HARTFORD FINANCIAL SERVICES GROUP INC/DE
Form 10-Q
July 29, 2009

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

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2009

OR

o **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: 001-13958

THE HARTFORD FINANCIAL SERVICES GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-3317783**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Hartford Plaza, Hartford, Connecticut 06155

(Address of principal executive offices) (Zip Code)

(860) 547-5000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of July 22, 2009, there were outstanding 328,158,459 shares of Common Stock, $0.01 par value per share, of the registrant.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009
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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
The Hartford Financial Services Group, Inc.
Hartford, Connecticut

We have reviewed the accompanying condensed consolidated balance sheet of The Hartford Financial Services Group, Inc. and subsidiaries (the Company) as of June 30, 2009, and the related condensed consolidated statements of operations and comprehensive income (loss) for the three-month and six-month periods ended June 30, 2009 and 2008, and changes in equity, and cash flows for the six-month periods ended June 30, 2009 and 2008. These interim financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2008, and the related consolidated statements of operations, changes in stockholders equity, comprehensive loss, and cash flows for the year then ended prior to retrospective adjustment for the adoption of FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*, described in Note 1, (not presented herein); and in our report dated February 11, 2009 (which report includes an explanatory paragraph relating to the Company s change in its method of accounting and reporting for the fair value measurement of financial instruments in 2008, and defined benefit pension and other postretirement plans in 2006), we expressed an unqualified opinion on those consolidated financial statements. We also audited the adjustments described in Note 1 that were applied to retrospectively adjust the December 31, 2008 consolidated balance sheet of the Company (not presented herein). In our opinion, such adjustments are appropriate and have been properly applied to the previously issued consolidated balance sheet in deriving the accompanying retrospectively adjusted condensed consolidated balance sheet as of December 31, 2008.

DELOITTE & TOUCHE LLP
Hartford, Connecticut
July 29, 2009

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Statements of Operations

(In millions, except for per share data)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
	(Unaudited)		(Unaudited)	
Revenues				
Earned premiums	$ 3,592	$ 3,891	$ 7,421	$ 7,734
Fee income	1,062	1,386	2,229	2,723
Net investment income (loss):				
Securities available-for-sale and other	1,021	1,230	1,941	2,423
Equity securities, trading	2,523	1,153	1,799	(2,425)
Total net investment income (loss)	3,544	2,383	3,740	(2)
Net realized capital gains (losses):				
Total other-than-temporary impairment (OTTI) losses	(562)	(164)	(786)	(468)
OTTI losses transferred to other comprehensive income	248		248	
Net OTTI losses recognized in earnings	(314)	(164)	(538)	(468)
Net realized capital losses, excluding net OTTI losses recognized in earnings	(367)	(118)	(59)	(1,185)
Total net realized capital losses	(681)	(282)	(597)	(1,653)
Other revenues	120	125	238	245
Total revenues	**7,637**	**7,503**	**13,031**	**9,047**
Benefits, losses and expenses				
Benefits, losses and loss adjustment expenses	3,092	3,586	7,729	6,943
Benefits, losses and loss adjustment expenses returns credited on International variable annuities	2,523	1,153	1,799	(2,425)
Amortization of deferred policy acquisition costs and present value of future profits	674	806	2,933	1,274
Insurance operating costs and expenses	959	1,047	1,857	1,997
Interest expense	119	77	239	144
Goodwill impairment			32	
Other expenses	252	182	441	371
Total benefits, losses and expenses	**7,619**	**6,851**	**15,030**	**8,304**
Income (loss) before income taxes	**18**	**652**	**(1,999)**	**743**
Income tax expense (benefit)	33	109	(775)	55
Net income (loss)	**$ (15)**	**$ 543**	**$ (1,224)**	**$ 688**

Preferred stock dividends		3				3		
Net income (loss) available to common shareholders	**$**	**(18)**	**$**	**543**	**$**	**(1,227)**	**$**	**688**
Earnings (Loss) per common share								
Basic	**$**	**(0.06)**	**$**	**1.74**	**$**	**(3.80)**	**$**	**2.20**
Diluted	**$**	**(0.06)**	**$**	**1.73**	**$**	**(3.80)**	**$**	**2.19**
Weighted average common shares outstanding		325.4		311.7		323.1		312.7
Weighted average common shares outstanding and dilutive potential common shares		325.4		313.1		323.1		314.4
Cash dividends declared per common share	$	0.05	$	0.53	$	0.10	$	1.06

See Notes to Condensed Consolidated Financial Statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.

Condensed Consolidated Balance Sheets

(In millions, except for share and per share data)	June 30, 2009	December 31, 2008
	(Unaudited)	
Assets		
Investments		
Fixed maturities, available-for-sale, at fair value (amortized cost of $76,196 and $78,238)	$ 64,868	$ 65,112
Equity securities, trading, at fair value (cost of $32,889 and $35,278)	30,813	30,820
Equity securities, available-for-sale, at fair value (cost of $1,518 and $1,554)	1,308	1,458
Mortgage loans on real estate	6,522	6,469
Policy loans, at outstanding balance	2,204	2,208
Limited partnerships and other alternative investments	1,838	2,295
Other investments	1,107	1,723
Short-term investments	12,701	10,022
Total investments	121,361	120,107
Cash	2,558	1,811
Premiums receivable and agents balances	3,510	3,604
Reinsurance recoverables	5,848	6,357
Deferred policy acquisition costs and present value of future profits	11,780	13,248
Deferred income taxes	5,321	5,239
Goodwill	1,204	1,060
Property and equipment, net	1,024	1,075
Other assets	3,148	4,898
Separate account assets	133,946	130,184
Total assets	**$ 289,700**	**$ 287,583**
Liabilities		
Reserve for future policy benefits and unpaid losses and loss adjustment expenses		
Property and casualty	$ 21,902	$ 21,933
Life	18,153	16,747
Other policyholder funds and benefits payable	49,257	53,753
Other policyholder funds and benefits payable International variable annuities	30,793	30,799
Unearned premiums	5,333	5,379
Short-term debt	342	398
Long-term debt	5,490	5,823
Consumer notes	1,199	1,210
Other liabilities	9,823	11,997
Separate account liabilities	133,946	130,184
Total liabilities	**276,238**	**278,223**
Commitments and Contingencies (Note 9)		

Equity		
Preferred stock, $0.01 par value 50,000,000 shares authorized, 3,400,000 and 6,048,387 shares issued, liquidation preference $1,000 and $0.02 per share	2,921	
Common stock, $0.01 par value 1,500,000,000 and 750,000,000 shares authorized, 355,392,612 and 329,920,310 shares issued	4	3
Additional paid-in capital	8,190	7,569
Retained earnings	10,991	11,336
Treasury stock, at cost 28,663,675 and 29,341,378 shares	(2,054)	(2,120)
Accumulated other comprehensive loss, net of tax	(6,610)	(7,520)
Total stockholders equity	**13,442**	**9,268**
Noncontrolling interest	20	92
Total equity	**13,462**	**9,360**
Total liabilities and equity	**$ 289,700**	**$ 287,583**

See Notes to Condensed Consolidated Financial Statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Statements of Changes in Equity

(In millions, except for share data)	Six Months Ended June 30, 2009	2008
	(Unaudited)	
Preferred Stock		
Balance at beginning of period	$	$
Issuance of shares to U.S. Treasury	2,920	
Accretion of preferred stock discount on issuance to U.S. Treasury	1	
Balance at end of period	2,921	
Common Stock	**4**	**3**
Additional Paid-in Capital		
Balance at beginning of period	7,569	6,627
Issuance of warrants to U.S. Treasury	480	
Issuance of shares under discretionary equity issuance plan	16	
Issuance of shares under incentive and stock compensation plans	(50)	(43)
Reclassification of warrants from other liabilities to equity and extension of warrants term	186	
Tax (expense) benefit on employee stock options and awards	(11)	7
Balance at end of period	8,190	6,591
Retained Earnings		
Balance at beginning of period, before cumulative effect of accounting change, net of tax	11,336	14,686
Cumulative effect of accounting change, net of tax		(3)
Balance at beginning of period, as adjusted	11,336	14,683
Net income (loss)	(1,224)	688
Cumulative effect of accounting change, net of tax	912	
Accretion of preferred stock discount on issuance to U.S. Treasury	(1)	
Dividends on preferred stock	(2)	
Dividends declared on common stock	(30)	(332)
Balance at end of period	10,991	15,039
Treasury Stock, at Cost		
Balance at beginning of period	(2,120)	(1,254)
Treasury stock acquired		(871)
Issuance of shares under incentive and stock compensation plans from treasury stock	69	113
Return of shares under incentive and stock compensation plans to treasury stock	(3)	(17)

Balance at end of period	(2,054)	(2,029)
Accumulated Other Comprehensive Loss, Net of Tax		
Balance at beginning of period	(7,520)	(858)
Cumulative effect of accounting change, net of tax	(912)	
Total other comprehensive income (loss)	1,822	(1,922)
Balance at end of period	(6,610)	(2,780)
Total Stockholders Equity	**13,442**	**16,824**
Noncontrolling Interest (Note 13)		
Balance at beginning of period	92	92
Change in noncontrolling interest ownership	(65)	57
Noncontrolling loss	(7)	(22)
Balance at end of period	20	127
Total Equity	**$ 13,462**	**$ 16,951**
Outstanding Preferred Shares (in thousands)		
Balance at beginning of period	6,048	
Conversion of preferred to common shares	(6,048)	
Issuance of shares to U.S. Treasury	3,400	
Balance at end of period	**3,400**	
Outstanding Common Shares (in thousands)		
Balance at beginning of period	300,579	313,842
Treasury stock acquired	(15)	(11,675)
Conversion of preferred to common shares	24,194	
Issuance of shares under discretionary equity issuance plan	1,301	
Issuance of shares under incentive and stock compensation plans	854	1,220
Return of shares under incentive and stock compensation plans to treasury stock	(184)	(244)
Balance at end of period	**326,729**	**303,143**

See Notes to Condensed Consolidated Financial Statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Statements of Comprehensive Income (Loss)

(In millions)	**Three Months Ended June 30, 2009**	**Three Months Ended June 30, 2008**	**Six Months Ended June 30, 2009**	**Six Months Ended June 30, 2008**
	(Unaudited)		(Unaudited)	
Comprehensive Income (Loss)				
Net income (loss)	$ (15)	$ 543	$ (1,224)	$ 688
Other comprehensive income (loss)				
Change in net unrealized loss on securities	2,373	(420)	2,340	(2,026)
Other-than-temporary impairment losses transferred to Other Comprehensive Income	(125)		(125)	
Change in net gain/loss on cash-flow hedging instruments	(320)	(76)	(368)	14
Change in foreign currency translation adjustments	164	(68)	(45)	74
Amortization of prior service cost and actuarial net losses included in net periodic benefit costs	11	9	20	16
Total other comprehensive income (loss)	2,103	(555)	1,822	(1,922)
Total comprehensive income (loss)	**$ 2,088**	**$ (12)**	**$ 598**	**$ (1,234)**

See Notes to Condensed Consolidated Financial Statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
Condensed Consolidated Statements of Cash Flows

(In millions)	Six Months Ended June 30, 2009	2008
	(Unaudited)	
Operating Activities		
Net income (loss)	$ (1,224)	$ 688
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Amortization of deferred policy acquisition costs and present value of future profits	2,933	1,274
Additions to deferred policy acquisition costs and present value of future profits		
Change in:	(1,450)	(1,903)
Reserve for future policy benefits and unpaid losses and loss adjustment expenses and unearned premiums	1,333	576
Reinsurance recoverables	(111)	78
Receivables and other assets	249	399
Payables and accruals	(389)	(690)
Accrued and deferred income taxes	(343)	(68)
Net realized capital losses	597	1,653
Net receipts to investment contracts related to policyholder funds -International variable annuities	(892)	(1,290)
Net decrease in equity securities, trading	885	1,235
Depreciation and amortization	259	476
Goodwill impairment	32	
Other, net	107	(167)
Net cash provided by operating activities	**1,986**	**2,261**
Investing Activities		
Proceeds from the sale/maturity/prepayment of:		
Fixed maturities, available-for-sale	33,229	12,595
Equity securities, available-for-sale	482	144
Mortgage loans	297	214
Partnerships	239	107
Derivatives	29	
Payments for the purchase of:		
Fixed maturities, available-for-sale	(35,015)	(14,455)
Equity securities, available-for-sale	(251)	(496)
Mortgage loans	(214)	(686)
Partnerships	(136)	(402)
Derivatives		(219)
Proceeds from business sold	7	
Purchase price of businesses acquired	(15)	(94)
Change in policy loans, net	4	(85)
Change in payables for collateral under securities lending, net	(2,262)	(199)
Change in all other securities, net	107	(556)
Additions to property and equipment, net	(58)	(185)

Net cash used for investing activities		**(3,557)**		**(4,317)**
Financing Activities				
Deposits and other additions to investment and universal life-type contracts		7,323		11,345
Withdrawals and other deductions from investment and universal life-type contracts		(11,516)		(13,694)
Net transfers from separate accounts related to investment and universal life-type contracts		3,646		3,725
Proceeds from issuance of long-term debt				1,487
Payments on capital lease obligations		(24)		(37)
Change in short-term debt		(375)		
Proceeds from issuance of consumer notes				304
Repayments at maturity or settlement of consumer notes		(11)		
Proceeds from issuance of preferred stock and warrants to U.S. Treasury		3,400		
Net proceeds from issuance of shares under discretionary equity issuance plan		14		
Proceeds from issuance of shares under incentive and stock compensation plans		7		34
Excess tax benefit on stock-based compensation				2
Treasury stock acquired				(811)
Return of shares under incentive and stock compensation plans to treasury stock		(3)		(17)
Dividends paid on preferred stock		(8)		
Dividends paid on common stock		(115)		(336)
Net cash provided by financing activities		**2,338**		**2,002**
Foreign exchange rate effect on cash		(20)		127
Net increase in cash		747		73
Cash beginning of period		1,811		2,011
Cash end of period	**$**	**2,558**	**$**	**2,084**
Supplemental Disclosure of Cash Flow Information				
Net Cash Paid (Received) During the Period For:				
Income taxes	$	(468)	$	65
Interest	$	243	$	128

See Notes to Condensed Consolidated Financial Statements.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollar amounts in millions, except for per share data, unless otherwise stated)
(Unaudited)

1. Basis of Presentation and Accounting Policies

Basis of Presentation

The Hartford Financial Services Group, Inc. is a financial holding company for a group of subsidiaries that provide investment products and life and property and casualty insurance to both individual and business customers in the United States and internationally (collectively, The Hartford or the Company). During the second quarter of 2009, the Company acquired Federal Trust Corporation and became a savings and loan holding company, see Note 16 for further information on the acquisition.

The condensed consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America (U.S. GAAP), which differ materially from the accounting practices prescribed by various insurance regulatory authorities.

The accompanying condensed consolidated financial statements and notes as of June 30, 2009, and for the three and six months ended June 30, 2009 and 2008 are unaudited. These financial statements reflect all adjustments (consisting only of normal accruals) which are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. These condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in The Hartford s 2008 Form 10-K Annual Report. The results of operations for the interim periods should not be considered indicative of the results to be expected for the full year.

Consolidation

The condensed consolidated financial statements include the accounts of The Hartford Financial Services Group, Inc., companies in which the Company directly or indirectly has a controlling financial interest and those variable interest entities in which the Company is the primary beneficiary. The Company determines if it is the primary beneficiary using both qualitative and quantitative analyses. Entities in which The Hartford does not have a controlling financial interest but in which the Company has significant influence over the operating and financing decisions are reported using the equity method. Material intercompany transactions and balances between The Hartford and its subsidiaries and affiliates have been eliminated.

Use of Estimates

The preparation of financial statements, in conformity with U.S. GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The most significant estimates include those used in determining property and casualty reserves, net of reinsurance; life estimated gross profits used in the valuation and amortization of assets and liabilities associated with variable annuity and other universal life-type contracts; living benefits required to be fair valued; valuation of investments and derivative instruments; evaluation of other-than-temporary impairments on available-for-sale securities; pension and other postretirement benefit obligations; contingencies relating to corporate litigation and regulatory matters; and goodwill impairment. Certain of these estimates are particularly sensitive to market conditions, and deterioration and/or volatility in the worldwide debt or equity markets could have a material impact on the condensed consolidated financial statements.

Subsequent Events

The Hartford has evaluated events subsequent to June 30, 2009, and through the condensed consolidated financial statement issuance date of July 29, 2009. The Company has not evaluated subsequent events after that date for presentation in these condensed consolidated financial statements.

Significant Accounting Policies

For a description of significant accounting policies, see Note 1 of Notes to Consolidated Financial Statements included in The Hartford s 2008 Form 10-K Annual Report, which, accordingly, should be read in conjunction with these accompanying condensed consolidated financial statements.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. Basis of Presentation and Accounting Policies (continued)

Adoption of New Accounting Standards

Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160). This statemen amends Accounting Research Bulletin No. 51, Consolidated Financial Statements . Noncontrolling interest refers to the minority interest portion of the equity of a subsidiary that is not attributable directly or indirectly to a parent. SFAS 160 establishes accounting and reporting standards that require for-profit entities that prepare consolidated financial statements to: (a) present noncontrolling interests as a component of equity, separate from the parent s equity, (b) separately present the amount of consolidated net income attributable to noncontrolling interests in the income statement, (c) consistently account for changes in a parent s ownership interests in a subsidiary in which the parent entity has a controlling financial interest as equity transactions, (d) require an entity to measure at fair value its remaining interest in a subsidiary that is deconsolidated, and (e) require an entity to provide sufficient disclosures that identify and clearly distinguish between interests of the parent and interests of noncontrolling owners. SFAS 160 applies to all for-profit entities that prepare consolidated financial statements, and affects those for-profit entities that have outstanding noncontrolling interests in one or more subsidiaries or that deconsolidate a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 with earlier adoption prohibited. The Company adopted SFAS 160 on January 1, 2009. Upon adoption, the Company reclassified $92 of noncontrolling interest, recorded in other liabilities, to equity as of January 1, 2008. See the Company s Condensed Consolidated Statement of Changes in Equity. The adoption of SFAS 160 did not have a material effect on the Company s Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) and the adoption of SFAS 160 did not impact the Company s accounting for separate account assets and liabilities. The FASB has added the following topic to the Emerging Issues Task Force (EITF) agenda, Consideration of an Insurer s Accounting for Majority Owned Investments When the Ownership Is Through a Separate Account . This topic will be discussed at a future EITF meeting. The FASB has expressed three separate views on the treatment of noncontrolling interest in majority owned separate accounts, upon implementation of SFAS 160, all of which are acceptable to the United States Securities and Exchange Commission (SEC). The Company follows one of these three acceptable views and currently excludes the noncontrolling interest from its majority owned separate accounts. The resolution of this EITF agenda item on the Company s accounting for separate account assets and liabilities is not known at this time.

Fair Value

In April 2009, the FASB issued Financial Statement of Position (FSP) No. FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4). FSP FAS 157-4 clarifies that the measurement objective in determining fair value when the volume and level of activity for the asset or liability have significantly decreased, is the price that would be received to sell the asset in an orderly transaction between willing market participants under current market conditions, and not the value in a hypothetical active market. The FSP includes additional factors for determining whether there has been a significant decrease in the volume and level of activity for an asset or liability compared to normal activity for that asset or liability (or similar assets or liabilities) and provides additional guidance in estimating fair value in those instances. The FSP requires an entity to base its conclusion about whether a transaction was not orderly on the weight of the evidence. The FSP expands fair value disclosures for quarterly financial statements and further requires an entity to disclose any change in valuation techniques, the related inputs, and the effects resulting from the application of the FSP. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted the provisions of the FSP for its interim reporting period ending on June 30, 2009 and the adoption did not have a material effect on the Company s condensed consolidated financial statements. See Note 4 for expanded interim disclosures.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1), which expands the disclosure requirements of SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to interim financial statements. FSP FAS 107-1 also requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in the financial statements on an interim basis and to highlight any changes of the method(s) and significant assumptions from prior periods. The disclosures in FSP FAS 107-1 are effective for interim reporting periods ending after June 15, 2009, and are not required for earlier periods that are presented for comparative purposes at initial adoption. In periods after initial adoption, FSP FAS 107-1 requires comparative disclosures only for periods ending after initial adoption. The Company adopted the FSP for its interim reporting period ending on June 30, 2009. See Note 4 for expanded interim disclosures.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. Basis of Presentation and Accounting Policies (continued)

Recognition and Presentation of Other-Than-Temporary Impairments

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2). FSP FAS 115-2 is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted FSP FAS 115-2 for its interim reporting period ending on June 30, 2009 which modifies the recognition of other-than-temporary impairment (impairment) losses for debt securities. This new FSP is also applied to certain equity securities with debt-like characteristics (collectively debt securities). Effective with the adoption of this FSP, a debt security is deemed to be other-than-temporarily impaired if the Company intends to sell or it is more likely than not the Company will be required to sell the security before a recovery in value. If a debt security meets either of these conditions, a charge is recorded in net realized capital losses equal to the difference between the fair value and amortized cost basis of the security. For those debt securities for which the Company does not expect to recover the entire amortized cost basis, the difference between the security s amortized cost basis and the fair value is separated into the portion representing a credit impairment, which is recorded in net realized capital losses, and the remaining impairment, which is recorded in other comprehensive income (OCI). Generally, the Company determines a security s credit impairment as the difference between its amortized cost basis and its best estimate of expected future cash flows discounted at the security s effective yield prior to impairment. The previous amortized cost basis less the impairment recognized in net realized capital losses becomes the security s new cost basis. The Company accretes the new cost basis to the estimated future cash flows over the expected remaining life of the security by prospectively adjusting the security s yield, if necessary.

The Company evaluates whether it expects to recover the entire amortized cost basis of a debt security or if a credit impairment exists, by considering primarily the following factors: (a) the length of time and extent to which the fair value has been less than the amortized cost of the security, (b) changes in the financial condition, credit rating and near-term prospects of the issuer, (c) whether the issuer is current on contractually obligated interest and principal payments, (d) changes in the financial condition of the security s underlying collateral and (e) the payment structure of the security. The Company s best estimate of expected future cash flows used to determine the credit loss amount is a quantitative and qualitative process that incorporates information received from third party sources along with certain internal assumptions and judgments regarding the future performance of the security. The Company s best estimate of future cash flows includes assumptions including, but not limited to, various performance indicators, such as historical default and recovery rates, credit ratings, current delinquency rates, and loan-to-value ratios. In addition, for securitized debt securities, the Company considers factors including, but not limited to, commercial and residential property value declines that vary by property type and location and average cumulative collateral loss rates that vary by vintage year. These assumptions require the use of significant management judgment and include the probability of issuer default and estimates regarding timing and amount of expected recoveries. In addition, projections of expected future debt security cash flows may change based upon new information regarding the performance of the issuer and/or underlying collateral.

FSP FAS 115-2 does not impact the evaluation for impairment for equity securities. For those equity securities where the decline in the fair value is deemed to be other-than-temporary, a charge is recorded in net realized capital losses equal to the difference between the fair value and cost basis of the security. The previous cost basis less the impairment becomes the security s new cost basis. The Company asserts its intent and ability to retain those equity securities deemed to be temporarily impaired until the price recovers. Once identified, these securities are systematically restricted from trading unless approved by a committee of investment and accounting professionals (the committee). The committee will only authorize the sale of these securities based on predefined criteria that relate to events that could not have been reasonably foreseen. Examples of the criteria include, but are not limited to, the deterioration in the issuer s financial condition, security price declines, a change in regulatory requirements or a major business combination or major disposition.

The primary factors considered in evaluating whether an impairment exists for an equity security include, but are not limited to: (a) the length of time and extent to which the fair value has been less than the cost of the security,

(b) changes in the financial condition, credit rating and near-term prospects of the issuer, (c) whether the issuer is current on contractually obligated payments and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery.

The FSP also expands and increases the frequency of existing disclosures about other-than-temporary impairments for debt and equity securities. As a result of the adoption of FSP FAS 115-2, the Company recognized a $912, net of tax and deferred acquisition costs, increase to Retained Earnings with an offsetting decrease in Accumulated Other Comprehensive Income (AOCI). See the Company s Condensed Consolidated Statement of Changes in Equity and Consolidated Statements of Operations and Comprehensive Loss. See Notes 4 and 5 for expanded interim disclosures.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. Basis of Presentation and Accounting Policies (continued)

Subsequent Events

In May 2009, the FASB issued SFAS No. 165, Subsequent Events (SFAS 165). SFAS 165 establishes principles and disclosure requirements for events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In particular, the Statement sets forth (a) the period after the balance sheet date during which management of a reporting entity shall evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (b) the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements, and (c) the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. An entity shall disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The Company adopted SFAS 165 for its interim reporting period ending on June 30, 2009. See Basis of Presentation within this Note 1 for expanded interim disclosures.

Future Adoption of New Accounting Standards

Accounting for Transfers of Financial Assets

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140 (SFAS 166). SFAS 166 amends the derecognition guidance in Statement 140 and eliminates the concept of a qualifying special-purpose entities (QSPEs). SFAS 166 is effective for fiscal years and interim periods beginning after November 15, 2009. Early adoption of SFAS 166 is prohibited. The Company will adopt SFAS 166 on January 1, 2010 and has not yet determined the effect of the adoption on its consolidated financial statements.

Amendments to FASB Interpretation No. 46(R)

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS 167) which amends the consolidation guidance applicable to variable interest entities (VIE s). An entity would consolidate a VIE, as the primary beneficiary, when the entity has both of the following characteristics: (a) The power to direct the activities of a VIE that most significantly impact the entity s economic performance and (b) The obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE. Ongoing reassessment of whether an enterprise is the primary beneficiary of a VIE is required. SFAS 167 amends interpretation 46(R) to eliminate the quantitative approach previously required for determining the primary beneficiary of a VIE. This Statement is effective for fiscal years and interim periods beginning after November 15, 2009. The Company will adopt SFAS 167 on January 1, 2010 and has not yet determined the effect of the adoption on its consolidated financial statements.

FASB Accounting Standards Codification

In June 2009, the FASB issued SFAS No. 168, The *FASB Accounting Standards Codification* and the Hierarchy of Generally Accepted Accounting Principles (SFAS 168). This standard identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements that are presented in conformity with U.S. GAAP. The Statement establishes the *FASB Accounting Standards Codification* (Codification) as the single source of authoritative accounting principles recognized by the FASB in the preparation of financial statements in conformity with U.S. GAAP. Codification does not create new accounting and reporting guidance rather it reorganizes U.S. GAAP pronouncements into approximately 90 topics within a consistent structure. All guidance contained in the Codification carries an equal level of authority. Relevant portions of authoritative content, issued by the SEC, for SEC registrants, have been included in the Codification. After the effective date of this Statement, all nongrandfathered, non-SEC accounting literature not included in the Codification is superseded and deemed nonauthoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company will adopt SFAS 168 on September 30, 2009 and will update all disclosures to reference Codification in its September 30, 2009 quarterly report.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. Basis of Presentation and Accounting Policies (continued)

Income Taxes

The effective tax rate for the three months ended June 30, 2009 and 2008 was 183% and 17%, respectively. The effective tax rate for the six months ended June 30, 2009 and 2008 was 39% and 7%, respectively. The principal causes of the difference between the effective rate and the U.S. statutory rate of 35% were tax-exempt interest earned on invested assets and the separate account dividends received deduction (DRD), offset in 2009 by a non-deductible expense related to a contingent obligation to Allianz as a result of the issuance of warrants to the federal government in connection with the Company s participation in the Capital Purchase Program.

The separate account DRD is estimated for the current year using information from the prior year-end, adjusted for current year equity market performance and other appropriate factors, including estimated levels of corporate dividend payments. The actual current year DRD can vary from estimates based on, but not limited to, changes in eligible dividends received by the mutual funds, amounts of distribution from these mutual funds, amounts of short-term capital gains at the mutual fund level and the Company s taxable income before the DRD. Given recent financial markets volatility, the Company is reviewing its DRD computations on a quarterly basis. The Company recorded benefits related to the separate account DRD of $37 and $67 in the three months ended June 30, 2009 and 2008, and $75 and $108 in the six months ended June 30, 2009 and 2008, respectively.

The Company s unrecognized tax benefits decreased by $8 during the six months ended June 30, 2009 as a result of the settlement of the 2002-2003 Internal Revenue Service (IRS) audit, bringing the total unrecognized tax benefits to $83 as of June 30, 2009. This entire amount, if it were recognized, would decrease the effective tax rate for the applicable periods.

The Company s federal income tax returns are routinely audited by the IRS. During the first quarter of 2009, the Company received notification of the approval by the Joint Committee on Taxation of the results of the 2002 through 2003 examination. As a result, the Company recorded a tax benefit of $7. The 2004 through 2006 examination began during the second quarter of 2008, and is expected to close in early 2010. In addition, the Company is working with the IRS on a possible settlement of a DRD issue related to prior periods which, if settled, may result in the booking of tax benefits. Such benefits are not expected to be material to the condensed consolidated statement of operations.

The Company s deferred tax asset valuation allowance has been determined pursuant to the provisions of FASB SFAS No. 109, Accounting for Income Taxes (SFAS 109), including the Company s estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized.

In assessing the need for a valuation allowance, management considered future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, and taxable income in prior carry back years as defined in SFAS 109, as well as tax planning strategies that include holding debt securities with market value losses until recovery, selling appreciated securities to offset capital losses, and sales of certain corporate assets. Such tax planning strategies are viewed by management as prudent and feasible and will be implemented if necessary to realize the deferred tax asset. However, future realized losses on investment securities could result in the recognition of a valuation allowance, if additional tax planning strategies are not available.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. Earnings (Loss) Per Share

The following tables present a reconciliation of net income (loss) and shares used in calculating basic earnings (loss) per common share to those used in calculating diluted earnings (loss) per common share.

	Three Months Ended June 30, 2009			Six Months Ended June 30, 2009		
(Shares in millions)	**Net Loss**	**Shares**	**Per Common Share Amount**	**Net Loss**	**Shares**	**Per Common Share Amount**
Basic Loss per Common Share						
Net loss	$ (15)			$ (1,224)		
Less: Preferred stock dividends	3			3		
Net loss available to common shareholders	(18)	325.4	$ (0.06)	(1,227)	323.1	$ (3.80)
Diluted Loss per Common Share [1]						
Warrants						
Stock compensation plans						
Net loss available to common shareholders plus assumed conversions	$ (18)	325.4	$ (0.06)	$ (1,227)	323.1	$ (3.80)

[1] As a result of the net loss in the three months ended June 30, 2009, the Company is required to use basic weighted average common shares outstanding in the calculation of the three months ended June 30, 2009 diluted loss per share, since the inclusion of 0.5 million shares for

warrants and 0.7 million shares for stock compensation plans would have been antidilutive to the earnings per share calculation. In the absence of the net loss, weighted average common shares outstanding and dilutive potential common shares would have totaled 326.6 million.

As a result of the net loss in the six months ended June 30, 2009, the Company is required to use basic weighted average common shares outstanding in the calculation of the six months ended June 30, 2009 diluted loss per share, since the inclusion of 0.2 million shares for warrants and 0.7 million shares for stock compensation plans would have been antidilutive to the earnings per *share calculation. In the absence of the net loss, weighted average common shares outstanding and dilutive potential common shares would have totaled 324.0 million.*

(Shares in millions)	**Three Months Ended June 30, 2008**			**Six Months Ended June 30, 2008**		
	Net Income	**Shares**	**Per Common Share Amount**	**Net Income**	**Shares**	**Per Common Share Amount**
Basic Earnings per Common Share						
Net income available to common shareholders	$ 543	311.7	$ 1.74	$ 688	312.7	$ 2.20
Diluted Earnings per Common Share						
Stock compensation plans		1.4			1.7	
Net income available to common shareholders plus assumed conversions	$ 543	313.1	$ 1.73	$ 688	314.4	$ 2.19

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Segment Information

The Hartford is organized into two major operations: Life and Property & Casualty, each containing reporting segments. Within the Life and Property & Casualty operations, The Hartford conducts business principally in eleven reporting segments. Corporate primarily includes the Company s debt financing and related interest expense, as well as other capital raising activities, banking operations and certain purchase accounting adjustments.

Life

Life is organized into four groups which are comprised of six reporting segments: The Retail Products Group (Retail) and Individual Life segments make up the Individual Markets Group. The Retirement Plans and Group Benefits segments make up the Employer Markets Group. The Institutional Solutions Group (Institutional) and International segments each make up their own group.

Life charges direct operating expenses to the appropriate segment and allocates the majority of indirect expenses to the segments based on an intercompany expense arrangement. Inter-segment revenues primarily occur between Life s Other category and the reporting segments. These amounts primarily include interest income on allocated surplus and interest charges on excess separate account surplus. In addition, during the first quarter of 2009, Institutional and International entered into a $1.5 billion funding agreement. The resulting interest income and interest expense in International and Institutional, respectively, are eliminated in consolidation.

Property & Casualty

Property & Casualty is organized into five reporting segments: the underwriting segments of Personal Lines, Small Commercial, Middle Market and Specialty Commercial (collectively, Ongoing Operations); and the Other Operations segment. For the three months ended June 30, 2009 and 2008, AARP accounted for earned premiums of $709 and $691, respectively, in Personal Lines. For both the six months ended June 30, 2009 and 2008, AARP accounted for earned premiums of $1.4 billion in Personal Lines.

Through inter-segment arrangements, Specialty Commercial reimburses Personal Lines, Small Commercial and Middle Market for losses incurred from uncollectible reinsurance and losses incurred under certain liability claims. Earned premiums assumed (ceded) under the inter-segment arrangements were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
Net assumed (ceded) earned premiums under inter-segment arrangements	**2009**	**2008**	**2009**	**2008**
Personal Lines	$ (2)	$ (2)	$ (3)	$ (3)
Small Commercial	(6)	(7)	(12)	(15)
Middle Market	(5)	(8)	(11)	(16)
Specialty Commercial	13	17	26	34
Total	**$**	**$**	**$**	**$**

Financial Measures and Other Segment Information

For further discussion of the types of products offered by each segment, see Note 3 of Notes to Consolidated Financial Statements included in The Hartford s 2008 Form 10-K Annual Report.

One of the measures of profit or loss used by The Hartford s management in evaluating the performance of its Life segments is net income. Within Property & Casualty, net income is a measure of profit or loss used in evaluating the performance of Ongoing Operations and the Other Operations segment. Within Ongoing Operations, the underwriting segments of Personal Lines, Small Commercial, Middle Market and Specialty Commercial are evaluated by The Hartford s management primarily based upon underwriting results. Underwriting results represent premiums earned less incurred losses, loss adjustment expenses and underwriting expenses. The sum of underwriting results, net servicing income, net investment income, net realized capital gains and losses, other expenses, and related income taxes is net income.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Segment Information (continued)

The following table presents revenues by segment.

	Three Months Ended June 30,		Six Months Ended June 30,	
Revenues	**2009**	**2008**	**2009**	**2008**
Life				
Retail	$ 647	$ 872	$ 1,852	$ 1,048
Individual Life	255	285	574	541
Total Individual Markets Group	902	1,157	2,426	1,589
Retirement Plans	80	170	171	292
Group Benefits	1,135	1,176	2,367	2,320
Total Employer Markets Group	1,215	1,346	2,538	2,612
International [1]	222	266	694	413
Institutional	237	472	440	776
Other [1]	7	46	21	57
Total Life segment revenues	2,583	3,287	6,119	5,447
Net investment income (loss) on equity securities, trading [2]	2,523	1,153	1,799	(2,425)
Total Life	**5,106**	**4,440**	**7,918**	**3,022**
Property & Casualty				
Ongoing Operations				
Earned premiums				
Personal Lines	985	980	1,964	1,963
Small Commercial	643	683	1,295	1,370
Middle Market	538	575	1,086	1,168
Specialty Commercial	311	346	643	696
Ongoing Operations earned premiums	2,477	2,584	4,988	5,197
Net investment income	239	334	424	644
Other revenues [3]	120	125	238	245
Net realized capital losses	(80)	(53)	(369)	(187)
Total Ongoing Operations	2,756	2,990	5,281	5,899
Other Operations	44	61	50	99
Total Property & Casualty	**2,800**	**3,051**	**5,331**	**5,998**
Corporate	(269)	12	(218)	27
Total revenues	**$ 7,637**	**$ 7,503**	**$ 13,031**	**$ 9,047**

[1]

Included in International s revenues for the three and six months ended June 30, 2009 are $19 and $30, respectively, of investment income from an inter-segment funding agreement with Institutional. This investment income is eliminated in Life Other.

[2] *Management does not include net investment income (loss) and the mark-to-market effects of equity securities, trading, supporting the international variable annuity business in its segment revenues since corresponding amounts are credited to policyholders.*

[3] *Represents servicing revenue.*

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Segment Information (continued)

The following table presents net income (loss) by segment. Underwriting results are presented for the Personal Lines, Small Commercial, Middle Market and Specialty Commercial segments, while net income (loss) is presented for each of Life s reporting segments, total Property & Casualty, Ongoing Operations, Other Operations and Corporate.

	Three Months Ended June 30,		Six Months Ended June 30,	
Net Income (Loss)	**2009**	**2008**	**2009**	**2008**
Life				
Retail	$ 192	$ 170	$ (552)	$ 93
Individual Life	16	30	(2)	50
Total Individual Markets Group	208	200	(554)	143
Retirement Plans	(40)	31	(128)	26
Group Benefits	14	62	83	108
Total Employer Markets Group	(26)	93	(45)	134
International [1]	119	72	(174)	80
Institutional [1]	(66)	(30)	(240)	(150)
Other [1]	(59)	(1)	(69)	(28)
Total Life	**176**	**334**	**(1,082)**	**179**
Property & Casualty				
Ongoing Operations				
Underwriting results				
Personal Lines	(10)	18	65	123
Small Commercial	74	69	161	188
Middle Market	56	3	125	58
Specialty Commercial	36	18	59	57
Total Ongoing Operations underwriting results	156	108	410	426
Net servicing income [2]	7	8	15	7
Net investment income	239	334	424	644
Net realized capital losses	(80)	(53)	(369)	(187)
Other expenses	(48)	(65)	(98)	(122)
Income before income taxes	274	332	382	768
Income tax expense	(52)	(86)	(49)	(210)
Ongoing Operations	222	246	333	558
Other Operations	(49)	3	(48)	17
Total Property & Casualty	**173**	**249**	**285**	**575**
Corporate	(364)	(40)	(427)	(66)
Net income (loss)	**$ (15)**	**$ 543**	**$ (1,224)**	**$ 688**

[1] *Included in net income (loss) of International and Institutional is investment income and interest expense, respectively, for the three and six months ended June 30, 2009 of $19 and $30, respectively, on an inter-segment funding agreement. This investment income and interest expense is eliminated in Life Other.*

[2] *Net of expenses related to service business.*

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements

The following financial instruments are carried at fair value in the Company s condensed consolidated financial statements: fixed maturities and equity securities, available-for-sale (AFS), short-term investments, freestanding and embedded derivatives, and separate account assets. These fair value disclosures include the fair value measurement and disclosure requirements of SFAS 157 and related FSPs including FSP FAS 157-4 and FSP FAS 107-1.

The following section applies the SFAS 157 fair value hierarchy and disclosure requirements for the Company s financial instruments that are carried at fair value. SFAS 157 establishes a fair value hierarchy that prioritizes the inputs in the valuation techniques used to measure fair value into three broad Levels (Level 1, 2 or 3).

Level 1	Observable inputs that reflect quoted prices for identical assets or liabilities in active markets that the Company has the ability to access at the measurement date. Level 1 securities include highly liquid U.S. Treasury securities, money market funds, certain mortgage backed securities, and exchange traded equity and derivative securities.
Level 2	Observable inputs, other than quoted prices included in Level 1, for the asset or liability or prices for similar assets and liabilities. Most debt securities and preferred stocks are model priced by vendors using observable inputs and are classified within Level 2. Also included in the Level 2 category are derivative instruments that are priced using models with significant observable market inputs, including interest rate, foreign currency and certain credit swap contracts and no or insignificant unobservable market inputs.
Level 3	Valuations that are derived from techniques in which one or more of the significant inputs are unobservable (including assumptions about risk). Level 3 securities include less liquid securities such as highly structured and/or lower quality asset-backed securities (ABS), commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS) primarily backed by sub-prime loans, and private placement debt and equity securities. Collateralized debt obligations (CDOs) included in Level 3 primarily represent commercial real estate (CRE) CDOs and collateralized loan obligations (CLOs) which are primarily priced by independent brokers due to the illiquidity of this sector. Embedded derivatives and complex derivatives securities, including equity derivatives, longer dated interest rate swaps and certain complex credit derivatives are also included in Level 3. Because Level 3 fair values, by their nature, contain unobservable market inputs as there is little or no observable market for these assets and liabilities, considerable judgment is used to determine the SFAS 157 Level 3 fair values. Level 3 fair values represent the Company s best estimate of an amount that could be realized in a current market exchange absent actual market exchanges.

In many situations, inputs used to measure the fair value of an asset or liability position may fall into different levels of the fair value hierarchy. In these situations, the Company will determine the level in which the fair value falls based upon the lowest level input that is significant to the determination of the fair value. In most cases, both observable (e.g., changes in interest rates) and unobservable (e.g., changes in risk assumptions) inputs are used in the determination of fair values that the Company has classified within Level 3. Consequently, these values and the related gains and losses are based upon both observable and unobservable inputs. The Company s fixed maturities included in Level 3 are classified as such as they are primarily priced by independent brokers and/or within illiquid markets. Corporate securities included in Level 3 primarily relate to private placement securities which are thinly traded and priced using a pricing matrix which includes significant non-observable inputs. RMBS included in Level 3 primarily represent sub-prime and Alt-A securities which are classified as Level 3 due to the lack of liquidity in the market.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

These disclosures provide information as to the extent to which the Company uses fair value to measure financial instruments and information about the inputs used to value those financial instruments to allow users to assess the relative reliability of the measurements. The following tables present assets and (liabilities) carried at fair value by SFAS 157 Hierarchy Level.

	June 30, 2009			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Fixed maturities, AFS				
ABS	$ 2,450	$	$ 1,948	$ 502
CDOs	2,563		1	2,562
CMBS	8,290		8,092	198
Corporate	30,835		24,305	6,530
Government/government agencies				
Foreign	1,031		963	68
United States	4,240	271	3,969	
RMBS	4,506		3,153	1,353
States, municipalities and political subdivisions	10,953		10,739	214
Total fixed maturities, AFS	64,868	271	53,170	11,427
Equity securities, trading	30,813	2,285	28,528	
Equity securities, AFS	1,308	241	839	228
Other investments				
Variable annuity hedging derivatives	604		3	601
Other derivatives[1]	342		305	37
Total other investments	946		308	638
Short-term investments	12,701	10,478	2,223	
Reinsurance recoverable for U.S. Guaranteed Minimum Withdrawal Benefit (GMWB)	632			632
Separate account assets [2]	131,069	98,229	32,167	673
Total assets accounted for at fair value on a recurring basis	**$ 242,337**	**$ 111,504**	**$ 117,235**	**$ 13,598**
Liabilities accounted for at fair value on a recurring basis				
Other policyholder funds and benefits payable				
Guaranteed living benefits	$ (3,344)	$	$	$ (3,344)
Institutional notes	2			2

Equity linked notes	(6)			(6)
Total other policyholder funds and benefits payable	(3,348)			(3,348)
Other liabilities [3]				
Variable annuity hedging derivatives	391		(143)	534
Other liabilities	(579)		(260)	(319)
Total other liabilities	(188)		(403)	215
Consumer notes [4]	(4)			(4)
Total liabilities accounted for at fair value on a recurring basis	**$ (3,540)**	**$**	**$ (403)**	**$ (3,137)**

[1] Includes over-the-counter derivative instruments in a net asset value position which may require the counterparty to pledge collateral to the Company. As of June 30, 2009, $580 of cash collateral liability was netted against the derivative asset value in the condensed consolidated balance sheet and is excluded from the table above. See footnote 3 below for derivative liabilities.

[2] Excludes approximately $3 billion of investment sales receivable net of investment purchases payable that are not subject to SFAS 157.

[3] *Includes over-the-counter derivative instruments in a net negative market value position (derivative liability). In the SFAS 157 Level 3 roll-forward table included below in this Note 4, the derivative asset and liability are referred to as freestanding derivatives and are presented on a net basis.*

[4] *Represents embedded derivatives associated with non-funding agreement-backed consumer equity linked notes.*

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
4. Fair Value Measurements (continued)

	December 31, 2008			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets accounted for at fair value on a recurring basis				
Fixed maturities, AFS	$ 65,112	$ 3,541	$ 49,761	$ 11,810
Equity securities, trading	30,820	1,634	29,186	
Equity securities, AFS	1,458	246	671	541
Other investments				
Variable annuity hedging derivatives	600		13	587
Other investments [1]	976		1,005	(29)
Total other investments	1,576		1,018	558
Short-term investments	10,022	7,025	2,997	
Reinsurance recoverable for U.S. GMWB	1,302			1,302
Separate account assets [2]	126,777	94,804	31,187	786
Total assets accounted for at fair value on a recurring basis	**$ 237,067**	**$ 107,250**	**$ 114,820**	**$ 14,997**
Liabilities accounted for at fair value on a recurring basis				
Other policyholder funds and benefits payable				
Guaranteed living benefits	$ (6,620)	$	$	$ (6,620)
Institutional notes	(41)			(41)
Equity linked notes	(8)			(8)
Total other policyholder funds and benefits payable	(6,669)			(6,669)
Other liabilities [3]				
Variable annuity hedging derivatives	2,201		14	2,187
Other derivative liabilities	(339)		76	(415)
Total other liabilities	1,862		90	1,772
Consumer notes [4]	(5)			(5)
Total liabilities accounted for at fair value on a recurring basis	**$ (4,812)**	**$**	**$ 90**	**$ (4,902)**

[1] *Includes over-the-counter derivative instruments in a net asset value position which may require the counterparty to pledge collateral to the Company. As of December 31, 2008, $574 of cash collateral liability was netted against the derivative asset value in the condensed consolidated balance sheet and is excluded from the table above. See footnote 3 below for derivative liabilities.*

[2] *Excludes approximately $3 billion of investment sales receivable net of investment purchases payable that are not subject to SFAS 157.*

[3] *Includes over-the-counter derivative instruments in a net negative market value position (derivative liability). In the SFAS 157 Level 3 roll-forward table included below in this Note 4, the*

derivative asset and liability are referred to as "freestanding derivatives" and are presented on a net basis.

[4] *Represents embedded derivatives associated with non-funding agreement-backed consumer equity linked notes.*

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

Determination of fair values

The valuation methodologies used to determine the fair values of assets and liabilities under the exit price notion of SFAS 157 and related FSPs, reflect market-participant objectives and are based on the application of the fair value hierarchy that prioritizes relevant observable market inputs over unobservable inputs. The Company determines the fair values of certain financial assets and financial liabilities based on quoted market prices, where available and where prices represent a reasonable estimate of fair value. The Company also determines fair value based on future cash flows discounted at the appropriate current market rate. Fair values reflect adjustments for counterparty credit quality, the Company s default spreads, liquidity and, where appropriate, risk margins on unobservable parameters. The following is a discussion of the methodologies used to determine fair values for the financial instruments listed in the above tables.

Fixed Maturity, Short-Term, and Equity Securities, Available-for-Sale

The fair value for fixed maturity, short-term and equity securities, AFS, in an active and orderly market (e.g. not distressed or forced liquidation) is determined by management after considering one of three primary sources of information: third party pricing services, independent broker quotations or pricing matrices. Security pricing is applied using a waterfall approach whereby publicly available prices are first sought from third party pricing services, the remaining unpriced securities are submitted to independent brokers for prices, or lastly, securities are priced using a pricing matrix. Typical inputs used by these three pricing methods include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, and/or estimated cash flows and prepayments speeds. Based on the typical trading volumes and the lack of quoted market prices for fixed maturities, third party pricing services will normally derive the security prices from recent reported trades for identical or similar securities making adjustments through the reporting date based upon available market observable information as outlined above. If there are no recent reported trades, the third party pricing services and brokers may use matrix or model processes to develop a security price where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Included in the pricing of ABS and RMBS are estimates of the rate of future prepayments of principal over the remaining life of the securities. Such estimates are derived based on the characteristics of the underlying structure and prepayment speeds previously experienced at the interest rate levels projected for the underlying collateral. Actual prepayment experience may vary from these estimates.

