

COMMUNITY BANK SYSTEM, INC.
Form 10-Q
November 09, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

OR

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

For the transition period from _____ to _____ .

Commission File Number: 001-13695

(Exact name of registrant as specified in its charter)

Delaware 16 1213679
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

5790 Widewaters Parkway, DeWitt, New York 13214-1883
(Address of principal executive offices) (Zip Code)

(315) 445 2282
(Registrant's telephone number, including area code)

NONE

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted to its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes No .

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

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

(Do not check if a smaller reporting
company)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

44,380,735 shares of Common Stock, \$1.00 par value per share, were outstanding on October 31, 2016.

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Part I. Financial Information

Item 1. Financial Statements

COMMUNITY BANK SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CONDITION (Unaudited)
(In Thousands, Except Share Data)

	September 30, 2016	December 31, 2015
Assets:		
Cash and cash equivalents	\$ 161,542	\$ 153,210
Available-for-sale investment securities (cost of \$2,702,088 and \$2,742,278, respectively)	2,842,255	2,808,113
Other securities, at cost	35,389	39,827
Loans held for sale, at fair value	633	932
Loans	4,940,621	4,801,375
Allowance for loan losses	(46,789)	(45,401)
Net loans	4,893,832	4,755,974
Goodwill, net	465,142	463,252
Core deposit intangibles, net	7,713	9,789
Other intangibles, net	9,264	11,105
Intangible assets, net	482,119	484,146
Premises and equipment, net	111,484	114,434
Accrued interest and fees receivable	28,700	25,904
Other assets	171,792	170,129
Total assets	\$8,727,746	\$8,552,669
Liabilities:		
Noninterest-bearing deposits	\$ 1,577,194	\$ 1,499,616
Interest-bearing deposits	5,500,225	5,373,858
Total deposits	7,077,419	6,873,474
Borrowings	133,900	301,300
Subordinated debt held by unconsolidated subsidiary trusts	102,164	102,146
Accrued interest and other liabilities	173,681	135,102
Total liabilities	7,487,164	7,412,022
Commitments and contingencies (See Note J)		
Shareholders' equity:		
Preferred stock, \$1.00 par value, 500,000 shares authorized, 0 shares issued	0	0
Common stock, \$1.00 par value, 75,000,000 shares authorized; 44,856,077 and 44,442,568		
shares issued, respectively	44,857	44,443
Additional paid-in capital	540,549	528,015
Retained earnings	602,513	566,591

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Accumulated other comprehensive income	66,091	19,235
Treasury stock, at cost (498,681 and 667,708 shares, respectively)	(13,428)	(17,637)
Total shareholders' equity	1,240,582	1,140,647
Total liabilities and shareholders' equity	\$8,727,746	\$8,552,669

The accompanying notes are an integral part of the consolidated financial statements.

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COMMUNITY BANK SYSTEM, INC.
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
(In Thousands, Except Per-Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Interest income:				
Interest and fees on loans	\$53,706	\$47,040	\$157,865	\$138,422
Interest and dividends on taxable investments	13,344	13,454	40,956	38,802
Interest on nontaxable investments	4,272	4,790	13,367	14,394
Total interest income	71,322	65,284	212,188	191,618
Interest expense:				
Interest on deposits	1,776	1,694	5,542	5,225
Interest on borrowings	337	587	835	1,081
Interest on subordinated debt held by unconsolidated subsidiary trusts	746	640	2,161	1,881
Total interest expense	2,859	2,921	8,538	8,187
Net interest income	68,463	62,363	203,650	183,431
Provision for loan losses	1,790	1,906	5,436	3,120
Net interest income after provision for loan losses	66,673	60,457	198,214	180,311
Noninterest revenues:				
Deposit service fees	14,894	13,459	43,636	39,142
Other banking services	2,863	2,045	6,039	3,899
Employee benefit services	11,267	11,330	34,949	33,727
Insurance revenues	5,702	367	17,340	1,091
Wealth management services	5,226	4,185	15,041	12,292
Total noninterest revenues	39,952	31,386	117,005	90,151
Noninterest expenses:				
Salaries and employee benefits	38,300	31,179	115,388	93,218
Occupancy and equipment	7,373	6,652	22,445	20,891
Data processing and communications	8,744	7,643	25,886	22,106
Amortization of intangible assets	1,359	843	4,204	2,642
Legal and professional fees	1,928	1,564	6,302	4,952
Office supplies and postage	1,713	1,636	5,336	4,733
Business development and marketing	2,004	1,889	6,167	5,711
FDIC insurance premiums	707	968	2,899	2,920
Acquisition expenses	2	562	342	1,318
Other expenses	4,096	3,143	11,282	9,584
Total noninterest expenses	66,226	56,079	200,251	168,075
Income before income taxes	40,399	35,764	114,968	102,387
Income taxes	13,239	10,742	37,548	31,228
Net income	\$27,160	\$25,022	\$77,420	\$71,159
Basic earnings per share	\$0.61	\$0.61	\$1.75	\$1.74

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Diluted earnings per share	\$0.61	\$0.60	\$1.74	\$1.72
Cash dividends declared per share	\$0.32	\$0.31	\$0.94	\$0.91

The accompanying notes are an integral part of the consolidated financial statements.

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COMMUNITY BANK SYSTEM, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
(In Thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
<u>Pension and other post retirement obligations:</u>				
Amortization of actuarial losses included in net periodic pension cost, gross	\$ 376	\$ 363	\$ 1,127	\$ 1,090
Tax effect	(144)	(140)	(432)	(421)
Amortization of actuarial losses included in net periodic pension cost, net	232	223	695	669
Amortization of prior service cost included in net periodic pension cost, gross	(34)	(43)	(101)	(127)
Tax effect	13	16	39	49
Amortization of prior service cost included in net periodic pension cost, net	(21)	(27)	(62)	(78)
Other comprehensive income related to pension and other post retirement obligations, net of taxes	211	196	633	591
<u>Unrealized gains/(losses) on available-for-sale securities:</u>				
Net unrealized holding (losses)/gains arising during period, gross	(24,465)	44,019	74,332	25,819
Tax effect	9,310	(16,979)	(28,109)	(11,223)
Net unrealized holding (losses)/gains arising during period, net	(15,155)	27,040	46,223	14,596
Other comprehensive (loss)/income related to unrealized (losses)/gains on available-for-sale securities, net of taxes	(15,155)	27,040	46,223	14,596
Other comprehensive (loss)/income, net of tax	(14,944)	27,236	46,856	15,187
Net income	27,160	25,022	77,420	71,159
Comprehensive income	\$ 12,216	\$ 52,258	\$ 124,276	\$ 86,346

As of
September 30,
2016

December 31,
2015

Accumulated Other Comprehensive Income By Component:

Unrealized loss for pension and other post-retirement obligations	\$ (33,321)	\$ (34,347)
Tax effect	12,671	13,064
Net unrealized loss for pension and other post-retirement obligations	(20,650)	(21,283)
Unrealized gain on available-for-sale securities	140,167	65,835
Tax effect	(53,426)	(25,317)

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Net unrealized gain on available-for-sale securities	86,741	40,518
Accumulated other comprehensive income	\$ 66,091	\$ 19,235

The accompanying notes are an integral part of the consolidated financial statements.

