earning assets of $3.7 billion was offset by a 98 basis point decrease in the cost of interest bearing liabilities of $3.2 billion.

Nonperforming assets increased $56.6 million to $78.5 million at December 31, 2008 from $22.0 million at December 31, 2007. Nonperforming assets as a percentage of total assets increased to 1.43% at December 31, 2008 from 0.56% at December 31, 2007. The provision for loan losses increased $5.0 million mostly as a result of decreased quality of the loan portfolio which caused an increase in the amount of the required reserve. Net charge-offs decreased $1.8 million for 2008 compared to 2007 principally due to prior year charge-offs for real estate construction loans for one borrower combined with an increase in recoveries both related to commercial and industrial loans and real estate loans.

Noninterest income increased $2.9 million or 6.6% during 2008. Increases in service charges of $3.8 million and gains on investment securities of $1.5 million were partially offset by a fourth quarter 2008 other than temporary impairment of available for sale securities of $1.9 million and a 2007 one-time gain of a sale-leaseback of bank properties transaction of $2.8 million. Other income increased $2.0 million during 2008 driven by increases in ATM and point of sale fee income of $835,000, fees on derivative instruments of $627,000 and a $405,000 death benefit earned on bank owned life insurance.

Noninterest expense increased $23.3 million or 28.6% in 2008 as compared to 2007. This increase is due primarily to increases of $7.3 million in salaries and benefits, $3.1 million in occupancy, $3.0 million in merger charges, $3.0 million in intangibles expense, $1.8 million in FDIC insurance and increases in consulting and legal fees. The increases in salaries and occupancy are mainly the result of a full year of expenses for East Penn Financial which was acquired in November 2007 as well as one month of expenses for Willow Financial. Intangibles expense in 2008 includes $1.4 million in valuation adjustments of mortgage servicing rights with the remaining increase relating to the acquisitions noted above. FDIC insurance expense increased as the Corporation had applied a one-time assessment credit in 2007 which offset most of the expense for the year.

Acquisitions/Dispositions

Effective after the market close on December 5, 2008, the Corporation completed its acquisition of Willow Financial. Under the terms of the merger agreement, dated as of May 20, 2008, Willow Financial was acquired by the Corporation and Willow Financial's wholly-owned subsidiary, Willow Financial Bank, a $1.6 billion savings bank with 29 branch offices in Southeastern Pennsylvania, was merged with and into the Bank. The merger of the Corporation and Willow Financial resulted in a combined company with approximately $5.5 billion in assets and delivers a significant market share in Chester County, one of the fastest-growing counties in Pennsylvania, increases the Corporation's market presence in Bucks and Montgomery counties, and establishes a new market presence in Philadelphia County. The combined company establishes a stronger presence in eastern Pennsylvania, including becoming the third largest financial institution headquartered in suburban Philadelphia. Willow Financial has complementary lines of business, a solid reputation with customers in growing markets, and a branch network that augments the Bank's traditional footprint. In conjunction with this transaction, the Corporation also acquired BeneServ, Inc., a respected provider of employee benefits services and Carnegie

Wealth Advisors, LLC (Carnegie). Carnegie was subsequently sold in December 2008. The Willow Financial merger is expected to be accretive to the Corporation's earnings for the fiscal year of 2009.

The Corporation acquired 100% of the outstanding shares of Willow Financial. The transaction was accounted for in accordance with SFAS No. 141, "Business Combinations." Based on the terms of the merger agreement, Willow Financial shareholders received 0.73 shares of the Corporation's common stock for each share of Willow Financial common stock they held with cash paid in lieu of fractional shares. The purchase price was $13.79 per common share and was based upon the average of the closing prices for the Corporation's common stock on the agreement date and for two days before and two days after the agreement date and the agreement date. The Corporation issued 11,515,366 shares of common stock, incurred $2.4 million in acquisition costs which were capitalized and converted stock options with a fair value of $2.0 million for a total purchase price of $163.2 million at the closing on December 5, 2008. Willow Financial's results of operations are included in the Corporation's results from the date of acquisition, December 5, 2008.

Effective November 16, 2007, the Corporation completed its acquisition of East Penn Financial and its subsidiary, East Penn Bank. At the acquisition date, East Penn Financial had approximately $451.1 million in assets with nine banking offices located in Lehigh, Northampton and Berks Counties. The acquisition expanded the branch network of the Corporation in the Lehigh Valley and its opportunity to provide East Penn customers with a broader mix of products and services. As part of the merger agreement, East Penn Bank continues to operate under the East Penn name and logo, and has become a division of the Bank. Nine of the Bank's existing branches were transferred to the East Penn division including those in Lehigh, Carbon, Monroe, and Northampton Counties. The Corporation acquired 100% of the outstanding shares of East Penn Financial for a total purchase price of $91.3 million. The transaction was accounted for in accordance with SFAS No. 141, "Business Combinations." East Penn Financial shareholders received 2,432,771 shares of the Corporation's common stock and $49.9 million for all outstanding common shares. East Penn Financial option holders received $792,000 and options to acquire 25,480 shares of the Corporation's common stock in exchange for all outstanding options. East Penn Financial's results of operations are included in the Corporation's results from the date of acquisition, November 16, 2007.

On March 1, 2007, the Cornerstone Companies, a subsidiary of the Bank, completed a selected asset purchase of McPherson Enterprises and related entities (McPherson), registered investment advisors specializing in estate and succession planning and life insurance for high-net-worth construction and aggregate business owners and families throughout the United States. McPherson became a part of the Cornerstone Companies, a component of the Bank's Millennium Wealth Management division. The acquisition was part of the Corporation's plan to continue to build its fee-based services businesses. The consideration for the transaction was $1.5 million in cash.

Effective January 1, 2006, the Bank completed its acquisition of the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Located in the Lehigh Valley, Pennsylvania, the firm serves clients throughout Pennsylvania and other mid-Atlantic states. The transaction was accounted for using the purchase method of accounting. The purchase price consisted of $15.0 million in cash paid at closing and a contingent payment of up to $7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of $7.0 million over this period. For 2006 through 2008, the minimum operating results were met resulting in earn-out payments totaling $3.6 million which was recorded as additional goodwill. At December 31, 2008, the remaining maximum payout is $3.4 million through 2010. The Cornerstone Companies results of operations are included in the Corporation's results from the effective date of the acquisition, January 1, 2006.

On December 27, 2007, the Bank settled and closed an agreement to sell fifteen properties to affiliates of American Realty Capital, LLC ("ARC") in a sale-leaseback transaction. The properties are located throughout Berks, Bucks, Lehigh, Montgomery, Northampton, and Carbon counties. Under the leases, the Bank continues to utilize the properties in the normal course of business. Lease payments on each property are institution-quality, triple net leases with an initial annual aggregate base rent of $3.0 million with annual rent escalations equal to the lower of CPI-U (Consumer Price Index for all Urban Consumers) or 2.0 percent commencing in the second year of the lease term. As tenant, the Bank is fully responsible for all costs associated with the operation, repair and maintenance of the properties during the lease terms and is recorded as occupancy expense. The agreement provides that each lease will have a term of 15 years, commencing on the closing date for the Agreement. The agreement also contains options to renew for periods aggregating up to 45 years. Under certain circumstances these renewal options are subject to revocation by the lessor. The Bank received net proceeds of $38.2 million and recorded a gain on sale from the transaction of $2.3 million (pre-tax) representing a portion of the total gain of $18.9 million. The remaining gain was deferred and is being amortized through a reduction of occupancy expense over the 15-year term of the leases an annual amount of $1.1 million. The Corporation also completed a separate sale-leaseback of office in October 2007 receiving net proceeds of $1.5 million with a recognized pre-tax gain of $473,000. The deferred gain of $552,000 is being amortized over the 10-year term of the lease. This strategic initiative was undertaken to help the Corporation translate a large non-earning asset into an earning asset in the form of loans, to help bolster earnings and increase liquidity.

For a five-year summary of financial information, see Item 6, "Selected Financial Data," which is incorporated herein by reference.

For quarterly information for 2008 and 2007, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Fourth Quarter 2008 Results," and Table 17, "Selected Quarterly Financial Data," which are incorporated herein by reference.

Investment Securities

SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" requires that debt and equity securities classified as available for sale be reported at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. The net effect of unrealized gains or losses, caused by marking an available for sale portfolio to market, causes fluctuations in the level of shareholders' equity and equity-related financial ratios as market interest rates cause the fair value of fixed-rate securities to fluctuate.

Investment securities and other investments increased 25.3% to $1.2 billion at December 31, 2008 from $982.9 million at December 31, 2007. The investment securities available for sale increased $231.6 million and the investment securities held to maturity decreased $6.9 million. The majority of the increase in available for sale securities is due to the securities acquired from Willow Financial of $238.3 million on December 5, 2008. The securities acquired from Willow Financial include $165.7 million in securities available for sale and $72.6 million in securities held to maturity. Upon acquisition, the Corporation recorded the securities held to maturity purchased from Willow as available for sale. During 2008, $208.5 million of securities available for sale were sold which generated a pre-tax gain of $2.6 million. The securities sold consisted primarily of bullet and callable agency, tax-exempt municipal and mortgage-backed securities. The increase in available for sale securities at December 31, 2007 compared to December 31, 2006 of $72.6 million was mainly due to the securities acquired from East Penn Financial of $66.2 million at November 16, 2007. During 2007, securities available for sale totaling $186.2 million were sold which generated a pretax gain of $1.2 million.

The following table shows the carrying value of the Corporation's investment securities available for sale and held to maturity:

Table 1—Investment Portfolio

(Dollars in thousands)	December 31, 2008	2007	2006
Investment securities available for sale:			
Obligations of U.S. government agencies and corporations	**$ 93,894**	$ 98,734	$119,956
Obligations of states and political subdivisions	**286,875**	228,436	201,643
Mortgage-backed securities	**705,483**	515,989	476,107
Other securities	**55,696**	67,208	37,960
Total investment securities available for sale	**$1,141,948**	$910,367	$835,666
Investment securities held to maturity:			
Obligations of U.S. government agencies and corporations	**$ 3,880**	$ 3,868	$ 3,856
Obligations of states and political subdivisions	**46,554**	53,479	55,023
Total investment securities held to maturity	**$ 50,434**	$ 57,347	$ 58,879

The maturity analysis of investment securities including the weighted average yield for each category as of December 31, 2008 is as follows. Actual maturities may differ from contractual maturities because issuers and borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Table 2—Maturity and Tax-Equivalent Yield Analysis of Investment Securities

	December 31, 2008				
	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years through 10 years	Due after 10 years	Total
	(Dollars in thousands)				
Investment securities available for sale:					
Obligations of U.S. government agencies and corporations:					
Fair value	$—	$58,094	$ 21,135	$ 14,665	$ 93,894
Weighted average yield	—%	3.13%	5.18%	5.39%	3.95%
Obligations of states and political subdivisions:					
Fair value	—	2,886	70,782	213,207	286,875
Weighted average yield(1)	—%	8.75%	5.97%	6.62%	6.48%
Mortgage-backed securities:					
Fair value	—	17,177	94,789	593,517	705,483
Weighted average yield	—%	4.62%	4.82%	5.37%	5.28%
Other debt securities:					
Fair value	1,507	10,599	6,008	15,917	34,031
Weighted average yield	4.73%	3.53%	2.68%	5.57%	4.39%
Equity securities:					
Fair value	—	—	—	—	21,665
Weighted average yield	—%	—%	—%	—%	3.77%
Total investment securities available for sale:					
Fair value	**$1,507**	**$88,756**	**$192,714**	**$837,306**	**$1,141,948**
Weighted average yield	**4.73%**	**3.65%**	**5.14%**	**5.69%**	**5.45%**
Investment securities held to maturity:					
Obligations of U.S. government agencies and corporations:					
Amortized cost	$ —	$ —	$ 3,880	$ —	$ 3,880
Weighted average yield	—%	—%	5.41%	—%	5.41%
Obligations of states and political subdivisions:					
Amortized Cost	—	—	13,308	33,246	46,554
Weighted average yield(1)	—%	—%	6.18%	6.68%	6.54%
Total investment securities held to maturity:					
Amortized Cost	**$ —**	**$ —**	**$ 17,188**	**$33,246**	**$50,434**
Weighted average yield	**—%**	**—%**	**6.01%**	**6.68%**	**6.45%**

(1) Weighted average yield on nontaxable investment securities is shown on a tax equivalent basis (tax rate of 35%).

Loans

Loans increased $1.2 billion in 2008. The acquisition of Willow Financial accounted for $1.1 billion of the increase as of December 5, 2008. Organic growth was approximately $125.7 million, or 5.1%. Loans increased $413.5 million in 2007 primarily attributed to the acquisition of East Penn Financial resulting in $337.7 million in additional loans with organic growth of approximately $81.9 million, or 4.0%.

The following table shows the composition of the Bank's loans, net of deferred costs:

Table 3—Composition of Loan Portfolio

	December 31,									
	2008		2007		2006		2005		2004	
	Amount	Percent of Loans	Amount	Percent of Loans	Amount	Percent of Loans	Amount	Percent of Loans	Amount	Percent of Loans
	(Dollars in thousands)									
Real estate	**$ 1,603,406**	**43%**	$ 959,064	39%	$ 845,880	41%	$ 791,358	40%	$ 693,468	37%
Commercial and industrial	**980,656**	**27%**	730,144	30%	507,899	25%	479,238	24%	473,514	26%
Consumer	**1,100,424**	**30%**	769,051	31%	685,988	34%	697,373	35%	645,718	35%
Lease financing	**758**	**—%**	2,564	—%	7,588	—%	17,524	1%	33,102	2%
Total	**$3,685,244**	**100%**	$2,460,823	100%	$2,047,355	100%	$1,985,493	100%	$1,845,802	100%

At the acquisition date, Willow Financial included $664.1 million in real estate loans, $116.6 million in commercial loans, and $317.5 million in consumer loans. The remaining growth in commercial loans was mainly due to the emphasis on owner-operated businesses. The reduction in lease financing was due to run-off of the existing portfolio. One of the Bank's strategic objectives is to increase its loan to deposit ratio by growing its loan portfolio at a faster pace than its deposits.

The following table details outstanding loans by type as of December 31, 2008, in terms of contractual maturity date:

Table 4—Selected Loan Maturity Data

	December 31, 2008			
	Due in 1 year or less	Due after 1 year through 5 years	Due after 5 years	Total
	(Dollars in thousands)			
Real estate	$252,911	$ 611,744	$ 738,751	$1,603,406
Commercial and industrial	352,189	389,500	238,967	980,656
Consumer	184,076	441,569	474,779	1,100,424
Lease financing	355	403	—	758
Total	$789,531	$1,443,216	$ 1,452,497	$3,658,244
Loans with variable or floating interest rates	$269,093	$ 805,257	$ 767,710	$1,842,060
Loans with fixed predetermined interest rates	520,438	637,959	684,787	1,843,184
Total	$789,531	$1,443,216	$ 1,452,497	$3,685,244

The Bank had no concentration of loans to individual borrowers which exceeded 10% of total loans at December 31, 2008 and 2007. The Bank actively monitors the risk of loan concentration. The Bank had no foreign loans, and the impact of nonaccrual and delinquent loans on total interest income continues to be immaterial.

Nonperforming Assets

Nonperforming assets include loans that are in nonaccrual status or 90 days or more past due and loans that are in the process of foreclosure. A loan is generally classified as nonaccrual when principal or interest has consistently been in default for a period of 90 days or more, when there has been deterioration in the financial condition of the borrower, or payment in full of principal or interest is not expected. Delinquent loans past due 90 days or more and still accruing interest are loans that are generally well-secured and expected to be restored to a current status in the near future.

Nonperforming assets (including nonaccrual loans, loans 90 days or more past due and net assets in foreclosure) were 1.43% of total assets at December 31, 2008, compared to 0.56% at December 31, 2007 and 0.54% at December 31, 2006. The ratio of nonperforming loans to total net loans was 2.12% at December 31, 2008, compared to 0.90% at December 31, 2007 and 0.87% at December 31, 2006.

Nonaccruing loans increased $54.0 million to $75.1 million at December 31, 2008, as compared to $21.1 million at December 31, 2007. The higher level of nonaccruing loans was mainly due to an increase in the nonaccrual status of commercial and residential construction, commercial and industrial, residential first mortgage and commercial mortgage loans during 2008. In addition, the December 5, 2008 acquisition of Willow Financial Bank contributed $12.5 million in non-accrual loans. The borrowers associated with these nonaccrual loans are generally unrelated and are primarily located in the Bank's market area and in most cases, for the residential real estate, the collateral is local land that has been subdivided for residential development in the growing counties of the Philadelphia suburbs and the Lehigh Valley. The Bank's management understands these markets and is confident that it can manage the collateral, if necessary. In response to the situation, the Bank increased its allowance for loan losses to approximately 1.25% of outstanding loans at June 30, 2008, and to 1.36% at December 31, 2008. The Bank continues to evaluate appraisals, financial reviews and inspections. All mortgage loans within the Bank's portfolio were booked with traditional bank customers through the branch network. The Bank has virtually no exposure to subprime borrowers – a benefit of the historically careful approach to residential mortgage lending. The Bank continues to take a conservative approach to its lending and loan review practices. With the expectation of continued economic pressures, management continues to provide more resources to resolve troubled credits including an increased focus on earlier identification of potential problem loans and a more active approach to managing the level of criticized loans that have not reached nonaccrual status.

Nonaccruing loans increased $5.9 million to $21.1 million at December 31, 2007, as compared to December 31, 2006. The increase in nonaccruing loans was principally due to an increase in non-accrual commercial construction, home equity revolving and installment loans during 2007 offset by a decrease in non-accrual commercial mortgages.

The Bank's policy for interest income recognition on nonaccrual loans is to recognize income under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Bank. The Bank will not recognize income if these factors do not exist. During 2008, interest accrued on nonaccruing loans and not recognized as interest income was $1.9 million and interest paid on nonaccruing loans of $299,000 was recognized as interest income. During 2007, interest accrued on nonaccruing loans and not recognized as interest income was $982,000 and interest paid on nonaccruing loans of $331,000 was recognized as interest income. During 2006, interest accrued on nonaccruing loans and not recognized as interest income was $788,000 and interest paid on nonaccruing loans of $191,000 was recognized as interest income.

Loans past due 90 days or more and still accruing interest are loans that are generally well secured and are in the process of collection. As of December 31, 2008, loans past due 90 days or more and still accruing interest were $1.8 million, compared to $857,000 at December 31, 2007 and $2.4 million at December 31, 2006. The higher level of loans past due 90 days or more at December 31, 2008 from December 31, 2007 was primarily driven by home equity revolving lines and residential first mortgage loans. The lower level of loans past due 90 days or more at December 31, 2007 from December 31, 2006 was primarily in the commercial loans, commercial mortgages, home equity revolving lines and home equity installment loans.

Net assets in foreclosure at December 31, 2008 were $1.6 million compared to $28,000 at December 31, 2007 and $0 at December 31, 2006. During 2008, transfers from loans to assets in foreclosure were $2.4 million, additions from Willow Financial were $426,000, disposals of foreclosed properties were $1.3 million, and no charge-offs were recorded. Efforts to liquidate assets acquired in foreclosure proceed as quickly as potential buyers can be located and legal constraints permit. Foreclosed assets are carried at the lower of cost (lesser of carrying value of the asset or fair value at date of acquisition) or estimated fair value.

The following table presents information concerning nonperforming assets. Nonperforming assets include loans that are in nonaccrual status or 90 days or more past due and loans that are in the process of foreclosure.

Table 5—Nonperforming Assets

	December 31,				
	2008	2007	2006	2005	2004
		(Dollars in thousands)			
Nonaccrual loans	**$75,060**	$21,091	$15,201	$7,493	$4,705
Loans 90 days or more past due	**1,849**	857	2,444	846	981
Total nonperforming loans	**76,909**	21,948	17,645	8,339	5,686
Net assets in foreclosure	**1,626**	28	-	29	370
Total nonperforming assets	**$78,535**	$21,976	$17,645	$8,368	$6,056
Allowance for loan losses to nonperforming loans	**65.00%**	124.5%	119.9%	238.2%	324.6%
Nonperforming loans to total loans	**2.12%**	0.90%	0.87%	0.42%	0.31%
Allowance for loan losses to total loans	**1.36%**	1.11%	1.03%	1.00%	1.00%
Nonperforming assets to total assets	**1.43%**	0.56%	0.54%	0.27%	0.20%

Local real estate, most with acceptable loan to value ratios, secures many of the nonperforming loans.

Allowance for Loan Losses

The Corporation uses the reserve method of accounting for loan losses. The balance in the allowance for loan losses is determined based on management's review and evaluation of the loan portfolio in relation to past loss experience, the size and composition of the portfolio, current economic events and conditions, and other pertinent factors, including management's assumptions as to future delinquencies, recoveries and losses. Increases to the allowance for loan losses are made by charges to the provision for loan losses. Credit exposures deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off amounts are credited to the allowance for loan losses.

While management considers the allowance for loan losses to be adequate based on information currently available, future additions to the allowance may be necessary due to changes in economic conditions or management's assumptions as to future delinquencies, recoveries and losses and management's intent with regard to the disposition of loans. In addition, the OCC, as an integral part of their examination process, periodically reviews the Corporation's allowance for loan losses. The OCC may require the Corporation to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

The Corporation performs periodic evaluations of the allowance for loan losses that include both historical, internal and external factors. The actual allocation of reserve is a function of the application of these factors to arrive at a reserve for each portfolio type and an additional component of the reserve allocated against the portfolio as a whole. Management assigns historical factors and environmental factors to homogeneous groups of loans that are grouped by loan type and credit rating. Changes in concentrations and quality are captured in the analytical metrics used in the calculation of the reserve. The components of the allowance for credit losses consist of both historical losses and estimates. Management bases its recognition and estimation of each allowance component on certain observable data that it believes is the most reflective of the underlying loan losses being estimated. The observable data and accompanying analysis is directionally consistent, based upon trends, with the resulting component amount for the allowance for loan losses. The Corporation's allowance for loan losses components includes the following: historical loss estimation by loan product type and by risk rating within each product type, payment (past due) status, industry concentrations, internal and external variables such as economic conditions, credit policy and underwriting changes and results of the loan review process. The Corporation's historical loss component is a significant component of the allowance for loan losses, and all other allowance components are based on the inherent loss attributes that management believes exist within the total portfolio that are not captured in the historical loss component as well as external factors impacting the portfolio taken as a whole.

The historical loss components of the allowance represent the results of analyses of historical charge-offs and recoveries within pools of homogeneous loans, within each risk rating and broken down further by segment, within the portfolio. Criticized assets are further assessed based on trends, expressed as percentages, relative to delinquency, risk rating and nonaccrual, by credit product.

The historical loss components of the allowance for commercial and industrial loans and commercial real estate loans (collectively "commercial loans") are based principally on current risk ratings, historical loss rates adjusted, by adjusting the risk window, to reflect current events and conditions, as well as analyses of other factors that may have affected the collectability of loans. All commercial loans with an outstanding balance over $500,000 are subject to review on an annual basis. A sample of commercial loans with a "pass" rating are individually reviewed annually. Commercial loans that management determines to be potential problem loans are individually reviewed at a minimum annually. The review is performed by a third party, and is designed to determine whether such loans are individually impaired, with impairment measured by reference to the collateral coverage and/or debt service coverage. Consumer credit and residential real estate reviews are limited to those loans reflecting delinquent payment status or performed on loans otherwise deemed to be at risk of nonpayment. Homogeneous loan pools, including consumer and 1-4 family residential mortgages are not subject to individual review but are evaluated utilizing risk factors such as concentration of one borrower group. The historical loss component of the allowance for these loans is based principally on loan payment status, retail classification and historical loss rates, adjusted by altering the risk window, to reflect current events and conditions.

The industry concentration component is recognized as a possible factor in the estimation of loan losses. Two industries represent possible concentrations: commercial real estate and consumer loans relying on residential home equity. No specific loss-related observable data is recognized by management currently, therefore no specific factor is calculated in the reserve solely for the impact of these concentrations, although management continues to carefully consider relevant data for possible future sources of observable data.

The historic loss model includes two judgmental components (product level and portfolio level environmental factors) that reflect management's belief that there are additional inherent credit losses based on loss attributes not adequately captured in the lagging indicators. The judgmental components are allocated to the specific segments of the portfolio based on the historic loss component of each segment under review.

Portfolio level environmental factors included in management's calculation entail the measurement of a wider array of both internal and external criteria impacting the portfolio as a whole. The portfolio level environmental factors are based upon management's review of trends in the Corporation's primary market area as well as regional and national economic trends. Management utilizes various economic factors that could impact borrowers' future ability to make loan payments such as changes in the interest rate environment, product supply shortages and negative industry specific events. Management utilizes relevant articles from newspapers and other publications that describe the economic events affecting specific geographic areas and other published economic reports and data. Furthermore, given that past-performance indicators may not adequately capture current risk levels, allowing for a real-time adjustment enhances the validity of the loss recognition process. There are many credit risk management reports that are synthesized by credit risk management staff to assess the direction of credit risk and its instant effect on losses. It is important to continue to use experiential data to confirm risk as measurable losses will continue to manifest themselves at higher than normal levels even after the economic cycle has begun an upward swing and lagging indicators begin to show improvement. The judgmental component is allocated to the entire portfolio based upon management's evaluation of the factors under review.

The provision for loan losses increased $5.0 million during 2008 compared to 2007 mostly as a result of a decrease in the quality of the loan portfolio which caused an increase in the amount of the required reserve. Net loans charged-off decreased $1.8 million for 2008 compared to 2007 principally due to prior year charge-offs for real estate construction loans for one borrower combined with an increase in recoveries both related to commercial and industrial loans and real estate loans. The profile of the Bank's customer base has remained relatively constant and management believes that the current deterioration in credit quality has been caused by the economic pressures being felt by borrowers. The Bank has experienced depressed economic cycles in the past. As the current trough deepens management continues to allocate dedicated resources to continue to manage at-risk credits. The Bank has experienced a similar decline in the past and expects that we could experience a similar decline in future economic cycles. The provision for loan losses increased $6.4 million in 2007 compared to 2006 primarily as a result of a decrease in the quality of the loan portfolio which caused an increase in the amount of the required reserve. Net loans charged-off increased $4.7 million during 2007 compared to 2006 principally from charge-offs related to real estate construction loans for one borrower and four unrelated commercial and industrial loans.

The allowance for loan losses increased $22.6 million, or 82.8%, to $50.0 million at December 31, 2008 from $27.3 million at December 31, 2007. The increase in the allowance was primarily due to the addition of the Willow Financial loan loss reserve of $12.9 million in December 2008, and the need to adjust for impacts on the portfolio in light of the current credit environment. Nonperforming loans have increased by $55.0 million as a result of these factors from December 31, 2008 compared to December 31, 2007. The allowance for loan losses increased $6.2 million, or 29.2%, to $27.3 million at December 31, 2007 from December 31, 2006. The increase in the allowance was mainly due to the addition of the East Penn Financial loan loss reserve in November 2007 as well as the inherent risk related to loan growth and the increase in nonperforming loans of $4.3 million.

A summary of the activity in the allowance for loan losses is as follows:

Table 6—Allowance for Loan Losses

	December 31,				
	2008	**2007**	**2006**	**2005**	**2004**
	(Dollars in thousands)				
Average loans	**$2,585,101**	$2,123,170	$2,014,420	$1,900,023	$1,625,419
Allowance, beginning of year	**$ 27,328**	$ 21,154	$ 19,865	$ 18,455	$ 16,753
Loans charged off:					
Real estate	**3,770**	4,847	1,047	383	208
Commercial and industrial	**1,079**	1,551	1,141	353	522
Consumer	**1,964**	1,693	1,481	2,123	1,921
Lease financing	**16**	51	42	188	883
Total loans charged off	**6,829**	8,142	3,711	3,047	3,534
Recoveries:					
Real estate	**389**	72	138	326	307
Commercial and industrial	**240**	142	55	66	58
Consumer	**329**	283	519	586	496
Lease financing	**6**	19	88	78	143
Total recoveries	**964**	516	800	1,056	1,004
Net loans charged off	**5,865**	7,626	2,911	1,991	2,530
Reserve from acquisitions	**12,925**	3,250	—	—	1,677
Provision for loan losses	**15,567**	10,550	4,200	3,401	2,555
Allowance, end of year	**$ 49,955**	$ 27,328	$ 21,154	$ 19,865	$ 18,455
Ratio of net charge offs to average loans outstanding	**0.23%**	0.36%	0.14%	0.10%	0.16%

Management has improved upon its estimation methods and assumptions through its inclusion of portfolio level environmental factors as previously discussed within the previous *Allowance for Loan Losses* section. These adjustments provide for greater clarity and transparency of macro and micro economic impacts as well as internal credit and operational impacts on the portfolio. The impact of the recession continues to be felt as the Bank's commercial real estate portfolio's increase in allowance shows. It is expected that the negative trends in the real estate industry will continue to affect credit quality throughout at least the first half of 2009, if not for the entire year. The growth in the loan portfolio and the change in the mix will result in an adjustment to the amount of the allowance allocated to each category based the current market environment and recent historical loss trends among other factors.

The following table sets forth an allocation of the allowance for loan losses by category. The specific allocations in any particular category may be reallocated in the future to reflect then current conditions. Accordingly, management considers the entire allowance to be available to absorb losses in any category.

Table 7—Allocation of the Allowance for Loan Losses by Loan Type

	December 31,									
	2008		2007		2006		2005		2004	
	Amount	Percent of Allowance	Amount	Percent of Allowance	Amount	Percent of Allowance	Amount	Percent of Allowance	Amount	Percent of Allowance
	(Dollars in thousands)									
Real estate	**$22,051**	**44%**	$10,491	38%	$ 7,918	38%	$ 6,422	32%	$ 4,923	27%
Commercial and industrial	**20,898**	**42%**	12,340	45%	9,119	43%	8,534	43%	7,456	40%
Consumer	**6,996**	**14%**	4,485	17%	4,041	19%	4,596	23%	5,515	30%
Lease financing	**10**	**–%**	12	–%	76	–%	313	2%	561	3%
Total	**$49,955**	**100%**	$27,328	100%	$21,154	100%	$19,865	100%	$18,455	100%

The factors affecting the allocation of the allowance during 2008 were changes in credit quality resulting from increases in criticized real estate construction loans and increases in loan volume from the Willow Financial acquisition. The allocation of the allowance for real estate loans at December 31, 2008 increased $11.6 million as compared to December 31, 2007 principally due to an increase in criticized real estate construction loans including loans to two borrowing relationships totaling $34.9 million. Both relationships are syndicated credits for local borrowers that have been negatively affected by the decline in area home sales. The allocation of the allowance for commercial and industrial loans at December 31, 2008 increased $8.6 million from December 31, 2007 mostly due to an increase in commercial loan volume from the Willow Financial acquisition. In addition, the allocation of the allowance for consumer loans at December 31, 2008 increased $2.5 million primarily due to the increased level of consumer loans related to the Willow Financial acquisition.