Prices from third party pricing services are often unavailable for securities that are rarely traded or are traded only in privately negotiated transactions. As a result, certain securities are priced via independent broker quotations which utilize inputs that may be difficult to corroborate with observable market based data. Additionally, the majority of these independent broker quotations are non-binding. A pricing matrix is used to price securities for which the Company is unable to obtain either a price from a third party pricing service or an independent broker quotation. The pricing matrix used by the Company begins with current spread levels to determine the market price for the security. The credit spreads, as assigned by a knowledgeable private placement broker, incorporate the issuer s credit rating and a risk premium, if warranted, due to the issuer s industry and the security s time to maturity. The issuer-specific yield adjustments, which can be positive or negative, are updated twice per year, as of June 30 and December 31, by the private placement broker and are intended to adjust security prices for issuer-specific factors. The Company assigns a credit rating to these securities based upon an internal analysis of the issuer s financial strength.

The Company performs a monthly analysis of the prices and credit spreads received from third parties to ensure that the prices represent a reasonable estimate of the fair value. As a part of this analysis the Company considers trading volume and other factors to determine whether the decline in market activity is significant when compared to normal activity in an active market, and if so, whether transactions may not be orderly considering the weight of available evidence. If the available evidence indicates that pricing is based upon transactions that are stale or not orderly, the Company places little, if any, weight on the transaction price and will estimate fair value utilizing an internal pricing model. This process involves quantitative and qualitative analysis and is overseen by investment and accounting professionals. Examples of procedures performed include, but are not limited to, initial and on-going review of third party pricing services methodologies, review of pricing statistics and trends, back testing recent trades, and monitoring of trading volumes, new issuance activity and other market activities. In addition, the Company ensures that prices received from independent brokers represent a reasonable estimate of fair value through the use of internal and external cash flow models developed based on spreads, and when available, market indices. As a result of this analysis, if the Company determines that there is a more appropriate fair value based upon the available market data, the price received from the third party is adjusted accordingly. The Company s internal pricing model utilizes the Company s best estimate of expected future cash flows discounted at a rate of return that a market participant would require. The significant inputs to the model include, but are not limited to, current market inputs, such as credit loss assumptions, estimated prepayment speeds and market risk premiums.

The Company adopted FSP No. FAS 157-4, Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP FAS 157-4) effective April 1, 2009. For further discussion of FSP FAS 157-4, see Note 1 of the Notes to the Condensed Consolidated Financial Statements. The Company s adoption of FSP FAS 157-4 did not have a material effect on the Company s Condensed Consolidated Financial Statements.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

In accordance with SFAS 157, the Company has analyzed the third party pricing services valuation methodologies and related inputs, and has also evaluated the various types of securities in its investment portfolio to determine an appropriate SFAS 157 fair value hierarchy level based upon trading activity and the observability of market inputs. The SFAS 157 fair value hierarchy prioritizes the inputs in the valuation techniques used to measure fair value into three broad levels (Level 1 quoted prices in active markets for identical assets, Level 2 significant observable inputs, or Level 3 significant unobservable inputs). For further discussion of SFAS 157, see Note 4 of the Notes to the Consolidated Financial Statements. Based on this, each price was classified into Level 1, 2, or 3. Most prices provided by third party pricing services are classified into Level 2 because the inputs used in pricing the securities are market observable.

Due to a general lack of transparency in the process that brokers use to develop prices, most valuations that are based on brokers prices are classified as Level 3. Some valuations may be classified as Level 2 if the price can be corroborated. Internal matrix priced securities, primarily consisting of certain private placement debt, are also classified as Level 3. The matrix pricing of certain private placement debt includes significant non-observable inputs, the internally determined credit rating of the security and an externally provided credit spread.

Derivative Instruments, including embedded derivatives within investments

Derivative instruments are reported in the condensed consolidated balance sheets at fair value and are reported in Other Investments and Other Liabilities. Embedded derivatives are reported with the host instruments in the condensed consolidated balance sheet. Derivative instruments are fair valued using pricing valuation models, which utilize market data inputs or independent broker quotations. Excluding embedded derivatives, as of June 30, 2009, 95% of derivatives based upon notional values were priced by valuation models, which utilize independent market data. The remaining derivatives were priced by broker quotations. The derivatives are valued using mid-market inputs that are predominantly observable in the market. Inputs used to value derivatives include, but are not limited to, interest swap rates, foreign currency forward and spot rates, credit spreads and correlations, interest and equity volatility and equity index levels. The Company performs a monthly analysis on derivative valuations which includes both quantitative and qualitative analysis. Examples of procedures performed include, but are not limited to, review of pricing statistics and trends, back testing recent trades, analyzing the impacts of changes in the market environment, and review of changes in market value for each derivative including those derivatives priced by brokers.

Derivative instruments classified as Level 1 include futures and certain option contracts which are traded on active exchange markets.

Derivative instruments classified as Level 2 primarily include interest rate, currency and certain credit default swaps. The derivative valuations are determined using pricing models with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Derivative instruments classified as Level 3 include complex derivatives, such as equity options and swaps, interest rate derivatives which have interest rate optionality, certain credit default swaps, and long-dated interest rate swaps. Also included in Level 3 classification for derivatives are customized equity swaps that partially hedge the U.S. GMWB liabilities. These derivative instruments are valued using pricing models which utilize both observable and unobservable inputs and, to a lesser extent, broker quotations. A derivative instrument containing Level 1 or Level 2 inputs will be classified as a Level 3 financial instrument in its entirety if it has as least one significant Level 3 input.

The Company utilizes derivative instruments to manage the risk associated with certain assets and liabilities. However, the derivative instrument may not be classified with the same fair value hierarchy level as the associated assets and liabilities. Therefore the realized and unrealized gains and losses on derivatives reported in Level 3 may not reflect the offsetting impact of the realized and unrealized gains and losses of the associated assets and liabilities.

U.S. GMWB Reinsurance Derivative

The fair value of the U.S. GMWB reinsurance derivative is calculated as an aggregation of the components described in the Living Benefits Required to be Fair Valued discussion below and is modeled using significant unobservable policyholder behavior inputs, identical to those used in calculating the underlying liability, such as lapses, fund selection, resets and withdrawal utilization and risk margins. As a result, the U.S. GMWB reinsurance derivative is categorized as Level 3.

Separate Account Assets

Separate account assets are primarily invested in mutual funds but also have investments in fixed maturity and equity securities. The separate account investments are valued in the same manner, and using the same pricing sources and inputs, as the fixed maturity, equity security, and short-term investments of the Company. Open-ended mutual funds are included in Level 1. Most debt securities and short-term investments are included in Level 2. Level 3 assets include less liquid securities, such as highly structured and/or lower quality ABS and CMBS, ABS backed by sub-prime loans, and any investment priced solely by broker quotes.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

Living Benefits Required to be Fair Valued (in Other Policyholder Funds and Benefits Payable)

Fair values for GMWB and guaranteed minimum accumulation benefit (GMAB) contracts and the related reinsurance and customized derivatives that hedge certain equity markets exposure for GMWB contracts are calculated based upon internally developed models because active, observable markets do not exist for those items. The fair value of the Company s guaranteed benefit liabilities, classified as embedded derivatives, and the related reinsurance and customized freestanding derivatives is calculated as an aggregation of the following components: Best Estimate (formerly known as the Pre-SFAS 157 Fair Value); Actively-Managed Volatility Adjustment; Credit Standing Adjustment; Market Illiquidity Premium; and Behavior Risk Margin. The resulting aggregation is reconciled or calibrated, if necessary, to market information that is, or may be, available to the Company, but may not be observable by other market participants, including reinsurance discussions and transactions. The Company believes the aggregation of each of these components, as necessary and as reconciled or calibrated to the market information available to the Company, results in an amount that the Company would be required to transfer, for a liability, or receive, for an asset, to or from market participants in an active liquid market, if one existed, for those market participants to assume the risks associated with the guaranteed minimum benefits and the related reinsurance and customized derivatives. The SFAS 157 fair value is likely to materially diverge from the ultimate settlement of the liability as the Company believes settlement will be based on our best estimate assumptions rather than those best estimate assumptions plus risk margins. In the absence of any transfer of the guaranteed benefit liability to a third party, the release of risk margins is likely to be reflected as realized gains in future periods net income. Each of the components described below are unobservable in the marketplace and require subjectivity by the Company in determining their value.

Best Estimate. This component represents the estimated amount for which a financial instrument could be exchanged in a current transaction between knowledgeable, unrelated willing parties using identifiable, measurable and significant inputs. Since a reliable estimate of market risk margins is not obtainable, the present value of expected future cash flows under a risk neutral framework, discounted at the risk free rate of interest, is used to estimate this component.

The Best Estimate is calculated based on actuarial and capital market assumptions related to projected cash flows, including benefits and related contract charges, over the lives of the contracts, incorporating expectations concerning policyholder behavior such as lapses, fund selection, resets and withdrawal utilization (for the customized derivatives, policyholder behavior is prescribed in the derivative contract). Because of the dynamic and complex nature of these cash flows, best estimate assumptions and a Monte Carlo stochastic process involving the generation of thousands of scenarios that assume risk neutral returns consistent with swap rates and a blend of observable implied index volatility levels were used. Estimating these cash flows involves numerous estimates and subjective judgments including those regarding expected markets rates of return, market volatility, correlations of market index returns to funds, fund performance, discount rates and policyholder behavior. At each valuation date, the Company assumes expected returns based on:

- risk-free rates as represented by the current LIBOR forward curve rates;
- forward market volatility assumptions for each underlying index based primarily on a blend of observed market implied volatility data;
- correlations of market returns across underlying indices based on actual observed market returns and relationships over the ten years preceding the valuation date;
- three years of history for fund regression; and
- current risk-free spot rates as represented by the current LIBOR spot curve to determine the present value of expected future cash flows produced in the stochastic projection process.

As many guaranteed benefit obligations are relatively new in the marketplace, actual policyholder behavior experience is limited. As a result, estimates of future policyholder behavior are subjective and based on analogous internal and external data. As markets change, mature and evolve and actual policyholder behavior emerges, management continually evaluates the appropriateness of its assumptions for this component of the fair value model.

Actively-Managed Volatility Adjustment. This component incorporates the basis differential between the observable index implied volatilities used to calculate the Best Estimate component and the actively-managed funds underlying the variable annuity product. The Actively-Managed Volatility Adjustment is calculated using historical fund and weighted index volatilities.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

Credit Standing Adjustment. This assumption makes an adjustment that market participants would make to reflect the risk that guaranteed benefit obligations or the GMWB reinsurance recoverables will not be fulfilled (nonperformance risk). As a result of sustained volatility in the Company s credit default spreads, during the first quarter of 2009 the Company changed its estimate of the Credit Standing Adjustment to incorporate observable Company and reinsurer credit default spreads from capital markets, adjusted for market recoverability. Prior to the first quarter of 2009, the Company calculated the Credit Standing Adjustment by using default rates published by rating agencies, adjusted for market recoverability. The changes made in the first quarter of 2009 resulted in a realized gain of $383, before-tax, for U.S. GMWB liabilities and a realized loss of $185, before-tax, for uncollateralized reinsurance recoverable assets.

Market Illiquidity Premium. This component makes an adjustment that market participants would require to reflect that guaranteed benefit obligations are illiquid and have no market observable exit prices in the capital markets.

Behavior Risk Margin and Other Policyholder Behavior Assumptions. The behavior risk margin adds a margin that market participants would require for the risk that the Company s assumptions about policyholder behavior could differ from actual experience. The behavior risk margin is calculated by taking the difference between adverse policyholder behavior assumptions and best estimate assumptions. During the first half of 2009, the Company revised certain adverse assumptions in the behavior risk margin for withdrawals, lapses and annuitization behavior as emerging policyholder behavior experience suggested the prior adverse policyholder behavior assumptions were no longer representative of an appropriate margin for risk. These changes resulted in a realized gain of $352, before-tax, in the first quarter of 2009 and a realized gain of $118, before-tax, in the second quarter of 2009.

Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

The tables below provide a fair value roll forward for the three and six months ending June 30, 2009 and 2008, for the financial instruments for which significant unobservable inputs (Level 3) are used in the fair value measurement on a recurring basis. The Company classifies the fair values of financial instruments within Level 3 if there are no observable markets for the instruments or, in the absence of active markets, the majority of the inputs used to determine fair value are based on the Company s own assumptions about market participant assumptions. However, the Company prioritizes the use of market-based inputs over entity-based assumptions in determining Level 3 fair values in accordance with SFAS 157. Therefore, the gains and losses in the tables below include changes in fair value due partly to observable and unobservable factors.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

These disclosures reflect the impacts of recurring fair value measurements on earnings or changes in net assets and assist in the broad assessment of the quality of those earnings.

Roll-forward of Financial Instruments Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3) for the three months ended June 30, 2009

Asset (Liability)	Fair value as of March 31, 2009	Total Realized/unrealized gains (losses) included in: Net income [1], [2]	Total Realized/unrealized gains (losses) included in: OCI [3]	Purchases, issuances, and settlements	Transfers in and/or (out) of Level 3 [4]	Fair value as of June 30, 2009	Changes in unrealized gains (losses) included in net income related to financial instruments still held at June 30, 2009 [2]
Assets							
Fixed maturities, AFS							
ABS	$ 544	$ (7)	$ 75	$ (29)	$ (81)	$ 502	$ (8)
CDO	2,422	(73)	246	(33)		2,562	(94)
CMBS	188	(35)	47	(4)	2	198	(26)
Corporate	6,597	6	427	(36)	(464)	6,530	(26)
Government/govt. agencies							
Foreign	65		4	(1)		68	
United States	8		(1)		(7)		
RMBS	1,278	(51)	(34)	157	3	1,353	(85)
States, municipalities and political subdivisions	172		1	(13)	54	214	
Fixed maturities, AFS	11,274	(160)	765	41	(493)	11,427	(239)
Equity securities, AFS	510		74	2	(358)	228	
Derivatives [5]							
Variable annuity hedging derivatives	2,552	(1,201)		(216)		1,135	(1,133)
Other freestanding derivatives	(380)	85	(5)	21	(3)	(282)	91
	2,172	(1,116)	(5)	(195)	(3)	853	(1,042)

Total freestanding derivatives							
Reinsurance recoverable for U.S. GMWB [1]	1,058	(433)		7		632	(433)
Separate accounts [6]	639			23	11	673	12
Liabilities							
Other policyholder funds and benefits payable							
Guaranteed living benefits[1]	$ (5,930)	$ 2,628	$ (7)	$ (35)	$	$ (3,344)	$ 2,628
Institutional notes	(25)	27				2	27
Equity linked notes	(5)	(1)				(6)	(1)
Total other policyholder funds and benefits payable	(5,960)	2,654	(7)	(35)		(3,348)	2,654
Consumer notes	(4)					(4)	

[1] The Company classifies gains and losses on GMWB reinsurance derivatives and Guaranteed Living Benefit embedded derivatives as unrealized gains/losses for purposes of disclosure in this table because it is impracticable to track on a contract-by-contract basis the realized gains/losses for these derivatives and embedded derivatives.

[2] All amounts in these columns are reported in net realized capital gains/losses except for $1 for the three months ended June 30, 2009, which

is reported in benefits, losses and loss adjustment expenses. All amounts are before income taxes and amortization of deferred policy acquisition costs and present value of future profits (DAC).

[3] *OCI refers to Other comprehensive income in the condensed consolidated statement of comprehensive income (loss). All amounts are before income taxes and amortization of DAC.*

[4] *Transfers in and/or (out) of Level 3 during the three months ended June 30, 2009 are attributable to a change in the availability of market observable information and re-evaluation of the observability of pricing inputs primarily for certain long-dated corporate bonds and preferred stocks.*

[5] *Derivative are reported in this table on a net basis for asset/(liability) positions and reported in the condensed*

consolidated balance sheet in other investments and other liabilities.

[6] *The realized/unrealized gains (losses) included in net income for separate account assets are offset by an equal amount for separate account liabilities, which results in a net zero impact on net income for the Company.*

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

Roll-forward of Financial Instruments Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3) for the six months ended June 30, 2009

Asset (Liability)	Fair value as of January 1, 2009	Total Realized/unrealized gains (losses) included in: Net income [1], [2]	OCI [3]	Purchases, issuances, and settlements	Transfers in and/or (out) of Level 3 [4]	Fair value as of June 30, 2009	Changes in unrealized gains (losses) included in net income related to financial instruments still held at June 30, 2009 [2]
Assets							
Fixed maturities, AFS							
ABS	$ 536	$ (9)	$ 36	$ 1	$ (62)	$ 502	$ (8)
CDO	2,612	(95)	98	(53)		2,562	(94)
CMBS	341	(48)	28	(8)	(115)	198	(26)
Corporate	6,396	(60)	407	198	(411)	6,530	(26)
Government/govt. agencies							
Foreign	100		(2)	(10)	(20)	68	
United States	8		(1)		(7)		
RMBS	1,662	(169)	(244)	101	3	1,353	(85)
States, municipalities and political subdivisions	155		(6)	(13)	78	214	
Fixed maturities, AFS	11,810	(381)	316	216	(534)	11,427	(239)
Equity securities, AFS	541	(1)	(1)	(2)	(309)	228	
Derivatives [5]							
Variable annuity hedging derivatives	2,774	(1,093)		(546)		1,135	(1,042)
Other freestanding derivatives	(281)	(5)	(10)	20	(6)	(282)	9
Total freestanding derivatives	2,493	(1,098)	(10)	(526)	(6)	853	(1,033)
Reinsurance recoverable for U.S. GMWB [1]	1,302	(685)		15		632	(685)
Separate account assets [6]	786	(122)		110	(101)	673	(73)

Liabilities							
Other policyholder funds and benefits payable[1]							
Guaranteed Living Benefits	$ (6,620)	$ 3,349	$ (3)	$ (70)	$	$ (3,344)	$ 3,349
Institutional notes	(41)	43				2	43
Equity linked notes	(8)	2				(6)	2
Total other policyholder funds and benefits payable[1]	(6,669)	3,394	(3)	(70)		(3,348)	3,394
Other derivative liabilities [7]	(163)	70		93			
Consumer notes	(5)	1				(4)	1

[1] *The Company classifies gains and losses on GMWB reinsurance derivatives and Guaranteed Living Benefit embedded derivatives as unrealized gains/losses for purposes of disclosure in this table because it is impracticable to track on a contract-by-contract basis the realized gains/losses for these derivatives and embedded derivatives.*

[2] *All amounts in these columns are reported in net realized capital gains/losses except for $2 for the six months ended June 30, 2009, which is reported in benefits, losses and loss adjustment expenses. All amounts are before income taxes and amortization of*

DAC.

[3] *OCI refers to Other comprehensive income in the condensed consolidated statement of comprehensive loss. All amounts are before income taxes and amortization of DAC.*

[4] *Transfers in and/or (out) of Level 3 during the six months ended June 30, 2009 are attributable to a change in the availability of market observable information and re-evaluation of the observability of pricing inputs for individual securities within the respective categories.*

[5] *Derivative are reported in this table on a net basis for asset/(liability) positions and reported in the condensed consolidated balance sheet in other investments and other liabilities.*

[6] *The realized/unrealized gains (losses) included in net income for separate account assets are offset by an equal amount for*

separate account liabilities, which results in a net zero impact on net income for the Company.

[7] *On March 26, 2009, certain of the Allianz warrants were reclassified to equity, at their current fair value, as shareholder approval of the conversion of these warrants to common shares was received. See Note 13 for further discussion.*

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

Roll-forward of Financial Instruments Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3) for the three months ended June 30, 2008

Asset (Liability)	Fair value as of March 31, 2008	Total Realized/unrealized gains (losses) included in: Net income [1], [2]	OCI [3]	Purchases, issuances, and settlements	Transfers in and/or (out) of Level 3 [4]	Fair value as of June 30, 2008	Changes in unrealized gains (losses) included in net income related to financial instruments still held at June 30, 2008 [2]
Assets							
Fixed maturities, AFS	$ 16,447	$ (74)	$ (286)	$ 305	$ 120	$ 16,512	$ (75)
Equity securities, AFS	1,285	4	(10)	236	(148)	1,367	(4)
Derivatives [5]							
Variable Annuity Hedging Derivatives	998	(208)		3		793	(195)
Other freestanding derivatives	(334)	(74)	(1)	11	(6)	(404)	(43)
Total freestanding derivatives	664	(282)	(1)	14	(6)	389	(238)
Reinsurance recoverable for U.S. GMWB [1]	291	(46)		5		250	(46)
Separate accounts [6]	580	23		(58)	120	665	18
Liabilities							
Other policyholder funds and benefits payable							
Guaranteed Living Benefits[1]	$ (1,993)	$ 322	$	$ (32)	$	$ (1,703)	$ 322
Institutional notes	(50)	29				(21)	29
Equity linked notes	(15)					(15)	
Total other policyholder funds and	(2,058)	351		(32)		(1,739)	351

benefits payable				
Consumer notes	(4)	1	(3)	1

[1] The Company classifies gains and losses on GMWB reinsurance derivatives and Guaranteed Living Benefit embedded derivatives as unrealized gains/losses for purposes of disclosure in this table because it is impracticable to track on a contract-by-contract basis the realized gains/losses for these derivatives and embedded derivatives.

[2] All amounts in these columns are reported in net realized capital gains/losses except for ($1) for the three months ended June 30, 2008, which is reported in benefits, losses and loss adjustment expenses. All amounts are before income taxes and amortization of DAC.

[3] OCI refers to Other comprehensive income in the consolidated statement of comprehensive loss. All amounts are before income taxes and amortization of DAC.

[4] *Transfers in and/or (out) of Level 3 during the three months ended June 30, 2008 are attributable to a change in the availability of market observable information and re-evaluation of the observability of pricing inputs for individual securities within the respective categories.*

[5] *Derivative instruments, are reported in this table on a net basis for asset/(liability) positions and reported in the condensed consolidated balance sheet in other investments and other liabilities.*

[6] *The realized/unrealized gains (losses) included in net income for separate account assets are offset by an equal amount for separate account liabilities, which results in a net zero impact on net income for the Company.*

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
4. Fair Value Measurements (continued)
Roll-forward of Financial Instruments Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3) for the six months ended June 30, 2008

Asset (Liability)	Fair value as of January 1, 2008	Total Realized/unrealized gains (losses) included in: Net income [1], [2]	OCI [3]	Purchases, issuances, and settlements	Transfers in and/or (out) of Level 3 [4]	Fair value as of June 30, 2008	Changes in unrealized gains (losses) included in net income related to financial instruments still held at June 30, 2008 [2]
Assets							
Fixed maturities, AFS	$ 17,996	$ (177)	$ (1,396)	$ 1,278	$ (1,189)	$ 16,512	$ (75)
Equity securities, AFS	1,339	(1)	(129)	327	(169)	1,367	(4)
Derivatives [5]							
Variable Annuity Hedging Derivatives	673	63		57		793	64
Other freestanding derivatives	(419)	(266)	2	178	101	(404)	(160)
Total freestanding derivatives	254	(203)	2	235	101	389	(96)
Reinsurance recoverable for U.S. GMWB [1] [6]	238	2		10		250	2
Separate accounts [7]	701	(56)		20		665	(54)
Liabilities							
Other policyholder funds and benefits payable							
Guaranteed Living Benefits[1]	$ (1,472)	$ (175)	$	$ (56)	$	$ (1,703)	$ (175)
Institutional notes	(24)	3				(21)	3
Equity linked notes	(21)	6				(15)	6
Total other policyholder funds and	(1,517)	(166)		(56)		(1,739)	(166)

benefits payable				
Consumer notes	(5)	2	(3)	2

[1] The Company classifies the gains and losses on GMWB reinsurance derivatives and Guaranteed Living Benefit embedded derivatives as unrealized gains/losses for purposes of disclosure in this table because it is impracticable to track on a contract-by-contract basis the realized gains/losses for these derivatives and embedded derivatives.

[2] All amounts in these columns are reported in net realized capital gains/losses except for $1 for the six months ended June 30, 2008, which is reported in benefits, losses and loss adjustment expenses. All amounts are before income taxes and amortization of DAC.

[3] OCI refers to Other comprehensive income in the consolidated statement of comprehensive loss. All amounts are before income taxes and amortization of DAC.

[4] *Transfers in and/or (out) of Level 3 during the six months ended June 30, 2008 are attributable to a change in the availability of market observable information and re-evaluation of the observability of pricing inputs for individual securities within the respective categories.*

[5] *Derivative instruments, are reported in this table on a net basis for asset/(liability) positions and reported in the condensed consolidated balance sheet in other investments and other liabilities.*

[6] *The January 1, 2008 fair value of $238 includes the pre-SFAS 157 fair value of $128 and transitional adjustment of $110.*

[7] *The realized/unrealized gains (losses) included in net income for separate account assets are offset by an equal amount for separate account liabilities, which results in a net zero impact on net income*

for the Company.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Fair Value Measurements (continued)

Financial Instruments Not Carried at Fair Value

The following include disclosures for other financial instruments not carried at fair value and not included in above SFAS 157 discussion.

The carrying amounts and fair values of The Hartford s financial instruments not carried at fair value, as of June 30, 2009 and December 31, 2008 were as follows:

	June 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Policy loans	$ 2,204	$ 2,409	$ 2,208	$ 2,435
Mortgage loans on real estate	6,522	5,231	6,469	5,654
Liabilities				
Other policyholder funds and benefits payable [1]	$ 14,466	$ 14,437	$ 14,839	$ 14,576
Commercial paper [2]			374	374
Long-term debt [3]	5,765	5,088	5,755	4,539
Consumer notes [4]	1,195	1,235	1,205	1,188

[1] Excludes guarantees on variable annuities, group accident and health and universal life insurance contracts, including corporate owned life insurance.

[2] Included in short-term debt in the consolidated balance sheets. As of June 30, 2009, The Hartford has no commercial paper outstanding.

[3] *Excludes capital lease obligations of $67 and $68 as of June 30, 2009 and December 31, 2008, respectively, and includes current maturities of long-term debt of $275 and $0 as of June 30, 2009 and December 31, 2008, respectively.*

[4] *Excludes amounts carried at fair value and included in SFAS 157 disclosures above.*

Included in other liabilities in the condensed consolidated balance sheet are carrying amounts of $389 and $149 for deposits and Federal Home Bank advances, respectively, related to Federal Trust Corporation. These carrying amounts approximate fair value.

The Company has not made any changes in its valuation methodologies for the following assets and liabilities since December 31, 2008.

- Fair value for policy loans and consumer notes were estimated using discounted cash flow calculations using current interest rates.
- Fair values for mortgage loans on real estate were estimated using discounted cash flow calculations based on current lending rates for similar type loans. Current lending rates reflect changes in credit spreads and the remaining terms of the loans.
- Other policyholder funds and benefits payable, not carried at fair value and not included in above SFAS 157 fair value information, is determined by estimating future cash flows, discounted at the current market rate.
- Carrying amounts approximate fair value for commercial paper. As of June 30, 2009, the Company has no outstanding commercial paper.
- Fair value for long-term debt is based primarily on market quotations from independent third party pricing services.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments

Available-for-Sale Securities

The following table presents the Company s AFS securities by type on a consolidated basis.

	June 30, 2009					December 31, 2008			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Non-Credit OTTI [1]	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
AFS securities									
ABS	$ 3,272	$ 13	$ (835)	$ 2,450	$ (66)	$ 3,431	$ 6	$ (971)	$ 2,466
CDOs	4,547	3	(1,987)	2,563	(141)	4,655	2	(2,045)	2,612
CMBS	12,361	51	(4,122)	8,290	(119)	12,973	43	(4,703)	8,313
Corporate	33,454	707	(3,326)	30,835	(28)	31,059	623	(4,501)	27,181
Govt./govt. agencies									
Foreign	1,014	41	(24)	1,031		2,786	100	(65)	2,821
United States	4,471	23	(254)	4,240		5,883	112	(39)	5,956
RMBS	5,738	92	(1,324)	4,506	(154)	6,045	96	(1,033)	5,108
States, municipalities and political subdivisions	11,339	210	(596)	10,953	(3)	11,406	202	(953)	10,655
Fixed maturities	**76,196**	**1,140**	**(12,468)**	**64,868**	**(511)**	**78,238**	**1,184**	**(14,310)**	**65,112**
Equity securities	1,518	233	(443)	1,308		1,554	203	(299)	1,458
Total AFS securities	**$ 77,714**	**$ 1,373**	**$ (12,911)**	**$ 66,176**	**$ (511)**	**$ 79,792**	**$ 1,387**	**$ (14,609)**	**$ 66,570**

[1] Represents the amount of cumulative non-credit other-than-temporary impairment (OTTI) losses transferred to other comprehensive loss in accordance with FSP FAS 115-2 for securities that also had a credit impairment, of which $248 was added for the three months ended June 30, 2009. These losses are

included in gross unrealized losses as of June 30, 2009.

The Company participates in securities lending programs to generate additional income. Through these programs, certain domestic fixed income securities are loaned from the Company s portfolio to qualifying third party borrowers in return for collateral in the form of cash or U.S. government securities. As of June 30, 2009 and December 31, 2008, under terms of securities lending programs, the fair value of loaned securities was approximately $695 and $2.9 billion, respectively, which was included in fixed maturities in the Condensed Consolidated Balance Sheet. As of June 30, 2009 and December 31, 2008, the Company held collateral associated with the loaned securities in the amount of $707 and $3.0 billion, respectively.

The following table presents the Company s fixed maturities by contractual maturity year.

	June 30, 2009	
Maturity	**Amortized Cost**	**Fair Value**
One year or less	$ 1,992	$ 2,041
Over one year through five years	12,061	11,980
Over five years through ten years	13,975	12,997
Over ten years	36,320	28,694
Subtotal	64,348	55,712
ABS, CDOs and RMBS [1]	11,848	9,156
Total	**$ 76,196**	**$ 64,868**

[1] *Excludes CRE CDOs.*

Estimated maturities may differ from contractual maturities due to security call or prepayment provisions. Due to the potential for prepayment on certain mortgage- and asset-backed securities, ABS, CDOs and RMBS are not categorized by contractual maturity. CMBS and CRE CDOs are categorized by contractual maturity because they generally are not subject to prepayment risk as these securities are generally structured to include forms of call protections such as yield maintenance charges, prepayment penalties or lockouts and defeasance.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments (continued)

Net Realized Capital Gains (Losses)

The following table presents the Company s net realized capital gains and losses.

	Three Months Ended June 30,				Six Months Ended June 30,			
(Before-tax)		**2009**		**2008**		**2009**		**2008**
Gross gains on sale	$	157	$	73	$	365	$	168
Gross losses on sale		(189)		(59)		(909)		(270)
Net other-than-temporary impairment losses recognized in earnings		(314)		(164)		(538)		(468)
Japanese fixed annuity contract hedges, net [1]		(6)		(9)		35		(23)
Periodic net coupon settlements on credit derivatives/Japan		(13)		(10)		(32)		(15)
SFAS 157 transition impact								(650)
Results of variable annuity hedge program								
GMWB derivatives, net [2]		671		(13)		1,260		(123)
Macro hedge program		(568)		(4)		(364)		5
Total results of variable annuity hedge program		103		(17)		896		(118)
Other, net [3]		(419)		(96)		(414)		(277)
Net realized capital gains (losses)	**$**	**(681)**	**$**	**(282)**	**$**	**(597)**	**$**	**(1,653)**

[1] Relates to the Japanese fixed annuity product (product and related derivative hedging instruments excluding periodic net coupon settlements).

[2] The net gain on GMWB derivatives for the three and six months ended June 30, 2009 was primarily due to a decline in equity

volatility levels, an increase in interest rates and liability model assumption updates for withdrawals, lapses, and credit standing.

[3] *Primarily consists of changes in fair value on non-qualifying derivatives, hedge ineffectiveness on qualifying derivative instruments, foreign currency gains and losses, valuation allowances, a loss of approximately $300 related to a contingent obligation associated with the Allianz transaction, and other investment gains and losses.*

Net realized capital gains and losses from investment sales, after deducting the life and pension policyholders share for certain products, are reported as a component of revenues and are determined on a specific identification basis. Net realized capital losses reported for the three and six months ended June 30, 2009 related to AFS other-than-temporary impairments and net losses on sales were $346 and $1.1 billion, respectively, and were previously reported as unrealized losses in AOCI. Proceeds from sales of AFS securities totaled $8.4 billion and $28.1 billion, respectively, for the three and six months ended June 30, 2009, and $3.6 billion and $8.7 billion, respectively, for the three and six months ended June 30, 2008.

Other-Than-Temporary Impairment Losses

The following table presents the Company s credit other-than-temporary impairments (credit impairments) on debt securities held as of June 30, 2009.

	Credit OTTI
Balance as of March 31, 2009	$ (1,320)
Additions for credit impairments recognized on [1]:	

Securities not previously impaired		(212)
Securities previously impaired		(49)
Reductions for credit impairments previously recognized on:		
Securities that matured or were sold during the period		
Securities that the Company intends to sell or more likely than not will be required to sell before recovery		3
Securities due to an increase in expected cash flows		
Balance as of June 30, 2009	**$**	**(1,578)**

[1] Total additions of $261 are included in the net other-than-temporary impairment losses recognized in earnings of $314 in the Condensed Consolidated Statements of Operations. Also included in the $314 are impairments of $8 representing securities the Company intends to sell and $45 representing equity securities.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Investments and Derivative Instruments (continued)
Security Unrealized Loss Aging

The following tables present the Company s unrealized loss aging for AFS securities by type and length of time the security was in a continuous unrealized loss position.

	June 30, 2009								
	Less Than 12 Months			12 Months or More			Total		
	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses
AFS securities									
ABS	$ 440	$ 328	$ (112)	$ 2,372	$ 1,649	$ (723)	$ 2,812	$ 1,977	$ (835)
CDOs	2,022	1,506	(516)	2,516	1,045	(1,471)	4,538	2,551	(1,987)
CMBS	3,394	2,430	(964)	8,014	4,856	(3,158)	11,408	7,286	(4,122)
Corporate	7,859	6,621	(1,238)	11,712	9,624	(2,088)	19,571	16,245	(3,326)
Government/government agencies									
Foreign	150	136	(14)	117	107	(10)	267	243	(24)
United States	3,034	2,780	(254)				3,034	2,780	(254)
RMBS	841	707	(134)	2,410	1,220	(1,190)	3,251	1,927	(1,324)
States, municipalities and political subdivisions	1,797	1,708	(89)	5,020	4,513	(507)	6,817	6,221	(596)
Fixed maturities	19,537	16,216	(3,321)	32,161	23,014	(9,147)	51,698	39,230	(12,468)
Equity securities	892	577	(315)	364	236	(128)	1,256	813	(443)
Total securities in an unrealized loss	**$ 20,429**	**$ 16,793**	**$ (3,636)**	**$ 32,525**	**$ 23,250**	**$ (9,275)**	**$ 52,954**	**$ 40,043**	**$ (12,911)**

	December 31, 2008								
	Less Than 12 Months			12 Months or More			Total		
	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses	Amortized Cost	Fair Value	Unrealized Losses
AFS securities									
ABS	$ 1,190	$ 958	$ (232)	$ 2,092	$ 1,353	$ (739)	$ 3,282	$ 2,311	$ (971)
CDOs	688	440	(248)	3,941	2,144	(1,797)	4,629	2,584	(2,045)
CMBS	5,704	4,250	(1,454)	6,647	3,398	(3,249)	12,351	7,648	(4,703)
Corporate	16,604	14,145	(2,459)	7,028	4,986	(2,042)	23,632	19,131	(4,501)
Government/government agencies									
Foreign	1,263	1,211	(52)	43	30	(13)	1,306	1,241	(65)
United States	4,120	4,083	(37)	66	64	(2)	4,186	4,147	(39)
RMBS	731	546	(185)	2,607	1,759	(848)	3,338	2,305	(1,033)
States, municipalities and political subdivisions	5,153	4,640	(513)	2,578	2,138	(440)	7,731	6,778	(953)

Fixed maturities	35,453	30,273	(5,180)	25,002	15,872	(9,130)	60,455	46,145	(14,310)
Equity securities	1,017	796	(221)	277	199	(78)	1,294	995	(299)
Total securities in an unrealized loss	**$ 36,470**	**$ 31,069**	**$ (5,401)**	**$ 25,279**	**$ 16,071**	**$ (9,208)**	**$ 61,749**	**$ 47,140**	**$ (14,609)**

As of June 30, 2009, AFS securities in an unrealized loss position, comprised of approximately 5,446 securities, primarily related to CMBS, corporate securities, most significantly within the financial services sector, CDOs and RMBS which have experienced significant price deterioration. The Company does not intend to sell nor does it expect to be required to sell the securities outlined above. In addition, the Company asserts its intent and ability to retain the above equity securities until price recovery. Furthermore, based upon the Company s cash flow modeling and the expected continuation of contractually required principal and interest payments, the Company has deemed these securities to be temporarily impaired as of June 30, 2009.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments (continued)

Mortgage Loans

The following table presents the Company s mortgage loans on real estate by type on a consolidated basis.

	June 30, 2009			December 31, 2008		
	Amortized Cost [1]	Valuation Allowance	Carrying Value	Amortized Cost [1]	Valuation Allowance	Carrying Value
Agricultural	$ 629	$	$ 629	$ 646	$ 11	$ 635
Commercial	5,832	163	5,669	5,849	15	5,834
Residential [2]	224		224			
Total	**$ 6,685**	**$ 163**	**$ 6,522**	**$ 6,495**	**$ 26**	**$ 6,469**

[1] Amortized cost represents carrying value prior to valuation allowances, if any.

[2] Relates to residential mortgage loans acquired through the purchase of Federal Trust Corporation. For further information on the acquisition, see Note 16 of the Notes to the Condensed Consolidated Financial Statements.

The Company has a monitoring process that is overseen by a committee of investment and accounting professionals that identifies mortgage loans for impairment. For those mortgage loans that, based upon current information and events, it is probable that the Company will not be able to collect all amounts due according to the contractual terms of the loan agreement, an impairment is recognized and a valuation allowance is established with an offsetting charge to net realized capital losses.

The following table presents the activity within the Company s valuation allowance for mortgage loans for the six months ended June 30, 2009.

		Valuation Allowance
Balance at December 31, 2008	$	26
Additions		153
Deductions		(16)
Balance at June 30, 2009	**$**	**163**

The following tables present the Company s commercial mortgage loans, including agricultural loans, by region and property type on a consolidated basis.

Commercial Mortgage Loans on Real Estate by Region

	June 30, 2009			December 31, 2008		
		Carrying Value	Percent of Total		Carrying Value	Percent of Total
East North Central	$	158	2.5%	$	162	2.5%
East South Central						
Middle Atlantic		764	12.1%		717	11.1%
Mountain		187	3.0%		223	3.4%
New England		469	7.4%		487	7.5%
Pacific		1,516	24.1%		1,495	23.1%
South Atlantic		1,162	18.4%		1,102	17.0%
West North Central		63	1.0%		64	1.0%
West South Central		332	5.3%		333	5.2%
Other [1]		1,647	26.2%		1,886	29.2%
Total	**$**	**6,298**	**100.0%**	**$**	**6,469**	**100.0%**

[1] Includes multi-regional properties.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments (continued)

Commercial Mortgage Loans on Real Estate by Property Type

	June 30, 2009		December 31, 2008	
	Carrying Value	Percent of Total	Carrying Value	Percent of Total
Agricultural	$ 629	10.0%	$ 635	9.8%
Industrial	1,109	17.6%	1,118	17.3%
Lodging	480	7.6%	483	7.5%
Multifamily	996	15.8%	1,131	17.5%
Office	1,872	29.7%	1,885	29.1%
Retail	824	13.1%	884	13.7%
Other	388	6.2%	333	5.1%
Total	**$ 6,298**	**100.0%**	**$ 6,469**	**100.0%**

Variable Interest Entities

The Company is involved with VIEs primarily as a collateral manager and as an investor through normal investment activities. The Company s involvement includes providing investment management and administrative services for a fee and holding ownership or other interests as an investor. The Company also has involvement with VIEs as a means of accessing capital.

The following table presents the carrying value of assets and liabilities and the maximum exposure to loss relating to VIEs for which the Company has concluded that it is the primary beneficiary and therefore are consolidated in the Company s consolidated financial statements.

	June 30, 2009			December 31, 2008		
	Total Assets	Total Liabilities [1]	Maximum Exposure to Loss [2]	Total Assets	Total Liabilities [1]	Maximum Exposure to Loss
CLOs	$ 251	$ 37	$ 230	$ 339	$ 69	$ 257
Limited partnerships	35	2	33	151	43	108
Other investments	163	19	147	249	59	221
Total	**$ 449**	**$ 58**	**$ 410**	**$ 739**	**$ 171**	**$ 586**

[1] Creditors have no recourse against the Company in the event of default by the VIE. Includes noncontrolling interest in limited

partnerships and other investments of $12 and $82 as of June 30, 2009 and December 31, 2008, respectively, that is reported as a separate component of equity in the Company s Condensed Consolidated Balance Sheet pursuant to SFAS 160.

[2] *The Company s maximum exposure to loss represents the maximum loss amount that the Company could recognize as a reduction in net investment income or as a realized capital loss and is the consolidated assets at cost net of liabilities. The Company has no implied or unfunded commitments to these VIEs.*

During the six months ended June 30, 2009, the Company liquidated or partially liquidated two investments for which the Company had been the primary beneficiary. As a result of the liquidations, the Company is no longer deemed to be the primary beneficiary and accordingly, these VIEs were deconsolidated.

The following table presents the carrying value of assets and liabilities and the maximum exposure to loss relating to VIEs for which the Company has a significant involvement with but has concluded that it is not the primary beneficiary and therefore are not consolidated. Each of these investments has been held by the Company for over two years.

	June 30, 2009		December 31, 2008	
		Maximum		**Maximum**

	Assets	Liabilities	Exposure to Loss	Assets	Liabilities	Exposure to Loss
CLOs [1]	$ 279	$	$ 311	$ 308	$	$ 349
CDOs [1]	2		31	3		15
Other [2]	38	38	5	42	40	5
Total [3]	**$ 319**	**$ 38**	**$ 347**	**$ 353**	**$ 40**	**$ 369**

[1] Maximum exposure to loss represents the Company s investment in securities issued by CLOs/CDOs at cost.

[2] Maximum exposure to loss represents issuance costs that were incurred to establish the contingent capital facility. For further information on the contingent capital facility, see the Variable Interest Entities section of Note 5 in The Hartford s 2008 Form 10-K Annual Report.

[3] The Company has no implied or unfunded commitments to these VIEs.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments (continued)

Derivative instruments

The Company utilizes a variety of over-the-counter and exchange traded derivative instruments, including swaps, caps, floors, forwards, futures and options, through one of four Company-approved objectives: to manage risk associated with interest rate, equity market, credit spread and issuer default, price, or currency exchange rate risk or volatility; to manage liquidity; to control transaction costs; or to enter into replication transactions. The Company also purchases and issues financial instruments and products that either are accounted for as free-standing derivatives, such as certain reinsurance contracts, or may contain features that are deemed to be embedded derivative instruments, such as the GMWB rider included with certain variable annuity products.

Derivative instruments are recorded in the Condensed Consolidated Balance Sheets at fair value. Pursuant to FIN No. 39, Offsetting of Amounts Related to Certain Contracts and FIN No. 39-1 Amendment of FASB Interpretation No. 39 , the Company offsets the fair value amounts, income accruals, and cash collateral held, related to derivative instruments executed in a legal entity and with the same counterparty under a master netting agreement. The following table summarizes the fair value of derivative instruments, excluding income accruals and cash collateral held, as they are presented in the Condensed Consolidated Balance Sheets:

	Net Derivatives		Asset Derivatives		Liability Derivatives	
	Jun. 30, 2009	Dec. 31, 2008	Jun. 30, 2009	Dec. 31, 2008	Jun. 30, 2009	Dec. 31, 2008
Fixed maturities, available-for-sale	$ (9)	$ (3)	$	$	$ (9)	$ (3)
Other investments	946	1,576	1,248	2,172	(302)	(596)
Reinsurance recoverables	632	1,302	632	1,302		
Other policyholder funds and benefits payable	(3,350)	(6,628)	2		(3,352)	(6,628)
Consumer notes	(4)	(5)			(4)	(5)
Other liabilities [1]	(188)	1,862	1,490	3,460	(1,678)	(1,598)
Total	**$ (1,973)**	**$ (1,896)**	**$ 3,372**	**$ 6,934**	**$ (5,345)**	**$ (8,830)**

[1] Included in Other liabilities in the Condensed Consolidated Balance Sheet is a liability value of $(660) and $(2,531) related to derivative collateral as of June 30, 2009 and December 31, 2008, respectively.

The Company will designate each derivative instrument in accordance with SFAS 133 as either a cash flow hedging instrument (cash flow hedge), a fair value hedging instrument (fair value hedge), or not qualified as a hedging instrument (non-qualifying strategies). See the related sections that follow for descriptions of the accounting treatment for each type of designation.