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COMMUNITY BANK SYSTEM, INC.
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)
Nine months ended September 30, 2016
(In Thousands, Except Share Data)

	Common Stock Shares Outstanding	Common Stock Amount Issued	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance at December 31, 2015	43,774,860	\$44,443	\$528,015	\$566,591	\$ 19,235	\$ (17,637)	\$1,140,647
Net income				77,420			77,420
Other comprehensive income, net of tax					46,856		46,856
Cash dividends declared: Common, \$0.94 per share				(41,498)			(41,498)
Common stock issued under employee stock plan, including tax benefits of \$2,229	413,509	414	7,142				7,556
Stock-based compensation			3,392				3,392
Treasury stock issued to benefit plan, net	169,027		2,000			4,209	6,209
Balance at September 30, 2016	44,357,396	\$44,857	\$540,549	\$602,513	\$ 66,091	\$ (13,428)	\$1,240,582

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(In Thousands)

	Nine Months Ended September 30,	
	2016	2015
Operating activities:		
Net income	\$77,420	\$71,159
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	10,742	9,820
Amortization of intangible assets	4,204	2,642
Net accretion on securities, loans and borrowings	(3,261)	(2,100)
Stock-based compensation	3,392	3,164
Provision for loan losses	5,436	3,120
Amortization of mortgage servicing rights	386	307
Income from bank-owned life insurance policies	(1,124)	(775)
Net gain on sale of loans and other assets	(624)	(48)
Change in other assets and liabilities	3,555	(5,637)
Net cash provided by operating activities	100,126	81,652
Investing activities:		
Proceeds from maturities of available-for-sale investment securities	86,885	131,709
Proceeds from maturities of other investment securities	9,050	172
Purchases of available-for-sale investment securities	(40,463)	(494,436)
Purchases of other securities	(4,612)	(9,947)
Net change in loans	(148,384)	(84,064)
Cash paid for acquisition, net of cash acquired of \$0 and \$0, respectively	(575)	0
Expenditure for intangible asset	0	(100)
Settlement of bank-owned life insurance policies	2,481	0
Purchases of premises and equipment, net	(7,832)	(9,184)
Net cash used in investing activities	(103,450)	(465,850)
Financing activities:		
Net increase in deposits	203,945	212,846
Net change in borrowings	(167,400)	220,100
Issuance of common stock	7,556	8,388
Purchases of treasury stock	(716)	(9,125)
Sales of treasury stock	6,925	5,472
Cash dividends paid	(40,883)	(36,584)
Tax benefits from share-based payment arrangements	2,229	1,541
Net cash provided by financing activities	11,656	402,638
Change in cash and cash equivalents	8,332	18,440
Cash and cash equivalents at beginning of period	153,210	138,396
Cash and cash equivalents at end of period	\$161,542	\$156,836
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$8,557	\$8,249
Cash paid for income taxes	23,717	21,334
Supplemental disclosures of noncash financing and investing activities:		
Dividends declared and unpaid	14,220	12,793
Transfers from loans to other real estate	2,137	2,934

Purchase of intangible asset

0

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The accompanying notes are an integral part of the consolidated financial statements.

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COMMUNITY BANK SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

SEPTEMBER 30, 2016

NOTE A: BASIS OF PRESENTATION

The interim financial data as of and for the three and nine months ended September 30, 2016 is unaudited; however, in the opinion of Community Bank System, Inc. (the "Company"), the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in conformity with generally accepted accounting principles ("GAAP"). The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period.

NOTE B: ACQUISITIONS

Pending Acquisition – Merchants Bancshares, Inc.

On October 24, 2016, the Company announced that it had entered into a definitive agreement to acquire Merchants Bancshares, Inc. ("Merchants"), parent company of Merchants Bank headquartered in South Burlington, Vermont, for approximately \$304 million in Company stock and cash. The acquisition will extend the Company's footprint into the Vermont and Western Massachusetts markets. Upon the completion of the merger, Community Bank will add 31 branch locations in Vermont and one location in Massachusetts with approximately \$1.9 billion of assets, and deposits of \$1.5 billion. The acquisition is expected to close during the second quarter of 2017, pending both customary regulatory and Merchants shareholder approval. The Company expects to incur certain one-time, transaction-related costs in 2016 and 2017.

On January 4, 2016, the Company, through its subsidiary, CBNA Insurance Agency, Inc. ("CBNA Insurance"), completed its acquisition of WJL Agencies Inc. doing business as The Clark Insurance Agencies ("WJL"), an insurance agency operating in northern New York. The Company paid \$0.6 million in cash for the intangible assets of the company. Goodwill in the amount of \$0.3 million and intangible assets in the amount of \$0.3 million were recorded in conjunction with the acquisition. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date. On August 19, 2016, the Company merged together its insurance subsidiaries and as of that date, the activities of CBNA Insurance were merged into OneGroup NY, Inc. ("OneGroup").

On December 4, 2015, the Company completed its acquisition of Oneida Financial Corp. ("Oneida"), parent company of Oneida Savings Bank, headquartered in Oneida, New York for approximately \$158 million in Company stock and cash, comprised of \$56.3 million of cash and the issuance of 2.38 million shares of common stock. Upon the completion of the merger, Community Bank, N.A. ("CBNA" or the "Bank") added 12 branch locations in Oneida and Madison counties and approximately \$769 million of assets, including approximately \$399 million of loans and \$226 million of investment securities, along with \$699 million of deposits. Through the acquisition of Oneida, the Company acquired, among others, OneGroup and Oneida Wealth Management, Inc. ("OWM") as wholly-owned subsidiaries primarily engaged in offering insurance and investment advisory services. These subsidiaries complement the Company's other non-banking financial services businesses. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date.

The assets and liabilities assumed in the acquisitions were recorded at their estimated fair values based on management's best estimates using information available at the date of the acquisition, and were subject to adjustment based on updated information not available at the time of acquisition. During the first quarter of 2016, the carrying amount of other assets decreased by \$0.9 million and other liabilities increased by \$0.7 million as a result of adjustments made to fair value estimates recorded for the Oneida acquisition. Other assets decreased as a result of new information obtained related to the fair value calculation of loans partially offset by a decrease in the fair value adjustment made to accounts receivable for uncollectible accounts as actual cash receipts exceed anticipated cash

receipts. Other liabilities increased as a result of updated information related to deferred taxes. Goodwill increased \$1.6 million as a result of these changes in fair value estimates.