Investment in Bank

The Corporation acquired an investment in Berkshire Bancorp, the holding company of Berkshire Bank, through the East Penn Financial acquisition. As of December 31, 2008, the total investment in Berkshire Bancorp, Inc. was $2.6 million represented by 679,728 shares, resulting in a 17.54% ownership in consideration of the combined ownership of the Corporation, its directors and officers. The Corporation is considered to be a passive investor under a Crown X Agreement which imposes certain restrictions on the Corporation. The Corporation is entitled to purchase additional shares of common stock from Berkshire Bank up to 24.9% of the outstanding shares of common stock at any time up to July 3, 2013 at an exercise price of $4.10, which is adjusted for stock splits. The investment is included in other assets at its cost basis.

Deposits and Borrowings

Deposits and borrowings are the primary funding sources of the Corporation. Core deposits increased 31.8%, or $567.1 million, to $2.3 billion at December 31, 2008, up from $1.8 billion at December 31, 2007. This growth is due to $685.4 million acquired from Willow Financial and an organic decrease of approximately $118.3 million. Total deposits increased $953.4 million, or 31.9% for the same period, which was primarily attributable to deposits associated with the acquisition of Willow Financial of $946.7 million. The Corporation continued its emphasis on government banking to provide additional funding sources through relationships with municipalities and school districts resulting in both interest-bearing checking accounts and large time deposits. Core deposits increased 7.1%, or $118.1 million at December 31, 2007 compared to December 31, 2006 due to $185.2 million acquired from East Penn Financial at November 16, 2007 and an organic decrease of approximately $67.2 million. Total deposits increased $468.2 million, or 18.6% during 2007 primarily from deposits associated with the acquisition of East Penn Financial of $382.7 million at acquisition date and growth in time deposits.

Deposit Structure

The following table is a distribution of average balances and average rates paid on the deposit categories for the last three years:

Table 8—Average Deposits

	December 31,					
	2008		2007		2006	
	Amount	Rate	Amount	Rate	Amount	Rate
	(Dollars in thousands)					
Demand—noninterest-bearing	**$ 345,717**	**—%**	$ 312,011	—%	$ 333,406	—%
Demand—interest-bearing	**431,138**	**1.55%**	517,520	3.52%	450,256	3.24%
Money market and savings	**978,803**	**1.89%**	864,062	3.45%	836,940	2.91%
Time deposits	**1,248,412**	**4.31%**	863,953	4.78%	848,912	4.29%
Total interest-bearing deposits	**$2,658,353**	**2.97%**	$2,245,535	3.98%	$2,136,108	3.53%
Total deposits	**$3,004,070**		$2,557,546		$2,469,514	

The maturity distribution of certificates of deposit of $100,000 and over as of December 31, 2008 is as follows:

Table 9—Maturity Distribution of Certificates of Deposit $100,000 and Over

	(Dollars in thousands)
Three months or less	$191,955
Over three months to six months	105,772
Over six months to twelve months	192,461
Over twelve months	136,028
Total	$626,216

Borrowings

Borrowings increased $482.2 million to $990.5 million at December 31, 2008 from $508.3 million at December 31, 2007. The Corporation increased long term debt with the Federal Home Loan Bank by $305.9 million due to $362.6 million in advances from the Willow Financial acquisition offset by paydowns during 2008. Long-term securities sold under agreement to repurchase increased by $132.0 million due to $82.0 million assumed in the Willow Financial acquisition and $50.0 million in new borrowings during 2008. Subordinated debt increased $10.8 million at December 31, 2008 as compared to December 31, 2007 due to the acquisition of $10.7 million of subordinated debt from Willow Financial. Fed funds purchased and short-term securities sold under repurchase agreements increased by $34.6 million primarily due to the Willow Financial acquisition.

Borrowings increased $118.8 million to $508.3 million at December 31, 2007 from $389.5 million at December 31, 2006. The Corporation decreased long term debt with the Federal Home Loan Bank by $23.0 million while increasing long-term securities sold under agreement to repurchase by $105.0 million. Subordinated debt increased from the private placement of $22.5 million in aggregate principal amount of fixed/floating rate preferred securities through a newly formed Delaware Trust affiliate HNC Statutory Trust IV and the acquisition of $8.2 million of subordinated debt from East Penn Financial on November 16, 2007.

The Bank, pursuant to a designated cash management agreement, utilizes securities sold under agreements to repurchase as vehicles for customers' sweep and term investment products. Securitization under these cash management agreements are in U.S. Treasury Securities and obligations of states and political subdivisions securities. Securities sold under agreements to repurchase are generally overnight transactions. These securities are held in a third-party custodian's account, designated by the Bank under a written custodial agreement that explicitly recognizes the Bank's interest in the securities.

Table 10—Securities Sold under Agreements to Repurchase

Securities sold under agreements to repurchase(1):	At or for the year ended December 31, 2008	2007	2006
	(Dollars in thousands)		
Balance at year-end	**$103,813**	$101,493	$ 96,840
Weighted average rate at year-end	**0.42%**	3.60%	4.61%
Maximum month-end balance	**$ 97,526**	$105,205	$100,944
Average balance during the year	**$109,092**	$121,392	$128,185
Weighted average rate during the year	**1.55%**	4.46%	4.37%

(1) Excludes long-term securities sold under agreements to repurchase with private entities of $237.0 million and $105.0 million at December 31, 2008 and 2007, respectively.

Results of Operations

Net income is affected by five major elements: (1) net interest income, or the difference between interest income earned on loans and investments and interest expense paid on deposits and borrowed funds; (2) the provision for loan losses, or the amount added to the allowance for loan losses to provide reserves for inherent losses on loans; (3) noninterest income, which is made up primarily of certain fees, wealth management income and gains and losses from sales of securities or other transactions; (4) noninterest expense, which consists primarily of salaries, employee benefits and other operating expenses; and (5) income taxes. Each of these major elements is reviewed in more detail in the following discussion.

Adoption of Fair Value Measurements Accounting Standard

Effective January 1, 2008, the Corporation adopted SFAS No. 157, "Fair Value Measurements". The adoption of SFAS 157 resulted in expanded disclosures as indicated in Note 1 and Note 21 of the Consolidated Financial Statements.

Net Interest Income

Net interest income is the most significant component of the Corporation's income from operations. Net interest income is the difference between interest earned on total interest-earning assets (primarily loans and investment securities), on a fully taxable equivalent basis, where appropriate, and interest paid on total interest-bearing liabilities (primarily deposits and borrowed funds). Fully taxable equivalent basis represents income on total interest-earning assets that is either tax-exempt or taxed at a reduced rate, adjusted to give effect to the prevailing incremental federal tax rate, and adjusted for nondeductible carrying costs and state income taxes, where applicable. Yield calculations, where appropriate, include these adjustments. Net interest income depends on the volume and interest rate earned on interest-earning assets and the volume and interest rate paid on interest-bearing liabilities.

The rate volume analysis in the following table, which is computed on a tax-equivalent basis (tax rate of 35%), analyzes changes in net interest income for the last three years by their volume and rate components. The change attributable to both volume and rate has been allocated proportionately.

Table 11—Analysis of Changes in Net Interest Income—Fully Taxable-Equivalent Basis

	2008 compared to 2007			2007 compared to 2006		
	Net	Due to Change in		Net	Due to Change in	
	Change	Volume	Rate	Change	Volume	Rate
	(Dollars in thousands)					
Increase (decrease) in interest income:						
Investment securities(1)	**$ 6,653**	**$ 5,027**	**$ 1,626**	$ 4,935	$ 953	$ 3,982
Federal funds sold, securities purchased under agreements to resell and deposits in banks	**(2,479)**	**(931)**	**(1,548)**	(477)	(376)	(101)
Loans(1)(2)	**9,047**	**29,406**	**(20,359)**	11,203	7,349	3,854
Total	**13,221**	**33,502**	**(20,281)**	15,661	7,926	7,735
Increase (decrease) in interest expense:						
Savings and money market deposits	**(22,840)**	**965**	**(23,805)**	9,074	2,992	6,082
Time deposits	**12,462**	**16,859**	**(4,397)**	4,849	651	4,198
Borrowed funds	**405**	**4,985**	**(4,580)**	2,436	1,730	706
Total	**(9,973)**	**22,809**	**(32,782)**	16,359	5,373	10,986
Net increase (decrease) in net interest income	**$ 23,194**	**$10,693**	**$12,501**	$ (698)	$2,553	$(3,251)

(1) The interest earned on nontaxable investment securities and loans is shown on a tax-equivalent basis using a tax rate of 35%, net.

(2) Nonaccrual loans have been included in the appropriate average loan balance category, but interest on nonaccrual loans has not been included for purposes of determining interest income.

The following table presents the major asset and liability categories on an average basis for the periods presented, along with interest income and expense, and key rates and yields:

Table 12—Average Balance Sheets and Interest Rates—Fully Taxable-Equivalent Basis

	Year Ended December 31,								
	2008			2007			2006		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate	Average Balance	Interest	Rate
	(Dollars in thousands)								
Assets									
Earning Assets:									
Investment securities:									
Taxable investments	**$ 738,640**	**$ 39,195**	**5.31%**	$ 681,788	$ 34,803	5.10%	$ 672,648	$ 30,296	4.50%
Nontaxable investments(1)	**298,472**	**18,110**	**6.07**	262,676	15,849	6.03	252,987	15,421	6.10
Total investment securities	**1,037,112**	**57,305**	**5.53**	944,464	50,652	5.36	925,635	45,717	4.94
Federal funds sold, securities purchased under agreements to resell and deposits in banks	**48,474**	**1,097**	**2.26**	72,087	3,576	4.96	79,670	4,053	5.09
Loans(1)(2)	**2,585,101**	**155,447**	**6.01**	2,123,170	146,400	6.90	2,014,420	135,197	6.71
Total earning assets	**3,670,687**	**213,849**	**5.83**	3,139,721	200,628	6.39	3,019,725	184,967	6.13
Noninterest-earning assets	**327,285**			231,583			209,499		
Total assets	**$3,997,972**			$3,371,304			$3,229,224		
Liabilities and Shareholders' Equity									
Interest-bearing liabilities:									
Interest-bearing deposits:									
Savings and money market	**$1,409,941**	**25,140**	**1.78%**	$1,381,582	47,980	3.47%	$1,287,196	38,906	3.02%
Time	**1,248,412**	**53,771**	**4.31**	863,953	41,309	4.78	848,912	36,460	4.29
Total interest-bearing deposits	**2,658,353**	**78,911**	**2.97**	2,245,535	89,289	3.98	2,136,108	75,366	3.53
Borrowed funds	**586,088**	**23,243**	**3.97**	471,296	22,838	4.85	434,938	20,402	4.69
Total interest-bearing liabilities	**3,244,441**	**102,154**	**3.15**	2,716,831	112,127	4.13	2,571,046	95,768	3.72
Noninterest-bearing liabilities:									
Demand deposits	**345,717**			312,011			333,406		
Other liabilities	**71,160**			44,069			42,925		
Total noninterest-bearing liabilities	**416,877**			356,080			376,331		
Total liabilities	**3,661,318**			3,072,911			2,947,377		
Shareholders' equity	**336,654**			298,393			281,847		
Total liabilities and shareholders' equity	**$3,997,972**			$3,371,304			$3,229,224		
Net interest spread			**2.68**			2.26			2.41
Effect of noninterest-bearing sources			**0.36**			0.56			0.54
Net interest income/margin on earning assets		**$111,695**	**3.04%**		$ 88,501	2.82%		$ 89,199	2.95%
Less tax equivalent adjustment		**7,555**			6,067			6,026	
Net interest income		**$104,140**			$ 82,434			$ 83,173	

(1) The interest earned on nontaxable investment securities and loans is shown on a tax-equivalent basis, net of deductions (tax rate of 35%).

(2) Nonaccrual loans have been included in the appropriate average loan balance category, but interest on nonaccrual loans has not been included for purposes of determining interest income.

The dramatic decline in the credit and liquidity markets and overall economic conditions continued in the fourth quarter of 2008 resulting in the Federal Open Market Committee reducing overnight rates by 175 basis points to effectively 0%. The total reduction in overnight rates for 2008 was 400 basis points. The Federal Reserve and U.S. Treasury Department also initiated a wide array of programs to improve liquidity, stabilize the credit markets and stimulate economic growth. These initiatives are continuing into 2009. The Corporation's lower cost of funds have resulted from the short-term and mid-term rate reductions throughout 2008 in response to the decline in the various market yield curves and resulting reduction in asset yields.

During 2007, the Corporation continued to manage its balance sheet in an effort to position it for the inverted yield curve and subsequent falling rates scenario. The Corporation sold securities with lower fixed rates and longer average lives and purchased securities with higher yields to take advantage of specific market sectors and more stable cash flows. As a result, the balance sheet is better positioned to mitigate market risk.

Net interest income on a tax-equivalent basis increased $23.2 million, or 26.2%, for the year ending December 31, 2008, over the same period in 2007. The net interest margin for 2008 increased to 3.04% compared to 2.82% for 2007. The net interest margin increased as a 56 basis point decrease in the yield on average earning assets of $3.7 billion was offset by a 98 basis point decrease in the cost of interest bearing liabilities of $3.2 billion. Net interest income on a tax equivalent basis in 2007 decreased $698,000, or .8% to $88.5 million, in comparison to 2006. The decrease during 2007 was mostly due to higher deposit costs offset in part by yield increases in loans and investments.

Interest income increased $13.2 million for 2008 as average loans receivable grew $461.9 million or 21.8% and average investment securities increased $92.6 million or 9.8%. The increases in average balances of loans receivable and investment securities attributed $34.4 million to the increase in interest income in 2008. The rates earned on average loan receivables as well as federal funds sold and deposits in banks decreased 89 basis points and 270 basis points, respectively. These changes in rates decreased interest income $21.9 million during 2008.

Interest income on a tax-equivalent basis in 2007 increased $15.7 million, or 8.5% to $200.6 million, as compared to 2006. The increase was primarily due to higher average loans of $108.8 million, or 5.4%, and a 19 basis point rise in the average rates earned on loans. The average yield on investments also increased 42 basis points.

Interest expense decreased $10.0 million for 2008 as average interest-bearing deposits and average borrowed funds increased $412.8 million and $114.8 million, or 18.4% and 24.4%, respectively. The increases in these average balances attributed $22.8 million in an increase to interest expense. Offsetting this was a decrease in the cost of average interest-bearing deposits and borrowed funds of 101 and 88 basis points, respectively. These changes in rates decreased interest expense $32.8 million during 2008.

Interest expense increased $16.4 million, to $112.1 million during 2007 mostly attributed to higher deposit rates and an increase in average deposits of $109.4 million. The average rate paid on deposits during 2007 of 3.98% was 45 basis points higher compared to 2006.

Net Interest Margin

The 2008 net interest margin of 3.04% was higher than the net interest margins for 2007 and 2006 of 2.82% and 2.95%, respectively. The increase in the net interest margin during 2008 was mainly attributable to decreases in yields on interest-bearing liabilities which outpaced declines in the yield on loans. In addition, yields on investment securities have increased slightly since the prior year.

Interest Rate Sensitivity Analysis

In the normal course of conducting business activities, the Corporation is exposed to market risk, principally interest rate risk, through the operations of its banking subsidiary. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and value of financial instruments.

The Corporation actively manages its interest rate sensitivity positions. The objectives of interest rate risk management are to control exposure of net interest income to risks associated with interest rate movements and to achieve consistent growth in net interest income. The Asset/Liability Committee, using policies and procedures approved by the Corporation's Board of Directors, is responsible for managing the rate sensitivity position. The Corporation manages interest rate sensitivity by changing the mix and repricing characteristics of its assets and liabilities through the management of its investment securities portfolio, its offering of loan and deposit terms and through wholesale borrowings from several providers, but primarily from the Federal Home Loan Bank. The nature of the Corporation's current operations is such that it is not subject to foreign currency exchange or commodity price risk.

The Corporation only utilizes derivative instruments for asset/liability management. These transactions involve both credit and market risk. The notional amounts are amounts on which calculations and payments are based. The notional amounts do not represent direct credit exposures. Direct credit exposure is limited to the net difference between the calculated amounts to be received and paid, if any. Interest rate swaps are contracts in which a series of interest-rate flows (fixed and floating) are exchanged over a prescribed period. The notional amounts on which the interest payments are based are not exchanged. Interest rate caps are purchased contracts that limit the exposure from the repricing of liabilities in a rising rate environment.

During 2008, the Corporation had cash flow hedges with notional amounts totaling $45.0 million which matured. These swaps had the effect of converting rates on money market deposit accounts to a fixed-rate cost of funds. This strategy was undertaken to allow the Bank to recognize, in a rising rate environment, a larger interest rate spread than it otherwise would have without the swaps in effect. In addition, two cash flow hedges with a notional amount of $10.0 million that had the effect of converting variable debt to a fixed rate matured during 2008. For both of these types of swaps, the Corporation recognized net interest expense of $192,000 for the year ended December 31, 2008 and net interest income of $287,000 and $442,000 for the years ended December 31, 2007, and 2006, respectively. During the first quarter of 2005, the Corporation terminated a cash flow hedge with a notional value of $25.0 million. The gross loss related to the termination of this swap was $310,000 which was amortized through October 2006 in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." For the year ended December 31, 2006, the Corporation amortized $151,000 into net interest income related to this swap.

Periodically, the Corporation may enter into fair value hedges to limit the exposure to changes in the fair value of loan assets. At December 31, 2008, the Corporation had a fair value hedge in the form of an interest rate swap with a notional amount of $1.9 million which matures in 2017. In addition, four fair value hedges with notional amounts totaling $7.5 million were acquired from Willow Financial with maturity dates ranging from 2013 to 2016. These swaps do not qualify for hedge accounting treatment and thus all changes in the fair value of the derivatives is recorded in the consolidated statements of income. As such, based on the decrease in the market value of these interest rate swaps, the Corporation recognized a loss of $183,000 in other expense in the consolidated statements of income in 2008. During 2008, the Corporation terminated a fair value hedge in the form of an interest rate swap with a notional amount of $2.0 million. For fair value hedges, the Corporation recognized net interest expense of $81,000 for the year ended December 31, 2008 and net interest income of $59,000 and $7,000 for the years ended December 31, 2007 and 2006, respectively. At December 31, 2008, the Corporation had swap agreements with a negative fair value of $1.1 million. At December 31, 2007, the Corporation had swap agreements with a positive fair value of $10,000 and with a negative fair value of $366,000. There was no hedge ineffectiveness recognized during 2008, 2007 and 2006.

During March 2007, the Corporation purchased one-month and three-month Treasury bill interest rate cap agreements with notional amounts totaling $200 million to limit its exposure on variable rate NOW deposit accounts. The initial premium related to these caps was $73,000 which is being amortized to interest expense over the life of the cap based on the cap market value. The Corporation recognized amortization of $16,000 and $8,000 for the year ended December 31, 2008 and 2007, respectively. At December 31, 2008, these caps, designated as cash flow hedges, had a fair value of $0. At December 31, 2007, these caps had a positive fair value of $222. The caps mature in March 2009. Due to notional mismatch, $43,000 was recognized in other expense on the consolidated statements of income during the year ended December 31, 2008. During 2007, the Corporation accelerated the reclassification of an immaterial amount in other comprehensive income to earnings as a result of variable-rate interest payments becoming probable not to occur. The accelerated amount was a loss of $7,000 recognized in interest expense on the consolidated statements of income.

During 2008, the Corporation began to offer certain derivative products directly to qualified commercial borrowers. The Corporation economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third parties. Derivative transactions executed as part of this program are not designated in SFAS 133-qualifying hedging relationships and are, therefore, marked-to-market through earnings each period. Because the derivatives have mirror-image contractual terms, the changes in fair value substantially offset through earnings. These derivatives have maturity dates ranging from 2010 to 2018. As of December 31, 2008, the fair value of the derivative assets and the fair value of the offsetting derivative liabilities were $4.5 million and $4.5 million, respectively. Fees earned in connection with the execution of derivatives related to this program are recognized in other noninterest fee income. The derivative asset and liability values above include an adjustment related to the consideration of credit risk required under FAS 157 of $18,000, which is also recognized as an adjustment to other income on the consolidated statements of income.

The Corporation uses three principal reports to measure interest rate risk: (1) asset/liability simulation reports; (2) gap analysis reports; and (3) net interest margin reports. The Corporation's interest rate sensitivity, as measured by the repricing of its interest sensitive assets and liabilities at December 31, 2008, is presented in the following table. The data in the table was based in part on assumptions that are regularly reviewed for accuracy. The table presents data at a single point in time and includes management assumptions estimating the prepayment rate and the interest rate environment prevailing at December 31, 2008. The table indicates a liability sensitive one-year cumulative gap position of 6.14% of total earning assets.

Table 13—Contractual Repricing Data of Interest Sensitive Assets and Liabilities

	December 31, 2008				
	0 to 90 days	91 to 365 days	After 1 year through 5 years	Over 5 years	Total
	(Dollars in thousands)				
Earning assets					
Investment securities	$ 164,261	$ 94,238	$ 222,475	$750,687	$1,231,661
Deposits in banks	27,221	—	—	—	27,221
Loans	1,169,088	340,841	1,317,399	857,916	3,685,244
Total earning assets	$ 1,360,570	$ 435,079	$1,539,874	$1,608,603	$4,944,126
Interest-bearing liabilities					
Interest-bearing checking accounts	$ 17,514	$ 49,308	$ 196,163	$ 293,870	$ 556,855
Money market funds	32,784	92,293	435,013	482,212	1,042,302
Savings accounts	8,520	23,986	95,424	142,955	270,885
Time deposits	378,842	748,223	460,435	1,421	1,588,921
Borrowed funds	181,198	83,392	473,564	252,344	990,498
Total interest-bearing liabilities	$ 618,858	$ 997,202	$1,660,599	$1,172,802	$4,449,461
Interest rate swaps	$ 124,138	$ —	$ (8,000)	$ (116,214)	$ —
Incremental gap	$ 865,925	$ (562,123)	$ (128,725)	$ 319,588	
Cumulative gap(1)	$ 865,925	$ 303,802	$ 175,077	$ 494,665	
Cumulative gap as a percentage of earning assets	17.51%	6.14%	3.54%	10.01%	

(1) The information is based upon significant assumptions, including the following: loans and leases are repaid by contractual maturity and repricing; securities are repaid according to contractual maturity adjusted for call features; interest-bearing demand, regular savings, and money market savings deposits are estimated to exhibit some rate sensitivity; and time deposits are shown in the table based on contractual maturity.

Management also simulates possible economic conditions and interest rate scenarios in order to quantify the impact on net interest income. The effect that changing interest rates have on the Corporation's net interest income is simulated by increasing and decreasing interest rates. This simulation is known as rate shocking.

The results of the December 31, 2008 net interest income rate shock simulations show that the Corporation is within guidelines set by the Corporation's Asset/Liability Policy when modeled rates increase 100 and 200 basis points and decrease by 100 and 200 basis points. The Corporation constantly monitors this position and takes steps to minimize any reduction in net interest income.

The following table forecasts changes in the Corporation's market value of equity under alternative interest rate environments as of December 31, 2008. The market value of equity is defined as the net present value of the Corporation's existing assets and liabilities. The Corporation is within guidelines set by the Corporation's Asset/Liability Policy for the percentage change in the market value of equity.

Table 14—Market Value of Equity

	December 31, 2008			
	Market Value of Equity	Change in Market Value of Equity	Percentage Change	Asset/Liability Approved Percent Change
	(Dollars in thousands)			
+300 Basis Points	$292,335	$(130,551)	−30.87%	+/−35%
+200 Basis Points	345,059	(77,826)	−18.40	+/−25
+100 Basis Points	391,542	(31,344)	−7.41	+/−15
Flat Rate	422,886	—	0.00	—
−100 Basis Points	407,956	(14,930)	−3.53	+/−15
−200 Basis Points	382,766	(40,120)	−9.49	+/−25
−300 Basis Points	387,900	(34,986)	−8.27	+/−35

In the event the Corporation should experience a mismatch in its desired gap ranges or an excessive decline in its market value of equity resulting from changes in interest rates, it has a number of options that it could use to remedy the mismatch. The Corporation could restructure its investment portfolio through the sale or purchase of securities with more favorable repricing attributes. It could also emphasize growth in loan products with appropriate maturities or repricing attributes, or attract deposits or obtain borrowings with desired maturities.

Provision for Loan Losses

The provision for loan losses increased $5.0 million during 2008 compared to 2007 mostly as a result of a decrease in the credit quality of the loan portfolio which caused an increase in the amount of the required reserve. The provision for loan losses increased $6.4 million during 2007 compared to 2006 mostly as a result of decreased quality of the loan portfolio. Total net loans charged off in 2008, 2007 and 2006 were $5.9 million, $7.6 million and $2.9 million, respectively.

Noninterest Income

For the year ended December 31, 2008, noninterest income was $46.2 million, an increase of $2.9 million, or 6.6%, from 2007. Noninterest income in 2007 included $2.8 million in gains on sale leaseback transactions. During the second half of 2007, the Bank revised its return check and overdraft charge process and in 2008, the Bank experienced an increase in service charge income of $3.8 million, or 39.5%, over 2007. Service charge income attributable to the acquisition of East Penn Financial in November 2007 which included approximately $380 million in deposits also contributed approximately $1.9 million to this 2008 service charge increase. Gains on sale of investment securities were $2.6 million during 2008 as compared to $1.2 million in the prior year. Other income increased $2.0 million to $10.6 million over the prior year driven by a $834,000 increase in automated teller machine and point of sale revenue, fees on derivative instruments of $627,000, a $405,000 death benefit received on bank owned life insurance, and a gain of $302,000 from the mandatory redemption of Visa Class B stock in conjunction with Visa's initial public offering. Offsetting these increases was a fourth quarter 2008 other than temporary impairment charge of $1.9 million on collateralized debt obligation investments in pooled trust preferred securities.

Noninterest income of $43.3 million during 2007 decreased $2.0 million or 4.4% compared to 2006. Wealth management fee income rose $3.9 million or 26.1% during 2007 primarily driven by a higher level of life insurance business at Cornerstone as well as growth in trust assets. The Bank experienced an increase in deposit service charges of $1.7 million or 21.1% over the prior year mainly from return check and overdraft fees and fees from East Penn deposit accounts. During the fourth quarter of 2007, the Bank recognized a pre-tax gain of $2.3

million on the sale-leaseback of fifteen bank properties representing a portion of the total gain of $18.9 million. The remaining gain was deferred and is being amortized through a reduction of occupancy expense over the 15-year term of the leases an annual amount of approximately $1.1 million. The Corporation also completed a separate sale-leaseback of office space in October with a recognized pre-tax gain of $473,000. The deferred gain of $552,000 is being amortized over the 10-year term of the lease. In addition, gains on sale of investment securities were $1.1 million during 2007 as compared to losses of $674,000 for 2006. In addition, noninterest income for 2006 included the pre-tax gains on the sales of the Bank's Honesdale branch and credit card portfolio of $10.7 million and $1.4 million, respectively.

Noninterest Expense

Noninterest expenses increased $23.3 million, or 28.6%, in 2008 as compared to 2007. Driving this increase was approximately $9.1 million in 2008 noninterest expenses stemming from a full year of additional expenses from East Penn Financial which was acquired in November 2007. Excluding these East Penn related expenses, noninterest expenses increased $14.2 million. The table below depicts the effect of the 2007 East Penn Financial acquisition on 2008 noninterest expense.

Table 15—Noninterest expense

(Dollars in thousands)	Year Ended December 31, 2008	Year Ended December 31, 2007	East Penn Financial	Net Change
Salaries, wages and employee benefits	$ 56,108	$48,832	$4,600	$ 2,676
Occupancy	10,101	7,008	1,122	1,971
Furniture and equipment	4,432	3,941	493	(2)
Intangibles expense	4,208	1,225	1,342	1,641
Merger charges	3,430	423	423	2,584
Other expenses	26,343	19,926	1,094	5,323
Total noninterest expense	$104,622	$81,355	$9,074	$14,193

Excluding East Penn Financial, the $2.7 million increase in salaries and benefits is primarily due to one month of expenses for Willow Financial, normal salary increases and non-merger related severance costs. Occupancy expense increased $2.0 million due to increased rent expense on the bank properties included in the sale-leaseback transaction completed in the fourth quarter of 2007. Intangibles expense increased primarily due to a $1.4 million valuation adjustment on mortgage servicing rights recorded in the fourth quarter of 2008. Merger charges increased $2.6 million and were directly related to the December 2008 Willow Financial acquisition. Other expenses increased $5.3 million due primarily to increases of $1.5 million in FDIC insurance costs, $1.9 million in professional services, and $1.0 million in data processing costs.

Noninterest expense of $81.4 million during 2007 increased $10.5 million or 14.9% compared to 2006. Salaries and benefits expense rose $4.2 million for the year of 2007 over 2006, primarily due to higher staffing levels resulting from new branch openings and the East Penn Financial acquisition and higher costs of medical benefits. Occupancy expense increased $1.3 million in 2007 over 2006 mostly due to several new office locations including the new operations center building in Harleysville and four new branch openings as well as the addition of the East Penn branches. Other expense increased $4.2 million during 2007 mainly as a result of the one-time pre-tax charge of $1.9 million related to the pension plan curtailment, increased professional and consulting expense and lower deferred loan origination costs resulting from lower loan volume. In addition, East Penn merger costs were approximately $423,000.