The purpose of the table presented below is to summarize the balance sheet classification of the Company s derivative fair value amounts, categorized by the accounting designation, type of derivative instrument, and risk that they are hedging as is noted in the strategy descriptions. This table presents on a strategy level basis the balance sheet location of net fair value amounts of derivative instruments, as well as the gross asset and liability amounts. Derivatives in the Company s separate accounts are not included because the associated gains and losses accrue directly to policyholders. The Company s derivative instruments are held for risk management purposes, unless otherwise noted in the tables below. The notional amount of derivative contracts represents the basis upon which pay or receive amounts are calculated and is presented in the table to quantify the volume of the Company s derivative activity. Notional amounts are not necessarily reflective of credit risk. Below the table, the primary changes of notional amount and fair value are discussed in detail. The most significant change in notional amount since December 31, 2008, is related to derivatives associated with the macro hedge program, which reflects the Company s increased focus on the protection of statutory surplus. The most significant contributors to the decrease in fair value are interest rate derivatives due to an increase in interest rates, Japan fixed annuity and 3Win hedging instruments due to strengthening of the U.S. dollar against the Japanese Yen, and credit derivatives that economically hedge fixed maturity securities due to credit spreads tightening. These declines were partially offset by an increase in fair value of GMWB derivatives primarily due to market-based valuation changes as well as policyholder behavior and liability model assumption updates.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Investments and Derivative Instruments (continued)

		Notional Amount		Net Derivatives Fair Value		Asset Derivatives Fair Value		Liability Derivatives Fair Value	
Accounting Designation/Type/Hedging Strategy		**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**
Cash flow hedges									
Interest rate swaps									
Interest rate swaps are primarily used to convert interest receipts on floating-rate fixed maturity securities or interest payments on floating-rate guaranteed investment contracts to fixed rates. These derivatives are predominantly used to better match cash receipts from assets with cash disbursements required to fund liabilities. The Company also enters into forward starting swap agreements to hedge the interest rate exposure related to the purchase of fixed-rate securities or the anticipated future cash flows of floating-rate fixed maturity securities due to changes in the benchmark interest rate, London-Interbank Offered Rate (LIBOR). These derivatives are primarily structured to hedge interest rate risk inherent in the assumptions used to price certain liabilities.									
Balance sheet location	Other investments	$ 2,658	$ 4,760	$ 141	$ 429	$ 157	$ 429	$ (16)	$
Balance sheet location	Other liabilities	7,442	4,270	(7)	211	148	214	(155)	(3)
Total interest rate swaps		10,100	9,030	134	640	305	643	(171)	(3)
Foreign currency swaps									
Foreign currency swaps are used to convert foreign denominated cash flows related to certain investment receipts and liabilities payments to U.S. dollars in order to minimize cash flow fluctuations due to changes in currency rates.									
Balance sheet location	Other investments	373	570	6	50	39	99	(33)	(49)
Balance sheet location	Other liabilities	494	640	(39)	(57)	21	55	(60)	(112)
Total foreign currency swaps		867	1,210	(33)	(7)	60	154	(93)	(161)
Total cash flow hedges		**10,967**	**10,240**	**101**	**633**	**365**	**797**	**(264)**	**(164)**
Fair value hedges									

Interest rate swaps									
Interest rate swaps are used to hedge the changes in fair value of certain fixed rate liabilities and fixed maturity securities due to changes in the benchmark interest rate, LIBOR.									
Balance sheet location	Other investments	117	1,043	(5)	(45)	1	16	(6)	(61)
Balance sheet location	Other liabilities	1,669	1,095	(42)	(41)	13	25	(55)	(66)
Total interest rate swaps		1,786	2,138	(47)	(86)	14	41	(61)	(127)
Foreign currency swaps									
Foreign currency swaps are used to hedge the changes in fair value of certain foreign denominated fixed rate liabilities due to changes in foreign currency rates.									
Balance sheet location	Other investments	164	164	32	36	32	36		
Balance sheet location	Other liabilities	532	532	(42)	(93)	10	11	(52)	(104)
Total foreign currency swaps		696	696	(10)	(57)	42	47	(52)	(104)
Total fair value hedges		**2,482**	**2,834**	**(57)**	**(143)**	**56**	**88**	**(113)**	**(231)**
Total cash flow hedges and fair value hedges		**$ 13,449**	**$ 13,074**	**$ 44**	**$ 490**	**$ 421**	**$ 885**	**$ (377)**	**$ (395)**

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Investments and Derivative Instruments (continued)

Accounting Designation/Type/Hedging Strategy		Net Derivatives Notional Amount Jun. 30, 2009	Net Derivatives Notional Amount Dec. 31, 2008	Net Derivatives Fair Value Jun. 30, 2009	Net Derivatives Fair Value Dec. 31, 2008	Asset Derivatives Fair Value Jun. 30, 2009	Asset Derivatives Fair Value Dec. 31, 2008	Liability Derivatives Fair Value Jun. 30, 2009	Liability Derivatives Fair Value Dec. 31, 2008
Non-qualifying strategies									
Interest rate swaps, caps, floors, and futures									
The Company uses interest rate swaps, caps, floors, and futures to manage duration risk between assets and liabilities in certain portfolios. In addition, the Company enters into interest rate swaps to terminate existing swaps, thereby offsetting the changes in value of the original swap. As of June 30, 2009 and December 31, 2008, the notional amount of interest rate swaps in offsetting relationships was $7.0 billion and $6.8 billion, respectively.									
Balance sheet location	Other investments	$ 2,315	$ 3,139	$ 21	$ 112	$ 116	$ 329	$ (95)	$ (217)
Balance sheet location	Other liabilities	5,970	5,017	(108)	(209)	233	602	(341)	(811)
Total interest rate swaps, caps, floors, and forwards		8,285	8,156	(87)	(97)	349	931	(436)	(1,028)
Foreign currency swaps and forwards									
The Company enters into foreign currency swaps and forwards to hedge the foreign currency exposures in certain of its foreign denominated fixed maturity investments.									
Balance sheet location	Fixed maturities, available-for-sale	185	185						
Balance sheet location	Other investments	510	256		11	4	13	(4)	(2)
Balance sheet location	Other liabilities	986	672	(6)	10	5	19	(11)	(9)
Total foreign currency swaps and forwards		1,681	1,113	(6)	21	9	32	(15)	(11)
Credit derivatives that purchase credit protection									
Credit default swaps are used to purchase credit protection on an individual entity or referenced index to economically hedge against default risk and credit-related changes in value on fixed maturity securities. These contracts require the Company to pay a periodic fee in exchange for compensation from the counterparty should a credit event occur, as defined in the contract, on the part of the referenced security issuers.									
Balance sheet location	Other investments	1,469	2,528	21	248	44	267	(23)	(19)

Balance sheet location	Other liabilities	2,801	1,140	(12)	92	71	94	(83)	(2)
Total credit derivatives that purchase credit protection		4,270	3,668	9	340	115	361	(106)	(21)
Credit derivatives that assume credit risk [1]									
Credit default swaps are used to assume credit risk related to an individual entity, referenced index, or asset pool, as a part of replication transactions. Replication transactions are used as an economical means to synthetically replicate the characteristics and performance of assets that would otherwise be permissible investments under the Company s investment policies. These contracts entitle the Company to receive a periodic fee in exchange for an obligation to compensate the derivative counterparty should a credit event occur, as defined in the contract, on the part of the referenced security issuers. The Company is also exposed to credit risk due to embedded derivatives associated with credit linked notes.									
Balance sheet location	Fixed maturities, available-for-sale	87	117	(9)	(3)			(9)	(3)
Balance sheet location	Other investments	230	625	(45)	(155)			(45)	(155)
Balance sheet location	Other liabilities	845	457	(271)	(245)			(271)	(245)
Total credit derivatives that assume credit risk		1,162	1,199	(325)	(403)			(325)	(403)

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Investments and Derivative Instruments (continued)

		Net Derivatives				Asset Derivatives		Liability Derivatives	
		Notional Amount		Fair Value		Fair Value		Fair Value	
Accounting Designation/Type/Hedging Strategy		**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**
Credit derivatives in offsetting positions									
The Company enters into credit default swaps to terminate existing credit default swaps, thereby offsetting the changes in value of the original swap going forward.									
Balance sheet location	Other investments	$ 1,859	$ 1,663	$ 41	$ 47	$ 109	$ 111	$ (68)	$ (64)
Balance sheet location	Other liabilities	1,899	963	(65)	(58)	145	14	(210)	(72)
Total credit derivatives in offsetting positions		3,758	2,626	(24)	(11)	254	125	(278)	(136)
Contingent Capital Facility Put Option									
The Company entered into a put option agreement that provides the Company the right to require a third party trust to purchase, at any time, The Hartford s junior subordinated notes in a maximum aggregate principal amount of $500. Under the put option agreement, The Hartford will pay premiums on a periodic basis and will reimburse the trust for certain fees and ordinary expenses.									
Balance sheet location	Other investments	500	500	38	42	38	42		
Total contingent capital facility		500	500	38	42	38	42		
Japanese fixed annuity hedging instruments									
The Company enters into currency rate swaps and forwards to mitigate the foreign currency exchange rate and Yen interest rate exposures associated with the Yen denominated individual fixed annuity product.									
Balance sheet location	Other investments	718	922	91	165	91	165		
Balance sheet location	Other liabilities	1,547	1,412	138	218	140	218	(2)	
Total Japanese fixed annuity hedging instruments		2,265	2,334	229	383	231	383	(2)	
Guaranteed Minimum Accumulation Benefit (GMAB) product derivatives [1]									
The GMAB rider associated with certain of the Company s Japanese variable annuity products is accounted for as a bifurcated embedded derivative. The GMAB provides the policyholder with their initial deposit in a lump sum after a specified									

waiting period. The notional amount of the embedded derivative is the Yen denominated GRB balance converted to U.S. dollars at the current foreign spot exchange rate as of the reporting period date.

Balance sheet location	Other policyholder funds and benefits payable	222	206	2	2	
Total GMAB product derivatives		222	206	2	2	

Japan 3Win hedging derivatives

During the first quarter of 2009, the Company traded foreign currency swaps to hedge the foreign currency risk exposure related to Japan 3Win product GMIB fixed liability payments. The Japan 3Win product offered both GMAB and GMIB riders attached to certain variable annuity contracts. If the policyholder account value drops below 80% of the initial deposit, either a GMIB must be exercised or the policyholder can elect a lump sum payment. During the fourth quarter of 2008, nearly all contract holder account values had dropped below 80% of the initial deposit, at which point the majority of policyholders had elected to exercise the GMIB.

Balance sheet location	Other investments	526		(5)	4	(9)
Balance sheet location	Other liabilities	2,214		(107)		(107)
Total Japanese fixed annuity hedging instruments		2,740		(112)	4	(116)

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Investments and Derivative Instruments (continued)

	Notional Amount		Net Derivatives Fair Value		Asset Derivatives Fair Value		Liability Derivatives Fair Value	
Accounting Designation/Type/Hedging Strategy	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**
GMWB product derivatives [1]								
The Company offers certain variable annuity products with a GMWB rider, primarily in the U.S. and, to a lesser extent, the U.K. and Japan. The GMWB is a bifurcated embedded derivative that provides the policyholder with a GRB if the account value is reduced to zero through a combination of market declines and withdrawals. The GRB is generally equal to premiums less withdrawals. Certain contract provisions can increase the GRB at contractholder election or after the passage of time. The notional value of the embedded derivative is the GRB balance.								
Balance sheet location Other policyholder funds and benefits payable	$ 48,466	$ 48,767	$ (3,346)	$ (6,620)	$	$	$ (3,346)	$ (6,620)
Total GMWB product derivatives	48,466	48,767	(3,346)	(6,620)			(3,346)	(6,620)
GMWB reinsurance contracts								
The Company has entered into reinsurance arrangements to offset a portion of its risk exposure to the GMWB for the remaining lives of covered variable annuity contracts. Reinsurance contracts covering GMWB are accounted for as free-standing derivatives. The notional amount of the reinsurance contracts is the GRB amount.								
Balance sheet location Reinsurance recoverables	10,843	11,437	632	1,302	632	1,302		
Total GMWB reinsurance contracts	10,843	11,437	632	1,302	632	1,302		
GMWB hedging instruments								
The Company enters into derivative contracts to partially hedge exposure to the income volatility associated with the portion of the GMWB liabilities which are not reinsured. These derivative contracts include customized swaps, interest rate swaps and futures, and equity swaps, put and call options, and futures, on certain indices including the S&P 500 index, EAFE index, and NASDAQ index.								
Balance sheet location Other investments	6,157	2,265	514	599	514	627		(28)

Balance sheet location	Other liabilities	9,920	16,355	341	2,065	565	2,070	(224)	(5)
Total GMWB hedging instruments		16,077	18,620	855	2,664	1,079	2,697	(224)	(33)
Equity index swaps, options, and futures									
The Company offers certain equity indexed products, which may contain an embedded derivative that requires bifurcation. The Company enters into S&P index swaps and options to economically hedge the equity volatility risk associated with these embedded derivatives. In addition, the Company is exposed to bifurcated options embedded in certain fixed maturity investments. The Company may also enter into equity indexed futures to hedge the equity volatility of certain liability contracts.									
Balance sheet location	Fixed maturities, available-for-sale		2						
Balance sheet location	Other investments	21	25	1	1	1	2		(1)
Balance sheet location	Other liabilities	82	101	(11)	(4)		1	(11)	(5)
Balance sheet location	Consumer notes	64	70	(4)	(5)			(4)	(5)
Balance sheet location	Other policyholder funds and benefits payable	58	58	(6)	(8)			(6)	(8)
Total equity index swaps, options, and futures		225	256	(20)	(16)	1	3	(21)	(19)
Japanese variable annuity hedging instruments									
The Company enters into foreign currency forward and option contracts that convert Euros to Yen in order to economically hedge the foreign currency risk associated with certain assumed Japanese variable annuity products.									
Balance sheet location	Other investments	71	207	4	36	6	36	(2)	
Balance sheet location	Other liabilities	173	52	(7)	(1)	3		(10)	(1)
Total Japanese variable annuity hedging instruments		244	259	(3)	35	9	36	(12)	(1)

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Investments and Derivative Instruments (continued)

	Net Derivatives				Asset Derivatives		Liability Derivatives	
	Notional Amount		Fair Value		Fair Value		Fair Value	
Accounting Designation/Type/Hedging Strategy	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**	**Jun. 30, 2009**	**Dec. 31, 2008**
Macro hedge program								
The Company utilizes equity and currency option and equity futures contracts to partially hedge the statutory reserve impact of equity risk and foreign currency risk arising primarily from guaranteed minimum death benefit (GMDB) and GMWB obligations against a decline in the equity markets or changes in foreign currency exchange rates. The notional amount as of June 30, 2009, includes approximately $1.1 billion of short put option contracts, therefore resulting in a net notional amount of approximately $8.3 billion.								
Balance sheet location Other investments	$ 2,008	$	$ 91	$	$ 92	$	$ (1)	$
Balance sheet location Other liabilities	7,349	2,188	50	137	136	137	(86)	
Total macro hedge program	9,357	2,188	141	137	228	137	(87)	
Warrants [1]								
During the fourth quarter of 2008, the Company issued warrants to purchase the Company s Series C Non-Voting Contingent Convertible Preferred Stock, which were required under EITF 00-19 to be accounted for as a derivative liability at December 31, 2008. See Note 21 of Notes to Consolidated Financial Statements in The Hartford s 2008 Form 10-K Annual Report for a discussion of Allianz SE s investment in The Hartford. As of March 31, 2009, the warrants were no longer required to be accounted for as derivatives and were reclassified to equity.								
Balance sheet location Other liabilities		869		(163)				(163)
Total warrants		869		(163)				(163)
Total non-qualifying strategies	**$ 110,095**	**$ 102,198**	**$ (2,017)**	**$ (2,386)**	**$ 2,951**	**$ 6,049**	**$ (4,968)**	**$ (8,435)**
Total cash flow hedges, fair value hedges, and non-qualifying strategies	**$ 123,544**	**$ 115,272**	**$ (1,973)**	**$ (1,896)**	**$ 3,372**	**$ 6,934**	**$ (5,345)**	**$ (8,830)**

[1] *The derivative instruments related to these hedging strategies are held for other investment purposes.*

<u>Change in Notional Amount</u>

The notional amount of derivatives increased approximately $8.3 billion since December 31, 2008, primarily due to the macro hedge program and, to a lesser extent, derivatives hedging the Japan 3Win product, partially offset by a decrease in notional of GMWB related derivatives.

- The Company increased the notional amount of derivatives associated with the macro hedge program by approximately $7.2 billion, while GMWB related derivatives decreased approximately $3.4 billion, as a result of the Company rebalancing its risk management strategy to place a greater relative emphasis on the protection of statutory surplus. Approximately $1.1 billion of the $7.2 billion increase in notional amount represents short put option contracts therefore resulting in a net increase in notional of approximately $6.1 billion.
- The Company added approximately $2.7 billion in notional related to foreign currency swaps used to hedge the GMIB fixed payments associated with the Japan 3Win product.

<u>Change in Fair Value</u>

The decrease of $77 in the total fair value of derivative instruments since December 31, 2008, was primarily related to a decline in fair value of interest rate derivatives, credit derivatives, and Japan fixed annuity and 3Win hedging instruments, partially offset by an increase in fair value of GMWB related derivatives.

- The fair value of interest rate derivatives used in cash flow hedge relationships declined due to rising interest rates.
- The fair value related to credit derivatives that economically hedge fixed maturity securities decreased as a result of credit spreads tightening. This decline was partially offset by an increase in the fair value related to credit derivatives that assume credit risk as a part of replication transactions.
- The fair value of the Japanese fixed annuity and Japan 3Win hedging instruments decreased primarily due to the U.S. dollar strengthening against the Japanese Yen.
- The fair value related to GMWB derivatives increased primarily due to market-based valuation changes, including a decrease in equity volatility levels and an increase in interest rates, as well as policyholder behavior and liability model assumption updates. For more information on the policyholder behavior and liability model assumption updates, refer to Note 4.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments (continued)

Cash Flow Hedges

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (OCI) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing hedge ineffectiveness are recognized in current earnings. All components of each derivative s gain or loss were included in the assessment of hedge effectiveness.

The following table presents the components of the gain or loss on derivatives that qualify as cash-flow hedges:

Derivatives in Cash Flow Hedging Relationships

	Gains (Losses) Recognized in OCI on Derivative (Effective Portion)				Net Realized Capital Gains (Losses) Recognized in Net Income on Derivative (Ineffective Portion)			
	Three Months Ended June 30,		Six Months Ended June 30,		Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008	2009	2008	2009	2008
Interest rate swaps	$ (381)	$ (163)	$ (466)	$ (21)	$ (2)	$ 2	$ (3)	$ 4
Foreign currency swaps	(154)	20	(139)	(44)	25		39	(1)
Total	**$ (535)**	**$ (143)**	**$ (605)**	**$ (65)**	**$ 23**	**$ 2**	**$ 36**	**$ 3**

Derivatives in Cash Flow Hedging Relationships

		Gain (Loss) Reclassified from AOCI into Income (Effective Portion)			
		Three Months Ended June 30,		Six Months Ended June 30,	
		2009	2008	2009	2008
Interest rate swaps	Net realized capital gains (losses)	$ 1	$ 1	$ 10	$ 1
Interest rate swaps	Net investment income (loss)	11	(5)	20	(13)
Foreign currency swaps	Net realized capital gains (losses)	(53)	(23)	(71)	(65)
Foreign currency swaps	Net investment income (loss)	1		2	
Total		**$ (40)**	**$ (27)**	**$ (39)**	**$ (77)**

As of June 30, 2009, the before-tax deferred net gains on derivative instruments recorded in AOCI that are expected to be reclassified to earnings during the next twelve months are $43. This expectation is based on the anticipated interest payments on hedged investments in fixed maturity securities that will occur over the next twelve months, at which time the Company will recognize the deferred net gains (losses) as an adjustment to interest income over the term of the investment cash flows. The maximum term over which the Company is hedging its exposure to the variability of future cash flows (for forecasted transactions, excluding interest payments on existing variable-rate financial instruments) is four years.

For the three and six months ended June 30, 2009, the Company had $1, before-tax, of net reclassifications from AOCI to earnings resulting from the discontinuance of cash flow hedges due to forecasted transactions that were no longer probable of occurring. For the three and six months ended June 30, 2008, the Company had $(4), before-tax, of net reclassifications from AOCI to earnings resulting from the discontinuance of cash flow hedges due to forecasted transactions that were no longer probable of occurring.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments (continued)

Fair Value Hedges

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings. The Company includes the gain or loss on the derivative in the same line item as the offsetting loss or gain on the hedged item. All components of each derivative s gain or loss were included in the assessment of hedge effectiveness. The Company recognized in income gains (losses) representing the ineffective portion of all fair value hedges as follows:

Derivatives in Fair Value Hedging Relationships

	Gain (Loss) Recognized in Income [1]							
	Three Months Ended June 30,				Six Months Ended June 30,			
	2009		2008		2009		2008	
	Derivative	Hedge Item	Derivative	Hedge Item	Derivative	Hedge Item	Derivative	Hedge Item
Interest rate swaps								
Net realized capital gains (losses)	$ 49	$ (45)	$ 84	$ (85)	$ 66	$ (62)	$ 1	$ (3)
Benefits, losses and loss adjustment expenses	(26)	27	(29)	29	(42)	44	(1)	3
Foreign currency swaps								
Net realized capital gains (losses)	63	(63)	(7)	7	47	(47)	24	(24)
Benefits, losses and loss adjustment expenses	(5)	5	(21)	21			(20)	20
Total	**$ 81**	**$ (76)**	**$ 27**	**$ (28)**	**$ 71**	**$ (65)**	**$ 4**	**$ (4)**

[1] *The amounts presented do not include the periodic net coupon settlements of the derivative or the coupon income (expense) related to the hedged item. The net of the amounts presented represents the*

ineffective portion of the hedge.

Non-qualifying Strategies

For non-qualifying strategies, including embedded derivatives that are required to be bifurcated from their host contracts and accounted for as derivatives, the gain or loss on the derivative is recognized currently in earnings within net realized capital gains or losses. The following table presents the gain or loss recognized in income on non-qualifying strategies:

Non-qualifying Strategies
Gain (Loss) Recognized within Net Realized Capital Gains (Losses)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Interest rate swaps, caps, floors, and forwards	$ 5	$ (19)	$ 20	$ 22
Foreign currency swaps, forwards, and swaptions	(32)	(12)	(22)	(18)
Credit derivatives that purchase credit protection	(279)	(48)	(390)	89
Credit derivatives that assume credit risk	157	(27)	77	(372)
Contingent capital facility put option	(1)	(4)	(5)	(3)
Japanese fixed annuity hedging instruments [1]	50	(141)	(118)	41
GMAB product derivatives	6	5	4	(23)
Japan 3Win hedging derivatives [2]	119		(110)	
GMWB product derivatives	2,622	317	3,345	(906)
GMWB reinsurance contracts	(433)	(46)	(685)	112
GMWB hedging instruments	(1,518)	(284)	(1,400)	45
Equity index swaps, options, and futures	(2)	(3)	(5)	
Japanese variable annuity hedging instruments	(8)	(13)	(19)	(10)
Macro hedge program	(568)	(4)	(364)	5
Warrants			70	
Total	**$ 118**	**$ (279)**	**$ 398**	**$ (1,018)**

[1] The associated liability is adjusted for changes in spot rates through realized capital gains and losses and was $(54) and $121 for the three months ended June 30, 2009 and 2008, respectively, and $151 and $(82) for the six months ended June 30, 2009 and 2008,

respectively.

[2] *The associated liability is adjusted for changes in spot rates through realized capital gains and losses and was $(44) for the three months ended June 30, 2009 and $140 for the six months ended June 30, 2009.*

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. Investments and Derivative Instruments (continued)

For the three and six months ended June 30, 2009, the net realized capital gain of $118 and $398, respectively, related to derivatives used in non-qualifying strategies was primarily due to the following:

The net gain associated with GMWB related derivatives was primarily due to market-based valuation changes, including a decrease in equity volatility levels and an increase in interest rates, as well as policyholder behavior and liability model assumption updates. For more information on the policyholder behavior and liability model assumption updates, refer to Note 4.

The net gain on the Japanese fixed annuity and Japan 3Win hedging instruments for the three months ended June 30, 2009, was primarily due to weakening of the U.S. dollar against the Japanese Yen and an increase in U.S. interest rates. The net loss for the six months ended June 30, 2009, was primarily due to the Japanese Yen weakening against the U.S. dollar.

The net loss on the macro hedge program was primarily the result of an increase in the equity markets and the impact of trading activity.

The net loss on credit derivatives that purchase credit protection to economically hedge fixed maturity securities and the net gain on credit derivatives that assume credit risk as a part of replication transactions resulted from credit spreads tightening.

For the three and six months ended June 30, 2008, the net realized capital loss related to derivatives used in non-qualifying strategies of $(279) and $(1,018), respectively, was primarily due to the following:

The net losses on GMWB related derivatives for the six months ended June 30, 2008, were primarily due to the transition to SFAS 157 and liability model assumption updates for mortality.

The net losses on credit derivatives were comprised of losses in the first quarter on credit derivatives that assume credit risk as a part of replication transactions due to credit spreads widening and losses in the second quarter on credit derivatives that purchase credit protection to economically hedge fixed maturity securities due to credit spreads tightening significantly on certain referenced corporate entities.

The net losses for three months ended June 30, 2008, on the Japanese fixed annuity hedging instruments were primarily due to a weakening of the Japanese yen in comparison to the U.S. dollar as well as an increase in Japanese interest rates.

Refer to Note 9 for additional disclosures regarding contingent credit related features in derivative agreements.

Credit Risk Assumed through Credit Derivatives

The Company enters into credit default swaps that assume credit risk from a single entity, referenced index, or asset pool in order to synthetically replicate investment transactions. The Company will receive periodic payments based on an agreed upon rate and notional amount and will only make a payment if there is a credit event. A credit event payment will typically be equal to the notional value of the swap contract less the value of the referenced security issuer s debt obligation. A credit event is generally defined as a default on contractually obligated interest or principal payments or bankruptcy of the referenced entity. The credit default swaps in which the Company assumes credit risk primarily reference investment grade single corporate issuers and baskets, which include trades ranging from baskets of up to five corporate issuers to standard and customized diversified portfolios of corporate issuers. The diversified portfolios of corporate issuers are established within sector concentration limits and are typically divided into tranches that possess different credit ratings.

The following tables present the notional amount, fair value, weighted average years to maturity, underlying referenced credit obligation type and average credit ratings, and offsetting notional amounts and fair value for credit derivatives in which the Company is assuming credit risk as of June 30, 2009 and December 31, 2008.

As of June 30, 2009

		Underlying Referenced Credit Obligation(s) [1]
	Weighted	

Credit Derivative type by derivative risk exposure	**Notional Amount [2]**	**Fair Value**	**Average Years to Maturity**	**Type**	**Average Credit Rating**	**Offsetting Notional Amount [3]**	**Offsetting Fair Value [3]**
Single name credit default swaps							
Investment grade risk exposure	$ 360	$ 3	5 years	Corporate Credit/ Foreign Gov.	AAA-	$ 335	$ (21)
Below investment grade risk exposure	105	(11)	4 years	Corporate Credit	B	30	(4)
Basket credit default swaps [4]							
Investment grade risk exposure	1,764	(170)	5 years	Corporate Credit	BBB+	989	12
Investment grade risk exposure	525	(225)	8 years	CMBS Credit	AA	525	225
Below investment grade risk exposure	200	(150)	5 years	Corporate Credit	BBB+		
Credit linked notes							
Investment grade risk exposure	87	78	2 years	Corporate Credit	BBB+		
Total	**$ 3,041**	**$ (475)**				**$ 1,879**	**$ 212**

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)
5. Investments and Derivative Instruments (continued)
As of December 31, 2008

Credit Derivative type by derivative risk exposure	Notional Amount[2]	Fair Value	Weighted Average Years to Maturity	Underlying Referenced Credit Obligation(s) [1] Type	Underlying Referenced Credit Obligation(s) [1] Average Credit Rating	Offsetting Notional Amount[3]	Offsetting Fair Value[3]
Single name credit default swaps							
Investment grade risk exposure	$ 60	$ (1)	4 years	Corporate Credit	A-	$ 35	$ (9)
Below investment grade risk exposure	82	(19)	4 years	Corporate Credit	B-		
Basket credit default swaps [4]							
Investment grade risk exposure	1,778	(235)	5 years	Corporate Credit	A-	1,003	21
Investment grade risk exposure	275	(92)	8 years	CMBS Credit	AAA	275	92
Below investment grade risk exposure	200	(166)	6 years	Corporate Credit	BB+		
Credit linked notes							
Investment grade risk exposure	117	106	2 years	Corporate Credit	BBB+		
Total	**$ 2,512**	**$ (407)**				**$ 1,313**	**$ 104**

[1] *The average credit ratings are based on availability and the midpoint of the applicable ratings among Moody s, S&P, and Fitch. If no rating is available from a rating agency, then an internally developed rating is used.*

[2] *Notional amount is equal to the maximum potential future loss amount. There is no specific collateral related to these contracts or recourse provisions included in the contracts to offset losses.*

[3] *The Company has entered into offsetting credit default swaps to terminate certain existing credit default swaps, thereby offsetting the future changes in value of, or losses paid related to, the original swap.*

[4] *Includes $2.2 billion and $1.9 billion as of June 30, 2009 and December 31, 2008, respectively, of standard market indices of diversified portfolios of corporate issuers referenced through credit default swaps. These swaps are subsequently*

valued based upon the observable standard market index. Also includes $325 as of June 30, 2009 and December 31, 2008, of customized diversified portfolios of corporate issuers referenced through credit default swaps.

6. Deferred Policy Acquisition Costs and Present Value of Future Profits

Changes in deferred policy acquisition costs and present value of future profits by Life and Property & Casualty were as follows:

Life

Unlock Results

During the second quarter of 2009, the Company revised its estimation of future gross profits using a Reversion to Mean (RTM) estimation technique to estimate future separate account returns. RTM is an estimation technique commonly used by insurance entities to project future separate account returns. Through this estimation technique, the Company s DAC model will be adjusted to reflect actual account values at the end of each quarter and through a consideration of recent returns, we will adjust future projected returns over a five year period so that the account value returns to the long-term expected rate of return, providing that those projected returns for the next five years do not exceed certain caps or floors. This will result in a DAC unlock, described below, each quarter. However, benefits and assessments used in the determination of SOP 03-1 reserves will be derived from a set of stochastic scenarios that have been calibrated to our reversion to mean separate account returns. The policy related in-force or account values at June 30, 2009 were used to project future gross profits using this new separate account return estimate. The after-tax impact on the Company s assets and liabilities as a result of the Unlock, which applied the RTM estimation technique, for the three months ended June 30, 2009 was:

Segment **After-tax (Charge) Benefit**	**DAC**	**Unearned Revenue Reserves**	**Death and Income Benefit Reserves [1]**	**Sales Inducement Assets**	**Total**
Retail	$ 163	$ (21)	$ 98	$ 13	$ 253
Retirement Plans	1				1
Individual Life	3	(1)			2
International [2]	(11)	6	117	(8)	104
Total	**$ 156**	**$ (16)**	**$ 215**	**$ 5**	**$ 360**

[1] As a result of the Unlock,

death benefit reserves, in Retail, decreased $307, pre-tax, offset by a decrease of $157, pre-tax, in reinsurance recoverables. In International, death benefit reserves decreased $184 pre-tax, offset by an increase of $4, pre-tax, in reinsurance recoverables.

[2] Includes $(49) related to DAC recoverability impairment associated with the decision to suspend sales in the U.K. variable annuity business.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

6. Deferred Policy Acquisition Costs and Present Value of Future Profits (continued)

In addition, during the first quarter of 2009, the Company failed its quarterly tests resulting in an Unlock of future estimated gross profits. The policy related in-force or account values at March 31, 2009 were used to project future gross profits. The after-tax impact on the Company s assets and liabilities as a result of the first quarter Unlock, based on our quantitative and qualitative tests and the second quarter Unlock using the RTM estimation technique, for the six months ended June 30, 2009 was:

Segment After-tax (Charge) Benefit	DAC	Unearned Revenue Reserves	Death and Income Benefit Reserves [1]	Sales Inducement Assets	Total [2]
Retail	$ (503)	$ 31	$ (230)	$ (30)	$ (732)
Retirement Plans	(53)		(2)	(1)	(56)
Individual Life	(64)	40			(24)
International	(99)	6	(216)	(9)	(318)
Corporate	(4)				(4)
Total	**$ (723)**	**$ 77**	**$ (448)**	**$ (40)**	**$ (1,134)**

[1] As a result of the Unlock, death benefit reserves, in Retail, increased $741, pre-tax, offset by an increase of $386, pre-tax, in reinsurance recoverables. In International, death benefit reserves increased $352, pre-tax, offset by a decrease of $20, pre-tax, in reinsurance recoverables.

[2] The most significant contributor to the Unlock amounts

recorded during the first quarter of 2009 were as a result of actual separate account returns from the period ending October 1, 2008 to March 31, 2009 being significantly below our aggregated estimated return.

Changes in deferred policy acquisition costs and present value of future profits were as follows:

	2009	2008
Balance, January 1	**$ 11,988**	**$ 10,514**
Deferred costs	418	841
Amortization Deferred policy acquisition costs and present value of future profits [1]	(824)	(230)
Amortization Unlock, pre-tax	(1,068)	
Adjustments to unrealized gains and losses on securities, available-for-sale and other [2]	192	490
Effect of currency translation adjustment	(99)	91
Effect of FSP FAS 115-2 [2]	(78)	
Balance, June 30	**$ 10,529**	**$ 11,706**

[1] The increase in amortization from the prior year period is due to lower actual gross profits in 2008 resulting from increased realized capital losses primarily from the adoption of SFAS 157 at the beginning of the first quarter of 2008.

[2]

The effect of adopting FSP FAS 115-2 resulted in an increase to retained earnings and as a result a DAC charge of $78. In addition, an offsetting amount was recorded in unrealized losses as unrealized losses increased upon adoption of FSP FAS 115-2.

Property & Casualty

	2009	2008
Balance, January 1	**$ 1,260**	**$ 1,228**
Deferred costs	1,032	1,062
Amortization Deferred policy acquisition costs	(1,041)	(1,044)
Balance, June 30	**$ 1,251**	**$ 1,246**

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

7. Separate Accounts, Death Benefits and Other Insurance Benefit Features

The Company records the variable portion of individual variable annuities, 401(k), institutional, 403(b)/457, private placement life and variable life insurance products within separate account assets and liabilities. Separate account assets are reported at fair value. Separate account liabilities are set equal to separate account assets. Separate account assets are segregated from other investments. Investment income and gains and losses from those separate account assets, which accrue directly to, and whereby investment risk is borne by the policyholder, are offset by the related liability changes within the same line item in the condensed consolidated statements of operations. The fees earned for administrative and contract holder maintenance services performed for these separate accounts are included in fee income. For the three and six months ended June 30, 2009 and 2008, there were no gains or losses on transfers of assets from the general account to the separate account.

Many of the variable annuity and universal life (UL) contracts issued by the Company offer various guaranteed minimum death, withdrawal, income, accumulation, and UL secondary guarantee benefits. UL secondary guarantee benefits ensure that the policy will not terminate, and will continue to provide a death benefit, even if there is insufficient policy value to cover the monthly deductions and charges. Guaranteed minimum death and income benefits are offered in various forms as described in further detail throughout this Note 7. The Company reinsures a portion of the death benefit guarantees associated with its in-force block of business. Changes in the gross U.S. GMDB, Japan GMDB/guaranteed minimum income benefits (GMIB), and UL secondary guarantee benefits sold with annuity and/or UL products accounted for and collectively known as SOP 03-1 reserve liabilities are as follows:

	U.S. GMDB [1]	Japan GMDB/GMIB [1]	UL Secondary Guarantees [1]
Liability balance as of January 1, 2009	**$ 870**	**$ 229**	**$ 40**
Incurred	185	60	14
Paid	(293)	(66)	
Unlock	742	350	
Currency translation adjustment		(6)	
Liability balance as of June 30, 2009	**$ 1,504**	**$ 567**	**$ 54**

[1] The reinsurance recoverable asset related to the U.S. GMDB was $927 as of June 30, 2009. The reinsurance recoverable asset related to the Japan GMDB was $41 as of June 30, 2009. The reinsurance recoverable asset related to

the UL secondary guarantees was $19 as of June 30, 2009.

	U.S. GMDB [1]		Japan GMDB/GMIB [1]		UL Secondary Guarantees [1]	
Liability balance as of January 1, 2008	**$**	**529**	**$**	**42**	**$**	**19**
Incurred		84		13		6
Paid		(67)		(13)		
Currency translation adjustment				2		
Liability balance as of June 30, 2008	**$**	**546**	**$**	**44**	**$**	**25**

[1] The reinsurance recoverable asset related to the U.S. GMDB was $338 as of June 30, 2008. The reinsurance recoverable asset related to the Japan GMDB was $7 as of June 30, 2008. The reinsurance recoverable asset related to the UL secondary guarantees was $12 as of June 30, 2008.

The net SOP 03-1 reserve liabilities are established by estimating the expected value of net reinsurance costs and death and income benefits in excess of the projected account balance. The excess death and income benefits and net reinsurance costs are recognized ratably over the accumulation period based on total expected assessments. The SOP 03-1 reserve liabilities are recorded in reserve for future policy benefits in the Company s condensed consolidated balance sheets. Changes in the SOP 03-1 reserve liabilities are recorded in benefits, losses and loss adjustment expenses in the Company s condensed consolidated statements of operations. In a manner consistent with the Company s accounting policy for deferred acquisition costs, the Company regularly evaluates estimates used and adjusts the additional liability balances, with a related charge or credit to benefit expense if actual experience or other evidence suggests that earlier assumptions should be revised.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

7. Separate Accounts, Death Benefits and Other Insurance Benefit Features (continued)

The following table provides details concerning GMDB and GMIB exposure as of June 30, 2009:

Breakdown of Individual Variable and Group Annuity Account Value by GMDB/GMIB Type

Maximum anniversary value (MAV) [1]	**Account Value**	**Net Amount at Risk [9]**	**Retained Net Amount at Risk [9]**	**Weighted Average Attained Age of Annuitant**
MAV only	$ 25,259	$ 12,600	$ 4,164	66
With 5% rollup [2]	1,835	1,016	413	65
With Earnings Protection Benefit Rider (EPB) [3]	5,280	2,091	217	63
With 5% rollup & EPB	729	346	68	65
Total MAV	33,103	16,053	4,862	
Asset Protection Benefit (APB) [4]	25,761	8,334	5,432	64
Lifetime Income Benefit (LIB) [5]	1,164	407	407	62
Reset [6] (5-7 years)	3,402	943	942	70
Return of Premium [7]/Other	18,434	3,124	2,915	63
Subtotal U.S. Guaranteed Minimum Death Benefits [10]	**81,864**	**$ 28,861**	**$ 14,558**	**65**
Less: General Account Value Subject to U.S. Guaranteed Minimum Death Benefits	6,961			
Subtotal Separate Account Liabilities Subject to U.S. Guaranteed Minimum Death Benefits	**74,903**			
Separate Account Liabilities Not Subject to U.S. Guaranteed Minimum Death Benefits	59,043			
Total Separate Account Liabilities	**$ 133,946**			
Japan Guaranteed Minimum Death and Income Benefit [8]	**$ 29,272**	**$ 6,904**	$ **5,765**	**67**

[1] MAV: the death benefit is the greatest of current account value, net premiums paid and the highest

account value on any anniversary before age 80 (adjusted for withdrawals).

[2] *Rollup: the death benefit is the greatest of the MAV, current account value, net premium paid and premiums (adjusted for withdrawals) accumulated at generally 5% simple interest up to the earlier of age 80 or 100% of adjusted premiums.*

[3] *EPB: the death benefit is the greatest of the MAV, current account value, or contract value plus a percentage of the contract s growth. The contract s growth is account value less premiums net of withdrawals, subject to a cap of 200% of premiums net of withdrawals.*

[4] *APB: the death benefit is the greater of current account value or MAV, not to exceed current account value plus 25% times the greater of net*

premiums and MAV (each adjusted for premiums in the past 12 months).

[5] *LIB: the death benefit is the greatest of current account value, net premiums paid, or for certain contracts a benefit amount that ratchets over time, generally based on market performance.*

[6] *Reset: the death benefit is the greatest of current account value, net premiums paid and the most recent five to seven year anniversary account value before age 80 (adjusted for withdrawals).*

[7] *Return of premium: the death benefit is the greater of current account value and net premiums paid.*

[8] *Death benefits include a Return of Premium and MAV (before age 80) paid in a single lump sum. The income benefit is a*

guarantee to return initial investment, adjusted for earnings liquidity, paid through a fixed annuity, after a minimum deferral period of 10, 15 or 20 years. The guaranteed remaining balance related to the Japan GMIB was $28.1 billion and $30.6 billion as of June 30, 2009 and December 31, 2008, respectively.

[9] Net amount at risk is defined as the guaranteed benefit in excess of the current account value. Retained net amount at risk is net amount at risk reduced by that amount which has been reinsured to third parties. Net amount at risk and retained net amount at risk are highly sensitive to equity markets movements for example, as equity market declines, net amount at risk and retained net amount at risk

will generally increase.

[10] *Account value includes the contractholder s investment in the separate account and the general account.*

Account balances of contracts with guarantees were invested in variable separate accounts as follows:

Asset type		**As of June 30, 2009**		**As of December 31, 2008**
Equity securities (including mutual funds)	$	65,476	$	63,114
Cash and cash equivalents		9,427		10,174
Total	$	**74,903**	$	**73,288**

As of June 30, 2009, approximately 16% of the equity securities above were invested in fixed income securities through these funds and approximately 84% were invested in equity securities.

See Note 4 for a description of the Company s guaranteed living benefits that are accounted for at fair value.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

8. Sales Inducements

The Company currently offers enhanced crediting rates or bonus payments to contract holders on certain of its individual and group annuity products. The expense associated with offering a bonus is deferred and amortized over the life of the related contract in a pattern consistent with the amortization of deferred policy acquisition costs. Consistent with the Company s Unlocks in the six months ended June 30, 2009, the Company unlocked the amortization of the sales inducement asset. See Note 6 for more information concerning the Unlocks.

Changes in deferred sales inducement activity were as follows for the six months ended June 30:

	2009	2008
Balance, January 1	**$ 553**	**$ 467**
Sales inducements deferred	34	83
Amortization	(80)	(6)
Amortization Unlock	(57)	
Balance, end of period, June 30	**$ 450**	**$ 544**

9. Commitments and Contingencies

Litigation

The Hartford is involved in claims litigation arising in the ordinary course of business, both as a liability insurer defending or providing indemnity for third-party claims brought against insureds and as an insurer defending coverage claims brought against it. The Hartford accounts for such activity through the establishment of unpaid loss and loss adjustment expense reserves. Subject to the uncertainties discussed below under the caption Asbestos and Environmental Claims, management expects that the ultimate liability, if any, with respect to such ordinary-course claims litigation, after consideration of provisions made for potential losses and costs of defense, will not be material to the consolidated financial condition, results of operations or cash flows of The Hartford.

The Hartford is also involved in other kinds of legal actions, some of which assert claims for substantial amounts. These actions include, among others, putative state and federal class actions seeking certification of a state or national class. Such putative class actions have alleged, for example, underpayment of claims or improper underwriting practices in connection with various kinds of insurance policies, such as personal and commercial automobile, property, life and inland marine; improper sales practices in connection with the sale of life insurance and other investment products; and improper fee arrangements in connection with investment products and structured settlements. The Hartford also is involved in individual actions in which punitive damages are sought, such as claims alleging bad faith in the handling of insurance claims. Like many other insurers, The Hartford also has been joined in actions by asbestos plaintiffs asserting, among other things, that insurers had a duty to protect the public from the dangers of asbestos and that insurers committed unfair trade practices by asserting defenses on behalf of their policyholders in the underlying asbestos cases. Management expects that the ultimate liability, if any, with respect to such lawsuits, after consideration of provisions made for estimated losses, will not be material to the consolidated financial condition of The Hartford. Nonetheless, given the large or indeterminate amounts sought in certain of these actions, and the inherent unpredictability of litigation, an adverse outcome in certain matters could, from time to time, have a material adverse effect on the Company s consolidated results of operations or cash flows in particular quarterly or annual periods.

Broker Compensation Litigation Following the New York Attorney General s filing of a civil complaint against Marsh & McLennan Companies, Inc., and Marsh, Inc. (collectively, Marsh) in October 2004 alleging that certain insurance companies, including The Hartford, participated with Marsh in arrangements to submit inflated bids for business insurance and paid contingent commissions to ensure that Marsh would direct business to them, private plaintiffs brought several lawsuits against the Company predicated on the allegations in the Marsh complaint, to which the Company was not party. Among these is a multidistrict litigation in the United States District Court for the District of

New Jersey. There are two consolidated amended complaints filed in the multidistrict litigation, one related to conduct in connection with the sale of property-casualty insurance and the other related to alleged conduct in connection with the sale of group benefits products. The Company and various of its subsidiaries are named in both complaints. The complaints assert, on behalf of a putative class of persons who purchased insurance through broker defendants, claims under the Sherman Act, the Racketeer Influenced and Corrupt Organizations Act (RICO), state law, and in the case of the group benefits complaint, claims under the Employee Retirement Income Security Act of 1974 (ERISA). The claims are predicated upon allegedly undisclosed or otherwise improper payments of contingent commissions to the broker defendants to steer business to the insurance company defendants. The district court has dismissed the Sherman Act and RICO claims in both complaints for failure to state a claim and has granted the defendants motions for summary judgment on the ERISA claims in the group-benefits products complaint. The district court further has declined to exercise supplemental jurisdiction over the state law claims, has dismissed those state law claims without prejudice, and has closed both cases. The plaintiffs have appealed the dismissal of the claims in both consolidated amended complaints, except the ERISA claims.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. Commitments and Contingencies (continued)

The Company is also a defendant in two consolidated securities actions and two consolidated derivative actions filed in the United States District Court for the District of Connecticut. The consolidated securities actions assert claims on behalf of a putative class of shareholders alleging that the Company and certain of its executive officers violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 by failing to disclose to the investing public that The Hartford s business and growth was predicated on the unlawful activity alleged in the New York Attorney General s complaint against Marsh. The consolidated derivative actions, brought by shareholders on behalf of the Company against its directors and an additional executive officer, allege that the defendants knew adverse non-public information about the activities alleged in the Marsh complaint and concealed and misappropriated that information to make profitable stock trades in violation of their duties to the Company. In July 2006, the district court granted defendants motion to dismiss the consolidated securities actions, and the plaintiffs appealed. In November 2008, the United States Court of Appeals for the Second Circuit vacated the decision and remanded the case to the district court. In May 2009, the parties reached an agreement in principle to settle the consolidated securities actions for an immaterial amount. The settlement is subject to certain contingencies, including the execution of a stipulation of settlement and the preliminary and final approval of the court. Defendants filed a motion to dismiss the consolidated derivative actions in May 2005. In July 2009, the parties reached an agreement in principle to settle the consolidated derivative actions for an immaterial amount, subject to the execution of a written settlement agreement and approval of the court.

In September 2007, the Ohio Attorney General filed a civil action in Ohio state court alleging that certain insurance companies, including The Hartford, conspired with Marsh in violation of Ohio s antitrust statute. The trial court denied defendants motion to dismiss the complaint in July 2008. The Company disputes the allegations and intends to defend this action vigorously.

Investment and Savings Plan ERISA Class Action Litigation In November and December 2008, following a decline in the share price of the Company s common stock, seven putative class action lawsuits were filed in the United States District Court for the District of Connecticut on behalf of certain participants in the Company s Investment and Savings Plan (the Plan), which offers the Company s common stock as one of many investment options. These lawsuits have been consolidated, and a consolidated amended class-action complaint was filed in March 2009, alleging that the Company and certain of its officers and employees violated ERISA by allowing the Plan s participants to invest in the Company s common stock and by failing to disclose to the Plan s participants information about the Company s financial condition. The lawsuit seeks restitution or damages for losses arising from the investment of the Plan s assets in the Company s common stock during the period from December 10, 2007 to the present. The Company disputes the allegations and intends to defend the actions vigorously.

Structured Settlement Class Action In October 2005, a putative nationwide class action was filed in the United States District Court for the District of Connecticut against the Company and several of its subsidiaries on behalf of persons who had asserted claims against an insured of a Hartford property & casualty insurance company that resulted in a settlement in which some or all of the settlement amount was structured to afford a schedule of future payments of specified amounts funded by an annuity from a Hartford life insurance company (Structured Settlements). The operative complaint alleges that since 1997 the Company has systematically deprived the settling claimants of the value of their damages recoveries by secretly deducting 15% of the annuity premium of every Structured Settlement to cover brokers commissions, other fees and costs, taxes, and a profit for the annuity provider, and asserts claims under the Racketeer Influenced and Corrupt Organizations Act (RICO) and state law. The plaintiffs seek compensatory damages, punitive damages, pre-judgment interest, attorney s fees and costs, and injunctive or other equitable relief. The Company vigorously denies that any claimant was misled or otherwise received less than the amount specified in the structured-settlement agreements. In March 2009, the district court certified a class for the RICO and fraud claims composed of all persons, other than those represented by a plaintiffs broker, who entered into a Structured Settlement since 1997 and received certain written representations about the cost or value of the settlement. The district court declined to certify a class for the breach-of-contract and unjust-enrichment claims. The Company has petitioned the

United States Court of Appeals for the Second Circuit for permission to file an interlocutory appeal of the class-certification ruling. Proceedings in the district court are stayed until proceedings in the Second Circuit conclude.

Fair Credit Reporting Act Class Action In February 2007, the United States District Court for the District of Oregon gave final approval of the Company s settlement of a lawsuit brought on behalf of a class of homeowners and automobile policy holders alleging that the Company willfully violated the Fair Credit Reporting Act by failing to send appropriate notices to new customers whose initial rates were higher than they would have been had the customer had a more favorable credit report. The Company paid approximately $84.3 to eligible claimants and their counsel in connection with the settlement, and sought reimbursement from the Company s Excess Professional Liability Insurance Program for the portion of the settlement in excess of the Company s $10 self-insured retention. Certain insurance carriers participating in that program disputed coverage for the settlement, and one of the excess insurers commenced an arbitration that resulted in an award in the Company s favor and payments to the Company of approximately $30.1, thereby exhausting the primary and first-layer excess policies. In June 2009, the second-layer excess carriers commenced an arbitration to resolve the dispute over coverage for the remainder of the amounts paid by the Company. Management believes it is probable that the Company s coverage position ultimately will be sustained.

THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. Commitments and Contingencies (continued)

Asbestos and Environmental Claims As discussed in Note 12, Commitments and Contingencies, of the Notes to Consolidated Financial Statements under the caption Asbestos and Environmental Claims , included in the Company s 2008 Form 10-K Annual Report, The Hartford continues to receive asbestos and environmental claims that involve significant uncertainty regarding policy coverage issues. Regarding these claims, The Hartford continually reviews its overall reserve levels and reinsurance coverages, as well as the methodologies it uses to estimate its exposures. Because of the significant uncertainties that limit the ability of insurers and reinsurers to estimate the ultimate reserves necessary for unpaid losses and related expenses, particularly those related to asbestos, the ultimate liabilities may exceed the currently recorded reserves. Any such additional liability cannot be reasonably estimated now but could be material to The Hartford s consolidated operating results, financial condition and liquidity.

Shareholder Demand Like the boards of directors of many other companies, The Hartford s board of directors (the Board) has received a demand from SEIU Pension Plans Master Trust, which purports to be a current holder of the Company s common stock. The demand requests the Board to bring suit to recover alleged excessive compensation paid to senior executives of the Company from 2005 through the present and to change the Company s executive compensation structure. The Board is conducting an investigation of the allegations in the demand.

Derivative Commitments

Certain of the Company s derivative agreements contain provisions that are tied to the financial strength ratings of the individual legal entity that entered into the derivative agreement as set by nationally recognized statistical rating agencies. If the insurance operating entity s financial strength were to fall below certain ratings, the counterparties to the derivative agreements could demand immediate and ongoing full collateralization and in certain instances demand immediate settlement of all outstanding derivative positions traded under each impacted bilateral agreement. The settlement amount is determined by netting the derivative positions transacted under each agreement. If the termination rights were to be exercised by the counterparties, it could impact the insurance operating entity s ability to conduct hedging activities by increasing the associated costs and decreasing the willingness of counterparties to transact with the insurance operating entity. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a net liability position as of June 30, 2009, is $695. Of this $695, the insurance operating entities have posted collateral of $594 in the normal course of business. Based on derivative market values as of June 30, 2009, a downgrade of one level below the current financial strength ratings by either Moody s or S&P could require approximately an additional $45 to be posted as collateral. Based on derivative market values as of June 30, 2009, a downgrade by either Moody s or S&P of two levels below the insurance operating entities current financial strength ratings could require approximately an additional $80 of assets to be posted as collateral. These collateral amounts could change as derivative market values change, as a result of changes in our hedging activities or to the extent changes in contractual terms are negotiated. The nature of the collateral that we may be required to post is primarily in the form of U.S. Treasury bills and U.S. Treasury notes.