The above referenced acquisitions expanded the Company's geographical presence in New York and management expects that the Company will benefit from greater geographic diversity and the advantages of other synergistic business development opportunities.

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The following table summarizes the estimated fair value of the assets acquired and liabilities assumed after considering the measurement period adjustments described above:

(000s omitted)	2016	2015
Consideration paid :		
Cash	\$575	\$56,266
Community Bank System, Inc. common stock	0	102,202
Total net consideration paid	575	158,468
Recognized amounts of identifiable assets acquired and liabilities assumed:		
Cash and cash equivalents	0	81,772
Investment securities	0	225,729
Loans	0	399,422
Premises and equipment	0	22,212
Accrued interest receivable	0	1,133
Other assets	0	26,529
Core deposit intangibles	0	2,570
Other intangibles	288	9,994
Deposits	0	(699,241)
Other liabilities	0	(1,333)
Total identifiable assets, net	288	68,787
Goodwill	\$287	\$89,681

Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments were aggregated by comparable characteristics and recorded at fair value without a carryover of the related allowance for loan losses. Cash flows for each loan were determined using an estimate of credit losses and an estimated rate of prepayments. Projected monthly cash flows were then discounted to present value using a market-based discount rate. The excess of the undiscounted expected cash flows over the estimated fair value is referred to as the "accretable yield" and is recognized into interest income over the remaining lives of the acquired loans.

The following is a summary of the loans acquired from Oneida at the date of acquisition:

(000s omitted)	Acquired Impaired Loans	Acquired Non-impaired Loans	Total Acquired Loans
Contractually required principal and interest at acquisition	\$ 5,138	\$ 484,937	\$490,075
Contractual cash flows not expected to be collected	(1,977)	(4,833)	(6,810)
Expected cash flows at acquisition	3,161	480,104	483,265
Interest component of expected cash flows	(341)	(83,502)	(83,843)
Fair value of acquired loans	\$ 2,820	\$ 396,602	\$399,422

The fair value of checking, savings and money market deposit accounts acquired were assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. Certificate of deposit accounts were valued at the present value of the certificates' expected contractual payments discounted at market rates for similar certificates.

The core deposit intangibles and other intangibles related to the Oneida acquisition and the other intangibles related to WJL are being amortized using an accelerated method over their estimated useful life of eight years. The goodwill, which is not amortized for book purposes, was assigned to the Banking and All Other segments for the Oneida acquisition and the All Other segment for WJL. Goodwill arising from the Oneida acquisition is not deductible for tax

purposes. Goodwill arising from the WJL acquisition is deductible for tax purposes.

Direct costs related to the acquisitions were expensed as incurred, and have been separately stated in the Consolidated Statements of Income. Merger and acquisition integration-related expenses were immaterial for the three months ended September 30, 2016 and \$0.6 million during the three months ended September 30, 2015. Merger and acquisition integration-related expenses were \$0.3 million and \$1.3 million for the nine months ended September 30, 2016 and 2015, respectively.

Supplemental Pro Forma Financial Information

The following unaudited condensed pro forma information assumes the Oneida acquisition had been completed as of January 1, 2015 for the three months and nine months ended September 30, 2015. The pro forma information does not include amounts related to WJL as the amounts were immaterial and financial information is not readily available. The table below has been prepared for comparative purposes only and is not necessarily indicative of the actual results that would have been attained had the acquisition occurred as of the beginning of the years presented, nor is it indicative of the Company's future results. Furthermore, the unaudited pro forma information does not reflect management's estimate of any revenue-enhancing opportunities nor anticipated cost savings or the impact of conforming certain acquiree accounting policies to the Company's policies that may have occurred as a result of the integration and consolidation of the acquisitions.

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The pro forma information set forth below reflects the historical results of Oneida combined with the Company's consolidated statement of income with adjustments related to (a) certain purchase accounting fair value adjustments; (b) amortization of customer lists and core deposit intangibles and (c) changes to effective tax rate as a result of the Company's assets size being above \$8 billion on a consolidated basis. Acquisition-related expenses totaling \$0.6 million and \$1.3 million are excluded from the pro forma information for the three and nine months ended September 30, 2015, respectively.

	Pro Forma (Unaudited) Three Months Ended September 30, 2015	Pro Forma (Unaudited) Nine Months Ended September 30, 2015
(000's omitted)		
Total revenue, net of interest expense	\$ 106,563	\$ 313,574
Net income	25,350	73,813

NOTE C: ACCOUNTING POLICIES

The accounting policies of the Company, as applied in the consolidated interim financial statements presented herein, are substantially the same as those followed on an annual basis as presented on pages 56 through 61 of the Annual Report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission ("SEC") on February 29, 2016.

Critical Accounting Policies

Acquired Loans

Acquired loans are initially recorded at their acquisition date fair values. The carryover of allowance for loan losses is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. Fair values for acquired loans are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, prepayment risk, liquidity risk, default rates, loss severity, payment speeds, collateral values and discount rate.

Acquired Impaired Loans

Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments are accounted for as impaired loans under Accounting Standards Codification ("ASC") 310-30. The excess of undiscounted cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loans using the interest method. The difference between contractually required payments at acquisition and the undiscounted cash flows expected to be collected at acquisition is referred to as the non-accretable discount. The non-accretable discount represents estimated future credit losses and other contractually required payments that the Company does not expect to collect. Subsequent decreases in expected cash flows are recognized as impairments through a charge to the provision for credit losses resulting in an increase in the allowance for loan losses. Subsequent improvements in expected cash flows result in a recovery of previously recorded allowance for loan losses or a reversal of a corresponding amount of the non-accretable discount, which the Company then reclassifies as an accretable discount that is recognized into interest income over the remaining life of the loans using the interest method.

Acquired loans that met the criteria for non-accrual of interest prior to acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, the Company may no longer consider the loans to be non-accrual or non-performing and may accrue interest on these loans, including the impact of any accretable discount.

Acquired Non-impaired Loans

Acquired loans that do not meet the requirements under ASC 310-30 are considered acquired non-impaired loans. The difference between the acquisition date fair value and the outstanding balance represents the fair value adjustment for a loan and includes both credit and interest rate considerations. Fair value adjustments may be discounts (or premiums) to a loan's cost basis and are accreted (or amortized) to net interest income (or expense) over the loan's remaining life in accordance with ASC 310-20. Fair value adjustments for revolving loans are accreted (or amortized) using a straight line method. Term loans are accreted (or amortized) using the constant effective yield method.