Income Taxes

The effective income tax rates for 2008, 2007 and 2006 were 16.8%, 21.5% and 26.3%, respectively, versus the applicable federal statutory rate of 35% and the applicable state tax rates. The Corporation's effective rates were lower than the statutory tax rate primarily as a result of tax-exempt income earned from state and municipal securities and loans and bank-owned life insurance. The effective tax rate for 2008 was lower than 2007 primarily due to a higher level of tax exempt income recognized during 2008. Tax exempt income increased by $2.9 million from 2007 to 2008 despite an overall decrease in taxable income for the same period. The effective tax rate for 2007 was lower than 2006 primarily due to the higher level of tax exempt income during 2007 as compared to 2006.

Capital

Capital formation is important to the Corporation's well being and future growth. Capital, at the end of 2008, was $474.7 million, an increase of $135.4 million over the end of 2007. The increase was mainly due to the issuance of $160.8 million in common stock in connection with the acquisition of Willow Financial partially offset by the increase of $26.5 million in the accumulated other comprehensive loss related to investment securities available for sale. At December 31, 2007, capital was $339.3 million, an increase of $44.6 million over December 31, 2006. The increase was primarily due to the issuance of $39.1 million in common stock in connection with the acquisition of East Penn Financial. Management believes that the Corporation's current capital position and liquidity position are adequate to support its operations.

Pursuant to the federal regulators' risk-based capital adequacy guidelines, the components of capital are called Tier 1 and Tier 2 capital. For the Corporation, Tier 1 capital is generally common stockholder's equity and retained earnings adjusted to exclude disallowed goodwill and identifiable intangibles as well as the inclusion of qualifying trust preferred securities. Tier 2 capital for the Corporation is the allowance for loan losses. The risk-based capital ratios are computed by dividing the components of capital by risk-adjusted assets. Risk-adjusted assets are determined by assigning credit risk-weighting factors from 0% to 200% to various categories of assets and off-balance sheet financial instruments. The minimum for the Tier 1 capital ratio is 4.0%, and the total capital ratio (Tier 1 plus Tier 2 capital divided by risk-adjusted assets) minimum is 8.0%. At December 31, 2008, the Corporation's Tier 1 risk-adjusted capital ratio was 7.73%, and the total risk-adjusted capital ratio was 8.88%. Both are above regulatory "adequately capitalized" requirements, however, the total risk adjusted capital ratio is below the regulatory "well capitalized" standard of 10.00%. Purchase accounting adjustments related to the acquisition of Willow Financial helped to push the Corporation's total risk-based capital ratio below the regulatory threshold for a "well capitalized" bank Company. The Corporation does not believe that these mark-to-market valuations reflect a reduction in the realizable value of Willow Financial's assets and expects to recover the discount through amortization in 2009 and beyond.

To supplement the risk-based capital adequacy guidelines, the Federal Reserve Board (FRB) established a leverage ratio guideline. The leverage ratio consists of Tier 1 capital divided by quarterly average total assets, excluding goodwill and identifiable intangibles. The minimum leverage ratio guideline is 3% for banking organizations that do not anticipate significant growth and that have well-diversified risk, excellent asset quality, high liquidity, good earnings and, in general, are considered top-rated, strong banking organizations. Other banking organizations are expected to have ratios of at least 4% or 5%, depending upon their particular condition and growth plans. Higher leverage ratios could be required by the particular circumstances or risk profile of a given banking organization. The Corporation's leverage ratios were 8.19% and 8.72% at December 31, 2008 and 2007, respectively. The lower leverage ratio of the Corporation at December 31, 2008 was mainly due to an increase in average assets from the acquisition of Willow Financial and increase in average loans.

Under FDIC regulations, a "well capitalized" institution must have a leverage ratio of at least 5%, a Tier 1 risk-based capital ratio of at least 6% and a total risk-based capital ratio of at least 10% and not be subject to a capital directive order. To be considered "adequately capitalized" an institution must generally have a leverage ratio of at least 4%, a Tier 1 risk-based capital ratio of at least 4% and a total risk-based capital ratio of at least 8%. An institution is deemed to be "critically under capitalized" if it has a tangible equity ratio of 2% or less. As of December 31, 2008, the Bank is above the regulatory minimum guidelines and meets the criteria to be categorized as a "well capitalized" institution for the risk-based capital and leverage ratios. For total risk-based capital, the Bank is categorized as "adequately capitalized." During the fourth quarter of 2008, the Bank fell below the "well capitalized" threshold as a result of valuation adjustments recorded for the Willow Financial acquisition. The Bank has instituted a plan targeted to return to "well capitalized" before the end of 2009.

The cash dividends paid during 2008 of $.80 per share were the same as the cash dividends paid in 2007. The proportion of net income paid out in dividends for 2008 was 100.06%, compared to 88.82% for 2007, the increase mainly resulting from lower net income during 2008. Management is focusing on improving and increasing earnings so that the dividend payout ratio is within acceptable limits and believes it prudent to build balance sheet strength and liquidity in response to the negative economic outlook for 2009 forecast by many leading economists, especially with respect to the credit markets. Accordingly, the Corporation reduced the quarterly dividend from $0.20 per share to $0.10 per share for 2009. Activity in both the Corporation's dividend reinvestment and stock purchase plan did not have a material impact on capital during 2008.

Liquidity

Liquidity is a measure of the ability of the Corporation to meet its current cash needs and obligations on a timely basis. For a bank, liquidity provides the means to meet the day-to-day demands of deposit customers and the needs of borrowing customers. Generally, the Bank arranges its mix of cash, money market investments, investment securities and loans in order to match the volatility, seasonality, interest sensitivity and growth trends of its deposit funds. The Corporation's decisions with regard to liquidity are based on the projections of potential sources and uses of funds for the next 120 days under the Corporation's asset/liability model.

The resulting projections as of December 31, 2008, show the potential sources of funds exceeding the potential uses of funds. The accuracy of this prediction can be affected by limitations inherent in the model and by the occurrence of future events not anticipated when the projections were made. The Corporation has external sources of funds which can be drawn upon when funds are required. One source of external liquidity is the available line of credit with the FHLB. As of December 31, 2008, the Bank had borrowings outstanding with the FHLB of $522.7 million, all of which were long-term. At December 31, 2008, the Bank had a maximum borrowing capacity of $1.1 billion at the FHLB, unused FHLB lines of credit of $574.7 million and unused federal funds lines of credit of $77.7 million. In addition, the Corporation's funding sources include investment and loan portfolio cash flows, fed funds sold and short-term investments, as well as access to the brokered certificate of deposit market and repurchase agreement borrowings. The Corporation has pledged available for sale investment securities with a carrying value of $953.6 million and held to maturity securities of $50.4 million. The Corporation could also increase its liquidity through its pricing on certificates of deposit products. The Corporation believes it has adequate funding sources to maintain sufficient liquidity under varying business conditions.

There are no known trends or any known demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in liquidity increasing or decreasing in any material way although a significant portion of the Corporation's time deposits mature in 2009. Despite the anticipated market volatility and rate environment for much of 2009, the Corporation expects to be able to retain most of these deposits. In the event that additional funds are required, the Corporation believes its short-term liquidity is adequate as outlined above.

Recent Developments

The global and U.S economies are experiencing significantly reduced business activity as a result of, among other factors, disruptions in the financial system in the past year. Dramatic declines in the housing market during the past year, with falling home prices and increasing foreclosures and unemployment, have resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities and major commercial and investment banks. These write-downs, initially of mortgage-backed securities but spreading to credit default swaps and other derivative securities have caused many financial institutions to seek additional capital, to merge with larger and stronger institutions and, in some cases, to fail.

In the third quarter of 2008, the Federal Reserve, the U.S. Treasury and the FDIC initiated measures to stabilize the financial markets and to provide liquidity for financial institutions. In response to the financial crisis, the United States government passed the Emergency Economic Stabilization Act of 2008, (the "EESA") on October 3, 2008 which provides the United States Treasury Department (the "Treasury") with broad authority to implement certain actions to help restore stability and liquidity to the U.S. markets. Pursuant to the EESA, the Treasury has the ability to purchase or insure up to $700 billion in troubled assets held by financial institutions under the Troubled Asset Relief Program ("TARP"). On October 14, 2008, the Treasury announced it would purchase equity stakes in financial institutions under a Capital Purchase Program (the "CPP") of up to $250 billion of the $700 billion authorized under the TARP. The CPP provides direct equity investment of perpetual preferred stock by the Treasury in qualified financial institutions. The program is voluntary and requires an institution to comply with a number of restrictions and provisions, including limits on executive compensation, stock redemptions and declaration of dividends. As a result of additional legislation passed in February 2009, the CPP also requires the Treasury to receive warrants for common stock equal to 15% of the capital invested by the Treasury. For a period of three years, the consent of the U.S. Treasury will be required for participating institutions to increase their common stock dividend or repurchase their common stock, other than in connection with benefit plans consistent with past practice. The minimum subscription amount available to a participating institution is one percent of total risk-weighted assets. The maximum subscription amount is three percent of risk-weighted assets.

In November 2008, the Corporation filed an application to participate in the CPP as part of the TARP. The Executive Committee of the Corporation's Board of Directors authorized management to apply for participation in the CPP up to the maximum of 3% of total risk-based assets, which is estimated at approximately $120 million.

The EESA included a provision for a temporary increase in the Federal Deposit Insurance (FDIC) from $100,000 to $250,000 per depositor effective October 3, 2008 through December 31, 2009. In addition, the FDIC announced the Temporary Liquidity Guarantee Program effective October 14, 2008, enabling the FDIC to temporarily provide a 100% guarantee of newly issued senior unsecured debt of all FDIC-insured institutions and their holding companies issued before June 30, 2009, as well as deposits in non-interest bearing transaction deposit accounts through December 31, 2009. Coverage under the Temporary Liquidity Guarantee Program was available for 30 days without charge and thereafter at a cost of 75 basis points per annum for senior unsecured debt and 10 basis points per annum for non-interest bearing transaction deposits. The Corporation has determined it will continue to participate in the Temporary Liquidity Guarantee Program for non-interest bearing deposit accounts after the 30 day initial period and is assessing its participation for issuance of unsecured debt.

It is not clear at this time what impact these programs announced by the Treasury and other bank regulatory agencies and any additional programs that may be initiated in the future, will have on the Corporation or the financial markets as a whole.

The following table sets forth contractual obligations and other commitments representing required and potential cash outflows as of December 31, 2008:

Table 16—Contractual Obligations and Other Commitments

	December 31, 2008				
	Total	One year or less	After one year through three years	After three years through five years	After five years
	(Dollars in thousands)				
Minimum annual operating leases	$ 124,557	$ 9,214	$ 17,008	$ 15,262	$ 83,073
Remaining contractual maturities of time deposits	1,588,921	1,124,899	426,564	36,029	1,429
Long-term borrowings	759,658	58,230	186,356	253,904	261,168
Subordinated debt	93,743	—	—	—	93,743
Unfunded home equity lines of credit(1)	456,328	14,400	25,898	54,905	361,125
Unfunded other loan lines of credit	538,797	385,435	115,960	37,402	—
Standby letters of credit	34,806	32,277	2,460	69	—
Total	$3,596,810	$1,624,455	$774,246	$397,571	$800,538

(1) Home equity lines of credit in the after five years category have no stated expiration.

The Bank also had commitments with customers to extend mortgage loans at a specified rate at December 31, 2008 and December 31, 2007 of $36.4 million and $3.4 million, respectively and commitments to sell mortgage loans at a specified rate at December 31, 2008 and December 31, 2007 of $53.1 million and $2.4 million, respectively. The commitments are accounted for as a derivative and recorded at fair value. The Bank estimates the fair value of these commitments by comparing the secondary market price at the reporting date to the price specified in the contract to extend or sell the loan initiated at the time of the loan commitment. At December 31, 2008, the Corporation had commitments with a positive fair value of $274,000 and negative fair value of $48,000 which was recorded as other income. At December 31, 2007, the Corporation had commitments with a positive fair value of $19,000 and negative fair value of $19,000 which was recorded as other income.

During January 2006, the Bank completed its acquisition of the Cornerstone Companies. The purchase price consisted of $15.0 million in cash paid at closing and a contingent payment of up to $7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of $7.0 million over this period. For 2008, 2007 and 2006, the minimum operating results were met resulting in earn-out payments totaling $3.6 million which was recorded as additional goodwill. At December 31, 2008, the remaining maximum payout is $3.4 million through 2010.

During December 2004 and January 2005, the Bank sold lease financing receivables of $10.5 million. Of these leases, $1.2 million were sold with full recourse and the remaining leases were sold subject to recourse with a maximum exposure of ten percent of the outstanding receivable. The total recourse exposure at the time of the sale of the leases was $2.0 million. The Bank's total recourse exposure at December 31, 2008 was $26,000. After the first anniversary of the sale agreement, and on a quarterly basis thereafter, upon written request by the Bank, the purchaser will review the portfolio performance and may reduce the total exposure to an amount equal to ten percent of the outstanding net book value. The Bank will be subject to the full and partial recourse obligations until all the lease financing receivables have been paid or otherwise been terminated and all equipment has been sold or disposed of. The final lease payment is due in 2010. The outstanding balance of these sold leases at December 31, 2008 was $187,000. At December 31, 2008 and December 31, 2007, the Bank had $1,000 and $17,000, respectively, on the balance sheet as a recourse liability.

For information on known uncertainties, see Item 1, "Business."

Fourth Quarter 2008 Results (Unaudited)

Net income for the fourth quarter of 2008 was $3.8 million, or $0.11 per diluted share, as compared to $6.2 million or $0.20 per diluted share for the fourth quarter of 2007.

During the fourth quarter of 2008, the provision for loan losses was $7.9 million, compared to $4.5 million in the fourth quarter of 2007. The increase in provision for loan losses reflects an increase in non-performing assets to $78.5 million at December 31, 2008 from $22.0 million at December 31, 2007.

Net interest income on a tax-equivalent basis in the fourth quarter 2008 increased $8.3 million, or 36.0%, over the same period in the prior year. The net interest margin increased to 3.16% in the fourth quarter compared to 2.76% for 2007. The net interest margin increased as a 59 basis point decrease in the yield on average earning assets of $4.0 billion was offset by a 120 basis point decrease in the cost of interest bearing liabilities of $3.6 billion.

Noninterest income of $13.3 million for the fourth quarter of 2008 decreased $827,000 from the comparable period in 2007. During the fourth quarter of 2007, the Corporation recognized gains from sale-leaseback transactions of $2.8 million. In addition, there was a fourth quarter 2008 other than temporary impairment charge of $1.9 million on collateralized debt obligation investments in pooled trust preferred securities. Offsetting these decreases were gains on sale of investment securities of $2.4 million as compared to $657,000 in the prior period. Deposit service charge income increased $796,000 or 27.7% over 2007 mainly from return check and overdraft fees as well as the larger deposit base from East Penn acquisition. Wealth management income rose 20.0% to $6.0 million driven by higher life insurance business at Cornerstone. Other income increased $252,000 or 11.6% primarily to due to fees on derivative instruments.

Noninterest expense increased $7.7 million for the fourth quarter of 2008 over the same period in the prior year. Salaries and benefits expense increased $1.5 million primarily due to higher staffing levels resulting from new branch openings, the East Penn acquisition which occurred during the fourth quarter 2007, and the Willow Financial acquisition which closed in December 2008. Occupancy expenses increased $620,000 over the prior period due to new branch openings as well as the aforementioned acquisitions. Intangible asset expense rose $1.8 million primarily due to a $1.4 million valuation adjustment on mortgage servicing rights. Merger costs increased $2.1 million due to the Willow acquisition. Other expenses increased $1.6 million primarily due to increased FDIC insurance premiums.

The following is the summarized (unaudited) consolidated quarterly financial data of the Corporation which, in the opinion of management, reflects all adjustments, consisting only of normal recurring adjustments, necessary for fair presentation of the Corporation's results of operations:

Table 17—Selected Quarterly Financial Data (Unaudited)

	Three Months Ended 2008 (1)				Three Months Ended 2007 (2)			
	Dec. 31	Sept. 30	June 30	March 31	Dec. 31	Sept. 30	June 30	March 31
	(Dollars in thousands, except per share information)							
Interest income	**$54,583**	**$49,942**	**$49,353**	**$52,416**	$51,133	$49,022	$47,711	$46,695
Interest expense	**25,136**	**24,645**	**24,164**	**28,209**	29,555	28,158	27,556	26,858
Net interest income	**29,447**	**25,297**	**25,189**	**24,207**	21,578	20,864	20,155	19,837
Provision for loan losses	**7,920**	**2,580**	**3,107**	**1,960**	4,475	2,525	1,125	2,425
Net interest income after provision for loan losses	**21,527**	**22,717**	**22,082**	**22,247**	17,103	18,339	19,030	17,412
Noninterest income	**13,344**	**10,445**	**11,596**	**10,832**	14,171	9,765	10,255	9,147
Noninterest expense	**31,293**	**25,153**	**24,458**	**23,718**	23,579	18,856	20,141	18,779
Income before income tax expense	**3,578**	**8,009**	**9,220**	**9,361**	7,695	9,248	9,144	7,780
Income tax (benefit) expense	**(245)**	**1,370**	**1,893**	**2,057**	1,514	2,047	2,065	1,646
Net income	**$ 3,823**	**$ 6,639**	**$ 7,327**	**$ 7,304**	$ 6,181	$ 7,201	$ 7,079	$ 6,134
Net income per share								
Basic	**$ 0.11**	**$ 0.21**	**$ 0.24**	**$ 0.23**	$ 0.20	$ 0.25	$ 0.25	$ 0.21
Diluted	**$ 0.11**	**$ 0.21**	**$ 0.23**	**$ 0.23**	$ 0.20	$ 0.25	$ 0.24	$ 0.21

(1) The results of operations include the acquisition of Willow Financial effective December 5, 2008.

(2) The results of operations include the acquisition of East Penn Financial effective November 16, 2007 and the sale lease-back of bank properties during the fourth quarter of 2007.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

In the normal course of conducting business activities, the Corporation is exposed to market risk, principally interest risk, through the operations of its banking subsidiary. Interest rate risk arises from market driven fluctuations in interest rates that affect cash flows, income, expense and values of financial instruments. The Asset/Liability Committee of the Corporation, using policies and procedures approved by the Bank's Board of Directors, is responsible for managing the rate sensitivity position.

During the fourth quarter of 2007 through 2008, the economy has experienced a continued decline in the housing market, reductions in credit facilities, disruptions in the financial system, and volatility in the financial markets, all resulting in short-term rate reductions by the Federal Open Market Committee and the creation of programs by Congress and the Treasury Department for the purpose of stabilizing and providing liquidity to the U.S. financial markets. This has created a challenging interest rate environment for the Corporation which has impacted our interest rate sensitivity exposure. Information on quantitative and qualitative disclosures about market risk is incorporated by reference to the discussion contained in Item 7, under the caption "Interest Rate Sensitivity," and Table 13, "Contractual Repricing Data of Interest Sensitive Assets and Liabilities," and Table 14, "Market Value of Equity."

Item 8. Financial Statements and Supplementary Data

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	December 31, 2008	December 31, 2007
	(Dollars in thousands)	
Assets		
Cash and due from banks	**$ 75,305**	$ 73,930
Federal funds sold and securities purchased under agreements to resell	**-**	131,600
Interest-bearing deposits in banks	**27,221**	3,873
Total cash and cash equivalents	**102,526**	209,403
Residential mortgage loans held for sale (measured at fair value at December 31, 2008)	**17,165**	1,140
Investment securities available for sale (amortized cost $1,186,586 and $914,139, respectively)	**1,141,948**	910,367
Investment securities held to maturity (fair value $50,059 and $57,518, respectively)	**50,434**	57,347
Federal Home Loan Bank stock, Federal Reserve Bank stock and other investments	**39,279**	15,201
Loans and leases	**3,668,079**	2,459,683
Less: Allowance for loan losses	**(49,955)**	(27,328)
Net loans	**3,618,124**	2,432,355
Premises and equipment, net	**50,605**	32,518
Accrued interest receivable	**21,120**	16,456
Goodwill	**240,701**	111,155
Intangible assets, net	**27,807**	13,340
Bank-owned life insurance	**87,081**	72,269
Other assets	**93,719**	31,450
Total assets	**$5,490,509**	$3,903,001
Liabilities and Shareholders' Equity		
Deposits		
Noninterest-bearing	**$ 479,469**	$ 358,258
Interest-bearing:		
Checking	**556,855**	482,104
Money market	**1,042,302**	796,325
Savings	**270,885**	145,681
Time deposits	**1,588,921**	1,202,690
Total deposits	**3,938,432**	2,985,058
Federal funds purchased and short-term securities sold under agreements to repurchase	**136,113**	101,493
Other short-term borrowings	**984**	2,015
Long-term borrowings	**759,658**	321,785
Accrued interest payable	**34,495**	28,810
Subordinated debt	**93,743**	82,992
Other liabilities	**52,377**	41,538
Total liabilities	**5,015,802**	3,563,691
Shareholders' equity:		
Series preferred stock, par value $1 per share; authorized 8,000,000 shares, none issued	**—**	—
Common stock, par value $1 per share; authorized 75,000,000 shares; issued 43,022,387 and 31,507,021 shares at December 31, 2008 and 2007, respectively	**43,022**	31,507
Additional paid-in capital	**379,551**	231,130
Retained earnings	**82,295**	82,311
Accumulated other comprehensive loss	**(29,017)**	(2,566)
Treasury stock, at cost: 76,635 and 174,605 shares at December 31, 2008 and 2007, respectively	**(1,144)**	(3,072)
Total shareholders' equity	**474,707**	339,310
Total liabilities and shareholders' equity	**$5,490,509**	$3,903,001

See accompanying notes to consolidated financial statements.

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands, except per share data)		
Interest income			
Loans and leases, including fees	**$153,725**	$145,319	$134,115
Investment securities:			
Taxable	**39,195**	34,803	30,296
Exempt from federal taxes	**12,277**	10,863	10,477
Federal funds sold and securities purchased under agreements to resell	**996**	3,084	3,838
Deposits in banks	**101**	492	215
Total interest income	**206,294**	194,561	178,941
Interest expense			
Savings and money market deposits	**25,140**	47,980	38,906
Time deposits	**53,771**	41,309	36,460
Short-term borrowings	**2,099**	5,431	5,202
Long-term borrowings	**21,144**	17,407	15,200
Total interest expense	**102,154**	112,127	95,768
Net interest income	**104,140**	82,434	83,173
Provision for loan losses	**15,567**	10,550	4,200
Net interest income after provision for loan losses	**88,573**	71,884	78,973
Noninterest income			
Service charges	**13,515**	9,690	8,002
Gain (loss) on sales of investment securities, net	**2,642**	1,187	(674)
Other-than-temporary impairment of available for sale securities	**(1,923)**	(55)	—
Gain on sale-leaseback of bank properties	—	2,788	—
Gain on sale of branch	—	—	10,650
Gain on sale of credit card portfolio	—	—	1,444
Wealth management	**18,644**	18,642	14,788
Bank-owned life insurance	**2,777**	2,489	2,386
Other income	**10,562**	8,597	8,752
Total noninterest income	**46,217**	43,338	45,348
Net interest income after provision for loan losses and noninterest income	**134,790**	115,222	124,321
Noninterest expense			
Salaries, wages and employee benefits	**56,108**	48,832	44,647
Occupancy	**10,101**	7,008	5,670
Furniture and equipment	**4,432**	3,941	3,664
Intangibles expense	**4,208**	1,225	1,140
Merger charges	**3,430**	423	—
Other expense	**26,343**	19,926	15,709
Total noninterest expense	**104,622**	81,355	70,830
Income before income tax expense	**30,168**	33,867	53,491
Income tax expense	**5,075**	7,272	14,076
Net income	**$ 25,093**	$ 26,595	$ 39,415
Net income per share information:			
Basic	**$ 0.78**	$ 0.91	$ 1.36
Diluted	**$ 0.78**	$ 0.90	$ 1.34
Cash dividends per share	**$ 0.80**	$ 0.80	$ 0.75
Weighted average number of common shares:			
Basic	**32,201,150**	29,218,671	28,946,847
Diluted	**32,364,137**	29,459,898	29,353,128

See accompanying notes to consolidated financial statements.

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock Number of Shares	Treasury Stock Number of Shares	Common Stock Par Value	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Treasury Stock	Total	Comprehensive Income (Loss)
	(Dollars and share information in thousands)								
Balance January 1, 2006	27,500	(64)	$27,500	$167,418	$88,285	$ (8,618)	$(1,353)	$273,232	
Issuance of stock for stock options, net of excess tax benefits	192	220	192	1,662	—	—	4,583	6,437	
Issuance of stock awards	—	—	—	5	—	—	—	5	
Stock-based compensation expense	—	—	—	440	—	—	—	440	
Stock dividend	1,382	—	1,382	25,188	(26,582)	—	—	(12)	
Net income	—	—	—	—	39,415	—	—	39,415	$39,415
Other comprehensive income, net of reclassifications and tax	—	—	—	—	—	4,050	—	4,050	4,050
Purchases of treasury stock	—	(265)	—	—	—	—	(5,502)	(5,502)	
Cash dividends	—	—	—	—	(21,779)	—	—	(21,779)	
Comprehensive income									$43,465
Adjustment for adoption of FAS No. 158, net of tax	—	—	—	—	—	(1,535)	—	(1,535)	
Balance December 31, 2006	29,074	(109)	29,074	194,713	79,339	(6,103)	(2,272)	294,751	
Issuance of stock for stock options, net of tax and excess tax benefits	—	76	—	(386)	—	—	1,391	1,005	
Issuance of stock awards	—	—	—	(1)	—	—	5	4	
Stock-based compensation expense	—	—	—	118	—	—	—	118	
Net income	—	—	—	—	26,595	—	—	26,595	$26,595
Other comprehensive income, net of reclassifications and tax	—	—	—	—	—	3,537	—	3,537	3,537
Issuance of common stock for acquisition of East Penn Financial	2,433	—	2,433	36,686	—	—	—	39,119	
Purchases of treasury stock	—	(141)	—	—	—	—	(2,196)	(2,196)	
Cash dividends	—	—	—	—	(23,623)	—	—	(23,623)	
Comprehensive income									$30,132
Balance December 31, 2007	31,507	(174)	31,507	231,130	82,311	(2,566)	(3,072)	339,310	
Issuance of stock for stock options, net of excess tax benefits	**—**	**165**	**—**	**(992)**	**—**	**—**	**2,850**	**1,858**	
Issuance of stock awards	**—**	**—**	**—**	**—**	**—**	**—**	**2**	**2**	
Stock-based compensation expense	**—**	**—**	**—**	**136**	**—**	**—**	**—**	**136**	
Net income	**—**	**—**	**—**	**—**	**25,093**	**—**	**—**	**25,093**	**$25,093**
Other comprehensive loss, net of reclassifications and tax	**—**	**—**	**—**	**—**	**—**	**(26,451)**	**—**	**(26,451)**	**(26,451)**
Issuance of common stock for acquisition of Willow Financial	**11,515**	**—**	**11,515**	**149,277**	**—**	**—**	**—**	**160,792**	
Cash dividends									
Treasury stock received in sale of subsidiary	**—**	**(66)**	**—**	**—**	**—**	**—**	**(906)**	**(906)**	
Cash dividends	**—**	**—**	**—**	**—**	**(25,109)**	**—**	**—**	**(25,109)**	
Other	**—**	**(1)**	**—**	**—**	**—**	**—**	**(18)**	**(18)**	
Comprehensive loss									**$(1,358)**
Balance December 31, 2008	**43,022**	**(76)**	**$43,022**	**$379,551**	**$82,295**	**$(29,017)**	**$ (1,144)**	**$474,707**	

See accompanying notes to consolidated financial statements.

HARLEYSVILLE NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Operating activities			
Net income	**$ 25,093**	$ 26,595	$ 39,415
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	**15,567**	10,550	4,200
Depreciation	**4,308**	4,007	3,343
Intangibles expense	**4,208**	1,225	1,140
Net amortization of discounts/premiums on investments and borrowings	**285**	1,758	3,327
Deferred income (benefit) expense	**(3,546)**	(7,859)	659
(Gain) loss on sales of investment securities, net	**(2,642)**	(1,132)	674
Other-than-temporary impairment on investments available for sale	**1,923**	—	—
Gain on sale-leaseback of bank properties	—	(2,788)	—
Gain on sale of branch	—	—	(10,650)
Gain on sale of credit card portfolio	—	—	(1,444)
Bank-owned life insurance income	**(2,777)**	(2,489)	(2,386)
Death benefit on bank-owned life insurance	**(405)**	—	—
Stock-based compensation expense	**136**	118	440
Pension termination expense	—	1,917	—
Net decrease (increase) in accrued interest receivable	**798**	307	(1,725)
Net increase (decrease) in accrued interest payable	**1,615**	(4,410)	4,412
Net (increase) decrease in other assets	**(1,723)**	5	(8,085)
Net (decrease) increase in other liabilities	**(1,303)**	5,773	1,711
Other, net	**(40)**	31	(89)
Net cash provided by operating activities	**41,497**	33,608	34,942
Investing activities			
Proceeds from sales of investment securities available for sale	**208,456**	186,218	110,842
Proceeds from maturity or calls of investment securities held to maturity	**6,864**	1,500	617
Proceeds from maturity or calls of investment securities available for sale	**167,067**	150,110	153,537
Proceeds, redemption Federal Home Loan Bank stock and reduction in other investments	**5,513**	7,811	4,609
Purchases of investment securities available for sale	**(409,861)**	(343,679)	(273,399)
Purchases of Federal Home Loan Bank stock, Federal Reserve Bank stock and other investments.	**(11,091)**	(3,737)	(4,664)
Net increase in loans	**(133,901)**	(83,162)	(101,554)
Net cash acquired (paid) due to acquisitions	**42,107**	(34,010)	(14,525)
Net cash paid in sale of branch	—	—	(42,472)
Net proceeds from sale of credit card portfolio	—	—	16,705
Payments to fund pension plan	**(1,250)**	—	—
Purchases of premises and equipment	**(10,072)**	(10,912)	(10,783)
Proceeds from sales of premises and equipment	**866**	39,712	857
Proceeds from sales of other real estate	**1,244**	13	109
Net cash used in investing activities	**(134,058)**	(90,136)	(160,121)
Financing activities			
Net increase in deposits	**6,722**	85,491	225,554
Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase	**9,605**	(6,429)	8,722
(Decrease) increase in short-term borrowings	**(1,031)**	658	(395)
Advances of long-term borrowings	**125,000**	125,000	10,000
Repayments of long-term borrowings	**(131,347)**	(62,003)	(68,000)
Proceeds from subordinated debt issuance	—	23,196	—
Cash dividends	**(25,109)**	(23,623)	(21,779)
Repurchase of common stock	—	(2,196)	(5,502)
Proceeds from the exercise of stock options	**1,567**	925	5,302
Excess tax benefits from stock-based compensation	**277**	42	948
Other, net	—	—	(12)
Net cash (used in) provided by financing activities	**(14,316)**	141,061	154,838
Net (decrease) increase in cash and cash equivalents	**(106,877)**	84,533	29,659
Cash and cash equivalents at beginning of year	**209,403**	124,870	95,211
Cash and cash equivalents at end of year	**$102,526**	$209,403	$124,870
Cash paid during the year for:			
Interest	**$101,550**	$116,649	$ 91,435
Income taxes	**$ 17,668**	$ 6,145	$ 17,088
Supplemental disclosure of noncash investing and financing activities:			
Transfer of assets from loans to other real estate owned	**$ 2,416**	$ 51	$ 128
Acquisitions, common stock issued	**$160,792**	$ 39,119	$ —

See accompanying notes to consolidated financial statements.

