CHEMUNG FINANCIAL CORP
Form 10-Q
October 31, 2018

UNITED STATES
SECURITIES AND
EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 10-Q

| | |
|---|---|
| [X] | QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 |

For Quarterly period ended September 30, 2018
Or

| | |
|---|---|
| [ ] | TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 |

Commission File No.
000-13888
CHEMUNG FINANCIAL CORPORATION
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| New York | 16-1237038 |
| (State or other jurisdiction of incorporation or organization) | I.R.S. Employer Identification No. |
| | |
| One Chemung Canal Plaza, Elmira, NY | 14901 |
| (Address of principal executive offices) | (Zip Code) |

(607) 737-3711 or (800) 836-3711
(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: X NO:____

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
YES: X NO:____

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

| | | | |
|---|---|---|---|
| Large accelerated filer | [ ] | Non-accelerated filer | [ ] |
| Accelerated filer | [X] | Smaller reporting company | [X] |
| | | Emerging growth company | [ ] |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):
YES: NO: X

The number of shares of the registrant's common stock, $.01 par value, outstanding on October 30, 2018 was 4,806,864.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

INDEX

## GLOSSARY OF ABBREVIATIONS AND TERMS

To assist the reader the Corporation has provided the following list of commonly used abbreviations and terms included in the Notes to the Unaudited Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

| Abbreviations | |
|---|---|
| ALCO | Asset-Liability Committee |
| ASU | Accounting Standards Update |
| Bank | Chemung Canal Trust Company |
| Basel III | The Third Basel Accord of the Basel Committee on Banking Supervision |
| Board of Directors | Board of Directors of Chemung Financial Corporation |
| CDARS | Certificate of Deposit Account Registry Service |
| CDO | Collateralized Debt Obligation |
| CECL | Current expected credit loss |
| CFS | CFS Group, Inc. |
| Corporation | Chemung Financial Corporation |
| CRM | Chemung Risk Management, Inc. |
| Dodd-Frank Act | The Dodd-Frank Wall Street Reform and Consumer Protection Act |
| EPS | Earnings per share |
| Exchange Act | Securities Exchange Act of 1934 |
| FASB | Financial Accounting Standards Board |
| FDIC | Federal Deposit Insurance Corporation |
| FHLBNY | Federal Home Loan Bank of New York |
| FRB | Board of Governors of the Federal Reserve System |
| FRBNY | Federal Reserve Bank of New York |
| Freddie Mac | Federal Home Loan Mortgage Corporation |
| GAAP | U.S. Generally Accepted Accounting Principles |
| ICS | Insured Cash Sweep Service |
| IFRS | International Financial Reporting Standards |
| MD&A | Management's Discussion and Analysis of Financial Condition and Results of Operations |
| NAICS | North American Industry Classification System |
| N/M | Not meaningful |
| OPEB | Other postemployment benefits |
| OREO | Other real estate owned |
| OTTI | Other-than-temporary impairment |
| PCI | Purchased credit impaired |
| ROA | Return on average assets |
| Regulatory Relief Act | Economic Growth, Regulatory Relief, and Consumer Protection Act |
| ROE | Return on average equity |
| RWA | Risk-weighted assets |
| SBA | Small Business Administration |
| SEC | Securities and Exchange Commission |
| Securities Act | Securities Act of 1933 |
| Tax Act | Tax Cuts and Jobs Act of 2017 |
| TDRs | Troubled debt restructurings |
| WMG | Wealth Management Group |

3

| Terms | |
|---|---|
| Allowance for loan losses to total loans | Represents period-end allowance for loan losses divided by retained loans. |
| Assets under administration | Represents assets that are beneficially owned by clients and all investment decisions pertaining to these assets are also made by clients. |
| Assets under management | Represents assets that are managed on behalf of clients. |
| Basel III | A comprehensive set of reform measures designed to improve the regulation, supervision, and risk management within the banking sector. The reforms require banks to maintain proper leverage ratios and meet certain capital requirements. |
| Benefit obligation | Refers to the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for OPEB plans. |
| Capital Bank | Division of Chemung Canal Trust Company located in the "Capital Region" of New York State and includes the counties of Albany and Saratoga. |
| CDARS | Product involving a network of financial institutions that exchange certificates of deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution. |
| Captive insurance company | A company that provides risk-mitigation services for its parent company. |
| Collateralized debt obligation | A structured financial product that pools together cash flow-generating assets, such as mortgages, bonds, and loans. |
| Collateralized mortgage obligations | A type of mortgage-backed security with principal repayments organized according to their maturities and into different classes based on risk. The mortgages serve as collateral and are organized into classes based on their risk profile. |
| Dodd-Frank Act | The Dodd-Frank Act was enacted on July 21, 2010 and significantly changed the bank regulatory landscape and has impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. |
| Fully taxable equivalent basis | Income from tax-exempt loans and investment securities that have been increased by an amount equivalent to the taxes that would have been paid if this income were taxable at statutory rates; the corresponding income tax impact related to tax-exempt items is recorded within income tax expense. |
| GAAP | Accounting principles generally accepted in the United States of America. |
| Holding company | Consists of the operations for Chemung Financial Corporation (parent only). |
| ICS | Product involving a network of financial institutions that exchange interest-bearing money market deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution. |
| Loans held for sale | Residential real estate loans originated for sale on the secondary market with maturities from 15-30 years. |
| Long term lease obligation | An obligation extending beyond the current year, which is related to a long term capital lease that is considered to have the economic characteristics of asset ownership. |
| Mortgage-backed securities | A type of asset-backed security that is secured by a collection of mortgages. |
| Municipal clients | A political unit, such as a city, town, or village, incorporated for local self-government. |

| | |
|---|---|
| N/A | Data is not applicable or available for the period presented. |
| N/M | Not meaningful. |
| Non-GAAP | A calculation not made according to GAAP. |
| Obligations of state and political subdivisions | An obligation that is guaranteed by the full faith and credit of a state or political subdivision that has the power to tax. |
| Obligations of U.S. Government | A federally guaranteed obligation backed by the full power of the U.S. government, including Treasury bills, Treasury notes and Treasury bonds. |

| | |
|---|---|
| Obligations of U.S. Government sponsored enterprise obligations | Obligations of agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government. |
| OREO | Represents real property owned by the Corporation, which is not directly related to its business and is most frequently the result of a foreclosure on real property. |
| OTTI | Impairment charge taken on a security whose fair value has fallen below the carrying value on the balance sheet and whose value is not expected to recover through the holding period of the security. |
| PCI loans | Represents loans that were acquired in the Fort Orange Financial Corp. transaction and deemed to be credit-impaired on the acquisition date in accordance with the guidance of FASB. |
| Political subdivision | A county, city, town, or other municipal corporation, a public authority, or a publicly-owned entity that is an instrumentality of a state or a municipal corporation. |
| Pre-provision profit/(loss) | Represents total net revenue less noninterest expense, before income tax expense (benefit). The Corporation believes that this financial measure is useful in assessing the ability of a bank to generate income in excess of its provision for credit losses. |
| Regulatory Relief Act | The Economic Growth, Regulatory Relief and Consumer Protection Act was enacted on May 24, 2018 provides certain limited amendments to the Dodd-Frank Act, as well as certain targeted modifications to other post-financial crisis regulatory requirements. In addition, the legislation establishes new consumer protections and amends various securities- and investment company-related requirements. |
| RWA | Risk-weighted assets consist of on- and off-balance sheet assets that are assigned to one of several broad risk categories and weighted by factors representing their risk and potential for default. On-balance sheet assets are risk-weighted based on the perceived credit risk associated with the obligor or counterparty, the nature of any collateral, and the guarantor, if any. Off-balance sheet assets such as lending-related commitments, guarantees, derivatives and other applicable off-balance sheet positions are risk-weighted by multiplying the contractual amount by the appropriate credit conversion factor to determine the on-balance sheet credit equivalent amount, which is then risk-weighted based on the same factors used for on-balance sheet assets. Risk-weighted assets also incorporate a measure for market risk related to applicable trading assets-debt and equity instruments. The resulting risk-weighted values for each of the risk categories are then aggregated to determine total risk-weighted assets. |
| SBA loan pools | Business loans partially guaranteed by the SBA. |
| Securities sold under agreements to repurchase | Sale of securities together with an agreement for the seller to buy back the securities at a later date. |
| Tax Act | The Tax Act was enacted on December 22, 2017 and amended the Internal Revenue Code of 1986. The legislation reduced the U.S. federal corporate income tax rate from 35 percent to 21 percent, with some related business deductions and credits being either reduced or eliminated. |
| TDR | A TDR is deemed to occur when the Corporation modifies the original terms of a loan agreement by granting a concession to a borrower that is experiencing financial difficulty. |
| Trust preferred securities | A hybrid security with characteristics of both subordinated debt and preferred stock which allows for early redemption by the issuer, makes fixed or variable payments, and matures at face value. |
| Unaudited | Financial statements and information that have not been subjected to auditing procedures sufficient to permit an independent certified public accountant to express an opinion. |
| WMG | Provides services as executor and trustee under wills and agreements, and guardian, custodian, trustee and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, financial planning, pension, estate planning and employee benefit administration services. |

5

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| (in thousands, except share and per share data) | September 30, 2018 | December 31, 2017 |
|---|---|---|
| ASSETS | | |
| Cash and due from financial institutions | $ 31,831 | $ 27,966 |
| Interest-earning deposits in other financial institutions | 82,081 | 2,763 |
| Total cash and cash equivalents | 113,912 | 30,729 |
| | | |
| Equity investments, at estimated fair value | 1,987 | 2,337 |
| Securities available for sale, at estimated fair value | 246,473 | 293,091 |
| Securities held to maturity, estimated fair value of $4,190 at September 30, 2018 and $3,776 at December 31, 2017 | 4,203 | 3,781 |
| FHLBNY and FRBNY Stock, at cost | 3,138 | 5,784 |
| | | |
| Loans, net of deferred loan fees | 1,320,638 | 1,311,824 |
| Allowance for loan losses | (19,635) | (21,161) |
| Loans, net | 1,301,003 | 1,290,663 |
| | | |
| Loans held for sale | 1,715 | 542 |
| Premises and equipment, net | 25,514 | 26,657 |
| Goodwill | 21,824 | 21,824 |
| Other intangible assets, net | 1,527 | 2,085 |
| Bank-owned life insurance | 3,032 | 2,982 |
| Accrued interest receivable and other assets | 29,536 | 27,145 |
| | | |
| Total assets | $ 1,753,864 | $ 1,707,620 |
| | | |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Deposits: | | |
| Non-interest-bearing | $ 469,887 | $ 467,610 |
| Interest-bearing | 1,106,110 | 999,836 |
| Total deposits | 1,575,997 | 1,467,446 |
| | | |
| FHLBNY overnight advances | — | 57,700 |
| Securities sold under agreements to repurchase | — | 10,000 |
| FHLBNY term advances | — | 2,000 |
| Long term capital lease obligation | 4,358 | 4,517 |
| Dividends payable | 1,249 | 1,233 |
| Accrued interest payable and other liabilities | 15,761 | 14,911 |
| Total liabilities | 1,597,365 | 1,557,807 |
| | | |
| Shareholders' equity: | | |
| Common stock, $0.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at September 30, 2018 and December 31, 2017 | 53 | 53 |
| Additional paid-in capital | 46,006 | 45,967 |
| Retained earnings | 138,654 | 128,453 |

| | | |
|---|---|---|
| Treasury stock, at cost; 504,676 shares at September 30, 2018 and 559,094 shares at December 31, 2017 | (12,927 ) | (14,320 ) |
| Accumulated other comprehensive loss | (15,287 ) | (10,340 ) |
| Total shareholders' equity | 156,499 | 149,813 |
| | | |
| Total liabilities and shareholders' equity | $ 1,753,864 | $ 1,707,620 |