Subsequent to the purchase date, the methods used to estimate the allowance for loan losses for the acquired non-impaired loans are consistent with the policy described below. However, the Company compares the net realizable value of the loans to the carrying value, for loans collectively evaluated for impairment. The carrying value represents the net of the loan's unpaid principal balance and the remaining purchase discount (or premium) that has yet to be accreted into interest income. When the carrying value exceeds the net realizable value, an allowance for loan loss is recognized.

Allowance for Loan Losses

Management continually evaluates the credit quality of the Company's loan portfolio, and performs a formal review of the adequacy of the allowance for loan losses on a quarterly basis. The allowance reflects management's best estimate of probable losses inherent in the loan portfolio. Determination of the allowance is subjective in nature and requires significant estimates. The Company's allowance methodology consists of two broad components - general and specific loan loss allocations.

The general loan loss allocation is composed of two calculations that are computed on five main loan segments: business lending; consumer direct; consumer indirect; home equity; and consumer mortgage. The first calculation is quantitative and determines an allowance level based on the latest 36 months of historical net charge-off data for each loan class (commercial loans exclude balances with specific loan loss allocations). The second calculation is qualitative and takes into consideration eight qualitative environmental factors: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. A component of the qualitative calculation is the unallocated allowance for loan loss. The qualitative and quantitative calculations are added together to determine the general loan loss allocation. The specific loan loss allocation relates to individual commercial loans that are both greater than \$0.5 million and in a nonaccruing status with respect to interest. Specific loan losses are based on discounted estimated cash flows, including any cash flows resulting from the conversion of collateral or collateral shortfalls. The allowance levels computed from the specific and general loan loss allocation methods are combined with unallocated allowances and allowances needed for acquired loans to derive the total required allowance for loan losses to be reflected on the Consolidated Statement of Condition.

Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on management's periodic evaluation of factors previously mentioned.

Investment Securities

The Company can classify its investments in debt and equity securities as held-to-maturity, available-for-sale, or trading. Held-to-maturity securities are those for which the Company has the positive intent and ability to hold until maturity, and are reported at cost, which is adjusted for amortization of premiums and accretion of discounts. Securities classified as available-for-sale are reported at fair value with net unrealized gains and losses reflected as a separate component of shareholders' equity, net of applicable income taxes. None of the Company's investment securities have been classified as trading securities at September 30, 2016. Certain equity securities are stated at cost and include restricted stock of the Federal Reserve Bank of New York ("Federal Reserve") and Federal Home Loan Bank of New York ("FHLB").

Fair values for investment securities are based upon quoted market prices, where available. If quoted market prices are not available, fair values are based upon quoted market prices of comparable instruments, or a discounted cash flow model using market estimates of interest rates and volatility.

The Company conducts an assessment of all securities in an unrealized loss position to determine if other-than-temporary impairment ("OTTI") exists on a quarterly basis. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. The OTTI assessment considers the security structure, recent security collateral performance metrics, if applicable, external credit ratings, failure of the issuer to make scheduled interest or principal payments, judgment about, and expectations of, future performance, and relevant independent industry research, analysis and forecasts. The severity of the impairment and the length of time the security has been impaired is also considered in the assessment. The assessment of whether an OTTI decline exists is performed on each security, regardless of the classification of the security as available-for-sale or held-to-maturity and involves a high degree of subjectivity and judgment that is based on the information available to management at a point in time.

An OTTI loss must be recognized for a debt security in an unrealized loss position if there is intent to sell the security or it is more likely than not the Company will be required to sell the security prior to recovery of its amortized cost basis. In this situation, the amount of loss recognized in income is equal to the difference between the fair value and the amortized cost basis of the security. Even if management does not have the intent, and it is not more likely than

not that the Company will be required to sell the securities, an evaluation of the expected cash flows to be received is performed to determine if a credit loss has occurred. For debt securities, a critical component of the evaluation for OTTI is the identification of credit-impaired securities, where the Company does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. In the event of a credit loss, only the amount of impairment associated with the credit loss would be recognized in income. The portion of the unrealized loss relating to other factors, such as liquidity conditions in the market or changes in market interest rates, is recorded in accumulated other comprehensive loss.

Equity securities are also evaluated to determine whether the unrealized loss is expected to be recoverable based on whether evidence exists to support a realizable value equal to or greater than the amortized cost basis. If it is probable that the amortized cost basis will not be recovered, taking into consideration the estimated recovery period and the ability to hold the equity security until recovery, OTTI is recognized in earnings equal to the difference between the fair value and the amortized cost basis of the security.

The specific identification method is used in determining the realized gains and losses on sales of investment securities and OTTI charges. Premiums and discounts on securities are amortized and accreted, respectively, on the interest method basis over the period to maturity or estimated life of the related security. Purchases and sales of securities are recognized on a trade date basis.

Intangible Assets

Intangible assets include core deposit intangibles, customer relationship intangibles and goodwill arising from acquisitions. Core deposit intangibles and customer relationship intangibles are amortized on either an accelerated or straight-line basis over periods ranging from seven to 20 years. The initial and ongoing carrying value of goodwill and other intangible assets is based upon discounted cash flow modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires use of a discount rate that reflects the current return requirements of the market in relation to present risk-free interest rates, required equity market premiums, peer volatility indicators, and company-specific risk indicators.

The Company evaluates goodwill for impairment on an annual basis, or more often if events or circumstances indicate there may be impairment. The implied fair value of a reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value. The fair value of each reporting unit is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated.

Retirement Benefits

The Company provides defined benefit pension benefits to eligible employees and post-retirement health and life insurance benefits to certain eligible retirees. The Company also provides deferred compensation and supplemental executive retirement plans for selected current and former employees, officers, and directors. Expense under these plans is charged to current operations and consists of several components of net periodic benefit cost based on various actuarial assumptions regarding future experience under the plans, including discount rate, rate of future compensation increases, and expected return on plan assets.

New Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). This new guidance supersedes the revenue recognition requirements in ASC 605, Revenue Recognition, and is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods and services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. This guidance is effective prospectively for the Company for annual and interim periods beginning after December 15, 2017. The Company is currently evaluating the effect the guidance will have on the Company's consolidated financial statements.

In January 2016, the FASB issued ASU 2016-1, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The primary focus of this guidance is to supersede the guidance to classify equity securities with readily determinable fair values into different categories (trading or available-for-sale) and requires equity securities to be measured at fair value with changes in the fair value recognized through net income. This guidance requires adoption through a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted for all companies in any interim or annual period. The Company is currently evaluating the effect the guidance will have on the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This new guidance supersedes the lease requirements in Topic 840, Leases and is based on the principle that a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The accounting applied by a lessor is largely unchanged from that applied under the previous guidance. In addition, the guidance requires an entity to separate the lease components from the nonlease components in a contract. The ASU requires disclosures about the amount, timing, and judgments

related to a reporting entity's accounting for leases and related cash flows. The standard is required to be applied to all leases in existence as of the date of adoption using a modified retrospective transition approach. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for all companies in any interim or annual period. The Company is currently evaluating the effect the guidance will have on the Company's consolidated financial statements.