Note 1—Summary of Significant Accounting Policies

Harleysville National Corporation (the Corporation) through its subsidiary bank, Harleysville National Bank (the Bank), provides a full range of banking services including loans, deposits, investment management, trust and investment advisory services to individual and corporate customers primarily located in eastern Pennsylvania. HNC Financial Company and HNC Reinsurance Company are wholly owned subsidiaries of the Corporation. HNC Financial Company's principal business function is to expand the investment opportunities of the Corporation. HNC Reinsurance Company functions as a reinsurer of consumer loan credit life and accident and health insurance.

The Corporation and the Bank are subject to regulations of certain state and federal agencies including the Federal Deposit Insurance Corporation, as insurer of the Bank's deposits, the Board of Governors of the Federal Reserve System, as regulator of the holding company and the Office of the Comptroller of Currency. Accordingly, these regulatory authorities periodically examine the Corporation and the Bank. As a consequence of the extensive regulation of commercial banking activities, the Corporation's and the Bank's businesses are susceptible to being affected by state and federal legislation and regulations.

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows.

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the Corporation and its wholly owned subsidiaries, the Bank, HNC Financial Company, and HNC Reinsurance Company. Willow Financial Bancorp, Inc. (Willow Financial) and its banking subsidiary are included in the Corporation's results effective December 5, 2008. East Penn Financial Corporation (East Penn Financial) and its banking subsidiary are included in the Corporation's results effective November 16, 2007. All significant intercompany accounts and transactions have been eliminated in consolidation and certain prior period amounts have been reclassified to conform to current year presentation. The accounting and reporting policies of the Corporation and its subsidiaries conform with U.S. generally accepted accounting principles (GAAP).

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities as of the dates of the balance sheets and revenues and expenditures for the periods presented. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash and due from banks, federal funds sold, securities purchased under agreements to resell and interest-bearing deposits in banks with original maturities of generally three months or less.

Investment Securities

The Corporation accounts for securities under Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Debt securities, which management has the intent and ability to hold until maturity, are classified as held to maturity and reported at amortized cost, adjusted for amortization of premiums and accretion of discounts using the interest method over the life of the securities. Debt and equity securities expected to be held for an indefinite period of time are

Note 1—Summary of Significant Accounting Policies (Continued)

classified as available for sale and are stated at fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income, net of income taxes. The Corporation receives estimated fair values of debt securities from independent valuation services and brokers. In developing these fair values, the valuation services and brokers use estimates of cash flows based on historical performance of similar instruments in similar rate environments.

Amortization of premiums and accretion of discounts for investment securities available for sale and held to maturity are included in interest income. Realized gains and losses on the sale of investment securities are recognized using the specific identification method and are included in the consolidated statements of income.

The Corporation follows Financial Accounting Standards Board (FASB) Financial Staff Position (FSP) FAS Nos. 115-1 and FAS 124-1 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," which provides guidance on determining when investments in certain debt and equity securities are considered impaired, whether that impairment is other than temporary, and on measuring such impairment loss. The Corporation uses various indicators in determining whether a security is other-than-temporarily impaired, including for equity securities, if the market value is below its cost for an extended period of time with low expectation of recovery or for debt securities, when it is probable that the contractual interest and principal will not be collected. The debt securities are monitored for changes in credit ratings. Adverse changes in credit ratings could affect the estimated cash flows of the underlying collateral or issuer.

Loans

Loans that management intends to hold to maturity are stated at the principal amount outstanding. Net loans represent the principal loan amount outstanding net of deferred fees and costs, unearned income and the allowance for loan losses. Interest on loans is credited to income based on the principal amount outstanding.

Loan origination fees and direct loan origination costs of completed loans are deferred and recognized over the life of the loan as an adjustment to the yield consistent with SFAS No. 91, "Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases." The net loan origination fees recognized as yield adjustments are reflected in loan interest income from loans and leases in the consolidated statements of income and the unamortized balance of the net loan origination fees is reported in net loans in the consolidated balance sheets.

Income recognition of interest on loans is discontinued when, in the opinion of management, the collectability of principal or interest becomes doubtful. A loan is generally classified as nonaccrual when principal or interest has consistently been in default for a period of 90 days or more or because of deterioration in the financial condition of the borrower, and payment in full of principal or interest is not expected. When a loan is placed on nonaccrual status, all accrued but uncollected interest is reversed from income. The Corporation recognizes income on nonaccrual loans under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Corporation. The Corporation will not recognize income if these factors do not exist. Loans past due 90 days or more and still accruing interest are loans that are generally well-secured and expected to be restored to a current status in the near future.

Loans are considered past due after one payment has been missed. Loans are charged off when it becomes evident that such balances are not fully collectible.

Note 1—Summary of Significant Accounting Policies (Continued)

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. The Corporation accounts for impaired loans under SFAS No. 114, "Accounting by Creditors for Impairment of a Loan", as amended by SFAS No. 118, "Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures." Impaired loans are measured individually based on the present value of expected future cash flows discounted at the loan's effective interest rate, a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. Regardless of the measurement method, impairment is based on the fair value of the collateral when foreclosure is probable. If the recorded investment in impaired loans exceeds the measure of estimated fair value, a specific allowance is established as a component of the allowance for loan losses. The Corporation's policy for interest income recognition on impaired loans is to recognize income on restructured loans under the accrual method.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level that management believes is sufficient to absorb estimated probable credit losses. The allowance for loan losses is based on estimated net realizable value unless it is probable that loans will be foreclosed, in which case the allowance for loan losses is based on the fair value of the collateral less selling costs. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and other relevant factors. However, this evaluation is inherently subjective as it requires significant estimates by management. Consideration is given to a variety of factors in establishing these estimates including historical losses, current and anticipated economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan review, borrowers' perceived financial and management strengths, the adequacy of underlying collateral, the dependence on collateral, and the strength of the present value of future cash flows and other relevant factors. These factors may be susceptible to significant change. Increases to the allowance for loan losses are made by charges to the provision for loan losses. Credit exposures deemed to be uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off amounts are credited to the allowance for loan losses. To the extent actual outcomes differ from management estimates, additional provisions for loan losses may be required which may adversely affect the Corporation's results of operations in the future. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgment of information available to them at the time of their examination.

The Corporation performs periodic evaluations of the allowance for loan losses that include both historical, internal and external factors. The actual allocation of reserve is a function of the application of these factors to arrive at a reserve for each portfolio type and an additional component of the reserve allocated against the portfolio as a whole. Management assigns historical factors and environmental factors to homogeneous groups of loans that are grouped by loan type and credit rating. Changes in concentrations and quality are captured in the analytical metrics used in the calculation of the reserve. The components of the allowance for credit losses consist of both historical losses and estimates. Management bases its recognition and estimation of each allowance component on certain observable data that it believes is the most reflective of the underlying loan losses being estimated. The observable data and accompanying analysis is directionally consistent, based upon trends, with the resulting component amount for the allowance for loan losses. The Corporation's allowance for loan losses components includes the following: historical loss estimation by loan product type and by risk rating within each product type, payment (past due) status, industry concentrations, internal and external variables such as economic conditions, credit policy and underwriting changes and results of the loan review process. The Corporation's historical loss component is a significant component of the allowance for loan losses, and all other allowance components are based on the inherent loss attributes that management believes exist within the total

Note 1—Summary of Significant Accounting Policies (Continued)

portfolio that are not captured in the historical loss component as well as external factors impacting the portfolio taken as a whole.

The historical loss components of the allowance represent the results of analyses of historical charge-offs and recoveries within pools of homogeneous loans, within each risk rating and broken down further by segment, within the portfolio. Criticized assets are further assessed based on trends, expressed as percentages, relative to delinquency, risk rating and nonaccrual, by credit product.

The historical loss components of the allowance for commercial and industrial loans and commercial real estate loans (collectively "commercial loans") are based principally on current risk ratings, historical loss rates adjusted, by adjusting the risk window, to reflect current events and conditions, as well as analyses of other factors that may have affected the collectability of loans. All commercial loans with an outstanding balance over $500,000 are subject to review on an annual basis. A sample of commercial loans with a "pass" rating are individually reviewed annually. Commercial loans that management determines to be potential problem loans are individually reviewed, at a minimum, annually. The review is performed by a third-party, and is designed to determine whether such loans are individually impaired, with impairment measured by reference to the collateral coverage and/or debt service coverage. Consumer credit and residential real estate reviews are limited to those loans reflecting delinquent payment status or performed on loans otherwise deemed to be at risk of nonpayment. Homogeneous loan pools, including consumer and 1-4 family residential mortgages are not subject to individual review but are evaluated utilizing risk factors such as concentration of one borrower group. The historical loss component of the allowance for these loans is based principally on loan payment status, retail classification and historical loss rates, adjusted by altering the risk window, to reflect current events and conditions.

The industry concentration component is recognized as a possible factor in the estimation of loan losses. Two industries represent possible concentrations: commercial real estate and consumer loans relying on residential home equity. No specific loss-related observable data is recognized by management currently, therefore no specific factor is calculated in the reserve solely for the impact of these concentrations, although management continues to carefully consider relevant data for possible future sources of observable data.

The historic loss model includes two judgmental components (product level and portfolio level environmental factors) that reflects management's belief that there are additional inherent credit losses based on loss attributes not adequately captured in the lagging indicators. The judgmental components are allocated to the specific segments of the portfolio based on the historic loss component of each segment under review.

Portfolio level environmental factors included in management's calculation entail the measurement of a wider array of both internal and external criteria impacting the portfolio as a whole. The portfolio level environmental factors are based upon management's review of trends in the Corporation's primary market area as well as regional and national economic trends. Management utilizes various economic factors that could impact borrowers' future ability to make loan payments such as changes in the interest rate environment, product supply shortages and negative industry specific events. Management utilizes relevant articles from newspapers and other publications that describe the economic events affecting specific geographic areas and other published economic reports and data. Furthermore, given that past-performance indicators may not adequately capture current risk levels, allowing for a real-time adjustment enhances the validity of the loss recognition process. There are many credit risk management reports that are synthesized by credit risk management staff to assess the direction of credit risk and its instant effect on losses. It is important to continue to use experiential data to confirm risk as measurable losses will continue to manifest themselves at higher than normal levels even after the economic

Note 1—Summary of Significant Accounting Policies (Continued)

cycle has begun an upward swing and lagging indicators begin to show improvement. The judgmental component is allocated to the entire portfolio based upon management's evaluation of the factors under review.

Statement of Position (SOP) 03-3, "Accounting for Loans or Certain Debt Securities Acquired in a Transfer" requires loans with evidence of deterioration of credit quality since origination for which it is probable that the investor will be unable to collect all contractually required payments receivable to be recorded at the present value of amounts expected to be received and prohibits carrying over or creation of valuation allowances in the initial accounting for these loans. The Corporation evaluates the assets acquired in its acquisitions for applicability to this statement.

Mortgage Servicing

The Corporation performs various servicing functions on mortgage loans owned by others. A fee, usually based on a percentage of the outstanding principal balance of the loan, is received for these services.

The Corporation accounts for its transfers and servicing financial assets in accordance with SFAS No. 156, "Amending Accounting for Separately Recognized Servicing Assets and Liabilities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." The Corporation originates mortgages under a definitive plan to sell or securitize those loans and service the loans owned by the investor. The Corporation initially recognizes and measures at fair value its servicing assets and allocates the carrying amount between the assets sold based on the relative fair values at the date of transfer. The Corporation recognizes and initially measures at fair value, a servicing asset each time it undertakes an obligation to service a financial asset by entering into a servicing contract. The Corporation uses the amortization method for subsequent measurement of its servicing assets. Servicing assets are amortized in proportion to and over the period of net servicing income and assessed for impairment based on fair value at each reporting period. As a result of these assessments, the Corporation recorded valuation adjustments of $1.4 million in 2008 which are recorded in intangibles expense on the consolidated statements of income.

The Corporation estimates the fair value of servicing rights based upon the present value of expected future cash flows associated with the servicing rights discounted at a current market rate using the same assumptions used by bidders of servicing portfolios. The loans are grouped into homogenous pools for analysis based upon the predominant risk characteristics including origination date, loan type, interest rate and term. Assumptions are developed that include estimates of servicing costs, loan defaults, prepayment speeds, discount rates, market conditions and other factors that impact the value of retained interests. If the carrying value of mortgage servicing rights for a pool exceeds the estimated fair value, an impairment loss is recognized through a charge to the valuation allowance with a corresponding adjustment to earnings.

As of December 31, 2008, mortgage loans originated and intended for sale in the secondary market are recorded at estimated fair value in accordance with the provisions with the provisions of SFAS No. 159, "Fair Value Option for Financial Assets and Financial Liabilities." As a result, in the fourth quarter of 2008, a fair value adjustment of $215,000 was recognized in other income on the consolidated statements of income.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is recorded using the straight-line and accelerated depreciation methods over the estimated useful lives of the assets. Leasehold improvements are amortized over the remaining useful lives of the leases (including renewal options) or estimated useful lives, whichever is shorter.

Note 1—Summary of Significant Accounting Policies (Continued)

Net Assets in Foreclosure

Net assets in foreclosure include foreclosed real estate which is carried at the lower of cost (lesser of carrying value of loan or fair value at date of acquisition) or estimated fair value of the collateral less selling costs. Any write-down, at or prior to the dates the real estate is considered foreclosed, is charged to the allowance for loan losses. Subsequent write-downs and expenses incurred in connection with holding such assets are recorded in other expenses. Any gain or loss upon the sale of real estate owned is charged to operations as incurred. Net assets in foreclosure also includes foreclosed leases which are carried at lower of cost (lesser of carrying value of loan or fair value at date of acquisition) or estimated fair value less selling costs.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the cost of an acquired entity over the fair value of the identifiable net assets acquired in accordance with the purchase method of accounting. Goodwill is not amortized but is reviewed for potential impairment on an annual basis, or more often if events or circumstances indicate that there may be impairment, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Goodwill is tested for impairment at the reporting unit level and an impairment loss is recorded to the extent that the carrying amount of goodwill exceeds its implied fair value. Core deposit intangibles are a measure of the value of checking, money market and savings deposits acquired in business combinations accounted for under the purchase method. Core deposit intangibles and other identified intangible assets with finite useful lives are amortized on a straight-line basis or sum of the years digits basis over their estimated lives (ranging from five to ten years). Identifiable intangible assets are evaluated for potential impairment on an annual basis, or more often if events or circumstances indicate that there may be impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Corporation employs general industry practices in evaluating the fair value of its goodwill and other intangible assets. The Corporation calculates the fair value, with the assistance of a third party specialist, using a combination of the following valuation methods: dividend discount analysis under the income approach, which calculates the present value of all excess cash flows plus the present value of a terminal value and market multiples (pricing ratios) under the market approach. Any impairment loss related to goodwill and other intangible assets is reflected as other noninterest expense in the statement of operations in the period in which the impairment was determined. No assurance can be given that future impairment tests will not result in a charge to earnings. See Note 2 – Acquisitions / Dispositions and Note 8 – Goodwill and Other Intangibles for additional information.

Derivatives

The Corporation accounts for derivatives in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" as amended. The Statement requires the Corporation to recognize all derivative instruments at fair value as either assets or liabilities. The accounting for changes in the fair value of a derivative instrument depends on whether, at inception, it has been designated and qualifies as part of a hedging relationship. For derivatives not designated as hedges, the gain or loss is recognized in current earnings. When the Corporation designates a derivative as hedging, it is required to establish at the inception of the hedge, the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the Corporation's approach to managing risk.

The Corporation enters into interest rate swap contracts to modify the interest rate characteristics from variable to fixed in order to reduce the impact of interest rate changes on future net interest income. Net amounts payable or receivable from these contracts are accrued as an adjustment to interest income or interest expense of the related asset or liability. Interest rate swap agreements are designated as either cash flow hedges or fair value

Note 1—Summary of Significant Accounting Policies (Continued)

hedges. For cashflow hedges, the fair value of these derivatives is reported in other assets or other liabilities on the consolidated balance sheets and offset in accumulated other comprehensive income (loss) for the effective portion of the derivatives. Amounts reclassed into earnings, when the hedged transaction culminates, are included in net interest income on the consolidated statements of income. Ineffectiveness of the strategy, as defined under SFAS 133, if any, is also reported in net interest income. In a fair value hedge, the fair values of the interest rate swap agreements and changes in the fair values of the hedged items are recorded in the Corporation's consolidated balance sheets with the corresponding gain or loss being recognized in current earnings. The difference between changes in the fair values of interest rate swap agreements and the hedged items represents hedge ineffectiveness and is recorded in net interest in the Corporation's consolidated statements of income. The Corporation performs an assessment, both at the inception of the hedge and quarterly thereafter, to determine whether these derivatives are highly effective in offsetting changes in the value of the hedged items.

Stock-Based Compensation

The Corporation recognizes compensation expense for stock options in accordance with SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS 123R) adopted at January 1, 2006 under the modified prospective application method of transition. The expense of the option is generally measured at fair value at the grant date with compensation expense recognized over the service period, which is usually the vesting period. For grants subject to a service condition, the Corporation utilizes the Black-Scholes option-pricing model (as used under SFAS 123) to estimate the fair value of each option on the date of grant. The Black-Scholes model takes into consideration the exercise price and expected life of the options, the current price of the underlying stock and its expected volatility, the expected dividends on the stock and the current risk-free interest rate for the expected life of the option. For grants subject to a market condition, the Corporation utilizes a Monte Carlo simulation to estimate the fair value and determine the derived service period. Compensation is recognized over the derived service period with any unrecognized compensation cost immediately recognized when the market condition is met. The Corporation's estimate of the fair value of a stock option is based on expectations derived from historical experience and may not necessarily equate to its market value when fully vested. In accordance with SFAS 123(R), the Corporation estimates the number of options for which the requisite service is expected to be rendered. See Note 14 – Stock-Based Compensation for additional information.

Income Taxes

There are two components of income tax expense: current and deferred. Current income tax expense approximates cash to be paid or refunded for taxes for the applicable period. Deferred tax assets and liabilities are recognized due to differences between the basis of assets and liabilities as measured by tax laws and their basis as reported in the financial statements. Deferred tax assets are subject to management's judgment based upon available evidence that future realizations are "more likely than not" in accordance with SFAS No. 109, "Accounting for Income Taxes." If management determines that the Corporation is not, more likely than not, to realize some or all of the net deferred tax asset in the future, a charge to income tax expense may be required to reduce the value of the net deferred tax asset to the expected realizable value. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax expense or benefit is recognized for the change in deferred tax liabilities or assets between periods.

Note 1—Summary of Significant Accounting Policies (Continued)

Pension Plans

The Corporation has certain employee benefit plans covering substantially all employees. The Corporation accrues service cost as incurred. The Corporation's current measurement date for plan assets and obligations is fiscal year-end. The Corporation's defined benefit pension plan was frozen at the current benefit levels as of December 31, 2007 at which time the accrual of future benefits for eligible employees ceased. The Corporation accounts for its Pension Plan in accordance with SFAS No. 87 "Employers' Accounting for Pensions," and SFAS No. 88 "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," as amended by SFAS No. 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans." SFAS 158, effective at the end of fiscal year 2006, requires companies to recognize the funded status of defined benefit pension plans on the balance sheet and recognize changes in the funded status of the plan in the year in which the changes occur. See Note 12 – Pension Plans for additional information.

Bank-Owned Life Insurance

The Corporation invests in bank-owned life insurance (BOLI). BOLI involves the purchasing of life insurance by the Corporation on a chosen group of employees. The Corporation is the owner and beneficiary of the policies. This pool of insurance, due to tax advantages to the Bank, is profitable to the Corporation. This profitability is used to offset a portion of future benefit cost increases. The Bank's deposits fund BOLI and the earnings from BOLI are recognized as noninterest income.

Earnings Per Share

The Corporation follows the provisions of SFAS No. 128, "Earnings per Share." Basic earnings per share exclude dilution and are computed by dividing income available to common shareholders by the weighted-average common shares outstanding during the period. Diluted earnings per share take into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock. Proceeds assumed to have been received on such exercise or conversion are assumed to be used to purchase shares of the Corporation's common stock at the average market price during the period, as required by the "treasury stock method" of accounting. The effects of securities or other contracts to issue common stock are excluded from the computation of diluted earnings per share in periods in which the effect would be antidilutive. All weighted average shares, actual shares and per share information in the financial statements are adjusted retroactively for the effect of stock dividends.

Marketing Costs

It is the Corporation's policy to expense marketing costs in the period in which they are incurred.

Comprehensive Income

The Corporation records unrealized gains and losses on available for sale investment securities, net of tax and gains and losses on cash flow hedges, net of tax in accumulated other comprehensive income (loss) in the consolidated balance sheets. Gains and losses on available for sale investment securities are reclassified to net income as the gains or losses are realized upon sale of the securities. Other-than-temporary impairment charges on investment securities are reclassified to net income at the time of the charge. Gains or losses on derivatives are reclassified to net income as the hedged item affects earnings. The Corporation follows the disclosure provisions of SFAS No. 130, "Reporting Comprehensive Income."

Note 1—Summary of Significant Accounting Policies (Continued)

Securities Sold Under Agreements to Repurchase

The Corporation accounts for securities sold under agreements to repurchase as secured borrowings as the Corporation maintains effective control over the transferred assets. Securities sold under agreements to repurchase are reflected at the amount of cash received in connection with the transaction. The Corporation may be required to provide additional collateral based on the fair value of the underlying securities.

Variable Interest Entities

Harleysville Statutory Trust I (Trust I), HNC Statutory Trust II (Trust II), HNC Statutory Trust III (Trust III), HNC Statutory Trust IV (Trust IV), East Penn Statutory Trust and Willow Grove Statutory Trust I, (collectively, the Trusts) are considered variable interest entities under FASB Interpretation 46, "Consolidation of Variable Interest Entities," as revised in December 2003 (FIN 46R). Accordingly, the Corporation is not considered the primary beneficiary and therefore the Trusts are not consolidated in the Corporation's financial statements.

Recent Accounting Pronouncements

In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, "Disclosure by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities." This FSP amends SFAS 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" to require public entities to provide additional disclosures about transferors' continuing involvements with transferred financial assets. It also amends FIN 46R to require public entities, including sponsors that have a variable interest in a variable interest entity, to provide additional disclosures about their involvement with variable interest entities. This FSP is effective for reporting periods that end after December 15, 2008. FSP FAS 140-4 and FIN 46(R)-8 did not impact the Corporation's financial statements, although it did result in expanded disclosures. See Note 10 – Borrowings for additional information.

In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active." FSP FAS 157-3 clarifies how a reporting entity's own assumptions should be considered when measuring fair value when relevant observable inputs do not exist, how available observable inputs in a market that is not active should be considered when measuring fair value and how the use of market quotes should be considered when assessing the relevance of observable and unobservable inputs available to measure fair value. The provisions of FSP FAS 157-3 were applied in calculating an other-than-temporary impairment charge on investment securities of $1.9 million during the fourth quarter of 2008. See Note 4 – Investment Securities for additional information.

In June 2008, the FASB issued FSP EITF Issue No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities." This FSP states that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. This staff position is not expected to have a material impact on the Corporation's financial statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States (the GAAP hierarchy). This Statement was effective 60 days following the SEC's approval of the Public Company Accounting

Note 1—Summary of Significant Accounting Policies (Continued)

Oversight Board amendment to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The provisions of SFAS 162 did not have a significant impact on the Corporation's current practice.

In May 2008, the FASB issued FSP Accounting Principles Board (APB) 14-1, "Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)." This FSP clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, "Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants," and specifies that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB 14-1 is effective for financial statements issued in fiscal years beginning after December 15, 2008, and is not anticipated to have a material impact on the Corporation's financial statements.

In April 2008, the FASB issued FSP FAS 142-3, "Determination of the Useful Life of Intangible Assets." FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset and expands disclosures under SFAS No. 142, "Goodwill and Other Intangible Assets." This FSP is effective for financial statements issued in fiscal years beginning after December 15, 2008, and is not expected to have a material impact on the Corporation's financials statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities." SFAS 161 requires enhanced disclosures to enable investors to better understand the effects of derivative instruments and hedging activities on an entity's financial statements. Specifically, it requires that objectives for using derivatives instruments be disclosed in terms of underlying risk and accounting designation, disclosing the fair values of derivative instruments and their gains and losses in a tabular format, disclosure about credit-risk-related contingent features and cross-referencing within the footnotes. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 will result in expanded disclosures within the Corporation's financial statements.

In February 2008, the FASB issued FSP FAS 140-3, "Accounting for Transfers of Financial Assets and Repurchase Financing Transactions." This FSP specifies that a transferor and transferee shall not separately account for a transfer of a financial asset and a related repurchase financing unless (a) the two transactions have a valid and distinct business or economic purpose for being entered into separately and (b) the repurchase financing does not result in the initial transferor regaining control over the financial asset. The two transactions shall be considered linked unless they meet all of the specified criteria in this FSP. The linked transaction should be evaluated to determine whether it meets the requirements for sale accounting under SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." If the linked transaction does not meet the requirements for sale accounting, it should be accounted for based on the economics of the combined transaction which generally represents a forward contract. FSP FAS 140-3 is effective prospectively for financial statements issued in fiscal years beginning after November 15, 2008. Early application is not permitted. FSP FAS 140-3 is not expected to have a material impact on the Corporation's financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations (revised 2007)." SFAS 141(R) will significantly change how entities apply the acquisition method to business combinations. The new standard requires the acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business

Note 1—Summary of Significant Accounting Policies (Continued)

combination. SFAS 141(R) requires the acquirer to recognize those restructuring costs that do not meet the criteria in SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" as an expense as incurred. Acquisition related transaction costs will be expensed as incurred. SFAS 141(R) requires an acquirer to recognize assets or liabilities arising from all other contingencies (contractual contingencies) as of the acquisition date, measured at their acquisition-date fair values only if it is more likely than not that they meet the definition of an asset or a liability on the acquisition date. Under SFAS 141(R), changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. Additionally, under SFAS 141(R), the allowance for loan losses of an acquiree will not be permitted to be recognized by the acquirer. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The provisions of SFAS 141(R) will only impact the Corporation if it is party to a business combination closing on or after January 1, 2009.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements–an amendment of Accounting Research Bulletin No. 51, "Consolidated Financial Statements." SFAS 160 requires all entities to report noncontrolling (minority) interests in subsidiaries as equity in the consolidated financial statements. Its intention is to eliminate the diversity in practice regarding the accounting for transactions between an entity and noncontrolling interests. SFAS 160 is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS 160 is not expected to have a material impact on the Corporation's financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115." SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS 159 provides entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. The Statement also establishes presentation and disclosure requirements. At each subsequent reporting date, unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The fair value option may be applied instrument by instrument, with a few exceptions, is irrevocable and is applied only to entire instruments. On December 5, 2008, the Corporation elected to measure residential mortgage loans held for sale acquired from Willow Financial at fair value under the provisions of SFAS 159. The adoption of SFAS 159 did not have a material impact on the Corporation's financial statements.

Effective January 1, 2008, the Corporation adopted SFAS No. 157, "Fair Value Measurements." SFAS 157 clarifies the definition of fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 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 at the measurement date." The Statement does not change existing accounting rules governing what can or what must be recognized and reported at fair value in the Corporation's financial statements, or disclosed at fair value in the Corporation's notes to the financial statements. As a result, the Corporation was not required to recognize any new instruments at fair value. See Note 21 – Fair Value Measurements for additional information.

In March 2008, the FASB issued FSP FAS 157-2, "Effective Date of FASB Statement No. 157" to partially delay the effective implementation of SFAS 157 until fiscal years beginning after November, 15, 2008 for all nonfinancial assets and liabilities except those that are recognized or disclosed at fair value in financial statements on a recurring basis (at least annually). Assets and liabilities currently reported or disclosed at fair value on a recurring basis in the Corporation's financial statements include investment securities, residential mortgage loans held for sale and derivatives. Assets reported at fair value on a nonrecurring basis (lower of cost

Note 1—Summary of Significant Accounting Policies (Continued)

or market) are impaired loans and mortgage servicing rights. See Note 21 – Fair Value Measurements for additional information.

Note 2—Acquisitions / Dispositions

Acquisition of Willow Financial Bancorp, Inc.

Effective after the market close on December 5, 2008, the Corporation completed its acquisition of Willow Financial. Under the terms of the merger agreement, dated as of May 20, 2008, Willow Financial was acquired by the Corporation and Willow Financial's wholly-owned subsidiary, Willow Financial Bank, a $1.6 billion savings bank with 29 branch offices in Southeastern Pennsylvania, was merged with and into the Bank. The merger of the Corporation and Willow Financial resulted in a combined company with approximately $5.5 billion in assets and delivers a significant market share in Chester County, one of the fastest-growing counties in Pennsylvania, increases the Corporation's market presence in Bucks and Montgomery counties, and establishes a new market presence in Philadelphia County. The combined company establishes a stronger presence in eastern Pennsylvania, including becoming the third largest financial institution headquartered in suburban Philadelphia. Willow Financial has complementary lines of business, a solid reputation with customers in growing markets, and a branch network that augments the Bank's traditional footprint. In conjunction with this transaction, the Corporation also acquired BeneServ, Inc., a respected provider of employee benefits services and Carnegie Wealth Advisors, LLC (Carnegie). Carnegie was subsequently sold in December 2008. The merger drives shareholder value by providing the opportunity to deliver synergies and accretion to earnings.