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THE HARTFORD FINANCIAL SERVICES GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Pension Plans and Postretirement Health Care and Life Insurance Benefit Plans

Components of Net Periodic Benefit Cost

Total net periodic benefit cost for the three months ended June 30, 2009 and 2008 include the following components:

	Pension Benefits		Other Postretirement Benefits	
	2009	**2008**	**2009**	**2008**
Service cost	$ 26	$ 30	$ 2	$ 1
Interest cost	61	58	6	7
Expected return on plan assets	(68)	(69)	(2)	(3)
Amortization of prior service credit	(3)	(3)	(1)	(1)
Amortization of actuarial loss	19	16		1
Net periodic benefit cost	**$ 35**	**$ 32**	**$ 5**	**$ 5**

Total net periodic benefit cost for the six months ended June 30, 2009 and 2008 include the following components:

	Pension Benefits		Other Postretirement Benefits	
	2009	**2008**	**2009**	**2008**
Service cost	$ 52	$ 60	$ 3	$ 3
Interest cost	121	114	12	12
Expected return on plan assets	(137)	(138)	(5)	(6)
Amortization of prior service credit	(5)	(5)	(1)	(1)
Amortization of actuarial loss	37	29		
Net periodic benefit cost	**$ 68**	**$ 60**	**$ 9**	**$ 8**

11. Stock Compensation Plans

The Company has two primary stock-based compensation plans, The Hartford 2005 Incentive Stock Plan and The Hartford Employee Stock Purchase Plan. For a description of these plans, see Note 18 of Notes to Consolidated Financial Statements included in The Hartford s 2008 Form 10-K Annual Report.

Shares issued in satisfaction of stock-based compensation may be made available from authorized but unissued shares, shares held by the Company in treasury or from shares purchased in the open market. The Company typically issues shares from treasury in satisfaction of stock-based compensation. The compensation expense recognized for the stock-based compensation plans was $8 and $21 for the three months ended June 30, 2009 and 2008, respectively. The compensation expense recognized for the stock-based compensation plans was $21 and $39 for the six months ended June 30, 2009 and 2008, respectively. The income tax benefit recognized for stock-based compensation plans was $3 and $6 for the three months ended June 30, 2009 and 2008, respectively. The income tax benefit recognized for stock-based compensation plans was $7 and $12 for the six months ended June 30, 2009 and 2008, respectively. The Company did not capitalize any cost of stock-based compensation. As of June 30, 2009, the total compensation cost related to non-vested awards not yet recognized was $92, which is expected to be recognized over a weighted average period of 2.2 years.

300,416 6.09

Total

$46,796 $4,247 $563,030

The following table sets forth the scheduled repayments of fixed- and adjustable-rate loans at September 30, 2006 that are contractually due after September 30, 2007.

	Due After September 30, 2007		
	Fixed	Adjustable	Total
		(In thousands)	
Residential first mortgage loans:			
One- to four-family	$ 396,189	55,972	452,161
Construction	5,773		5,773
Commercial	3,260	558	3,818
Commercial real estate	18,396	23,479	41,875
Home equity loans and lines of credit	28,018	18,704	46,722
Other	1,935		1,935
Total	$ 453,571	$ 98,713	$ 552,284

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Loan Originations and Repayments. Historically, we have originated residential mortgage loans pursuant to underwriting standards that generally conform to Fannie Mae and Freddie Mac guidelines. Loan origination activities are primarily concentrated in Monroe and Northampton Counties, Pennsylvania. New loans are generated primarily from walk-in customers, customer referrals, a network of mortgage brokers, and other parties with whom we do business, and from the efforts of employees and advertising. Loan applications are underwritten and processed at our corporate center.

One- to Four-Family Residential Loans. Historically, our primary lending activity has consisted of the origination of one- to four-family residential mortgage loans secured primarily by properties located in Monroe and Northampton Counties, Pennsylvania. At September 30, 2006, approximately $452.4 million, or 80.4% of our loan portfolio, consisted of one- to four-family residential loans. Our origination of one- to four-family loans increased in fiscal year 2006 compared to fiscal years 2005 and 2004, although such loans are declining as a percentage of our total loan portfolio. Generally, one- to four-family residential mortgage loans are originated in amounts up to 80% of the lesser of the appraised value or purchase price of the property, although loans may be made with higher loan-to-value ratios at a higher interest rate to compensate for the risk. Private mortgage insurance is generally required on loans with a loan-to-value ratio in excess of 80%. Fixed-rate loans are originated for terms of 10, 15, 20 and 30 years. At September 30, 2006, our largest loan secured by one- to four-family real estate had a principal balance of approximately $605,000 and was secured by a single-family residence. This loan was performing in accordance with its terms.

We also offer adjustable-rate mortgage loans which have fixed terms of one, three, five or ten-years before converting to an annual adjustment schedule based on changes in a designated United States Treasury index. We originated $11.9 million of adjustable rate one- to four-family residential loans during the year ended September 30, 2006 and $13.7 million during the year ended September 30, 2005. Our adjustable rate mortgage loans provide for maximum rate adjustments of 200 basis points per adjustment, with a lifetime maximum adjustment of 600 basis points. Our adjustable rate mortgage loans amortize over terms of up to 30 years.

Adjustable rate mortgage loans decrease the risk associated with changes in market interest rates by periodically repricing, but involve other risks because, as interest rates increase, the interest payments on the loan increase, thus increasing the potential for default by the borrower. At the same time, the marketability of the underlying collateral may be adversely affected by higher interest rates. Upward adjustment of the contractual interest rate is also limited by the maximum periodic and lifetime interest rate adjustments permitted by our loan documents, and therefore, is potentially limited in effectiveness during periods of rapidly rising interest rates. At September 30, 2006, $56.0 million, or 12.4%, of our one- to four-family residential loans had adjustable rates of interest.

All one- to four-family residential mortgage loans that we originate include due-on-sale clauses, which give us the right to declare a loan immediately due and payable in the event that, among other things, the borrower sells or otherwise disposes of the real property subject to the mortgage and the loan is not repaid.

Regulations limit the amount that a savings bank may lend relative to the appraised value of the real estate securing the loan, as determined by an appraisal of the property at the time the loan is originated. For all loans, we utilize outside independent appraisers approved by the Board of Directors. All borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

Commercial Real Estate Loans. At September 30, 2006, $47.5 million, or 8.4% of our total loan portfolio consisted of commercial real estate loans. Commercial real estate loans are secured by office buildings, mixed-use properties and other commercial properties. We generally originate adjustable rate commercial real estate loans with an initial term of five years and a repricing option, and a maximum term of up to 25 years. The maximum loan-to-value ratio of our commercial real estate loans is 85%. At September 30, 2006, we had 202 commercial real estate loans with an outstanding balance of $47.5 million. At September 30, 2006, our largest commercial real estate loan balance was $2.8 million. At September 30, 2006, all but one of our loans secured by commercial real estate were performing in accordance with their terms. One secured commercial line of credit totaling approximately $50,000 was between 60 and 90 days past due at September 30, 2006.

We consider a number of factors in originating commercial real estate loans. We evaluate the qualifications and financial condition of the borrower, including credit history, profitability and expertise, as well as the value and condition of the mortgaged property securing the loan. When evaluating the qualifications of the borrower, we consider the financial resources of the borrower, the borrower s experience in owning or managing similar property and the borrower s payment history with us and other financial institutions. In evaluating the property securing the loan, the factors we consider include the net operating income of the mortgaged property before debt service and depreciation, the ratio of the loan amount to the appraised value of the mortgaged property and the debt service coverage ratio (the ratio of net operating income to debt service) to ensure that it is at least 120% of the monthly debt service. All commercial real estate loans in excess of $250,000 are appraised by outside independent appraisers approved by the Board of Directors. Personal guarantees are obtained from commercial real estate borrowers although we will consider waiving this requirement based upon the loan-to-value ratio of the proposed loan. All purchase money and asset refinance borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance.

Loans secured by commercial real estate generally are considered to present greater risk than one- to four-family residential loans. Commercial real estate loans often involve large loan balances to single borrowers or groups of related borrowers. Repayment of these loans depends to a large degree on the results of operations and management of the properties securing the loans or the businesses conducted on such property, and may be affected to a greater extent by adverse conditions in the real estate market or the economy in general. Accordingly, the nature of these loans makes them more difficult for management to monitor and evaluate.

First Mortgage Construction Loans. At September 30, 2006, $5.9 million, or 1.1%, of our total loan portfolio consisted of first mortgage construction loans. Most of our first mortgage construction loans are for the first mortgage construction of residential properties. We currently offer fixed and adjustable-rate residential first mortgage construction loans. First mortgage construction loans are generally structured for permanent mortgage financing once the construction is completed. At September 30, 2006, our largest first mortgage construction loan balance was $600,000. The loan was performing in accordance with its terms. First mortgage construction loans, once converted to permanent financing, generally repay over a thirty-year period. First mortgage construction loans require only the payment of interest during the construction period. First mortgage construction loans will generally be made in amounts of up to 80% of the appraised value of the completed property, or the actual cost of the improvements. In certain circumstances first mortgage construction loans may be made in amounts up to 100% of the appraised value with appropriate credit enhancements such as private mortgage insurance. Funds are disbursed based on our inspections in accordance with a schedule reflecting the completion of portions of the project.

First mortgage construction loans generally involve a greater degree of credit risk than one- to four-family residential mortgage loans. The risk of loss on a construction loan depends upon the accuracy of the initial estimate of the value of the property at completion of construction compared to the estimated cost of construction. For all loans, we utilize outside independent appraisers approved by the Board of Directors. All borrowers are required to obtain title insurance. We also require fire and casualty insurance and, where circumstances warrant, flood insurance on properties.

Other Loans**.** We offer a variety of loans that are either unsecured or secured by property other than real estate. These loans include loans secured by deposits, personal loans and automobile loans. At September 30, 2006, these other loans totaled $4.2 million, or 0.7% of the total loan portfolio.

Loan Approval Procedures and Authority. The loan approval process is intended to assess the borrower s ability to repay the loan, the viability of the loan, and the adequacy of the value of the property that will secure the loan. To assess the borrower s ability to repay, we review each borrower s employment and credit history and information on the historical and projected income and expenses of mortgagors. All residential mortgage loans in excess of the conforming loan limit but less than $500,000 must be approved by any two of the following: President, Chief Lending Officer and the Vice President, Retail Lending. All loans in excess of $500,000 but less than $750,000 must be approved by the Chief Executive Officer and either the Chief Lending Officer or the Vice President, Retail Lending. All loans in excess of $750,000 must be approved by the Management Loan Committee and all loans in excess of $1.0 million must be approved by the Director Loan Committee.

Non-Performing Loans and Problem Assets

After a real estate secured loan becomes 15 days late, we deliver a computer generated late charge notice to the borrower and will attempt to contact the borrower by telephone. When a loan becomes 30 days delinquent, we send a delinquency letter to the borrower. We then attempt to make satisfactory arrangements to bring the account current, including interviewing the borrower, until the mortgage is brought current or a determination is made to recommend foreclosure, deed-in-lieu of foreclosure or other appropriate action. After 60 days, we will generally refer the matter to the Board of Directors who may authorize legal counsel to commence foreclosure proceedings.

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Mortgage loans are reviewed on a regular basis and such loans are placed on non-accrual status when they become more than 90 days delinquent. When loans are placed on non-accrual status, unpaid accrued interest is fully reserved, and further income is recognized only to the extent received.

Non-performing Loans. At September 30, 2006, $623,000 (or less than 1.0% of our total loans) were non-performing loans.

As of September 30, 2006, we had no outstanding non-performing commercial real estate loans.

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Non-Performing Assets. The table below sets forth the amounts and categories of our non-performing assets at the dates indicated. At each date presented, we had no troubled debt restructurings (loans for which a portion of interest or principal has been forgiven and loans modified at interest rates materially less than current market rates).

	At September 30,				At November 30,
	2006	2005	2004	2003	2002
	(Dollars in thousands)				
Non-accrual loans:					
Residential first mortgage loans:					
One- to four-family	$ 436	$ 554	$ 578	$ 379	$ 578
Construction					
Commercial					
Commercial real estate					
Home equity loans and lines of credit	40	50	79	98	17
Other		1	8	47	76
Total	476	605	665	524	671
Accruing loans 90 days or more past due:					
Residential first mortgage loans:					
One- to four-family					
Construction					
Commercial					
Commercial real estate					
Home equity loans and lines of credit					
Other					
Total loans 90 days or more past due					
Total non-performing loans	476	605	665	524	671
Real estate owned		19	101	202	101
Other non-performing assets					
Total non-performing assets	$ 476	$ 624	$ 766	$ 726	$ 772
Troubled debt restructurings:					
Residential first mortgage loans::					
One- to four-family	$ 53	$ 94	$ 167	$ 270	$ 372
Construction					
Commercial					
Commercial real estate					
Home equity loans and lines of credit					
Other					15
Total	$ 53	$ 94	$ 167	$ 270	$ 387
Ratios:					
Total non-performing loans to total loans	0.08%	0.12%	0.14%	0.12%	0.17%
Total non-performing loans to total assets	0.06%	0.09%	0.11%	0.10%	0.14%
Total non-performing assets to total assets	0.07%	0.10%	0.13%	0.14%	0.16%

For the year ended September 30, 2006, gross interest income that would have been recorded had our non-accruing loans been current in accordance with their original terms was insignificant.

Delinquencies. The following table sets forth certain information with respect to our loan portfolio delinquencies at the dates indicated. Loans delinquent for 90 days or more are generally classified as nonaccrual loans.

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	Loans Delinquent For 60-89 Days Number	Amount	90 Days and Over Number	Amount	Total Number	Amount
			(Dollars in thousands)			
At September 30, 2006						
Residential first mortgage loans:						
One- to four-family			5	436	5	436
Construction						
Commercial						
Commercial real estate	1	49			1	49
Home equity loans and lines of credit			1	40	1	40
Other						
Total	1	$ 49	6	$ 476	7	$ 525
At September 30, 2005						
Residential first mortgage loans:						
One- to four-family	4	590	8	554	12	1,144
Construction						
Commercial						
Commercial real estate						
Home equity loans and lines of credit	1	16	3	50	4	66
Other			1	1	1	1
Total	5	$ 606	12	$ 605	17	$ 1,211
At September 30, 2004						
Residential first mortgage loans:						
One- to four-family	5	237	5	497	10	734
Construction						
Commercial						
Commercial real estate						
Home equity loans and lines of credit			5	79	5	79
Other	1	4	3	8	4	12
Total	6	$ 241	13	$ 584	19	$ 825
At September 30, 2003						
Residential first mortgage loans:						
One- to four-family	2	118	5	379	7	497
Construction						
Commercial						
Commercial real estate						
Home equity loans and lines of credit			6	98	6	98
Other	1	1	6	47	7	48
Total	3	$ 119	17	$ 524	20	$ 643
At September 30, 2002						
Residential first mortgage loans:						
One- to four-family	4	243	10	578	14	821
Construction						
Commercial						
Commercial real estate						
Home equity loans and lines of credit	1	5	1	16	2	21
Other	4	42	4	77	8	119

Total	9	$ 290	15	$ 671	24	$ 961

Classified Assets. Banking regulations and our Asset Classification Policy provide that loans and other assets considered to be of lesser quality should be classified as substandard, doubtful or loss assets. An asset is considered substandard if it is inadequately protected by the current n worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses present make collection or liquidation in full, on the basis of

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currently existing facts, conditions, and values, highly questionable and improbable. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. We classify an asset as special mention if the asset has a potential weakness that warrants management s close attention. While such assets are not impaired, management has concluded that if the potential weakness in the asset is not addressed, the value of the asset may deteriorate, thereby adversely affecting the repayment of the asset.

An institution is required to establish general allowances for loan losses in an amount deemed prudent by management for loans classified substandard or doubtful, as well as for other problem loans. General allowances represent loss allowances which have been established to recognize the inherent losses associated with lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. When an institution classifies problem assets as loss, it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount. An institution s determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the Office of Thrift Supervision which can order the establishment of additional general or specific loss allowances.

On the basis of management s review of its assets, at September 30, 2006, we classified approximately $3.0 million of our assets as special mention and $586,000 as substandard. At September 30, 2006, none of our assets were classified as doubtful or loss.

The loan portfolio is reviewed on a regular basis to determine whether any loans require classification in accordance with applicable regulations. Not all classified assets constitute non-performing assets.

Allowance for Loan Losses

Our allowance for loan losses is maintained at a level necessary to absorb loan losses that are both probable and reasonably estimable. Management, in determining the allowance for loan losses, considers the losses inherent in its loan portfolio and changes in the nature and volume of loan activities, along with the general economic and real estate market conditions. Our allowance for loan losses consists of two elements: (1) an allocated allowance, which comprises allowances established on specific loans and class allowances based on historical loss experience and current trends, and (2) an unallocated allowance based on general economic conditions and other risk factors in our markets and portfolios. We maintain a loan review system, which allows for a periodic review of our loan portfolio and the early identification of potential impaired loans. Such system takes into consideration, among other things, delinquency status, size of loans, type and market value of collateral and financial condition of the borrowers. Specific loan loss allowances are established for identified losses based on a review of such information. A loan evaluated for impairment is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. All loans identified as impaired are evaluated independently. We do not aggregate such loans for evaluation purposes. Loan impairment is measured based on the fair value of collateral method, taking into account the appraised value,

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any valuation assumptions used, estimated costs to sell and trends in the market since the appraisal date. General loan loss allowances are based upon a combination of factors including, but not limited to, actual loan loss experience, composition of the loan portfolio, current economic conditions, management s judgment and losses which are probable and reasonably estimable. The allowance is increased through provisions charged against current earnings and recoveries of previously charged-off loans. Loans that are determined to be uncollectible are charged against the allowance. While management uses available information to recognize probable and reasonably estimable loan losses, future loss provisions may be necessary based on changing economic conditions. Payments received on impaired loans are applied first to accrued interest receivable and then to principal. The allowance for loan losses as of September 30, 2006 is maintained at a level that represents management s best estimate of losses inherent in the loan portfolio, and such losses were both probable and reasonably estimable.

In addition, the Office of Thrift Supervision and the Pennsylvania Department of Banking, as an integral part of its examination process, periodically reviews our allowance for loan losses. The banking regulators may require that we recognize additions to the allowance based on its analysis and review of information available to it at the time of its examination.

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The following table sets forth activity in our allowance for loan losses for the periods indicated.

	At or For the Years Ended September 30, 2006	2005	2004	At or for the ten months ended September 30, 2003	At or for the year ended November 30, 2002
			(Dollars in thousands)		
Balance at beginning of year	$ 3,563	$ 3,027	$ 2,509	$ 2,154	$ 1,371
Charge-offs:					
Residential first mortgage loans:					
One- to four-family		(10)		(28)	(42)
Construction					
Commercial					
Commercial real estate					
Home equity loans and lines of credit	(7)		(31)	(6)	(11)
Other	(2)	(5)	(4)	(51)	(97)
Total charge-offs	$ (9)	$ (15)	$ (35)	$ (85)	$ (150)
Recoveries:					
Residential first mortgage loans:					
One- to four-family			7	2	12
Construction					
Commercial					
Commercial real estate					
Home equity loans and lines of credit					
Other	1	1	16	8	21
Total recoveries	$ 1	$ 1	$ 23	$ 10	$ 33
Net charge-offs	(8)	(14)	(12)	(75)	(117)
Provision for loan losses	300	550	530	430	900
Balance at end of year	$ 3,855	$ 3,563	$ 3,027	$ 2,509	$ 2,154
Ratios:					
Net charge-offs to average loans outstanding	%	%	%	(0.02)%	(0.03)%
Allowance for loan losses to non-performing loans at end of year	809.87%	588.93%	455.19%	478.82%	321.01%
Allowance for loan losses to total loans at end of year	0.69%	0.70%	0.63%	0.57%	0.55%

As indicated in the table above, we charged off a de minimus amount of loans since fiscal year 2004, due, in part, to a stable local economy with significant appreciation in real estate values, conservative underwriting of loans and aggressive monitoring of the loan portfolio to identify and address non-performing loans and potential problem assets at an early date. The amount of foreclosures we incurred in the last five years was not material to our financial statements taken as a whole and ESSA Bank & Trust suffered no material losses on foreclosed assets during that period. See Non-Performing Loans and Problem Assets. There can be no assurance that we will not experience a deterioration of its loan portfolio, including increases in non-performing loans, problem assets and charge-offs, in the future.

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Allocation of Allowance for Loan Losses. The following tables set forth the allowance for loan losses allocated by loan category, the percent of the allowance to the total allowance and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	At September 30,								
	2006			2005			2004		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
	(Dollars in thousands)								
Residential first mortgage loans:									
One- to four-family	$ 2,026	52.56%	80.36%	$ 1,887	52.96%	81.68%	$ 1,397	46.15%	82.41%
Construction	86	2.23	1.06	104	2.92	1.47	108	3.57	1.72
Commercial	133	3.45	1.09	114	3.20	1.03	62	2.05	0.51
Commercial real estate	773	20.05	8.43	471	13.22	7.17	332	10.97	6.08
Home equity loans and lines of credit	746	19.35	8.31	661	18.55	7.82	504	16.65	7.07
Other	46	1.19	0.75	39	1.09	0.83	106	3.50	2.21
Total allocated allowance	3,810	98.83	100.00%	3,276	91.94	100.00%	2,509	82.89	100.00%
Unallocated allowance	45	1.17		287	8.06		518	17.11	
Total allowance for loan losses	$ 3,855	100.00%	100.00%	$ 3,563	100.00%	100.00%	$ 3,027	100.00%	100.00%

	At September 30, 2003			At November 30, 2002		
	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans	Amount	Percent of Allowance to Total Allowance	Percent of Loans in Category to Total Loans
	(Dollars in thousands)					
Residential first mortgage loans:						
One- to four-family	$ 1,326	52.87%	85.16%	$ 1,177	54.65%	84.88%
Construction	87	3.47	1.37	95	4.41	1.89
Commercial	44	1.75	0.51	42	1.95	0.35
Commercial real estate	208	8.29	4.19	184	8.54	2.63
Home equity loans and lines of credit	393	15.66	5.99	252	11.70	6.48
Other	123	4.90	2.78	150	6.96	3.77
Total allocated allowance	2,181	86.94	100.00%	1,900	88.21	100.00%
Unallocated allowance	328	13.06		254	11.79	
Total allowance for loan losses	$ 2,509	100.00%	100.00%	$ 2,154	100.00%	100.00%

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We use the accrual method of accounting for all performing loans. The accrual of interest income is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. When a loan is placed on nonaccrual status, unpaid interest previously credited to income is reversed. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management s judgment as to the collectibility of principal. Generally, residential and consumer loans are restored to accrual status when the obligation is brought in accordance with the contractual terms for a reasonable period of time and ultimate collectibility of total contractual principal and interest is no longer in doubt. Commercial loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time and ultimate collectibility of total contractual principal and interest no longer is in doubt.

In its collection efforts, we will first attempt to cure any delinquent loan. If a real estate secured loan is placed on nonaccrual status, it will be subject to transfer to the real estate owned (REO) portfolio (properties acquired by or in lieu of foreclosure), upon which our loan servicing department will pursue the sale of the real estate. Prior to this transfer, the loan balance will be reduced, if necessary, to reflect its current market value less estimated costs to sell. Write downs of REO that occur after the initial transfer from the loan portfolio and costs of holding the property are recorded as other operating expenses, except for significant improvements which are capitalized to the extent that the carrying value does not exceed estimated net realizable value.

Fair values for determining the value of collateral are estimated from various sources, such as real estate appraisals, financial statements and from any other reliable sources of available information. For those loans deemed to be impaired, collateral value is reduced for the estimated costs to sell. Reductions of collateral value are based on historical loss experience, current market data, and any other source of reliable information specific to the collateral.

This analysis process is inherently subjective, as it requires us to make estimates that are susceptible to revisions as more information becomes available. Although we believe that we have established the allowance at levels to absorb probable and estimable losses, future additions may be necessary if economic or other conditions in the future differ from the current environment.

Securities Activities

Our securities investment policy is established by our Board of Directors. This policy dictates that investment decisions be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, and consistency with our interest rate risk management strategy. Our investment policy is reviewed annually by our ALCO/Investment Committee. All policy changes recommended by this Committee must be approved by the Board of Directors. The Committee is composed of three members of the Board of Directors,

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one to serve as chairperson. The Chief Financial Officer, Controller, Chairman of the Board of Directors and Chief Executive Officer are ex-officio members of the Investment Committee. Authority to make investments under the approved guidelines will be delegated by the Committee to appropriate officers. While general investment strategies will be developed and authorized by the ALCO/Investment Committee, the execution of specific actions rests with the Chief Financial Officer.

The approved investment officers are authorized to execute investment transactions up to $4.0 million per transaction without the prior approval of the ALCO/Investment Committee and within the scope of the established investment policy. These officers are also authorized to execute investment transactions between $4.0 million and $6.0 million with the additional approval from two of the following officers: Chief Executive Officer, Chief Operating Officer, or Chief Lending Officer. Each transaction in excess of $6.0 million must receive prior approval of the Investment Committee.

Our current investment policy generally permits securities investments in debt securities issued by the U.S. government and U.S. agencies, municipal bonds, and corporate debt obligations, as well as investments in preferred and common stock of government agencies and government sponsored enterprises such as Fannie Mae, Freddie Mac and the Federal Home Loan Bank of Pittsburgh (federal agency securities) and, to a much lesser extent, other equity securities. Securities in these categories are classified as investment securities for financial reporting purposes. The policy also permits investments in mortgage-backed securities, including pass-through securities issued and guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae as well as commercial paper, corporate debt and municipal securities. As of September 30, 2006, we held no asset-backed securities, and other equity securities consisted almost exclusively of securities issued by Fannie Mae and the Federal Home Loan Bank of Pittsburgh. Our current investment strategy uses a risk management approach of diversified investing in fixed-rate securities with short- to intermediate-term maturities, as well as adjustable-rate securities, which may have a longer term to maturity. The emphasis of this approach is to increase overall investment securities yields while managing interest rate risk.

SFAS No. 115 requires that, at the time of purchase, we designate a security as held to maturity, available-for-sale, or trading, depending on our ability and intent. Securities available-for-sale are reported at fair value, while securities held to maturity are reported at amortized cost.

Mortgage-Backed Securities. We purchase mortgage-backed securities in order to generate positive interest rate spreads with minimal administrative expense, lower credit risk as a result of the guarantees provided by Freddie Mac, Fannie Mae and Ginnie Mae, and increased liquidity. We invest primarily in mortgage-backed securities issued or sponsored by Fannie Mae, Freddie Mac, and Ginnie Mae. To a lesser extent, we also invest in securities backed by U.S. government agencies. At September 30, 2006 our mortgage-backed securities portfolio had a fair value of $54.4 million, consisting of Freddie Mac, Fannie Mae and Ginnie Mae mortgage-backed securities.

Mortgage-backed securities are created by pooling mortgages and issuing a security collateralized by the pool of mortgages with an interest rate that is less than the interest rate on the underlying mortgages. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family mortgages, although most of our mortgage-backed securities are collateralized by single-family mortgages. The issuers of such securities (generally U.S. government agencies and U.S. government sponsored enterprises, including Fannie Mae, Freddie Mac and Ginnie Mae) pool and resell the participation interests in the form of securities to investors, such as ESSA Bank & Trust, and guarantee the payment of principal and interest to these investors. Investments in mortgage-backed securities involve a risk that actual prepayments will be greater or less than the prepayment rate estimated at the time of purchase, which may require adjustments to the amortization of any premium or accretion of any discount relating to such instruments, thereby affecting the net yield on such securities. We review prepayment estimates for our mortgage-backed securities at the time of purchase to ensure that prepayment assumptions are reasonable considering the underlying collateral for the securities at issue and current interest rates, and to determine the yield and estimated maturity of the mortgage-backed securities portfolio. Periodic reviews of current prepayment speeds are performed in order to ascertain whether prepayment estimates require modification that would cause amortization or accretion adjustments.

Equity Securities. At September 30, 2006, our equity securities consisted almost entirely of securities issued by Fannie Mae, which are classified as available-for-sale.

In addition, we hold Federal Home Loan Bank of Pittsburgh common stock to qualify for membership in the Federal Home Loan Bank System and to be eligible to borrow funds under the Federal Home Loan Bank of Pittsburgh advance program. There is no market for the common stock.

The aggregate fair value of our Federal Home Loan Bank of Pittsburgh common stock as of September 30, 2006 was $13.7 million based on its par value. No unrealized gains or losses have been recorded because we have determined that the par value of the common stock represents its fair value. We owned shares of Federal Home Loan Bank of Pittsburgh common stock at September 30, 2006 with a par value that was $189,000 more than we were required to own to maintain our membership in the Federal Home Loan Bank System and to be eligible to obtain advances. We are required to purchase additional stock as our outstanding advances increase. Any excess stock we own is redeemed monthly by the Federal Home Loan Bank of Pittsburgh.

We review equity and debt securities with significant declines in fair value on a periodic basis to determine whether they should be considered temporarily or other than temporarily impaired. If a decline in the fair value of a security is determined to be other than temporary, we are required to reduce the carrying value of the security to its fair value and record a non-cash impairment charge in the amount of the decline, net of tax effect, against our current income.

Our investment securities portfolio contains unrealized losses of securities, including mortgage-related instruments issued or backed by the full faith and credit of the United States government, or generally viewed as having the implied guarantee of the U.S. government, and debt obligations of a U.S. state or political subdivision.

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Our policy is to recognize an other-than-temporary impairment of equity securities where the fair value has been significantly below cost for three consecutive quarters. For fixed maturity investments with unrealized losses due to interest rates where we have the positive intent and ability to hold the investment for a period of time sufficient to allow a market recovery, declines in value below cost are not assumed to be other than temporary. We review our position quarterly and concluded that at September 30, 2006, the declines outlined in the table below represent temporary declines due to interest rate change, and we have the intent and ability to hold those securities either to maturity or to allow a market recovery. However, as of September 30, 2005, we recognized a loss of $130,000 on equity securities that we deemed, through analysis of the security, to be other than a temporary loss.

The following table sets forth the composition of our securities portfolio (excluding Federal Home Loan Bank of Pittsburgh common stock) at the dates indicated.

	At September 30,					
	2006		2005		2004	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)					
Investment securities available for sale:						
U.S. Government agency obligations	$ 41,960	$ 41,815	$ 34,989	$ 34,729	$ 14,981	$ 14,992
Obligations of state and political subdivisions	6,240	6,465	5,102	5,377	5,341	5,691
Mortgage-backed securities	40,327	39,907	18,799	18,491	20,482	20,444
Corporate notes			3,039	3,030	3,041	3,039
Total debt securities	88,527	88,187	61,929	61,627	43,845	44,166
Equity securities	882	935	882	879	1,012	908
Total investment securities available-for-sale	$ 89,409	$ 89,122	$ 62,811	$ 62,506	$ 44,857	$ 45,074
Investment securities held-to-maturity:						
U.S. Government agency obligations	$ 4,730	$ 4,681	$ 4,730	$ 4,704	$	$
Mortgage-backed securities	14,985	14,512	16,775	16,593	10,263	10,282
Total securities held to maturity	$ 19,715	$ 19,193	$ 21,505	$ 21,297	$ 10,263	$ 10,282

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Portfolio Maturities and Yields. The composition and maturities of the investment securities portfolio at September 30, 2006 are summarized in the following table. Maturities are based on the final contractual payment dates, and do not reflect the impact of prepayments or early redemptions that may occur.

	One Year or Less		More than One Year through Five Years		More than Five Years through Ten Years		More than Ten Years		Total Securities		
	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Fair Value	Weighted Average Yield
	(Dollars in thousands)										
Investment securities available for sale:											
U.S. Government agency obligations	$ 22,968	3.95%	$ 17,070	4.73%	$ 1,922	5.00%	$	%	$ 41,960	$ 41,815	4.32%
Obligations of state and political subdivisions							6,240	4.72	6,240	6,465	4.72
Mortgage-backed securities	511	5.29	12,538	4.46	169	5.50	27,109	4.88	40,327	39,907	4.76
Corporate notes											
Total debt securities	23,479	3.98%	29,608	4.62%	2,091	5.04%	33,349	4.85%	88,527	88,187	4.55%
Equity securities	882								882	935	
Total investment securities available for-sale	$ 24,361		$ 29,608		$ 2,091		$ 33,349		$ 89,409	$ 89,122	
Investment securities held-to-maturity:											
U.S. Government agency obligations	$	%	$ 4,730	4.35%	$	%	$	%	$ 4,730	$ 4,681	4.35%
Mortgage-backed securities			7,261	4.54	3,312	4.76	4,412	4.64	14,985	14,512	4.62
Total securities held to maturity	$	%	$ 11,991	4.46%	$ 3,312	4.76%	$ 4,412	4.64%	$ 19,715	$ 19,193	4.55%

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Sources of Funds

General. Deposits, borrowings, repayments and prepayments of loans and securities, proceeds from maturing securities and cash flows from operations are the primary sources of our funds for use in lending, investing and for other general purposes.

Deposits. We offer a variety of deposit accounts with a range of interest rates and terms. Our deposit accounts consist of savings accounts, NOW accounts, checking accounts, money market accounts, club accounts, certificates of deposit and IRAs and other qualified plan accounts. We provide commercial checking accounts for businesses.

At September 30, 2006, our deposits totaled $402.2 million. Interest-bearing NOW, savings and club and money market deposits totaled $168.9 million at September 30, 2006. At September 30, 2006, we had a total of $209.6 million in certificates of deposit. Noninterest-bearing demand deposits totaled $23.7 million. Although we have a significant portion of our deposits in shorter-term certificates of deposit, we monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity.

Our deposits are obtained predominantly from the areas in which our branch offices are located. We rely on our favorable locations, customer service and competitive pricing to attract and retain these deposits. While we accept certificates of deposit in excess of $100,000 for which we may provide preferential rates, we generally do not solicit such deposits as they are more difficult to retain than core deposits. At September 30, 2006, we had a total of $28.4 million of brokered certificates of deposits, an increase of $7.1 million from the prior fiscal year end. Our brokered certificates of deposits range from one- to five-year terms, and are purchased only through pre-approved brokers.

The following table sets forth the distribution of total deposit accounts, by account type, at the dates indicated.

	For the Years Ended September 30,								
	2006			2005			2004		
	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weighted Average Rate	Average Balance	Percent	Weighted Average Rate
	(Dollars in thousands)								
Deposit type:									
Noninterest bearing demand accounts	$ 21,383	5.49%	%	$ 17,527	5.00%	%	$ 13,281	4.01%	%
Interest bearing NOW	59,709	15.34	0.07	61,562	17.57	0.13	61,792	18.66	0.16
Money market	31,618	8.12	2.17	33,386	9.53	1.26	33,078	9.99	0.74
Savings and club	79,452	20.41	0.45	88,727	25.32	0.44	90,853	27.44	0.49
Certificates of deposit	197,064	50.64	4.47	149,267	42.58	3.32	132,119	39.90	3.20
Total deposits	$ 389,226	100.00%	2.32%	$ 350,469	100.00%	1.67%	$ 331,123	100.00%	1.51%

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As of September 30, 2006, the aggregate amount of outstanding certificates of deposit in amounts greater than or equal to $100,000 was approximately $81.0 million. The following table sets forth the maturity of those certificates as of September 30, 2006.

	At September 30, 2006 (In thousands)
Three months or less	$ 15,157
Over three months through six months	17,882
Over six months through one year	22,969
Over one year	25,027
Total	$ 81,035

At September 30, 2006, $147.2 million of our certificates of deposit had maturities of one year or less. We monitor activity on these accounts and, based on historical experience and our current pricing strategy, we believe we will retain a large portion of these accounts upon maturity.

The following tables sets forth, by interest rate ranges, information concerning certificates of deposit.

	At September 30, 2006 Period to Maturity					
	Less Than or Equal to One Year	More Than One to Two Years	More Than Two to Three Years	More Than Three Years	Total	Percent of Total
	(Dollars in thousands)					
Interest Rate Range:						
2.00% and below	$ 49	$	$	$	$ 49	$ 0.02%
2.01% to 3.00%	3,991	670			4,661	2.22%
3.01% to 4.00%	42,910	11,314	8,683	1,860	64,767	30.90%
4.01% to 5.00%	57,345	15,300	6,024	14,695	93,364	44.56%
5.01% to 6.00%	42,949	1,911	200	1,673	46,733	22.30%
6.01% and above	3				3	%
Total	$ 147,247	$ 29,195	$ 14,907	$ 18,228	$ 209,577	$ 100%

The following table sets forth time deposits classified by interest rate at the dates indicated.

	At September 30,		
	2006	2005	2004
	(In thousands)		
Interest Rate			
2.00% and below	$ 49	$ 4,737	$ 44,520
2.01% to 3.00%	4,661	37,440	16,395
3.01% to 4.00%	64,767	80,140	24,755
4.01% to 5.00%	93,364	31,470	19,560
5.01% to 6.00%	46,733	19,131	20,783
6.01% and above	3	226	1,502
Total	$ 209,577	$ 173,144	$ 127,515

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Borrowings. Our short-term borrowings consist of Federal Home Loan Bank advances. The following table sets forth information concerning balances and interest rates on all of our short-term borrowings at the dates and for the years indicated.

	At or For the Years Ended September 30,		
	2006	2005	2004
	(Dollars in thousands)		
Balance at end of year	$ 35,299	$ 27,479	$ 11,134
Maximum outstanding at any month end	$ 35,299	$ 27,479	$ 16,878
Average balance during year	$ 21,957	$ 18,991	$ 10,388
Weighted average interest rate at end of year	5.40%	3.84%	1.96%
Average interest rate during year	4.92%	2.92%	1.36%

At September 30, 2006, we had the ability to borrow approximately $496.1 million under our credit facilities with the Federal Home Loan Bank of Pittsburgh.

Competition

We face significant competition in both originating loans and attracting deposits. The counties in which we operate have a significant concentration of financial institutions, many of which are significantly larger institutions and have greater financial resources than we, and many of which are our competitors to varying degrees. Our competition for loans comes principally from commercial banks, savings banks, mortgage banking companies, credit unions, leasing companies, insurance companies and other financial service companies. Our most direct competition for deposits has historically come from commercial banks, savings banks and credit unions. We face additional competition for deposits from nondepository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

We seek to meet this competition by the convenience of our branch locations, emphasizing personalized banking and the advantage of local decision-making in our banking business. Specifically, we promote and maintain relationships and build customer loyalty within local communities by focusing our marketing and community involvement on the specific needs of individual neighborhoods. As of June 30, 2006 ESSA Bank & Trust had the second largest deposit market share in Monroe County, Pennsylvania. We do not rely on any individual, group, or entity for a material portion of our deposits.

Employees

As of September 30, 2006, we had 142 full-time employees and 28 part-time employees. The employees are not represented by a collective bargaining unit and we consider our relationship with our employees to be good.

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Properties

As of September 30, 2006, the net book value of our properties was $6.4 million. The following is a list of our offices:

Location	Leased or Owned	Year Acquired or Leased	Square Footage
Main Office:			
200 Palmer Street Stroudsburg, PA 18360	Owned	2003	36,000
Full Service Branches:			
Route 940 HC 1 Box 1192 Blakeslee, PA 18610	Owned	2002	2,688
Route 209 & Lake Mineola Road P.O. Box 35 Brodheadsville, PA 18301	Owned	1983	4,100
Route 209 7001 Milford Road East Stroudsburg, PA	Leased	1997	1,700
Routes 209 & 447 695 North Courtland Street East Stroudsburg, PA 18301	Leased	1999	420
75 Washington Street East Stroudsburg, PA 18301	Owned	1966	3,300
Route 209 P.O. Box 1009 Marshalls Creek, PA 18335	Leased	1991	1,560
Mount Pocono Plaza 601 Route 940 Mt. Pocono, PA 18344	Leased	1999	536
1309 Blue Valley Drive Pen Argyl, PA 18072	Leased	2001	444
744 Main Street P.O. Box L	Owned	1985	12,000

Stroudsburg, PA 18360			
Route 611 1070 North Ninth Street Stroudsburg, PA 18360	Leased	2000	488
Route 611 RR1 Box 402 Tannersville, PA 18372	Leased	1993	611
Route 209 & Weir Lake Road P.O. Box 271 Brodheadsville, PA 18322	Leased	1997	576
Other Properties			
746-752 Main Street Stroudsburg, PA 18360	Owned	2004	4,650

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Subsidiary Activities

ESSA Bank & Trust has two wholly-owned subsidiaries, ESSACOR, Inc. and Pocono Investment Company. ESSACOR, Inc. is a Pennsylvania corporation that is currently inactive. Pocono Investment Company is a Delaware corporation formed as an investment company subsidiary to hold and manage certain investments of ESSA Bank & Trust, including certain intellectual property.

Legal Proceedings

We are not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business, which, in the aggregate, involve amounts which we believe are immaterial to our consolidated financial condition and results of operations.

REGULATION

General

ESSA Bancorp, Inc. is a Pennsylvania corporation. As a savings and loan holding company, we are required to file certain reports with, and otherwise comply with the rules and regulations of the Office of Thrift Supervision.

ESSA Bank & Trust is a Pennsylvania-chartered savings association and its deposit accounts are insured up to applicable limits by the Federal Deposit Insurance Corporation under the Deposit Insurance Fund (DIF). We are subject to extensive regulation by the Pennsylvania Department of Banking, as its chartering agency, and by the Office of Thrift Supervision, as its primary federal regulator. We must file reports with the Pennsylvania Department of Banking and the Office of Thrift Supervision concerning its activities and financial condition in addition to obtaining regulatory approvals prior to entering into certain transactions including, but not limited to, mergers with or acquisitions of other savings institutions. There are periodic examinations by the Pennsylvania Department of Banking and the Office of Thrift Supervision to test our compliance with various regulatory requirements. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the Federal Deposit Insurance Corporation insurance fund and depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and with their examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in such regulation, whether by the Pennsylvania Department of Banking or the Office of Thrift Supervision could have a material adverse impact on us and our operations.

Regulation by the Pennsylvania Department of Banking

The Pennsylvania Savings Association Code of 1967, as amended (the Savings Association Code) contains detailed provisions governing the organization, location of offices, rights and responsibilities of directors, officers, employees, and depositors, as well as corporate powers, savings and investment operations and other aspects of ESSA Bank & Trust and its affairs. The Savings Association Code delegates extensive rulemaking power and administrative discretion to the Pennsylvania Department of Banking so that the supervision and regulation of state-chartered savings associations may be flexible and readily responsive to changes in economic conditions and in savings and lending practices.

One of the purposes of the Savings Association Code is to provide savings associations with the opportunity to be competitive with each other and with other financial institutions existing under other Pennsylvania laws as well as other state, federal and foreign laws. A Pennsylvania savings association may locate or change the location of its principal place of business and establish an office anywhere in Pennsylvania, with the prior approval of the Pennsylvania Department of Banking.

The Department generally examines each savings association not less frequently than once every two years. Although the Department may accept the examinations and reports of the

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Office of Thrift Supervision in lieu of the Department s examination, the current practice is for the Department to conduct individual examinations. The Department may order any savings association to discontinue any violation of law or unsafe or unsound business practice and may direct any trustee, officer, attorney, or employee of a savings association engaged in an objectionable activity, after the Department has ordered the activity to be terminated, to show cause at a hearing before the Department why such person should not be removed.

Regulation by the Office of Thrift Supervision

ESSA Bank & Trust is also subject to extensive regulation, examination and supervision by the Office of Thrift Supervision, as its primary federal regulator. Such regulation and supervision:

establishes a comprehensive framework of activities in which the Bank can engage;

limits the ability of ESSA Bank & Trust to extend credit to any given borrower;

significantly limits the transactions in which ESSA Bank & Trust may engage with its affiliates;

requires ESSA Bank & Trust to meet a qualified thrift lender test which requires ESSA Bank & Trust to invest in qualified thrift investments, which include primarily residential mortgage loans and related investments;

places limitations on capital distributions by savings associations, such as ESSA Bank & Trust, including cash dividends;

imposes assessments to the Office of Thrift Supervision to fund their operations;

establishes a continuing and affirmative obligation, consistent with ESSA Bank & Trust s safe and sound operation, to help meet the credit needs of its community, including low and moderate income neighborhoods;

establishes various capital categories resulting in various levels of regulatory scrutiny applied to the institutions in a particular category; and

establishes standards for safety and soundness.

The Office of Thrift Supervision generally examines each savings association not less frequently than once every two years. The Office of Thrift Supervision has the authority to order any savings association or its directors, trustees, officers, attorneys or employees to discontinue any violation of law or unsafe or unsound banking practice. See - Regulatory Enforcement Authority.

Transactions with Affiliates

Sections 23A and 23B of the Federal Reserve Act and its implementing regulations, govern transactions between depository institutions and their affiliates. These provisions are made applicable to savings associations, such as ESSA Bank & Trust, by the Home Owners Loan Act and Office of Thrift Supervision regulation. In a holding company context, the parent holding company of a savings association and any companies that are controlled by the parent holding company, are affiliates of the savings association.

Section 23A limits the extent to which the savings association or its subsidiaries may engage in certain transactions with its affiliates. These transactions include, among other things, the making of loans or other extensions of credit to an affiliate and the purchase of assets from an affiliate. Generally, these transactions between the savings association and any one affiliate cannot exceed 10% of the savings association s capital stock and surplus, and these transactions between the savings institution and all of its affiliates cannot, in the aggregate, exceed 20% of the savings institution s capital stock and surplus. Section 23A also establishes specific collateral requirements for loans or extensions of credit to an affiliate, and for guarantees or acceptances on letters of credit issued on behalf of an affiliate. Applicable regulations prohibit a savings association from lending to any affiliate engaged in activities not permissible for a bank holding company or for the purpose of acquiring the securities of most affiliates.

Section 23B requires that transactions covered by Section 23A and a broad list of other specified transactions be on terms and under circumstances substantially the same, or no less favorable to the savings association or its subsidiary, as similar transactions with non-affiliates. In addition to the restrictions on transactions with affiliates that Sections 23A and 23B of the Federal Reserve Act impose on depository institutions, the regulations of the Office of Thrift Supervision also generally prohibit a savings association from purchasing or investing in securities issued by an affiliate.

Insurance of Accounts and Regulation by the Federal Deposit Insurance Corporation

Deposit accounts in ESSA Bank & Trust are insured by the Federal Deposit Insurance Corporation generally up to a maximum of $100,000 per separately insured depositor and up to a maximum of $250,000 for self-directed retirement accounts. ESSA Bank & Trust s deposits, therefore, are subject to Federal Deposit Insurance Corporation deposit insurance assessments.

On February 15, 2006, federal legislation to reform federal deposit insurance was enacted. This new legislation required, among other things, that the Federal Deposit Insurance Corporation adopt regulations increasing the maximum amount of federal deposit insurance coverage per separately insured depositor to $130,000 (with a cost of living adjustment to become effective in five years) and modifying the deposit fund s reserve ratio for a range between 1.15% and 1.50% of estimated insured deposits.

On November 2, 2006, the Federal Deposit Insurance Corporation adopted final regulations establishing a risk-based assessment system that will enable the Federal Deposit Insurance Corporation to more closely tie each financial institution s premiums to the risk it

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poses to the deposit insurance fund. Under the new risk-based assessment system, which becomes effective in the beginning of 2007, the Federal Deposit Insurance Corporation will evaluate the risk of each financial institution based on three primary sources of information: (1) its supervisory rating, (2) its financial ratios, and (3) its long-term debt issuer rating, if the institution has one. The new rates for nearly all of the financial institution industry will vary between five and seven cents for every $100 of domestic deposits. At the same time, the Federal Deposit Insurance Corporation also adopted final regulations designating the reserve ratio for the deposit insurance fund during 2007 at 1.25% of estimated insured deposits.

Effective March 31, 2006, the Federal Deposit Insurance Corporation merged the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) into a single insurance fund called the Deposit Insurance Fund. As a result of the merger, the BIF and SAIF were abolished. The merger of the BIF and SAIF into the Deposit Insurance Fund does not affect the authority of the Financing Corporation (FICO) to impose and collect, with approval of the Federal Deposit Insurance Corporation, assessments for anticipated payments, insurance costs and custodial fees on bonds issued by the FICO in the 1980s to recapitalize the Federal Savings and Loan Insurance Corporation. The bonds issued by the FICO are due to mature in 2017 through 2019. For the quarter ended June 30, 2006, the FICO assessment was equal to 1.28 basis points for each $100 in domestic deposits maintained at an institution.