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In March 2016, the FASB issued ASU 2016-09, Compensation – Stock Compensation (Topic 718). The amendments simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The new guidance requires all excess tax benefits and tax deficiencies be recognized as income tax expense or benefit in the income statement. The tax effects of exercised or vested awards should be treated as discrete items in the reporting period in which they occur. This guidance requires certain amendments to be applied through a cumulative-effect adjustment to equity as of the beginning of the fiscal period in which the guidance is adopted while other amendments are required to be applied retrospectively or prospectively. This ASU is effective for fiscal periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. The Company is currently evaluating the effect the guidance will have on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326). This new guidance significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. This ASU will replace the "incurred loss" model under existing guidance with an "expected loss" model for instruments measured at amortized cost, and require entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. This ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. This guidance requires adoption through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for all companies as of fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the effect the guidance will have on the Company's consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). The amendments provide guidance on the following eight specific cash flow issues: 1) debt prepayment or debt extinguishment costs; 2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; 3) contingent consideration payments made after a business combination; 4) proceeds from the settlement of insurance claims; 5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; 6) distributions received from equity method investees; 7) beneficial interests in securitization transactions; and 8) separately identifiable cash flows and application of the predominance principle. This ASU is effective for fiscal years beginning after December 31, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. As this guidance only affects the classification within the statement of cash flows, this ASU is not expected to have a material impact on the Company's consolidated financial statements.

NOTE D: INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities as of September 30, 2016 and December 31, 2015 are as follows:

	September 30, 2016				December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(000's omitted)								
Available-for-Sale Portfolio:								
U.S. Treasury and agency securities	\$1,873,698	\$102,914	\$0	\$1,976,612	\$1,866,819	\$35,186	\$2,027	\$1,899,978

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Obligations of state and political subdivisions	595,376	28,847	1	624,222	640,455	26,487	59	666,883
Government agency mortgage-backed securities	216,942	8,033	242	224,733	205,220	6,906	1,261	210,865
Corporate debt securities	5,735	39	0	5,774	16,672	66	58	16,680
Government agency collateralized mortgage obligations	10,086	418	0	10,504	12,862	446	0	13,308
Marketable equity securities	251	178	19	410	250	163	14	399
Total available-for-sale portfolio	\$2,702,088	\$140,429	\$262	\$2,842,255	\$2,742,278	\$69,254	\$3,419	\$2,808,113
Other Securities:								
Federal Home Loan Bank common stock	\$11,682			\$11,682	\$19,317			\$19,317
Federal Reserve Bank common stock	19,781			19,781	16,050			16,050
Other equity securities	3,926			3,926	4,460			4,460
Total other securities	\$35,389			\$35,389	\$39,827			\$39,827

A summary of investment securities that have been in a continuous unrealized loss position is as follows:

As of September 30, 2016

(000's omitted)	Less than 12 Months			12 Months or Longer			Total		
	#	Fair Value	Gross Unrealized Losses	#	Fair Value	Gross Unrealized Losses	#	Fair Value	Gross Unrealized Losses
Available-for-Sale Portfolio:									
Obligations of state and political subdivisions	4	\$1,987	\$ 1	0	\$0	\$ 0	4	\$1,987	\$ 1
Government agency mortgage-backed securities	9	10,116	40	15	23,228	202	24	33,344	242
Government agency collateralized mortgage obligations	0	0	0	2	2	0	2	2	0
Marketable equity securities	0	0	0	1	82	19	1	82	19
Total available-for-sale investment portfolio	13	\$12,103	\$ 41	18	\$23,312	\$ 221	31	\$35,415	\$ 262

As of December 31, 2015

(000's omitted)	Less than 12 Months			12 Months or Longer			Total		
	#	Fair Value	Gross Unrealized Losses	#	Fair Value	Gross Unrealized Losses	#	Fair Value	Gross Unrealized Losses
Available-for-Sale Portfolio:									
U.S. Treasury and agency obligations	9	\$353,844	\$ 2,027	0	\$0	\$ 0	9	\$353,844	\$ 2,027
Obligations of state and political subdivisions	18	8,804	34	2	735	25	20	9,539	59
Government agency mortgage-backed securities	17	24,178	161	19	30,103	1,100	36	54,281	1,261
Corporate debt securities	1	3,024	0	1	2,710	58	2	5,734	58
Government agency collateralized mortgage obligations	0	0	0	2	3	0	2	3	0
Marketable equity securities	1	87	14	0	0	0	1	87	14
Total available-for-sale investment portfolio	46	\$389,937	\$ 2,236	24	\$33,551	\$ 1,183	70	\$423,488	\$ 3,419

The unrealized losses reported pertain to securities issued by the U.S. government and its sponsored entities, include treasuries, agencies, and mortgage-backed securities issued by the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA"), and the Federal Home Loan Corporation ("FHLMC"), which are currently rated AAA by Moody's Investor Services, AA+ by Standard & Poor's and are guaranteed by the U.S. government. The majority of the obligations of state and political subdivisions and corporations carry a credit rating of A or better. Additionally, a majority of the obligations of state and political subdivisions carry a secondary level of credit enhancement. The Company does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell these securities prior to recovery of the amortized cost. The unrealized losses in the portfolios are primarily attributable to changes in interest rates. As such, management does not believe any individual unrealized loss as of September 30, 2016 represents OTTI.

The amortized cost and estimated fair value of debt securities at September 30, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	Available-for-Sale	
	Amortized Cost	Fair Value
(000's omitted)		
Due in one year or less	\$34,640	\$34,835
Due after one through five years	872,160	910,105
Due after five years through ten years	1,360,056	1,440,555
Due after ten years	207,953	221,113
Subtotal	2,474,809	2,606,608
Government agency mortgage-backed securities	216,942	224,733
Government agency collateralized mortgage obligations	10,086	10,504
Total	\$2,701,837	\$2,841,845

NOTE E: LOANS

The segments of the Company's loan portfolio are disaggregated into the following classes that allow management to monitor risk and performance:

Consumer mortgages consist primarily of fixed rate residential instruments, typically 10 – 30 years in contractual term, secured by first liens on real property.

Business lending is comprised of general purpose commercial and industrial loans including, but not limited to, agricultural-related and dealer floor plans, as well as mortgages on commercial properties.

Consumer indirect consists primarily of installment loans originated through selected dealerships and are secured by automobiles, marine and other recreational vehicles.