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands, except per share data) | 2018 | 2017 | 2018 | 2017 |
| Interest and dividend income: | | | | |
| Loans, including fees | $14,580 | $13,709 | $42,930 | $39,025 |
| Taxable securities | 1,200 | 1,369 | 3,753 | 4,189 |
| Tax exempt securities | 272 | 322 | 875 | 836 |
| Interest-earning deposits | 84 | 97 | 116 | 445 |
| Total interest and dividend income | 16,136 | 15,497 | 47,674 | 44,495 |
| Interest expense: | | | | |
| Deposits | 858 | 545 | 1,967 | 1,632 |
| Securities sold under agreements to repurchase | — | 95 | 137 | 383 |
| Borrowed funds | 199 | 94 | 574 | 273 |
| Total interest expense | 1,057 | 734 | 2,678 | 2,288 |
| Net interest income | 15,079 | 14,763 | 44,996 | 42,207 |
| Provision for loan losses | 300 | 1,289 | 3,371 | 2,750 |
| Net interest income after provision for loan losses | 14,779 | 13,474 | 41,625 | 39,457 |
| | | | | |
| Non-interest income: | | | | |
| WMG fee income | 2,406 | 2,147 | 7,095 | 6,525 |
| Service charges on deposit accounts | 1,231 | 1,269 | 3,539 | 3,678 |
| Interchange revenue from debit card transactions | 982 | 925 | 3,013 | 2,809 |
| Net gains (losses) on security transactions | — | — | — | 12 |
| Changes in fair value of equity investments | 2,141 | 32 | 2,165 | 96 |
| Net gains on sales of loans held for sale | 79 | 71 | 184 | 193 |
| Net gains on sales of other real estate owned | 123 | 30 | 119 | 38 |
| Income from bank-owned life insurance | 17 | 17 | 50 | 52 |
| Other | 402 | 675 | 2,016 | 1,632 |
| Total non-interest income | 7,381 | 5,166 | 18,181 | 15,035 |
| | | | | |
| Non-interest expenses: | | | | |
| Salaries and wages | 5,691 | 5,480 | 16,969 | 16,177 |
| Pension and other employee benefits | 1,262 | 1,325 | 4,438 | 4,416 |
| Other components of net periodic pension and postretirement benefits | (408) | (333) | (1,224) | (999) |
| Net occupancy | 1,671 | 1,476 | 4,922 | 4,784 |
| Furniture and equipment | 581 | 657 | 1,941 | 2,119 |
| Data processing | 1,782 | 1,667 | 5,288 | 4,858 |
| Professional services | 479 | 452 | 1,527 | 1,169 |
| Legal accruals and settlements | — | — | 989 | 850 |
| Amortization of intangible assets | 182 | 214 | 558 | 653 |
| Marketing and advertising | 212 | 213 | 816 | 580 |
| Other real estate owned | 83 | 4 | 321 | 35 |
| FDIC insurance | 263 | 312 | 881 | 946 |
| Loan expense | 262 | 165 | 615 | 447 |
| Other | 1,368 | 1,644 | 4,520 | 4,618 |

| | | | | |
|---|---|---|---|---|
| Total non-interest expenses | 13,428 | 13,276 | 42,561 | 40,653 |
| Income before income tax expense | 8,732 | 5,364 | 17,245 | 13,839 |
| Income tax expense | 1,802 | 1,710 | 3,349 | 4,250 |
| Net income | $6,930 | $3,654 | $13,896 | $9,589 |
| | | | | |
| Weighted average shares outstanding | 4,834 | 4,802 | 4,828 | 4,796 |
| Basic and diluted earnings per share | $1.43 | $0.76 | $2.88 | $2.00 |

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2018 | 2017 |
| Net income | $6,930 | $3,654 | $13,896 | $9,589 |
| Other comprehensive income (loss): | | | | |
| Unrealized holding gains (losses) on securities available for sale | (1,583) | (522) | (6,422) | 5,498 |
| Reclassification adjustment for gains realized in net income | — | — | — | (12) |
| Net unrealized gains (losses) | (1,583) | (522) | (6,422) | 5,486 |
| Tax effect | (404) | (198) | (1,637) | 2,069 |
| Net of tax amount | (1,179) | (324) | (4,785) | 3,417 |
| | | | | |
| Change in funded status of defined benefit pension plan and other benefit plans: | | | | |
| Reclassification adjustment for amortization of prior service costs | (55) | (55) | (165) | (165) |
| Reclassification adjustment for amortization of net actuarial loss | 72 | 88 | 218 | 264 |
| Total before tax effect | 17 | 33 | 53 | 99 |
| Tax effect | 4 | 12 | 13 | 37 |
| Net of tax amount | 13 | 21 | 40 | 62 |
| | | | | |
| Total other comprehensive income (loss) | (1,166) | (303) | (4,745) | 3,479 |
| | | | | |
| Comprehensive income | $5,764 | $3,351 | $9,151 | $13,068 |

See accompanying notes to unaudited consolidated financial statements.
8

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(UNAUDITED)

| (in thousands, except share and per share data) | Common Stock | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Loss | Total |
|---|---|---|---|---|---|---|
| Balances at January 1, 2017 | $ 53 | $ 45,603 | $ 124,111 | $ (15,265) | $ (10,754) | $ 143,748 |
| Net income | — | — | 9,589 | — | — | 9,589 |
| Other comprehensive income | — | — | — | — | 3,479 | 3,479 |
| Restricted stock awards | — | 162 | — | — | — | 162 |
| Restricted stock units for directors' deferred compensation plan | — | 72 | — | — | — | 72 |
| Cash dividends declared ($0.78 per share) | — | — | (3,694) | — | — | (3,694) |
| Distribution of 7,880 shares of treasury stock for directors' compensation | — | 68 | — | 201 | — | 269 |
| Distribution of 5,861 shares of treasury stock for employee compensation | — | 50 | — | 150 | — | 200 |
| Distribution of 2,438 shares of treasury stock for deferred directors’ compensation | — | (51) | — | 62 | — | 11 |
| Sale of 11,688 shares of treasury stock (a) | — | 142 | — | 299 | — | 441 |
| Forfeiture of 1,139 shares of restricted stock awards | — | 43 | — | (43) | — | — |
| Balances at September 30, 2017 | $ 53 | $ 46,089 | $ 130,006 | $ (14,596) | $ (7,275) | $ 154,277 |
| | | | | | | |
| Balances at December 31, 2017, as reported | $ 53 | $ 45,967 | $ 128,453 | $ (14,320) | $ (10,340) | $ 149,813 |
| Cumulative effect of accounting change (b) | — | — | 40 | — | (202) | (162) |
| Balances at January 1, 2018, as adjusted | 53 | 45,967 | 128,493 | (14,320) | (10,542) | 149,651 |
| Net income | — | — | 13,896 | — | — | 13,896 |
| Other comprehensive loss | — | — | — | — | (4,745) | (4,745) |
| Restricted stock awards | — | 301 | — | — | — | 301 |
| Restricted stock units for directors' deferred compensation plan | — | 57 | — | — | — | 57 |
| Cash dividends declared ($0.78 per share) | — | — | (3,735) | — | — | (3,735) |
| Distribution of 6,015 shares of treasury stock for directors' compensation | — | 147 | — | 154 | — | 301 |
| Distribution of 1,784 shares of treasury stock for employee compensation | — | 44 | — | 45 | — | 89 |
| Distribution of 36,681 shares of treasury stock for deferred directors’ compensation | — | (722) | — | 940 | — | 218 |
| Sale of 9,938 shares of treasury stock (a) | — | 212 | — | 254 | — | 466 |
| Balances at September 30, 2018 | $ 53 | $ 46,006 | $ 138,654 | $ (12,927) | $ (15,287) | $ 156,499 |

(a) All treasury stock sales were completed at the prevailing market price with the Chemung Canal Trust Company Profit Sharing, Savings, and Investment Plan which is a defined contribution plan sponsored by the Bank.
(b) Due to implementation of ASC 2016-01. See "Adoption of New Accounting Standards" discussion in Note 1.

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| (in thousands) | Nine Months Ended September 30, | |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | 2018 | 2017 |
| Net income | $13,896 | $9,589 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of intangible assets | 558 | 653 |
| Provision for loan losses | 3,371 | 2,750 |
| Net losses on disposal of fixed assets | 10 | 15 |
| Depreciation and amortization of fixed assets | 2,625 | 2,820 |
| Amortization of premiums on securities, net | 910 | 1,098 |
| Gains on sales of loans held for sale, net | (184) | (193) |
| Proceeds from sales of loans held for sale | 9,476 | 9,655 |
| Loans originated and held for sale | (10,465) | (10,296) |
| Changes in fair value on equity investments | (2,165) | (96) |
| Proceeds from sales of equity investments | 2,288 | 20 |
| Net gains on securities transactions | — | (12) |
| Net gains on sales of other real estate owned | (119) | (38) |
| Purchase of equity investments | (84) | (59) |
| Expense related to restricted stock units for directors' deferred compensation plan | 57 | 72 |
| Expense related to employee stock compensation | 89 | 200 |
| Expense related to employee restricted stock awards | 301 | 162 |
| Income from bank-owned life insurance | (50) | (52) |
| (Increase) decrease in other assets and accrued interest receivable | (3,510) | 888 |
| (Increase) decrease in other assets and accrued interest payable | 28 | (26) |
| Increase (decrease) in other liabilities | 3,073 | (565) |
| Net cash provided by operating activities | 20,105 | 16,585 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sales and calls of securities available for sale | 1,385 | 1,620 |
| Proceeds from maturities and principal collected on securities available for sale | 37,901 | 35,262 |
| Proceeds from maturities and principal collected on securities held to maturity | 988 | 2,807 |
| Purchases of securities available for sale | — | (41,306) |
| Purchases of securities held to maturity | (1,410) | (1,967) |
| Purchase of FHLBNY and FRBNY stock | (22,003) | (1,708) |
| Redemption of FHLBNY and FRBNY stock | 24,649 | 2,252 |
| Proceeds from sale of equipment | — | 16 |
| Purchases of premises and equipment | (1,492) | (1,294) |
| Proceeds from sales of other real estate owned | 1,576 | 383 |
| Net increase in loans | (13,955) | (90,019) |
| Net cash (used in) provided by investing activities | 27,639 | (93,954) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts | 82,012 | 98,599 |
| Net increase (decrease) in time deposits | 26,539 | (17,924) |
| Net decrease in securities sold under agreements to repurchase | (10,000) | (17,606) |

| | | |
|---|---|---|
| Net decrease in FHLBNY overnight advances | (57,700) | — |
| Repayments of FHLBNY long term advances | (2,000) | (84) |
| Payments made on capital leases | (159) | (154) |
| Sale of treasury stock | 466 | 441 |
| Cash dividends paid | (3,719) | (3,687) |
| Net cash (used in) provided by financing activities | 35,439 | 59,585 |
| Net increase (decrease) in cash and cash equivalents | 83,183 | (17,784) |
| Cash and cash equivalents, beginning of period | 30,729 | 74,162 |
| Cash and cash equivalents, end of period | $113,912 | $56,378 |

(continued)

See accompanying notes to unaudited consolidated financial statements.

10

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(UNAUDITED)

| (in thousands) | Nine Months Ended September 30, | |
|---|---|---|
| Supplemental disclosure of cash flow information: | 2018 | 2017 |
| Cash paid (received) for: | | |
| Interest | $2,650 | $2,314 |
| Income taxes | $1,355 | $4,050 |
| Supplemental disclosure of non-cash activity: | | |
| Transfer of loans to other real estate owned | $244 | $187 |
| Dividends declared, not yet paid | $1,249 | $1,232 |
| Distribution of treasury stock for directors' compensation | $301 | $269 |
| Distribution of treasury stock for deferred directors' compensation | $218 | $11 |

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Organization

The Corporation, through its wholly-owned subsidiaries, the Bank and CFS, provides a wide range of banking, financing, fiduciary and other financial services to its clients. The Corporation and the Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

CRM, a wholly-owned subsidiary of the Corporation, which was formed and began operations on May 31, 2016, is a Nevada-based captive insurance company which insures against certain risks unique to the operations of the Corporation and its subsidiaries and for which insurance may not be currently available or economically feasible in today's insurance marketplace. CRM pools resources with several other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves. CRM is subject to regulations of the State of Nevada and undergoes periodic examinations by the Nevada Division of Insurance.

### Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X of the Exchange Act. These financial statements include the accounts of the Corporation and its subsidiaries, and all significant intercompany balances and transactions are eliminated in consolidation. Amounts in the prior periods' consolidated financial statements are reclassified whenever necessary to conform to the current period's presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures necessary for the fair presentation of the accompanying consolidated financial statements have been included. The unaudited consolidated financial statements should be read in conjunction with the Corporation's 2017 Annual Report on Form 10-K for the year ended December 31, 2017. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year or any other period.

### Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

### Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires companies that lease valuable assets to recognize on their balance sheets the assets and liabilities generated by contracts longer than a year. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, though early adoption is permitted. The Corporation intends to adopt the new lease guidance as of January 1, 2019 and is currently evaluating the impact that adoption of these updates will have on its consolidated financial statements. Currently, the Corporation believes the implementation of this ASU will create a right of use asset of less than $15.0 million for the Corporation's 16 leased facilities and a related capital obligation of the same amount as of January 1, 2019.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date by replacing the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to form credit loss estimates. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2019, though entities may adopt the amendments earlier for fiscal years beginning after December 15, 2018. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements. The Corporation anticipates that the adoption of the CECL model will result in an increase to the Corporation's allowance for loan losses. The Corporation has established a committee to oversee the implementation of CECL and has selected a vendor to assist in the implementation process. In 2018 the committee plans to begin establishing parameters which will be used in the CECL model with the selected vendor. The Corporation further plans to run its current incurred loss model and a CECL model concurrently for twelve months prior to the adoption of this guidance on January 1, 2020.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The objective of the ASU is to simplify the manner in which an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Additionally, the ASU removes the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails such qualitative test, to perform Step 2 of the goodwill impairment test. The amendments in this ASU are effective for annual, or any interim, goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The objective of the ASU is to align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities. The amendment requires that the premium be amortized to the earliest call date, but does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this ASU are effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

Adoption of New Accounting Standards

On January 1, 2018, the Corporation adopted ASU 2016-01, an amendment to Recognition and Measurement of Financial Assets and Financial Liabilities ("ASC 825"). The objectives of the ASC 825 were (1) require equity investments to be measured at fair value, with changes in fair value recognized in net income, (2) simplify the impairment assessment of equity investments without readily determinable fair values, (3) eliminate the requirement to disclose methods and significant assumptions used to estimate fair value for financial instruments measured at amortized cost on the balance sheet, (4) require the use of the exit price notion when measuring the fair value of financial instruments, and (5) clarify the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets.