Capital Requirements

Any savings institution that fails any of the capital requirements is subject to possible enforcement actions by the Office of Thrift Supervision. Such actions could include a capital directive, a cease and desist order, civil money penalties, the establishment of restrictions on an institution s operations, termination of federal deposit insurance, and the appointment of a conservator or receiver. Certain actions are required by law. The Office of Thrift Supervision s capital regulation provides that such actions, through enforcement proceedings or otherwise, could require one or more of a variety of corrective actions.

We are also subject to more stringent capital guidelines of the Department. Although not adopted in regulation form, the Department utilizes capital standards of 6% leverage capital and 10% risk-based capital. The components of leverage and risk-based capital are substantially the same as those defined by the Office of Thrift Supervision.

Loans-to-One Borrower Limitation

Under federal regulations, with certain limited exceptions, a Pennsylvania chartered savings association may lend to a single or related group of borrowers on an unsecured basis an amount equal to 15% of its unimpaired capital and surplus. An additional amount, equal to 10% of unimpaired capital and surplus, may be lent if such loan is secured by readily marketable collateral, which is defined to include certain securities, but generally does not include real estate. Our internal policy, however, is to not make loans either individually or in the aggregate to one entity in excess of $3.0 million in commercial relationships, nor $3.5 million in total loan relationships, including the borrower s residential mortgage and consumer loans. However, in special circumstances this limit may be exceeded subject to the approval of the Management Loan Committee in addition to a majority of the members of the Board of Directors.

Prompt Corrective Action

Under federal regulations, a savings association is deemed to be (i) well capitalized if it has total risk-based capital of 10.0% or more, has a Tier 1 risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more and is not subject to any written capital order or directive; (ii) adequately capitalized if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well capitalized ; (iii) undercapitalized if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based capital ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances); (iv) significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%; and (v) critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. Federal regulations also specify circumstances under which a federal banking agency may reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution to comply with supervisory actions as if it were in the next lower category (except that the Office of Thrift Supervision may not reclassify a significantly undercapitalized institution as critically undercapitalized). As of September 30, 2006, the Bank was a well-capitalized institution for this purpose.

The USA PATRIOT Act

The USA PATRIOT Act of 2001 gave the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. The USA PATRIOT Act also required the federal banking agencies to take into consideration the effectiveness of controls designed to combat money laundering activities in determining whether to approve a merger or other acquisition application of a member institution. Accordingly, if we engage in a merger or other acquisition, our controls designed to combat money laundering would be considered as part of the application process. We have established policies, procedures and systems designed to comply with these regulations.

Holding Company Regulation

Upon completion of the conversion, ESSA Bancorp, Inc. will be a unitary savings and loan holding company, subject to regulation and supervision by the Office of Thrift Supervision. The Office of Thrift Supervision will have enforcement authority over ESSA Bancorp and its non-savings institution subsidiaries. Among other things, this authority permits the Office of Thrift Supervision to restrict or prohibit activities that are determined to be a risk to ESSA Bank & Trust.

Under prior law, a unitary savings and loan holding company generally had no regulatory restrictions on the types of business activities in which it could engage, provided that its subsidiary savings association was a qualified thrift lender. The Gramm-Leach-Bliley Act of 1999, however, restricts unitary savings and loan holding companies not existing on, or applied

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for before, May 4, 1999 to those activities permissible for financial holding companies or for multiple savings and loan holding companies. The Company will not be a grandfathered unitary savings and loan holding company and, therefore, will be limited to the activities permissible for financial holding companies or for multiple savings and loan holding companies. A financial holding company may engage in activities that are financial in nature, including underwriting equity securities and insurance as well as activities that are incidental to financial activities or complementary to a financial activity. A multiple savings and loan holding company is generally limited to activities permissible for bank holding companies under Section 4(c)(8) of the Bank Holding Company Act, subject to the prior approval of the Office of Thrift Supervision, and certain additional activities authorized by Office of Thrift Supervision regulations.

Federal law prohibits a savings and loan holding company, directly or indirectly, or through one or more subsidiaries, from acquiring control of another savings institution or holding company thereof, without prior written approval of the Office of Thrift Supervision. It also prohibits the acquisition or retention of, with specified exceptions, more than 5% of the equity securities of a company engaged in activities that are not closely related to banking or financial in nature or acquiring or retaining control of an institution that is not federally insured. In evaluating applications by holding companies to acquire savings institutions, the Office of Thrift Supervision must consider the financial and managerial resources and future prospects of the savings institution involved, the effect of the acquisition on the risk to the insurance fund, the convenience and needs of the community, the effectiveness of each parties anti-money laundering program, and competitive factors.

Federal Securities Laws

Shares of ESSA Bancorp, Inc. s common stock are registered with the SEC under Section 12(g) of the Securities Exchange Act of 1934, as amended (the Exchange Act). ESSA Bancorp, Inc. is also subject to the proxy rules, tender offer rules, insider trading restrictions, annual and periodic reporting, and other requirements of the Exchange Act.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was enacted in response to public concerns regarding corporate accountability in connection with certain accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies, and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws. The Sarbanes-Oxley Act generally applies to all companies that file or are required to file periodic reports with the Securities and Exchange Commission, under the Securities Exchange Act of 1934.

The Sarbanes-Oxley Act includes specific additional disclosure requirements, requires the Securities and Exchange Commission and national securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules, and mandates further studies of certain issues by the Securities and Exchange Commission. The Sarbanes-Oxley Act

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represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees.

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

Regulatory Enforcement Authority

Federal law provides federal banking regulators with substantial enforcement powers. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders, and to initiate injunctive actions against banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Dividends

Our ability to pay dividends depends, to a large extent, upon ESSA Bank & Trust s ability to pay dividends to ESSA Bancorp. The Savings Association Code states, in part, that dividends may be declared and paid by the Bank only out of net earnings for the then current year. A dividend may not be declared or paid if it would impair the general reserves of ESSA Bank & Trust required to be maintained under the Savings Association Code. In addition, we are required to notify the Office of Thrift Supervision prior to declaring a dividend to the Company, and receive the nonobjection of the Office of Thrift Supervision to any such dividend.

TAXATION

Federal Taxation

General. ESSA Bancorp, Inc. and ESSA Bank & Trust are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize material federal income tax matters and is not a comprehensive description of the tax rules applicable to ESSA Bancorp, Inc. and ESSA Bank & Trust.

Method of Accounting. For federal income tax purposes, ESSA Bank & Trust currently reports its income and expenses on the accrual method of accounting and uses a tax year ending September 30th for filing its consolidated federal income tax returns. The Small Business Protection Act of 1996 eliminated the use of the reserve method of accounting for bad debt reserves by savings institutions, effective for taxable years beginning after 1995.

Bad Debt Reserves. Prior to the Small Business Protection Act of 1996, ESSA Bank & Trust was permitted to establish a reserve for bad debts for tax purposes and to make annual additions to the reserve. These additions could, within specified formula limits, be deducted in arriving at ESSA Bank & Trust s taxable income. As a result of the Small Business Protection Act of 1996, ESSA Bank & Trust must use the specific charge off method in computing its bad debt deduction for tax purposes.

Taxable Distributions and Recapture. Prior to the Small Business Protection Act of 1996, bad debt reserves created prior to 1988 were subject to recapture into taxable income if ESSA Bank & Trust failed to meet certain thrift asset and definition tests. The Small Business Protection Act of 1996 eliminated these thrift-related recapture rules. However, under current law, pre-1988 reserves remain subject to tax recapture should ESSA Bank & Trust make certain distributions from its tax bad debt reserve or cease to maintain a financial institution charter. At September 30, 2006, ESSA Bank & Trust s total federal pre-1988 reserve was approximately $4.3 million. This reserve reflects the cumulative effects of federal tax deductions by ESSA Bank & Trust for which no federal income tax provision has been made.

Minimum Tax. The Internal Revenue Code of 1986, as amended, imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, referred to as alternative minimum taxable income. The alternative minimum tax is payable to the extent alternative minimum taxable income is in excess of an exemption amount. Net operating losses can, in general, offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. At September 30, 2006, ESSA Bank & Trust had no minimum tax credit carryforward.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding two taxable years (five years for losses incurred in 2001 and 2002) and forward to the succeeding 20 taxable years. At September 30, 2006, ESSA Bank & Trust had no net operating loss carryforward for federal income tax purposes.

Corporate Dividends. We may exclude from our income 100% of dividends received from ESSA Bank & Trust as a member of the same affiliated group of corporations.

Audit of Tax Returns. ESSA Bank & Trust s federal income tax return for the 2004 tax year remains open.

State Taxation

Pennsylvania State Taxation. As a Pennsylvania business corporation, ESSA Bancorp, Inc. will be required to file annual returns and pay annual fees to the State of Pennsylvania.

MANAGEMENT OF ESSA BANCORP, INC.

Shared Management Structure

The directors of ESSA Bancorp, Inc. are those same persons who are the directors of ESSA Bank & Trust. In addition, each executive officer of ESSA Bancorp, Inc. is also an executive officer of ESSA Bank & Trust. We expect that ESSA Bancorp, Inc. and ESSA Bank & Trust will continue to have common executive officers until there is a business reason to

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establish separate management structures. To date, executive officers have been compensated for their services by ESSA Bank & Trust.

Executive Officers of ESSA Bancorp, Inc. and ESSA Bank & Trust

The following individuals are the executive officers of ESSA Bancorp, Inc. and ESSA Bank & Trust, their ages as of September 30, 2006 and the position they hold.

Name	Age	Position
Gary S. Olson	52	President and Chief Executive Officer
Allan A. Muto	46	Executive Vice President and Chief Financial Officer
Robert S. Howes, Jr.,	53	Senior Vice President, Lending Services Division
Diane K. Reimer	50	Vice President, Administrative Services Division
V. Gail Warner	50	Vice President, Retail Services Division
Thomas J. Grayuski	45	Vice President, Human Resource Services Division

The executive officers of ESSA Bancorp, Inc. are elected annually.

Directors of ESSA Bank & Trust and ESSA Bancorp, Inc.

Composition of our Board. ESSA Bancorp, Inc. has nine directors. Directors serve three-year staggered terms so that approximately one-third of the directors are elected at each annual meeting. Directors of ESSA Bank & Trust are elected by ESSA Bancorp, Inc. as its sole stockholder.

The following table states our directors names, their ages as of September 30, 2006, and the years when they began serving as directors of ESSA Bank & Trust and when their current term expires:

Name	Position(s) Held With ESSA Bancorp, Inc.	Age	Director Since	Current Term Expires
Daniel J. Henning	Director	54	1995	2007
Frederick E. Kutteroff	Director	63	2005	2007
Elizabeth B. Weekes	Director	47	2001	2007
John E. Burrus	Chairman of the Board	67	1970	2008
John S. Schoonover, Jr.	Director	65	1989	2008
Robert C. Selig, Jr.	Director	58	1990	2008
William P. Douglass	Director	64	1978	2009
Gary S. Olson	Director, President and Chief Executive Officer	52	2000	2009
William A. Viechnicki, D.D.S.	Director	62	1981	2009

The Business Background of Our Directors and Executive Officers. The business experience for the past five years of each of our directors and executive officers is set forth below. Unless otherwise indicated, directors and executive officers have held their positions for the past five years.

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Directors

John E. Burrus has served as Chairman of the Board of ESSA Bank & Trust since 1989. In 2005, Mr. Burrus retired as the owner of John E. Burrus Landscape which designs, sells, installs and maintains landscapes for private homes, and commercial properties in Monroe County, Easton and Scranton, Pennsylvania. Mr. Burrus is a graduate of Rutgers University.

William P. Douglass has been President of Douglass Enterprises, Inc., doing business as Olde Engine Works Market Place which is an antiques and collectibles co-operative. Mr. Douglass is a graduate of Texas Christian University.

Daniel J. Henning is a builder/real estate developer has been the Owner/President of A.C. Henning Enterprises, Inc., a general contract of custom built homes, multi-family townhouses and light commercial construction and renovation, since 1982. Mr. Henning is a graduate of Spring Garden College.

Frederick E. Kutteroff served as President, Chief Executive Officer of Keystone Savings Bank from 1990 until his retirement in 2003. Mr. Kutteroff holds a Certificate of Business Administration from Temple University.

Gary S. Olson has been President and Chief Executive Officer of ESSA Bank & Trust since 2000. Mr. Olson began his career at ESSA Bank & Trust in 1977. Mr. Olson is a graduate of East Stroudsburg University.

John S. Schoonover, Jr. has been a registered architect/principal in the architectural firm of Schoonover and Vanderhoof, LLC since 1978. He is a licensed architect registered to practice in Pennsylvania, New Jersey, New York and North Carolina. Mr. Schoonover served in the United States Marine Corps from 1962 through 1967.

Robert C. Selig, Jr. has served as President of Selig Construction Company since 1972. Selig Construction Company is in the business of building primary and vacation residences. Mr. Selig is a graduate of West Side Area Vocational/Technical School.

William A. Viechnicki, D.D.S. has been in the private practice of orthodontics in East Stroudsburg, Pennsylvania since 1971. Dr. Viechnicki is a graduate of Pennsylvania State University and Temple University School of Dentistry where he serves as a professor of orthodontics.

Elizabeth B. Weekes has been a partner in the law firm Bensinger and Weekes, P.A. since 1987. Ms. Weekes practice focuses on real estate, civil litigation, domestic relations, banking, municipalities and estates. Ms. Weekes is a graduate of Colgate University and Dickinson School of Law.

Executive Officers of ESSA Bank & Trust Who Are Not Also Directors

Allan A. Muto has been the Executive Vice President and Chief Financial Officer of ESSA Bank & Trust since January 2006. Prior to that time Mr. Muto served as Executive Vice

President, Chief Operating Officer beginning in 2001. Mr Muto previously served as Senior Vice President, Chief Financial Officer at Pioneer American Bank, N.A. in Carbondale, Pennsylvania.

Robert S. Howes, Jr. has been with ESSA Bank & Trust in various capacities since 1985 and has been Senior Vice President, Lending Services Division since 2001. Previously, Mr. Howes served as Branch Manager at Franklin First Federal Savings and Loan Association in Wilkes-Barre, Pennsylvania.

Diane K. Reimer has been Vice President, Administrative Services Division since 1998 and first joined ESSA Bank & Trust in 1983.

V. Gail Warner has been Vice President, Retail Services Division since 1999. Previously, Ms. Warner served as Assistant Vice President, Branch Sales Manager at First Eastern Bank in Mount Pocono, Pennsylvania.

Thomas J. Grayuski has been Vice President, Human Resources Services Division since 2000. Previously, Mr. Grayuski was the Senior Personnel Management Specialist at the United States Army Armament Research, Development and Engineering Center in Dover, New Jersey.

Meetings and Committees of the Board of Directors of ESSA Bancorp, Inc.

We conduct business through meetings of our Board of Directors and its committees. During the fiscal year ended September 30, 2006, the Board of Directors of ESSA Bancorp, Inc. did not meet and the Board of Directors of ESSA Bank & Trust met 13 times. The Board of Directors of ESSA Bancorp, Inc. has established the following standing committees: the Compensation Committee, the Corporate Governance Committee and the Audit Committee.

The Audit Committee, currently consisting of Messrs. Henning (Chair), Douglass, Kutteroff and Viechnicki, is responsible for providing oversight relating to our financial statements and financial reporting process, systems of internal accounting and financial controls, internal audit function, annual independent audit and the compliance and ethics programs established by management and the board. Each member of the Audit Committee is independent in accordance with the listing standards of the Nasdaq Stock Market. The Board of Directors believes that Mr. Kutteroff qualifies as an audit committee financial expert as that term is defined in the rules and regulations of the Securities and Exchange Commission. The Audit Committee of ESSA Bank & Trust met four times in fiscal year 2006.

The Compensation Committee, currently consisting of Messrs. Douglass (Chair), Burrus, Viechnicki and Olson and Ms. Weekes, is responsible for human resources policies, salaries and benefits, incentive compensation, executive development and management succession planning. Each member of the Compensation Committee, except for Mr. Olson, is independent in accordance with the listing standards of the Nasdaq Stock Market.

The Corporate Governance Committee, currently consisting of Messrs. Douglass (Chair), Henning, Selig, Burrus and Olson and Ms. Weekes, is responsible for identifying individuals qualified to become board members and recommending a group of nominees for election as

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directors at each annual meeting of stockholders, ensuring that the board and its committees have the benefit of qualified and experienced independent directors, and developing a set of corporate governance policies and procedures.

Each of these committees operates under a written charter, which governs its composition, responsibilities and operations.

In addition, ESSA Bank & Trust maintains an Operations Committee (chaired by Mr. Selig), ALCO/Investment Committee (chaired by Mr. Viechnicki), Trust Audit Committee (chaired by Mr. Schoonover) and Trust Committee (chaired by Ms. Weekes) and an Executive Committee.

Corporate Governance Policies and Procedures

In addition to having established committees of the Board of Directors, ESSA Bancorp, Inc. has adopted policies to govern the activities of both ESSA Bancorp, Inc. and ESSA Bank & Trust, including a corporate governance policy and a code of business conduct and ethics. The corporate governance policy sets forth:

- the duties and responsibilities of each director;
- the composition, responsibilities and operation of the Board of Directors;
- the establishment and operation of board committees, including audit, nominating and compensation committees;
- succession planning;
- convening executive sessions of independent directors;
- the Board of Directors interaction with management and third parties; and
- the evaluation of the performance of the Board of Directors and the chief executive officer.

ESSA Bancorp, Inc. has adopted a code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer and persons performing similar functions. The code of ethics is designed to deter wrongdoing and to promote honest and ethical conduct, the avoidance of conflicts of interest, full and accurate disclosure and compliance with all applicable laws, rules and regulations.

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Director Fees

Director Fees. Each of the individuals who serves as a director of ESSA Bancorp, Inc. also serves as a director of ESSA Bank & Trust and earns director fees in that capacity. Each non-employee director (except for the Chairman of the Board) is paid a fee of $2,000 per month for their service and $1,000 for each Board meeting attended. In addition, the Chairperson of a committee is paid $750 for each committee meeting attended and committee members are paid $500 for each committee meeting attended. In lieu of the above mentioned fees, the Chairman of the Board is paid an annual retainer of $60,000 and $1,500 for each Board meeting attended. The Chairman of the Board is not compensated for attendance at any committee meetings.

Executive Officer Compensation

Summary Compensation Table. The following table sets forth for the fiscal year ended September 30, 2006, certain information as to the total remuneration paid by ESSA Bank & Trust to its Chief Executive Officer as well as to the four most highly compensated executive officers of ESSA Bank & Trust, other than the Chief Executive Officer, who received total annual salary and bonus in excess of $100,000. Each of the individuals listed in the table below is referred to as a Named Executive Officer.

		Annual Compensation (1)			
Name and Principal Position	**Fiscal Year**	**Salary (2)**	**Bonus**	**Other Annual Compensation (3)**	**All Other Compensation (4)**
Gary S. Olson, President and Chief Executive Officer	2006	$ 201,500	$ 94,000		$ 18,700
Allan A. Muto, Executive Vice President and Chief Financial Officer	2006	$ 131,500	$ 49,000		$ 11,900
Robert S. Howes, Jr., Senior Vice President, Lending Services Division	2006	$ 112,800	$ 37,000		$ 10,800
V. Gail Warner, Vice President, Retail Services Division	2006	$ 103,500	$ 34,000		$ 11,900
Diane K. Reimer, Vice President, Administrative Services Division	2006	$ 92,700	$ 26,000		$ 12,800

(1) Summary compensation information is excluded for the fiscal years ended September 30, 2005 and 2004, as ESSA Bancorp, Inc. was not a public company during those periods.

(2) Current base salaries for Messrs. Olson, Muto and Howes and Mmes. Warner and Reimer are $211,900, $141,700, $117,100, $111,500 and $97,200, respectively.

(3) ESSA Bank & Trust provides certain of its executive officers with non-cash benefits and perquisites. Management believes that the aggregate value of these benefits for fiscal year 2006 did not, in the case of the named executive officers, exceed the greater of $50,000 or 10% of the aggregate salary and annual bonus reported for them in the Summary Compensation Table.

(4) Represents employer contributions under ESSA Bank & Trust s 401(k) Plan for Named Executive Officer as well as health, life and disability insurance premiums.

Benefit Plans

Employment Agreements. ESSA Bancorp, Inc. intends to enter into employment agreements with each of Messrs. Olson, Muto, Howes and Grayuski and Ms. Warner and Ms. Reimer. The agreements with Messrs. Olson and Muto will have an initial term of three years. The agreements with Messrs. Howes and Grayuski and Ms. Warner and Ms. Reimer will have terms of two years. Unless notice of non-renewal is provided, the agreements renew annually. Under the agreements, the initial base salaries for Messrs. Olson, Muto, Howes, Ms. Warner, Ms. Reimer and Mr. Grayuski are $211,900, $141,700, $117,100, $111,500, $97,200 and $80,000, respectively. Base salaries will be reviewed at least annually and may be increased, but not

decreased. In addition to the base salary, each agreement will provide for, among other things, participation in bonus programs and other employee pension benefit and fringe benefit plans applicable to executive employees and use of an automobile (in the case of Mr. Olson). The executive s employment may be terminated for cause at any time, in which event the executive would have no right to receive compensation or other benefits for any period after termination.

Each of the executives is entitled to severance payments and benefits in the event of his or her termination of employment under specified circumstances. In the event the executive s employment is terminated for reasons other than for cause, disability or retirement, or in the event the executive resigns within 90 days following (1) the failure to elect or reelect or to appoint or reappoint the executive to his executive position, (2) a material change in the executive s functions, duties, or responsibilities, which change would cause executive s position to become one of lesser responsibility, importance or scope, (3) the relocation of executive s principal place of employment to a location that is more than 50 miles from the location of the Bank s principal executive offices as of the date of the agreement, (4) a material reduction in benefits and perquisites including base salary (except for any Bank-wide or officer-wide reduction), (5) the liquidation or dissolution of ESSA Bancorp, Inc. or ESSA Bank & Trust, (6) a change in control of ESSA Bancorp, Inc. or (7) a breach of the employment agreement by ESSA Bancorp, Inc., the executive would be entitled to a severance payment equal to three times (in the case of Messrs. Olson and Muto, two times for Mr. Howes, Ms. Warner, Ms. Reimer and Mr. Grayuski) the sum of the executive s base salary and the highest rate of bonus awarded to the executive during the prior three years, payable in a lump sum. In addition, the executive would be entitled, at ESSA Bancorp, Inc. s sole expense, to the continuation of life, medical, dental, vision and disability coverage for 36 months (in the case of Messrs. Olson and Muto; twenty-four months for all other executives) after termination of the agreement. The executive would also receive a lump sum payment of the excess, if any, of the present value of the benefits he would be entitled to under the ESSA Bancorp, Inc. or ESSA Bank & Trust s defined benefit pension plan if he had continued working for ESSA Bancorp, Inc. for 36 months (in the case of Messrs. Olson and Muto; twenty-four months for all other executives) over the present value of the benefits to which he is actually entitled as of the date of termination. In the event that the severance payment provisions of the employment agreement are triggered for one of the covered executives at September 30, 2006, the executive would be entitled to a cash severance benefit in the amount of approximately $__________, $__________, $__________, $__________ and $__________, in the case of Messrs. Olson, Muto, Howes, Ms. Warner, Ms. Reimer or Mr. Grayuski, respectively. The executive would be entitled to no additional benefits under the employment agreement upon retirement at age 65.

Upon termination of the executive s employment other than in connection with a change in control, the executive agrees not to compete with ESSA Bancorp, Inc. for one year following termination of employment within 50 miles of any existing branch of ESSA Bank & Trust or 50 miles of any office for which ESSA Bank & Trust or a subsidiary has filed an application for regulatory approval. Should the executive become disabled, ESSA Bancorp, Inc. would continue to pay the executive his base salary for the longer of the remaining term of the agreement or one year, provided that any amount paid to the executive pursuant to any disability insurance would reduce the compensation he would receive. In the event the executive dies while employed by ESSA Bancorp, Inc., the executive s estate will be paid the executive s base salary for one year and the executive s family will be entitled to continuation of medical, dental and vision benefits for one year after the executive s death.

The employment agreements for Messrs. Howes and Grayuski and Ms. Warner and Ms. Reimer also provide for an automatic reduction in the amount of any payments made in connection with a change in control which would otherwise constitute excess parachute payments under Section 280G of the Internal Revenue Code. The total payment owed to the executive upon a change in control will be reduced to an amount that is $1.00 less than the amount that would otherwise be an excess parachute payment under Code Section 280G. Messrs. Olson and Muto may elect to have such reductions made in their sole discretion.

Change-in-Control Agreements. ESSA Bancorp, Inc. intends to enter into change-in-control agreements with up to six officers who are not entering into employment agreements, which would provide certain benefits in the event of a termination of employment following a change in control of ESSA Bancorp, Inc. or ESSA Bank & Trust. Each of the change-in-control agreements provides for a term of eighteen months. Commencing on each anniversary date, the agreements will be renewed for an additional year so that the remaining term will be eighteen months, subject to notice of non-renewal. The change-in-control agreements enable ESSA Bancorp, Inc. to offer to designated officers certain protections against termination without cause in the event of a change in control (as defined in the agreements). Such protections are frequently offered by other financial institutions, and ESSA Bancorp, Inc. may be at a competitive disadvantage in attracting and retaining key employees if it does not offer similar protections.

Following a change in control of ESSA Bancorp, Inc. or ESSA Bank & Trust, an officer is entitled under the agreement to a payment if the officer s employment is terminated during the term of such agreement, other than for cause, or if the officer voluntarily terminates employment during the term of such agreement as a result of a demotion, loss of title, office or significant authority (in each case, other than as a result of the fact that either ESSA Bank & Trust or ESSA Bancorp, Inc. is merged into another entity in connection with a change in control and will not operate as a stand-alone, independent entity), reduction in his annual compensation or benefits, or relocation of his or her principal place of employment by more than 30 miles from its location immediately prior to the change in control. In the event an officer who is a party to a change-in-control agreement is entitled to receive payments pursuant to the change-in-control agreement, he will receive a cash payment equal to 1.5 times his or her highest rate of base salary and the highest rate of bonus awarded to the executive during the prior two years, payable in a lump sum. In addition to the cash payment, each covered officer is entitled to receive life, medical, and dental coverage for a period of 18 months from the date of termination. Notwithstanding any provision to the contrary in the change-in-control agreement, payments under the change in control agreements are limited so that they will not constitute an excess parachute payment under Section 280G of the Internal Revenue Code.

Director Emeritus Plan. ESSA Bank & Trust maintains a director emeritus plan. Any director who is not an active employee of ESSA Bank & Trust upon retirement from board service as of the next annual meeting following his or her attainment of age 74, is eligible to participate in the plan. In order to receive retirement benefits under the plan, the director must remain a director emeritus in good standing after retirement, must agree to attend meetings if requested, provide advice and act as a goodwill ambassador (as requested) by the Board of Directors and must not engage in any business enterprise which competes with ESSA Bank & Trust nor disclose any confidential information relative to the business of ESSA Bank & Trust. At retirement, an eligible director will receive the then-current monthly Board meeting fee for five additional years (the current monthly board meeting fee for directors is $1,000). At retirement, the Chairman of the Board, will continue to receive the then-current monthly Board meeting fee for five additional years (the current monthly Chairman s Board meeting fee is $1,500).

Defined Benefit Pension Plan. Since 1969, ESSA Bank & Trust has maintained an individually designed, tax-qualified defined benefit plan (the Pension Plan). Effective January 1, 2007, the Plan operates on a calendar year basis. Effective January 1, 2007, the Pension Plan will be operated on a calendar year basis. All employees age 21 or older who have completed one year of employment with ESSA Bank & Trust are eligible for membership in the Pension Plan; however, only employees who have been credited with 1,000 or more hours of service with ESSA Bank & Trust are eligible to accrue benefits under the Pension Plan. ESSA Bank & Trust annually contributes an amount to the plan necessary to satisfy the minimum funding requirements established under the Employee Retirement Income Security Act of 1974, as amended (ERISA).

The regular form of retirement benefit is a straight life annuity (if single) and a joint and survivor annuity (if married), however, various alternative forms of joint and survivor annuities may be selected instead. Upon termination of employment at or after age 65 with at least 5 years of employment, a participant is entitled to a normal retirement annual benefit equal to a percentage of average monthly compensation determined over the participant s high 5-year average salary during the 10 years before the participant s retirement. If the participant terminates employment on or after attaining age 60 with 15 years of service, his normal retirement benefit will be reduced by 0.5% for each month by which the participant s actual retirement date precedes his or her normal retirement date. A participant may postpone retirement beyond normal retirement date, in which case the participant will continue earning service towards his or her accrued benefit. If a married participant dies while in active service and after having become fully vested (i.e., completed 5 years of service), a qualified 50% survivor spouse benefit will be payable to the participant s beneficiary. No pre-retirement death benefits are available to unmarried participants. Upon termination of employment due to disability, the participant will be entitled to an early or normal retirement benefit, where the participant s accrued benefit is determined based on service performed through the disability date.

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The following table indicates the annual retirement benefit that would be payable under the plan upon retirement at age 65 during the plan year ended November 30, 2006, expressed in the form of a single life annuity for the final average salary and benefit service classification specified below:

Final Average Annual Compensation	Years of Benefit Service and Benefit Payable at Retirement 5	10	20	30	40
$ 10,000	$ 750	$ 1,500	$ 3,000	$ 4,500	$ 5,000
$ 30,000	$ 2,250	$ 4,500	$ 9,000	$ 13,500	$ 15,000
$ 60,000	$ 4,500	$ 9,000	$ 18,000	$ 27,000	$ 30,000
$ 90,000	$ 6,750	$ 13,500	$ 27,000	$ 40,500	$ 45,000
$ 120,000	$ 9,000	$ 18,000	$ 36,000	$ 54,000	$ 60,000
$ 150,000	$ 11,250	$ 22,500	$ 45,000	$ 67,500	$ 75,000
$ 160,000	$ 12,000	$ 24,000	$ 48,000	$ 72,000	$ 80,000
$ 170,000	$ 12,750	$ 25,500	$ 51,000	$ 76,500	$ 85,000
$ 200,000	$ 15,000	$ 30,000	$ 60,000	$ 90,000	$ 100,000
$ 220,000 and above(1)	$ 16,500	$ 33,000	$ 66,000	$ 99,000	$ 110,000

(1) Reflects the maximum benefit payable under the Defined Benefit Pension Plan due to tax law limitations.

At November 30, 2006, Messrs. Olson, Muto, Howes, Ms. Warner and Ms. Reimer had 29, 5, 20, 12 and 23 years of credited service, respectively, under the plan.

401(k) Plan. ESSA Bank & Trust maintains a non-standardized prototype 401(k) plan through Massachusetts Mutual Life Insurance Company (MassMutual). Effective January 1, 2007, the 401(k) plan will be operated on a calendar year basis. Employees may participate in the plan when they have attained age 21 and completed one year of service and have been credited with 1,000 hours during the year of service. Participants may make pre-tax salary deferrals to the plan not to exceed $15,500 (which is the 2007 limit; the limit is adjusted annual for IRS-announced cost-of-living increases). In addition, participants who are 50 or older may make pre-tax catch up contributions to the plan up to $5,000 (this limit is also adjusted annually by the IRS for cost-of-living increases). The plan is a 401(k) safe harbor which means that the employer matches participant pre-tax salary deferrals dollar for dollar up to 3% of compensation, then the employer matches pre-tax salary deferrals at the rate of 50 cents on the dollar for amounts up to 5% of compensation. All contributions are 100% vested. Distributions will be made upon death, disability, termination of employment, or attainment of age 59 $^{1}/2$. In addition to the other self-directed investment alternatives offered under the plan, Participants will be offered the opportunity to purchase stock in the offering through a unitized employer stock fund, consisting of 95% stock and 5% cash. Benefits are paid in the form of lump sum, installments, partial withdrawals, or a joint and 100% survivor annuity.

Supplemental Retirement Plan. ESSA Bank & Trust has entered into Executive Salary Continuation Agreements (Supplemental Retirement Plan) with Mr. Olson, Ms. Reimer, Mr. Howes and Mr. Grayuski. If the designated executive has been employed with ESSA Bank & Trust for at least 30 years upon normal retirement age (65) or early retirement age (60), then the benefit described in the agreement will be paid to the executive for no less than 192 months following the executive s retirement, unless the executive elects to receive the present value of the payments as a lump sum. The amount of the normal benefit equals 70% of the executive s final compensation determined over the participant s high 5-year average salary during the 10 years before the participant s retirement. The normal retirement benefit is reduced by 0.05% for

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each month the executive terminates employment after early retirement age but prior to normal retirement age. If the executive voluntarily terminates employment before age 65 or has his or her employment involuntarily terminated other than for cause, the employer shall pay in a lump sum or 60 monthly installments, the amount accrued to fund the promised benefit as of the date of such termination. If a change in control occurs, then the benefits promised under the Supplemental Retirement Plan at normal retirement age will be paid to the executive at normal retirement age, even if the executive s employment terminates before normal retirement age (except no payment shall be made if the termination is due to cause). Benefits become vested after 5 years of service and before completing 5 years of service, benefits are zero percent vested. If the executive dies while actively employed by us, but before attaining age 65, the amount accrued under the plan as of the executive s date of death will be paid to the executive s designated beneficiaries. If the executive dies after the commencement of payment of benefits under the Supplemental Retirement Plan, remaining payments will be made to the executive s beneficiaries. We recorded an expense of $160,155 for the Supplemental Retirement Plan during the fiscal year ended September 30, 2006.

Stock Benefit Plans

Employee Stock Ownership Plan and Trust. We intend to implement an employee stock ownership plan in connection with the stock offering. As part of the stock offering, the employee stock ownership plan trust intends to borrow funds from ESSA Bancorp, Inc. and use those funds to purchase a number of shares equal to 8% of the common stock sold in the stock offering and issued to the Charitable Foundation. Collateral for the loan will be the common stock purchased by the employee stock ownership plan. The loan will be repaid principally from discretionary contributions by ESSA Bank & Trust to the employee stock ownership plan over a period of up to 30 years. The loan documents will provide that the loan may be repaid over a shorter period, without penalty for prepayments. We anticipate that the interest rate on the loan will equal the prime interest rate at the closing of the stock offering, and will adjust annually at the beginning of each calendar year. Shares purchased by the employee stock ownership plan will be held in a suspense account for allocation among participants as the loan is repaid.

Shares released from the suspense account will be allocated among employee stock ownership plan participants on the basis of compensation in the year of allocation. Benefits under the plan will not vest at all until a participant has three years of credited service at which time participants will become fully vested. Credit will be given for vesting purposes to participants for years of service with ESSA Bank & Trust prior to the adoption of the plan. A participant s interest in his account under the plan will also fully vest in the event of termination of service due to a participant s early or normal retirement, death, disability, or upon a change in control (as defined in the plan). Vested benefits will be payable generally in the form of common stock, or to the extent participants accounts contain cash, benefits will be paid in cash. ESSA Bank & Trust s contributions to the employee stock ownership plan are discretionary, subject to the loan terms and tax law limits. Therefore, benefits payable under the employee stock ownership plan cannot be estimated. Pursuant to SOP 93-6, we will be required to record compensation expense each year in an amount equal to the fair market value of the shares released from the suspense account. In the event of a change in control, the employee stock ownership plan will terminate.

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Transactions with Certain Related Persons

Loans and Extensions of Credit. The Sarbanes-Oxley Act of 2002 generally prohibits us from making loans to our executive officers and directors, but it contains a specific exemption from such prohibition for loans made by ESSA Bank & Trust to our executive officers and directors in compliance with federal banking regulations. Federal regulations require that all loans or extensions of credit to executive officers and directors of insured institutions must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and must not involve more than the normal risk or repayment or present other unfavorable features. ESSA Bank & Trust is therefore prohibited from making any loans or extensions of credit to executive officers and directors at different rates or terms than those offered to the general public, except for loans made under a benefit program generally available to all other employees and that does not give preference to any executive officer or director over any other employee.

In addition, loans made to a director or executive officer must be approved in advance by a majority of the disinterested members of the Board of Directors. The aggregate amount of our loans to our officers and directors and their related entities was $2.0 million at September 30, 2006. As of September 30, 2006, these loans were performing according to their original terms.

Benefits to be Considered Following Completion of the Conversion

We intend to adopt and request stockholder approval of one or more stock-based incentive plans, including a stock option plan and a stock recognition and retention plan, no earlier than six months after the completion of the conversion. The stock option plan and stock recognition and retention plan may be established as separate plans or part of a single stock-based incentive plan.

Stock Option Plan. If adopted within one year of the conversion and approved by stockholders, the stock option plan would reserve an amount equal to 10% of the shares of common stock sold in the offering for issuance upon exercise of stock options. 10% of the shares of common stock issued in the offering would amount to 1,000,450 shares, 1,177,000 shares, 1,353,550 shares and 1,556,583 shares at the minimum, midpoint, maximum and adjusted maximum of the offering range, respectively. If we adopt the stock option plan after one year following the completion of the conversion, we may grant options in an amount greater than 10% of the shares of common stock sold in the offering. We have not yet determined whether we will present this plan for stockholder approval within 12 months following the completion of the conversion or whether we will present this plan for stockholder approval more than 12 months following the completion of the conversion. No options would be granted under the new stock option plan until stockholder approval of the plan is received. In the event that shares underlying options come from authorized but unissued shares of common stock, stockholders would experience dilution of approximately 9.1% of their ownership interest in ESSA Bancorp, Inc. We will have to recognize compensation expense for accounting purposes ratably over the vesting period, equal to the fair value of the options on the original grant date.

The exercise price of the options granted under the stock option plan will be equal to the fair market value of ESSA Bancorp, Inc. common stock on the date of grant of the stock options.

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If the stock option plan is adopted within one year following the conversion, options may vest no faster than 20% per year beginning 12 months after the date of grant. Options granted under the stock option plan would be adjusted for capital changes such as stock splits and stock dividends. Awards will be 100% vested upon termination of employment due to death, disability or following a change in control, and if the stock option plan is adopted more than one year after the conversion, awards would be 100% vested upon normal retirement. Under Office of Thrift Supervision regulations, if the stock option plan is adopted within one year of the conversion, no individual officer may receive more than 25% of the awards under the plan, no non-employee director may receive more than 5% of the awards under the plan and all non-employee directors as a group may receive in the aggregate no more than 30% of the awards under the plan.

The stock option plan would be administered by a committee of non-employee members of ESSA Bancorp, Inc. s Board of Directors. Options granted under the stock option plan to employees may be incentive stock options, which are designed to result in a beneficial tax treatment to the employee but no tax deduction to ESSA Bancorp, Inc. Non-qualified stock options may also be granted to employees under the stock option plan, and will be granted to the non-employee directors who receive stock options. In the event an option recipient terminated his or her employment or service as an employee or director, the options would terminate after certain specified periods following termination.

Stock Recognition and Retention Plan. If adopted within one year of the conversion and approved by stockholders, the stock recognition and retention plan would reserve an amount equal to 4% of the shares of common stock sold in the offering, or 400,180 shares, 470,800 shares, 541,420 shares and 622,633 shares at the minimum, midpoint, maximum and adjusted maximum of the offering range, respectively. If we adopt the recognition and retention plan after one year following the completion of the conversion, we may grant shares in an amount greater than 4% of the shares of common stock sold in the offering. We have not yet determined whether we will present this plan for stockholder approval within 12 months following the completion of the conversion or whether we will present this plan for stockholder approval more than 12 months following the completion of the conversion. We must recognize an expense for shares of common stock awarded over their vesting period at the fair market value of the shares on the date they are awarded. The recipients will be awarded shares of common stock under the stock recognition and retention plan at no cost to them. No awards would be made under the stock recognition and retention plan until the plan is approved by stockholders. If the shares awarded under the stock recognition and retention plan come from authorized but unissued shares of the common stock totaling 4% of the shares sold in the offering, stockholders would experience dilution of approximately 3.8% in their ownership interest in ESSA Bancorp, Inc.

Awards granted under the stock recognition and retention plan would be nontransferable and nonassignable. Under Office of Thrift Supervision regulations, if the stock recognition and retention plan is adopted within one year following the conversion, the shares of common stock which are subject to an award may vest no faster than 20% per year beginning 12 months after the date of grant of the award. Awards would be adjusted for capital changes such as stock dividends and stock splits. Awards would be 100% vested upon termination of employment or service due to death, disability or following a change in control, and if the stock recognition and retention plan is adopted more than one year after the conversion, awards also would be 100% vested upon normal retirement. Under Office of Thrift Supervision rules, if the stock recognition

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and retention plan is adopted within one year of the conversion, no individual officer may receive more than 25% of the awards under the plan, no non-employee director may receive more than 5% of the awards under the plan, and all non-employee directors as a group may receive no more than 30% of the awards under the plan in the aggregate.

The recipient of an award will recognize income equal to the fair market value of the stock earned, determined as of the date of vesting, unless the recipient makes an election under Section 83(b) of the Internal Revenue Code of 1986, as amended, to be taxed earlier. The amount of income recognized by the recipient would be a deductible expense of ESSA Bancorp, Inc. for tax purposes.

SUBSCRIPTIONS BY DIRECTORS AND EXECUTIVE OFFICERS

The following table sets forth information regarding intended common stock subscriptions by each of the directors and executive officers of ESSA Bank & Trust and their associates, and by all directors and executive officers as a group. In the event the individual maximum purchase limitation is increased, persons subscribing for the maximum amount may increase their purchase order. Directors and executive officers will purchase shares of common stock at the same $10.00 purchase price per share and on the same terms as other purchasers in the offering. This table excludes shares of common stock to be purchased by the employee stock ownership plan, as well as any recognition and retention plan awards or stock option grants that may be made no earlier than six months after the completion of the offering. The directors and officers have indicated their intention to subscribe in the offering for an aggregate of $4.3 million of shares of common stock, equal to 4.6% of the number of shares of common stock to be sold in the offering at the minimum of the offering range, assuming shares are available. Purchases by directors, executive officers and their associates will be included in determining whether the required minimum number of shares has been subscribed for in the offering.

Name	Number of Shares (1)	Aggregate Purchase Price (1)	Percent at Midpoint
John E. Burrus	10,000	$ 100,000	*%
William P. Douglass	15,000	150,000	*
Daniel J. Henning	50,000	500,000	*
Frederick E. Kutteroff	25,000	250,000	*
Gary S. Olson	50,000	500,000	*
John S. Schoonover, Jr.	2,000	20,000	*
Robert C. Selig, Jr.	50,000	500,000	*
William A. Viechnicki, D.D.S.	50,000	500,000	*
Elizabeth B. Weekes	5,000	50,000	*
Allan A. Muto	25,000	250,000	*
Robert S. Howes, Jr.	20,000	200,000	*
Diane K. Reimer	45,000	450,000	*
V. Gail Warner	35,000	350,000	*
Thomas J. Grayuski	45,000	450,000	*
All directors and executive officers as a group	427,000	$4.27 million	4.6%

* Less than 1%.

(1) Includes purchases by the individual s spouse and other relatives of the named individual living in the same household. The above named individuals are not aware of any other purchases by a person who, or entity which, would be considered an associate of the named individuals under the Plan of Conversion.

THE CONVERSION

The Boards of Directors of ESSA Bancorp, Inc. and ESSA Bank & Trust have approved the plan of conversion. The plan of conversion must also be approved by the members of ESSA Bank & Trust (depositors and certain borrowers of ESSA Bank & Trust at _______). A special meeting of members has been called for this purpose. The Office of Thrift Supervision and the Pennsylvania Department of Banking have each conditionally approved the plan of conversion; however, such approval does not constitute a recommendation or endorsement of the plan of conversion by that agency.

General

Pursuant to the plan of conversion, ESSA Bank & Trust will convert from mutual to stock form and will be wholly owned by ESSA Bancorp, Inc., a new Pennsylvania corporation. When the conversion is completed, all of the capital stock of ESSA Bank & Trust will be owned by ESSA Bancorp, Inc., our newly formed Pennsylvania holding company, and all of the common stock of ESSA Bancorp, Inc. will be owned by public stockholders.

We intend to retain between $91.5 million and $124.2 million of the net proceeds of the offering, or $143.1 million if the offering range is increased by 15%, and to contribute the balance of the net proceeds to ESSA Bank & Trust. The conversion will be consummated only upon the issuance of at least 9,350,000 shares of our common stock offered pursuant to the plan of conversion.

The plan of conversion provides that we will offer shares of common stock for sale in the subscription offering to eligible account holders, our tax-qualified employee benefit plans, including the employee stock ownership plan and our 401(k), supplemental eligible account holders and other members (depositors and certain borrowers of ESSA Bank & Trust). If all shares are not subscribed for in the subscription offering, we may, at our discretion, offer common stock for sale in a community offering to members of the general public, with a preference given to natural persons residing in the Pennsylvania Counties of Monroe and Northampton.

We have the right to accept or reject, in whole or in part, any orders to purchase shares of the common stock received in the community offering. The community offering, if any, may begin at the same time as, during, or after the subscription offering, and must be completed within 45 days after the completion of the subscription offering unless otherwise extended by us with the approval of the Office of Thrift Supervision. See Community Offering.

We determined the number of shares of common stock to be offered in the offering based upon an independent valuation appraisal of the estimated consolidated pro forma market value of ESSA Bancorp, Inc. All shares of common stock to be sold in the offering will be sold at $10.00 per share. Investors will not be charged a commission to purchase shares of common stock in the offering. The independent valuation will be updated and the final number of the shares of common stock to be issued in the offering will be determined at the completion of the offering. See Determination of Share Price and Number of Shares to be Issued for more information as to the determination of the estimated pro forma market value of the common stock.

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The following is a brief summary of the conversion and is qualified in its entirety by reference to the provisions of the plan of conversion. A copy of the plan of conversion is available for inspection at each branch office of ESSA Bank & Trust and at the Northeast Regional and the Washington, D.C. offices of the Office of Thrift Supervision. The plan of conversion is also filed as an exhibit to ESSA Bank & Trust s application to convert from mutual to stock form of which this prospectus is a part, copies of which may be obtained from the Office of Thrift Supervision. See Where You Can Find Additional Information.

Reasons for the Conversion

The primary reasons for the conversion and related stock offering are:

- to support our internal growth through lending in communities we serve or may serve in the future;
- to enhance our existing products and services and to support the development of new products and services;
- to improve our overall competitive position;
- to provide additional financial resources to pursue limited *de novo* branching opportunities and future acquisition opportunities;
- to reduce a portion of our existing borrowings;
- to provide better capital management tools, including the ability to pay dividends and to repurchase shares of our common stock; and
- to retain and attract qualified personnel by establishing stock benefit plans for management and employees, including a stock option plan, a stock recognition and retention plan and an employee stock ownership plan.

In the stock holding company structure, we will have greater flexibility in structuring mergers and acquisitions. Potential sellers often want stock for at least part of the acquisition consideration. Our new stock holding company structure will enable us to offer stock or cash consideration, or a combination thereof, and will therefore enhance our ability to compete with other bidders when acquisition opportunities arise.

We have no current arrangements or agreements to acquire other banks, thrifts and financial service companies or branch offices. We have received regulatory approval to open a new branch office in Tannersville, Pennsylvania which we anticipate opening in May 2007. There can be no assurance that we will be able to consummate any acquisitions or establish any additional new branches.

Approvals Required

The affirmative vote of a majority of the total eligible votes of the members of ESSA Bank & Trust at the special meeting of members is required to approve the plan of conversion.

The members of ESSA Bank & Trust will also be asked to approve the establishment and funding of ESSA Bank & Trust Foundation. The plan of conversion also must be approved by the Office of Thrift Supervision and the Pennsylvania Banking Department, which have each given its conditional approval.

A special meeting of members to consider and vote upon the plan of conversion and the charitable foundation has been set for __________.

Effects of Conversion on Depositors, Borrowers and Members

Continuity. While the conversion is being accomplished, the normal business of ESSA Bank & Trust of accepting deposits and making loans will continue without interruption. ESSA Bank & Trust will continue to be a Pennsylvania chartered savings association and will continue to be regulated by the Pennsylvania Department of Banking. After the conversion, ESSA Bank & Trust will continue to offer existing services to depositors, borrowers and other customers. The directors serving ESSA Bank & Trust, at the time of the conversion will be the directors of ESSA Bancorp, Inc., a Pennsylvania corporation, and ESSA Bank & Trust after the conversion.

Effect on Deposit Accounts. Pursuant to the plan of conversion, each depositor of ESSA Bank & Trust at the time of the conversion will automatically continue as a depositor after the conversion, and the deposit balance, interest rate and other terms of such deposit accounts will not change as a result of the conversion. Each such account will be insured by the Federal Deposit Insurance Corporation to the same extent as before the conversion. Depositors will continue to hold their existing certificates, passbooks and other evidences of their accounts.

Effect on Loans. No loan outstanding from ESSA Bank & Trust will be affected by the conversion, and the amount, interest rate, maturity and security for each loan will remain as it was contractually fixed prior to the conversion.