The Corporation acquired 100% of the outstanding shares of Willow Financial. Based on the terms of the merger agreement, Willow Financial shareholders received 0.73 shares of the Corporation's common stock for each share of Willow Financial common stock they held with cash paid in lieu of fractional shares. The purchase price was $13.79 per common share and was based upon the average of the closing prices for the Corporation's common stock on the agreement date and for two days before and two days after the agreement date and the agreement date. The Corporation issued 11,515,366 shares of common stock, incurred $2.4 million in acquisition costs which were capitalized and converted stock options with a fair value of $2.0 million for a total purchase price of $163.2 million at the closing on December 5, 2008.

Goodwill of $130.0 million has been recorded in this transaction which will not be amortizable and is not deductible for tax purposes. The Corporation allocated $126.9 million of the goodwill resulting from this transaction to the Community Banking segment and $3.1 million to the Wealth Management segment. The Corporation also recorded $14.1 million in core deposit intangibles and $2.9 million in other identifiable intangible assets which will be amortized over ten years using the sum of the years digits amortization method. The $2.9 million of other identifiable intangibles were allocated to the Wealth Management segment.

The acquisition of Willow Financial constituted a business combination under SFAS No. 141, "Business Combinations," and was accounted for using the purchase method. Accordingly, the purchase price was allocated to the respective assets acquired and liabilities assumed based on their estimated fair values on the date of acquisition. The excess of purchase price over the fair value of net assets acquired was recorded as goodwill. The purchase price allocation, as of December 31, 2008, is subject to revision in future periods, including adjustments that may be necessary upon the filing of final tax returns for Willow Financial. The results of operations of Willow Financial have been included in the Corporation's results of operations since December 5, 2008, the date of acquisition.

Note 2—Acquisitions / Dispositions (Continued)

The following is the calculation of the purchase price for the Willow Financial acquisition.

	(Dollars in thousands)
Purchase price of Willow Financial:	
Market value of the Corporation's stock issued	$158,797
Purchase price assigned to fractional shares exchanged for cash	18
Fair value assigned to converted Willow Financial stock options	1,996
Capitalized costs	2,388
Total purchase price	$163,199

The following are the assets acquired and liabilities assumed from Willow Financial at December 5, 2008 including the adjustments made to record the transaction and to adjust the assets and liabilities to their estimated fair values.

	Willow Financial	Fair Market Value Adjustments	As Adjusted
		(Dollars in thousands)	
Assets acquired:			
Cash and cash equivalents	$ 45,116	$ -	$ 45,116
Investment securities available for sale	165,657	-	165,657
Investment securities held to maturity	84,504	(11,861)	72,643
Federal Home Loan Bank stock and other investments	18,495	-	18,495
Loans, net	1,115,145	(29,366)	1,085,779
Premises and equipment, net	9,406	3,702	13,108
Goodwill	-	129,958	129,958
Core deposit intangible	-	14,112	14,112
Other identifiable intangible assets	-	2,916	2,916
Bank-owned life insurance	12,624	-	12,624
Other assets (includes deferred taxes)	29,692	13,968	43,660
Total assets acquired	1,480,639	123,429	1,604,068
Liabilities assumed:			
Deposits	945,876	776	946,652
Repurchase agreements	100,015	7,120	107,135
Advances from the FHLB	346,277	16,317	362,594
Subordinated debentures	25,774	(15,030)	10,744
Other liabilities	8,841	4,903	13,744
Total liabilities assumed	1,426,783	14,086	1,440,869
Assets acquired less liabilities assumed	$ 53,856	$ 109,343	$ 163,199

Note 2—Acquisitions / Dispositions (Continued)

The fair value of certain assets and certain liabilities acquired were based on quoted market prices from reliable market sources. When quoted market prices were not available, the estimated fair values were based upon the best information available, including obtained prices for similar assets and liabilities, and the results of using other valuation techniques. The prominent other valuation techniques used were the present value technique and appraisal/third party valuations. When the present value technique was employed, the associated cash flow estimates incorporated assumptions that marketplace participants would use in estimating fair values. In instances where reliable market information was not available, the Corporation used its own assumptions in an effort to determine a reasonable fair value. In other instances, the Corporation assumed the historical book value of certain assets and liabilities represented a reasonable proxy of fair value. The Corporation determined that there were no other categories of identifiable intangible assets arising from the Willow Financial acquisition other than the core deposit and customer intangibles.

AICPA Statement of Position 03-3, "Accounting for Certain Loans or Debt Securities Acquired in a Transfer" (SOP 03-3) addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor's initial investment in loans or debt securities acquired in a transfer if those differences are attributable, at least in part, to credit quality. It includes loans acquired in purchase business combinations. SOP 03-3 does not apply to loans originated by the Corporation. The Corporation's assessment identified $17.3 million in acquired loans from Willow Financial to which the application of the provisions of SOP 03-3 was required. As a result of the application of SOP 03-3, the Corporation recorded purchase accounting adjustments reflecting a reduction in loans of $6.3 million related to acquired impaired loans, thus reducing the carrying value of these loans to $11.0 million as of December 31, 2008. Income recognition under this SOP is dependent on having a reasonable expectation about the timing and amount of cash flows expected to be collected. The loans deemed impaired under this SOP were considered collateral dependent, however the timing of the sale of loan collateral is indeterminate and as such the loans will remain on non-accrual status and will have no accretable yield. The Corporation will use the cash basis method of interest income recognition.

The following are the loans acquired from Willow Financial for which it was probable at acquisition that all contractually required payments would not be collected:

	(Dollars in thousands)
Contractually required payments at acquisition:	
Real estate	$ 3,724
Commercial and industrial	13,140
Consumer	480
Total	$17,344
Cash flows expected to be collected at acquisition	$11,025

The following is the carrying value by category as of December 31, 2008:

	(Dollars in thousands)
Real estate	$ 3,005
Commercial and industrial	7,593
Consumer	427
Total carrying value	$11,025

Note 2—Acquisitions / Dispositions (Continued)

The following are the unaudited pro forma consolidated results of operations of the Corporation for the years ended December 31, 2008 and 2007 as though Willow Financial had been acquired on January 1, 2007:

	2008	2007
	(Dollars in thousands, except for per share data)	
Total interest income	$287,402	$287,102
Total interest expense	132,274	150,632
Net interest income	155,128	136,470
Provision for loan losses	23,079	11,964
Net interest income after provision for loan losses	132,049	124,506
Total non-interest income	57,030	57,428
Total non-interest expense	173,973	133,798
Income before income taxes	15,106	48,136
Income tax expense (1)	1,736	10,852
Net income	$ 13,370	$ 37,284
Basic earnings per share	$0.31	$0.92
Diluted earnings per share	$0.31	$0.91

(1) Tax effects are reflected at an assumed rate of 35%

In connection with the purchase of Willow Financial, on December 15, 2008, the Corporation sold the net assets of Carnegie. Carnegie was a wealth management subsidiary of Willow Financial with approximately $160 million under management that provided professional investment consulting services to retirement plan administrators, foundations, corporations and high net worth investors. At the time of acquisition, this subsidiary had net assets of approximately $22,000. The assets and liabilities of the subsidiary were recorded at their fair values as of the acquisition date and the excess of the net assets acquired over the purchase price of approximately $935,000 was recorded as goodwill and allocated to this subsidiary. The subsequent sale price of the net assets of Carnegie was approximately $935,000 in the form of 65,966 shares of Harleysville National Corporation common stock and $29,000 in cash. The Corporation recorded the receipt of the common shares as treasury shares and recorded no gain or loss on the transaction.

Note 2—Acquisitions / Dispositions (Continued)

On December 27, 2007, the Bank settled and closed an agreement to sell fifteen properties to affiliates of American Realty Capital, LLC ("ARC") in a sale-leaseback transaction. The properties are located throughout Berks, Bucks, Lehigh, Montgomery, Northampton, and Carbon counties. Under the leases, the Bank continues to utilize the properties in the normal course of business. Lease payments on each property are institution-quality, triple net leases with an initial annual aggregate base rent of $3.0 million with annual rent escalations equal to the lower of CPI-U (Consumer Price Index for all Urban Consumers) or 2.0 percent commencing in the second year of the lease term. As tenant, the Bank is fully responsible for all costs associated with the operation, repair and maintenance of the properties during the lease terms and is recorded as occupancy expense. The agreement provides that each lease has a term of 15 years, commencing on the closing date for the agreement. The agreement also contains options to renew for periods aggregating up to 45 years. Under certain circumstances these renewal options are subject to revocation by the lessor. The Bank received net proceeds of $38.2 million and recorded a gain on sale from the transaction of $2.3 million (pre-tax) representing a portion of the total gain of $18.9 million. The remaining gain was deferred and is being amortized through a reduction of occupancy expense over the 15-year term of the leases an annual amount of approximately $1.1 million. The properties sold had a carrying value of $19.5 million. The Corporation also completed a separate sale-leaseback of office space in October 2007 receiving net proceeds of $1.5 million with a recognized pre-tax gain of $473,000. The deferred gain of $552,000 is being amortized over the 10-year term of the lease.

Effective November 16, 2007, the Corporation completed its acquisition of East Penn Financial Corporation (East Penn Financial) and its wholly owned subsidiary, East Penn Bank, a $451 million state chartered, FDIC insured bank, was merged with and into Harleysville National Bank. Headquartered in Emmaus, Pennsylvania, East Penn Financial had nine banking offices located in Lehigh, Northampton and Berks Counties. The acquisition expanded the branch network that the Corporation had in the Lehigh Valley and its opportunity to provide East Penn customers with a broader mix of products and services. The aggregate purchase price was $91.3 million in cash and stock. The Corporation acquired 100% of the outstanding shares of East Penn Financial. The transaction was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." East Penn Financial shares of 2,890,125 were exchanged at a conversion ratio of .8416 for 2,432,771 shares of the Corporation's common stock and East Penn Financial shares of 3,444,229 were exchanged for cash consideration of $14.50 per share totaling $49.9 million. East Penn Financial stock options of 136,906 were exchanged for cash consideration of $792,000 and options of 29,092 were exchanged at a conversion ratio of .8416 to acquire 25,480 shares of the Corporation's common stock options with a total fair value of $111,000. On the acquisition date, East Penn Financial had approximately $451.1 million in assets, $337.7 million in loans and $382.7 million in deposits. Goodwill of $63.9 million and a core deposit intangible of $7.4 million were recorded in connection with the acquisition of East Penn Financial and allocated to the Community Banking segment. These numbers include the finalized allocation of the purchase price based upon third party valuation of goodwill and certain intangible assets which occurred during the first six months of 2008. East Penn Financial's results of operations are included in the Corporation's results from the date of acquisition, November 16, 2007.

On March 1, 2007, the Cornerstone Companies, a subsidiary of the Bank, completed a selected asset purchase of McPherson Enterprises and related entities (McPherson), registered investment advisors specializing in estate and succession planning and life insurance for high-net-worth construction and aggregate business owners and families throughout the United States. Located in Towson, Maryland, McPherson became a part of the Cornerstone Companies, a component of the Bank's Millennium Wealth Management division. The Bank paid $1.5 million in cash. Goodwill of $1.2 million and customer relationship intangibles of $380,000 were recorded in connection with the asset purchase. These numbers include the finalized allocation of the purchase price based upon third party valuation of goodwill and certain intangible assets which occurred during the first three months of 2008.

Note 2—Acquisitions / Dispositions (Continued)

On November 10, 2006, the Bank completed the sale of its Honesdale branch located in Wayne County, Pennsylvania with deposits of $74.2 million, as well as loans and other assets of $22.5 million to First National Community Bank. In connection with the sale, the Bank paid net cash of $42.5 million and recorded a gain in the fourth quarter of 2006, net of federal income taxes, of $6.9 million or $.24 per diluted share. The sale of this single Wayne County location allowed the Bank to focus on expanding within its core markets and also helped to provide the resources required to support strategic initiatives.

On April 14, 2006, the Bank sold its existing credit card portfolio to Elan Financial Services, a national credit card issuer and established an agent issuing relationship with Elan Financial Services. Under the agreement, credit cards for the Bank are issued under the Harleysville National Bank name. The Bank sold $15.3 million in credit card receivables resulting in a gain from the sale of these credit cards, net of federal income taxes, of approximately $939,000 or $.03 per diluted share. The Bank continues to earn certain fees from ongoing portfolio activity.

Effective January 1, 2006, the Bank completed its acquisition of the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Located in the Lehigh Valley, Pennsylvania, the firm serves clients throughout Pennsylvania and other mid-Atlantic states. The purchase price consisted of $15.0 million in cash paid at closing and a contingent payment of up to $7.0 million to be paid post-closing. The contingent payment is based upon the Cornerstone Companies meeting certain minimum operating results during a five-year earn-out period with a maximum payout of $7.0 million over this period. For 2008, 2007 and 2006, the minimum operating results were met resulting in earn-out payments of $1.4 million, $1.2 million and $1.0 million for each year, respectively, which were recorded as additional goodwill. At December 31, 2008, the remaining maximum payout is $3.4 million through 2010. The Cornerstone Companies acquisition was accounted for using the purchase method of accounting in accordance with SFAS No. 141, "Business Combinations." The Cornerstone Companies results of operations are included in the Corporation's results from the effective date of the acquisition, January 1, 2006. Goodwill of $15.0 million (including the earn-out payments) and customer relationship intangibles of $3.9 million were recorded in connection with the acquisition and allocated to the Wealth Management segment.

Note 3—Restrictions on Cash and Due from Banks

As of December 31, 2008 and 2007, the Bank did not need to maintain reserves (in the form of deposits with the Federal Reserve Bank) to satisfy federal regulatory requirements.

Note 4—Investment Securities

The amortized cost, unrealized gains and losses, and the estimated fair value of the Corporation's investment securities available for sale and held to maturity are as follows:

	December 31, 2008			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
Available for sale				
Obligations of U.S. government agencies and corporations	**$ 93,501**	**$ 419**	**$ (26)**	**$ 93,894**
Obligations of states and political subdivisions	**288,415**	**4,798**	**(6,338)**	**286,875**
Mortgage-backed securities	**710,385**	**14,389**	**(19,291)**	**705,483**
Other securities	**94,285**	**1,077**	**(39,666)**	**55,696**
Total investment securities available for sale	**$1,186,586**	**$20,683**	**$(65,321)**	**$1,141,948**
Held to maturity				
Obligations of U.S. government agencies and corporations	**$ 3,880**	**$ 122**	**$ —**	**$ 4,002**
Obligations of states and political subdivisions	**46,554**	**119**	**(616)**	**46,057**
Total investment securities held to maturity	**$ 50,434**	**$ 241**	**$ (616)**	**$ 50,059**

	December 31, 2007			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(Dollars in thousands)			
Available for sale				
Obligations of U.S. government agencies and corporations	$ 98,926	$ 122	$ (314)	$ 98,734
Obligations of states and political subdivisions	228,125	1,261	(950)	228,436
Mortgage-backed securities	516,560	2,347	(2,918)	515,989
Other securities	70,528	139	(3,459)	67,208
Total investment securities available for sale	$914,139	$3,869	$(7,641)	$910,367
Held to maturity				
Obligations of U.S. government agencies and corporations	$ 3,868	$ 29	$ —	$ 3,897
Obligations of states and political subdivisions	53,479	354	(212)	53,621
Total investment securities held to maturity	$ 57,347	$ 383	$ (212)	$ 57,518

Note 4—Investment Securities (Continued)

The tables below indicate the length of time individual securities have been in a continuous unrealized loss position at December 31, 2008 and 2007:

	December 31, 2008								
	Less than 12 months			12 months or longer			Total		
Description of Securities	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
	(Dollars in thousands)								
Obligations of U.S. government agencies and corporations	3	$ 29,145	$ (26)	—	$ —	$ —	3	$ 29,145	$ (26)
Obligations of states and political subdivisions	290	202,231	(6,715)	11	5,416	(239)	301	207,647	(6,954)
Mortgage-backed securities	35	121,085	(16,303)	36	43,851	(2,988)	71	164,936	(19,291)
Other securities	17	28,262	(6,004)	20	17,607	(33,662)	37	45,869	(39,666)
Totals	345	$380,723	$(29,048)	67	$66,874	$(36,889)	412	$447,597	$(65,937)

	December 31, 2007								
	Less than 12 months			12 months or longer			Total		
Description of Securities	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses	# of Securities	Fair Value	Unrealized Losses
	(Dollars in thousands)								
Obligations of U.S. government agencies and corporations	3	$ 6,964	$ (7)	24	$ 64,392	$ (307)	27	$ 71,356	$ (314)
Obligations of states and political subdivisions	46	37,484	(415)	82	41,769	(747)	128	79,253	(1,162)
Mortgage-backed securities	26	58,067	(730)	77	132,269	(2,188)	103	190,336	(2,918)
Other securities	20	51,552	(1,896)	8	13,062	(1,563)	28	64,614	(3,459)
Totals	95	$154,067	$(3,048)	191	$251,492	$(4,805)	286	$405,559	$(7,853)

The unrealized losses associated with the securities portfolio, are temporary in nature since they are not related to the underlying credit of the issuers, and the Corporation has the ability and intent to hold these investments for the time necessary to recover its cost which may be at maturity (i.e. these investments have contractual maturities that, absent credit default, ensure a recovery of cost). In making its other-than temporary evaluation, management considered the fact that the expected cash flow is not affected by the underlying collateral or issuer. Other factors considered in evaluating the securities portfolio for other-than-temporary impairment are the length of time and the extent to which the fair value has been below the cost, analyst reports, analysis of the current interest rate environment, anticipated volatility in the market and the underlying credit rating of the issuers. In certain cases where sufficient data is not available, a cash flow model is utilized.

The change in the unrealized losses on securities other than obligations of U.S. government agencies and corporations, which includes certain collateralized mortgage obligations and collateralized debt obligations were caused by changes in interest rates, credit spread and liquidity issues in the marketplace. There were 67 individual securities in a continuous unrealized loss position for twelve months or longer as of December 31, 2008. The Corporation recognized an other-than temporary impairment charge of $1.9 million during the fourth quarter of 2008 as a result of deterioration in the individual credits of a collateralized debt obligation investment in a

Note 4—Investment Securities (Continued)

pooled trust preferred security. As relevant observable inputs did not exist, a cash flow model was utilized to determine the fair value of the impaired security.

Securities with a carrying value of $100.4 million and $756.3 million at December 31, 2008 and 2007, respectively, were pledged to secure public funds, customer trust funds, government deposits and repurchase agreements.

Accrued interest receivable on investment securities was $8.5 million and $7.1 million at December 31, 2008 and 2007, respectively.

The amortized cost and estimated fair value of investment securities, at December 31, 2008, by contractual maturities are shown in the following table. Actual maturities will differ from contractual maturities because issuers and borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	December 31, 2008			
	Held to Maturity		Available for Sale	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	(Dollars in thousands)			
Due in one year or less	$ —	$ —	$ 1,502	$ 1,507
Due after one year through five years	—	—	72,013	71,579
Due after five years through ten years	17,188	17,183	99,594	97,925
Due after ten years	33,246	32,876	280,095	243,789
	50,434	50,059	453,204	414,800
Mortgage-backed securities	—	—	710,385	705,483
Equity securities	—	—	22,997	21,665
Totals	$50,434	$50,059	$1,186,586	$1,141,948

Proceeds from the sales of investment securities available for sale for the years ended December 31, 2008, 2007 and 2006 were $208.5 million, $186.2 million and $110.8 million, respectively. The components of net realized gains on sales of investment securities were as follows:

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Gross realized gains	**$3,238**	$1,329	$ 445
Gross realized losses	**(596)**	(142)	(1,119)
Net realized gain (loss) on sales of investment securities	**$2,642**	$1,187	$ (674)

Note 5—Loans

Major classifications of loans are as follows:

	December 31, 2008	December 31, 2007
	(Dollars in thousands)	
Real estate (including loans held for sale of $17,165 and $1,140)	**$1,602,654**	$ 959,716
Commercial and industrial	**980,190**	728,293
Consumer loans	**1,099,903**	764,860
Lease financing	**758**	2,564
Total loans	**3,683,505**	2,455,433
Deferred costs, net	**1,739**	5,390
Allowance for loan losses	**(49,955)**	(27,328)
Net loans (including loans held for sale)	**$3,635,289**	$2,433,495

On December 31, 2008, nonaccrual loans were $75.1 million and loans 90 days or more past due and still accruing interest were $1.8 million. On December 31, 2007, nonaccrual loans were $21.1 million and loans 90 days or more past due and still accruing interest were $857,000. The Bank's policy for interest income recognition on nonaccrual loans is to recognize income under the cash basis when the loans are both current and the collateral on the loan is sufficient to cover the outstanding obligation to the Bank. The Bank will not recognize income if these factors do not exist. During 2008, interest accrued on nonaccruing loans and not recognized as interest income was $1.9 million and interest paid on nonaccruing loans of $299,000 was recognized as interest income. During 2007, interest accrued on nonaccruing loans and not recognized as interest income was $982,000 and interest paid on nonaccruing loans of $331,000 was recognized as interest income. During 2006, interest accrued on nonaccruing loans and not recognized as interest income was $788,000 and interest paid on nonaccruing loans of $191,000 was recognized as interest income.

The balance of impaired loans at December 31, 2008 and 2007 was $70.2 million and $9.8 million, respectively. At December 31, 2008 and 2007, impaired loans with specific loss allowances were $38.4 million and $9.8 million and the related specific allowance for loan losses were $8.4 million and $2.2 million, respectively. The average impaired loan balance was $23.5 million in 2008, compared to $7.5 million and $3.2 million in 2007 and 2006, respectively. The income recognized on impaired loans during 2008, 2007 and 2006 was $151,000, $31,000 and $60,000, respectively. Impaired loans are included in the nonaccrual loan total.

Residential mortgage loans held for sale at December 31, 2008 and 2007 totaled $17.2 million and $1.1 million, respectively. Gains on the sale of residential mortgage loans for the years ended December 31, 2008 and 2007 were $557,000 and $472,000, respectively (recorded in other income on consolidated statements of income).

Residential mortgage loans serviced for others totaled $397.5 million at December 31, 2008 (included $16.0 million with recourse) and totaled $335.8 million at December 31, 2007 (included $5.8 million with recourse). The residential mortgage loans serviced for others with recourse were assumed from acquisitions.

The Bank has no concentration of loans to individual borrowers which exceeded 10% of total loans at December 31, 2008 and 2007. The Bank actively monitors the risk of loan concentration.

Net assets in foreclosure at December 31, 2008 and 2007 were $1.6 million and $28,000, respectively, and are recorded in other assets on the consolidated balance sheets. During 2008, transfers from loans to assets in foreclosure were $2.4 million, additions from Willow Financial were $426,000, disposals of foreclosed properties were $1.3 million, and no charge-offs were recorded. Gains on the sale of net assets in foreclosure for the years

Note 5—Loans (Continued)

ended December 31, 2008 and 2007 were $56,000 and $0, respectively, and are recorded in other income on the consolidated statements of income.

Loans to directors, executive officers and their associates are made in the ordinary course of business and on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. Activity of these loans is as follows:

	Year Ended December 31,		
	2008	2007 (1)	2006
	(Dollars in thousands)		
Balance, January 1	**$12,043**	$17,393	$22,099
New loans	**2,730**	4,451	66,666
Loans acquired through acquisition	**1,903**	—	—
Repayments and other reductions	**(3,238)**	(9,801)	(71,372)
Balance, December 31	**$13,438**	$12,043	$17,393

(1) A director's affiliation with a borrower ended during the fourth quarter of 2006 accounting for the majority of the decrease in activity during 2007.

Note 6—Allowance for Loan Losses

The table below summarizes the changes in the allowance for loan losses:

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Balance, beginning of year	**$27,328**	$21,154	$19,865
Provision for loan losses	**15,567**	10,550	4,200
Reserve from Willow Financial acquisition	**12,925**	—	—
Reserve from East Penn Financial acquisition	—	3,250	—
Loans charged off	**(6,829)**	(8,142)	(3,711)
Recoveries	**964**	516	800
Balance, end of year	**$49,955**	$27,328	$21,154

Note 7—Premises and Equipment

Premises and equipment consist of the following:

	Estimated Useful Lives	December 31,	
		2008	2007
		(Dollars in thousands)	
Land	Indefinite	**$ 5,467**	$ 3,397
Buildings	15-39 years	**41,111**	22,146
Furniture, fixtures and equipment	3-7 years	**37,336**	41,357
Total cost		**83,914**	66,900
Less accumulated depreciation and amortization		**(33,309)**	(34,382)
Premises and equipment, net		**$50,605**	$32,518

Note 7—Premises and Equipment (Continued)

Depreciation expense for the years ended December 31, 2008, 2007, and 2006 was $4.3 million, $4.0 million and $3.3 million, respectively. During 2008, the Corporation disposed of premises and equipment with a cost basis of $6.0 million and accumulated depreciation of $5.4 million. The net gain on disposal of these assets of $42,000 is recorded in other income on the consolidated statements of operations.

Note 8—Goodwill and Other Intangibles

Goodwill and identifiable intangibles were $240.7 million and $26.2 million, respectively at December 31, 2008, and $111.2 million and $10.6 million, respectively at December 31, 2007. The goodwill and identifiable intangibles balances resulted from acquisitions. Goodwill of $130.0 million, core deposit intangible of $14.1 million and customer relationship intangibles of $2.9 million were recorded related to the acquisition of Willow Financial. An earn-out payment of $1.4 million related to the acquisition of the Cornerstone Companies for meeting minimum operating results was earned and recorded as additional goodwill at December 31, 2008. During the first six months of 2008, the Corporation recorded purchase accounting adjustments related to the East Penn Financial acquisition which increased the core deposit intangible by $940,000 and reduced goodwill by $948,000. In addition, goodwill of $935,000 was written off due to the sale of Carnegie Wealth Advisors LLC which had been acquired in the Willow Financial merger. For further information related to goodwill and intangible assets, see Note 2 – Acquisitions / Dispositions.

The changes in the carrying amount of goodwill by business segment were as follows:

	Community Banking	Wealth Management	Total
	(Dollars in thousands)		
Balance, January 1, 2007	$ 31,552	$12,404	$ 43,956
Net addition to goodwill from acquisitions	64,874	2,325	67,199
Balance, December 31, 2007	96,426	14,729	111,155
Net addition to goodwill from acquisitions	125,955	4,526	130,481
Goodwill written off due to sale of subsidiary	—	(935)	—
Balance, December 31, 2008	**$222,381**	**$18,320**	**$240,701**

The gross carrying value and accumulated amortization related to core deposit intangibles and other identifiable intangibles at December 31, 2008 and 2007 are presented below:

	December 31,			
	2008		2007	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(Dollars in thousands)			
Core deposit intangibles	**$23,256**	**$2,692**	$ 8,351	$1,061
Other identifiable intangibles	**7,209**	**1,524**	4,288	927
Total	**$30,465**	**$4,216**	$12,639	$1,988

Note 8—Goodwill and Other Intangibles (Continued)

In 2008 and 2007, management performed its annual review of goodwill and other identifiable intangibles in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets" and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Management performed its review by reporting unit and determined that there was no impairment of goodwill and other identifiable intangible assets as a part of this annual review. As part of the annual review of goodwill, management also evaluated any additional circumstances that may have required an impairment test subsequent to June 30, 2008 which also resulted in no impairment charge.

The amortization of core deposit intangibles allocated to the Community Banking segment was $1.8 million, $328,000 and $246,000 for the years ended December 31, 2008, 2007 and 2006, respectively. Amortization of identifiable intangibles related to the Wealth Management segment totaled $596,000, $479,000 and $448,000 for the years ended December 31, 2008, 2007 and 2006, respectively. The Corporation estimates that aggregate amortization expense for core deposit and other identifiable intangibles will be $4.1 million, $3.6 million, $3.0 million, $2.5 million and $2.8 million for 2009, 2010, 2011, 2012 and 2013, respectively.

Mortgage servicing rights of $1.6 million and $2.7 million at December 31, 2008 and 2007, respectively are included on the Corporation's balance sheet in other intangible assets and subsequently measured using the amortization method. The mortgage servicing rights had a fair value of $1.6 million and $3.3 million at December 31, 2008 and 2007, respectively. In accordance with the provisions of SFAS No.156, "Amending Accounting for Separately Recognized Servicing Assets and Liabilities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," the Corporation recorded impairment charges of $1.4 million on its mortgage servicing rights in intangibles expense on the consolidated statements of income for the year ended December 31, 2008.

Note 9—Deposits

Time deposits with balances of $100,000 or more were $626.2 million and $483.7 million at December 31, 2008 and 2007, respectively. Deposits from directors and executive officers of the Corporation were approximately $3.1 million and $2.9 million as of December 31, 2008 and 2007, respectively.

At December 31, 2008, scheduled maturities of time deposits are as follows:

	Amount (Dollars in thousands)
2009	$1,124,899
2010	327,376
2011	99,188
2012	31,766
2013	4,263
Thereafter	1,429
Total	$1,588,921

Deposit overdraft balances reclassified to loans totaled $4.9 million and $1.5 million at December 31, 2008 and 2007, respectively.

Note 10—Borrowings

Federal Funds Lines of Credit with Correspondent Banks

Total federal funds lines of credit with correspondent banks at December 31, 2008 were $110.0 million, of which $77.7 million was unused. The weighted average rate on the outstanding balance at December 31, 2008 was 0.62%. Total federal funds lines of credit with correspondent banks at December 31, 2007 were $195.0 million, all of which was unused. These lines of credit are available for overnight funds and the rate is based on the correspondent bank's quoted rate at the time of the transaction.

Securities Sold under Agreements to Repurchase

As of December 31, 2008, long- term securities sold under agreements to repurchase with private entities were $237.0 million. The maturity dates range from 2011 through 2017, with call dates ranging from 2009 to 2012. The weighted average interest rate was 3.44% as of December 31, 2008. The balance and weighted average interest rate at December 31, 2008 include the purchase accounting discount and amortization related to the Willow Financial acquisition. Additionally, at December 31, 2008, the Corporation had $103.8 million of short-term securities sold under agreements to repurchase primarily with commercial customers. As of December 31, 2007, long- term securities sold under agreements to repurchase with private entities were $105.0 million with a weighted average interest rate of 4.71% and short-term securities sold under agreements to repurchase were $101.5 million.