On January 1, 2018, the Corporation adopted ASU 2017-07, Compensation - Retirement Benefits - Improving the Presentation of Net Periodic Cost and Net Periodic Postretirement Benefit Cost ("ASC 715"). The objective of ASC 715 was to improve guidance related to the presentation of defined benefit costs in the income statement. Specifically, ASC 715 required that an employer report the service cost component in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. Additionally, ASC 715 allows only the service cost component to be eligible for capitalization, when applicable. Results for reporting periods beginning after January 1, 2018 are presented under ASC 715, while prior period amounts continue to be reported in accordance with legacy GAAP, with comparable periods presented retrospectively for the presentation of the service cost and net periodic postretirement benefit cost in the income statement. The Corporation elected the practical expedient, which permits employers to use the amounts disclosed in its pension and other postretirement benefit plan note for the prior comparative periods as the estimation for applying retrospective presentation requirements.

NOTE 2 EARNING PER COMMON SHARE (shares in thousands)

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities and are considered outstanding at grant date. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,834 and 4,802 weighted average shares outstanding for the three-month periods ended September 30, 2018 and 2017, respectively. Earnings per share were computed by dividing net income by 4,828 and 4,796 weighted average shares outstanding for the nine- month periods ended September 30, 2018 and 2017, respectively. There were no common stock equivalents during the three and nine-month periods ended September 30, 2018 or 2017.

NOTE 3 SECURITIES

Amortized cost and estimated fair value of securities available for sale are as follows (in thousands):

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $10,487 | $ 8 | $ 42 | $10,453 |
| Mortgage-backed securities, residential | 196,977 | 58 | 10,258 | 186,777 |
| Obligations of states and political subdivisions | 46,544 | 17 | 1,016 | 45,545 |
| Corporate bonds and notes | 249 | 1 | — | 250 |
| SBA loan pools | 3,494 | — | 46 | 3,448 |
| Total | $257,751 | $ 84 | $ 11,362 | $246,473 |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $15,492 | $ 20 | $ 21 | $15,491 |
| Mortgage-backed securities, residential | 224,939 | 136 | 5,166 | 219,909 |
| Obligations of states and political subdivisions | 52,928 | 355 | 151 | 53,132 |
| Corporate bonds and notes | 249 | 2 | — | 251 |
| SBA loan pools | 4,339 | 1 | 32 | 4,308 |
| Total | $297,947 | $ 514 | $ 5,370 | $293,091 |

Amortized cost and estimated fair value of securities held to maturity are as follows (in thousands):

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of states and political subdivisions | $2,123 | $ — | $ — | $ 2,123 |
| Time deposits with other financial institutions | 2,080 | — | 13 | 2,067 |

| | | | | |
|---|---|---|---|---|
| Total | $4,203 | $ — | $ 13 | $ 4,190 |

14

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Obligations of states and political subdivisions | $1,946 | $ — | $ — | $ 1,946 |
| Time deposits with other financial institutions | 1,835 | — | 5 | 1,830 |
| Total | $3,781 | $ — | $ 5 | $ 3,776 |

The amortized cost and estimated fair value of debt securities are shown below by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately (in thousands):

| | September 30, 2018 | | | |
|---|---|---|---|---|
| | Available for Sale | | Held to Maturity | |
| | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Within one year | $16,284 | $16,241 | $1,785 | $1,781 |
| After one, but within five years | 15,932 | 15,728 | 2,185 | 2,176 |
| After five, but within ten years | 24,580 | 23,831 | 233 | 233 |
| After ten years | 484 | 448 | — | — |
| | 57,280 | 56,248 | 4,203 | 4,190 |
| Mortgage-backed securities, residential | 196,977 | 186,777 | — | — |
| SBA loan pools | 3,494 | 3,448 | — | — |
| Total | $257,751 | $246,473 | $4,203 | $4,190 |

The proceeds from sales and calls of securities resulting in gains or losses for the three months ended September 30, 2018 and 2017 are listed below (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Proceeds | $ — | $545 |
| Gross gains | — | — |
| Tax expense | — | — |

The proceeds from sales and calls of securities resulting in gains or losses for the nine months ended September 30, 2018 and 2017 are listed below (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Proceeds | $ — | $1,620 |
| Gross gains | — | 12 |
| Tax expense | — | 4 |

The following tables summarize the investment securities available for sale with unrealized losses at September 30, 2018 and December 31, 2017 by aggregated major security type and length of time in a continuous unrealized loss position (in thousands):

| | Less than 12 months | | 12 months or longer | | Total | |
|---|---|---|---|---|---|---|
| September 30, 2018 | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $9,953 | $ 42 | $— | $ — | $9,953 | $ 42 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Mortgage-backed securities, residential | 11,248 | 448 | 173,420 | 9,810 | 184,668 | 10,258 |
| Obligations of states and political subdivisions | 38,405 | 746 | 4,250 | 270 | 42,655 | 1,016 |
| SBA loan pools | 214 | 1 | 3,234 | 45 | 3,448 | 46 |
| Total temporarily impaired securities | $59,820 | $ 1,237 | $180,904 | $ 10,125 | $240,724 | $ 11,362 |

| December 31, 2017 | Less than 12 months Fair Value | Less than 12 months Unrealized Losses | 12 months or longer Fair Value | 12 months or longer Unrealized Losses | Total Fair Value | Total Unrealized Losses |
|---|---|---|---|---|---|---|
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $14,982 | $ 21 | $— | $ — | $14,982 | $ 21 |
| Mortgage-backed securities, residential | 83,562 | 1,013 | 131,165 | 4,153 | 214,727 | 5,166 |
| Obligations of states and political subdivisions | 20,526 | 133 | 271 | 18 | 20,797 | 151 |
| SBA loan pools | 3,937 | 32 | — | — | 3,937 | 32 |
| Total temporarily impaired securities | $123,007 | $ 1,199 | $131,436 | $ 4,171 | $254,443 | $ 5,370 |

Other-Than-Temporary Impairment

As of September 30, 2018, the majority of the Corporation's unrealized losses in the investment securities portfolio related to mortgage-backed securities. At September 30, 2018, all of the unrealized losses related to mortgage-backed securities were issued by U.S. government sponsored entities, Fannie Mae and Freddie Mac. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because it is not likely that the Corporation will be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at September 30, 2018.

Equity Investments

Beginning January 1, 2018, upon adoption of ASU 2016-01, equity securities with readily determinable fair values are stated at fair value with realized and unrealized gains and losses reported in the consolidated statement of income. For periods prior to adoption, equity investments were classified as available-for-sale and stated at fair value with unrealized gains and losses reports as a separate component of accumulated other comprehensive income, net of tax.

The Corporation recognized a change in fair value of equity investments of $2.1 million during the three and nine month period ending September 30, 2018, primarily related to the sale of Visa Class B shares during the third quarter of 2018.

## NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio, net of deferred origination fees and costs, is summarized as follows (in thousands):

| | September 30, 2018 | December 31, 2017 |
|---|---|---|
| Commercial and agricultural: | | |
| Commercial and industrial | $192,093 | $198,463 |
| Agricultural | 287 | 544 |
| Commercial mortgages: | | |
| Construction | 50,353 | 45,558 |
| Commercial mortgages, other | 615,221 | 598,772 |
| Residential mortgages | 188,636 | 194,440 |
| Consumer loans: | | |
| Credit cards | 1,393 | 1,517 |
| Home equity lines and loans | 98,239 | 100,591 |
| Indirect consumer loans | 157,123 | 153,060 |

| | | |
|---|---|---|
| Direct consumer loans | 17,293 | 18,879 |
| Total loans, net of deferred origination fees and costs | 1,320,638 | 1,311,824 |
| Interest receivable on loans | 3,884 | 3,758 |
| Total recorded investment in loans | $1,324,522 | $1,315,582 |

The Corporation's concentrations of credit risk by loan type are reflected in the preceding table. The concentrations of credit risk with standby letters of credit, committed lines of credit and commitments to originate new loans generally follow the loan classifications in the table above.

The following tables present the activity in the allowance for loan losses by portfolio segment for the three and nine-month periods ended September 30, 2018 and 2017 (in thousands):

| | Three Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance | $4,969 | $ 8,740 | $ 1,445 | $ 4,491 | $19,645 |
| Charge-offs | — | — | (60 ) | (380 ) | (440 ) |
| Recoveries | 13 | — | — | 117 | 130 |
| Net recoveries (charge-offs) | 13 | — | (60 ) | (263 ) | (310 ) |
| Provision | 285 | (91 ) | 11 | 95 | 300 |
| Ending balance | $5,267 | $ 8,649 | $ 1,396 | $ 4,323 | $19,635 |

| | Three Months Ended September 30, 2017 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance | $1,883 | $ 7,778 | $ 1,517 | $ 3,926 | $15,104 |
| Charge-offs | (89 ) | (154 ) | (133 ) | (440 ) | (816 ) |
| Recoveries | 34 | 1 | — | 82 | 117 |
| Net recoveries (charge-offs) | (55 ) | (153 ) | (133 ) | (358 ) | (699 ) |
| Provision | 99 | 758 | 12 | 420 | 1,289 |
| Ending balance | $1,927 | $ 8,383 | $ 1,396 | $ 3,988 | $15,694 |

| | Nine Months Ended September 30, 2018 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance: | $6,976 | $ 8,514 | $ 1,316 | $ 4,355 | $21,161 |
| Charge-offs: | (3,644 ) | (145 ) | (225 ) | (1,301 ) | (5,315 ) |
| Recoveries: | 34 | 2 | 5 | 377 | 418 |
| Net recoveries (charge-offs) | (3,610 ) | (143 ) | (220 ) | (924 ) | (4,897 ) |
| Provision | 1,901 | 278 | 300 | 892 | 3,371 |
| Ending balance | $5,267 | $ 8,649 | $ 1,396 | $ 4,323 | $19,635 |

| | Nine Months Ended September 30, 2017 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Beginning balance: | $1,589 | $ 7,270 | $ 1,523 | $ 3,871 | $14,253 |
| Charge-offs: | (96 ) | (154 ) | (193 ) | (1,265 ) | (1,708 ) |
| Recoveries: | 95 | 4 | 30 | 270 | 399 |
| Net recoveries (charge-offs) | (1 ) | (150 ) | (163 ) | (995 ) | (1,309 ) |
| Provision | 339 | 1,263 | 36 | 1,112 | 2,750 |
| Ending balance | $1,927 | $ 8,383 | $ 1,396 | $ 3,988 | $15,694 |

17

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of September 30, 2018 and December 31, 2017 (in thousands):

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Ending allowance balance attributable to loans: | | | | | |
| Individually evaluated for impairment | $1,713 | $ 496 | $ — | $ — | $2,209 |
| Collectively evaluated for impairment | 3,554 | 8,153 | 1,396 | 4,323 | 17,426 |
| Total ending allowance balance | $5,267 | $ 8,649 | $ 1,396 | $ 4,323 | $19,635 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| Allowance for loan losses: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Ending allowance balance attributable to loans: | | | | | |
| Individually evaluated for impairment | $5,135 | $ 802 | $ — | $ — | $5,937 |
| Collectively evaluated for impairment | 1,841 | 7,683 | 1,316 | 4,355 | 15,195 |
| Loans acquired with deteriorated credit quality | — | 29 | — | — | 29 |
| Total ending allowance balance | $6,976 | $ 8,514 | $ 1,316 | $ 4,355 | $21,161 |

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| Loans: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Loans individually evaluated for impairment | $2,181 | $ 6,572 | $ 410 | $ 58 | $9,221 |
| Loans collectively evaluated for impairment | 190,777 | 661,003 | 188,751 | 274,770 | 1,315,301 |
| Total ending loans balance | $192,958 | $ 667,575 | $ 189,161 | $274,828 | $1,324,522 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| Loans: | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Total |
| Loans individually evaluated for impairment | $6,133 | $ 7,302 | $ 427 | $ 64 | $13,926 |
| Loans collectively evaluated for impairment | 193,443 | 638,080 | 194,510 | 274,831 | 1,300,864 |
| Loans acquired with deteriorated credit quality | — | 792 | — | — | 792 |
| Total ending loans balance | $199,576 | $ 646,174 | $ 194,937 | $274,895 | $1,315,582 |