Effect on Voting Rights of Members. At present, all depositors and certain borrowers of ESSA Bank & Trust are members of, and have voting rights in, ESSA Bank & Trust as to all matters requiring membership action. Upon completion of the conversion, depositors and borrowers will cease to be members of ESSA Bank & Trust and will no longer have voting rights. Upon completion of the conversion, all voting rights in ESSA Bank & Trust will be vested in ESSA Bancorp, Inc. as the sole stockholder of ESSA Bank & Trust. The stockholders of ESSA Bancorp, Inc. will possess exclusive voting rights with respect to ESSA Bancorp, Inc. common stock.

Tax Effects. We will receive an opinion of counsel or tax advisor with regard to federal and state income tax consequences of the conversion to the effect that the conversion will not be taxable for federal or state income tax purposes to ESSA Bank & Trust, ESSA Bancorp, Inc., members of ESSA Bank & Trust, eligible account holders, supplemental eligible account holders, or ESSA Bank & Trust See Material Income Tax Consequences.

Effect on Liquidation Rights. Each depositor in ESSA Bank & Trust has both a deposit account in ESSA Bank & Trust and a pro rata ownership interest in the net worth of ESSA Bank & Trust based upon the deposit balance in his or her account. This ownership interest is tied to the depositor s account and has no tangible market value separate from the deposit account. This

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interest may only be realized in the event of a complete liquidation of ESSA Bank & Trust . Any depositor who opens a deposit account obtains a pro rata ownership interest in ESSA Bank & Trust without any additional payment beyond the amount of the deposit. A depositor who reduces or closes his or her account receives a portion or all, respectively, of the balance in the deposit account but nothing for his or her ownership interest in the net worth of ESSA Bank & Trust, which is lost to the extent that the balance in the account is reduced or closed.

Consequently, depositors in a stock subsidiary of a holding company normally have no way of realizing the value of their ownership interest, which has realizable value only in the unlikely event that ESSA Bank & Trust is completely liquidated. If this occurs, the depositors of record at that time, as owners, would share pro rata in any residual surplus and reserves of ESSA Bank & Trust after other claims, including claims of depositors to the amounts of their deposits, are paid.

In the unlikely event that ESSA Bank & Trust were to liquidate after the conversion, all claims of creditors, including those of depositors, also would be paid first, followed by distribution of the liquidation account to depositors as of ___________ and ____________________ who continue to maintain their deposit accounts as of the date of liquidation, with any assets remaining thereafter distributed to ESSA Bancorp, Inc. as the holder of ESSA Bank & Trust s capital stock. Pursuant to the rules and regulations of the Office of Thrift Supervision, a post-conversion merger, consolidation, sale of bulk assets or similar combination or transaction with another insured savings institution would not be considered a liquidation and, in such a transaction, the liquidation account would be assumed by the surviving institution. See Liquidation Rights.

Determination of Share Price and Number of Shares to be Issued

The plan of conversion and bank regulations require that the aggregate purchase price of the common stock sold in the offering be based on the appraised pro forma market value of the common stock, as determined by an independent valuation. ESSA Bank & Trust and ESSA Bancorp, Inc. have retained RP Financial, LC. to prepare an independent valuation appraisal. For its services in preparing the initial valuation, RP Financial will receive a fee of $90,000, and will be reimbursed for its expenses. RP Financial will receive an additional fee of $10,000 for each update to the valuation appraisal. ESSA Bank & Trust and ESSA Bancorp, Inc. have agreed to indemnify RP Financial and its employees and affiliates against specified losses, including any losses in connection with claims under the federal securities laws, arising out of its services as independent appraiser, except where such liability results from its negligence or bad faith.

The independent valuation appraisal considered the pro forma impact of the offering. Consistent with the Office of Thrift Supervision appraisal guidelines, the appraisal applied three primary methodologies: the pro forma price-to-book value approach applied to both reported book value and tangible book value; the pro forma price-to-earnings approach applied to reported and core earnings; and the pro forma price-to-assets approach. The market value ratios applied in the three methodologies were based upon the current market valuations of the peer group companies identified by RP Financial, subject to valuation adjustments applied by RP Financial to account for differences between ESSA Bancorp, Inc. and the peer group. RP

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Financial placed the greatest emphasis on the price-to-core earnings and price-to-book value approaches in estimating pro forma market value.

The independent valuation was prepared by RP Financial in reliance upon the information contained in this prospectus, including the consolidated financial statements of ESSA Bank & Trust. RP Financial also considered the following factors, among others:

- the present results and financial condition of ESSA Bank & Trust, and the projected results and financial condition of ESSA Bancorp, Inc., a Pennsylvania corporation;
- the economic and demographic conditions in ESSA Bank & Trust s existing market area;
- certain historical, financial and other information relating to ESSA Bank & Trust;
- a comparative evaluation of the operating and financial characteristics of ESSA Bank & Trust with those of other similarly situated publicly traded savings institutions located in the Commonwealth of Pennsylvania, and other states in the mid-Atlantic and midwest regions of the United States;
- the impact of the conversion and the offering on ESSA Bancorp, Inc. s stockholders equity and earnings potential;
- the proposed dividend policy of ESSA Bancorp, Inc.; and
- the trading market for securities of comparable institutions and general conditions in the market for such securities.

Included in RP Financial s independent valuation were certain assumptions as to the pro forma earnings of ESSA Bancorp, Inc. after the conversion that were utilized in determining the appraised value. These assumptions included estimated expenses, an assumed after-tax rate of return on the net offering proceeds and purchases in the open market of 4% of the common stock issued in the offering by the recognition and retention plan at the $10.00 purchase price. See Pro Forma Data for additional information concerning these assumptions. The use of different assumptions may yield different results.

The independent valuation states that as of November 24, 2006, the estimated pro forma market value of ESSA Bancorp, Inc. ranged from $100.0 million to $135.4 million, with a midpoint of $117.7 million. The Board of Directors of ESSA Bancorp, Inc. decided to offer the shares of common stock for a price of $10.00 per share primarily because it is the price most commonly used in mutual-to-stock conversions of financial institutions. The number of shares offered will be equal to the aggregate offering price of the shares divided by the price per share. Based on the valuation range and the $10.00 price per share, the minimum of the offering range will be 9,350,000 shares, the midpoint of the offering range will be 11,000,000 shares and the maximum of the offering range will be 12,650,000 shares, or 14,547,500 if the maximum amount is adjusted because of demand for shares or changes in market conditions.

The following table presents a summary of selected pricing ratios for ESSA Bancorp, Inc. and our peer group companies identified by RP Financial. These ratios are based on earnings for the twelve months ended September 30, 2006 and book value as of September 30, 2006. Compared to the average pricing of the peer group, our pro forma pricing ratios at the maximum of the offering range indicated a premium of 22.5% on a price-to-earnings basis, a discount of 42.6% on a price-to-book value basis and a discount of 45.7% on a price-to-tangible book value basis. The pricing ratios result from our generally having higher levels of equity but lower earnings than the companies in the peer group on a pro forma basis. Our Board of Directors, in reviewing and approving the valuation, considered the range of price-to-core earnings multiples and the range of price-to-book value ratios and price-to-tangible book value ratios at the different amounts of shares to be sold in the offering. The appraisal did not consider one valuation approach to be more important than the other. Instead, the appraisal concluded that these ranges represented the appropriate balance of the two approaches to valuing ESSA Bancorp, Inc., and the number of shares to be sold, in comparison to the identified peer group institutions. Specifically, in approving the valuation, the board believed that ESSA Bancorp, Inc. would not be able to sell its shares at a price-to-book value that was in line with the peer group without unreasonably exceeding the peer group on a price-to-core earnings basis. The estimated appraised value and the resulting premium/discount took into consideration the potential financial impact of the conversion and offering.

	Pro forma price-to-earnings multiple	**Pro forma price-to-book value ratio**	**Pro forma price-to-tangible book value ratio**
ESSA Bancorp, Inc.			
Maximum	22.73x	81.04%	81.04%
Minimum	18.18	72.10	72.10
Valuation of peer group companies as of November 24, 2006			
Averages	18.55x	141.13%	149.25%
Medians	16.70	137.70	145.80

The Board of Directors of ESSA Bancorp, Inc. reviewed the independent valuation and, in particular, considered the following:

- ESSA Bank & Trust s financial condition and results of operations;
- comparison of financial performance ratios of ESSA Bank & Trust to those of other financial institutions of similar size; and
- market conditions generally and, in particular, for financial institutions.

All of these factors are set forth in the independent valuation. The Board of Directors also reviewed the methodology and the assumptions used by RP Financial, LC. in preparing the independent valuation and believes that such assumptions were reasonable. The offering range may be amended with the approval of the Office of Thrift Supervision, if required, as a result of subsequent developments in the financial condition of ESSA Bancorp, Inc. or ESSA Bank & Trust or market conditions generally.

The independent valuation is not intended, and must not be construed, as a recommendation of any kind as to the advisability of purchasing shares of our common

stock. RP Financial, LC. did not independently verify our consolidated financial statements and other information that we provided to them, nor did RP Financial, LC. independently value our assets or liabilities. The independent valuation considers ESSA Bank & Trust as a going concern and should not be considered as an indication of the liquidation value of ESSA Bank & Trust. Moreover, because the valuation is necessarily based upon estimates and projections of a number of matters, all of which may change from time to time, no assurance can be given that persons purchasing our common stock in the offering will thereafter be able to sell their shares at prices at or above the $10.00 offering price per share.

Following commencement of the subscription offering, the maximum of the valuation range may be increased by up to 15%, or up to $155.7 million, without resoliciting subscribers, which will result in a corresponding increase of up to 15% in the maximum of the offering range to up to 14,547,500 shares, in addition to the 1,018,325 shares to be issued to the ESSA Bank & Trust charitable foundation to reflect changes in the market and financial conditions or demand for the shares. We will not decrease the minimum of the valuation range and the minimum of the offering range without a resolicitation of subscribers. The subscription price of $10.00 per share will remain fixed. See Limitations on Common Stock Purchases as to the method of distribution and allocation of additional shares that may be issued in the event of an increase in the offering range to fill unfilled orders in the offering.

If the update to the independent valuation at the conclusion of the offering results in an increase in the maximum of the valuation range to more than $155.7 million and a corresponding increase in the offering range to more than 14,547,500 shares, or a decrease in the minimum of the valuation range to less than $100.0 million and a corresponding decrease in the offering range to fewer than 9,350,000 shares, then, with regulatory approval, we may terminate the offering and promptly return, with interest at ESSA Bank & Trust s passbook savings rate, all funds previously delivered to us to purchase shares of common stock and cancel deposit account withdrawal authorizations, and, after consulting with the Office of Thrift Supervision, we may terminate the plan of conversion. Alternatively, we may establish a new offering range and extend the offering period and commence a resolicitation of subscribers or take other actions as permitted by the Office of Thrift Supervision in order to complete the conversion and the offering. In the event that a resolicitation is commenced, we will notify subscribers of the extension of time and of the rights of subscribers to confirm, change or cancel their stock orders for a specified resolicitation period. If a subscriber does not respond, we will cancel the stock order and return funds, as described above. Any resolicitation following the conclusion of the subscription and community offerings would not exceed 45 days.

An increase in the number of shares to be issued in the offering would decrease both a subscriber s ownership interest and ESSA Bancorp, Inc. s pro forma earnings and stockholders equity on a per share basis while increasing pro forma earnings and stockholders equity on an aggregate basis. A decrease in the number of shares to be issued in the offering would increase both a subscriber s ownership interest and ESSA Bancorp, Inc. s pro forma earnings and stockholders equity on a per share basis, while decreasing pro forma earnings and stockholders equity on an aggregate basis. For a presentation of the effects of these changes, see Pro Forma Data.

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Copies of the independent valuation appraisal report of RP Financial, LC. and the detailed memorandum setting forth the method and assumptions used in the appraisal report are available for inspection at the main office of ESSA Bank & Trust and as specified under Where You Can Find Additional Information.

Subscription Offering and Subscription Rights

In accordance with the plan of conversion, rights to subscribe for shares of common stock in the subscription offering have been granted in the following descending order of priority. The filling of all subscriptions that we receive will depend on the availability of common stock after satisfaction of all subscriptions of all persons having prior rights in the subscription offering and to the maximum, minimum and overall purchase limitations set forth in the plan of conversion and as described below under Limitations on Common Stock Purchases.

Priority 1: Eligible Account Holders. Each ESSA Bank & Trust depositor with aggregate deposit account balances of $50.00 or more (a Qualifying Deposit) as of the close of business on April 30, 2005 (an Eligible Account Holder) will receive, without payment therefor, nontransferable subscription rights to purchase, subject to the overall purchase limitations, up to $350,000 or 35,000 shares of our common stock or, if greater, 15 times the number of subscription shares offered multiplied by a fraction of which the numerator is the aggregate Qualifying Deposit account balances of the Eligible Account Holder and the denominator is the aggregate Qualifying Deposit account balances of all Eligible Account Holders, subject to the overall purchase limitations. See Limitations on Common Stock Purchases. If there are not sufficient shares available to satisfy all subscriptions, shares will first be allocated so as to permit each Eligible Account Holder to purchase a number of shares sufficient to make his or her total allocation equal to the lesser of 100 shares or the number of shares for which he or she subscribed. Thereafter, unallocated shares will be allocated to each Eligible Account Holder whose subscription remains unfilled in the proportion that the amount of his or her Qualifying Deposit bears to the total amount of Qualifying Deposits of all subscribing Eligible Account Holders whose subscriptions remain unfilled. If an amount so allocated exceeds the amount subscribed for by any one or more Eligible Account Holders, the excess shall be reallocated among those Eligible Account Holders whose subscriptions are not fully satisfied until all available shares have been allocated.

To ensure proper allocation of shares of our common stock, each Eligible Account Holder must list on his or her stock order form all deposit accounts in which he or she has an ownership interest on April 30, 2005. In the event of oversubscription, failure to list an account could result in fewer shares being allocated than if all accounts had been disclosed. In the event of an oversubscription, the subscription rights of Eligible Account Holders who are also directors or executive officers of ESSA Bancorp, Inc. or their associates will be subordinated to the subscription rights of other Eligible Account Holders to the extent attributable to increased deposits in the twelve months preceding April 30, 2005.

Priority 2: Tax-Qualified Plans. Our tax-qualified employee benefit plans, including our employee stock ownership plan and 401(k) plan, will receive, without payment therefor, nontransferable subscription rights to purchase in the aggregate up to 10% of the shares of common stock sold in the offering.

Priority 3: Supplemental Eligible Account Holders. To the extent that there are sufficient shares of common stock remaining after satisfaction of subscriptions by Eligible Account Holders and our tax-qualified employee benefit plans, each ESSA Bank & Trust depositor with a Qualifying Deposit as of the close of business on ____________________ who is not an Eligible Account Holder (Supplemental Eligible Account Holder) will receive, without payment therefor, nontransferable subscription rights to purchase up to $350,000 or 35,000 shares of common stock or, if greater, 15 times the number of subscription shares offered multiplied by a fraction of which the numerator is the aggregate Qualifying Deposit account balances of the Supplemental Eligible Account Holder and the denominator is the aggregate Qualifying Deposit account balances of all Supplemental Eligible Account Holders, subject to the overall purchase limitations. See Limitations on Common Stock Purchases. If there are not sufficient shares available to satisfy all subscriptions, shares will be allocated so as to permit each Supplemental Eligible Account Holder to purchase a number of shares sufficient to make his or her total allocation equal to the lesser of 100 shares of common stock or the number of shares for which he or she subscribed. Thereafter, unallocated shares will be allocated to each Supplemental Eligible Account Holder whose subscription remains unfilled in the proportion that the amount of his or her Qualifying Deposit bears to the total amount of Qualifying Deposits of all Supplemental Eligible Account Holders whose subscriptions remain unfilled. If an amount so allocated exceeds the amount subscribed for by any one or more Supplemental Eligible Account Holders, the excess shall be reallocated among those Supplemental Eligible Account Holders whose subscriptions are not fully satisfied until all available shares have been allocated.

To ensure proper allocation of common stock, each Supplemental Eligible Account Holder must list on the stock order form all deposit accounts or loan accounts in which he or she has an ownership interest at ____________________. In the event of oversubscription, failure to list an account could result in fewer shares being allocated than if all accounts had been disclosed.

Priority 4: Other Members. To the extent that there are shares of common stock remaining after satisfaction of subscriptions by Eligible Account Holders, our tax-qualified employee benefit plans and Supplemental Eligible Account Holders, each depositor of ESSA Bank & Trust on the voting record date of ____________________ and each borrower as of ___________ who is not an Eligible Account Holder or Supplemental Eligible Account Holder (Other Members) will receive, without payment therefor, nontransferable subscription rights to purchase up to $350,000 or 35,000 shares of common stock, subject to the overall purchase limitations. See Limitations on Common Stock Purchases. If there are not sufficient shares available to satisfy all subscriptions, available shares will be allocated on a pro rata basis based on the size of the order of each Other Member whose order remains unfilled.

To ensure proper allocation of common stock, each Other Member must list on the stock order form all deposit accounts or loan accounts in which he or she has an ownership interest at ____________________. In the event of oversubscription, failure to list an account could result in fewer shares being allocated than if all accounts had been disclosed.

Expiration Date. The Subscription Offering will expire at 12:00 Noon, Eastern time, on ____________, unless extended by us for up to 45 days or such additional periods with the approval of the Office of Thrift Supervision, if necessary. Subscription rights will expire whether

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or not each eligible depositor or borrower can be located. We may decide to extend the expiration date of the subscription offering for any reason, whether or not subscriptions have been received for shares at the minimum, midpoint or maximum of the offering range. Subscription rights which have not been exercised prior to the expiration date will become void. We may extend the offering, without notice, until __________, 2007.

We will not execute orders until we have received orders to purchase at least the minimum number of shares of common stock. If we have not received orders to purchase at least 9,350,000 shares by ________, 2007, and the Office of Thrift Supervision has not consented to an extension, all funds delivered to us to purchase shares of common stock in the offering will be returned promptly to the subscribers with interest calculated at ESSA Bank & Trust s passbook savings rate and all deposit account withdrawal authorizations will be canceled. If an extension beyond the 45-day period following the expiration date is granted by the Office of Thrift Supervision, for any reason, we will notify all subscribers in the stock offering of the extension of time and of the rights of subscribers to confirm, change or cancel their stock order during a specified resolicitation period. Aggregate extensions may not go beyond _________, which is two years after the special meeting of voting members of ESSA Bank & Trust to vote on the plan of conversion.

Community Offering

To the extent that shares of common stock remain available for purchase after satisfaction of all subscriptions of the Eligible Account Holders, our tax-qualified employee benefit plans, Supplemental Eligible Account Holders and Other Members, we may offer shares pursuant to the plan of conversion to members of the general public in a community offering. Shares may be offered with a preference to natural persons residing in the Pennsylvania Counties of Monroe and Northampton.

Subscribers in the community offering may purchase up to 35,000 shares of common stock, subject to the overall purchase limitations. See Limitations on Common Stock Purchases. **The opportunity to purchase shares of common stock in the community offering category is subject to our right, in our sole discretion, to accept or reject any such orders in whole or in part either at the time of receipt of an order or as soon as practicable following the expiration date of the offering.**

If we do not have sufficient shares of common stock available to fill the orders of natural persons residing in the Pennsylvania Counties of Monroe and Northampton, we will allocate the available shares among those persons in a manner that permits each of them, to the extent possible, to purchase the lesser of 100 shares, or the number of shares subscribed for by such person. Thereafter, unallocated shares will be allocated among natural persons residing in the Pennsylvania Counties of Monroe and Northampton whose orders remain unsatisfied on an equal number of shares basis per order.

The term residing or resident as used in this prospectus means any person who occupies a dwelling within the Pennsylvania Counties of Monroe and Northampton, has a present intent to remain within this community for a period of time and manifests the genuineness of that intent by establishing an ongoing physical presence within the community, together with an indication that this presence within the community is something other than merely transitory in nature. We may utilize deposit or loan records or other evidence provided to us to decide whether a person is a resident. In all cases, however, the determination shall be in our sole discretion.

Expiration Date. The community offering may begin with, during or after the subscription offering, and is currently expected to terminate at the same time as the subscription offering, and must terminate no more than 45 days following the subscription offering.

Syndicated Community Offering

The plan of conversion provides that, if necessary, shares of common stock not purchased in the subscription offering and community offering may be offered for sale to the general public in a syndicated community offering to be managed by Ryan Beck & Co., Inc., acting as our agent. In such capacity, Ryan Beck & Co., Inc. may form a syndicate of other broker-dealers. Neither Ryan Beck & Co., Inc. nor any registered broker-dealer will have any obligation to take or purchase any shares of the common stock in the syndicated community offering; however, Ryan Beck & Co., Inc. has agreed to use its best efforts in the sale of shares in any syndicated community offering. The syndicated community offering would terminate no later than 45 days after the expiration of the subscription offering, unless extended by us, with approval of the Office of Thrift Supervision. See Community Offering above for a discussion of rights of subscribers in the event an extension is granted.

The syndicated community offering, if held, will be managed by Ryan Beck & Co., Inc., acting as our agent. In such capacity, Ryan Beck & Co., Inc., may form a syndicate of other brokers-dealers who are National Association of Securities Dealers, Inc. member firms. Neither Ryan Beck & Co., Inc. nor any registered broker-dealer will have any obligation to take or purchase any shares of the common stock in the syndicated community offering. The syndicated community offering will be conducted in accordance with certain Securities and Exchange Commission rules applicable to best efforts offerings. Generally under those rules, Ryan Beck & Co., Inc., a broker-dealer, will deposit funds it receives prior to closing from interested investors into a separate non-interest-bearing bank account. If and when all the conditions for the closing are met, funds for common stock sold in the syndicated community offering will be promptly delivered to us. If the offering is consummated, but some or all of an interested investor s funds are not accepted by us, those funds will be returned to the interested investor promptly, without interest. If the offering is not consummated, funds in the account will be promptly returned, without interest, to the potential investor. Normal customer ticketing will be used for order placement. In the syndicated community offering, order forms will not be used.

The opportunity to subscribe for shares of common stock in the syndicated community offering is subject to our right to reject orders, in whole or in part, either at the time of receipt of an order or as soon as practicable following the expiration date of the offering. If your order is rejected in part, you will not have the right to cancel the remainder of your order.

Purchasers in the syndicated community offering are eligible to purchase up to $350,000 or 35,000 shares of common stock, subject to the overall purchase limitations.

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See Limitations on Common Stock Purchases. We may begin the syndicated community offering at any time following the commencement of the subscription offering.

If we are unable to find purchasers from the general public to meet the minimum of the offering range we will make other purchase arrangements, if feasible. Other purchase arrangements must be approved by the Office of Thrift Supervision and may provide for purchases by directors, officers, their associates and other persons in excess of the limitations provided in the plan of conversion and in excess of the proposed director purchases discussed earlier, although no purchases are currently intended. If other purchase arrangements cannot be made, we may do any of the following: terminate the offering and promptly return all funds; set a new offering range, notifying all subscribers of the opportunity to confirm, cancel or change their orders; or take such other actions as may be permitted by the Office of Thrift Supervision.

Limitations on Common Stock Purchases

The plan of conversion includes the following limitations on the number of shares of common stock that may be purchased in the offering:

No person (or persons exercising subscription rights through a single qualifying deposit or loan account held jointly) may purchase fewer than 25 shares of common stock or generally more than $350,000 or 35,000 shares;

Our tax-qualified stock benefit plans, including our employee stock ownership plan and 401(k) plan may purchase in the aggregate up to 10% of the shares of common stock issued in the offering, including shares issued in the event of an increase in the offering range of up to 15%;

Except for the tax-qualified employee benefit plans, as described above, no person or entity, together with associates or persons acting in concert with such person or entity, may purchase more than $500,000 or 50,000 shares in all categories of the offering combined; and

The maximum number of shares of common stock that may be purchased in all categories of the offering by our executive officers and directors and their associates, in the aggregate may not exceed 25% of the shares issued in the offering.

Depending upon market or financial conditions, our Board of Directors, with the approval of the Office of Thrift Supervision and without further approval of members of ESSA Bank & Trust, may decrease or increase the purchase limitations. If a purchase limitation is increased, subscribers in the subscription offering who ordered the maximum amount will be, and, in our sole discretion, some other large subscribers may be, given the opportunity to increase their subscriptions up to the then applicable limit. The effect of this type of resolicitation will be an increase in the number of shares of common stock owned by subscribers who choose to increase their subscriptions.

In the event of an increase in the offering range of up to 15% of the total number of shares of common stock offered in the offering, shares will be allocated in the following order of priority in accordance with the plan of conversion:

(1) to fill our tax-qualified employee benefit plans subscriptions for up to 10% of the total number of shares of common stock issued in the offering;

(2) in the event that there is an oversubscription at the Eligible Account Holder, Supplemental Eligible Account Holder or Other Member levels, to fill unfulfilled subscriptions of these subscribers according to their respective priorities; and

(3) to fill unfulfilled subscriptions in the community offering, with preference given first to natural persons residing in the Pennsylvania Counties of Monroe and Northampton.

The term associate of a person means:

(1) any corporation or organization, other than ESSA Bancorp, Inc., ESSA Bank & Trust or a majority-owned subsidiary of ESSA Bank & Trust, of which the person is a director, senior officer, partner or 10% beneficial stockholder;

(2) any trust or other estate in which the person has a substantial beneficial interest or serves as a trustee or in a fiduciary capacity, excluding any employee stock benefit plan in which the person has a substantial beneficial interest or serves as trustee or in a fiduciary capacity; and

(3) any blood or marriage relative of the person, who either lives in the same home as the person or who is a director or senior officer of ESSA Bancorp, Inc. or ESSA Bank & Trust, or a subsidiary of either of them

The term acting in concert means:

(1) knowing participation in a joint activity or interdependent conscious parallel action towards a common goal whether or not pursuant to an express agreement; or

(2) a combination or pooling of voting or other interests in the securities of an issuer for a common purpose pursuant to any contract, understanding, relationship, agreement or other arrangement, whether written or otherwise.

Any persons or companies having the same address on an account or stock order form may be considered to be acting in concert. A person or company which acts in concert with another person or company (other party) shall also be deemed to be acting in concert with any person or company who is also acting in concert with that other party, except that any tax-qualified employee stock benefit plan will not be deemed to be acting in concert with its trustee or a person who serves in a similar capacity solely for the purpose of determining whether common stock held by the trustee and common stock held by the employee stock benefit plan will be aggregated.

Our directors are not treated as associates of each other solely because of their membership on the Board of Directors. We have the right to determine whether prospective purchasers are associates or acting in concert. Shares of common stock purchased in the offering will be freely transferable except for shares purchased by executive officers and directors of ESSA Bancorp, Inc. or ESSA Bank & Trust and except as described below. Any purchases made by any associate of ESSA Bancorp, Inc. or ESSA Bank & Trust for the explicit purpose of meeting the minimum number of shares of common stock required to be sold in order to complete the offering shall be made for investment purposes only and not with a view toward redistribution. In addition, under the guidelines of the National Association of Securities Dealers, Inc., members of the National Association of Securities Dealers and their associates are subject to certain restrictions on transfer of securities purchased in accordance with subscription rights and to certain reporting requirements upon purchase of these securities. For a further discussion of limitations on purchases of shares of our common stock at the time of conversion and thereafter, see Certain Restrictions on Purchase or Transfer of Our Shares After Conversion and Restrictions on Acquisition of ESSA Bancorp, Inc.

Marketing and Distribution; Compensation

Offering materials have been initially distributed to certain persons by mail, with additional copies made available through our Stock Information Center.

We have engaged Ryan Beck & Co., Inc. a broker-dealer registered with the National Association of Securities Dealers, as a financial and marketing advisor in connection with the offering of our common stock. In its role in providing advisory, administrative and marketing services, Ryan Beck & Co. Inc. will assist us in the offering as follows:

- acting as our financial advisor for the conversion and offering;
- providing administrative services and managing the Stock Information Center;
- educating our employees regarding the stock offering;
- targeting our sales efforts, including assisting in the preparation of marketing materials;
- soliciting orders for common stock; and
- assisting in soliciting proxies of our members regarding the special meeting of members.

For these services, Ryan Beck & Co., Inc. will receive an advisory and administrative fee of $50,000 and if the conversion is consummated, a sales fee of 1.0% of the aggregate dollar amount of the common stock sold in the subscription and community offerings up to $100 million; and 0.75% of the aggregate dollar amount in excess of $100 million, excluding in each case shares purchased by our charitable foundation, tax qualified employee benefit plans and shares purchased by our directors, officers and employees and their immediate families. For these services, we made an initial advance payment of $25,000 and a payment of $12,500 upon the initial filing of this prospectus. We will make another payment of $12,500 upon the closing of the conversion and offering.

The plan of conversion provides that, if necessary, all shares of common stock not purchased in the subscription offering and community offering may be offered for sale to the general public in a syndicated community offering to be managed by Ryan Beck & Co., Inc. In such capacity, Ryan Beck & Co., Inc. may form a syndicate of other broker-dealers. Neither Ryan Beck & Co., Inc. nor any registered broker-dealer will have any obligation to take or purchase any shares of the common stock in the syndicated community offering; however, Ryan Beck & Co., Inc. has agreed to use its best efforts in the sale of shares in any syndicated community offering. If there is a syndicated community offering, Ryan Beck & Co., Inc. will receive a management fee of 1.0% of the aggregate dollar amount of the common stock sold in the syndicated community offering. The total fees payable to Ryan Beck & Co., Inc. and other NASD member firms in the syndicated community offering will not exceed 6.0% of the aggregate dollar amount of the common stock sold in the syndicated community offering.

We also will reimburse Ryan Beck & Co., Inc. for its reasonable out-of-pocket expenses associated with its marketing effort, up to a maximum of $20,000 unless otherwise agreed by us. We will also reimburse Ryan Beck & Co., Inc. for its legal fees (excluding the out-of-pocket expenses of counsel) up to $75,000. If the plan of conversion is terminated or if Ryan Beck & Co., Inc. s engagement is terminated in accordance with the provisions of the agreement, Ryan Beck & Co., Inc. will only receive reimbursement of its reasonable out-of-pocket expenses and will return any amounts paid or advanced by us in excess of these expenses. We will indemnify Ryan Beck & Co., Inc. against liabilities and expenses (including legal fees) incurred in connection with certain claims or litigation arising out of or based upon untrue statements or omissions contained in the offering material for the common stock, including liabilities under the Securities Act of 1933.

Our directors and executive officers may participate in the solicitation of offers to purchase common stock. These persons will be reimbursed for their reasonable out-of-pocket expenses incurred in connection with the solicitation. Other trained employees of ESSA Bank & Trust may assist in the offering in ministerial capacities, providing clerical work in effecting a sales transaction or answering questions of a ministerial nature. No offers or sales may be made by tellers or at the teller counters. All sales activity will be conducted in a segregated or separately identifiable area of ESSA Bank & Trust s office facility apart from the area accessible to the general public. Other questions of prospective purchasers will be directed to executive officers or registered representatives of Ryan Beck & Co., Inc. Our other employees have been instructed not to solicit offers to purchase shares of common stock or provide advice regarding the purchase of common stock. We will rely on Rule 3a4-1 under the Securities Exchange Act of 1934, as amended, and sales of common stock will be conducted within the requirements of Rule 3a4-1, so as to permit officers, directors and employees to participate in the sale of common stock. None of our officers, directors or employees will be compensated in connection with their participation in the offering by the payment of commissions or other remuneration based either directly or indirectly on the transactions in the shares of common stock.

The offering will comply with the requirements of Rule 10b-9 under the Securities Exchange Act of 1934.

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Procedure for Purchasing Shares

Expiration Date. The subscription offering is expected to expire at 12:00 Noon, Eastern time, on __________. The community offering is expected to expire at the same time. We may extend the offering for up to 45 days without notice to purchasers in the offering. Any extension of the subscription and/or community offering beyond ____________ would require the Office of Thrift Supervision s approval.

To ensure that each purchaser receives a prospectus at least 48 hours before the expiration date of the offering in accordance with Rule 15c2-8 of the Securities Exchange Act of 1934, as amended, no prospectus will be mailed any later than five days prior to the expiration date or hand delivered any later than two days prior to the expiration date. Execution of an order form will confirm receipt of delivery in accordance with Rule 15c2-8. Order forms will be distributed only with a prospectus. Subscription funds will be maintained in a segregated account at ESSA Bank & Trust or at another insured depository institution and will earn interest at our passbook savings rate from the date of receipt.

We reserve the right in our sole discretion to terminate the offering at any time and for any reason, in which case we will cancel any deposit account withdrawal orders and promptly return all funds delivered to us, with interest calculated at ESSA Bank & Trust s passbook savings rate from the date of receipt.

We have the right to reject any order submitted in the offering by a person who we believe is making false representations or who we otherwise believe, either alone or acting in concert with others, is violating, evading, circumventing, or intends to violate, evade or circumvent the terms and conditions of the plan of conversion.

Use of Order Forms. In order to purchase shares of common stock in the subscription offering and community offering, you must complete an order form and remit full payment. We will not be required to accept incomplete order forms, unsigned order forms, orders submitted on photocopied or facsimiled order forms. All order forms must be received (not postmarked) by the Stock Information Center prior to 12:00 Noon, Eastern time, on _____________. We are not required to accept order forms that are not received by that time, are executed defectively or are received without full payment or without appropriate withdrawal instructions. We are not required to notify subscribers of incomplete or improperly executed order forms. We have the right to permit the correction of incomplete or improperly executed order forms or waive immaterial irregularities. We do not represent, however, that we will do so and we have no affirmative duty to notify any prospective subscriber of any such defects. You may submit your order form and payment by mail using the order reply envelope provided, by bringing your order form to our Stock Information Center or by overnight delivery to the indicated address on the order form. Once tendered, an order form cannot be modified or revoked without our consent. We reserve the absolute right, in our sole discretion, to reject orders received in the community offering, in whole or in part, at the time of receipt or at any time prior to completion of the offering. If you are ordering shares, you must represent that you are purchasing shares for your own account and that you have no agreement or understanding with any person for the sale or transfer of the shares. Our interpretation of the terms and conditions of the plan of conversion and of the acceptability of the order forms will be final, subject to the authority of the Office of Thrift Supervision.

By signing the order form, you will be acknowledging that the common stock is not a deposit or savings account and is not federally insured or otherwise guaranteed by ESSA Bank & Trust or the federal government, and that you received a copy of this prospectus. However, signing the order form will not result in you waiving your rights under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Payment for Shares. Payment for all shares of common stock will be required to accompany completed order forms, in order for the purchase to be valid. Payment for shares may only be made by:

(1) personal check, bank check or money order, made payable to ESSA Bancorp, Inc.; or

(2) authorization of withdrawal from the types of ESSA Bank & Trust deposit accounts designated on the stock order form.

Appropriate means for designating withdrawals from deposit accounts at ESSA Bank & Trust are provided on the order form. The funds designated must be available in the account(s) at the time the order form is received. A hold will be placed on these funds, making them unavailable to the depositor. Funds authorized for withdrawal will continue to earn interest within the account at the contract rate until the offering is completed, at which time the designated withdrawal will be made. Interest penalties for early withdrawal applicable to certificate accounts will not apply to withdrawals authorized for the purchase of shares of common stock; however, if a withdrawal results in a certificate account with a balance less than the applicable minimum balance requirement, the certificate will be canceled at the time of withdrawal without penalty and the remaining balance will earn interest at the current passbook rate subsequent to the withdrawal. In the case of payments made by personal check these funds must be available in the account(s). Checks and money orders will be immediately cashed and placed in a segregated account at ESSA Bank & Trust and/or another insured depository institution and will earn interest at ESSA Bank & Trust s passbook savings rate from the date payment is received until the offering is completed or terminated.

Cash and wire transfers will not be accepted. You may not use a check drawn on a ESSA Bank & Trust line of credit, and we will not accept third-party checks (a check written by

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someone other than you) payable to you and endorsed over to ESSA Bancorp, Inc. Once we receive your executed order form, it may not be modified, amended or rescinded without our consent, unless the offering is not completed by the expiration date, in which event purchasers may be given the opportunity to increase, decrease or rescind their orders for a specified period of time.

If you are interested in using your individual retirement account funds to purchase shares of common stock, you must do so through a self-directed individual retirement account such as a brokerage firm individual retirement account. By regulation, ESSA Bank & Trust s individual retirement accounts are not self-directed, so they cannot be invested in shares of our common stock. Therefore, if you wish to use your funds that are currently in a ESSA Bank & Trust individual retirement account, you may not designate on the order form that you wish funds to be withdrawn from the account for the purchase of common stock. The funds you wish to use for the purchase of common stock will have to be transferred to a brokerage account. It may take several weeks to transfer your ESSA Bank & Trust individual retirement account to an independent trustee, so please allow yourself sufficient time to take this action. An annual administrative fee may be payable to the new trustee. There will be no early withdrawal or Internal Revenue Service interest penalties for these transfers. If you are interested in using funds in an ESSA Bank & Trust individual retirement account or any other retirement account to purchase shares of common stock please contact our Stock Information Center as soon as possible, preferably at least two weeks prior to the end of the offering period, because processing such transactions takes additional time, and whether such funds can be used may depend on limitations imposed by the institutions where such funds are currently held. We cannot guarantee that you will be able to use such funds.

We will have the right, in our sole discretion, to permit institutional investors to submit irrevocable orders together with the legally binding commitment for payment and to thereafter pay for the shares of common stock for which they subscribe in the community offering at any time prior to 48 hours before the completion of the offering. This payment may be made by wire transfer.

Our employee stock ownership plan will not be required to pay for any shares purchased in the offering until consummation of the offering, provided there is a loan commitment from an unrelated financial institution or ESSA Bancorp, Inc. to lend to the employee stock ownership plan the necessary amount to fund the purchase.

Regulations prohibit ESSA Bank & Trust from knowingly lending funds or extending credit to any persons to purchase shares of common stock in the offering.

Delivery of Stock Certificates. Certificates representing shares of common stock issued in the offering will be mailed by ESSA Bancorp, Inc. to the persons entitled thereto at the certificate registration address noted by them on the order form, as soon as practicable following consummation of the offering. Any certificates returned as undeliverable will be held by our transfer agent until claimed by persons legally entitled thereto or otherwise disposed of in accordance with applicable law. **Until certificates for the shares of common stock are delivered, purchasers may not be able to sell the shares of common stock which they ordered, even though the common stock will have begun trading.**

Other Restrictions. Notwithstanding any other provision of the plan of conversion, no person is entitled to purchase any shares of common stock to the extent the purchase would be illegal under any federal or state law or regulation, including state blue sky regulations, or would violate regulations or policies of the National Association of Securities Dealers, Inc., particularly those regarding free riding and withholding. We may ask for an acceptable legal opinion from any purchaser as to the legality of his or her purchase and we may refuse to honor any purchase order if an opinion is not timely furnished. In addition, we are not required to offer shares of common stock to any person who resides in a foreign country.

Restrictions on Transfer of Subscription Rights and Shares

Office of Thrift Supervision regulations prohibit any person with subscription rights, including the Eligible Account Holders, Supplemental Eligible Account Holders and Other Members, from transferring or entering into any agreement or understanding to transfer the legal or beneficial ownership of the subscription rights issued under the plan of conversion or the shares of common stock to be issued upon their exercise. These rights may be exercised only by the person to whom they are granted and only for his or her account. Each person exercising subscription rights will be required to certify that he or she is purchasing shares solely for his or her own account and that he or she has no agreement or understanding regarding the sale or transfer of subscription rights or stock shares. The regulations also prohibit any person from offering or making an announcement of an offer or intent to make an offer to purchase subscription rights or shares of common stock to be issued upon their exercise prior to completion of the offering.

We intend to pursue any and all legal and equitable remedies in the event we become aware of the transfer of subscription rights, and we will not honor orders that we believe involve the transfer of subscription rights.

How You Can Obtain Additional Information

Our branch office personnel may not, by law, assist with investment-related questions about the offering or accept stock order forms or proxy cards. If you have any questions regarding the conversion or the offering, please call or visit our Stock Information Center, toll free, at 1-________, Monday through Friday between 10:00 a.m. and 4:00 p.m., Eastern time. The Stock Information Center is located at ____. The Stock Information Center will be closed on weekends and bank holidays.

Liquidation Rights

In the unlikely event of a complete liquidation of ESSA Bancorp, Inc. prior to the conversion, all claims of creditors of ESSA Bancorp, Inc., including those of depositors of ESSA Bank & Trust (to the extent of their deposit balances), would be paid first. Thereafter, if there were any assets of ESSA Bancorp, Inc. remaining, these assets would be distributed to stockholders, including ESSA Bank & Trust. In the unlikely event that ESSA Bank & Trust and ESSA Bancorp, Inc. liquidated prior to the conversion, all claims of their creditors would be paid first. Then, if there were any assets of ESSA Bank & Trust remaining, members of ESSA Bank & Trust would receive those remaining assets, pro rata, based upon the deposit balances in their deposit account in ESSA Bank & Trust immediately prior to liquidation. In the unlikely event that ESSA Bank & Trust were to liquidate after the conversion, all claims of creditors, including those of depositors, would be paid first, followed by distribution of the liquidation account to certain depositors, with any assets remaining thereafter distributed to ESSA Bancorp, Inc. as the holder of ESSA Bank & Trust capital stock. Pursuant to the rules and regulations of the Office of Thrift Supervision, a post-conversion merger, consolidation, sale of bulk assets or similar combination or transaction with another insured savings institution would not be considered a liquidation and, in these types of transactions, the liquidation account would be assumed by the surviving institution.

The plan of conversion provides for the establishment, upon the completion of the conversion, of a special liquidation account for the benefit of Eligible Account Holders and Supplemental Eligible Account Holders in an amount equal to the total equity of ESSA Bank & Trust as of the date of its latest balance sheet contained in this prospectus.

The purpose of the liquidation account is to provide Eligible Account Holders and Supplemental Eligible Account Holders who maintain their deposit accounts with ESSA Bank & Trust after the conversion with a liquidation interest in the unlikely event of the complete liquidation of ESSA Bank & Trust after the conversion. Each Eligible Account Holder and Supplemental Eligible Account Holder that continues to maintain his or her deposit account at ESSA Bank & Trust, would be entitled, on a complete liquidation of ESSA Bank & Trust after the conversion, to an interest in the liquidation account prior to any payment to the stockholders of ESSA Bancorp, Inc. Each Eligible Account Holder and Supplemental Eligible Account Holder would have an initial interest in the liquidation account for each deposit account, including savings accounts, transaction accounts such as negotiable order of withdrawal accounts, money market deposit accounts, and certificates of deposit, with a balance of $50 or more held in ESSA Bank & Trust on April 30, 2005 and ____________________, respectively. Each Eligible Account Holder and Supplemental Eligible Account Holder would have a pro rata interest in the total liquidation account for each such deposit account, based on the proportion that the balance of each such deposit account on April 30, 2005 or ____________________, respectively, bears to the balance of all deposit accounts in ESSA Bank & Trust on such dates.

If, however, on any December 31 annual closing date commencing on or after the effective date of the conversion, the amount in any such deposit account is less than the amount in the deposit account on April 30, 2005 or ____________________, as applicable, or any other annual closing date, then the interest in the liquidation account relating to such deposit account would be reduced from time to time by the proportion of any such reduction, and such interest will cease to exist if such deposit account is closed. In addition, no interest in the liquidation account would ever be increased despite any subsequent increase in the related deposit account. Payment pursuant to liquidation rights of Eligible Account Holders and Supplemental Eligible Account Holders would be separate and apart from the payment of any insured deposit accounts to such depositor. Any assets remaining after the above liquidation rights of Eligible Account Holders and Supplemental Eligible Account Holders are satisfied would be distributed to ESSA Bancorp, Inc. as the sole stockholder of ESSA Bank & Trust.

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Material Income Tax Consequences

Consummation of the conversion is subject to the prior receipt of an opinion of counsel or tax advisor with respect to federal and state income taxation that the conversion will not be a taxable transaction to ESSA Bank & Trust or ESSA Bancorp, Inc., Eligible Account Holders, Supplemental Eligible Account Holders, and other members of ESSA Bank & Trust. Unlike private letter rulings, opinions of counsel or tax advisors are not binding on the Internal Revenue Service or any state taxing authority, and such authorities may disagree with such opinions. In the event of such disagreement, there can be no assurance that ESSA Bancorp, Inc. or ESSA Bank & Trust would prevail in a judicial proceeding.

ESSA Bank & Trust and ESSA Bancorp, Inc. have received an opinion of counsel, Luse Gorman Pomerenk & Schick, P.C., regarding all of the material federal income tax consequences of the conversion, which includes the following:

1. The conversion of ESSA Bank & Trust to a Pennsylvania chartered stock savings association will qualify as a tax-free reorganization within the meaning of Section 368(a)(1)(F) of the Internal Revenue Code.

2. Neither ESSA Bancorp, Inc., a Pennsylvania corporation nor ESSA Bank & Trust will recognize any gain or loss upon the transfer of assets of ESSA Bancorp, Inc. to ESSA Bank & Trust in exchange for shares of common stock of ESSA Bank & Trust, which will be constructively received by ESSA Bank & Trust (Sections 361 and 1032(a) of the Internal Revenue Code).

3. The basis of the assets of ESSA Bancorp, Inc. and the holding period of such assets to be received by ESSA Bank & Trust will be the same as the basis and holding period in such assets in the hands of ESSA Bancorp, Inc. immediately before the exchange. (Sections 362(b) and 1223(2) of the Internal Revenue Code).

4. The exchange of Eligible Account Holders and Supplemental Account Holders interests in ESSA Bank & Trust for interests in a liquidation account established in ESSA Bank & Trust will satisfy the continuity of interest requirement of Section 1.368-1(b) of the Federal Income Tax Regulations.

5. None of ESSA Bank & Trust, nor Eligible Account Holders, Supplemental Eligible Account Holders or Other Members, will recognize any gain or loss on the transfer of the assets of ESSA Bank & Trust to ESSA Bank & Trust in exchange for an interest in a liquidation account established in ESSA Bank & Trust for the benefit of Eligible Account Holders and Supplemental Eligible Account holders who remain depositors of ESSA Bank & Trust and nontransferable subscription rights to purchase shares of ESSA Bancorp, Inc. common stock.

6. It is more likely than not that the nontransferable subscription rights have no value, based on the fact that these rights are acquired by the recipients without cost, are nontransferable and of short duration, and afford the recipients the right

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only to purchase the common stock at a price equal to its estimated fair market value, which will be the same price as the subscription price for the shares of common stock in the offering. Accordingly, no gain or loss will be recognized by Eligible Account Holders, Supplemental Eligible Account Holders or other members upon distribution to them of nontransferable subscription rights to purchase shares of ESSA Bancorp, Inc. common stock, provided that the amount to be paid for ESSA Bancorp, Inc. common stock is equal to the fair market value of ESSA Bancorp, Inc. common stock.

7. The basis of the shares of ESSA Bancorp, Inc. common stock purchased in the offering will be the purchase price. The holding period of the ESSA Bancorp, Inc. common stock purchased pursuant to the exercise of nontransferable subscription rights will commence on the date on which the right to acquire such stock was exercised.

8. No gain or loss will be recognized by ESSA Bancorp, Inc. on the receipt of money in exchange for shares of ESSA Bancorp, Inc. common stock sold in the offering.

In the view of RP Financial, LC. (who is acting as independent appraiser of the value of the shares of ESSA Bancorp, Inc. common stock in connection with the conversion), which view is not binding on the Internal Revenue Service, the subscription rights do not have any value for the reasons set forth in paragraph 6, above. If the subscription rights granted to Eligible Account Holders and Supplemental Eligible Account Holders are deemed to have an ascertainable value, receipt of these rights could result in taxable gain to those Eligible Account Holders and Supplemental Eligible Account Holders who exercise the subscription rights in an amount equal to their value, and ESSA Bancorp, Inc. could recognize gain on a distribution. Eligible Account Holders and Supplemental Eligible Account Holders are encouraged to consult with their own tax advisors as to the tax consequences in the event that subscription rights are deemed to have an ascertainable value.

The Internal Revenue Service has announced that it will not issue private letter rulings with respect to the issue of whether nontransferable rights have value. Unlike private letter rulings, an opinion of counsel or the view of an independent appraiser is not binding on the Internal Revenue Service and the Internal Revenue Service could disagree with the conclusions reached therein. Depending on the conclusion or conclusions with which the Internal Revenue Service disagrees, the Internal Revenue Service may take the position that the transaction is taxable to any one or more of ESSA Bank & Trust, the members of ESSA Bank & Trust, ESSA Bancorp, Inc. and the Eligible Account Holders and Supplemental Eligible Account Holders who exercise their subscription rights. In the event of a disagreement, there can be no assurance that ESSA Bancorp, Inc. or ESSA Bank & Trust would prevail in a judicial or administrative proceeding.