Consumer direct consists of all other loans to consumers such as personal installment loans and lines of credit

Home equity products are consumer purpose installment loans or lines of credit most often secured by a first or second lien position on residential real estate with terms up to 30 years.

The balances of these classes are summarized as follows:

	September 30, 2016	December 31, 2015
(000's omitted)		
Consumer mortgage	\$ 1,798,748	\$ 1,769,754
Business lending	1,506,878	1,497,271
Consumer indirect	1,037,077	935,760
Consumer direct	196,134	195,076
Home equity	401,784	403,514
Gross loans, including deferred origination costs	4,940,621	4,801,375
Allowance for loan losses	(46,789)	(45,401)
Loans, net of allowance for loan losses	\$ 4,893,832	\$ 4,755,974

The outstanding balance related to credit impaired acquired loans was \$8.0 million and \$8.5 million at September 30, 2016 and December 31, 2015, respectively. The changes in the accretable discount related to the credit impaired acquired loans are as follows:

(000's omitted)	
Balance at December 31, 2015	\$ 810
Accretion recognized, year-to-date	(359)
Net reclassification to accretable from non-accretable	129
Balance at September 30, 2016	\$ 580

Credit Quality

Management monitors the credit quality of its loan portfolio on an ongoing basis. Measurement of delinquency and past due status are based on the contractual terms of each loan. Past due loans are reviewed on a monthly basis to identify loans for non-accrual status. The following is an aged analysis of the Company's past due loans, by class as of September 30, 2016:

Legacy Loans (excludes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 – 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total	
				Past Due	Total Loans
				Current	

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Consumer mortgage	\$9,672	\$ 927	\$ 11,663	\$22,262	\$1,608,451	\$1,630,713
Business lending	2,995	390	3,774	7,159	1,267,092	1,274,251
Consumer indirect	10,657	162	0	10,819	993,023	1,003,842
Consumer direct	1,318	86	0	1,404	183,576	184,980
Home equity	1,205	304	1,529	3,038	310,262	313,300
Total	\$25,847	\$ 1,869	\$ 16,966	\$44,682	\$4,362,404	\$4,407,086

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Acquired Loans (includes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 – 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total Past Due	Acquired Impaired ⁽¹⁾	Current	Total Loans
	Consumer mortgage	\$ 1,237		\$ 61	\$ 2,464		\$ 3,762
Business lending	226	0	1,460	1,686	6,863	224,078	232,627
Consumer indirect	208	15	0	223	0	33,012	33,235
Consumer direct	166	0	0	166	0	10,988	11,154
Home equity	1,474	70	411	1,955	0	86,529	88,484
Total	\$ 3,311	\$ 146	\$ 4,335	\$ 7,792	\$ 6,863	\$ 518,880	\$ 533,535

Acquired impaired loans were not classified as nonperforming assets as the loans are considered to be performing ⁽¹⁾under ASC 310-30. As a result interest income, through the accretion of the difference between the carrying amount of the loans and the expected cashflows, is being recognized on all acquired impaired loans.

The following is an aged analysis of the Company's past due loans by class as of December 31, 2015:

Legacy Loans (excludes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 – 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans
	Consumer mortgage	\$ 10,482		\$ 1,411		\$ 11,394
Business lending	4,442	126	5,381	9,949	1,223,679	1,233,628
Consumer indirect	11,575	102	0	11,677	878,662	890,339
Consumer direct	1,414	51	1	1,466	176,585	178,051
Home equity	1,093	111	2,029	3,233	297,012	300,245
Total	\$ 29,006	\$ 1,801	\$ 18,805	\$ 49,612	\$ 4,134,109	\$ 4,183,721

Acquired Loans (includes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 – 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total Past Due	Acquired Impaired ⁽¹⁾	Current	Total Loans
	Consumer mortgage	\$ 1,373		\$ 394	\$ 1,396		\$ 3,163
Business lending	535	0	1,186	1,721	7,299	254,623	263,643
Consumer indirect	245	0	0	245	0	45,176	45,421
Consumer direct	140	0	14	154	0	16,871	17,025
Home equity	636	0	327	963	0	102,306	103,269

Total	\$2,929	\$ 394	\$ 2,923	\$6,246	\$ 7,299	\$604,109	\$617,654
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Acquired impaired loans were not classified as nonperforming assets as the loans are considered to be performing (1)under ASC 310-30. As a result interest income, through the accretion of the difference between the carrying amount of the loans and the expected cashflows, is being recognized on all acquired impaired loans.

The Company uses several credit quality indicators to assess credit risk in an ongoing manner. The Company's primary credit quality indicator for its business lending portfolio is an internal credit risk rating system that categorizes loans as "pass", "special mention", "classified", or "doubtful". Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. In general, the following are the definitions of the Company's credit quality indicators:

- Pass The condition of the borrower and the performance of the loans are satisfactory or better.
- Special
Mention The condition of the borrower has deteriorated although the loan performs as agreed.
- Classified The condition of the borrower has significantly deteriorated and the performance of the loan could further deteriorate, if deficiencies are not corrected.
- Doubtful The condition of the borrower has deteriorated to the point that collection of the balance is improbable based on current facts and conditions.

The following table shows the amount of business lending loans by credit quality category:

(000's omitted)	September 30, 2016			December 31, 2015		
	Legacy	Acquired	Total	Legacy	Acquired	Total
Pass	\$1,053,914	\$173,950	\$1,227,864	\$1,048,364	\$219,374	\$1,267,738
Special mention	137,855	32,820	170,675	124,768	20,007	144,775
Classified	82,466	18,994	101,460	60,181	16,963	77,144
Doubtful	16	0	16	315	0	315
Acquired impaired	0	6,863	6,863	0	7,299	7,299
Total	\$1,274,251	\$232,627	\$1,506,878	\$1,233,628	\$263,643	\$1,497,271

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or nonperforming. Performing loans include loans classified as current as well as those classified as 30 - 89 days past due. Nonperforming loans include 90+ days past due and still accruing and nonaccrual loans. The following table details the balances in all other loan categories at September 30, 2016:

Legacy Loans (excludes loans acquired after January 1, 2009)

(000's omitted)	Consumer	Consumer	Consumer	Home	Total
	Mortgage	Indirect	Direct	Equity	
Performing	\$1,618,123	\$1,003,680	\$184,894	\$311,467	\$3,118,164
Nonperforming	12,590	162	86	1,833	14,671
Total	\$1,630,713	\$1,003,842	\$184,980	\$313,300	\$3,132,835

Acquired Loans (includes loans acquired after January 1, 2009)

(000's omitted)	Consumer	Consumer	Consumer	Home	Total
	Mortgage	Indirect	Direct	Equity	
Performing	\$165,510	\$33,220	\$11,154	\$88,003	\$297,887
Nonperforming	2,525	15	0	481	3,021
Total	\$168,035	\$33,235	\$11,154	\$88,484	\$300,908