The following table presents loans individually evaluated for impairment recognized by class of loans as of September 30, 2018 and December 31, 2017 (in thousands):

| | September 30, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| With no related allowance recorded: | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated |
| Commercial and agricultural: | | | | | | |
| Commercial and industrial | $405 | $ 405 | $ — | $861 | $ 867 | $ — |
| Commercial mortgages: | | | | | | |
| Construction | 322 | 323 | — | 364 | 365 | — |
| Commercial mortgages, other | 4,342 | 4,309 | — | 4,135 | 4,138 | — |
| Residential mortgages | 432 | 410 | — | 450 | 427 | — |
| Consumer loans: | | | | | | |
| Home equity lines and loans | 57 | 58 | — | 64 | 64 | — |
| With an allowance recorded: | | | | | | |
| Commercial and agricultural: | | | | | | |
| Commercial and industrial | 1,773 | 1,776 | 1,713 | 5,231 | 5,266 | 5,135 |
| Commercial mortgages: | | | | | | |
| Commercial mortgages, other | 1,939 | 1,940 | 496 | 2,989 | 2,799 | 802 |
| Total | $9,270 | $ 9,221 | $ 2,209 | $14,094 | $ 13,926 | $ 5,937 |

The following table presents the average recorded investment and interest income of loans individually evaluated for impairment recognized by class of loans as of the three and nine-month periods ended September 30, 2018 and 2017 (in thousands):

| | Three Months Ended September 30, 2018 | | Three Months Ended September 30, 2017 | | Nine Months Ended September 30, 2018 | | Nine Months Ended September 30, 2017 | |
|---|---|---|---|---|---|---|---|---|
| With no related allowance recorded: | Average Recorded Investment | Interest Income Recognized (1) | Average Recorded Investment | Interest Income Recognized (1) | Average Recorded Investment | Interest Income Recognized (1) | Average Recorded Investment | Interest Income Recognized (1) |
| Commercial and agricultural: | | | | | | | | |
| Commercial and industrial | $526 | $ 1 | $661 | $ 8 | $673 | $ 11 | $666 | $ 24 |
| Commercial mortgages: | | | | | | | | |
| Construction | 330 | 3 | 974 | 3 | 344 | 8 | 946 | 9 |
| Commercial mortgages, other | 4,339 | 5 | 4,946 | 5 | 4,257 | 16 | 5,973 | 73 |
| Residential mortgages | 413 | 2 | 439 | 2 | 420 | 6 | 416 | 6 |
| Consumer loans: | | | | | | | | |
| Home equity lines & loans | 59 | 1 | 68 | 1 | 61 | 2 | 76 | 2 |
| With an allowance recorded: | | | | | | | | |
| Commercial and agricultural: | | | | | | | | |
| Commercial and industrial | 1,573 | 1 | 291 | 3 | 3,359 | 2 | 145 | 4 |
| Commercial mortgages: | | | | | | | | |
| Commercial mortgages, other | 2,040 | 1 | 4,721 | 4 | 2,419 | 4 | 3,989 | 10 |
| Consumer loans: | | | | | | | | |
| Home equity lines and loans | — | — | — | — | — | — | 180 | — |
| Total | $9,280 | $ 14 | $12,100 | $ 26 | $11,533 | $ 49 | $12,391 | $ 128 |

(1)Cash basis interest income approximates interest income recognized.

20

The following table presents the recorded investment in non-accrual and loans past due 90 days or more and still accruing by class of loans as of September 30, 2018 and December 31, 2017 (in thousands):

| | Non-accrual | | Loans Past Due 90 Days or More and Still Accruing | |
|---|---|---|---|---|
| | September 30, 2018 | December 31, 2017 | September 30, 2018 | December 31, 2017 |
| Commercial and agricultural: | | | | |
| Commercial and industrial | $2,075 | $ 5,250 | $ — | $ 5 |
| Commercial mortgages: | | | | |
| Construction | 115 | 135 | — | — |
| Commercial mortgages, other | 5,849 | 6,520 | — | — |
| Residential mortgages | 2,654 | 3,160 | — | — |
| Consumer loans: | | | | |
| Credit cards | — | — | 14 | 24 |
| Home equity lines and loans | 1,289 | 1,310 | — | — |
| Indirect consumer loans | 616 | 935 | — | — |
| Direct consumer loans | 31 | 14 | — | — |
| Total | $12,629 | $ 17,324 | $ 14 | $ 29 |

The following tables present the aging of the recorded investment in loans as of September 30, 2018 and December 31, 2017 (in thousands):

| | September 30, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Loans Acquired with Deteriorated Credit Quality | Loans Not Past Due | Total |
| Commercial and agricultural: | | | | | | | |
| Commercial and industrial | $5,894 | $121 | $14 | $6,029 | $ — | $186,641 | $192,670 |
| Agricultural | — | — | — | — | — | 288 | 288 |
| Commercial mortgages: | | | | | | | |
| Construction | — | — | — | — | — | 50,504 | 50,504 |
| Commercial mortgages, other | 2,137 | 25 | 436 | 2,598 | — | 614,473 | 617,071 |
| Residential mortgages | 1,324 | 510 | 946 | 2,780 | — | 186,381 | 189,161 |
| Consumer loans: | | | | | | | |
| Credit cards | 5 | 4 | 14 | 23 | — | 1,370 | 1,393 |
| Home equity lines and loans | 244 | 111 | 816 | 1,171 | — | 97,366 | 98,537 |
| Indirect consumer loans | 1,424 | 240 | 305 | 1,969 | — | 155,557 | 157,526 |
| Direct consumer loans | 59 | 21 | 23 | 103 | — | 17,269 | 17,372 |
| Total | $11,087 | $1,032 | $2,554 | $14,673 | $ — | $1,309,849 | $1,324,522 |

| | December 31, 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30 - 59 Days Past Due | 60 - 89 Days Past Due | 90 Days or More Past Due | Total Past Due | Loans Acquired with Deteriorated Credit Quality | Loans Not Past Due | Total |
| Commercial and agricultural: | | | | | | | |
| Commercial and industrial | $1,689 | $999 | $20 | $2,708 | $ — | $196,322 | $199,030 |
| Agricultural | — | — | — | — | — | 546 | 546 |
| Commercial mortgages: | | | | | | | |
| Construction | — | — | — | — | — | 45,688 | 45,688 |
| Commercial mortgages, other | 2,399 | 115 | 748 | 3,262 | 792 | 596,432 | 600,486 |
| Residential mortgages | 1,399 | 939 | 1,474 | 3,812 | — | 191,125 | 194,937 |
| Consumer loans: | | | | | | | |
| Credit cards | 17 | 9 | 24 | 50 | — | 1,466 | 1,516 |
| Home equity lines and loans | 265 | 31 | 983 | 1,279 | — | 99,599 | 100,878 |
| Indirect consumer loans | 1,822 | 484 | 581 | 2,887 | — | 150,645 | 153,532 |
| Direct consumer loans | 48 | 28 | 2 | 78 | — | 18,891 | 18,969 |
| Total | $7,639 | $2,605 | $3,832 | $14,076 | $ 792 | $1,300,714 | $1,315,582 |

Troubled Debt Restructurings:

A modification of a loan may result in classification as a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Corporation offers various types of modifications which may involve a change in the schedule of payments, a reduction in the interest rate, an extension of the maturity date, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, requesting additional collateral, releasing collateral for consideration, substituting or adding a new borrower or guarantor, a permanent reduction of the recorded investment in the loan or a permanent reduction of the interest on the loan.

As of September 30, 2018 and December 31, 2017, the Corporation has a recorded investment in TDRs of $6.6 million and $7.7 million, respectively. There were specific reserves of $0.5 million and $0.7 million allocated for TDRs at September 30, 2018 and December 31, 2017, respectively. As of September 30, 2018, TDRs totaling $0.9 million were accruing interest under the modified terms and $5.7 million were on non-accrual status. As of December 31, 2017, TDRs totaling $1.7 million were accruing interest under the modified terms and $6.0 million were on non-accrual status. The Corporation had committed no additional amounts as of both September 30, 2018 and December 31, 2017, to customers with outstanding loans that are classified as TDRs.

There were no loans modified as TDRs during the three month period ended September 30, 2018 while the terms of certain loans were modified as TDRs during the three month period ended September 30, 2017. The modification of the terms of two commercial and industrial term loans during the three months ended September 30, 2017 included a reduction of the schedule amortized payments for greater than a three month period, the release of collateral related to one of the loans, and the extension of a maturity date.

During the nine months ended September 30, 2018 and 2017, the terms of certain loans were modified as TDRs. The modification of the terms of one commercial and industrial term loan during the nine months ended September 30, 2018 included an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk. In addition to the modification noted above, the modification of two commercial and industrial term loans and one line of credit during the nine months ended September 30, 2017 included consolidating the loans into one commercial and industrial loan, extending the maturity date by approximately two years, and lowering the monthly payment. An additional piece of equipment was taken as collateral, but was not considered to be of greater value than the concession given. The modification of the terms of one commercial mortgage loan during the nine months ended September 30, 2017 included a reduction of the scheduled amortized payments of the loan for greater than a three month period. The modification of the terms of a residential mortgage loan during the nine months ended September 30, 2017 included an extension of the maturity date by approximately five years and a postponement of the scheduled amortized past due payments to the end of the loan.

The following table presents loans by class modified as TDRs that occurred during the three month period ended September 30, 2017 (dollars in thousands):

| September 30, 2017 | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Troubled debt restructurings: | | | |
| Commercial and agricultural: | | | |
| Commercial and industrial | 2 | $ 506 | $ 506 |
| Total | 2 | $ 506 | $ 506 |

The TDRs described above increased the allowance for loan losses by $0.1 million and resulted in no charge-offs during the three month period ended September 30, 2017.

The following tables present loans by class modified as TDRs that occurred during the nine months ended September 30, 2018 and 2017 (dollars in thousands):

| September 30, 2018 | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Troubled debt restructurings: | | | |
| Commercial and agricultural: | | | |
| Commercial and industrial | 1 | $ 100 | $ 100 |
| Total | 1 | $ 100 | $ 100 |

| September 30, 2017 | Number of Loans | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Troubled debt restructurings: | | | |
| Commercial and agricultural: | | | |
| Commercial and industrial | 3 | $ 677 | $ 677 |
| Commercial mortgages: | | | |
| Commercial mortgages | 1 | $ 166 | $ 166 |
| Residential mortgages | 1 | 105 | 105 |
| Total | 5 | $ 948 | $ 948 |

The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the nine months ended September 30, 2018. The TDRs described above increased the allowance for loan losses by $0.2 million and resulted in no charge-offs during the nine months ended September 30, 2017.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no payment defaults on any loans previously modified as TDRs within twelve months following the modification during the three and nine month periods ended September 30, 2018 and 2017.

Credit Quality Indicators

The Corporation establishes a risk rating at origination for all commercial loans. The main factors considered in assigning risk ratings include, but are not limited to: historic and future debt service coverage, collateral position, operating performance, liquidity, leverage, payment history, management ability, and the customer's industry. Commercial relationship managers monitor all loans in their respective portfolios for any changes in the borrower's ability to service its debt and affirm the risk ratings for the loans at least annually.

For the retail loans, which include residential mortgages, indirect and direct consumer loans, home equity lines and loans, and credit cards, once a loan is properly approved and closed, the Corporation evaluates credit quality based upon loan repayment.

The Corporation uses the risk rating system to identify criticized and classified loans. Commercial relationships within the criticized and classified risk ratings are analyzed quarterly. The Corporation uses the following definitions for criticized and classified loans (which are consistent with regulatory guidelines):

Special Mention – Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution's credit position at some future date.