Federal Home Loan Bank Advances

Federal Home Loan Bank (FHLB) advances at December 31, 2008 totaled $522.7 million, all of which were long-term with a weighted average interest rate of 3.03%. FHLB advances at December 31, 2007 totaled $216.8 million, all of which were long-term with a weighted average interest rate of 4.37%. The advances are collateralized by unpledged levels of agency bonds, agency mortgage-backed securities, 1-4 family first mortgage loans, FHLB stock and other real estate related collateral net of varying market value haircuts based on the asset. Advances are made pursuant to several different credit programs offered from time to time by the FHLB. Unused lines of credit with the FHLB were $574.7 million at December 31, 2008 and $363.1 million at December 31, 2007.

At December 31, 2008, scheduled maturities of long-term borrowings with the FHLB are as follows:

	Balance	Weighted Average Rate (1)
	(Dollars in thousands)	
2009	$ 58,230	3.65%
2010	73,115	2.98%
2011	87,090	3.39%
2012	61,994	3.28%
2013	91,289	2.75%
Thereafter	150,953	2.20%
Total	$522,671	3.03%

(1) The FHLB borrowings balance and weighted average interest rate include purchase accounting fair value adjustments, net of related amortization from the Willow Financial acquisition.

Note 10—Borrowings (Continued)

Trust Preferred Subordinated Debentures

As of December 31, 2008, the Corporation has six statutory trust affiliates (collectively, the Trusts). These trusts were formed to issue mandatorily redeemable trust preferred securities to investors and loan the proceeds to the Corporation for general corporate purposes. The Trusts hold, as their sole assets, subordinated debentures of the Corporation totaling $105.5 million. The trust preferred securities represent undivided beneficial interests in the assets of the Trusts. The financial statement carrying value of the trust preferred subordinated debentures, net of a $15.0 million purchase accounting fair value adjustment from the acquisition of Willow Financial, is $93.7 million at December 31, 2008. The Corporation owns all of the trust preferred securities of the Trusts and has accordingly, recorded $3.3 million in other assets on the consolidated statements of financial condition at December 31, 2008 representing its investment in the common securities of the Trusts. As the shareholders of the trust preferred securities are the primary beneficiaries, the Trusts qualify as variable interest entities under FIN 46R and are not consolidated in the Corporation's financial statements.

The trust preferred securities require quarterly distributions to the holders of the trust preferred securities at a rate per annum equal to the interest rate on the debentures held by that trust. The Corporation has the right to defer payment of interest on the debentures, at any time or from time to time for a period not exceeding five years, provided that no extension period may extend beyond the stated maturity of the debentures. During any such extension period, distributions on the trust securities will also be deferred, and the Corporation shall not pay dividends or distributions on, or redeem, purchase or acquire any shares of its capital stock.

The trust preferred securities must be redeemed upon the stated maturity dates of the subordinated debentures. The Corporation may redeem the debentures, in whole but not in part, (except for Harleysville Statutory Trust II and Willow Grove Statutory Trust I which may be redeemed in whole or in part) at any time within 90 days at the specified special event redemption price following the occurrence of a capital disqualification event, an investment company event or a tax event as set forth in the indentures relating to the trust preferred securities and in each case subject to regulatory approval. For HNC Statutory Trust II, III and IV, East Penn Statutory Trust I and Willow Grove Statutory Trust I, the Corporation also may redeem the debentures, in whole or in part, at the stated optional redemption dates (after five years from the issuance date) and quarterly thereafter, subject to regulatory approval if required. The optional redemption price is equal to 100% of the principal amount of the debentures being redeemed plus accrued and unpaid interest on the debentures to the redemption date. For Harleysville Statutory Trust I, the Corporation may redeem the debt securities, in whole or in part, at the stated optional redemption date of February 22, 2011 and semi-annually thereafter, subject to regulatory approval if required. The redemption price on February 22, 2011 is equal to 105.10% of the principal amount, and declines annually to 100.00% on February 22, 2021 and thereafter, plus accrued and unpaid interest on the debentures to the redemption date.

The Corporation's obligations under the debentures and related documents, taken together, constitute a full and unconditional guarantee by the Corporation of the Trust's obligations under the trust preferred securities.

In March 2005, the Federal Reserve Board adopted a final rule that allows the continued limited inclusion of outstanding and prospective issuances of trust preferred securities in Tier 1 capital of bank holding companies. Under the final rule, trust preferred securities and other restricted core capital elements will be subject to stricter quantitative limits. The Board's final rule limits restricted core capital elements to 25% of all core capital elements, net of goodwill, less any associated deferred tax liability. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The final rule provides a five-year transition period ending March 31, 2009, for application of the quantitative limits. In addition, the requirement for trust preferred securities to include a call option has been eliminated, and standards for the junior subordinated debt underlying trust preferred securities eligible for Tier 1 capital treatment have been clarified. Management has

Note 10—Borrowings (Continued)

evaluated the effects of the rule and does not anticipate a material impact on its capital ratios upon implementation.

The following table is a summary of the subordinated debentures as of December 31, 2008 as originated by the Corporation and assumed from the acquisitions of Willow Financial and East Penn Financial:

Trust Preferred Subordinated Debentures	Principal Amount of Subordinated Debentures	Principal Amount of Trust Preferred Securities
	(Dollars in thousands)	
Issued to Harleysville Statutory Trust I in February 2001, matures in February 2031, interest rate of 10.20% per annum	$ 5,155	$ 5,000
Issued to HNC Statutory Trust II in March 2004, matures in April 2034, interest rate of three-month London Interbank Offered Rate (LIBOR) plus 2.70% per annum	20,619	20,000
Issued to HNC Statutory Trust III in September 2005, matures in November 2035, bearing interest at 5.67% per annum through November 2010 and thereafter three-month LIBOR plus 1.40% per annum	25,774	25,000
Issued to HNC Statutory Trust IV in August 2007, matures in October 2037, bearing interest at 6.35% per annum through October 2012 and thereafter three-month LIBOR plus 1.28% per annum	23,196	22,500
Issued to East Penn Statutory Trust I in July 2003, matures in September 2033, interest rate of 6.80% per annum through September 2008 and thereafter at three-month LIBOR plus 3.10% per annum	8,248	8,000
Issued to Willow Grove Statutory Trust I in March 2006, matures in June 2036, interest rate of three-month LIBOR plus 1.31% per annum	25,774	25,000
Total	$108,766	$105,500

Note 11—Income Taxes

Uncertain Tax Positions

The Corporation adopted the provisions of FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes" (FIN 48) on January 1, 2007. Previously, the Corporation had accounted for tax contingencies in accordance with SFAS No. 5, "Accounting for Contingencies." As required by FIN 48, which clarifies SFAS No. 109, "Accounting for Income Taxes," the Corporation recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more-likely-than-not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, the Corporation applied FIN 48 to all tax positions for which the statute of limitations remained open. The amount of unrecognized tax benefits as of January 1, 2007, was $175,000.

Note 11—Income Taxes (Continued)

A reconciliation of the beginning and ending amounts of unrecognized tax benefits is as follows:

(Dollars in thousands)	
Balance, January 1, 2007	$175
Additions based on tax positions related to prior years	26
Additions based on tax positions related to the current year	48
Balance, December 31, 2007	249
Statute of limitations expiration related to prior years	(75)
Additions based on tax positions related to the current year	50
Balance, December 31, 2008	$224

The amount of unrecognized tax benefits at December 31, 2008 and December 31, 2007, included $224,000 and $249,000, respectively, of unrecognized tax benefits which, if ultimately recognized, will reduce the Corporation's annual effective tax rate.

The Corporation is subject to income taxes in the U.S. federal jurisdiction, and various states, the majority of activity residing in Pennsylvania. The statue of limitations for Pennsylvania has expired on years prior to 2005. The expiration of the statute of limitations related to the various state income tax returns the Corporation and subsidiaries file, varies by state, and are expected to expire over the term of 2009 through 2013.

The Corporation's policy for recording interest and penalties associated with audits is to record such items as a component of income before income taxes on the consolidated statements of income. Penalties are recorded in other expenses, net, and interest paid or received is recorded in interest expense or interest income, respectively, in the consolidated statements of income. Interest accrued was $40,000, $43,000 and $17,000 as of December 31, 2008, December 31, 2007 and January 1, 2007, respectively. No penalties have been accrued to date.

The components of income tax expense were as follows:

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Current income tax expense:			
Federal	**$8,473**	$15,943	$13,221
State	**155**	245	162
Total current income tax expense	**8,628**	16,188	13,383
Deferred income tax	**(3,553)**	(8,916)	693
Total income tax expense	**$ 5,075**	$ 7,272	$14,076

The effective income tax rates of 16.8% for 2008, 21.5% for 2007 and 26.3% for 2006 were less than the applicable federal income tax rate of 35% for each year. The reasons for these differences are as follows:

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Expected income tax expense	**$10,707**	$12,102	$18,779
Tax-exempt income net of interest disallowance	**(5,925)**	(4,707)	(4,740)
Other	**293**	(123)	37
Actual income tax expense	**$ 5,075**	$ 7,272	$14,076

Note 11—Income Taxes (Continued)

The tax effect of temporary differences that give rise to significant portions of deferred tax assets and liabilities are as follows:

	2008		2007	
	Asset	Liability	Asset	Liability
	(Dollars in thousands)			
Allowance for loan losses	**$15,272**	**$ —**	$ 8,494	$ —
Bad debt recapture	**—**	**54**	—	—
Specific reserves	**2,212**	**—**	—	—
Lease assets	**—**	**—**	—	1,666
Deferred loan fees	**—**	**2,970**	—	2,895
Deferred compensation	**3,365**	**—**	2,936	—
Pension	**162**	**—**	595	—
Stock-based compensation expense	**54**	**—**	40	—
Mortgage servicing rights	**—**	**545**	—	941
Depreciation	**—**	**445**	—	513
Unrealized loss on investment securities	**15,623**	**—**	1,320	—
Net unrealized gain on derivative used for cash flow hedge	**2**	**—**	62	—
Purchase accounting adjustments	**19,800**	**—**	—	1,284
Deferred gain on sale-leaseback of bank properties	**5,760**	**—**	5,979	—
Other	**2,256**	**—**	—	1,857
Total deferred taxes	**$64,506**	**$4,014**	$19,426	$9,156

As a result of the acquisitions of Willow Financial in 2008, the Corporation recorded a net deferred tax asset of approximately $32.4 million. As a result of the acquisition of East Penn Financial during 2007, the Corporation recorded a net deferred tax liability of approximately $1.3 million. For additional information related to the deferred gain on sale-leaseback of bank properties during 2007 of $6.0 million, see Note 2—"Acquisitions / Dispositions."

Note 12—Pension Plans

Defined Benefit Pension Plan

The Corporation has a non-contributory defined benefit pension plan covering substantially all employees. The plan's benefits were based on years of service and the employee's average compensation during any five consecutive years within the ten-year period preceding retirement. On October 31, 2007, the Corporation announced that it formally amended its pension plan to provide for its termination. Employees ceased to accrue additional pension benefits as of December 31, 2007, and pension benefits are not being provided under a successor pension plan. All retirement benefits earned in the pension plan as of December 31, 2007 were preserved and all participants became fully vested in their benefits upon plan termination. On July 3, 2008, the Corporation purchased $896,000 of terminal funding annuity contracts for participants in pay status at that time. During 2008, the majority of assets were distributed to those participants that elected lump sum payments.

Note 12—Pension Plans (Continued)

The following table summarizes the effect of the pension plan settlement which occurred in 2008:

Assets and obligations:	Before Settlement	Effect of Settlement	After Settlement
	Year Ended December 31, 2008 (Dollars in thousands)		
Vested benefit obligation	$12,226	$(11,831)	$395
Non-vested benefits	-	-	-
Accumulated benefit obligation	12,226	(11,831)	395
Effect of future compensation levels	-	-	-
Projected benefit obligation	$12,226	$(11,831)	$395
Plan assets at fair value	$11,695	$(11,624)	$71
Unrecognized net asset at transition	(33)	32	(1)
Unrecognized net loss (gain) subsequent to transition	1,707	(1,657)	50
Adjustment required to recognize minimum liability	(1,674)	1,625	(49)
(Prepaid)/accrued pension cost	531	(207)	324

The Corporation recorded a one-time pre-tax charge related to the pension plan curtailment of approximately $1.9 million in 2007 as detailed in the following table. The curtailment charge was recorded in other expenses in the consolidated statements of income and impacted the Community Banking and Wealth Management segments.

Assets and obligations:	Before Curtailment	Effect of Curtailment	After Curtailment
	Year Ended December 31, 2007 (Dollars in thousands)		
Vested benefit obligation	$ 8,786	$2,557	$11,343
Non-vested benefits	383	148	531
Accumulated benefit obligation	9,169	2,705	11,874
Effect of future compensation levels	3,015	(3,015)	-
Projected benefit obligation	$12,184	$ (310)	$11,874
Plan assets at fair value	$10,200	$ -	$10,200
Unrecognized net asset at transition	(51)	-	(51)
Unrecognized net loss (gain) subsequent to transition	2,252	(310)	1,942
Adjustment required to recognize minimum liability	-	1,891	1,891
(Prepaid)/accrued pension cost	(217)	1,891	1,674

Note 12—Pension Plans (Continued)

The plan's funded status for the years ended December 31, 2008 and 2007 is as follows:

	2008	2007
	(Dollars in thousands)	
Change in benefit obligation:		
Benefit obligation at beginning of year	**$11,874**	$11,586
Service cost	**-**	1,166
Interest cost	**426**	683
Actual (gain) loss	**(281)**	182
Benefits paid	**(11,624)**	(1,433)
Change in assumptions (plan curtailment)	**-**	(310)
Benefits obligation at end of year	**$ 395**	$11,874
Change in plan assets:		
Fair value of plan assets at beginning of year	**$10,200**	$ 9,575
Actual return on plan assets	**245**	808
Employer contribution	**1,250**	1,250
Benefits paid	**(11,624)**	(1,433)
Fair value of plan assets at end of year	**$ 71**	$10,200
Funded status at end of year	**$ (324)**	$(1,674)

The accumulated benefit obligation for the defined benefit pension plan was $395,000 and $11.9 million at December 31, 2008 and December 31, 2007, respectively.

Information for the Corporation's defined benefit pension plan with an accumulated benefit obligation in excess of plan assets follows:

	Year Ended December 31,	
	2008	2007
	(Dollars in thousands)	
Projected benefit obligation	**$395**	$11,874
Accumulated benefit obligation	**395**	11,874
Fair value of plan assets	**71**	10,200

Weighted-average assumptions used to determine pension plan obligations as of December 31,	Year Ended December 31,		
	2008	2007	2006
Discount rate	**4.75%**	4.75%	6.00%
Rate of compensation increase	**0.00%**	0.00%	4.00%

Weighted-average assumptions used to determine Pension plan net periodic benefit cost as of December 31,	Year Ended December 31,		
	2008	2007	2006
Discount rate	**4.75%**	6.00%	6.00%
Expected return on plan assets	**4.75%**	6.00%	6.00%
Rate of compensation increase	**0.00%**	4.00%	4.00%

Note 12—Pension Plans (Continued)

Components of net periodic benefit expense	Year Ended December 31, 2008	2007	2006
	(Dollars in thousands)		
Service cost	**$ —**	$1,166	$1,041
Interest cost	**426**	683	654
Expected return on plan assets	**(349)**	(600)	(551)
Amortization of unrecognized net actuarial losses	**41**	76	118
Net periodic benefit expense	**$118**	$1,325	$1,262

The pension plan assets were previously invested with a growth and income strategy with a target asset allocation of 60% equity and 40% fixed income securities. This allocation was changed to a preservation of capital objective pursuant to the decision to terminate the plan. In 2007, the pension plan equity reduction strategy was implemented along with a re-allocation of fixed income securities and cash equivalents in preparation for the third quarter 2008 final distribution to participants. The reduction in equities began in late August 2007 and accelerated with sales in September 2007. At December 31, 2008, any remaining undistributed funds have been allocated to cash and cash equivalents.

During November 2007, the final sales were initiated to close out the remaining equity positions, which represented less than 5% of the portfolio. The Fixed Income portfolio was re-allocated with maturity considerations for final benefits to be paid in 2008. Cash has been reinvested into high quality fixed income instruments and cash equivalents such as, secondary certificate of deposits, government agencies and insured taxable municipals.

The Corporation's pension plan weighted-average asset allocations by asset category are as follows:

	Percentage of Plan Assets at December 31, 2008	2007
Asset Category		
Equity securities	**—%**	—%
Debt securities	**—%**	33.4%
Cash and cash equivalents	**100.0%**	66.6%
Total	**100.0%**	100.0%

In March 2009, the Corporation will process a final contribution of $371,000 to the pension plan, which together with the remaining plan assets, will be utilized to purchase $435,000 in terminal funding annuity contracts for any remaining participants entering pay status. At December 31, 2008, the contribution is accrued in other liabilities on the consolidated balance sheets.

Supplemental Benefit Plans

The Corporation maintains a Supplemental Executive Retirement Plan for certain officers and key employees. The plan provides for payment to the covered employee of an annual supplemental retirement benefit up to 50% of their average annual compensation upon retirement, thereafter offset by the employer's share of social security, defined benefit pension and available employer's 401(k) matching contribution. There is a lifetime payout in retirement benefits with a minimum payout of 10 years. There is a pre-retirement death benefit, payable for 10 years, of 100% of the average annual compensation for the first year, and up to 50% of the average annual compensation for the next 9 years. The Corporation's liability under these agreements is being

Note 12—Pension Plans (Continued)

accrued over the participants' remaining service period. The accrued benefit obligation as of December 31, 2008 and 2007 was $5.1 million and $5.4 million, respectively.

In connection with the acquisition of East Penn Financial in 2007, the Corporation assumed an obligation under the East Penn Supplemental Executive Retirement Plan which provides for a fixed payment to the covered employee beginning at age 62 with a 15 year benefit period. The pre-retirement death benefit is the accrued benefit. The liability for this agreement has been fully accrued. The accrued benefit obligation as of December 31, 2008 and 2007 was $594,000 and $593,000, respectively.

In connection with the acquisition of Willow Financial in 2008, the Corporation assumed obligations under the Willow Financial Supplemental Executive Retirement Plan covering seven executives. Upon the effective date of the Willow Financial acquisition, each individual's interest in the plan became fully vested. The accrued obligation as of December 31, 2008 was $724,000, of which $416,000 will be paid in the first quarter of 2009 to individuals electing a lump-sum payment. The remaining balance is for one executive who elected to receive five annual payments commencing in February 2009. As a result of the Willow Financial acquisition, the Corporation also assumed the Willow Financial Directors' Retirement Plan (Directors' Plan) and the Willow Financial Presidents' Supplemental Retirement Agreement (Presidents' Plan). The Directors' Plan provides for a fixed monthly payment for a 10-year period beginning in June 2009 to the participating former Willow Financial directors. The Presidents' Plan for a former President provides for a fixed monthly payment through February 2016. The accrued liabilities of the Directors' Plan and President's Plan were $944,000 and $582,000, respectively at December 31, 2008.

Defined Contribution Plan

The Corporation maintains a 401(k) defined contribution retirement savings plan which allows employees to contribute a portion of their compensation on a pre-tax and/or after-tax basis in accordance with specified guidelines. Prior to January 1, 2008, the Corporation matched 50% of pre-tax employee contributions up to a maximum of 3%. Effective January 1, 2008, in addition to the company match up to a maximum of 3%, all eligible employees began receiving a company funded basic contribution to the 401(k) plan equal to 2% of eligible earnings. For 2008, the company funded 401(k) match contribution was $931,000 and the basic company funded 401(k) contribution was $822,000 for a total of $1.8 million in contributions charged to earnings. Contributions charged to earnings for 2007 and 2006 were $742,000 and $628,000, respectively.

Willow Financial Bank Employee Stock Ownership Plan

In connection with the acquisition of Willow Financial on December 5, 2008, the Corporation assumed the Willow Financial Bank 401(k)/ Employee Stock Ownership Plan (ESOP). As of December 5, 2008, the 401(k)/ESOP was frozen with termination and final distributions pending approval by the appropriate regulatory authorities. No additional contributions to the plan will be accepted, but loan repayments by participants are permitted. At December 5, 2008, the ESOP portion of the plan had two outstanding loans with a total principal balance of $4.2 million due to Willow Financial Bancorp, Inc. The shares originally purchased with the loan funds were held in a suspense account for allocation among the participants as the loans are repaid. Shares released from the loan collateral were in an amount proportional to repayment of the original ESOP loans. At December 31, 2008, there were 324,113 unallocated ESOP shares remaining to be utilized to pay down the remaining loan principal balance, representing a fair value of $4.7 million. Upon repayment of the loans, any remaining shares will be allocated to the participants.

Note 13—Stock Repurchase Program and Stock Dividend

The Corporation has a stock repurchase program that permits the repurchase of up to five percent of its outstanding common stock. The repurchased shares will be used for general corporate purposes. On May 12, 2005, the Board of Directors authorized a plan to purchase up to 1,416,712 shares (adjusted for five percent stock dividend paid on September 15, 2006 and September 15, 2005) or 4.9% of its outstanding common stock. As of December 31, 2008, the maximum number of shares that may yet be purchased under the plan is 731,761.

On September 15, 2006, the Corporation paid a five percent stock dividend on its common stock to shareholders of record as of September 1, 2006. All prior period amounts in the consolidated financial statements and footnotes have been restated to reflect these stock dividends.

Note 14—Stock-Based Compensation

The Corporation has four shareholder approved fixed stock option plans that allow the Corporation to grant options up to an aggregate of 3,797,861 shares of common stock to key employees and directors. At December 31, 2008, 2,663,395 stock options had been granted under the stock option plans. The options have a term of ten years when issued and typically vest over a five-year period. The options granted during 2008 have a term of three years and vest over seven years. The exercise price of each option is the market price of the Corporation's stock on the date of grant. Additionally, at December 31, 2008, the Corporation had 556,506 assumed stock options from the Willow Financial acquisition completed in 2008. The options have a term of ten years and are exercisable at prices ranging from \$5.19 to \$22.34. Also, at December 31, 2008, the Corporation had 25,480 assumed stock options from the East Penn Financial acquisition completed in 2007. The options have a term of ten years and are exercisable at prices ranging from \$5.94 to \$13.07.

The Corporation recognizes compensation expense for stock options in accordance with SFAS 123 (revised 2004), "Share-Based Payment" (SFAS 123(R)) adopted at January 1, 2006 under the modified prospective application method of transition. Prior to January 1, 2006, the Corporation followed SFAS 123 and APB 25, "Accounting for Stock Issued to Employees" with *pro forma* disclosures of net income and earnings per share, as if the fair value-based method of accounting defined in SFAS 123 had been applied. The Corporation recognizes compensation expense for the portion of outstanding awards at January 1, 2006 for which the requisite service has not yet been rendered, based on the grant-date fair value of those awards calculated under SFAS 123 for pro forma disclosures.

For grants subject to a service condition that were awarded on or after January 1, 2006, the Corporation utilizes the Black-Scholes option-pricing model (as used under SFAS 123) to estimate the fair value of each option on the date of grant. Grants subject to a service condition were awarded in 2008 and 2006 while grants subject to a market condition were awarded in 2007. The Black-Scholes model takes into consideration the exercise price and expected life of the options, the current price of the underlying stock and its expected volatility, the expected dividends on the stock and the current risk-free interest rate for the expected life of the option. The fair value of options granted with a service condition were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions based on historical data for grants in 2008 and 2006, respectively: weighted-average dividend yield of 5.74% and 3.52%; weighted-average expected volatility of 44.31% and 32.19%, weighted average risk-free interest rate of 2.40% and 4.64% (4.42% to 5.08%) and a weighted-average expected life of 6.20 and 7.28 years.

For grants subject to a market condition that were awarded in 2007, the Corporation utilized a Monte Carlo simulation to estimate the fair value and determine the derived service period. Compensation is recognized over the derived service period with any unrecognized compensation cost immediately recognized when the market condition is met. These awards vest when the Corporation's common stock reaches targeted average trading prices for 30 days within five years from the grant date. Vesting cannot commence before six months from the

Note 14—Stock-Based Compensation (Continued)

grant date. The term and exercise price of the options are the same as previously mentioned. The fair value and derived service period (the median period in which the market condition is met) were determined using a Monte Carlo simulation with the following assumptions: weighted average dividend yield of 4.59% based on historical data, weighted-average expected volatility of 32.65% based on historical data, risk-free rate of 4.54% to 5.17%, weighted average expected life of 6.04 years and a uniform post-vesting exercise rate (mid-point of vesting and contractual term).

Expected volatility is based on the historical volatility of the Corporation's stock over the expected life of the grant. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury strip rate in effect at the time of the grant. The life of the option is based on historical factors which include the contractual term, vesting period, exercise behavior and employee terminations.

In accordance with SFAS 123(R), stock based compensation expense is based on awards that are ultimately expected to vest and therefore has been reduced for estimated forfeitures. The Corporation estimates forfeitures using historical data based upon the groups identified by management. Stock-based compensation expense was $136,000, $118,000 and $440,000 for 2008, 2007, and 2006, respectively.

The Corporation has the following shareholder approved fixed stock option plans that are maintained to advance the development, growth and financial condition of the Corporation as described below. In connection with the acquisition of Willow Financial in 2008, the Corporation assumed all obligations under the Willow Financial 1999 and 2002 Stock Option Plans, as well as obligations that remained open under the Willow Grove Bank and Chester Valley Bank stock option plans at the effective time of the merger. The Plans provided options grants to non-employee directors, as well as employees. The change in control accelerated the vesting of all outstanding stock options to 100%. In connection with the acquisition of East Penn Financial in 2007, the Corporation assumed all obligations under the East Penn Financial 1999 Independent Director Stock Option Plan and the 1999 Stock Incentive Plan. In connection with the acquisition of Millennium Bank in 2004, the Corporation assumed all obligations under the Millennium Bank Stock Compensation Program. All share information has been adjusted to reflect stock dividends. For additional information on the accounting for share-based compensation plans, see Note 1, "Significant Accounting Policies—Stock-Based Compensation."

1998 Independent Directors Stock Option Plan: This plan provides that shares of the Corporation's stock be issued to non-employee directors. During 2008, no stock options were granted under the plan. At December 31, 2008, there were 258,564 stock options outstanding under the plan. The plan expired on October 8, 2008; therefore, no further stock options may be awarded under the plan.

East Penn Financial 1999 Independent Director Stock Option Plan Converted to Harleysville Stock Options: In connection with the acquisition of East Penn Financial in 2007, the Corporation assumed all obligations under the East Penn Financial 1999 Independent Director Stock Option Plan. The change in control accelerated the vesting of all outstanding stock options to 100%. Upon consummation of the merger, outstanding stock options were converted according to pro-ration parameters outlined in the merger agreement. Stock options totaling 23,548 were assumed on the effective date of the merger. A total of 21,025 stock options remained outstanding under the plan at December 31, 2008. No further stock options may be granted under the plan.

1993 Stock Incentive Plan: This plan provides that shares of the Corporation's common stock be issued to certain employees of the Corporation and the Bank. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock. No stock options remain available for grant under the 1993 Stock Incentive Plan. At December 31, 2008, there were 7,855 stock options outstanding under the plan.

Note 14—Stock-Based Compensation (Continued)

1998 Stock Incentive Plan: This plan provides that shares of the Corporation's common stock be issued to certain employees of the Corporation and the Bank. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock. No stock options were granted during 2008. The plan expired on October 8, 2008; therefore, no future stock options may be awarded under the plan. At December 31, 2008, there were 561,377 options outstanding under the plan.

2004 Omnibus Stock Incentive: This plan provides that shares of the Corporation's common stock be issued to certain employees and/or directors of the Corporation and the Bank. Awards can be made in the form of incentive stock options, non-qualified stock options, stock appreciation rights or restricted stock. During 2008, there were 210,082 stock options granted under the plan. As of December, 31, 2008, stock options of 910,468 remained available for grant. At December 31, 2008, there were 247,157 stock options outstanding under the plan.

Millennium Bank Stock Compensation Program Converted to Harleysville Stock Options: In connection with the acquisition of Millennium Bank in 2004, the Corporation assumed all obligations under the Millennium Bank Stock Compensation Program. The change in control accelerated the vesting of all outstanding stock options to 100%. Upon consummation of the merger, outstanding stock options were converted according to proration parameters outlined in the merger agreement. Stock options totaling 328,327 were assumed on the effective date of the merger. In conjunction with the sale of Cumberland Advisors, Inc. which took place in 2005, 36,209 non-qualified performance based stock options were cancelled. No stock option awards remain outstanding and exercisable under the program at December 31, 2008. No further stock options may be granted under the program.

East Penn Financial 1999 Stock Incentive Plan Converted to Harleysville Stock Options: In connection with the acquisition of East Penn Financial in 2007, the Corporation assumed all obligations under the East Penn Financial 1999 Stock Incentive Plan. The change in control accelerated the vesting of all outstanding stock options to 100%. Upon consummation of the merger, outstanding stock options were converted according to proration parameters outlined in the merger agreement. Stock options totaling 1,932 were assumed on the effective date of the merger. A total of 1,092 stock options remained outstanding under the plan at December 31, 2008. No further stock options may be granted under the plan.

Willow Financial Bancorp Stock Incentive Plans: In connection with the acquisition of Willow Financial Bancorp in 2008, the Corporation assumed all obligations under Willow's 1999 and 2002 Stock Option Plans, as well as obligations that remained open under the Willow Grove Bank and Chester Valley Bank stock option plans at the effective time of the merger. The Plans provided stock options grants to non-employee directors, as well as employees. The change in control accelerated the vesting of all outstanding stock options to 100%. Upon consummation of the merger, 556,506 stock options were converted according to proration parameters outlined in the merger agreement. At December 31, 2008, a total of 551,653 stock options remained outstanding and exercisable under the plan. No further stock options may be granted under the plans.

Note 14—Stock-Based Compensation (Continued)

A summary of option activity under the Corporation's stock option plans as of December 31, 2008 and changes during the year then ended is presented in the following table. The number of shares and weighted-average share information have been adjusted to reflect stock dividends.