The federal tax opinion has been filed with the Securities and Exchange Commission as an exhibit to ESSA Bancorp, Inc. s registration statement. Advice regarding the Pennsylvania state income tax consequences consistent with the federal tax opinion has been issued by S.R. Snodgrass, A.C.

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Certain Restrictions on Purchase or Transfer of Our Shares after Conversion

All shares of common stock purchased in the offering by a director or an executive officer of ESSA Bank & Trust generally may not be sold for a period of one year following the closing of the conversion, except in the event of the death of the director or executive officer. Each certificate for restricted shares will bear a legend giving notice of this restriction on transfer, and instructions will be issued to the effect that any transfer within this time period of any certificate or record ownership of the shares other than as provided above is a violation of the restriction. Any shares of common stock issued at a later date as a stock dividend, stock split or otherwise with respect to the restricted stock will be similarly restricted. The directors and executive officers of ESSA Bancorp, Inc. also will be restricted by the insider trading rules promulgated pursuant to the Securities Exchange Act of 1934.

Purchases of shares of our common stock by any of our directors, executive officers and their associates, during the three-year period following the closing of the conversion may be made only through a broker or dealer registered with the Securities and Exchange Commission, except with the prior written approval of the Office of Thrift Supervision. This restriction does not apply, however, to negotiated transactions involving more than 1% of our outstanding common stock or to purchases of our common stock by our stock option plan or any of our tax-qualified employee stock benefit plans or nontax-qualified employee stock benefit plans, including any recognition and retention plans or restricted stock plans.

Office of Thrift Supervision regulations prohibit ESSA Bancorp, Inc. from repurchasing its shares of common stock during the first year following conversion unless compelling business reasons exist for such repurchases. After one year, the Office of Thrift Supervision does not impose any repurchase restrictions.

ESSA BANK & TRUST FOUNDATION

General

In furtherance of our commitment to our local community, the plan of conversion provides that we will establish ESSA Bank & Trust Foundation as a non-stock, nonprofit Delaware corporation in connection with the stock offering. The charitable foundation will be funded with cash and shares of ESSA Bancorp, Inc. common stock, as further described below. By further enhancing our visibility and reputation in our local community, we believe that the charitable foundation will enhance the long-term value of ESSA Bank & Trust s community banking franchise. The stock offering presents us with a unique opportunity to provide a substantial and continuing benefit to our community and to receive the associated tax benefits.

The establishment and funding of the charitable foundation has been approved by the Board of Directors of ESSA Bancorp, Inc. and ESSA Bank & Trust and is subject to approval by members of ESSA Bank & Trust. If the members do not approve the charitable foundation, we may, in our discretion, complete the conversion and stock offering without the inclusion of the charitable foundation and without resoliciting subscribers. We may also determine in our discretion, not complete the conversion and stock offering if the members do not approve the charitable foundation.

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Purpose of the Charitable Foundation

In connection with the closing of the stock offering, ESSA Bancorp, Inc. intends to contribute up to $1.5 million cash and issue a number of shares equal to 7.0% of the shares of common stock that will be sold in the stock offering to ESSA Bank & Trust Foundation. The purpose of the charitable foundation is to provide financial support to charitable organizations in the communities in which we operate and to enable our communities to share in our long-term growth. ESSA Bank & Trust Foundation will be dedicated completely to community activities and the promotion of charitable causes, and may be able to support such activities in ways that are not presently available to us. ESSA Bank & Trust Foundation will also support our ongoing obligations to the community under the Community Reinvestment Act. ESSA Bank & Trust received an outstanding rating in its most recent Community Reinvestment Act examination by the Federal Deposit Insurance Corporation.

Funding ESSA Bank & Trust Foundation with shares of ESSA Bancorp, Inc. common stock is also intended to allow our community to share in the potential growth and success of ESSA Bank & Trust after the stock offering is completed because ESSA Bank & Trust Foundation will benefit directly from any increases in the value of ESSA Bancorp, Inc. common stock. In addition, ESSA Bank & Trust Foundation will maintain close ties with ESSA Bank & Trust, thereby forming a partnership within the communities in which ESSA Bank & Trust operates.

Structure of the Charitable Foundation

The ESSA Bank & Trust Foundation will be incorporated under Delaware law as a non-stock, nonprofit corporation. The certificate of incorporation of ESSA Bank & Trust Foundation will provide that the corporation is organized exclusively for charitable purposes as set forth in Section 501(c)(3) of the Internal Revenue Code. ESSA Bank & Trust Foundation s certificate of incorporation will further provide that no part of the net earnings of the charitable foundation will inure to the benefit of, or be distributable to, its directors or officers.

We have selected Messrs. _______________________________ of our current directors to serve on the initial board of directors of the charitable foundation. As required by Office of Thrift Supervision regulations, we also will select one additional person to serve on the initial board of directors who will not be one of our officers or directors and who will have experience with local charitable organizations and grant making. While there are no plans to change the size of the initial board of directors during the year following the completion of the stock offering, following the first anniversary of the stock offering, the charitable foundation may alter the size and composition of its board of directors. For five years after the stock offering, one seat on the charitable foundation s board of directors will be reserved for a person from our local community who has experience with local community charitable organizations and grant making and who is not one of our officers, directors or employees, and one seat on the charitable foundation s board of directors will be reserved for one of ESSA Bank & Trust s directors.

The business experience of our current directors is described in Management of ESSA Bancorp, Inc.

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The board of directors of ESSA Bank & Trust Foundation will be responsible for establishing its grant and donation policies, consistent with the purposes for which it was established. As directors of a nonprofit corporation, directors of ESSA Bank & Trust Foundation will at all times be bound by their fiduciary duty to advance the charitable foundation s charitable goals, to protect its assets and to act in a manner consistent with the charitable purposes for which the charitable foundation is established. The directors of ESSA Bank & Trust Foundation also will be responsible for directing the activities of the charitable foundation, including the management and voting of the shares of common stock of ESSA Bancorp, Inc. held by the charitable foundation. However, as required by Office of Thrift Supervision regulations, all shares of common stock held by ESSA Bank & Trust Foundation must be voted in the same ratio as all other shares of the common stock on all proposals considered by stockholders of ESSA Bancorp, Inc.

ESSA Bank & Trust Foundation s place of business will be located at our administrative offices. The board of directors of ESSA Bank & Trust Foundation will appoint such officers and employees as may be necessary to manage its operations. To the extent applicable, we will comply with the affiliates restrictions set forth in Sections 23A and 23B of the Federal Reserve Act and the Office of Thrift Supervision regulations governing transactions between ESSA Bank & Trust and the charitable foundation.

ESSA Bank & Trust Foundation will receive working capital from its initial cash contribution of up to $1.5 million and:

(1) any dividends that may be paid on ESSA Bancorp, Inc. s shares of common stock in the future;

(2) within the limits of applicable federal and state laws, loans collateralized by the shares of common stock; or

(3) the proceeds of the sale of any of the shares of common stock in the open market from time to time.

As a private foundation under Section 501(c)(3) of the Internal Revenue Code, ESSA Bank & Trust Foundation will be required to distribute annually in grants or donations a minimum of 5% of the average fair market value of its net investment assets. One of the conditions imposed on the gift of common stock is that the amount of shares of common stock that may be sold by ESSA Bank & Trust Foundation in any one year shall not exceed 5% of the average market value of the assets held by ESSA Bank & Trust Foundation, except where the board of directors of the charitable foundation determines that the failure to sell an amount of common stock greater than such amount would result in a long-term reduction of the value of its assets and/or would otherwise jeopardize its capacity to carry out its charitable purposes.

Tax Considerations

Our independent tax advisor, Luse Gorman Pomerenk & Schick, P.C., has advised us that an organization created for the above purposes should qualify as a Section 501(c)(3) exempt organization under the Internal Revenue Code and should be classified as a private foundation. ESSA Bank & Trust Foundation will submit a timely request to the Internal Revenue Service to be recognized as an exempt organization. As long as ESSA Bank & Trust Foundation files its application for tax-exempt status within 15 months from the date of its organization, and provided the Internal Revenue Service approves the application, its effective date as a Section 501(c)(3) organization will be the date of its organization. Our independent tax advisor, however, has not rendered any advice on whether ESSA Bank & Trust Foundation s tax exempt status will be affected by the regulatory requirement that all shares of common stock of ESSA Bancorp, Inc. held by ESSA Bank & Trust Foundation must be voted in the same ratio as all other outstanding shares of common stock of ESSA Bancorp, Inc. on all proposals considered by stockholders of ESSA Bancorp, Inc.

ESSA Bancorp, Inc. and ESSA Bank & Trust are authorized by federal law to make charitable contributions. We believe that the stock offering presents a unique opportunity to establish and fund a charitable foundation given the substantial amount of additional capital being raised. In making such a determination, we considered the dilutive impact to our stockholders of the contribution of shares of common stock to ESSA Bank & Trust Foundation. We believe that the contribution to ESSA Bank & Trust Foundation in excess of the 10% annual limitation on charitable deductions described below is justified given ESSA Bank & Trust s capital position and its earnings, the substantial additional capital being raised in the stock offering and the potential benefits of ESSA Bank & Trust Foundation to our community. See Capitalization, Historical and Pro Forma Regulatory Capital Compliance , and Comparison of Valuation and Pro Forma Information With and Without the Charitable Foundation. The amount of the contribution will not adversely affect our financial condition. We therefore believe that the amount of the charitable contribution is reasonable given our pro forma capital position, and it does not raise safety and soundness concerns.

We have received an opinion from our independent tax advisor that ESSA Bancorp, Inc. s contribution of its shares of stock to ESSA Bank & Trust Foundation should not constitute an act of self-dealing and that we should be entitled to a deduction in the amount of the fair market value of the stock at the time of the contribution less the nominal amount that ESSA Bank & Trust Foundation is required to pay ESSA Bancorp, Inc. for such stock. We are permitted to deduct only an amount equal to 10% of our annual taxable income in any one year. We are permitted under the Internal Revenue Code to carry the excess contribution over the five-year period following the contribution to ESSA Bank & Trust Foundation. We estimate that most of the contribution should be deductible over the six-year period (*i.e.*, the year in which the contribution is made and the succeeding five-year period). However, we do not have any assurance that the Internal Revenue Service will grant tax-exempt status to the charitable foundation. Furthermore, even if the contribution is deductible, we may not have sufficient earnings to be able to use the deduction in full. Any such decision to continue to make additional contributions to ESSA Bank & Trust Foundation in the future would be based on an assessment of, among other factors, our financial condition at that time, the interests of our stockholders and depositors, and the financial condition and operations of the foundation.

Although we have received an opinion from our independent tax advisor that we should be entitled to a deduction for the charitable contribution, there can be no assurances that the Internal Revenue Service will recognize ESSA Bank & Trust Foundation as a Section 501(c)(3) exempt organization or that the deduction will be permitted. In such event, our contribution to

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ESSA Bank & Trust Foundation would be expensed without tax benefit, resulting in a reduction in earnings in the year in which the Internal Revenue Service makes such a determination.

As a private foundation, earnings and gains, if any, from the sale of common stock or other assets are exempt from federal and state income taxation. However, investment income, such as interest, dividends and capital gains, is generally taxed at a rate of 2.0%. ESSA Bank & Trust Foundation will be required to file an annual return with the Internal Revenue Service within four and one-half months after the close of its fiscal year. ESSA Bank & Trust Foundation will be required to make its annual return available for public inspection. The annual return for a private foundation includes, among other things, an itemized list of all grants made or approved, showing the amount of each grant, the recipient, any relationship between a grant recipient and the foundation s managers and a concise statement of the purpose of each grant.

Regulatory Requirements Imposed on the Charitable Foundation

Office of Thrift Supervision regulations impose the following requirements on the establishment of the charitable foundation:

- the Office of Thrift Supervision may examine the charitable foundation at the foundation s expense;
- the charitable foundation must comply with all supervisory directives imposed by the Office of Thrift Supervision;
- the charitable foundation must provide annually to the Office of Thrift Supervision a copy of the annual report that the foundation submits to the Internal Revenue Service;
- the charitable foundation must operate according to written policies adopted by its board of directors, including a conflict of interest policy;
- the charitable foundation may not engage in self-dealing and must comply with all laws necessary to maintain its tax-exempt status under the Internal Revenue Code; and
- the charitable foundation must vote its shares in the same ratio as all of the other shares voted on each proposal considered by the stockholders of ESSA Bancorp, Inc.

Within six months of completing the stock offering, the ESSA Bank & Trust Foundation must submit to the Office of Thrift Supervision a three-year operating plan.

RESTRICTIONS ON ACQUISITION OF ESSA BANCORP, INC.

Although the Board of Directors of ESSA Bancorp, Inc. is not aware of any effort that might be made to obtain control of ESSA Bancorp, Inc. after the conversion, the Board of Directors believes that it is appropriate to include certain provisions as part of ESSA Bancorp, Inc. s articles of incorporation to protect the interests of ESSA Bancorp, Inc. and its stockholders

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from takeovers which the Board of Directors of ESSA Bancorp, Inc. might conclude are not in the best interests of ESSA Bank & Trust, ESSA Bancorp, Inc. or ESSA Bancorp, Inc. s stockholders.

The following discussion is a general summary of the material provisions of ESSA Bancorp, Inc. s articles of incorporation and bylaws, ESSA Bank & Trust s charter and bylaws and certain other statutory and regulatory provisions that may be deemed to have an anti-takeover effect. The following description of certain of these provisions is necessarily general and, with respect to provisions contained in ESSA Bancorp, Inc. s articles of incorporation and bylaws and ESSA Bank & Trust s charter and bylaws, reference should be made in each case to the document in question, each of which is part of ESSA Bank & Trust s application for conversion with the Office of Thrift Supervision and ESSA Bancorp, Inc. s registration statement filed with the Securities and Exchange Commission. See Where You Can Find Additional Information.

ESSA Bancorp, Inc. s Articles of Incorporation and Bylaws

ESSA Bancorp, Inc. s articles of incorporation and bylaws contain a number of provisions relating to corporate governance and rights of stockholders that might discourage future takeover attempts. As a result, stockholders who might desire to participate in such transactions may not have an opportunity to do so. In addition, these provisions will also render the removal of the Board of Directors or management of ESSA Bancorp, Inc. more difficult.

The following description is a summary of the provisions of the articles of incorporation and bylaws. See Where You Can Find Additional Information as to how to review a copy of these documents.

Directors. Initially, the Board of Directors will be divided into three classes. Only one class of directors will be elected annually. Thus, it would take at least two annual elections to replace a majority of ESSA Bancorp, Inc. s Board of Directors. Further, the articles of incorporation authorize the Board of Directors to fill any vacancies so created, including any vacancy created by an increase in the number of directors, by a majority vote of directors then in office. The bylaws impose notice, informational and other requirements and conditions in connection with the nomination by stockholders of candidates for election to the Board of Directors or the proposal by stockholders of business to be acted upon at an annual meeting of stockholders.

Any person appointed or elected to ESSA Bancorp, Inc. s Board of Directors shall own, or within a reasonable time following such appointment or election shall acquire, at least 1,000 shares of the ESSA Bancorp, Inc. s common stock. In addition, at the time of initial appointment/election, such person must reside, or work, in a county in which ESSA Bank & Trust maintains an office or in a county contiguous to a county in which ESSA Bank & Trust maintains an office.

Restrictions on Call of Special Meetings. The bylaws provide that special meetings of stockholders can be called by the Chairman of the Board, the President or the Board of Directors pursuant to a resolution adopted by a majority of the total number of directors authorized by our

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articles of incorporation and bylaws. The articles of incorporation and the bylaws do not provide for stockholder ability to call a special meeting.

Prohibition of Cumulative Voting. The articles of incorporation prohibit cumulative voting for the election of Directors.

Limitation of Voting Rights. The articles of incorporation provide that in no event will any person who beneficially owns, directly or indirectly, more than 10% of the then-outstanding shares of common stock, be entitled or permitted to vote any of the shares of common stock held in excess of the 10% limit.

Restrictions on Removing Directors from Office. The articles of incorporation provide that directors can be removed from office for cause if the removal is approved by the vote of stockholders owning not less than 60% of the total votes eligible to be cast by stockholders at a duly constituted meeting (after giving effect to the limitation on voting rights discussed above in Limitation of Voting Rights).

Authorized but Unissued Shares. After the conversion, ESSA Bancorp, Inc. will have authorized but unissued shares of common and preferred stock. See Description of Capital Stock. The articles of incorporation authorize 40,000,000 shares of common stock and 10,000,000 shares of serial preferred stock. The Board of Directors of ESSA Bancorp, Inc. may amend the articles of incorporation, without action by the stockholders, to increase or decrease the aggregate number of shares of stock or the number of shares of stock of any class or series that ESSA Bancorp, Inc. has authority to issue. In addition, the Board of Directors of ESSA Bancorp, Inc. is authorized, without further approval of the stockholders, to issue additional shares of common or preferred stock and to classify or reclassify any unissued shares of stock (including common stock and preferred stock) from time to time into one or more classes or series subject to applicable provisions of law, and the Board of Directors is authorized to fix by setting or changing the designations, and the relative preferences, conversion or other rights (including offering rights), voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption for each class or series, voting rights, if any, including without limitation, offering rights of such shares (which could be multiple or as a separate class). In the event of a proposed merger, tender offer or other attempt to gain control of ESSA Bancorp, Inc. that the Board of Directors does not approve, it might be possible for the Board of Directors to authorize the issuance of common stock or a series of preferred stock with rights and preferences that would impede the completion of the transaction. An effect of the possible issuance of common or preferred stock therefore may be to deter a future attempt to gain control of ESSA Bancorp, Inc. The Board of Directors has no present plan or understanding to issue any preferred stock.

Amendments to Articles of Incorporation and Bylaws. Pennsylvania law provides that, subject to limited exceptions, the amendment or repeal of any provision of our articles of incorporation requires the approval of a majority of votes cast by all stockholders entitled to vote on the matter (after giving effect to the limitation on voting rights discussed above in Limitation of Voting Rights). Our articles of incorporation, however, provide that amendments to certain provisions of our article of incorporation requires the approval of 80% of shares entitled to vote (after giving effect to the limitation on voting rights discussed above in

Limitation of Voting Rights). The provisions of our articles of incorporation that require approval of 80% shares entitled to vote relate to the limitation on voting rights, the authority of the Board of Directors to fix terms of preferred stock, the number, classification, terms, prohibition of cumulative voting, board vacancies, removal of directors, meetings of shareholders, liability of directors and officers and the amendment of the articles of incorporation and bylaws. Our articles of incorporation also provide that, in any event, the proposed amendment or repeal of any provision of our articles of incorporation must be approved by a majority of our Board of Directors then in office before it can be submitted for consideration at an annual or special meeting.

The bylaws may be amended exclusively by the affirmative vote of a majority of the directors then in office or by the affirmative vote of at least 80% of the shares entitled to vote.

Approval of Consolidations, Mergers, and Other Similar Transactions. Pennsylvania law provides that, subject to limited exceptions, consolidations, mergers and other similar transactions require the approval of a majority of the votes cast by shareholders eligible to vote.

Pennsylvania General Corporate Law

The Pennsylvania Business Corporation Law of 1988, as amended, also contains certain provisions applicable to ESSA Bancorp, Inc. that may have the effect of deterring or discouraging an attempt to take control of ESSA Bancorp, Inc. These provisions, among other things:

Require that, following any acquisition by any person or group of 20% of a public corporation s voting power, the remaining shareholders have the right to receive payment for their shares, in cash, from such person or group in an amount equal to the fair value of the shares, including an increment representing a proportion of any value payable for control of the corporation (Subchapter 25E of the Business Corporation Law);

Prohibit for five years, subject to certain exceptions, a business combination (which includes a merger or consolidation of the corporation or a sale, lease or exchange of assets) with a person or group beneficially owning 20% or more of a public corporation s voting power (Subchapter 25F of the Business Corporation Law);

Prevent a person or group acquiring different levels of voting power (20%, 33% and 50%) from voting any shares over the applicable threshold, unless disinterested shareholders approve such voting rights (Subchapter 25G of the Business Corporation Law);

Require any person or group that publicly announces that it may acquire control of a corporation, or that acquires or publicly discloses an intent to acquire 20% or more of the voting power of a corporation, to disgorge to the corporation any profits that it receives from sales of the corporation s equity securities purchased over the prior 18 months (Subchapter 25H of the Business Corporation Law);

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Expand the factors and groups (including shareholders) which a corporation s Board of Directors can consider in determining whether an action is in the best interests of the corporation;

Provide that a corporation s Board of Directors need not consider the interests of any particular group as dominant or controlling;

Provide that a corporation s directors, in order to satisfy the presumption that they have acted in the best interests of the corporation, need not satisfy any greater obligation or higher burden of proof with respect to actions relating to an acquisition or potential acquisition of control;

Provide that actions relating to acquisitions of control that are approved by a majority of disinterested directors are presumed to satisfy the directors fiduciary duty, unless it is proven by clear and convincing evidence that the directors did not assent to such action in good faith after reasonable investigation; and

Provide that the fiduciary duty of a corporation s directors is solely to the corporation and may be enforced by the corporation or by a shareholder in a derivative action, but not by a shareholder directly.

The Pennsylvania Business Corporation Law also explicitly provides that the fiduciary duty of directors does not require them to:

Redeem any rights under, or to modify or render inapplicable, any shareholder rights plan;

Render inapplicable, or make determinations under, provisions of the Pennsylvania Business Corporation Law relating to control transactions, business combinations, control-share acquisitions or disgorgement by certain controlling shareholders following attempts to acquire control; or

Act as the Board of Directors, a committee of the board or an individual director, solely because of the effect the action might have on an acquisition or potential acquisition of control of the corporation or the consideration that might be offered or paid to shareholders in such an acquisition.

One effect of these provisions may be to make it more difficult for a shareholder to successfully challenge the actions of ESSA Bancorp, Inc. s Board of Directors in a potential change in control context. Pennsylvania case law appears to provide that the fiduciary duty standard under the Pennsylvania Business Corporation Law grants directors the statutory authority to reject or refuse to consider any potential or proposed acquisition of the corporation.

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Conversion Regulations

Office of Thrift Supervision regulations prohibit any person from making an offer, announcing an intent to make an offer or participating in any other arrangement to purchase stock or acquiring stock or subscription rights in a converting institution or its holding company from another person prior to completion of its conversion. Further, without the prior written approval of the Office of Thrift Supervision, no person may make an offer or announcement of an offer to purchase shares or actually acquire shares of a converted institution or its holding company for a period of three years from the date of the completion of the conversion if, upon the completion of such offer, announcement or acquisition, the person would become the beneficial owner of more than 10% of the outstanding stock of the institution or its holding company. The Office of Thrift Supervision has defined person to include any individual, group acting in concert, corporation, partnership, association, joint stock company, trust, unincorporated organization or similar company, a syndicate or any other group formed for the purpose of acquiring, holding or disposing of securities of an insured institution. However, offers made exclusively to a bank or its holding company, or an underwriter or member of a selling group acting on the converting institution s or its holding company s behalf for resale to the general public are excepted. The regulation also provides civil penalties for willful violation or assistance in any such violation of the regulation by any person connected with the management of the converting institution or its holding company or who controls more than 10% of the outstanding shares or voting rights of a converted institution or its holding company.

Change of Control Regulations

Under the Change in Bank Control Act, no person may acquire control of an insured federal savings bank or its parent holding company unless the Office of Thrift Supervision has been given 60 days prior written notice and has not issued a notice disapproving the proposed acquisition. In addition, Office of Thrift Supervision regulations provide that no company may acquire control of a savings bank without the prior approval of the Office of Thrift Supervision. Any company that acquires such control becomes a savings and loan holding company subject to registration, examination and regulation by the Office of Thrift Supervision.

Control, as defined under federal law, means ownership, control of or holding irrevocable proxies representing more than 25% of any class of voting stock, control in any manner of the election of a majority of the savings bank s directors, or a determination by the Office of Thrift Supervision that the acquiror has the power to direct, or directly or indirectly to exercise a controlling influence over, the management or policies of the institution. Acquisition of more than 10% of any class of a savings bank s voting stock, if the acquiror is also subject to any one of eight control factors, constitutes a rebuttable determination of control under the regulations. Such control factors include the acquiror being one of the two largest stockholders. The determination of control may be rebutted by submission to the Office of Thrift Supervision, prior to the acquisition of stock or the occurrence of any other circumstances giving rise to such determination, of a statement setting forth facts and circumstances which would support a finding that no control relationship will exist and containing certain undertakings. The regulations provide that persons or companies which acquire beneficial ownership exceeding 10% or more of any class of a savings bank s stock who do not intend to participate in or seek to exercise control over a savings bank s management or policies may qualify for a safe harbor by filing with the Office of Thrift Supervision a certification form that states, among other things, that the holder is not in control of such institution, is not subject to a rebuttable determination of control and will take no action which would result in a determination or rebuttable determination of control without prior notice to or approval of the Office of Thrift Supervision, as applicable. There are also rebuttable presumptions in the regulations concerning whether a group acting in concert exists, including presumed action in concert among members of an immediate family.

The Office of Thrift Supervision may prohibit an acquisition of control if it finds, among other things, that:

(1) the acquisition would result in a monopoly or substantially lessen competition;

(2) the financial condition of the acquiring person might jeopardize the financial stability of the institution; or

(3) the competence, experience or integrity of the acquiring person indicates that it would not be in the interest of the depositors or the public to permit the acquisition of control by such person.

DESCRIPTION OF CAPITAL STOCK

General

At the effective date, ESSA Bancorp, Inc. will be authorized to issue 40,000,000 shares of common stock, par value of $0.01 per share, and 10,000,000 shares of preferred stock, par value $0.01 per share. ESSA Bancorp, Inc. currently expects to issue in the offering up to _________ shares of common stock, subject to adjustment. ESSA Bancorp, Inc. will not issue shares of preferred stock in the conversion. Each share of ESSA Bancorp, Inc. common stock will have the same relative rights as, and will be identical in all respects to, each other share of common stock. Upon payment of the subscription price for the common stock, in accordance with the plan of conversion, all of the shares of common stock will be duly authorized, fully paid and nonassessable.

The shares of common stock of ESSA Bancorp, Inc. will represent nonwithdrawable capital, will not be an account of an insurable type, and will not be insured by the Federal Deposit Insurance Corporation or any other government agency.

Common Stock

Dividends. ESSA Bancorp, Inc. may pay dividends out of statutory surplus or from net earnings if, as and when declared by its Board of Directors. The payment of dividends by ESSA Bancorp, Inc. is subject to limitations that are imposed by law and applicable regulation. The holders of common stock of ESSA Bancorp, Inc. will be entitled to receive and share equally in dividends as may be declared by the Board of Directors of ESSA Bancorp, Inc. out of funds legally available therefor. If ESSA Bancorp, Inc. issues shares of preferred stock, the holders thereof may have a priority over the holders of the common stock with respect to dividends.

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Voting Rights. Upon consummation of the conversion, the holders of common stock of ESSA Bancorp, Inc. will have exclusive voting rights in ESSA Bancorp, Inc. They will elect ESSA Bancorp, Inc. s Board of Directors and act on other matters as are required to be presented to them under Pennsylvania law or as are otherwise presented to them by the Board of Directors. Generally, each holder of common stock will be entitled to one vote per share and will not have any right to cumulate votes in the election of directors. Any person who beneficially owns more than 10% of the then-outstanding shares of ESSA Bancorp, Inc. s common stock, however, will not be entitled or permitted to vote any shares of common stock held in excess of the 10% limit. If ESSA Bancorp, Inc. issues shares of preferred stock, holders of the preferred stock may also possess voting rights. See Restrictions on Acquisition of ESSA Bancorp, Inc. Pennsylvania General Corporate Law for additional information regarding voting rights.

As a Pennsylvania stock savings association, corporate powers and control of ESSA Bank & Trust are vested in its Board of Directors, who elect the officers of ESSA Bank & Trust and who fill any vacancies on the Board of Directors. Voting rights of ESSA Bank & Trust are vested exclusively in the owners of the shares of capital stock of ESSA Bank & Trust, which will be ESSA Bancorp, Inc., and voted at the direction of ESSA Bancorp, Inc. s Board of Directors. Consequently, the holders of the common stock of ESSA Bancorp, Inc. will not have direct control of ESSA Bank & Trust

Liquidation. In the event of any liquidation, dissolution or winding up of ESSA Bank & Trust, ESSA Bancorp, Inc., as the holder of 100% of ESSA Bank & Trust s capital stock, would be entitled to receive all assets of ESSA Bank & Trust available for distribution, after payment or provision for payment of all debts and liabilities of ESSA Bank & Trust, including all deposit accounts and accrued interest thereon, and after distribution of the balance in the liquidation account to Eligible Account Holders and Supplemental Eligible Account Holders. In the event of liquidation, dissolution or winding up of ESSA Bancorp, Inc., the holders of its common stock would be entitled to receive, after payment or provision for payment of all its debts and liabilities, all of the assets of ESSA Bancorp, Inc. available for distribution. If preferred stock is issued, the holders thereof may have a priority over the holders of the common stock in the event of liquidation or dissolution.

Preemptive Rights. Holders of the common stock of ESSA Bancorp, Inc. will not be entitled to preemptive rights with respect to any shares that may be issued. The common stock is not subject to redemption.

Preferred Stock

None of the shares of ESSA Bancorp, Inc. s authorized preferred stock will be issued as part of the offering. Preferred stock may be issued with preferences and designations as our Board of Directors may from time to time determine. Our Board of Directors may, without stockholder approval, issue shares of preferred stock with voting, dividend, liquidation and conversion rights that could dilute the voting strength of the holders of the common stock and may assist management in impeding an unfriendly takeover or attempted change in control.

TRANSFER AGENT

The transfer agent and registrar for ESSA Bancorp, Inc. s common stock is ______________________.

EXPERTS

The Consolidated Financial Statements of ESSA Bank & Trust as of September 30, 2006 and 2005, and for the years then ended appearing elsewhere in this prospectus have been included herein and in the registration statement in reliance upon the report of S.R. Snodgrass, A.C. an independent registered public accounting firm, which is included herein and upon the authority of said firm as experts in accounting and auditing.

The Consolidated Financial Statements of ESSA Bank & Trust as of September 30, 2004 and for the year then ended elsewhere in this prospectus and in the registration statement have been audited by BMC LLP, an independent registered public accounting firm, as set forth in its report appearing elsewhere in this prospectus and elsewhere in the registration statement are included in reliance upon such report given upon the authority of such firm as experts in accounting and auditing.

RP Financial, LC. has consented to the publication herein of the summary of its report to ESSA Bancorp, Inc. setting forth its opinion as to the estimated pro forma market value of the shares of common stock upon completion of the conversion and offering and its letter with respect to subscription rights.

LEGAL MATTERS

Luse Gorman Pomerenk & Schick, P.C., Washington, D.C., counsel to ESSA Bancorp, Inc., ESSA Bank & Trust and ESSA Bank & Trust, will issue to ESSA Bancorp, Inc. its opinion regarding the legality of the common stock and the federal income tax consequences of the conversion. Certain legal matters will be passed upon for Ryan Beck & Co., Inc. by Rhoads & Sinon LLP, Harrisburg, Pennsylvania.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

ESSA Bancorp, Inc. has filed with the Securities and Exchange Commission a registration statement under the Securities Act of 1933 with respect to the shares of common stock offered hereby. As permitted by the rules and regulations of the Securities and Exchange Commission, this prospectus does not contain all the information set forth in the registration statement. Such information, including the appraisal report which is an exhibit to the registration statement, can be examined without charge at the public reference facilities of the Securities and Exchange Commission located at 100 F Street, N.E., Washington, D.C. 20549, and copies of such material can be obtained from the Securities and Exchange Commission at prescribed rates. The Securities and Exchange Commission telephone number is 1-800-SEC-0330. In addition, the Securities and Exchange Commission maintains a web site (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Securities and Exchange Commission, including ESSA Bancorp, Inc. The statements contained in this prospectus as to the contents of any contract or other

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document filed as an exhibit to the registration statement are, of necessity, brief descriptions of the material terms of, and should be read in conjunction with, such contract or document.

ESSA Bank & Trust has filed with the Office of Thrift Supervision an Application on Form AC with respect to the conversion. This prospectus omits certain information contained in the application. The application may be examined at the principal office of the Office of Thrift Supervision, 1700 G Street, N.W., Washington, D.C. 20552, and at the Northeast Regional Office of the Office of Thrift Supervision, located at Harborside Financial Center Plaza Five, Suite 1600, Jersey City, New Jersey 07311.

In connection with the offering, ESSA Bancorp, Inc. will register its common stock under Section 12(b) of the Securities Exchange Act of 1934 and, upon such registration, ESSA Bancorp, Inc. and the holders of its common stock will become subject to the proxy solicitation rules, reporting requirements and restrictions on common stock purchases and sales by directors, officers and greater than 10% stockholders, the annual and periodic reporting and certain other requirements of the Securities Exchange Act of 1934. Under the plan of conversion, ESSA Bancorp, Inc. has undertaken that it will not terminate such registration for a period of at least three years following the conversion and the offering.

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ESSA BANK & TRUST

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors

ESSA Bank & Trust

We have audited the consolidated balance sheet of ESSA Bank & Trust and subsidiaries as of September 30, 2006 and 2005, and the related consolidated statements of income, changes in equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Bank s management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ESSA Bank & Trust and subsidiaries as of September 30, 2006 and 2005, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

/s/ S.R. Snodgrass, A.C.

Wexford, PA
October 27, 2006

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

ESSA Bank & Trust

Stroudsburg, Pennsylvania

We have audited the accompanying consolidated statements of income, changes in equity, and cash flows of ESSA Bank & Trust for the year ended September 30, 2004. These consolidated financial statements are the responsibility of the Bank s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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. The Bank is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of ESSA Bank & Trust and subsidiaries for the year ended September 30, 2004, in conformity with U.S. generally accepted accounting principles.

/s/ Beard Miller Company LLP

Beard Miller Company LLP

Harrisburg, Pennsylvania

October 29, 2004

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ESSA BANK & TRUST AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

	September 30, 2006	September 30, 2005
	(dollars in thousands)	
ASSETS		
Cash and due from banks	$ 11,677	$ 12,240
Interest-bearing deposits with other institutions	1,053	1,068
Commercial paper		6,982
Total cash and cash equivalents	12,730	20,290
Investment securities available for sale	89,122	62,506
Investment securities held to maturity (market value of $19,193 and $21,297)	19,715	21,505
Loans receivable (net of allowance for loan losses of $3,855 and $3,563)	556,677	508,981
Federal Home Loan Bank stock	13,675	11,916
Premises and equipment	11,447	11,560
Bank-owned life insurance	13,376	12,864
Other assets	9,054	6,444
TOTAL ASSETS	$ 725,796	$ 656,066
LIABILITIES		
Deposits	$ 402,153	$ 374,759
Short-term borrowings	35,299	27,479
Other borrowings	224,000	194,000
Advances by borrowers for taxes and insurance	2,198	1,591
Other liabilities	3,809	3,866
TOTAL LIABILITIES	667,459	601,695
Commitment and contingencies (Note 11)		
EQUITY		
Retained earnings	58,526	54,572
Accumulated other comprehensive loss	(189)	(201)
TOTAL EQUITY	58,337	54,371
TOTAL LIABILITIES AND EQUITY	$ 725,796	$ 656,066

See accompanying notes to the consolidated financial statements.

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ESSA BANK & TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INCOME

	Year Ended September 30,		
	2006	2005	2004
	(dollars in thousands)		
INTEREST INCOME			
Loans receivable	$ 31,744	$ 28,829	$ 27,152
Investment securities:			
Taxable	3,579	2,225	1,070
Exempt from federal income tax	278	267	274
Other investment income	850	598	314
Total interest income	36,451	31,919	28,810
INTEREST EXPENSE			
Deposits	9,012	5,851	5,011
Short-term borrowings	1,081	554	141
Other borrowings	9,124	7,918	6,781
Total interest expense	19,217	14,323	11,933
NET INTEREST INCOME	17,234	17,596	16,877
Provision for loan losses	300	550	530
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	16,934	17,046	16,347
NONINTEREST INCOME			
Service fees on deposit accounts	3,825	3,747	2,825
Services charges and fees on loans	491	486	475
Trust and investment fees	642	404	515
Impairment loss on securities		(130)	
Gain on sale of loans, net	7	96	
Earnings on Bank-owned life insurance	512	495	369
Other	41	183	96
Total noninterest income	5,518	5,281	4,280
NONINTEREST EXPENSE			
Compensation and employee benefits	9,194	9,035	7,872
Occupancy and equipment	2,395	2,218	2,054
Professional fees	736	828	955
Data processing	1,819	1,896	2,163
Advertising	577	477	503
Contributions	423	484	416
Other	1,541	1,555	1,577
Total noninterest expense	16,685	16,493	15,540
Income before income taxes	5,767	5,834	5,087
Income taxes	1,813	1,383	1,172

NET INCOME	$ 3,954	$ 4,451	$ 3,915

See accompanying notes to the consolidated financial statements.

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ESSA BANK & TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Equity	Comprehensive Income
		(dollars in thousands)		
Balance, September 30, 2003	$ 46,206	$ 175	$ 46,381	
Net income	3,915		3,915	$ 3,915
Other comprehensive loss:				
Unrealized loss on securities available for sale, net of income tax benefit of $12		(36)	(36)	(36)
Comprehensive income				$ 3,879
Balance, September 30, 2004	50,121	139	50,260	
Net income	4,451		4,451	$ 4,451
Other comprehensive loss:				
Unrealized loss on securities available for sale, net of reclassification adjustment, net of income tax benefit of $176		(340)	(340)	(340)
Comprehensive income				$ 4,111
Balance, September 30, 2005	54,572	(201)	54,371	
Net income	3,954		3,954	$ 3,954
Other comprehensive income:				
Unrealized gain on securities available for sale, net of income taxes of $6		12	12	12
Comprehensive income				$ 3,966
Balance, September 30, 2006	$ 58,526	$ (189)	$ 58,337	

	2006	2005	2004
Components of other comprehensive income (loss):			
Change in net unrealized gain (loss) on investment securities available for sale	$ 12	$ (426)	$ (36)
Realized impairment loss included in net income, net of taxes of $44 in 2005		(86)	
Total	$ 12	$ (340)	$ (36)

See accompanying notes to the consolidated financial statements.

ESSA BANK & TRUST AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year Ended September 30,		
	2006	2005	2004
	(dollars in thousands)		
OPERATING ACTIVITIES			
Net income	$ 3,954	$ 4,451	$ 3,915
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for loan losses	300	550	530
Provision for depreciation and amortization.	1,063	969	956
Amortization (accretion) of discounts and premiums	(500)	(394)	348
Impairment loss on securities		130	
Gain on sale of loans, net	(7)	(96)	
Decrease (increase) in accrued interest receivable	(530)	(303)	76
Increase (decrease) in accrued interest payable	551	139	(2,924)
Increase in other receivables	(1,841)		
Earnings on Bank-owned life insurance	(512)	(495)	(369)
Deferred federal income taxes	76	159	183
Other, net	(708)	(180)	352
Net cash provided by operating activities	1,846	4,930	3,067
INVESTING ACTIVITIES			
Investment securities available for sale:			
Proceeds from principal repayments and maturities	23,537	11,356	16,165
Purchases	(50,213)	(27,126)	(38,639)
Investment securities held to maturity:			
Proceeds from principal repayments and maturities	3,753	3,293	3,950
Purchases	(1,988)	(17,191)	(10,305)
Increase in loans receivable, net	(47,800)	(36,244)	(39,906)
Proceeds from sale of loans	340	5,605	
Redemption of FHLB stock	2,325	2,696	1,394
Purchase of FHLB stock	(4,084)	(3,254)	(3,565)
Purchase of Bank-owned life insurance		(2,000)	(10,000)
Proceeds from sale of other real estate	83	118	221
Purchase of premises, equipment, and software	(1,180)	(1,053)	(2,152)
Net cash used for investing activities	(75,227)	(63,800)	(82,837)
FINANCING ACTIVITIES			
Increase in deposits, net	27,394	41,232	14,032
Net increase (decrease) in short-term borrowings	7,820	16,345	(6,786)
Proceeds from other borrowings	57,000	23,000	64,000
Repayment of other borrowings	(27,000)	(23,000)	(13,000)
Increase (decrease) in advances by borrowers for taxes and insurance	607	125	(105)
Net cash provided by financing activities	65,821	57,702	58,141
Decrease in cash and cash equivalents	(7,560)	(1,168)	(21,629)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	20,290	21,458	43,087

CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 12,730	$ 20,290	$ 21,458
SUPPLEMENTAL CASH FLOW DISCLOSURES			
Cash paid:			
Interest	$ 18,666	$ 14,303	$ 11,982
Income taxes	1,550	900	1,375
Noncash items:			
Other real estate owned	74	42	81

See accompanying notes to the consolidated financial statements.

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ESSA BANK & TRUST AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of significant accounting and reporting policies applied in the presentation of the accompanying financial statements follows:

Nature of Operations and Basis of Presentation

ESSA Bank & Trust (the Bank) is a Pennsylvania chartered savings and loan institution located in Stroudsburg, Pennsylvania. The Bank s primary business consists of the taking of deposits and granting of loans to customers generally in Monroe and Northampton counties, Pennsylvania. The Bank is subject to regulation and supervision by the Pennsylvania Department of Banking and the Office of Thrift Supervision (the OTS).

The consolidated financial statements include the accounts of ESSA Bank & Trust and its wholly owned subsidiaries, ESSACOR Inc. and Pocono Investment Company. All intercompany transactions have been eliminated in consolidation.

Use of Estimates in the Preparation of Financial Statements

The accounting principles followed by the Bank and its subsidiaries and the methods of applying these principles conform to U.S. generally accepted accounting principles and to general practice within the banking industry. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and related revenues and expenses for the period. Actual results could differ significantly from those estimates.

Securities

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each balance sheet date.

Securities classified as available for sale are those securities that the Bank intends to hold for an indefinite period of time but not necessarily to maturity. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Bank s assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Unrealized gains and losses are reported in other comprehensive income, net of the related deferred tax effects. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Securities classified as held to maturity are those debt securities the Bank has both the intent and ability to hold to maturity regardless of changes in market conditions, liquidity needs, or changes in general economic conditions. These securities are carried at cost adjusted for the amortization of premium and accretion of discount, recognized in interest income using the interest method over the period to maturity.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Securities (Continued)

Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers: (1) the length of time and the extent to which the fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer; and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Federal law requires a member institution of the Federal Home Loan Bank (FHLB) system to hold stock of its district FHLB according to a predetermined formula. This restricted stock is carried at cost.

Loans Receivable

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of an allowance for loan losses and any deferred fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Bank is generally amortizing these amounts over the contractual life of the loan. Mortgage loans sold in the secondary market are sold without recourse.

The accrual of interest is generally discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectibility of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Interest received on nonaccrual loans generally is either applied against principal or reported as interest income, according to management s judgment as to the collectibility of principal. Generally loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectibility of the total contractual principal and interest is no longer in doubt.

Allowance for Loan Losses

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

The allowance for loan losses is maintained at a level by management which represents the evaluation of known and inherent risks in the loan portfolio at the consolidated balance sheet date. Management s periodic evaluation of the adequacy of the allowance is based on the Bank s past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower s ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans.

The allowance consists of specific and general components. The specific component related to loans that are classified as either doubtful, substandard, or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassfied loans and is based on historical loss experience adjusted for qualitative factors.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential mortgage loans for impairment disclosures.

Loan Servicing

Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance to the extent that fair value is less than the capitalized amount. Total servicing assets included in other assets as of September 30, 2006 and 2005, were $215,000 and $253,000, respectively.

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the useful lives of the related assets, which range from 10 to 40 years for building and leasehold improvements and 3 to 7 years for furniture, fixtures, and equipment. Expenditures for maintenance and repairs are charged to operations as incurred. Costs of major additions and improvements are capitalized.

Real Estate Owned

Real estate owned acquired in settlement of foreclosed loans is carried at the lower of cost or fair value minus estimated costs to sell. Valuation allowances for estimated losses are provided when the carrying value of the real estate acquired exceeds fair value minus estimated costs to sell. Operating expenses of such properties, net of related income, are expensed in the period incurred. Foreclosed real estate included in other assets totaled $0 and $19,000 at September 30, 2006 and 2005, respectively.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee Benefit Plans

The Bank maintains a noncontributory, defined benefit pension plan for all employees who have met age and length of service requirements. The Bank s funding policy is to contribute annually the maximum amount that can be deducted for federal income tax purposes. The Bank also maintains a defined contribution Section 401(k) plan covering eligible employees. Contributions matching those made by eligible employees and an elective contribution are made annually at the discretion of the Board of Directors.

Advertising Costs

In accordance with Statement of Position No. 93-7, *Reporting on Advertising Costs*, the Bank expenses all advertising expenditures incurred.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Federal Income Taxes

Deferred tax assets and liabilities are reflected based on the differences between the financial statement and the income tax basis of assets and liabilities using the enacted marginal tax rates. Deferred income tax expense and benefit are based on the changes in the deferred tax assets or liabilities from period to period.

The Bank files a consolidated federal income tax return. Deferred tax assets and liabilities are reflected at currently enacted income tax rates applicable to the period in which such items are expected to be realized or settled. As changes in tax rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Cash and Cash Equivalents

The Bank has defined cash and cash equivalents as cash and due from banks, interest-bearing deposits with other institutions, and commercial paper with original maturities of 90 days or less.

Comprehensive Income

The Bank is required to present comprehensive income and its components in a full set of general-purpose financial statements for all periods presented. Other comprehensive income is composed exclusively of net unrealized holding gains or losses on its available-for-sale investment and mortgage-backed securities portfolio. The Bank has elected to report the effects of other comprehensive income as part of the Consolidated Statement of Changes in Equity.

Reclassification of Comparative Amounts

Certain items previously reported have been reclassified to conform to the current year s reporting format. Such reclassifications did not affect net income or equity.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (FAS No. 123R). FAS No. 123R revised FAS No. 123, *Accounting for Stock-Based Compensation*, and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. FAS No. 123R will require compensation costs related to share-based payment transactions to be recognized in the financial statement (with limited exceptions). The amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. Compensation cost will be recognized over the period during which an employee provides service in exchange for the award.

In April 2005, the Securities and Exchange Commission adopted a new rule that amends the compliance dates for FAS No. 123R. The statement requires that compensation cost relating to share-based payment transactions be recognized in financial statements and that this cost be measured based on the fair value of the equity or liability instruments issued. FAS No. 123R covers a wide range of share-based compensation arrangements, including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. The Bank will adopt FAS No. 123R on October 1, 2006, and unless options are granted, management does not anticipate any compensation expense as a result of the adoption of this statement.

In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 107 (SAB No. 107), *Share-Based Payment*, providing guidance on option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of FAS No. 123R, and the disclosures in MD&A subsequent to the adoption. Unless options are granted management does not anticipate any compensation expense as a result of the adoption of this statement.

In June 2005, the FASB issued FAS No. 154, *Accounting Changes and Errors Corrections, a replacement of APB Opinion No. 20 and FAS No. 3*. The statement applies to all voluntary changes in accounting principle and changes the requirements for accounting for and reporting of a change in accounting principle. FAS No. 154 requires retrospective application to prior periods financial statements of a voluntary change in accounting principle unless it is impractical. APB Opinion No. 20 previously required that most voluntary changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. FAS No. 154 improves the financial reporting because its requirements enhance the consistency of financial reporting between periods. The provisions of FAS No. 154 are effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this standard is not expected to have a material effect on the Bank s results of operations or financial position.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In February 2006, the FASB issued FAS No. 155, *Accounting for Certain Hybrid Instruments, an amendment of FASB Statements No. 133 and 140*. FAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. This statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Bank s results of operations or financial position.

In March 2006, the FASB issued FAS No. 156, *Accounting for Servicing of Financial Assets*. This Statement, which is an amendment to FAS No. 140, will simplify the accounting for servicing assets and liabilities, such as those common with mortgage securitization activities. Specifically, FAS No. 156 addresses the recognition and measurement of separately recognized servicing assets and liabilities and provides an approach to simplify efforts to obtain hedge-like (offset) accounting. FAS No. 156 also clarifies when an obligation to service financial assets should be separately recognized as a servicing asset or a servicing liability, requires that a separately recognized servicing asset or servicing liability be initially measured at fair value, if practicable, and permits an entity with a separately recognized servicing asset or servicing liability to choose either of the amortization or fair value methods for subsequent measurement. The provisions of FAS No. 156 are effective as of the beginning of the first fiscal year that begins after September 15, 2006. The Bank is currently evaluating the impact the adoption of the standard will have on the Bank s results of operations.

In September 2006, the FASB issued FAS No. 157, *Fair Value Measurements*, which provides enhanced guidance for using fair value to measure assets and liabilities. The standard applies whenever other standards require or permit assets or liabilities to be measured at fair value. The Standard does not expand the use of fair value in any new circumstances. FAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. Early adoption is permitted. The adoption of this standard is not expected to have a material effect on the Bank s results of operations or financial position.