Substandard – Loans classified as substandard are inadequately protected by the current net worth and paying capability of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Commercial loans not meeting the criteria above to be considered criticized or classified are considered to be pass rated loans. Loans listed as not rated are included in groups of homogeneous loans performing under terms of the loan notes. Based on the analyses performed as of September 30, 2018 and December 31, 2017, the risk category of the recorded investment of loans by class of loans is as follows (in thousands):

| | September 30, 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Not Rated | Pass | Special Mention | Substandard | Doubtful | Loans acquired with deteriorated credit quality | Total |
| Commercial and agricultural: | | | | | | | |
| Commercial and industrial | $— | $179,502 | $9,421 | $ 2,021 | $ 1,726 | $ — | $192,670 |
| Agricultural | — | 288 | — | — | — | — | 288 |
| Commercial mortgages: | | | | | | | |
| Construction | — | 50,389 | — | 115 | — | — | 50,504 |
| Commercial mortgages | — | 592,724 | 10,793 | 12,252 | 1,302 | — | 617,071 |
| Residential mortgages | 186,507 | — | — | 2,654 | — | — | 189,161 |
| Consumer loans: | | | | | | | |
| Credit cards | 1,393 | — | — | — | — | — | 1,393 |
| Home equity lines and loans | 97,248 | — | — | 1,289 | — | — | 98,537 |
| Indirect consumer loans | 156,910 | — | — | 616 | — | — | 157,526 |
| Direct consumer loans | 17,341 | — | — | 31 | — | — | 17,372 |
| Total | $459,399 | $822,903 | $20,214 | $ 18,978 | $ 3,028 | $ — | $1,324,522 |

25

| | December 31, 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Not Rated | Pass | Special Mention | Substandard | Doubtful | Loans acquired with deteriorated credit quality | Total |
| Commercial and agricultural: | | | | | | | |
| Commercial and industrial | $— | $186,556 | $4,447 | $ 6,605 | $ 1,422 | $ — | $199,030 |
| Agricultural | — | 546 | — | — | — | — | 546 |
| Commercial mortgages: | | | | | | | |
| Construction | — | 45,553 | — | 135 | — | — | 45,688 |
| Commercial mortgages | — | 575,321 | 9,665 | 13,331 | 1,377 | 792 | 600,486 |
| Residential mortgages | 191,777 | — | — | 3,160 | — | — | 194,937 |
| Consumer loans: | | | | | | | |
| Credit cards | 1,516 | — | — | — | — | — | 1,516 |
| Home equity lines and loans | 99,568 | — | — | 1,310 | — | — | 100,878 |
| Indirect consumer loans | 152,598 | — | — | 934 | — | — | 153,532 |
| Direct consumer loans | 18,955 | — | — | 14 | — | — | 18,969 |
| Total | $464,414 | $807,976 | $14,112 | $ 25,489 | $ 2,799 | $ 792 | $1,315,582 |

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of September 30, 2018 and December 31, 2017 (in thousands):

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| | | Consumer Loans | | | |
| | Residential Mortgages | Credit Card | Home Equity Lines and Loans | Indirect Consumer Loans | Other Direct Consumer Loans |
| Performing | $186,507 | $1,393 | $97,248 | $156,910 | $ 17,341 |
| Non-Performing | 2,654 | — | 1,289 | 616 | 31 |
| | $189,161 | $1,393 | $98,537 | $157,526 | $ 17,372 |

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | | Consumer Loans | | | |
| | Residential Mortgages | Credit Card | Home Equity Lines and Loans | Indirect Consumer Loans | Other Direct Consumer Loans |
| Performing | $191,777 | $1,516 | $99,568 | $152,598 | $ 18,955 |
| Non-Performing | 3,160 | — | 1,310 | 934 | 14 |
| | $194,937 | $1,516 | $100,878 | $153,532 | $ 18,969 |

NOTE 5 FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

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

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods and significant assumptions to estimate fair value on a recurring basis:

Available for Sale Securities: The fair values of securities available for sale are usually determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs), or matrix pricing, which is a mathematical technique widely used to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3 inputs).

Equity Investments: Securities that are held to fund a deferred compensation plan and securities that have a readily determinable fair market value, are recorded at fair value with changes in fair value included in earnings. The fair values of equity investments are determined by quoted market prices (Level 1 inputs).

Impaired Loans: At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value have been partially charged-off or receive specific allocations as part of the allowance for loan loss accounting. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower’s financial statements, or aging reports, adjusted or discounted based on management’s historical knowledge, changes in market conditions from the time of the valuation, and management’s expertise and knowledge of the client and client’s business, typically resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

OREO: Assets acquired through or instead of loan foreclosures are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (commercial properties) or certified residential appraisers (residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Once received, appraisals are reviewed for reasonableness of assumptions, approaches utilized, Uniform Standards of Professional Appraisal Practice and other regulatory compliance, as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals are generally completed within the previous 12 month period prior to a property being placed into OREO. On impaired loans, appraisal values are adjusted based on the age of the appraisal, the position of the lien, the type of the property and its condition.

Derivatives: The fair values of interest rate swaps are based on valuation models using observable market data as of the measurement date (Level 2 inputs). Derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices, and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The Corporation also incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counter-party's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Corporation has considered the impact of any applicable credit enhancements, such as collateral postings. Although the Corporation has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize credit default rate assumptions (Level 3 inputs).

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

| | | Fair Value Measurement at September 30, 2018 Using | | |
|---|---|---|---|---|
| Financial Assets: | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $10,453 | $— | $ 10,453 | $ — |
| Mortgage-backed securities, residential | 186,777 | — | 186,777 | — |
| Obligations of states and political subdivisions | 45,545 | — | 45,545 | — |
| Corporate bonds and notes | 250 | — | 250 | — |
| SBA loan pools | 3,448 | — | 3,448 | — |
| Total available for sale securities | $246,473 | $— | $ 246,473 | $ — |
| | | | | |
| Equity investments | $1,153 | $1,153 | $ — | $ — |
| Derivative assets | 2,503 | — | 2,503 | — |
| | | | | |
| Financial Liabilities: | | | | |
| Derivative liabilities | $2,516 | $— | $ 2,503 | $ 13 |

There were no transfers between Level 1 and Level 2 during the three and nine month periods ended September 30, 2018.

| | | Fair Value Measurement at December 31, 2017 Using | | |
|---|---|---|---|---|
| Financial Assets: | Fair Value | Quoted Prices in Active | Significant Other Observable Inputs | Significant Unobservable Inputs (Level 3) |

| | | Markets for Identical Assets (Level 1) | (Level 2) | | |
|---|---|---|---|---|---|
| Obligations of U.S. Government and U.S. Government sponsored enterprises | $15,491 | $— | $ 15,491 | $ | — |
| Mortgage-backed securities, residential | 219,909 | — | 219,909 | — | |
| Obligations of states and political subdivisions | 53,132 | — | 53,132 | — | |
| Corporate bonds and notes | 251 | — | 251 | — | |
| SBA loan pools | 4,308 | — | 4,308 | — | |
| Total available for sale securities | $293,091 | $— | $ 293,091 | $ | — |
| | | | | | |
| Equity investments | $1,192 | $1,192 | $ — | $ | — |
| Derivative assets | 974 | — | 974 | — | |
| | | | | | |
| Financial Liabilities: | | | | | |
| Derivative liabilities | $1,049 | $— | $ 974 | $ | 75 |

There were no transfers between Level 1 and Level 2 during the three and nine month periods ended September 30, 2017. During the three months ended September 30, 2017, the Corporation transferred corporate bonds with a fair market value of $242 thousand from Level 3 to Level 2 due to the availability of pricing in secondary markets.

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three-month periods ended September 30, 2018 and September 30, 2017 (in thousands):

| | Assets (Liabilities) | | | |
|---|---|---|---|---|
| | Corporate Bonds and Notes | | Derivative Liabilities | |
| | September 30, 2018 | September 30, 2017 | September 30, 2018 | September 30, 2017 |
| Balance of recurring Level 3 assets at July 1 | $— | $ 252 | $(18) | $ (71) |
| Derivative instruments entered into | — | — | — | — |
| Total gains or losses for the period: | | | | |
| Included in earnings - other non-interest income | — | — | 5 | — |
| Included in other comprehensive income | — | (10) | — | — |
| Transfers out of Level 3 | — | (242) | — | — |
| Balance of recurring Level 3 assets at September 30 | $— | $ — | $(13) | $ (71) |

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the nine month periods ended September 30, 2018 and September 30, 2017 (in thousands):

| | Assets (Liabilities) | | | |
|---|---|---|---|---|
| | Corporate Bonds and Notes | | Derivative Liabilities | |
| | September 30, 2018 | September 30, 2017 | September 30, 2018 | September 30, 2017 |
| Balance of recurring Level 3 assets at January 1 | $— | $ 250 | $(75) | $ (68) |
| Derivative instruments entered into | — | — | — | (1) |
| Total gains or losses for the period: | | | | |
| Included in earnings - other non-interest income | — | — | 62 | (2) |
| Included in other comprehensive income | — | (8) | — | — |
| Transfers out of Level 3 | — | (242) | — | — |
| Balance of recurring Level 3 assets at September 30 | $— | $ — | $(13) | $ (71) |

The following table presents information related to Level 3 recurring fair value measurements at September 30, 2018 and December 31, 2017 (in thousands):

| Description | Fair Value at September 30, 2018 | Valuation Technique | Unobservable Inputs | Range [Weighted Average] at September 30, 2018 |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Derivative liabilities | $ 13 | Historical trend | Credit default rate | 8.04% - 8.04% [8.04%] |

| Description | Fair Value at December 31, 2017 | Valuation Technique | Unobservable Inputs | Range [Weighted Average] at December 31, 2017 |
|---|---|---|---|---|
| Derivative liabilities | $ 75 | Historical trend | Credit default rate | 5.67% - 5.67% [5.67%] |

Assets and liabilities measured at fair value on a non-recurring basis are summarized below (in thousands):

| | | Fair Value Measurement at September 30, 2018 Using | | | |
|---|---|---|---|---|---|
| Financial Assets: | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) |
| Impaired Loans: | | | | | |
| Commercial and agricultural: | | | | | |
| Commercial and industrial | $ 12 | $ — | $ — | $ 12 | $ — |
| Total impaired loans | $ 12 | $ — | $ — | $ 12 | $ — |
| Other real estate owned: | | | | | |
| Commercial mortgages: | | | | | |
| Commercial mortgages | $ 375 | $ — | $ — | $ 375 | $ — |
| Residential mortgages | 204 | — | — | 204 | — |
| Consumer loans: | | | | | |
| Home equity lines and loans | 148 | — | — | 148 | — |
| Total other real estate owned, net | $ 727 | $ — | $ — | $ 727 | $ — |

| | | Fair Value Measurement at December 31, 2017 Using | | | |
|---|---|---|---|---|---|
| Financial Assets: | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total Gains (Losses) |
| Impaired Loans: | | | | | |
| Commercial and agricultural: | | | | | |
| Commercial and industrial | $ 96 | $ — | $ — | $ 96 | $ (70 ) |
| Commercial mortgages: | | | | | |
| Commercial mortgages | 411 | — | — | 411 | (105 ) |
| Total impaired loans | $ 507 | $ — | $ — | $ 507 | $ (175 ) |
| Other real estate owned: | | | | | |
| Commercial mortgages: | | | | | |
| Commercial mortgages | $ 1,483 | $ — | $ — | $ 1,483 | $ (43 ) |
| Residential mortgages | 382 | — | — | 382 | — |
| Consumer loans: | | | | | |
| Home equity lines and loans | 75 | — | — | 75 | — |

| | | | | | |
|---|---|---|---|---|---|
| Total other real estate owned, net | $1,940 | $— | $— | $ 1,940 | $ (43) |

30

The following tables present information related to Level 3 non-recurring fair value measurement at September 30, 2018 and December 31, 2017 (in thousands):

| Description | Fair Value at September 30, 2018 | Valuation Technique | Unobservable Inputs | Range [Weighted Average] at September 30, 2018 |
|---|---|---|---|---|
| Impaired loans: | | | | |
| Commercial and agricultural: | | | | |
| Commercial and industrial | $ 12 | Sales comparison | Discount to appraised value | 0.00% - 0.00% [0.00%] |
| | $ 12 | | | |
| OREO: | | | | |
| Commercial mortgages: | | | | |
| Commercial mortgages | $ 375 | Sales comparison | Discount to appraised value | 10.00% - 22.00% [14.56%] |
| Residential mortgages | 204 | Sales comparison | Discount to appraised value | 20.80% - 39.78% [22.94%] |
| Consumer loans: | | | | |
| Home equity lines and loans | 148 | Sales comparison | Discount to appraised value | 20.80% - 20.80% [20.80%] |
| | $ 727 | | | |

| Description | Fair Value at December 31, 2017 | Valuation Technique | Unobservable Inputs | Range [Weighted Average] at December 31, 2017 |
|---|---|---|---|---|
| Impaired loans: | | | | |
| Commercial and agricultural: | | | | |
| Commercial and industrial | $ 96 | Sales comparison | Discount to appraised value | 0.00% - 36.07% [33.02%] |
| Commercial mortgages: | | | | |
| Commercial mortgages | 411 | Sales comparison | Discount to appraised value | 10.00% - 89.98% [51.35%] |
| | $ 507 | | | |
| OREO: | | | | |
| Commercial mortgages: | | | | |
| Commercial mortgages | $ 1,483 | Sales comparison | Discount to appraised value | 10.00% - 22.95% [19.75%] |
| Residential mortgages | 382 | Sales comparison | Discount to appraised value | 17.28% - 27.97% [20.77%] |
| Consumer loans: | | | | |
| Home equity lines and loans | 75 | Sales comparison | Discount to appraised value | 20.80% - 20.80% [20.80%] |
| | $ 1,940 | | | |

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of other financial instruments, at September 30, 2018 and December 31, 2017, are as follows (in thousands):

| | September 30, 2018 | | | | |
|---|---|---|---|---|---|
| Financial assets: | Carrying Amount | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Estimated Fair Value (1) |
| Cash and due from financial institutions | $31,831 | $31,831 | $ — | $ — | $31,831 |
| Interest-earning deposits in other financial institutions | 82,081 | 82,081 | — | — | 82,081 |
| Equity investments | 1,153 | 1,153 | — | — | 1,153 |
| Securities available for sale | 246,473 | — | 246,473 | — | 246,473 |
| Securities held to maturity | 4,203 | — | 2,067 | 2,123 | 4,190 |
| FHLBNY and FRBNY stock | 3,138 | — | — | — | N/A |
| Loans, net and loans held for sale | 1,302,718 | — | — | 1,283,057 | 1,283,057 |
| Accrued interest receivable | 4,768 | 17 | 867 | 3,884 | 4,768 |
| Derivative assets | 2,503 | — | 2,503 | — | 2,503 |
| | | | | | |
| Financial liabilities: | | | | | |
| Deposits: | | | | | |
| Demand, savings, and insured money market accounts | $1,431,096 | $1,431,096 | $ — | $ — | $1,431,096 |
| Time deposits | 144,901 | — | 145,401 | — | 145,401 |
| Accrued interest payable | 176 | 29 | 147 | — | 176 |
| Derivative liabilities | 2,516 | — | 2,503 | 13 | 2,516 |