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2008	1,113,499	$15.74		
Granted	210,082	14.06		
Options assumed from Willow Financial acquisition (see note 2)	556,506	14.17		
Exercised	(161,163)	9.41		
Forfeited (unvested)	(25,574)	21.66		
Cancelled (vested)	(44,627)	24.72		
Outstanding at December 31, 2008	1,648,723	$15.28	3.94	$3,204
Exercisable at December 31, 2008	1,385,057	$15.36	3.34	$3,125

The weighted-average grant-date fair value of options granted during the years ended December 31, 2008, 2007 and 2006 were $3.54, $3.73 and $5.23, respectively. The total intrinsic value of options exercised during the years ended December 31, 2008, 2007 and 2006 were $890,000, $514,000 and $4.6 million, respectively. Intrinsic value is measured using the fair market value price of the Corporation's common stock less the applicable exercise price.

A summary of the status of the Corporation's nonvested shares as of December 31, 2008 is as follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2008	108,736	$5.37
Granted	210,082	3.54
Share obligations assumed from Willow Financial acquisition	556,506	3.59
Vested	(586,086)	3.73
Forfeited	(25,574)	6.00
Nonvested at December 31, 2008	263,664	$3.74

Note 14—Stock-Based Compensation (Continued)

As of December 31, 2008, there was a total of $857,000 of unrecognized compensation cost related to nonvested awards under stock option plans. This cost is expected to be recognized over a weighted-average period of 2.8 years. The total fair value of shares vested during the years ended December 31, 2008, 2007 and 2006 were $2.2 million (includes $2.0 million from Willow Financial acquisition), $356,000 and $360,000, respectively. The tax benefit realized for the tax deductions from option exercises totaled $305,000, $119,000 and $1.3 million for 2008, 2007, and 2006, respectively.

In addition, the Corporation maintains the Harleysville National Corporation Stock Bonus Plan to award employees in recognition of exemplary service during each calendar year. The Corporation's Board of Directors authorized the registration of 70,354 shares of common stock for issuance under this plan in December 1996. The Stock Bonus Plan is administered by the Compensation Committee of the Corporation. The committee annually determines, in its sole discretion, the amount of shares the Corporation awards. The Corporation awarded 129 shares during 2008. As of December 31, 2008, a total of 22,695 shares remained available for awards under the plan.

Note 15—Earnings Per Share

The calculations of basic and diluted earnings per share are presented below. All weighted average shares, actual shares and per share information in the financial statements have been adjusted retroactively for the effect of stock dividends and splits. See Note 1 of the consolidated financial statements for a discussion on the calculation of earnings per share.

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands, except per share information)		
Basic earnings per share			
Net income available to common shareholders	**$ 25,093**	$ 26,595	$ 39,415
Weighted average common shares outstanding	**32,201,150**	29,218,671	28,946,847
Basic earnings per share	**$ 0.78**	$ 0.91	$ 1.36
Diluted earnings per share			
Net income available to common shareholders and assumed conversions	**$ 25,093**	$ 26,595	$ 39,415
Weighted average common shares outstanding	**32,201,150**	29,218,671	28,946,847
Dilutive potential common shares(1),(2)	**162,987**	241,227	406,281
Total diluted weighted average common shares outstanding	**32,364,137**	29,459,898	29,353,128
Diluted earnings per share	**$ 0.78**	$ 0.90	$ 1.34

(1) Includes incremental shares from assumed conversions of stock options.

(2) Antidilutive options have been excluded in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common stock. For 2008, 2007, and 2006, there were 1,037,645, 475,952 and 416,353 antidilutive options at an average price of $18.79, $23.44 and $24.50 per share, respectively.

Note 16—Comprehensive (Loss) Income and Accumulated Other Comprehensive (Loss) Income

The components of other comprehensive (loss) income are as follows:

For the year ended December 31, 2008	Before tax amount	Tax Benefit (Expense)	Net of tax amount
	(Dollars in thousands)		
Net unrealized losses on available for sale securities:			
Net unrealized holding losses arising during period	**$(40,146)**	**$14,051**	**$(26,095)**
Less reclassification adjustment for net gains on sales of available for sale securities realized in net income	**2,642**	**(925)**	**1,717**
Less reclassification adjustment for other-than-temporary impairment of available for sale securities recognized in net income	**(1,923)**	**673**	**(1,250)**
Net unrealized losses	**(40,865)**	**14,303**	**(26,562)**
Change in fair value of derivatives used for cash flow hedges	**171**	**(60)**	**111**
Other comprehensive loss, net	**$(40,694)**	**$14,243**	**$(26,451)**

For the year ended December 31, 2007	Before tax amount	Tax (Expense) Benefit	Net of tax amount
	(Dollars in thousands)		
Net unrealized gains on available for sale securities:			
Net unrealized holding gains arising during period	$4,856	$(1,700)	$3,156
Less reclassification adjustment for net gains realized in net income	1,187	(415)	772
Less reclassification adjustment for other-than-temporary impairment of available for sale securities recognized in net income	(55)	19	(36)
Net unrealized gains	3,724	(1,304)	2,420
Change in fair value of derivatives used for cash flow hedges	(643)	225	(418)
Reversal of FAS 158 adjustment due to defined benefit pension plan curtailment	2,361	(826)	1,535
Other comprehensive income, net	$5,442	$(1,905)	$3,537

For the year ended December 31, 2006	Before tax amount	Tax (Expense) Benefit	Net of tax amount
	(Dollars in thousands)		
Net unrealized gains on available for sale securities:			
Net unrealized holding gains arising during period	$5,548	$(1,942)	$3,606
Less reclassification adjustment for net losses realized in net income	(674)	236	(438)
Net unrealized gains	6,222	(2,178)	4,044
Change in fair value of derivatives used for cash flow hedges	(141)	49	(92)
Amortization of unrealized loss on termination of cash flow hedge	151	(53)	98
Other comprehensive income, net	$6,232	$(2,182)	$4,050

Note 16—Comprehensive (Loss) Income and Accumulated Other Comprehensive (Loss) Income (Continued)

The components of other accumulated other comprehensive (loss) income, net of tax, which is a component of shareholders' equity were as follows:

	Net Unrealized (Losses) Gains on Available For Sale Securities	Net Change in Fair Value of Derivatives Used for Cash Flow Hedges	Net Change in Termination of Cash Flow Hedge	Net Change Related to Defined Benefit Pension Plan	Transition Asset Related to Defined Benefit Pension Plan	Accumulated Other Comprehensive (Loss) Income
Balance, December 31, 2005	$ (8,916)	$ 396	$ (98)	$ -	$ -	$ (8,618)
Net Change	4,044	(92)	98	(1,579)	44	2,515
Balance, December 31, 2006(1)	(4,872)	304	-	(1,579)	44	(6,103)
Net Change	2,420	(418)	-	1,579	(44)	3,537
Balance, December 31, 2007	(2,452)	(114)	-	-	-	(2,566)
Net Change	(26,562)	111	-	-	-	(26,451)
Balance, December 31, 2008	$(29,014)	$ (3)	$ -	$ -	$ -	$(29,017)

(1) At December 31, 2006, the Corporation adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" and recognized as an adjustment to the December 31, 2006 balance of accumulated other comprehensive income, net of tax, the net loss and transition asset that had not been included in the net periodic benefit cost of its pension plan for $1.5 million.

Note 17—Segment Information

The Corporation operates two main lines of business along with several other operating segments. SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS 131) establishes standards for the way public business enterprises report information about operating segments. Operating segments are components of an enterprise, which are evaluated regularly by the chief operating decision-maker in deciding how to allocate and assess resources and performance. The Corporation's chief operating decision-maker is the President and Chief Executive Officer. The Corporation has applied the aggregation criteria set forth in SFAS 131 for operating segments establishing two reportable segments: Community Banking and Wealth Management.

The Community Banking segment provides financial services to consumers, businesses and governmental units primarily in southeastern Pennsylvania. These services include full-service banking, comprised of accepting time and demand deposits, making secured and unsecured commercial loans, mortgages, consumer loans, and other banking services. The treasury function income is included in the Community Banking segment, as the majority of effort of this function is related to this segment. Primary sources of income include net interest income and service fees on deposit accounts. Expenses include costs to manage credit and interest rate risk, personnel, and branch operational and technical support.

The Wealth Management segment includes: trust and investment management services, providing investment management, trust and fiduciary services, estate settlement and executor services, financial planning, and retirement plan and institutional investment services; employee benefits services; and the Cornerstone Companies, registered investment advisors for high net worth, privately held business owners, wealthy families and institutional clients. Major revenue component sources include investment management and advisory fees, trust fees, estate and tax planning fees, brokerage fees, and insurance related fees. Expenses primarily consist of personnel and support charges. Additionally, the Wealth Management segment includes an inter-segment credit related to trust deposits which are maintained within the Community Banking segment using a transfer pricing methodology.

Note 17—Segment Information (Continued)

The Corporation has also identified several other operating segments. These operating segments within the Corporation's operations do not have similar characteristics to the Community Banking or Wealth Management segments and do not meet the quantitative thresholds requiring separate disclosure. These non-reportable segments include HNC Reinsurance Company, HNC Financial Company, and the parent holding company and are included in the "Other" category.

Information about reportable segments and reconciliation of the information to the consolidated financial statements follows:

	Community Banking	Wealth Management	All Other	Consolidated Totals
		(Dollars in thousands)		
Year Ended December 31, 2008				
Net interest income (expense)	**$ 109,030**	**$ 280**	**$ (5,170)**	**$ 104,140**
Provision for loan losses	**15,567**	**-**	**-**	**15,567**
Noninterest income	**27,175**	**18,689**	**353**	**46,217**
Noninterest expense	**86,852**	**16,869**	**901**	**104,622**
Income (loss) before income taxes (benefit)	**33,786**	**2,100**	**(5,718)**	**30,168**
Income taxes (benefit)	**6,138**	**833**	**(1,896)**	**5,075**
Net income (loss)	**$ 27,648**	**$ 1,267**	**$ (3,822)**	**$ 25,093**
Assets	**$5,447,646**	**$ 30,437**	**$ 12,426**	**$5,490,509**

	Community Banking	Wealth Management	All Other	Consolidated Totals
		(Dollars in thousands)		
Year Ended December 31, 2007				
Net interest income (expense)	$ 84,563	$ 451	$ (2,580)	$ 82,434
Provision for loan losses	10,550	-	-	10,550
Noninterest income	23,947	18,658	733	43,338
Noninterest expense	64,751	15,744	860	81,355
Income (loss) before income taxes (benefit)	33,209	3,365	(2,707)	33,867
Income taxes (benefit)	6,917	1,502	(1,147)	7,272
Net income (loss)	$ 26,292	$ 1,863	$ (1,560)	$ 26,595
Assets	$3,862,378	$ 25,572	$ 15,051	$3,903,001

	Community Banking	Wealth Management	All Other	Consolidated Totals
Year Ended December 31, 2006		(Dollars in thousands)		
Net interest income (expense)	$ 84,775	$ 470	$ (2,072)	$ 83,173
Provision for loan losses	4,200	-	-	4,200
Noninterest income	29,735	14,878	735	45,348
Noninterest expense	56,049	13,553	1,228	70,830
Income (loss) before income taxes (benefit)	54,261	1,795	(2,565)	53,491
Income taxes (benefit)	14,475	717	(1,116)	14,076
Net income (loss)	$ 39,786	$ 1,078	$ (1,449)	$ 39,415
Assets	$3,195,051	$ 19,475	$ 35,302	$3,249,828

The accounting policies of the segments are the same as those described in the summary of significant accounting policies disclosed in Note 1 of the consolidated financial statements. Consolidating adjustments reflecting certain eliminations of inter-segment revenues, cash and investment in subsidiaries are included in the "All Other" segment.

Note 18—Lease Commitments and Contingent Liabilities

Lease Commitments

Lease commitments for equipment and banking locations expire intermittently over the years through 2037. As a part of the acquisition of Willow Financial, the Corporation assumed 28 additional leases with intermittent expirations through 2027. Most banking location leases require the lessor to pay insurance, maintenance costs, and property taxes. In December 2007, the Corporation sold its headquarter's property along with fourteen branch properties and entered into a sale-leaseback agreement with the purchaser. At December 31, 2008, the remaining term of these leases was fourteen years with options to renew for up to forty additional years. Approximate minimum rental commitments for non-cancelable operating leases at December 31, 2008, are as follows:

	Minimum Lease Payments (Dollars in thousands)
For the year ending:	
2009	$ 9,214
2010	8,655
2011	8,353
2012	7,714
2013	7,548
Thereafter	83,073
Total	$124,557

Total rent expense amounted to $5.6 million, $3.2 million and $2.4 million for the years ended December 31, 2008, 2007 and 2006, respectively.

Other

As a result of the acquisition of Willow Financial, the Corporation recorded a liability in purchase accounting of $2.7 million in connection with certain legal contingencies which existed prior to the acquisition. The amount accrued represents estimated settlement and legal costs on ongoing litigation assumed from Willow Financial. There can be no assurance that any of the outstanding legal proceedings to which the Corporation is a party as a successor in interest to Willow Financial will not be decided adversely to the Corporation's interests and have a material effect on the financial condition and operations of the Corporation.

Based on consultation with the Corporation's legal counsel, management is not aware of any litigation that would have a material adverse effect on the consolidated financial position of the Corporation. Except as noted above, there are no proceedings pending other than the ordinary routine litigation incident to the business of the Corporation. In addition, no material proceedings are pending or are known to be threatened or contemplated against the Corporation by government authorities.

Note 19—Financial Instruments with Off-Balance Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they become payable. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's maximum exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual or notional amounts of those instruments. The Bank uses the same stringent credit policies in extending these commitments as they do for recorded financial instruments and controls exposure to loss through credit approval and monitoring procedures. These commitments often expire without being drawn upon and often are secured with appropriate collateral; therefore, the total commitment amount does not necessarily represent the actual risk of loss or future cash requirements.

The Bank offers commercial, mortgage and consumer credit products to its customers in the normal course of business. These products represent a diversified credit portfolio and are generally issued to borrowers within the Bank's branch office systems in eastern Pennsylvania. The ability of the customers to repay their credits is, to some extent, dependent upon the economy in the Bank's market areas.

The approximate contract amounts are as follows:

Commitments	Total Amount Committed at December 31, 2008	2007
	(Dollars in thousands)	
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	**$995,125**	$822,995
Standby letters of credit and financial guarantees written	**34,806**	23,473
Financial instruments whose notional or contract amounts exceed the amount of credit risk:		
Interest rate swap agreements	**124,214**	58,928
Interest rate cap agreements	**200,000**	200,000

Standby letters of credit expire as follows: $32.3 million in one year or less, $2.5 million after one year through three years, $69,000 after three years through five years and $0 after five years.

During 2008, the Corporation had cash flow hedges with notional amounts totaling $45.0 million which matured. These swaps had the effect of converting rates on money market deposit accounts to a fixed-rate cost of funds. This strategy was undertaken to allow the Bank to recognize, in a rising rate environment, a larger interest rate spread than it otherwise would have without the swaps in effect. In addition, two cash flow hedges with a notional amount of $10.0 million that had the effect of converting variable debt to a fixed rate matured during 2008. For both of these types of swaps, the Corporation recognized net interest expense of 192,000 for the year ended December 31, 2008 and net interest income of $287,000 and $442,000 for the years ended December 31, 2007, and 2006, respectively. During the first quarter of 2005, the Corporation terminated a cash flow hedge with a notional value of $25.0 million. The gross loss related to the termination of this swap was $310,000 which was amortized through October 2006 in accordance with SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities." For the year ended December 31, 2006, the Corporation amortized $151,000 into net interest income related to this swap. Periodically, the Corporation may enter into fair value hedges to limit the exposure to

Note 19—Financial Instruments with Off-Balance Sheet Risk (Continued)

changes in the fair value of loan assets. At December 31, 2008, the Corporation had a fair value hedge in the form of an interest rate swap with a notional amount of $1.9 million which matures in 2017. In addition, four fair value hedges with notional amounts totaling $7.5 million were acquired from Willow Financial with maturity dates ranging from 2013 to 2016. These swaps do not qualify for hedge accounting treatment and thus all changes in the fair value of the derivatives is recorded in the consolidated statements of income. As such, based on the decrease in the market value of these interest rate swaps during 2008, the Corporation recognized a loss of $183,000 in other expense in the consolidated statement of operations. During 2008, the Corporation terminated a fair value hedge in the form of an interest rate swap with a notional amount of $2.0 million. For fair value hedges, the Corporation recognized net interest expense of $81,000 for the year ended December 31, 2008 and net interest income of $59,000 and $7,000 for the years ended December 31, 2007 and 2006, respectively. At December 31, 2008, the Corporation had swap agreements with a negative fair value of $1.1 million. At December 31, 2007, the Corporation had swap agreements with a positive fair value of $10,000 and with a negative fair value of $366,000. There was no hedge ineffectiveness recognized during 2008, 2007 and 2006.

During March 2007, the Corporation purchased one and three month Treasury bill interest rate cap agreements with notional amounts totaling $200 million to limit its exposure on variable rate NOW deposit accounts. The initial premium related to these caps was $73,000 which is being amortized to interest expense over the life of the cap based on the cap market value. The Corporation recognized amortization of $16,000 and $8,000 for the year ended December 31, 2008 and 2007, respectively. At December 31, 2008, these caps, designated as cash flow hedges, had a positive fair value of $0. At December 31, 2007, these caps had a positive fair value of $222. The caps mature in March 2009. Due to notional mismatch, $43,000 was recognized in other expense during the year ended December 31, 2008. During 2007, the Corporation accelerated the reclassification of an immaterial amount in other comprehensive income to earnings as a result of variable-rate interest payments becoming probable not to occur. The accelerated amount was a loss of $7,000 recognized in interest expense.

During 2008, the Corporation began to offer certain derivative products directly to qualified commercial borrowers. The Corporation economically hedges derivative transactions executed with commercial borrowers by entering into mirror-image, offsetting derivatives with third parties. Derivative transactions executed as part of this program are not designated in SFAS 133-qualifying hedging relationships and are, therefore, marked-to-market through earnings each period. Because the derivatives have mirror-image contractual terms, the changes in fair value substantially offset through earnings. These derivatives have maturity dates ranging from 2010 to 2018. As of December 31, 2008, the fair value of the derivative assets and the fair value of the offsetting derivative liabilities were $4.5 million and $4.5 million, respectively. Fees earned in connection with the execution of derivatives related to this program are recognized in other noninterest fee income. The derivative asset and liability values above include an adjustment related to the consideration of credit risk required under FAS 157 of $18,000, which is also recognized as an adjustment to other noninterest fee income.

The Bank also had commitments with customers to extend mortgage loans at a specified rate at December 31, 2008 and December 31, 2007 of $36.4 million and $3.4 million, respectively and commitments to sell mortgage loans at a specified rate at December 31, 2008 and December 31, 2007 of $53.1 million and $2.4 million, respectively. The commitments are accounted for as a derivative and recorded at fair value. The Bank estimates the fair value of these commitments by comparing the secondary market price at the reporting date to the price specified in the contract to extend or sell the loan initiated at the time of the loan commitment. At December 31, 2008, the Corporation had commitments with a positive fair value of $274,000 and negative fair value of $48,000 which was recorded as other income. At December 31, 2007, the Corporation had commitments with a positive fair value of $19,000 and negative fair value of $19,000 which was recorded as other income.

Note 19—Financial Instruments with Off-Balance Sheet Risk (Continued)

During December 2004 and January 2005, the Bank sold lease financing receivables of $10.5 million. Of these leases, $1.2 million were sold with full recourse and the remaining leases were sold subject to recourse with a maximum exposure of ten percent of the outstanding receivable. The total recourse exposure at the time of the sale of the leases was $2.0 million. The Bank's total recourse exposure at December 31, 2008 was $26,000. After the first anniversary of the sale agreement, and on a quarterly basis thereafter, upon written request by the Bank, the purchaser will review the portfolio performance and may reduce the total exposure to an amount equal to ten percent of the outstanding net book value. The Bank will be subject to the full and partial recourse obligations until all the lease financing receivables have been paid or otherwise been terminated and all equipment has been sold or disposed of. The final lease payment is due in 2010. The outstanding balance of these sold leases at December 31, 2008 was $187,000. At December 31, 2008 and December 31, 2007, the Bank had $1,000 and $17,000, respectively, on the balance sheet as a recourse liability.

Note 20—Regulatory Capital

As of December 31, 2008	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
Total Capital (to risk weighted assets):						
Corporation	**$384,522**	**8.88%**	**$346,333**	**8.00%**	**$432,917**	**10%**
Harleysville National Bank	**370,552**	**8.58%**	**345,536**	**8.00%**	**431,920**	**10%**
Tier 1 Capital (to risk weighted assets):						
Corporation	**334,467**	**7.73%**	**173,167**	**4.00%**	**259,750**	**6%**
Harleysville National Bank	**320,497**	**7.42%**	**172,768**	**4.00%**	**259,152**	**6%**
Tier 1 Capital (to average assets):						
Corporation	**334,467**	**8.19%**	**163,315**	**4.00%**	**204,144**	**5%**
Harleysville National Bank	**320,497**	**7.88%**	**162,689**	**4.00%**	**203,361**	**5%**

As of December 31, 2007	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
			(Dollars in thousands)			
Total Capital (to risk weighted assets):						
Corporation	$329,887	10.67%	$247,273	8.00%	$309,091	10%
Harleysville National Bank	312,880	10.16%	246,286	8.00%	307,858	10%
Tier 1 Capital (to risk weighted assets):						
Corporation	302,459	9.79%	123,637	4.00%	185,455	6%
Harleysville National Bank	285,452	9.27%	123,143	4.00%	184,715	6%
Tier 1 Capital (to average assets):						
Corporation	302,459	8.72%	138,795	4.00%	173,494	5%
Harleysville National Bank	285,452	8.29%	137,722	4.00%	172,153	5%

Note 20—Regulatory Capital (Continued)

The Bank 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 affect on the Corporation's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank'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 the Bank to maintain minimum amounts and ratios (set forth in the table) of total and Tier 1 capital to risk-weighted assets. Management believes, as of December 31, 2008, that the Bank meets all capital adequacy requirements to which it is subject. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table.

The National Banking Laws require the approval of the Office of the Comptroller of the Currency if the total of all dividends declared by a national bank in any calendar year exceed the net profits of the bank (as defined) for that year combined with its retained net profits for the preceding two calendar years. Under this formula, the Bank may declare dividends in 2009 of approximately $8.3 million plus an amount equal to the net profits of the Bank in 2009 up to the date of any such dividend declaration.

Banking regulations limit the amount of investments, loans, extensions of credit and advances that a subsidiary bank can make to an affiliate at any time to 10% and in the aggregate or to a single financial subsidiary, to 20% of the Bank's capital stock and surplus. These regulations also require that certain covered transactions including a loan, extension of credit or advance to an affiliate be secured by securities having a market value in excess of the amount thereof. At December 31, 2008, the Bank's investments in the Cornerstone Companies and BeneServ, Inc. (financial subsidiaries) of $27.5 million were in compliance with the limitations and not subject to collateral requirements.

Note 21—Fair Value Measurements

Effective January 1, 2008, the Corporation adopted SFAS No. 157, "Fair Value Measurements" (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosure about fair value. SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value. A financial instrument's level within the fair value hierarchy is based on the lowest level of input significant to the fair value measurement. There have been no material changes in valuation techniques as a result of the adoption of SFAS No. 157.

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

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets; quoted prices in markets that are not active for identical or similar assets or liabilities; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Note 21—Fair Value Measurements (Continued)

Level 3 - Unobservable inputs that are supported by little or no market activity and significant to the fair value of the assets or liabilities that are developed using the reporting entities' estimates and assumptions, which reflect those that market participants would use.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

A description of the valuation methodologies used for financial instruments measured at fair value on a recurring basis, as well as the classification of the instruments pursuant to the valuation hierarchy, are as follows:

Securities Available for Sale

Securities classified as available for sale are reported using Level 1, Level 2 and Level 3 inputs. Level 1 instruments generally include equity securities valued based on quoted market prices in active markets. Level 2 instruments include U.S. government agency obligations, state and municipal bonds, mortgage-backed securities, collateralized mortgage obligations and corporate bonds. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. During the fourth quarter of 2008, certain collateralized debt obligation investments in pooled trust preferred securities were transferred from Level 2 into Level 3. The Corporation obtained a third party cash flow analysis to determine the projected level of uncollected principal and the resulting fair value. The cash flow analysis included market information such as instrument performance and relevant corporate data associated with certain issuers included within the pooled trust. The Federal Home Loan Bank stock, Federal Reserve Bank stock and other investments which were classified as Level 3 securities available for sale in the Corporation's previously issued financial statements were reclassified to a separate line item on the Corporation's consolidated balance sheets as of December 31, 2007 since they do not have readily determinable fair values for purposes of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." These investment securities are carried at cost and periodically evaluated for impairment. This presentation change is considered to be immaterial.

Residential Mortgage Loans Held for Sale

Residential mortgage loans originated and intended for sale in the secondary market are carried at estimated fair value. The Corporation estimates the fair value of mortgage loans held for sale using current secondary loan market rates. The Corporation has determined that the inputs used to value its mortgage loans held for sale fall within Level 2 of the fair value hierarchy. The Corporation elected to apply the provisions of SFAS 159 in December 2008 as a result of the portfolio of loans held for sale acquired from Willow Financial. This election resulted in a fair value adjustment of $215,000 recorded in other income on the consolidated statements of income in the fourth quarter of 2008. Prior to the fourth quarter of 2008, residential mortgage loans held for sale were carried at lower of cost or market.

Derivative Financial Instruments

Currently, the Corporation uses cash flow hedges, fair value hedges and interest rate caps to manage its interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs,

Note 21—Fair Value Measurements (Continued)

including interest rate curves, foreign exchange rates, and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments (or receipts) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves.

The fair values of interest rate options are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates fell below (rise above) the strike rate of the floors (caps). The variable interest rates used in the calculation of projected receipts on the floor (cap) are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities. To comply with the provisions of SFAS No. 157, the Corporation incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Corporation has considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although the Corporation has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of December 31, 2008, the Corporation has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and has determined that the credit valuation adjustments are not significant to the overall valuation of its derivatives. As a result, the Corporation has determined that its derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

The Corporation also has commitments with customers to extend mortgage loans at a specified rate and commitments to sell mortgage loans at a specified rate. These interest rate and forward contracts for mortgage loans originated and intended for sale in the secondary market are accounted for as derivatives and carried at estimated fair value. The Corporation estimates the fair value of the contracts using current secondary loan market rates. The Corporation has determined that the inputs used to value its interest rate and forward contracts fall within Level 2 of the fair value hierarchy.

Assets and liabilities measured at fair value on a recurring basis are summarized below.

	Fair Value Measurement Using			
(Dollars in thousands)	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance December 31, 2008
Assets				
Investment securities available for sale	$21,666	$1,117,133	$ 3,149	$1,141,948
Residential mortgage loans held for sale	—	17,165	—	17,165
Derivatives	—	4,797	—	4,797
Total assets	$21,666	$1,139,095	$ 3,149	$1,163,910
Liabilities				
Derivatives	$ —	$ 5,689	$ —	$ 5,689
Total liabilities	$ —	$ 5,689	$ —	$ 5,689

Note 21—Fair Value Measurements (Continued)

Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

The table below presents a reconciliation for assets measured at fair value on a recurring basis for which the Corporate has utilized significant unobservable inputs (Level 3).

(Dollars in thousands)	Investment Securities Available for Sale
Balance, January 1, 2008	$ —
Transfers into Level 3	5,072
Total losses realized	
Included in earnings(1)	(1,923)
Included in other comprehensive income	—
Balance, December 31, 2008	$ 3,149
The amount of total gains or losses for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at December 31, 2008	$ —

(1) The loss is reported as an other–than-temporary impairment loss on investment securities available for sale in the income statement.

Assets Measured at Fair Value on a Nonrecurring Basis

A description of the valuation methodologies and classification levels used for financial instruments measured at fair value on a nonrecurring basis are listed as follows. These listed instruments are subject to fair value adjustments (impairment) as they are valued at the lower of cost or market.

Impaired Loans

Impaired loans are evaluated and valued at the time the loan is identified as impaired, at the lower of cost or market value. Individually impaired loans are measured based on the fair value of the collateral for collateral dependent loans. The value of the collateral is determined based on an appraisal by qualified licensed appraisers hired by the Corporation or other observable market data which is readily available in the marketplace. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly. At December 31, 2008, impaired loans had a carrying amount of $70.2 million with a valuation allowance of $8.4 million. Impaired loans with a carrying amount of $67.9 million were evaluated during 2008 using the practical expedient fair value measurement which resulted in an additional valuation allowance of $6.9 million as compared to December 31, 2007.

Mortgage Servicing Rights

The Corporation estimates the fair value of mortgage servicing rights based upon the present value of future cash flows using a current market discount rate appropriate for each investor group. Some of the primary

Note 21—Fair Value Measurements (Continued)

components in valuing a servicing portfolio are estimates of anticipated prepayment, current market yields for servicing, reinvestment rate, servicing spread retained on the loans, and the cost to service each loan.

The Corporation's entire portfolio consists of fixed rate loans with a remittance type of schedule/actual and a weighted average servicing fee of .25%. The market value calculation was based on long term prepayment assumptions obtained from Bloomberg for similar pools based on original term, remaining term, and coupon. Where prepayment assumptions for loan pools could not be obtained, projections based on current prepayments, secondary loan market, and input from servicing buyers were used. The Corporation has determined that the inputs used to value its mortgage servicing rights fall within Level 2 of the fair value hierarchy. At December 31, 2008, the Corporation's mortgage servicing rights had a carrying amount of $1.6 million. In accordance with the provisions of SFAS No.156, "Amending Accounting for Separately Recognized Servicing Assets and Liabilities" and SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," mortgage servicing rights with a carrying amount of $3.0 million were written down to their fair value of $1.6 million resulting in an impairment charge of $1.4 million for the year ended December 31, 2008.

Certain assets measured at fair value on a non-recurring basis are presented below:

	Fair Value Measurement Using			
(Dollars in thousands)	Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance December 31, 2008
Assets				
Impaired loans	$ —	$59,987	$ —	$59,987
Mortgage servicing rights	—	1,558	—	1,558
Total assets	$ —	$61,545	$ —	$61,545

SFAS No. 157 Fair value measurement implementation for nonfinancial assets including goodwill and identifiable intangibles with balances of $240.7 million and $26.2 million, respectively, and nonfinancial liabilities at December 31, 2008 have been delayed until January 1, 2009 in accordance with SFAS No. 157-2.