The following table details the balances in all other loan categories at December 31, 2015:

Legacy Loans (excludes loans acquired after January 1, 2009)

(000's omitted)	Consumer	Consumer	Consumer	Home	Total
	Mortgage	Indirect	Direct	Equity	
Performing	\$1,568,653	\$890,237	\$177,999	\$298,105	\$2,934,994
Nonperforming	12,805	102	52	2,140	15,099
Total	\$1,581,458	\$890,339	\$178,051	\$300,245	\$2,950,093

Acquired Loans (includes loans acquired after January 1, 2009)

(000's omitted)	Consumer	Consumer	Consumer	Home	Total
	Mortgage	Indirect	Direct	Equity	
Performing	\$186,506	\$45,421	\$17,011	\$102,942	\$351,880
Nonperforming	1,790	0	14	327	2,131

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Total \$ 188,296 \$ 45,421 \$ 17,025 \$ 103,269 \$ 354,011

All loan classes are collectively evaluated for impairment except business lending, as described in Note C. A summary of individually evaluated impaired loans as of September 30, 2016 and December 31, 2015 follows:

	September 30, 2016	December 31, 2015
(000's omitted)		
Loans with allowance allocation	\$ 786	\$ 0
Loans without allowance allocation	591	2,376
Unpaid principal balance	1,377	2,376
Contractual balance	3,009	3,419
Allowance for loan loss allocated	17	0

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In the course of working with borrowers, the Company may choose to restructure the contractual terms of certain loans. In this scenario, the Company attempts to work-out an alternative payment schedule with the borrower in order to optimize collectability of the loan. Any loans that are modified are reviewed by the Company to identify if a troubled debt restructuring ("TDR") has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial standing and the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two.

In accordance with the clarified guidance issued by the Office of the Comptroller of the Currency ("OCC"), loans that have been discharged in Chapter 7 bankruptcy but not reaffirmed by the borrower, are classified as TDRs, irrespective of payment history or delinquency status, even if the repayment terms for the loan have not been otherwise modified. The Company's lien position against the underlying collateral remains unchanged. Pursuant to that guidance, the Company records a charge-off equal to any portion of the carrying value that exceeds the net realizable value of the collateral. The amount of loss incurred in the three and nine months ended September 30, 2016 and 2015 was immaterial.

TDRs that are less than \$0.5 million are collectively included in the general loan loss allocation and the qualitative review. TDRs that are commercial loans and greater than \$0.5 million are individually evaluated for impairment, and if necessary, a specific allocation of the allowance for loan losses is provided. As a result, the determination of the amount of allowance for loan losses related to TDRs is the same as detailed in the critical accounting policies.

Information regarding TDRs as of September 30, 2016 and December 31, 2015 is as follows:

(000's omitted)	September 30, 2016						December 31, 2015					
	Nonaccrual		Accruing		Total		Nonaccrual		Accruing		Total	
	#	<u>Amount</u>	#	<u>Amount</u>	#	<u>Amount</u>	#	<u>Amount</u>	#	<u>Amount</u>	#	<u>Amount</u>
Consumer mortgage	41	\$ 1,951	40	\$ 1,760	81	\$ 3,711	37	\$ 1,472	54	\$ 2,486	91	\$ 3,958
Business lending	8	180	5	699	13	879	8	217	6	737	14	954
Consumer indirect	0	0	76	762	76	762	0	0	77	691	77	691
Consumer direct	0	0	9	68	9	68	0	0	32	37	32	37
Home equity	14	229	7	219	21	448	10	203	14	301	24	504
Total	63	\$ 2,360	137	\$ 3,508	200	\$ 5,868	55	\$ 1,892	183	\$ 4,252	238	\$ 6,144

The following table presents information related to loans modified in a TDR during the three months and nine months ended September 30, 2016 and 2015. Of the loans noted in the table below, all loans for the three months and nine months ended September 30, 2016 and 2015 were modified due to a Chapter 7 bankruptcy as described previously. The financial effects of these restructurings were immaterial.

(000's omitted)	Three Months Ended September 30, 2016		Three Months Ended September 30, 2015	
	Number of loans modified	Outstanding Balance	Number of loans modified	Outstanding Balance
	#	\$	#	\$
Consumer mortgage	2	\$ 206	4	\$ 404
Business lending	0	0	0	0
Consumer indirect	9	89	12	112
Consumer direct	0	0	1	0

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Home equity	0	0	0	0
Total	11	\$ 295	17	\$ 516

	Nine Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
	Number of loans Outstanding modified Balance		Number of loans Outstanding modified Balance	
(000's omitted)				
Consumer mortgage	9	\$ 787	8	\$ 585
Business lending	1	29	0	0
Consumer indirect	27	392	23	263
Consumer direct	1	51	2	1
Home equity	3	48	1	13
Total	41	\$ 1,307	34	\$ 862

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Allowance for Loan Losses

The allowance for loan losses is general in nature and is available to absorb losses from any loan type despite the analysis below. The following presents by class the activity in the allowance for loan losses:

(000's omitted)	Three Months Ended September 30, 2016							Acquired Impaired	Total
	Consumer Mortgage	Business Lending	Consumer Indirect	Consumer Direct	Home Equity	Unallocated			
Beginning balance	\$9,853	\$16,949	\$13,215	\$3,020	\$2,500	\$850	\$139	\$46,526	
Charge-offs	(202)	(284)	(2,037)	(395)	(6)	0	0	(2,924)	
Recoveries	12	220	892	246	27	0	0	1,397	
Provision	305	(283)	1,503	170	10	85	0	1,790	
Ending balance	\$9,968	\$16,602	\$13,573	\$3,041	\$2,531	\$935	\$139	\$46,789	

(000's omitted)	Three Months Ended September 30, 2015							Acquired Impaired	Total
	Consumer Mortgage	Business Lending	Consumer Indirect	Consumer Direct	Home Equity	Unallocated			
Beginning balance	\$10,192	\$15,353	\$11,602	\$2,991	\$2,677	\$2,374	\$93	\$45,282	
Charge-offs	(276)	(234)	(1,597)	(427)	(66)	0	(59)	(2,659)	
Recoveries	9	107	740	174	29	0	0	1,059	
Provision	421	112	1,367	359	102	(461)	6	1,906	
Ending balance	\$10,346	\$15,338	\$12,112	\$3,097	\$2,742	\$1,913	\$40	\$45,588	