(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| Financial assets: | Carrying Amount | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Estimated Fair Value (1) |
| Cash and due from financial institutions | $27,966 | $27,966 | $ — | $ — | $27,966 |
| Interest-earning deposits in other financial institutions | 2,763 | 2,763 | — | — | 2,763 |
| Equity investments | 1,192 | 1,192 | — | — | 1,192 |
| Securities available for sale | 293,091 | — | 293,091 | — | 293,091 |
| Securities held to maturity | 3,781 | — | 1,830 | 1,946 | 3,776 |
| FHLBNY and FRBNY stock | 5,784 | — | — | — | N/A |
| Loans, net | 1,291,205 | — | — | 1,289,584 | 1,289,584 |
| Loans held for sale | 542 | — | 542 | — | 542 |
| Accrued interest receivable | 4,642 | 1 | 867 | 3,774 | 4,642 |
| Derivative assets | 974 | — | 974 | — | 974 |
| | | | | | |
| Financial liabilities: | | | | | |
| Deposits: | | | | | |
| Demand, savings, and insured money market accounts | $1,349,084 | $1,349,084 | $ — | $ — | $1,349,084 |
| Time deposits | 118,362 | — | 118,598 | — | 118,598 |
| Securities sold under agreements to repurchase | 10,000 | — | 10,058 | — | 10,058 |
| FHLBNY overnight advances | 57,700 | — | 57,700 | — | 57,700 |
| FHLBNY term advances | 2,000 | — | 2,001 | — | 2,001 |
| Accrued interest payable | 148 | 24 | 124 | — | 148 |
| Derivative liabilities | 1,049 | — | 974 | 75 | 1,049 |

(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

## NOTE 6 GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill included in the core banking segment during the nine month periods ended September 30, 2018 and 2017 were as follows (in thousands):

| | 2018 | 2017 |
|---|---|---|
| Beginning of year | $21,824 | $21,824 |
| Acquired goodwill | — | — |
| Ending balance September 30, | $21,824 | $21,824 |

Acquired intangible assets were as follows at September 30, 2018 and December 31, 2017 (in thousands):

| | At September 30, 2018 | | At December 31, 2017 | |
|---|---|---|---|---|
| | Balance Acquired | Accumulated Amortization | Balance Acquired | Accumulated Amortization |

| | | | | |
|---|---|---|---|---|
| Core deposit intangibles | $5,975 | $ 5,489 | $5,975 | $ 5,196 |
| Other customer relationship intangibles | 5,633 | 4,592 | 5,633 | 4,327 |
| Total | $11,608 | $ 10,081 | $11,608 | $ 9,523 |

Aggregate amortization expense was $0.2 million for both of the three month periods ended September 30, 2018 and 2017. Aggregate amortization expense was $0.6 million and $0.7 million for the nine month periods ended September 30, 2018 and 2017, respectively.

The remaining estimated aggregate amortization expense at September 30, 2018 is listed below (in thousands):

| Year | Estimated Expense |
|---|---|
| 2018 | $ 176 |
| 2019 | 609 |
| 2020 | 484 |
| 2021 | 258 |
| 2022 | — |
| Total | $ 1,527 |

NOTE 7 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Corporation enters into sales of securities under agreements to repurchase and the amounts received under these agreements represent borrowings and are reflected as a liability in the consolidated balance sheets. The securities underlying these agreements are included in investment securities in the consolidated balance sheets.

The Corporation has no control over the market value of the securities which fluctuate due to market conditions, however, the Corporation is obligated to promptly transfer additional securities if the market value of the securities falls below the repurchase agreement price. The Corporation manages this risk by utilizing highly marketable and easily priced securities, monitoring these securities for significant changes in market valuation routinely, and maintaining an unpledged securities portfolio believed to be sufficient to cover a decline in the market value of the securities sold under agreements to repurchase.

There were no securities sold under agreements to repurchase as of September 30, 2018.

A summary of securities sold under agreements to repurchase as of December 31, 2017 is as follows (in thousands):

| | December 31, 2017 | | | | |
|---|---|---|---|---|---|
| | Overnight and Continuous | Up to 1 Year | 1 - 3 Years | 3+ Years | Total |
| Mortgage-backed securities, residential | $ — | $ 11,798 | $ — | $ — | $ 11,798 |
| Excess collateral held | — | (1,798) | — | — | (1,798) |
| Gross amount of recognized liabilities for repurchase agreements | $ — | $ 10,000 | $ — | $ — | $ 10,000 |

NOTE 8 COMMITMENTS AND CONTINGENCIES

The Corporation is a party to certain financial instruments with off-balance sheet risk such as commitments under standby letters of credit, unused portions of lines of credit, overdraft protection and commitments to fund new loans. In accordance with GAAP, these financial instruments are not recorded in the financial statements. The Corporation's policy is to record such instruments when funded. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are generally used by the Corporation to manage clients' requests for funding and other client needs.

The following table lists the contractual amounts of financial instruments with off-balance sheet risk at September 30, 2018 and December 31, 2017 (in thousands):

| | September 30, 2018 | | December 31, 2017 | |
|---|---|---|---|---|
| | Fixed Rate | Variable Rate | Fixed Rate | Variable Rate |
| Commitments to make loans | $14,516 | $26,544 | $16,019 | $28,591 |
| Unused lines of credit | 1,246 | 202,355 | 1,604 | 200,353 |
| Standby letters of credit | — | 15,627 | — | 15,022 |

On June 15, 2018, the Bank, through mediation, reached a resolution by way of a settlement agreement in the matter of Fane v. Chemung Canal Trust Company (the "Action"). The parties agreed to release each other from any and all liabilities, claims, counterclaims, demands, charges, complaints and causes of action, to dismiss the Action with prejudice, and the Bank agreed to pay Fane $3.3 million in connection with the settlement of the Action. As of March 31, 2018, the Corporation had a legal reserve of $2.3 million for the Action and therefore recognized an additional $1.0 million of legal expense during the second quarter of 2018.

In the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. As of September 30, 2018, we believe that we are not a party to any pending legal, arbitration, or regulatory proceedings that could have a material adverse impact on our financial results or liquidity.

## NOTE 9 ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss represents the net unrealized holding gains or losses on securities available for sale and the funded status of the Corporation's defined benefit pension plan and other benefit plans, as of the consolidated balance sheet dates, net of the related tax effect.

The following is a summary of the changes in accumulated other comprehensive loss by component, net of tax, for the periods indicated (in thousands):

| | Unrealized Gains and Losses on Securities Available for Sale | Defined Benefit and Other Benefit Plans | Total |
|---|---|---|---|
| Balance at July 1, 2018 | $ (7,223) | $(6,898) | $(14,121) |
| Other comprehensive income before reclassification | (1,179) | — | (1,179) |
| Amounts reclassified from accumulated other comprehensive income | — | 13 | 13 |
| Net current period other comprehensive income (loss) | (1,179) | 13 | (1,166) |
| Balance at September 30, 2018 | $ (8,402) | $(6,885) | $(15,287) |

| | Unrealized Gains and Losses on Securities Available for Sale | Defined Benefit and Other Benefit Plans | Total |
|---|---|---|---|
| Balance at July 1, 2017 | $ (615) | $(6,357) | $(6,972) |

| | | | |
|---|---|---|---|
| Other comprehensive loss before reclassification | (324 ) | — | (324 ) |
| Amounts reclassified from accumulated other comprehensive income | — | 21 | 21 |
| Net current period other comprehensive income (loss) | (324 ) | 21 | (303 ) |
| Balance at September 30, 2017 | $ (939 ) | $(6,336) | $(7,275) |

| | Unrealized Gains and Losses on Securities Available for Sale | Defined Benefit and Other Benefit Plans | Total |
|---|---|---|---|
| Balance at January 1, 2018 | $ (3,415 ) | $(6,925) | $(10,340) |
| Cumulative effect of account change | (202 ) | — | (202 ) |
| Balance at January 1, 2018, as adjusted | (3,617 ) | (6,925 ) | (10,542 ) |
| Other comprehensive income before reclassification | (4,785 ) | — | (4,785 ) |
| Amounts reclassified from accumulated other comprehensive income | — | 40 | 40 |
| Net current period other comprehensive income (loss) | (4,785 ) | 40 | (4,745 ) |
| Balance at September 30, 2018 | $ (8,402 ) | $(6,885) | $(15,287) |

| | Unrealized Gains and Losses on Securities Available for Sale | Defined Benefit and Other Benefit Plans | Total |
|---|---|---|---|
| Balance at January 1, 2017 | $ (4,356 ) | $(6,398) | $(10,754) |
| Other comprehensive income before reclassification | 3,425 | — | 3,425 |
| Amounts reclassified from accumulated other comprehensive income | (8 ) | 62 | 54 |
| Net current period other comprehensive income | 3,417 | 62 | 3,479 |
| Balance at September 30, 2017 | $ (939 ) | $(6,336) | $(7,275 ) |

The following is the reclassification out of accumulated other comprehensive income for the periods indicated (in thousands):

| Details about Accumulated Other Comprehensive Income Components | Three Months Ended September 30, 2018 | 2017 | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|---|
| Unrealized gains and losses on securities available for sale: | | | |
| Realized gains on securities available for sale | $— | $— | Net gains (losses) on securities transactions |
| Tax effect | — | — | Income tax expense |
| Net of tax | — | — | |
| Amortization of defined pension plan and other benefit plan items: | | | |
| Prior service costs (a) | (55 ) | (55 ) | Other components of net periodic pension and postretirement benefits |
| Actuarial losses (a) | 72 | 88 | Other components of net periodic pension and postretirement benefits |
| Tax effect | (4 ) | (12 ) | Income tax expense |
| Net of tax | 13 | 21 | |
| Total reclassification for the period, net of tax | $13 | $21 | |

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and other benefit plan costs (see Note 11 for additional information).

| Details about Accumulated Other Comprehensive Income Components | Nine Months Ended September 30, 2018 | 2017 | Affected Line Item in the Statement Where Net Income is Presented |
|---|---|---|---|
| Unrealized gains and losses on securities available for sale: | | | |
| Realized gains on securities available for sale | $— | $(12) | Net gains (losses) on securities transactions |
| Tax effect | — | 4 | Income tax expense |
| Net of tax | — | (8) | |
| Amortization of defined pension plan and other benefit plan items: | | | |
| Prior service costs (a) | (165) | (165) | Other components of net periodic pension and postretirement benefits |
| Actuarial losses (a) | 218 | 264 | Other components of net periodic pension and postretirement benefits |
| Tax effect | (13) | (37) | Income tax expense |
| Net of tax | 40 | 62 | |
| Total reclassification for the period, net of tax | $40 | $54 | |

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and other benefit plan costs (see Note 11 for additional information).