Disclosures about Fair Value of Financial Instruments

SFAS No. 107, "Disclosures about Fair Values of Financial Instruments," (SFAS 107) requires disclosure of the estimated fair value of an entity's assets and liabilities considered to be financial instruments. For the Corporation, as for most financial institutions, the majority of its assets and liabilities are considered financial instruments as defined in SFAS 107. However, many such instruments lack an available trading market, as characterized by a willing buyer and seller engaging in an exchange transaction. Also, it is the Corporation's general practice and intent to hold its financial instruments to maturity and not to engage in trading or sales activities, except for certain loans and investments. Therefore, the Corporation had to use significant estimates and present value calculations to prepare this disclosure.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Also, management is concerned that there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

Note 21—Fair Value Measurements (Continued)

Estimated fair values have been determined by the Corporation using the best available data and an estimation methodology suitable for each category of financial instruments. The estimation methodologies used at December 31, 2008 and 2007 are outlined below. The methodologies for estimating the fair value of financial assets and financial liabilities that are measured at fair value on a recurring or non-recurring basis are discussed in the fair value measurements section above. The estimated fair value approximates carrying value for cash and cash equivalents, accrued interest and the cash surrender value of life insurance policies. The methodologies for other financial assets and financial liabilities are discussed below:

Short-term financial instruments

The carrying value of short-term financial instruments including cash and due from banks, federal funds sold and securities purchased under agreements to resell, interest-bearing deposits in banks and other short-term investments and borrowings, approximates the fair value of these instruments. These financial instruments generally expose the Corporation to limited credit risk and have no stated maturities or have short-term maturities with interest rates that approximate market rates.

Investment securities held to maturity

The estimated fair values of investment securities held to maturity are based on quoted market prices, provided by independent third parties that specialize in those investment sectors. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments.

Loans

The loan portfolio, net of unearned income, has been valued by a third party specialist using quoted market prices, if available. When market prices were not available, a credit risk based present value discounted cash flow analysis was utilized. The primary assumptions utilized in this analysis are the discount rate based on the libor curve, adjusted for credit risk, and prepayment estimates based on factors such as refinancing incentives, age of the loan and seasonality. These assumptions were applied by loan category and different spreads were applied based upon prevailing market rates by category.

Deposits

The estimated fair values of demand deposits (i.e., interest and noninterest-bearing checking accounts, savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). The fair value for certificates of deposit was calculated by an independent third party by discounting contractual cash flows using current market rates for instruments with similar maturities, using a credit based risk model. The carrying amount of accrued interest receivable and payable approximates fair value

Long-term borrowings and subordinated debt

The amounts assigned to long-term borrowings and subordinated debt were based on quoted market prices, when available, or were based on discounted cash flow calculations using prevailing market interest rates for debt of similar terms.

Note 21—Fair Value Measurements (Continued)

The carrying and fair values of certain financial instruments were as follows:

	December 31,			
	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
Cash and cash equivalents	**$ 102,526**	**$ 102,526**	$ 209,403	$ 209,403
Investment securities available for sale	**1,141,948**	**1,141,948**	910,367	910,367
Investment securities held to maturity	**50,434**	**50,059**	57,347	57,518
Residential mortgage loans held for sale	**17,165**	**17,165**	1,140	1,140
Loans and leases, net	**3,618,124**	**3,591,202**	2,432,355	2,447,474
Bank-owned life insurance	**87,081**	**87,081**	72,269	72,269
Time deposits	**1,588,921**	**1,613,684**	1,202,690	1,195,811
Long-term borrowings	**759,658**	**809,618**	321,785	328,084
Subordinated debt	**93,743**	**50,474**	82,992	81,954

Note 22—Parent-Company Only Financial Information

Condensed financial statements of Harleysville National Corporation follow:

CONDENSED BALANCE SHEETS

	December 31, 2008	December 31, 2007
	(Dollars in thousands)	
Assets		
Cash	**$ 7,181**	$ 5,779
Investments in subsidiaries	**558,524**	410,381
Other investments	**3,804**	2,492
Other assets	**5,598**	4,528
Total assets	**$575,107**	$423,180
Liabilities and shareholders' equity		
Subordinated debt	**$ 93,743**	$ 82,992
Other liabilities	**6,639**	878
Total liabilities	**100,382**	83,870
Shareholders' equity	**474,725**	339,310
Total liabilities and shareholders' equity	**$575,107**	$423,180

CONDENSED STATEMENTS OF INCOME

	Year Ended December 31, 2008	2007	2006
	(Dollars in thousands)		
Dividends from subsidiaries	**$27,859**	$48,623	$21,779
Interest from subsidiaries	**70**	433	290
Investment income	**163**	152	130
Total income	**28,092**	49,208	22,199
Interest on subordinated debt	**5,484**	4,314	3,653
Noninterest expense	**148**	180	556
Total expense	**5,632**	4,494	4,209
Income before income tax benefit and equity in undistributed net income of subsidiaries	**22,460**	44,714	17,990
Income tax benefit	**(1,820)**	(1,302)	(1,206)
Income before equity in undistributed net income of subsidiaries	**24,280**	46,016	19,196
Equity in undistributed net income (losses) of subsidiaries	**813**	(19,421)	20,219
Net income	**$25,093**	$26,595	$39,415

Note 22—Parent-Company Only Financial Information (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Operating activities:			
Net income	**$25,093**	$26,595	$39,415
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in undistributed net (income) losses of subsidiaries	**(813)**	19,421	(20,219)
Stock-based compensation expense	**136**	118	440
Net (increase) decrease in other assets	**(65)**	(133)	1,846
Net (decrease) increase in other liabilities	**(517)**	69	274
Other, net	**16**	(709)	(30)
Net cash provided by operating activities	**23,850**	45,361	21,726
Investing activities:			
Net cash paid acquired (paid) due to acquisition	**817**	(49,761)	—
Capital contributions made to the subsidiaries	**—**	—	(15,000)
Net cash provided by (used) in investing activities	**817**	(49,761)	(15,000)
Financing activities:			
Advances of long-term subordinated debt	**—**	23,196	—
Cash dividends	**(25,109)**	(23,623)	(21,779)
Repurchase of common stock	**—**	(2,196)	(5,502)
Proceeds from the exercise of stock options	**1,567**	925	5,302
Excess tax benefits from stock-based compensation	**277**	42	948
Other, net	**—**	—	(12)
Net cash used in financing activities	**(23,265)**	(1,656)	(21,043)
Net increase (decrease) in cash	**1,402**	(6,056)	(14,317)
Cash and cash equivalents at beginning of year	**5,779**	11,835	26,152
Cash and cash equivalents at end of year	**$ 7,181**	$ 5,779	$11,835

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Harleysville National Corporation

We have audited the accompanying consolidated balance sheets of Harleysville National Corporation (a Pennsylvania corporation) and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Harleysville National Corporation and subsidiaries as of December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 and 14 to the consolidated financial statements, the Corporation has adopted Financial Accounting Standards Board Statement(FASB) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – An Amendment of FASB Statements No. 87, 88, 106 and 132(R)* and FASB No. 123(R), *Share Based Payments* in 2006. As also discussed in Note 1 to the financial statements, the Company adopted FASB No. 157, *Fair Value Measurements*, and No. 159, *the Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115*, in 2007.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Harleysville National Corporation and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 13, 2009 expressed an unqualified opinion.

Grant Thornton LLP

Philadelphia, Pennsylvania
March 13, 2009

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

There have been no changes in the Corporation's internal control over financial reporting during the fourth quarter of 2008 that have materially affected, or reasonably likely to materially affect, the Corporation's internal control over financial reporting.

(i) Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15(d)-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and regulations and are operating in an effective manner and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(ii) Management's Report on Internal Control Over Financial Reporting and Compliance with Federal Laws and Regulations

Management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting and compliance with federal laws and regulations. Internal control over financial reporting is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, as a process designed by, or under the supervision of, the Corporation's principal executive and principal financial officers and effected by the Corporation's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America and includes those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Corporation;
- 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 Corporation are being made only in accordance with authorizations of management and directors of the Corporation; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Corporation's assets that could have a material effect of the financial statements.

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

Management assessed the effectiveness of the Corporation's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework.*

In accordance with the SEC's published guidance, the Corporation's management determined that it would exclude the operations of Willow Financial (acquired on December 5, 2008) from the scope of its assessment of internal control over financial reporting as of December 31, 2008. As of December 31, 2008, the Corporation's total reported consolidated assets were $5.5 billion, of which Willow Financial's assets accounted for approximately 29.2%. For the year ended December 31, 2008, the Corporation's consolidated interest and non-interest income was $252.5 million, of which Willow Financial accounted for approximately 2.5%.

Management believes that, as of December 31, 2008, the Corporation's internal control over financial reporting was effective. Management also assessed the effectiveness of the Corporation's internal controls for compliance with federal laws and regulations as of December 31, 2008, in accordance with reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA). Management believes that as of December 31, 2008, the Corporation's internal controls over compliance with federal laws and regulations were effective.

The Corporation's independent registered Public Accounting Firm has issued an attestation report on the Corporation's internal control over financial reporting. This report appears herein in Item 9A, section iii.

(iii) REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Harleysville National Corporation

We have audited Harleysville National Corporation's (a Pennsylvania Corporation) and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Harleysville National Corporation's management is responsible 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 Report on Internal Control over Financial Reporting*. Our responsibility is to express an opinion on Harleysville National Corporation's internal control over financial reporting based on our audit.

As indicated in Management's Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of the operations of Willow Financial which was acquired in December 2008 and constituted approximately 29.2% of total consolidated assets as of December 31, 2008 and approximately 2.5% of total consolidated revenues for the year then ended. Our audit on internal control over financial reporting of Harleysville National Corporation and subsidiaries did not include an evaluation of the internal control over financial reporting of Willow Financial.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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.

In our opinion, Harleysville National Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework issued by COSO.*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Harleysville National Corporation and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008 and our report dated March 13, 2009 expressed an unqualified opinion.

Grant Thornton LLP

Philadelphia, Pennsylvania
March 13, 2009

Item 9B. Other Information

None

PART III

Item 10. Directors, Executive Officers and Corporate Governance

The Corporation has a Code of Ethics for directors, officers and employees of the corporation. It is intended to promote honest and ethical conduct, full and accurate reporting, and compliance with laws as well as other matters.

The SEC requires disclosure concerning whether or not the Corporation has at least one "audit committee financial expert" on the Audit Committee. Walter R. Bateman, II, until his retirement on April 22, 2008, was the committee's independent financial expert, as defined by SEC regulations, and chaired the committee. James A. Wimmer succeeded Mr. Bateman as the financial expert and chairperson of the committee.

Additional information regarding directors, executive officers and corporate governance is included under the following captions in the Corporation's proxy statement relating to its 2009 annual meeting of shareholders (the "2009 Proxy Statement") and is incorporated herein by reference:

"Director Information"
"Executive Officers"
"Corporate Governance"
"Meetings and Committees of the Board of Directors"
"Section 16(a) Beneficial Ownership Reporting Compliance"

In addition, the Corporation makes available on *www.hncbank.com* (under "Corporate Governance") the following: 1) Audit Committee Charter, 2) Code of Ethics, 3) Whistleblower Policy, 4) Nominating and Corporate Governance Committee Charter and 5) Compensation Committee Charter.

Item 11. Executive Compensation

Information regarding executive compensation included under the following captions in the 2009 Proxy Statement is incorporated herein by reference:

"Director Information"
"Meetings and Committees of the Board of Directors"
"Director Compensation"
"Compensation Discussion and Analysis"
"Compensation Committee Report"
"Compensation Committee Interlocks and Insider Participation"
"Executive Compensation"
"Potential Payments upon Termination or Change in Control"
"Executive Employment Agreements" and "Executive Separation Agreements"

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Security ownership information of certain beneficial owners and management is included under the caption, "Beneficial Ownership by Directors, Officers and Nominees," in the 2009 Proxy Statement is incorporated herein by reference.

The information required by this item concerning Equity Compensation Plan information is included in Part II, Item 5, "Equity Compensation Plan Information" of this Report on Form 10-K and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Information included in Part II, Item 8, Footnote 5 "Loans" of this Report on Form 10-K is incorporated herein by reference.

Information included under the captions, "Related Party Transactions," "Corporate Governance," and "Meetings and Committees of the Board of Directors" in the 2009 Proxy Statement is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

Information included under the caption, "Independent Registered Public Accounting Firm," in the 2009 Proxy Statement is incorporated herein by reference.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) The following documents are filed as part of this report (see Part II, Item 8, "Financial Statements and Supplementary Data"):

  (1) Financial Statements:

    (a) Consolidated Balance Sheets at December 31, 2008 and 2007

    (b) Consolidated Statements of Income for the years ended December 31, 2008, 2007 and 2006

    (c) Consolidated Statements of Shareholders' Equity for the years ended December 31, 2008, 2007 and 2006

    (d) Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006

    (e) Notes to Consolidated Financial Statements

    (f) Report of Independent Registered Public Accounting firm

  (2) Financial Statement Schedules are not applicable

  (3) The exhibits listed on the Exhibit Index at the end of this Report are filed with or incorporated as part of this Report (as indicated in connection with each Exhibit).

SIGNATURES

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

HARLEYSVILLE NATIONAL CORPORATION

By: /S/ PAUL D. GERAGHTY
Paul D. Geraghty
President and Chief Executive Officer

Date: March 11, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/S/ LEEANN B. BERGEY LeeAnn B. Bergey	Director	March 11, 2009
/S/ MICHAEL L. BROWNE Michael L. Browne	Director	March 11, 2009
/S/ JOHN J. CUNNINGHAM, III John J. Cunningham, III	Director	March 11, 2009
/S/ WALTER E. DALLER, JR. Walter E. Daller, Jr.	Chairman and Director	March 11, 2009
/S/ PAUL D. GERAGHTY Paul D. Geraghty	President, Chief Executive Officer and Director (Principal Executive Officer)	March 11, 2009
/S/ HAROLD A. HERR Harold A. Herr	Director	March 11, 2009
/S/ THOMAS C. LEAMER Thomas C. Leamer	Director	March 11, 2009
/S/ JAMES E. MCERLANE James E. McErlane	Director	March 11, 2009
/S/ STEPHANIE S. MITCHELL Stephanie S. Mitchell	Director	March 11, 2009
/A/ A. ROSS MYERS A. Ross Myers	Director	March 11, 2009

Signature	Title	Date
/S/ BRENT L. PETERS Brent L. Peters	Director	March 11, 2009
/S/ GEORGE S. RAPP George S. Rapp	Chief Financial Officer (Principal Financial and Accounting Officer)	March 11, 2009
/S/ DEMETRA M. TAKES Demetra M. Takes	Director	March 11, 2009
/S/ JAMES A. WIMMER James A. Wimmer	Director	March 11, 2009

EXHIBIT INDEX

Exhibit No.	Description of Exhibits
(2.1)	Purchase Agreement, dated as of November 15, 2005, by and among Harleysville National Bank and Trust Company, Cornerstone Financial Consultants, Ltd., Cornerstone Advisors Asset Management, Inc., Cornerstone Institutional Investors, Inc., Cornerstone Management Resources, Inc., John R. Yaissle, Malcolm L. Cowen, II, and Thomas J. Scalici. (Incorporated by reference to Exhibit 2.1 of the Registrant's Annual Report on Form 10-K for the year ended December 31, 2005, filed with the Commission on March 15, 2006. The schedules and exhibits to the Purchase Agreement are listed at the end of the Purchase Agreement but have been omitted from the exhibit to Form 10-K. The Registrant agrees to supplementally furnish a copy of any omitted schedule or exhibit to the Securities and Exchange Commission upon request.)
(2.2)	Merger Agreement, dated as of May 15, 2007, by and among Harleysville National Corporation, East Penn Financial Corporation, East Penn Bank and HNC-EPF, LLC, as amended. (Incorporated by reference to Annex A of the Corporation's Registration Statement No. 333-145820 on Form S-4/A, filed with the Commission on September 27, 2007. The schedules and exhibits to the Merger Agreement are listed at the end of the Merger Agreement but have been omitted from the Annex to Form S-4. The Registrant agrees to supplementally furnish a copy of any omitted schedule or exhibit to the Securities and Exchange Commission upon request.)
(2.3)	Agreement for Purchase and Sale of Partnership Interests, dated as of December 27, 2007, by and among each of the applicable entities ("Buyer") and 2007 PA HOLDINGS, LLC ("HNB") and PA BRANCH HOLDINGS, LLC, ("Bank Branch") (HNB and Bank Branch are referred to collectively as "Seller"). (Incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Commission on March 14, 2008. The schedules and exhibits to the Agreement for Purchase and Sale of Partnership Interests are listed at the end of the agreement but have been omitted from the Exhibit to Form 10-K. The Registrant agrees to supplementally furnish a copy of any omitted schedule or exhibit to the Securities and Exchange Commission upon request.)
(2.4)	Merger Agreement, dated as of May 20, 2008, by and among Harleysville National Corporation and Willow Financial Bancorp. (Incorporated by reference to Annex A of the Registrant's Registration Statement No. 333-152007 on Form S-4, as amended, filed with the Commission on July 31, 2008. The schedules and exhibits to the Merger Agreement are listed at the end of the Merger Agreement but have been omitted from the Annex to Form S-4. The Registrant agrees to supplementally furnish a copy of any omitted schedule or exhibit to the Securities and Exchange Commission upon request.)
(3.1)	Harleysville National Corporation Amended and Restated Articles of Incorporation. (Incorporated by reference to Exhibit 3.1 to the Corporation's Registration Statement No. 333-111709 on Form S-4, as filed on January 5, 2004.)
(3.2)	Harleysville National Corporation Amended and Restated By-laws. (Incorporated by reference to Exhibit 3.1 to the Corporation's Current Report on Form 8-K/A, filed with the Commission on August 16, 2007.)
(10.1)	Harleysville National Corporation 1993 Stock Incentive Plan.** (Incorporated by reference to Exhibit 4.3 of Registrant's Registration Statement No. 33-69784 on Form S-8, filed with the Commission on October 1, 1993.)
(10.2)	Harleysville National Corporation Stock Bonus Plan.*** (Incorporated by reference to Exhibit 99A of Registrant's Registration Statement No. 333-17813 on Form S-8, filed with the Commission on December 13, 1996.)
(10.3)	Supplemental Executive Retirement Plan.* (Incorporated by reference to Exhibit 10.3 of Registrant's Annual Report in Form 10-K for the year ended December 31, 1997, filed with the Commission on March 27, 1998.)

Exhibit No.	Description of Exhibits
(10.4)	Walter E. Daller, Jr., Chairman and former President and Chief Executive Officer's Employment Agreement dated October 26, 1998.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 25, 1999.)
(10.5)	Consulting Agreement and General Release dated November 12, 2004 between Walter E. Daller, Jr., Harleysville National Corporation and Harleysville National Bank and Trust Company.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 16, 2004.)
(10.6)	Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Walter E. Daller, Jr.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
(10.7)	Employment Agreement dated October 26, 1998 by and among Harleysville National Corporation, Harleysville National Bank and Trust Company and Demetra M. Takes, President and Chief Executive Officer of Harleysville National Bank and Trust Company.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 25, 1999.)
(10.8)	Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Demetra M. Takes, President and Chief Executive Officer of Harleysville National Bank and Trust Company.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
(10.9)	Harleysville National Corporation 1998 Stock Incentive Plan.** (Incorporated by reference to Registrant's Registration Statement No. 333-79971 on Form S-8, filed with the Commission on June 4, 1999.)
(10.10)	Harleysville National Corporation 1998 Independent Directors Stock Option Plan, as amended and restated effective February 8, 2001.** (Incorporated by reference to Appendix "A" of Registrant's Definitive Proxy Statement, filed with the Commission on March 9, 2001.)
(10.11)	Supplemental Executive Retirement Benefit Agreement dated February 23, 2004 between Michael B. High, former Executive Vice President of the Corporation, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q, filed with the Commission on May 10, 2004.)
(10.12)	Employment Agreement effective April 1, 2005 between Michael B. High, former Executive Vice President and Chief Operating Officer of the Corporation, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 16, 2004.)
(10.13)	Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Michael B. High, former Executive Vice President and Chief Operating Officer of the Corporation.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
(10.14)	Complete Settlement Agreement and General Release effective October 17, 2008 by and between Michael B. High, former Executive Vice President and Chief Operating Officer of the Corporation, and Harleysville National Corporation, Harleysville National Bank and Trust Company and Harleysville Management Services, LLC .* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on October 23, 2008.)

Exhibit No.	Description of Exhibits
(10.15)	Harleysville National Corporation 2004 Omnibus Stock Incentive Plan, as amended and restated effective November 9, 2006.** (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 15, 2006).
(10.16)	Employment Agreement dated August 23, 2004 between James F. McGowan, Jr., Executive Vice President & Chief Credit Officer and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on August 25, 2004.)
(10.17)	Supplemental Executive Retirement Benefit Agreement dated August 23, 2004 between James F. McGowan, Jr., Executive Vice President & Chief Credit Officer, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on August 25, 2004.)
(10.18)	Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and James F. McGowan, Jr., Executive Vice President & Chief Credit Officer.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
(10.19)	Employment Agreement dated September 27, 2004 between John Eisele, former Executive Vice President & President of Millennium Wealth Management and Private Banking, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on September 29, 2004.)
(10.20)	Supplemental Executive Retirement Benefit Agreement dated September 27, 2004 between John Eisele, former Executive Vice President & President of Millennium Wealth Management and Private Banking, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on September 29, 2004.)
(10.21)	Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and John Eisele, former Executive Vice President & President of Millennium Wealth Management and Private Banking.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
(10.22)	Separation Agreement and Mutual Release dated June 15, 2007 and effective July 19, 2007 between John Eisele, former Executive Vice President & President of Millennium Wealth Management and Private Banking, Harleysville Management Services, LLC., Harleysville National Bank and Trust Company and Harleysville National Corporation.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on July 19, 2007.)
(10.23)	Employment Agreement effective January 1, 2005 between Gregg J. Wagner, the former President and Chief Executive Officer of the Corporation, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on November 16, 2004.)
(10.24)	Amendment to Supplemental Executive Retirement Benefit Agreement dated March 14, 2005 by and among Harleysville Management Services, LLC and Gregg J. Wagner, the former President and Chief Executive Officer of the Corporation.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on March 14, 2005.)
(10.25)	Complete Settlement Agreement and General Release dated November 29, 2006 and effective December 8, 2006 between Gregg J. Wagner and Harleysville National Corporation, Harleysville National Bank and Trust Company and Harleysville Management Services, LLC .* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on December 13, 2006.)

Exhibit No.	Description of Exhibits
(10.26)	Employment Agreement dated May 18, 2005, between George S. Rapp, Senior Vice President and Chief Financial Officer, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on May 20, 2005.)
(10.27)	Amended and Restated Declaration of Trust for HNC Statutory Trust III by and among Wilmington Trust Company, as Institutional Trustee and Delaware Trustee, Harleysville National Corporation, as Sponsor, and the Administrators named therein, dated as of September 28, 2005. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q/A, filed with the Commission on November, 9, 2005.)
(10.28)	Indenture between Harleysville National Corporation, as Issuer, and Wilmington Trust Company, as Trustee, for Fixed/Floating Rate Junior Subordinated Debt Securities, dated as of September 28, 2005. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q/A, filed with the Commission on November, 9, 2005.)
(10.29)	Guarantee Agreement between Harleysville National Corporation and Wilmington Trust Company, dated as of September 28, 2005. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q/A, filed with the Commission on November, 9, 2005.)
(10.30)	Employment Agreement effective July 12, 2006 between Lewis C. Cyr, Chief Lending Officer of the Corporation, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K, filed with the Commission on July 12, 2006.)
(10.31)	Employment Agreement dated July 12, 2007 between Paul D. Geraghty, President and Chief Executive Officer of the Corporation and Harleysville Management Services, LLC* (Incorporated by reference to Registrant's Current Report on Form 8-K filed with the Commission on July 12, 2007.)
(10.32)	Amended and Restated Declaration of Trust for HNC Statutory Trust IV by and among Wilmington Trust Company, as Institutional Trustee and Delaware Trustee, Harleysville National Corporation, as Depositor, and the Administrators named therein, dated as of August 22, 2007. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q, filed with the Commission on November 8, 2007.)
(10.33)	Indenture between Harleysville National Corporation, as Issuer, and Wilmington Trust Company, as Trustee, for Fixed/Floating Rate Junior Subordinated Debt Securities, dated as of August 22, 2007. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q, filed with the Commission on November 8, 2007.)
(10.34)	Guarantee Agreement between Harleysville National Corporation and Wilmington Trust Company, dated as of August 22, 2007. (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q, filed with the Commission on November 8, 2007.)
(10.35)	Employment Agreement dated November 16, 2007 between Brent L. Peters, Executive Vice President and President of the East Penn Bank Division of Harleysville National Bank and Trust Company, and Harleysville Management Services, LLC. * (Incorporated by reference to Registrant's Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Commission on March 14, 2008.)
(10.36)	Employment Agreement dated April 17, 2008 between Joseph D. Blair, Executive Vice President and President of the Millennium Wealth Management Division of Harleysville National Bank and Trust Company, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Quarterly Report on Form 10-Q filed with the Commission on August 8, 2008.)
(10.37)	Employment Agreement dated May 20, 2008 and effective December 5, 2008 between Donna M. Coughey, Executive Vice President of the Corporation and the Bank, and Harleysville Management Services, LLC.* (Incorporated by reference to Registrant's Current Report on Form 8-K filed with the Commission on December 5, 2008.)
(11)	Computation of Earnings per Common Share, incorporated by reference to Part II, Item 8, Footnote 15, "Earnings Per Share," of this Report on Form 10-K.
(21)	Subsidiaries of Registrant
(23)	Consent of Grant Thornton LLP, Independent Registered Public Accounting firm

Exhibit No.	Description of Exhibits
(31.1)	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
(31.2)	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, filed herewith.
(32.1)	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.
(32.2)	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, furnished herewith.

* Management contract or compensatory plan arrangement.

** Shareholder approved compensatory plan pursuant to which the Registrant's Common Stock may be issued to employees of the Corporation.

*** Non-shareholder approved compensatory plan pursuant to which the Registrant's Common Stock may be issued to employees of the Corporation.

Exhibit 21

HARLEYSVILLE NATIONAL CORPORATION
SUBSIDIARIES

Name	Jurisdiction of Incorporation
Harleysville National Bank and Trust Company	Pennsylvania
Cornerstone Advisors Asset Management, Inc.	Pennsylvania
Cornerstone Financial Consultants, Ltd.	Pennsylvania
Cornerstone Institutional Investors, Inc.	Pennsylvania
HNB Auto Sales, LLC	Pennsylvania
HNC Insurance Agency, Inc	Pennsylvania
Harleysville Management Services, LLC	Pennsylvania
East Penn Mortgage Company	Pennsylvania
East Penn Mortgage Company LLC	Pennsylvania
BeneServ, Inc.	Pennsylvania
Willow Grove Investment Corporation	Delaware
D and S Service Corporation	Pennsylvania
D & F Projects, Inc.	Pennsylvania
Wildman Projects, Inc.	Pennsylvania
HNC Financial Company	Delaware
HNC Reinsurance Company	Arizona
Harleysville Statutory Trust I	Connecticut
HNC Statutory Trust II	Delaware
HNC Statutory Trust III	Delaware
HNC Statutory Trust IV	Delaware
East Penn Statutory Trust I	Connecticut
Willow Grove Statutory Trust I	Connecticut

Exhibit 23

Consent of Independent Registered Public Accounting Firm

We have issued our reports dated March 13, 2009 with respect to the consolidated financial statements and internal control over financial reporting included in the Annual Report of Harleysville National Corporation and subsidiaries on Form 10-K for the year ended December 31, 2008. We hereby consent to the incorporation by reference of said reports in the Registration Statements of Harleysville National Corporation on Forms S-8 (File No. 33-69784, effective October 1, 1993, File No. 333-17813, effective December 13, 1996, File No. 333-79971, effective June 4, 1999, and File No. 333-79973, effective June 4, 1999, File No. 333-116183, effective June 4, 2004, File No. 333-139579, effective December 21, 2006, File No. 333-148377, effective December 28, 2007, File No. 333-156956, effective January 27, 2009).

Grant Thornton LLP

Philadelphia, Pennsylvania
March 13, 2009

Exhibit 31.1

CERTIFICATION

I, Paul D. Geraghty, President, Chief Executive Officer and Director, certify, that:

1. I have reviewed this annual report on Form 10-K of Harleysville National Corporation.
2. Based on my knowledge, the annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report.
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 11, 2009

By:

President, Chief Executive Officer and Director
Harleysville National Corporation

Exhibit 31.2

CERTIFICATION

I, George S. Rapp, Executive Vice President and Chief Financial Officer, certify, that:

1. I have reviewed this annual report on Form 10-K of Harleysville National Corporation.
2. Based on my knowledge, the annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report.
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonable likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 11, 2009

By:

Executive Vice President and Chief Financial Officer
Harleysville National Corporation

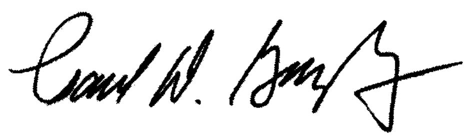
Exhibit 32.1

HARLEYSVILLE NATIONAL CORPORATION
CERTIFICATION
PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Harleysville National Corporation Annual Report on Form 10-K for the period ending December 31, 2008, as filed with the Securities and Exchange Commission (the "Report"), I, Paul D. Geraghty, President, Chief Executive Officer and Director, certify, pursuant to 18 U.S.C. Section 1350, as added Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

By:



President, Chief Executive Officer and Director
Harleysville National Corporation

Date: March 11, 2009

Exhibit 32.2

HARLEYSVILLE NATIONAL CORPORATION
CERTIFICATION
PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350

In connection with the Harleysville National Corporation Annual Report on Form 10-K for the period ending December 31, 2008, as filed with the Securities and Exchange Commission (the "Report"), I, George S. Rapp, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as added Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

By:

Executive Vice President and
Chief Financial Officer
Harleysville National Corporation

Date: March 11, 2009

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Harleysville
NATIONAL CORPORATION

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