In September 2006, the FASB issued FAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Post Retirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R)*. FAS No. 158 requires that a company recognize the overfunded or underfunded status of its defined benefit post retirement plans (other than multiemployer plans) as an asset or liability in its statement of financial position and that it recognize changes in the funded status in the year in which the changes occur through other comprehensive income. FAS No. 158 also requires the measurement of defined benefit plan assets and obligations as of the fiscal year end, in addition to footnote disclosures. FAS No. 158 is effective for fiscal years ending after December 15, 2006. The Bank is currently evaluating the impact the adoption of the standard will have on the Bank s financial position.

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. FIN 48 is an interpretation of FAS No. 109, *Accounting for Income Taxes*, and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN No. 48 requires expanded disclosure with respect to the uncertainty in income taxes and is effective for fiscal years beginning after December 15, 2006. The Bank is currently evaluating the impact the adoption of the standard will have on the Bank s results of operations.

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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements (Continued)

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108), *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements*, providing guidance on quantifying financial statement misstatement and implementation when first applying this guidance. Under SAB No. 108, companies should evaluate a misstatement based on its impact on the current year income statement, as well as the cumulative effect of correcting such misstatements that existed in prior years existing in the current year s ending balance sheet. SAB 108 is effective for fiscal years ending after November 15, 2006. The Bank is currently evaluating the impact the adoption of the standard will have on the Bank s results of operations.

In September 2006, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 06-4 (EITF 06-4), *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*. The guidance is applicable to endorsement split-dollar life insurance arrangements, whereby the employer owns and controls the insurance policy, that are associated with a postretirement benefit. EITF 06-4 requires that for a split-dollar life insurance arrangement within the scope of the Issue, an employer should recognize a liability for future benefits in accordance with FAS No. 106 (if, in substance, a postretirement benefit plan exists) or Accounting Principles Board Opinion No. 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. EITF 06-4 is effective for fiscal years beginning after December 15, 2007. The Bank is currently evaluating the impact the adoption of the standard will have on the Bank s results of operations or financial condition.

In September 2006, the FASB reached consensus on the guidance provided by Emerging Issues Task Force Issue 06-5(EITF 06-5), *Accounting for Purchases of Life Insurance Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, Accounting for Purchases of Life Insurance*. EITF 06-5 states that a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract. EITF 06-5 also states that a policyholder should determine the amount that could be realized under the life insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). EITF 06-5 is effective for fiscal years beginning after December 15, 2006. The Bank is currently evaluating the impact the adoption of the standard will have on the Bank s results of operations or financial condition.

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2. INVESTMENT SECURITIES

The amortized cost and estimated market value of investment securities available for sale and held to maturity are summarized as follows (in thousands):

	2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available for Sale				
Fannie Mae	$ 6,988	$ 33	$ (31)	$ 6,990
Freddie Mac	22,836	3	(523)	22,316
Governmental National Mortgage Association securities	10,503	98		10,601
Total mortgage-backed securities	40,327	134	(554)	39,907
Obligations of states and political subdivisions	6,240	225		6,465
U.S. government agency securities	41,960	35	(180)	41,815
Total debt securities	88,527	394	(734)	88,187
Equity securities	882	64	(11)	935
Total	$ 89,409	$ 458	$ (745)	$ 89,122
Held to Maturity				
Fannie Mae	$ 9,263	$ 4	$ (309)	$ 8,958
Freddie Mac	5,722		(168)	5,554
Total mortgage-backed securities	14,985	4	(477)	14,512
U.S. government agency securities	4,730		(49)	4,681
Total	$ 19,715	$ 4	$ (526)	$ 19,193

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2. INVESTMENT SECURITIES (Continued)

	2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
Available for Sale				
Fannie Mae	$ 1,599	$ 5	$ (24)	$ 1,580
Freddie Mac	17,135	4	(292)	16,847
Governmental National Mortgage Association securities	65		(1)	64
Total mortgage-backed securities	18,799	9	(317)	18,491
Obligations of states and political subdivisions	5,102	275		5,377
U.S. government agency securities	34,989		(260)	34,729
Corporate securities	3,039		(9)	3,030
Total debt securities	61,929	284	(586)	61,627
Equity securities	882	15	(18)	879
Total	$ 62,811	$ 299	$ (604)	$ 62,506
Held to Maturity				
Fannie Mae	$ 11,724	$ 5	$ (131)	$ 11,598
Freddie Mac	5,051	1	(57)	4,995
Total mortgage-backed securities	16,775	6	(188)	16,593
U.S. government agency securities	4,730		(26)	4,704
Total	$ 21,505	$ 6	$ (214)	$ 21,297

The amortized cost and estimated market value of debt securities at September 30, 2006, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	AVAILABLE FOR SALE		HELD TO MATURITY	
	Amortized Cost	Estimated Market Value	Amortized Cost	Estimated Market Value
Due in one year or less	$ 23,479	$ 23,399	$	$
Due after one year through five years	29,608	29,032	11,991	11,655
Due after five years through ten years	2,091	2,114	3,312	3,248
Due after ten years	33,349	33,642	4,412	4,290
Total	$ 88,527	$ 88,187	$ 19,715	$ 19,193

The Bank had no sale of investment securities for the three years ending September 30, 2006.

Investment securities with a carrying value of $6,493,000 and $4,448,000 at September 30, 2006 and 2005, respectively, were pledged to secure public deposits and other purposes as required by law.

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3. UNREALIZED LOSSES ON SECURITIES

The following table shows the Bank s gross unrealized losses and fair value, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position (in thousands):

	2006						
		Less than Twelve Months		Twelve Months or Greater		Total	
	Number of Securities	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses
Fannie Mae	11	$ 3,081	$ (97)	$ 6,730	$ (243)	$ 9,811	$ (340)
Freddie Mac	34	9,911	(69)	15,776	(622)	25,687	(691)
U.S. government agency securities	28	12,898	(32)	27,509	(197)	40,407	(229)
Equity securities	1	489	(11)			489	(11)
Total	74	$ 26,379	$ (209)	$ 50,015	$ (1,062)	$ 76,394	$ (1,271)

	2005						
		Less than Twelve Months		Twelve Months or Greater		Total	
	Number of Securities	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses	Estimated Market Value	Gross Unrealized Losses
Fannie Mae	10	$ 7,104	$ (88)	$ 3,565	$ (67)	$ 10,669	$ (155)
Freddie Mac	28	15,432	(217)	5,779	(132)	21,211	(349)
Governmental National Mortgage Association securities	1	64	(1)			64	(1)
U.S. government agency securities	29	38,440	(279)	993	(7)	39,433	(286)
Corporate securities	3	3,030	(9)			3,030	(9)
Equity securities	1			482	(18)	482	(18)
Total	72	$ 64,070	$ (594)	$ 10,819	$ (224)	$ 74,889	$ (818)

The Bank s investment securities portfolio contains unrealized losses on securities, including mortgage-related instruments issued or backed by the full faith and credit of the United States government, or generally viewed as having the implied guarantee of the U.S. government, and debt obligations of a U.S. state or political subdivision.

The policy of the Bank is to recognize an other-than-temporary impairment of equity securities where the fair value has been significantly below cost for three consecutive quarters. For fixed maturity investments with unrealized losses due to interest rates where the Bank has the positive intent and ability to hold the investment for a period of time sufficient to allow a market recovery, declines in value below cost are not assumed to be other than temporary. The Bank reviews its position quarterly and has asserted that at September 30, 2006, the declines outlined in the above table represent temporary declines and the Bank does have the intent and ability to hold those securities either to maturity or to allow a market recovery.

The Bank has concluded that any impairment of its investment securities portfolio is not other than temporary but is the result of interest rate changes that are not expected to result in the noncollection of principal and interest during the period. However, as of September 30, 2005, the Bank recognized a loss of $130,000 on equity securities that it deemed, through analysis of the security, to be other than a temporary loss.

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4. LOANS RECEIVABLE

Loans receivable consist of the following (in thousands):

	2006	2005
Real estate loans:		
Residential	$ 452,406	$ 421,169
Construction	5,943	7,597
Commercial	47,479	36,984
Commercial	6,159	5,310
Home equity loans and lines of credit	46,796	40,342
Other	4,247	4,204
	563,030	515,606
Less deferred loan fees	2,498	3,062
	560,532	512,544
Less allowance for loan losses	3,855	3,563
Net loans	$ 556,677	$ 508,981

Mortgage loans serviced by the Bank for others amounted to $21,894,000 and $25,554,000 at September 30, 2006 and 2005, respectively.

At September 30, 2006, 2005, and 2004, the Bank had nonaccrual loans of $476,000, $605,000, and $665,000, respectively. Additional interest income that would have been recorded under the original terms of the loan agreements amounted to $37,000, $56,000, and $23,000 for the years ended September 30, 2006, 2005, and 2004.

The Bank s primary business activity is with customers located within its local trade area. Commercial, residential, and consumer loans are granted. The Bank also funds commercial and residential loans originated outside its immediate trade area provided such loans meet the Bank s credit policy guidelines. Although the Bank has a diversified loan portfolio at September 30, 2006 and 2005, loans outstanding to individuals and businesses are dependent upon the local economic conditions in its immediate trade area.

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4. LOANS RECEIVABLE (Continued)

Activity in the allowance for loan losses for the years ended is summarized as follows (in thousands):

	2006	2005	2004
Balance, beginning of period	$ 3,563	$ 3,027	$ 2,509
Add:			
Provision charged to operations	300	550	530
Loan recoveries	1	1	23
	3,864	3,578	3,062
Less loans charged off	(9)	(15)	(35)
Balance, end of period	$ 3,855	$ 3,563	$ 3,027

The Bank has had, and may be expected to have in the future, banking transactions in the ordinary course of business with directors, officers, their immediate families, and affiliated companies (commonly referred to as related parties), on the same terms including interest rates and collateral, as those prevailing at the time for comparable transactions with others. At September 30, 2006 and 2005, these persons were indebted to the Bank for loans totaling $1,750,000 and $1,838,000, respectively. During the year ended September 30, 2006, $82,000 of new loans were made and repayments totaled $170,000.

5. FEDERAL HOME LOAN BANK STOCK

The Bank is a member of the Federal Home Loan Bank System. As a member, the Bank maintains an investment in the capital stock of the FHLB of Pittsburgh in an amount not less than 70 basis points of the outstanding unused FHLB borrowing capacity or 1/20 of its outstanding FHLB borrowings, whichever is greater, as calculated throughout the year.

6. PREMISES AND EQUIPMENT

Premises and equipment consist of the following (in thousands):

	2006	2005
Land and land improvements	$ 2,199	$ 1,816
Buildings and leasehold improvements	10,043	9,896
Furniture, fixtures, and equipment	6,070	5,828
Construction in process	201	121
	18,513	17,661
Less accumulated depreciation	(7,066)	(6,101)
Total	$ 11,447	$ 11,560

Depreciation expense amounted to $985,000, $911,000, and $809,000 for the years ended September 30, 2006, 2005, and 2004, respectively.

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7. DEPOSITS

Deposits and their respective weighted average interest rate consist of the following major classifications (in thousands):

	2006		2005	
	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate	Amount
Non-interest bearing demand accounts	%	$ 23,675	%	$ 21,134
NOW accounts	0.07	59,480	0.09	62,880
Money market accounts	2.78	33,255	1.66	33,749
Savings and club accounts	0.40	76,166	0.40	83,852
Certificates of deposit	4.40	209,577	3.67	173,144
Total	2.59%	$ 402,153	1.94%	$ 374,759

	2006		2005	
	Amount	Weighted Average Interest Rate	Amount	Weighted Average Interest Rate
Time certificates of deposit:				
0.00 - 2.00%	$ 49	1.76%	$ 4,737	1.52%
2.01 - 4.00%	69,429	3.66	117,580	3.31
4.01 - 6.00%	140,096	4.76	50,601	4.70
6.01 - 8.00%	3	6.11	226	6.06
Total	$ 209,577	4.40%	$ 173,144	3.67%

At September 30, scheduled maturities of certificates of deposit are as follows (in thousands):

2007	$ 147,246
2008	29,196
2009	14,907
2010	10,944
2011	7,284
Total	$ 209,577

The aggregate amount of certificates of deposit with a minimum denomination of $100,000 was $81,035,000 and $56,835,000 at September 30, 2006 and 2005, respectively.

The scheduled maturities of time certificates of deposit in denominations of $100,000 or more are as follows (in thousands):

	2006
Within three months	$ 15,157
Three through six months	17,882
Six through twelve months	22,969
Over twelve months	25,027

Total	$ 81,035

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7. DEPOSITS (Continued)

A summary of interest expense on deposits for the years ended is as follows (in thousands):

	2006	2005	2004
NOW accounts	$ 44	$ 79	$ 100
Money market accounts	687	421	245
Savings and club accounts	355	388	442
Certificates of deposits	7,926	4,963	4,224
Total	$ 9,012	$ 5,851	$ 5,011

8. SHORT-TERM BORROWINGS

As of September 30, 2006 and 2005, the Bank had $35,299,000 and $27,479,000 of short-term borrowings, respectively, of which $22,298,000 and $25,479,000, respectively, were advances on a $75,000,000 line of credit with the FHLB.

All borrowings from the FHLB are secured by a blanket lien on qualified collateral, defined principally as investment securities and mortgage loans which are owned by the Bank free and clear of any liens or encumbrances. During 2006, the Bank had a borrowing limit of approximately $496 million, with a variable rate of interest, based on the FHLB s cost of funds.

The following table sets forth information concerning short-term borrowings (in thousands):

	2006	2005
Balance at year-end	$ 35,299	$ 27,479
Maximum amount outstanding at any month-end	35,299	27,479
Average balance outstanding during the year	21,957	18,991
Weighted-average interest rate:		
As of year-end	5.40%	3.84%
Paid during the year	4.92%	2.92%

Average balances outstanding during the year represent daily average balances, and average interest rates represent interest expenses divided by the related average balance.

9. OTHER BORROWINGS

The following table presents contractual maturities of FHLB long-term advances (in thousands):

Description	Maturity range from	Maturity range to	Weighted-average interest rate	Stated interest rate ranged from	Stated interest rate ranged to	2006	2005
Convertible	2/20/2008	8/25/2015	5.46%	4.17%	6.06%	$ 32,000	$ 33,000
Fixed rate	11/15/2006	5/5/2014	4.39	2.49	5.95	147,000	126,000
Mid-term	12/22/2006	9/21/2009	4.56	2.46	5.69	45,000	35,000
Total						$ 224,000	$ 194,000

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9. OTHER BORROWINGS (Continued)

Maturities of FHLB long-term advances are summarized as follows (in thousands):

Year Ending September 30,	Amount	Weighted-average Rate
2007	$ 27,000	3.49%
2008	43,000	4.43
2009	56,000	4.61
2010	20,000	4.74
2011	45,000	5.17
2012 and thereafter	33,000	4.67
Total	$ 224,000	4.57%

Included above are seven convertible notes which total $32,000,000 and are convertible to variable-rate advances on specific dates at the discretion of the FHLB. Should the FHLB convert these advances, the Bank has the option of accepting the variable rate or repaying the advance without penalty.

The advances are secured by qualifying assets of the Bank which include the FHLB stock, securities, and first mortgage loans.

10. INCOME TAXES

The provision for income taxes consists of (in thousands):

	2006	2005	2004
Federal:			
Current	$ 1,737	$ 1,224	$ 989
Deferred	76	159	183
Total	$ 1,813	$ 1,383	$ 1,172

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10. INCOME TAXES (Continued)

The tax effects of deductible and taxable temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows (in thousands):

	2006	2005
Deferred tax assets:		
Allowance for loan losses	$ 1,311	$ 1,211
Net unrealized loss on securities	97	104
Charitable contributions carryover	145	163
Other	135	232
Total gross deferred tax assets	1,688	1,710
Deferred tax liabilities:		
Pension plan	632	468
Mortgage servicing rights	73	86
Premises and equipment	568	652
Other	88	94
Total gross deferred tax liabilities	1,361	1,300
Net deferred tax assets	$ 327	$ 410

No valuation allowance was established at September 30, 2006 and 2005, in view of the Bank s ability to carryback to taxes paid in previous years and certain tax strategies, coupled with the anticipated future taxable income as evidenced by the Bank s earnings potential.

The reconciliation of the federal statutory rate and the Bank s effective income tax rate is as follows (in thousands):

	2006		2005		2004	
	Amount	% of Pre tax Income	Amount	% of Pre tax Income	Amount	% of Pre tax Income
Provision of statutory rate	$ 1,961	34.0%	$ 1,984	34.0%	$ 1,730	34.0%
Income from Bank-owned life insurance	(174)	(3.0)	(168)	(2.9)	(125)	(2.5)
Tax-exempt income	(124)	(2.2)	(117)	(2.0)	(116)	(2.3)
Low-income housing credits	(68)	(1.2)	(72)	(1.2)	(138)	(2.7)
Other, net	218	3.8	(244)	(4.2)	(179)	(3.5)
Actual tax expense and effective rate	$ 1,813	31.4%	$ 1,383	23.7%	$ 1,172	23.0%

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10. INCOME TAXES (Continued)

The Bank is subject to the Pennsylvania Mutual Thrift Institutions Tax that is calculated at 11.5 percent of earnings based on U.S. generally accepted accounting principles with certain adjustments.

Retained earnings include $4,308,000 at September 30, 2006, for which no provision for federal income tax has been made. This amount represents deductions for bad debt reserves for tax purposes which were only allowed to savings institutions which met certain definitional tests prescribed by the Internal Revenue Code of 1986, as amended. The Small Business Job Protection Act of 1996 eliminated the special bad debt deduction granted solely to thrifts. Under the terms of the Act, there would be no recapture of the pre-1988 (base year) reserves. However, these pre-1988 reserves would be subject to recapture under the rules of the Internal Revenue Code if the Bank itself pays a cash dividend in excess of earnings and profits or liquidates. The Act also provides for the recapture of deductions arising from applicable excess reserve: defined as the total amount of reserve over the base year reserve. The Bank s total reserve exceeds the base year reserve and deferred taxes have been provided for this excess.

11. COMMITMENTS

In the normal course of business, management makes various commitments which are not reflected in the consolidated financial statements. These commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheet. The Bank s exposure to credit loss in the event of nonperformance by the other parties to the financial instruments is represented by the contractual amounts as disclosed. Losses, if any, are charged to the allowance for loan losses. The Bank minimizes its exposure to credit loss under these commitments by subjecting them to credit approval and review procedures and collateral requirements, as deemed necessary, in compliance with lending policy guidelines.

The off-balance-sheet commitments consist of the following (in thousands):

	2006	2005
Commitments to extend credit	$ 10,939	$ 10,333
Standby letters of credit	2,758	1,491
Unfunded lines of credit	42,073	42,900

Commitments to extend credit consist of fixed-rate commitments with interest rates ranging from 5.85 percent to 10.25 percent. The commitments outstanding at September 30, 2006, contractually mature in less than one year.

The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheet. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. The amount of collateral obtained, as deemed necessary, is based upon management s credit evaluation in compliance with the lending policy guidelines. Since many of the credit line commitments are expected to expire without being fully drawn upon, the total contractual amounts do not necessarily represent future funding requirements.

Standby letters of credit and financial guarantees represent conditional commitments issued to guarantee performance of a customer to a third party. The coverage period for these instruments is typically a one-year period with renewal option subject to prior approval by management. Fees earned from the issuance of these letters are recognized over the coverage period. For secured letters of credit, the collateral is typically Bank deposit instruments.

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12. LEASE COMMITMENTS AND TOTAL RENTAL EXPENSE

The Bank leases various branch locations and other offices under long-term operating leases. Future minimum lease payments by year and in the aggregate, under noncancellable operating leases with initial or remaining terms of one year or more, consisted of the following at September 30, 2006 (in thousands):

2007	$ 210
2008	181
2009	116
2010	78
2011	56
2012 and beyond	209
Total	$ 850

The total rental expense for the above leases for the years ended September 30, 2006, 2005, and 2004, were $368,000, $343,000, and $361,000, respectively.

13. EMPLOYEE BENEFITS

The Bank sponsors a trusteed, noncontributory defined benefit pension plan covering substantially all employees and officers. The plan calls for benefits to be paid to eligible employees at retirement based primarily upon years of service with the Bank and compensation rates near retirement. The Bank s funding policy is to make annual contributions, if needed, based upon the funding formula developed by the plan s actuary.

Pension Plan

The following table sets forth the status (in thousands):

	2006	2005
Change in benefit obligation		
Benefit obligation at beginning of year	$ 4,966	$ 4,740
Service cost	534	377
Interest cost	397	295
Actuarial loss	873	213
Benefits paid	(696)	(659)
Benefit obligation at end of year	6,074	4,966
Change in plan assets		
Fair value of plan assets at beginning of year	4,322	3,106
Actual return on plan assets	254	456
Employer contribution	1,654	1,419
Benefits paid	(696)	(659)
Fair value of plan assets at end of year	5,534	4,322
Funded status	(540)	(644)
Unrecognized transition adjustment		2
Unrecognized net actuarial loss	2,383	1,499
Unrecognized prior service cost	47	56

Net Prepaid Benefit Cost Recognized	$ 1,890	$ 913

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13. EMPLOYEE BENEFITS (Continued)

Pension Plan (Continued)

The accumulated benefit obligation for the defined benefit pension plan was $3,044,000 and $2,805,000 as of September 30, 2006 and 2005, respectively.

The following table comprises the components of net periodic benefit cost for the years ended (in thousands):

	2006	2005	2004
Service cost	$ 534	$ 377	$ 393
Interest cost	397	295	314
Expected return on plan assets	(387)	(235)	(186)
Amortization of prior service cost	9	9	9
Amortization of unrecognized loss	122	43	84
Amortization of transition obligation	2	3	3
Net periodic benefit cost	$ 677	$ 492	$ 617

Weighted-average assumptions used to determine benefit obligations:

	2006	2005
Discount rate	6.25%	6.25%
Rate of compensation increase	5.50	5.50

Weighted-average assumptions used to determine net periodic benefit cost for years ended:

	2006	2005	2004
Discount rate	6.25%	6.25%	7.00%
Expected long-term return on plan assets	8.00	8.00	8.00
Rate of compensation increase	5.50	5.50	5.50

The expected long-term rate of return was estimated using market benchmarks by which the plan assets would outperform the market in the future, based on historical experience adjusted for changes in asset allocation and expectations for overall lower future returns on similar investments compared to past periods.

Plan Assets

The Bank s pension plan weighted-average asset allocations by asset category are as follows:

	2006	2005
Cash and fixed income securities	35.4%	35.4%
Equity securities	64.6	64.6
Total	100.0%	100.0%

The Bank believes that the plan s risk and liquidity position are, in large part, a function of the asset class mix. The Bank desires to utilize a portfolio mix that results in a balanced investment strategy. Three asset classes are outlined, as above. The target allocations of these classes are as follows: equities, 65 percent; cash and fixed income, 35 percent.

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13. EMPLOYEE BENEFITS (Continued)

Pension Plan (Continued)

The Bank expects to contribute $536,000 to its pension plan in 2007.

Estimated future benefit payments, which reflect expected future service, as appropriate, are as follows (in thousands):

2007	$ 40
2008	42
2009	73
2010	74
2011	80
2012 - 2016	576

401(k) Plan

The Bank also has a savings plan qualified under Section 401(k) of the Internal Revenue Code which covers substantially all employees over 21 years of age. Employees can contribute to the Plan, but are not required to. Employer contributions are allocated based on employee contribution levels. The expense related to the Plan for the years ended September 30, 2006, 2005, and 2004, were $190,000, $152,000, $106,000, respectively.

Supplemental Executive Retirement Plan

On September 15, 2004, the Bank entered into a salary continuation agreement with certain executives of the Bank, which provides for benefits upon retirement to be paid to the executive for no less than 192 months, unless the executive elects to receive the present value of the payments as a lump sum. The Bank has recorded an accrual of $284,000 and $124,000, at September 30, 2006 and September 30, 2005, respectively, which represents the estimated present value (using a discount rate of 7.5 percent) of the benefits earned under this agreement.

14. REGULATORY RESTRICTIONS

The Bank is required to maintain reserve funds in cash or in deposit with the Federal Reserve Bank. The required reserve at September 30, 2006 and 2005, was $4 million and $0, respectively.

15. REGULATORY CAPITAL REQUIREMENTS

Federal regulations require the Bank to maintain certain minimum amounts of capital. Specifically, the Bank is required to maintain certain minimum dollar amounts and ratios of Total and Tier I capital to risk-weighted assets and of Tier I capital to average total assets.

In addition to the capital requirements, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) established five capital categories ranging from well capitalized to critically undercapitalized. Should any institution fail to meet the requirements to be considered adequately capitalized, it would become subject to a series of increasingly restrictive regulatory actions. Management believes as of September 30, 2006, the Bank met all capital adequacy requirements to which they are subject.

As of September 30, 2006 and 2005, the OTS categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be classified as a well capitalized financial institution, Total risk-based, Tier 1 risk-based, core capital, and tangible equity capital ratios must be at least 10 percent, 6 percent, 5 percent, and 1.5 percent, respectively. There have been no conditions or events since the notification that management believes have changed the Bank s category.

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15. REGULATORY CAPITAL REQUIREMENTS (Continued)

The following table reconciles the Bank s capital under U.S. generally accepted accounting principles to regulatory capital (in thousands):

	2006	2005
Total equity	$ 58,337	$ 54,371
Accumulated other comprehensive loss	189	201
Disallowed servicing assets	(193)	(229)
Tier I, core, and tangible capital	58,333	54,343
Allowance for loan losses	3,855	3,563
Unrealized gains on equity securities	24	
Total risk-based capital	$ 62,212	$ 57,906

The Bank s actual capital ratios are presented in the following table (dollars in thousands):

	2006		2005	
	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-Weighted Assets)				
Actual	$ 62,212	15.8%	$ 57,906	15.6%
For Capital Adequacy Purposes	31,557	8.0	32,993	8.0
To Be Well Capitalized	39,446	10.0	37,242	10.0
Tier I Capital (to Risk-Weighted Assets)				
Actual	$ 58,333	14.8%	$ 54,343	14.6%
For Capital Adequacy Purposes	15,778	4.0	14,897	4.0
To Be Well Capitalized	23,667	6.0	22,345	6.0
Tier I Capital (to Average Assets)				
Actual	$ 58,333	8.1%	$ 54,343	8.3%
For Capital Adequacy Purposes	28,959	4.0	26,193	4.0
To Be Well Capitalized	36,199	5.0	32,741	5.0
Tangible Capital (to Adjusted Assets)				
Actual	$ 58,333	8.1%	$ 54,343	8.3%
For Capital Adequacy Purposes	10,859	1.5	9,822	1.5

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16. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair values of the Bank s financial instruments are as follows (in thousands):

	2006		2005	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Cash and cash equivalents	$ 12,730	$ 12,730	$ 20,290	$ 20,290
Investment and mortgage- backed securities:				
Available for sale	89,122	89,122	62,506	62,506
Held to maturity	19,715	19,193	21,505	21,297
Loans receivable, net	556,677	554,405	508,981	508,162
Accrued interest receivable	3,185	3,185	2,655	2,655
FHLB stock	13,675	13,675	11,916	11,916
Mortgage servicing rights	215	244	253	253
Bank-owned life insurance	13,376	13,376	12,864	12,864
Financial liabilities:				
Deposits	$ 402,153	$ 401,035	$ 374,759	$ 373,662
Short-term borrowings	35,299	35,299	27,479	27,479
Other borrowings	224,000	224,495	194,000	191,652
Advances by borrowers for taxes and insurance	2,198	2,198	1,591	1,591
Accrued interest payable	1,399	1,399	848	848

Financial instruments are defined as cash, evidence of an ownership interest in an entity, or a contract which creates an obligation or right to receive or deliver cash or another financial instrument from/to a second entity on potentially favorable or unfavorable terms.

Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties other than in a forced or liquidation sale. If a quoted market price is available for a financial instrument, the estimated fair value would be calculated based upon the market price per trading unit of the instrument.

If no readily available market exists, the fair value estimates for financial instruments should be based upon management s judgment regarding current economic conditions, interest rate risk, expected cash flows, future estimated losses, and other factors as determined through various option pricing formulas or simulation modeling.

As many of these assumptions result from judgments made by management based upon estimates which are inherently uncertain, the resulting estimated values may not be indicative of the amount realizable in the sale of a particular financial instrument. In addition, changes in the assumptions on which the estimated values are based may have a significant impact on the resulting estimated values.

As certain assets and liabilities, such as deferred tax assets, premises and equipment, and many other operational elements of the Bank, are not considered financial instruments but have value, this estimated fair value of financial instruments would not represent the full market value of the Bank.

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16. FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

The Bank employed simulation modeling in determining the estimated fair value of financial instruments for which quoted market prices were not available based upon the following assumptions:

Cash and Cash Equivalents, Accrued Interest Receivable, Short-Term Borrowings, Advances by Borrowers for Taxes and Insurance, and Accrued Interest Payable

The fair value approximates the current book value.

Bank-Owned Life Insurance

The fair value is equal to the cash surrender value of the Bank-owned life insurance.

Investment and Mortgage-Backed Securities Available for Sale and Held to Maturity and FHLB Stock

The fair value of investment and mortgage-backed securities available for sale is equal to the available quoted market price. If no quoted market price is available, fair value is estimated using the quoted market price for similar securities. Since the FHLB stock is not actively traded on a secondary market and held exclusively by member financial institutions, the estimated fair market value approximates the carrying amount.

Loans Receivable, Deposits, Other Borrowings, and Mortgage Servicing Rights

The estimated fair values for loans and mortgage servicing rights are estimated by discounting contractual cash flows and adjusting for prepayment estimates. Discount rates are based upon rates generally charged for such loans with similar characteristics. Demand, savings, and money market deposit accounts are valued at the amount payable on demand as of year end. Fair values for time deposits and other borrowings are estimated using a discounted cash flow calculation that applies contractual costs currently being offered in the existing portfolio to current market rates being offered for deposits and borrowings of similar remaining maturities.

Commitments to Extend Credit

These financial instruments are generally not subject to sale, and estimated fair values are not readily available. The carrying value, represented by the net deferred fee arising from the unrecognized commitment, and the fair value, determined by discounting the remaining contractual fee over the term of the commitment using fees currently charged to enter into similar agreements with similar credit risk, are not considered material for disclosure. The contractual amounts of unfunded commitments are presented in Note 11.

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17. PLAN OF REORGANIZATION AND STOCK ISSUANCE

On July 25, 2006, the Board of Directors of the Bank unanimously adopted a Plan of Conversion (the Plan) pursuant to which the Bank will convert into a Pennsylvania chartered stock savings association (the Stock Savings Association) and form ESSA Bancorp, Inc., a Pennsylvania chartered company (the Stock Holding Company). The newly chartered Stock Holding Company will offer shares of its common stock to the Bank s eligible account holders, to the Bank s tax-qualified employee benefit plans, and, if necessary, to the general public in accordance with the priorities set forth in the Plan. The Plan is subject to the approval of the OTS, the Pennsylvania Department of Banking, as well as the Members of the Bank, as set forth in the Plan.

Following the sale of common stock, all depositors who had membership or liquidation rights with respect to the Bank as of the effective date of the transaction will continue to have such rights solely with respect to the Stock Savings Association as long as they continue to hold deposit accounts with the Bank. In addition, all persons who become depositors of the Bank subsequent to the date of the transaction will have such membership and liquidation rights with respect to the Stock Savings Association. Borrowers of the Bank as of the date of the transaction will have the same membership rights in the Stock Savings Association that they had in the Bank immediately prior to the date of the transaction as long as their existing borrowings remain outstanding.

The regulations of the OTS prohibit the Bank from declaring or paying a cash dividend if the effect thereof would cause the Bank s regulatory capital to be reduced below either the amount required for the liquidation account or the federal regulatory capital requirement in section 567.2 of the Rules and Regulations of the OTS.

Costs associated with the conversion will be deferred and deducted from the proceeds of the stock offering. If, for any reason, the offering is not successful, the deferred costs will be charged to operations. As of September 30, 2006, there was approximately $119,000 of costs incurred with the conversion.

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You should rely only on the information contained in this document or that to which we have referred you. No person has been authorized to give any information or to make any representation other than as contained in this prospectus and, if given or made, such other information or representation must not be relied upon as having been authorized by ESSA Bancorp, Inc. or ESSA Bank & Trust. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any of the securities offered hereby to any person in any jurisdiction in which such offer or solicitation is not authorized or in which the person making such offer or solicitation is not qualified to do so, or to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction. Neither the delivery of this prospectus nor any sale hereunder shall under any circumstances create any implication that there has been no change in the affairs of ESSA Bancorp, Inc. or ESSA Bank & Trust since any of the dates as of which information is furnished herein or since the date hereof.

ESSA Bancorp, Inc.

(Proposed Holding Company for

ESSA Bank & Trust)

12,650,000 Shares of

Common Stock

Par value $0.01 per share

(Subject to Increase to up to 14,547,500)

PROSPECTUS

Ryan Beck & Co., Inc.

Until __________ or 25 days after commencement of the syndicated community offering, if any, whichever is later, all dealers effecting transactions in the registered securities, whether or not participating in this distribution, may be required to deliver a prospectus. This is in addition to the dealers obligation to deliver the prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

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PART II: INFORMATION NOT REQUIRED IN PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution

		Amount(1)
*	Registrant s Legal Fees and Expenses	$ 450,000
*	Marketing Agent Legal Fees and Expenses	75,000
*	Registrant s Accounting Fees and Expenses	120,000
*	Conversion Agent and Data Processing Fees	50,000
*	Marketing Agent Fees and Expenses	1,221,753
*	Appraisal and Business Plan Fees and Expenses	127,000
*	Printing, Postage and Mailing	225,000
*	Filing Fees (OTS, NASD, Nasdaq and SEC)	132,783
*	Other	18,464
*	Total	$ 2,420,000

* Estimated

(1) ESSA Bancorp, Inc. has retained Ryan Beck & Co., Inc. to assist in the sale of common stock on a best efforts basis in the offerings. Fees are estimated at the midpoint of the offering range.

Item 14. Indemnification of Directors and Officers

Indemnification of Directors and Officers of ESSA Bank & Trust. Article VI of the bylaws of ESSA Bank & Trust, set forth circumstances under which directors, officers, employees and agents of ESSA Bank & Trust may be insured or indemnified against liability which they incur in their capacities as such:

Article VI; Indemnification and Liability of Directors and Officers

Section 1. Personal Liability of Directors. A director of ESSA Bank & Trust shall not be personally liable for monetary damages for any action taken, or any failure to take any action, as a director except to the extent that by law (including the Director s Liability Act, 42 Pa. C.S. 8361 et seq.) a director s liability for monetary damages may not be limited.

Section 2. Indemnification. The Bank shall indemnify in accordance with its Indemnification Policy any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, including actions by or in the right of ESSA Bank & Trust, whether civil, criminal, administrative or investigative, by reason of the fact that such a person is or was a director or officer of ESSA Bank & Trust, or is or was serving while a director or officer of ESSA Bank & Trust and at the request of ESSA Bank & Trust, as a director, officer, employee, agent, fiduciary or other representative of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, against expenses (including attorneys fees), judgments, fines, excise taxes and amounts paid n settlement actually and reasonable incurred by such person in connection with such action, suit or proceeding to the full extent permissible under Pennsylvania law.

Section 3. Advancement of Expenses. Reasonable expenses incurred by an officer or director of ESSA Bank & Trust in defending a civil or criminal action, suit or proceeding described in Section 2 shall be paid by ESSA Bank & Trust in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such person to repay such amount if it shall ultimately be determined that the person is not entitled to be indemnified by ESSA Bank & Trust.

Section 4. Other Rights. The indemnification and advancement of expenses provided by or pursuant to this Article shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled**,** any insurance or other agreement, vote of shareholders or directors or otherwise, both as to actions in their official capacity and as to actions in another capacity while holding an office, and shall continue as a person who has ceased to be a director or officer and shall inure to the benefit of the heirs, executors and administrators of such person.

Section 5. Insurance. The Bank shall have the power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of ESSA Bank & Trust, or is or was serving at the request of ESSA Bank & Trust as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, against any liability asserted against him/her and incurred by him/her in any such capacity, or arising out of his/her status as such, whether or not ESSA Bank & Trust should have the power to indemnify him/her against such liability under the provisions of these By-Laws.

Section 6. Security Fund; Indemnity Agreements. By action of the Board of Directors (notwithstanding their interest in the transaction) ESSA Bank & Trust may create and fund a trust or fund of any nature, any may enter into agreements with its officers and directors, for the purpose of securing or insuring in any manner its obligation to indemnify or advance expenses provided for in this Article.

Section 7. Modification. The duties of ESSA Bank & Trust to indemnify and to advance expenses to a director or officer provided in this Article shall be in the nature of a contract between ESSA Bank & Trust and each such director or officer, and no amendment or repeal of any provision of the Article, and no amendment or termination of any trust or other fund created pursuant to Section 6 shall alter, the detriment of such director or officer, the right of such person to the advance of expenses or indemnification related to a claim based on an act or failure to act which took place prior to such amendment, repeal or termination.

Indemnification of Directors and Officers of ESSA Bancorp, Inc. Article VI of the bylaws of ESSA Bancorp, Inc., a Pennsylvania corporation, set forth circumstances under which directors, officers, employees and agents of ESSA Bancorp, Inc. may be insured or indemnified against liability which they incur in their capacities as such:

Article VI; Indemnification

6.1 Persons Covered. Subject to, and in accordance with, the provisions of this Article VI, ESSA Bancorp, Inc. shall indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending, or completed action, suit, or proceeding, including actions by or in the right of ESSA Bancorp, Inc., whether civil, criminal, administrative, or investigative, by reason of the fact that such person is or was a director, officer, employee, fiduciary, trustee, or agent of ESSA Bancorp, Inc., or is or was serving at the request of ESSA Bancorp, Inc. as a director, officer, employee, fiduciary, trustee, or agent of another corporation, partnership, joint venture, trust, or other enterprise.

6.2 Derivative Actions.

(a) In the case of a threatened, pending, or completed action or suit by or in the right of ESSA Bancorp, Inc. against a person named in Section 6.1 by reason of such person holding a position named in Section 6.1, ESSA Bancorp, Inc. shall indemnify such person if such person satisfies the standard in Section 6.2(b), for expenses (including attorneys fees) actually and reasonably incurred by such person in connection with the defense or settlement of the action or suit.

(b) In the case of a threatened, pending, or completed action or suit by or in the right of ESSA Bancorp, Inc., a person named in Section 6.1 shall be indemnified only if:

(1) such person is successful on the merits or otherwise; or

(2) such person acted in good faith in the transaction that is the subject of the suit or action, and in a manner reasonably believed to be in, or not opposed to, the best interests of ESSA Bancorp, Inc. However, such person shall not be indemnified in respect of any claim, issue, or matter as to which such person has been adjudged liable to ESSA Bancorp, Inc. unless (and only to the extent that) the court of common pleas or the court in which the suit was brought shall determine, upon application, that despite the adjudication of liability but in view of all the circumstances, such person is fairly and reasonably entitled to indemnity for such expenses as the court shall deem proper.

6.3 Third-Party Actions.

(a) In case of a threatened, pending, or completed suit, action, or proceeding (whether civil, criminal, administrative, or investigative), other than a suit by or in the right of ESSA Bancorp, Inc., together hereafter referred to as a third-party action, against a person named in Section 6.1 by reason of such person holding a position named in Section 6.1, ESSA Bancorp, Inc. shall indemnify such person if such person satisfies the standard in Section 6.3(b), for amounts actually and reasonably incurred by such person in connection with the defense or settlement of the third-party action, including, but not limited to (i) expenses (including attorneys fees), (ii) amounts paid in settlement, (iii) judgments, and (iv) fines.

(b) In case of a third-party action, a person named in Section 6.1 shall be indemnified only if:

(1) such person is successful on the merits or otherwise; or

(2) such person acted in good faith in the transaction that is the subject of the third-party action and in a manner such person reasonably believed to be in, or not opposed to, the best interests of the Corporation and, with respect to any criminal action or proceeding, such person had no reasonable cause to believe such person s conduct was unlawful. The termination of a third-party action by judgment, order, settlement, conviction, or upon a pleas of nolo contendere or its equivalent shall not, in itself, create a presumption that the person failed to satisfy the standard of this Section 6.3(b).

6.4 Determination That Standard Has Been Met. A determination that the standard of either Section 6.2(b) or 6.3(b) has been satisfied may be made by a court, or, except as stated in the record sentence of Section 6.2(b), the determination may be made by:

(1) the Board of Directors by a majority vote of a quorum consisting of directors of ESSA Bancorp, Inc. who were not parties to the action, suit, or proceeding;

(2) if such a quorum is not obtainable or if obtainable and a majority of a quorum of disinterested directors so directs, by independent legal counsel in a written opinion; or

(3) the shareholders of ESSA Bancorp, Inc.

6.5 Proration. Anyone making a determination under Section 6.4 may determine that a person has met the standard as to some matters but not as to others, and may reasonably prorate amounts to be indemnified.

6.6 Advancement of Expenses. Reasonable expenses incurred by a director, officer, employee, or agent of ESSA Bancorp, Inc. in defending a civil or criminal action, suit, or proceeding described in Section 6.1 shall be paid by ESSA Bancorp, Inc. in advance of the final disposition of such action, suit, or proceeding upon receipt of an undertaking by or on behalf of such person to repay such amount if it shall ultimately be determined that the person is not entitled to be indemnified by ESSA Bancorp, Inc.

6.7 Other Rights. The indemnification and advancement of expenses provided by or pursuant to this Article VI shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any insurance or other agreement, vote of shareholders or directors, or otherwise, both as to actions in their official capacity and as to actions in another capacity while holding an office, and shall continue as to a person who has ceased to be a director, officer, employee, or agent and shall inure to the benefit of the heirs, executors, and administrators of such person.

6.8 Insurance. The Corporation shall have the power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee, director, officer, employee, or agent of another corporation, partnership, joint venture, trust, or other enterprise, against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person s status as such, whether or not ESSA Bancorp, Inc. would have the power to indemnify such person against such liability under the provisions of this Article VI.

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6.9 Security Fund; Indemnity Agreements. By action of the Board of Directors (notwithstanding their interest in the transaction), ESSA Bancorp, Inc. may create and fund a trust fund or fund of any nature, and may enter into agreements with its officers, directors, employees, and agents for the purpose of securing or insuring in any manner its obligation to indemnify or advance expenses provided for in this Article VI.

6.10 Modification. The duties of ESSA Bancorp, Inc. to indemnify and to advance expenses to any person as provided in this Article VI shall be in the nature of a contract between ESSA Bancorp, Inc. and each such person, and no amendment or repeal of any provision of this Article VI, and no amendment or termination of any trust fund or other fund created pursuant to Section 6.9 hereof, shall alter to the detriment of such person the right of such person to the advancement of expenses or indemnification related to a claim based on an act or failure to act which took place prior to such amendment, repeal, or termination.

6.11 Proceedings Initiated by Indemnified Persons. Notwithstanding any other provision in this Article VI, ESSA Bancorp, Inc. shall not indemnify a director, officer, employee, or agent for any liability incurred in an action, suit, or proceeding initiated by (which shall not be deemed to include counter-claims or affirmative defenses) or participated in as an intervenor or amicus curiae by the person seeking indemnification unless such initiation of or participation in the action, suit, or proceeding is authorized, either before or after its commencement, by the affirmative vote of a majority of the directors then in office.

6.12 Savings Clause. If this Article VI or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then ESSA Bancorp, Inc. shall nevertheless indemnify each director, officer, employee, and agent of ESSA Bancorp, Inc. as to costs, charges, and expenses (including attorneys fees), judgments, fines, and amounts paid in settlement with respect to any action, suit, or proceeding, whether civil, criminal, administrative, or investigative, including an action by or in the right of ESSA Bancorp, Inc., to the fullest extent permitted by any applicable portion of this Article VI that shall not have been invalidated and to the fullest extent permitted by applicable law.

If the laws of the Commonwealth of Pennsylvania are amended to permit further indemnification of the directors, officers, employees, and agents of ESSA Bancorp, Inc., then ESSA Bancorp, Inc. shall indemnify such persons to the fullest extent permitted by law. Any repeal or modification of this Article VI by the Board of Directors or the shareholders of ESSA Bancorp, Inc. shall not adversely affect any right or protection of a director, officer, employee, or agent existing at the time of such repeal or modification.

Item 15. Recent Sales of Unregistered Securities

Not Applicable.

Item 16. Exhibits and Financial Statement Schedules:

The exhibits and financial statement schedules filed as part of this registration statement are as follows:

(a) List of Exhibits

1.1 Engagement Letter between ESSA Bank & Trust and Ryan Beck & Co., Inc.

1.2 Form of Agency Agreement between ESSA Bank & Trust, ESSA Bancorp, Inc., and Ryan Beck & Co., Inc. *

2 Plan of Conversion

3.1 Articles of Incorporation of ESSA Bancorp, Inc.

3.2 Bylaws of ESSA Bancorp, Inc.

4 Form of Common Stock Certificate of ESSA Bancorp, Inc.

5 Opinion of Luse Gorman Pomerenk & Schick regarding legality of securities being registered

8	Federal Tax Opinion of Luse Gorman Pomerenk & Schick
10.1	Form of Employee Stock Ownership Plan

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10.2	Form of Employment Agreement for Chief Executive Officer
10.3	Form of Employment Agreement for Executive Officers
10.4	Form of Change in Control Agreement
10.5	Director Emeritus Plan
10.6	Supplemental Retirement Plan for Gary S. Olson
10.7	Supplemental Retirement Plan for Robert S. Howes, Jr.
10.8	Supplemental Retirement Plan for Diane K. Reimer
10.9	Supplemental Retirement Plan for Thomas J. Grayuski
21	Subsidiaries of Registrant
23.1	Consent of Luse Gorman Pomerenk & Schick (contained in Opinions included as Exhibits 5 and 8)
23.2	Consent of S.R. Snodgrass, A.C.
23.3	Consent of Beard Miller Company LLP
23.4	Consent of RP Financial, LC.
24	Power of Attorney (set forth on signature page)
99.1	Appraisal Agreement between ESSA Bank & Trust and RP Financial, LC.
99.2	Letter of RP Financial, LC. with respect to Subscription Rights
99.3	Appraisal Report of RP Financial, LC.**
99.4	Marketing Materials*
99.5	Order and Acknowledgment Form*

* To be filed supplementally or by amendment.

** Supporting financial schedules filed pursuant to Rule 202 of Regulation S-T.

(b) Financial Statement Schedules

No financial statement schedules are filed because the required information is not applicable or is included in the consolidated financial statements or related notes.

Item 17. Undertakings

The undersigned Registrant hereby undertakes:

(1) To file, during any period in which it offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20 percent change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective registration statement;

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement.

(2) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

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(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act, and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Stroudsburg, Commonwealth of Pennsylvania on December 7, 2006.

ESSA BANCORP, INC.

By: /s/ Gary S. Olson
Gary S. Olson
Chief Executive Officer and President
(Duly Authorized Representative)

POWER OF ATTORNEY

We, the undersigned directors and officers of ESSA Bancorp, Inc. (the Company) hereby severally constitute and appoint Gary S. Olson as our true and lawful attorney and agent, to do any and all things in our names in the capacities indicated below which said Gary S. Olson may deem necessary or advisable to enable the Company to comply with the Securities Act of 1933, and any rules, regulations and requirements of the Securities and Exchange Commission, in connection with the registration statement on Form S-1 relating to the offering of the Company s common stock, including specifically, but not limited to, power and authority to sign for us in our names in the capacities indicated below the registration statement and any and all amendments (including post-effective amendments) thereto; and we hereby approve, ratify and confirm all that said Gary S. Olson shall do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates indicated.

Signatures	Title	Date
/s/ Gary S. Olson	President, Chief Executive Officer and Director (Principal Executive Officer)	December 7, 2006
Gary S. Olson		
/s/ Allan A. Muto	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	December 7, 2006
Allan A. Muto		
/s/ John E. Burrus	Director	December 7, 2006
John E. Burrus		
/s/ William P. Douglass	Director	December 7, 2006
William P. Douglass		
/s/ Daniel J. Henning	Director	December 7, 2006
Daniel J. Henning		

/s/ Frederick E. Kutteroff	Director	December 7, 2006
Frederick E. Kutteroff		
/s/ Robert C. Selig, Jr.	Director	December 7, 2006
Robert C. Selig, Jr.		
/s/ John S. Schoonover, Jr.	Director	December 7, 2006
John S. Schoonover, Jr.		
/s/ William A. Viechnicki, D.D.S.	Director	December 7, 2006
William A. Viechnicki, D.D.S.		
/s/ Elizabeth B. Weeks	Director	December 7, 2006
Elizabeth B. Weekes		