## NOTE 10 REVENUE FROM CONTRACTS WITH CUSTOMERS

All of the Corporation's revenue from contracts with customers in the scope of ASC 606 is recognized within non-interest income. The following tables present the Corporation's non-interest income by revenue stream and reportable segment for the three and nine months ended September 30, 2018 and 2017 (in thousands). Items outside the scope of ASC 606 are noted as such.

| | Three Months Ended September 30, 2018 | | | |
|---|---|---|---|---|
| Revenue by Operating Segment: | Core Banking | WMG | Holding Company, CFS, and CRM[c] | Total |
| Non-interest income | | | | |
| Service charges on deposit accounts | | | | |
| Overdraft fees | $1,035 | $— | $ — | $1,035 |
| Other | 196 | — | — | 196 |
| Interchange revenue from debit card transactions | 982 | — | — | 982 |
| WMG fee income | — | 2,406 | — | 2,406 |
| CFS fee and commission income | — | — | 120 | 120 |
| Net gains (losses) on sales of OREO | 123 | — | — | 123 |
| Net gains on sales of loans[a] | 79 | — | — | 79 |
| Loan servicing fees[a] | 22 | — | — | 22 |
| Changes in fair value of equity investments[a] | 2,140 | — | 1 | 2,141 |
| Other[a] | 410 | — | (133) | 277 |

| | | | | |
|---|---|---|---|---|
| Total non-interest income (loss) | $4,987 | $2,406 | $ (12 ) | $7,381 |

| Revenue by Operating Segment: | Three Months Ended September 30, 2017 (b) | | | |
|---|---|---|---|---|
| | Core Banking | WMG | Holding Company, CFS, and CRM[c] | Total |
| Non-interest income | | | | |
| Service charges on deposit accounts | | | | |
| Overdraft fees | $1,142 | $— | $ — | $1,142 |
| Other | 127 | — | — | 127 |
| Interchange revenue from debit card transactions | 925 | — | — | 925 |
| WMG fee income | — | 2,147 | — | 2,147 |
| CFS fee and commission income | — | — | 139 | 139 |
| Net gains (losses) on sales of OREO | 30 | — | — | 30 |
| Net gains on sales of loans[a] | 71 | — | — | 71 |
| Loan servicing fees[a] | 21 | — | — | 21 |
| Net gains on sales of securities[a] | — | — | — | — |
| Changes in fair value of equity investments[a] | 32 | — | — | 32 |
| Other[a] | 641 | — | (109) | 532 |
| Total non-interest income | $2,989 | $2,147 | $ 30 | $5,166 |

(a) Not within scope of ASC 606.
(b) The Corporation elected the modified retrospective approach of adoption; therefore, prior period balances are presented under legacy GAAP and may not be comparable to current year presentation.
(c) The Holding Company, CFS, and CRM column above includes amounts to eliminate transactions between segments.

| Revenue by Operating Segment: | Nine Months Ended September 30, 2018 | | | |
|---|---|---|---|---|
| | Core Banking | WMG | Holding Company, CFS, and CRM[c] | Total |
| Non-interest income | | | | |
| Service charges on deposit accounts | | | | |
| Overdraft fees | $2,939 | $— | $ — | $2,939 |
| Other | 600 | — | — | 600 |
| Interchange revenue from debit card transactions | 3,013 | — | — | 3,013 |
| WMG fee income | — | 7,095 | — | 7,095 |
| CFS fee and commission income | — | — | 365 | 365 |
| Net gains (losses) on sales of OREO | 119 | — | — | 119 |
| Net gains on sales of loans[a] | 184 | — | — | 184 |
| Loan servicing fees[a] | 67 | — | — | 67 |
| Changes in fair value of equity investments[a] | 2,148 | — | 17 | 2,165 |
| Other[a] | 1,922 | — | (288) | 1,634 |
| Total non-interest income | $10,992 | $7,095 | $ 94 | $18,181 |

| Revenue by Operating Segment: | Nine Months Ended September 30, 2017 (b) Core Banking | WMG | Holding Company, CFS, and CRM[c] | Total |
|---|---|---|---|---|
| Non-interest income | | | | |
| Service charges on deposit accounts | | | | |
| Overdraft fees | $3,092 | $— | $ — | $3,092 |
| Other | 586 | — | — | 586 |
| Interchange revenue from debit card transactions | 2,809 | — | — | 2,809 |
| WMG fee income | — | 6,525 | — | 6,525 |
| CFS fee and commission income | — | — | 452 | 452 |
| Net gains on sales of OREO | 38 | — | — | 38 |
| Net gains on sales of loans[a] | 193 | — | — | 193 |
| Loan servicing fees[a] | 62 | — | — | 62 |
| Net gains on sales of securities[a] | 12 | — | — | 12 |
| Change in fair value of equity securities[a] | 96 | — | — | 96 |
| Other[a] | 1,340 | — | (170) | 1,170 |
| Total non-interest income | $8,228 | $6,525 | $ 282 | $15,035 |

(a) Not within scope of ASC 606.
(b) The Corporation elected the modified retrospective approach of adoption; therefore, prior period balances are presented under legacy GAAP and may not be comparable to current year presentation.
(c) The Holding Company, CFS, and CRM column above includes amounts to eliminate transactions between segments.

A description of the Corporation's revenue streams accounted for under ASC 606 follows:

Service Charges on Deposit Accounts:  The Corporation earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which included services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are recognized at the time the maintenance occurs. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Interchange Income from Debit Card Transactions:  The Corporation earns interchange fees from debit cardholder transactions conducted through the Mastercard payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to cardholder.

WMG Fee Income (Gross):  The Corporation earns wealth management fees from its contracts with trust customers to manage assets for investment, and/or to conduct transactions on their accounts. These fees are primarily earned over time as the Corporation provides the contracted monthly or quarterly services and are generally assessed based on a tiered scale of the market value of assets under management (AUM) at quarter-end.

CFS Fee and Commission Income (Net):  The Corporation earns fees from investment brokerage services provided to its customers by a third-party service provider. The Corporation receives commissions from the third-party service provider on a monthly basis based upon customer activity for the month. The Corporation (i) acts as an agent in arranging the relationship between the customer and the third-party service provider and (ii) does not control the services rendered to the customers. Investment brokerage fees are presented net of related costs. The Corporation also earns fees from tax services provided to its customers.

Net Gains/Losses on Sales of OREO: The Corporation records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Corporation adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

## NOTE 11 COMPONENTS OF QUARTERLY AND YEAR TO DATE NET PERIODIC BENEFIT COSTS

The components of net periodic expense for the Corporation's pension and other benefit plans for the periods indicated are as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Qualified Pension Plan | | | | |
| Service cost, benefits earned during the period | $— | $— | $— | $— |
| Interest cost on projected benefit obligation | 385 | 403 | 1,154 | 1,209 |
| Expected return on plan assets | (826 ) | (785 ) | (2,478 ) | (2,355) |
| Amortization of unrecognized transition obligation | — | — | — | — |
| Amortization of unrecognized prior service cost | — | — | — | — |
| Amortization of unrecognized net loss | 43 | 58 | 130 | 174 |
| Net periodic pension benefit | $(398) | $(324) | $(1,194) | $(972) |
| | | | | |
| Supplemental Pension Plan | | | | |
| Service cost, benefits earned during the period | $— | $— | $— | $— |
| Interest cost on projected benefit obligation | 12 | 12 | 36 | 36 |
| Expected return on plan assets | — | — | — | — |
| Amortization of unrecognized prior service cost | — | — | — | — |
| Amortization of unrecognized net loss | 1 | 1 | 5 | 3 |
| Net periodic supplemental pension cost | $13 | $13 | $41 | $39 |
| | | | | |
| Postretirement Plan, Medical and Life | | | | |
| Service cost, benefits earned during the period | $— | $— | $— | $— |
| Interest cost on projected benefit obligation | 4 | 3 | 11 | 11 |
| Expected return on plan assets | — | — | — | — |
| Amortization of unrecognized prior service cost | (55 ) | (55 ) | (165 ) | (165 ) |
| Amortization of unrecognized net loss | 28 | 29 | 83 | 87 |
| Net periodic postretirement, medical and life benefit | $(23 ) | $(23 ) | $(71 ) | $(67 ) |

## NOTE 12 SEGMENT REPORTING

The Corporation manages its operations through two primary business segments: core banking and WMG. The core banking segment provides revenues by attracting deposits from the general public and using such funds to originate consumer, commercial, commercial real estate, and residential mortgage loans, primarily in the Corporation's local markets, and to invest in securities. The WMG services segment provides revenues by providing trust and investment advisory services to clients.

Accounting policies for the segments are the same as those described in Note 1 of the Corporation's 2017 Annual Report on Form 10-K, which was filed with the SEC on March 8, 2018. Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results are shown in the following table. Income taxes are allocated based on the separate taxable income of each entity and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. The

Holding Company, CFS, and CRM column below includes amounts to eliminate transactions between segments (in thousands).

40

| | Three months ended September 30, 2018 | | | |
|---|---|---|---|---|
| | Core Banking | WMG | Holding Company, CFS, and CRM | Consolidated Totals |
| Interest and dividend income | $16,122 | $— | $ 14 | $ 16,136 |
| Interest expense | 1,057 | — | — | 1,057 |
| Net interest income | 15,065 | — | 14 | 15,079 |
| Provision for loan losses | 300 | — | — | 300 |
| Net interest income after provision for loan losses | 14,765 | — | 14 | 14,779 |
| Other non-interest income | 4,987 | 2,406 | (12) | 7,381 |
| Other non-interest expenses | 11,871 | 1,307 | 250 | 13,428 |
| Income (loss) before income tax expense (benefit) | 7,881 | 1,099 | (248) | 8,732 |
| Income tax expense (benefit) | 1,555 | 281 | (34) | 1,802 |
| Segment net income (loss) | $6,326 | $ 818 | $ (214) | $ 6,930 |

| | Three months ended September 30, 2017 | | | |
|---|---|---|---|---|
| | Core Banking | WMG | Holding Company, CFS, and CRM | Consolidated Totals |
| Interest and dividend income | $15,487 | $— | $ 10 | $ 15,497 |
| Interest expense | 734 | — | — | 734 |
| Net interest income | 14,753 | — | 10 | 14,763 |
| Provision for loan losses | 1,289 | — | — | 1,289 |
| Net interest income after provision for loan losses | 13,464 | — | 10 | 13,474 |
| Other non-interest income | 2,989 | 2,147 | 30 | 5,166 |
| Other non-interest expenses | 11,651 | 1,370 | 255 | 13,276 |
| Income (loss) before income tax expense (benefit) | 4,802 | 777 | (215) | 5,364 |
| Income tax expense (benefit) | 1,457 | 295 | (42) | 1,710 |
| Segment net income (loss) | $3,345 | $ 482 | $ (173) | $ 3,654 |

| | Nine months ended September 30, 2018 | | | |
|---|---|---|---|---|
| | Core Banking | WMG | Holding Company, CFS, and CRM | Consolidated Totals |
| Interest and dividend income | $47,645 | $— | $ 29 | $47,674 |
| Interest expense | 2,678 | — | — | 2,678 |
| Net interest income | 44,967 | — | 29 | 44,996 |
| Provision for loan losses | 3,371 | — | — | 3,371 |
| Net interest income after provision for loan losses | 41,596 | — | 29 | 41,625 |
| Other non-interest income | 10,992 | 7,095 | 94 | 18,181 |
| Legal settlements | 989 | — | — | 989 |
| Other non-interest expenses | 36,300 | 4,414 | 858 | 41,572 |
| Income (loss) before income tax expense (benefit) | 15,299 | 2,681 | (735) | 17,245 |
| Income tax expense (benefit) | 2,791 | 684 | (126) | 3,349 |
| Segment net income (loss) | $12,508 | $1,997 | $ (609) | $13,896 |

| | | | | |
|---|---|---|---|---|
| Segment assets | $1,740,311 | $3,800 | $ 9,753 | $1,753,864 |

41

| | Nine months ended September 30, 2017 | | | |
|---|---|---|---|---|
| | Core Banking | WMG | Holding Company, CFS, and CRM | Consolidated Totals |
| Interest and dividend income | $44,478 | $— | $ 17 | $ 44,495 |
| Interest expense | 2,288 | — | — | 2,288 |
| Net interest income | 42,190 | — | 17 | 42,207 |
| Provision for loan losses | 2,750 | — | — | 2,750 |
| Net interest income after provision for loan losses | 39,440 | — | 17 | 39,457 |
| Other non-interest income | 8,228 | 6,525 | 282 | 15,035 |
| Legal accruals and settlements | 850 | — | — | 850 |
| Other non-interest expenses | 34,795 | 4,142 | 866 | 39,803 |
| Income (loss) before income tax expense (benefit) | 12,023 | 2,383 | (567 ) | 13,839 |
| Income tax expense (benefit) | 3,523 | 904 | (177 ) | 4,250 |
| Segment net income (loss) | $8,500 | $1,479 | $ (390 ) | $ 9,589 |
| | | | | |
| Segment assets | $1,721,571 | $4,112 | $ 5,999 | $ 1,731,682 |

NOTE 13 STOCK COMPENSATION

Board of Directors' Stock Compensation

Pursuant to the Corporation's Directors' Compensation Plan, members of the Board of Directors receive common shares of the Corporation equal in value to the amount of fees individually earned during the previous year for service as a director. The common shares are distributed to the Corporation's individual board members from treasury shares of the Corporation on or about January 15 following the calendar year of service.

Additionally, the Chief Executive Officer of the Corporation, who does not receive cash compensation as a member of the Board of Directors, is awarded common shares equal in value to the average of those awarded to board members not employed by the Corporation who have served for 12 months during the prior year.

During January 2018 and 2017, 6,015 and 7,880 shares, respectively, were re-issued from treasury to fund the stock component of directors' compensation. An expense of $86 thousand and $68 thousand related to this compensation was recognized during the three month periods ended September 30, 2018 and 2017, respectively. An expense of $271 thousand and $222 thousand related to this compensation was recognized during the nine month periods ended September 30, 2018 and 2017, respectively. This expense is accrued as shares are earned.

Restricted Stock Plan

Pursuant to the Corporation's Restricted Stock Plan, the Corporation may make discretionary grants of restricted stock to officers other than the Corporation's Chief Executive Officer. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date.

A summary of restricted stock activity for the three month period ended September 30, 2018 is presented below:

| | Shares | Weighted–Average Grant Date Fair Value |
|---|---|---|
| Nonvested at July 1, 2018 | 23,084 | $ 37.88 |
| Granted | — | — |
| Vested | — | — |
| Forfeited or cancelled | — | — |
| Nonvested at September 30, 2018 | 23,084 | $ 37.88 |

A summary of restricted stock activity for the nine month period ended September 30, 2018 is presented below:

| | Shares | Weighted–Average Grant Date Fair Value |
|---|---|---|
| Nonvested at January 1, 2018 | 25,522 | $ 38.01 |
| Granted | — | — |
| Vested | (2,438 ) | 39.28 |
| Forfeited or cancelled | — | — |
| Nonvested at September 30, 2018 | 23,084 | $ 37.88 |

As of September 30, 2018, there was $654 thousand of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.08 years. The total fair value of shares vested was $112 thousand and $16 thousand for the nine month periods ended September 30, 2018 and 2017, respectively.

## Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

### Introduction

The following is the MD&A of the Corporation in this Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2018 and 2017. Reference should be made to the accompanying unaudited consolidated financial statements and footnotes, and the Corporation’s 2017 Annual Report on Form 10-K, which was filed with the SEC on March 8, 2018, for an understanding of the following discussion and analysis. See the list of commonly used abbreviations and terms on pages 3–5.

The MD&A included in this Form 10-Q contains statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on the current beliefs and expectations of the Corporation's management and are subject to significant risks and uncertainties. Actual results may differ from those set forth in the forward-looking statements. For a discussion of those risks and uncertainties and the factors that could cause the Corporation’s actual results to differ materially from those risks and uncertainties, see Forward-looking Statements below and in Part I, Item 1A, Risk Factors, on pages 17–24 of the Corporation’s 2017 Form 10-K. For a discussion of use of non-GAAP financial measures, see pages 64–67 of the Corporation's 2017 Form 10-K or pages 71-74 in this Form 10-Q.

The Corporation has been a financial holding company since 2000, the Bank was established in 1833, CFS in 2001, and CRM in 2016. Through the Bank and CFS, the Corporation provides a wide range of financial services, including demand, savings and time deposits, commercial, residential and consumer loans, interest rate swaps, letters of credit, wealth management services, employee benefit plans, insurance products, mutual funds and brokerage services. The

Bank relies substantially on a foundation of locally generated deposits. The Corporation, on a stand-alone basis, has minimal results of operations. The Bank derives its income primarily from interest and fees on loans, interest income on investment securities, WMG fee income, and fees received in connection with deposit and other services. The Bank's operating expenses are interest expense paid on deposits and borrowings, salaries and employee benefit plans, and general operating expenses. CRM is a Nevada-based captive insurance company which insures against certain risks unique to the operations of the Corporation and its subsidiaries and for which insurance may not be currently available or economically feasible in today's insurance marketplace. CRM pools resources with several other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves.

Forward-looking Statements

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot guarantee that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing the Corporation’s growth, competition, changes in law or the regulatory environment, including the Dodd-Frank Act, and changes in general business and economic trends. Information concerning these and other factors can be found in the Corporation’s periodic filings with the SEC, including the discussion under the heading “Item 1A. Risk Factors” in the Corporation’s 2017 Annual Report on Form 10-K. These filings are available publicly on the SEC’s web site at http://www.sec.gov, on the Corporation's web site at http://www.chemungcanal.com or upon request from the Corporate Secretary at (607) 737-3746. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

Consolidated Financial Highlights

| | As of or for the Three Months Ended | | | | | As of or for the Nine Months Ended | |
|---|---|---|---|---|---|---|---|
| | Sept. 30 | June 30, | March 31, | Dec. 31, | Sept. 30, | Sept. 30, | Sept. 30, |
| (in thousands, except per share data) | 2018 | 2018 | 2018 | 2017 | 2017 | 2018 | 2017 |
| RESULTS OF OPERATIONS | | | | | | | |
| Interest income | $16,136 | $15,869 | $15,669 | $15,560 | $15,497 | $47,674 | $44,495 |
| Interest expense | 1,057 | 852 | 769 | 780 | 734 | 2,678 | 2,288 |
| Net interest income | 15,079 | 15,017 | 14,900 | 14,780 | 14,763 | 44,996 | 42,207 |
| Provision for loan losses | 300 | 2,362 | 709 | 6,272 | 1,289 | 3,371 | 2,750 |
| Net interest income after provision for loan losses | 14,779 | 12,655 | 14,191 | 8,508 | 13,474 | 41,625 | 39,457 |
| Non-interest income | 7,381 | 5,325 | 5,475 | 5,456 | 5,166 | 18,181 | 15,035 |
| Non-interest expense | 13,428 | 14,967 | 14,166 | 13,111 | 13,276 | 42,561 | 40,653 |
| Income before income tax expense | 8,732 | 3,013 | 5,500 | 853 | 5,364 | 17,245 | 13,839 |
| Income tax expense | 1,802 | 486 | 1,061 | 3,012 | 1,710 | 3,349 | 4,250 |
| Net income (loss) | $6,930 | $2,527 | $4,439 | $(2,159) | $3,654 | $13,896 | $9,589 |
| | | | | | | | |
| Basic and diluted earnings per share | $1.43 | $0.52 | $0.92 | $(0.45) | $0.76 | $2.88 | $2.00 |
| Average basic and diluted shares outstanding | 4,834 | 4,828 | 4,822 | 4,809 | 4,802 | 4,828 | 4,796 |
| | | | | | | | |
| PERFORMANCE RATIOS - Annualized | | | | | | | |
| Return on average assets | 1.61 % | 0.59 % | 1.06 % | (0.50)% | 0.85 % | 1.09 % | 0.75 % |
| Return on average equity | 17.81 % | 6.70 % | 11.96 % | (5.53)% | 9.46 % | 12.22 % | 8.54 % |
| Return on average tangible equity (a) | 21.01 % | 7.94 % | 14.21 % | (6.55)% | 11.24 % | 14.47 % | 10.21 % |
| Efficiency ratio (a) (b) | 64.72 % | 67.47 % | 68.21 % | 63.43 % | 64.83 % | 66.80 % | 67.72 % |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Non-interest expense to average assets | 3.13 % | 3.52 % | 3.37 % | 3.01 % | 3.09 % | 3.34 % | 3.18 % |
| Loans to deposits | 83.80 % | 90.23 % | 86.94 % | 89.40 % | 83.85 % | 83.80 % | 83.85 % |
| | | | | | | | |
| YIELDS / RATES - Fully Taxable Equivalent | | | | | | | |
| Yield on loans | 4.36 % | 4.33 % | 4.34 % | 4.26 % | 4.34 % | 4.34 % | 4.24 % |
| Yield on investments | 2.18 % | 2.21 % | 2.22 % | 2.15 % | 2.16 % | 2.20 % | 2.05 % |
| Yield on interest-earning assets | 3.96 % | 3.94 % | 3.94 % | 3.82 % | 3.86 % | 3.95 % | 3.72 % |
| Cost of interest-bearing deposits | 0.33 % | 0.24 % | 0.20 % | 0.20 % | 0.20 % | 0.25 % | 0.20 % |
| Cost of borrowings | 2.38 % | 2.41 % | 2.23 % | 2.42 % | 2.95 % | 2.33 % | 2.95 % |
| Cost of interest-bearing liabilities | 0.39 % | 0.32 % | 0.29 % | 0.28 % | 0.27 % | 0.33 % | 0.27 % |
| Interest rate spread | 3.57 % | 3.62 % | 3.65 % | 3.54 % | 3.59 % | 3.62 % | 3.45 % |
| Net interest margin, fully taxable equivalent | 3.71 % | 3.73 % | 3.75 % | 3.63 % | 3.68 % | 3.73 % | 3.53 % |
| | | | | | | | |
| CAPITAL | | | | | | | |
| Total equity to total assets at end of period | 8.92 % | 8.88 % | 8.84 % | 8.77 % | 8.91 % | 8.92 % | 8.91 % |
| Tangible equity to tangible assets at end of period (a) | 7.69 % | 7.60 % | 7.55 % | 7.48 % | 7.62 % | 7.69 % | 7.62 % |
| | | | | | | | |
| Book value per share | $32.35 | $31.42 | $31.16 | $31.10 | $32.11 | $32.35 | $32.11 |
| Tangible book value per share (a) | 27.53 | 26.55 | 26.24 | 26.14 | 27.09 | 27.53 | 27.09 |
| Period-end market value per share | 42.43 | 50.11 | 46.47 | 48.10 | 47.10 | 42.43 | 47.10 |
| Dividends declared per share | 0.26 | 0.26 | 0.26 | 0.26 | 0.26 | 0.78 | 0.78 |
| | | | | | | | |
| AVERAGE BALANCES | | | | | | | |
| | $1,330,071 | $1,328,386 | $1,315,207 | $1,291,414 | $1,259,919 | $1,324,610 | $1,237,681 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Loans and loans held for sale (c) | | | | | | | |
| Earning assets | 1,625,132 | 1,625,591 | 1,623,748 | 1,639,257 | 1,615,833 | 1,624,830 | 1,618,788 |
| Total assets | 1,704,721 | 1,703,722 | 1,703,047 | 1,727,616 | 1,707,111 | 1,703,834 | 1,708,360 |
| Deposits | 1,501,082 | 1,495,410 | 1,488,708 | 1,516,390 | 1,512,685 | 1,495,111 | 1,513,804 |
| Total equity | 154,331 | 151,216 | 150,495 | 154,767 | 153,244 | 152,026 | 150,038 |
| Tangible equity (a) | 130,891 | 127,591 | 126,665 | 130,759 | 129,024 | 128,396 | 125,603 |
| | | | | | | | |
| ASSET QUALITY | | | | | | | |
| Net charge-offs | $310 | $4,107 | $480 | $805 | $699 | $4,897 | $1,309 |

45

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Non-performing loans (d) | 12,629 | 12,790 | 17,280 | 17,324 | 14,028 | 12,629 | 14,028 |
| Non-performing assets (e) | 13,356 | 13,676 | 19,113 | 19,264 | 14,216 | 13,356 | 14,216 |
| Allowance for loan losses | 19,635 | 19,645 | 21,390 | 21,161 | 15,694 | 19,635 | 15,694 |
| | | | | | | | |
| Annualized net charge-offs to average loans | 0.09 % | 1.24 % | 0.15 % | 0.25 % | 0.22 % | 0.49 % | 0.14 % |
| Non-performing loans to total loans | 0.96 % | 0.96 % | 1.31 % | 1.32 % | 1.09 % | 0.96 % | 1.09 % |
| Non-performing assets to total assets | 0.76 % | 0.80 % | 1.12 % | 1.13 % | 0.82 % | 0.76 % | 0.82 % |
| Allowance for loan losses to total loans | 1.49 % | 1.47 % | 1.62 % | 1.61 % | 1.22 % | 1.49 % | 1.22 % |
| Allowance for loan losses to non-performing loans | 155.48 % | 153.60 % | 123.78 % | 122.15 % | 111.88 % | 155.48 % | 111.88 % |

(a) See the GAAP to Non-GAAP reconciliations.
(b) Efficiency ratio is non-interest expense less amortization of intangible assets less legal reserve divided by the total of fully taxable equivalent net interest income plus non-interest income less changes in fair value of equity investments less net gains on securities transactions.
(c) Loans and loans held for sale do not reflect the allowance for loan losses.
(d) Non-performing loans include non-accrual loans only.
(e) Non-performing assets include non-performing loans plus other real estate owned.

In addition to analyzing the Corporation's results on a reported basis, management uses certain non-GAAP financial measures because it believes these non-GAAP financial measures provide information to investors about the underlying operational performance and trends of the Corporation and, therefore, facilitate a comparison of the Corporation with the performance of its competitors. Non-GAAP financial measures used by the Corporation may not be comparable to similarly named non-GAAP financial measures used by other companies. Refer to pages 71-74 for further explanation and reconciliation of the Corporation's use of non-GAAP measures.

Executive Summary

This executive summary of the MD&A includes selected information and may not contain all of the information that is important to readers of this Form 10-Q. For a complete description of the trends and uncertainties, as well as the risks and critical accounting estimates affecting the Corporation, this Form 10-Q should be read in its entirety.

The following table presents selected financial information for the periods indicated, and the dollar and percent change (in thousands, except per share and ratio data):

| | Three Months Ended September 30, | | | |
|---|---|---|---|---|
| | 2018 | 2017 | Change | Percentage Change |
| Net interest income | $15,079 | $14,763 | $316 | 2.1 % |
| Non-interest income | 7,381 | 5,166 | 2,215 | 42.9 % |
| Non-interest expense | 13,428 | 13,276 | 152 | 1.1 % |
| Pre-provision income | 9,032 | 6,653 | 2,379 | 35.8 % |
| Provision for loan losses | 300 | 1,289 | (989 ) | (76.7 )% |
| Income tax expense | 1,802 | 1,710 | 92 | 5.4 % |
| Net income | $6,930 | $3,654 | $3,276 | 89.7 % |
| | | | | |
| Basic and diluted earnings per share | $1.43 | $0.76 | $0.67 | 88.2 % |
| | | | | |
| Selected financial ratios: | | | | |
| Return on average assets | 1.61 % | 0.85 % | | |

| | | | | |
|---|---|---|---|---|
| Return on average equity | 17.81 | % | 9.46 | % |
| Net interest margin, fully taxable equivalent | 3.71 | % | 3.68 | % |
| Efficiency ratio | 64.72 | % | 64.83 | % |
| Non-interest expenses to average assets | | | | |