(000's omitted)	Nine Months Ended September 30, 2016							Acquired Impaired	Total
	Consumer Mortgage	Business Lending	Consumer Indirect	Consumer Direct	Home Equity	Unallocated			
Beginning balance	\$10,198	\$15,749	\$12,422	\$2,997	\$2,666	\$1,201	\$168	\$45,401	
Charge-offs	(445)	(1,263)	(5,439)	(1,246)	(142)	0	(26)	(8,561)	
Recoveries	96	511	3,146	705	55	0	0	4,513	
Provision	119	1,605	3,444	585	(48)	(266)	(3)	5,436	
Ending balance	\$9,968	\$16,602	\$13,573	\$3,041	\$2,531	\$935	\$139	\$46,789	

(000's omitted)	Nine Months Ended September 30, 2015							Acquired Impaired	Total
	Consumer Mortgage	Business Lending	Consumer Indirect	Consumer Direct	Home Equity	Unallocated			
Beginning balance	\$10,286	\$15,787	\$11,544	\$3,083	\$2,701	\$1,767	\$173	\$45,341	
Charge-offs	(917)	(667)	(4,421)	(1,066)	(188)	0	(102)	(7,361)	
Recoveries	75	715	3,077	566	55	0	0	4,488	
Provision	902	(497)	1,912	514	174	146	(31)	3,120	
Ending balance	\$10,346	\$15,338	\$12,112	\$3,097	\$2,742	\$1,913	\$40	\$45,588	

NOTE F: GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

The gross carrying amount and accumulated amortization for each type of identifiable intangible asset are as follows:

(000's omitted)	September 30, 2016			December 31, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizing intangible assets:						

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Core deposit intangibles	\$39,688	\$ (31,975)	\$7,713	\$39,688	\$ (29,899)	\$9,789
Other intangibles	17,852	(8,588)	9,264	17,565	(6,460)	11,105
Total amortizing intangibles	\$57,540	\$ (40,563)	\$16,977	\$57,253	\$ (36,359)	\$20,894

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The estimated aggregate amortization expense for each of the five succeeding fiscal years ended December 31 is as follows:

(000's omitted)	
Oct – Dec 2016	\$1,275
2017	4,413
2018	3,566
2019	2,782
2020	2,119
Thereafter	2,822
Total	\$16,977

Shown below are the components of the Company's goodwill at December 31, 2015 and September 30, 2016:

	December		September	
(000's omitted)	31, 2015	Activity	30, 2016	
Goodwill	\$468,076	\$ 1,890	\$469,966	
Accumulated impairment	(4,824)	0	(4,824)	
Goodwill, net	\$463,252	\$ 1,890	\$465,142	

NOTE G: MANDATORILY REDEEMABLE PREFERRED SECURITIES

The Company sponsors two business trusts, Community Statutory Trust III and Community Capital Trust IV, of which 100% of the common stock is owned by the Company. The trusts were formed for the purpose of issuing company-obligated mandatorily redeemable preferred securities to third-party investors and investing the proceeds from the sale of such preferred securities solely in junior subordinated debt securities of the Company. The debentures held by each trust are the sole assets of that trust. Distributions on the preferred securities issued by each trust are payable quarterly at a rate per annum equal to the interest rate being earned by the trust on the debentures held by that trust and are recorded as interest expense in the consolidated financial statements. The preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the preferred securities subject to the terms of each of the guarantees. The terms of the preferred securities of each trust are as follows:

	Issuance Date	Par Amount	Interest Rate	Maturity Date	Call Price
III	7/31/2001	\$24.5 million	3 month LIBOR plus 3.58% (4.34%)	7/31/2031	Par
IV	12/8/2006	\$75 million	3 month LIBOR plus 1.65% (2.50%)	12/15/2036	Par

NOTE H: BENEFIT PLANS

The Company provides a qualified defined benefit pension to eligible employees and retirees, other post-retirement health and life insurance benefits to certain retirees, an unfunded supplemental pension plan for certain key executives, and an unfunded stock balance plan for certain of its nonemployee directors. The Company accrues for the estimated cost of these benefits through charges to expense during the years that employees earn these benefits. No contributions to the defined benefit pension plan are required or planned for 2016.

The net periodic benefit cost for the three and nine months ended September 30, 2016 and 2015 is as follows:

Pension Benefits

Post-retirement Benefits

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	Three Months Ended		Nine Months Ended		Three Months Ended		Nine Months Ended	
	September 30,		September 30,		September 30,		September 30,	
(000's omitted)	2016	2015	2016	2015	2016	2015	2016	2015
Service cost	\$ 1,027	\$ 831	\$ 3,079	\$ 2,493	\$ 0	\$ 0	\$ 0	\$ 0
Interest cost	1,406	1,375	4,218	4,124	20	22	61	65
Expected return on plan assets	(2,961)	(3,042)	(8,882)	(9,127)	0	0	0	0
Amortization of unrecognized net loss/(gain)	377	366	1,131	1,099	(1)	(3)	(4)	(10)
Amortization of prior service cost/(credit)	11	2	33	6	(45)	(45)	(134)	(134)
Net periodic benefit cost	\$ (140)	\$ (468)	\$ (421)	\$ (1,405)	\$ (26)	\$ (26)	\$ (77)	\$ (79)

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NOTE I: EARNINGS PER SHARE

The two class method is used in the calculations of basic and diluted earnings per share. Under the two class method, earnings available to common shareholders for the period are allocated between common shareholders and participating securities according to dividends declared and participation rights in undistributed earnings. The Company has determined that all of its outstanding non-vested stock awards are participating securities as of September 30, 2016.

Basic earnings per share are computed based on the weighted-average of the common shares outstanding for the period. Diluted earnings per share are based on the weighted-average of the shares outstanding adjusted for the dilutive effect of restricted stock and the assumed exercise of stock options during the year. The dilutive effect of options is calculated using the treasury stock method of accounting. The treasury stock method determines the number of common shares that would be outstanding if all the dilutive options (those where the average market price is greater than the exercise price) were exercised and the proceeds were used to repurchase common shares in the open market at the average market price for the applicable time period. There were no weighted-average anti-dilutive stock options outstanding for the three months ended September 30, 2016, and approximately 0.3 million weighted-average anti-dilutive stock options outstanding for the nine months ended September 30, 2016, compared to approximately 0.6 million weighted-average anti-dilutive stock options outstanding for the three months ended September 30, 2015, and approximately 0.5 million weighted-average anti-dilutive stock options outstanding for the nine months ended September 30, 2015 that were not included in the computation below.

The following is a reconciliation of basic to diluted earnings per share for the three and nine months ended September 30, 2016 and 2015:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(000's omitted, except per share data)	2016	2015	2016	2015
Net income	\$27,160	\$25,022	\$77,420	\$71,159
Income attributable to unvested stock-based compensation awards	(157)	(129)	(398)	(352)
Income available to common shareholders	\$27,003	\$24,893	\$77,022	\$70,807
Weighted-average common shares outstanding – basic	44,184	40,873	44,023	40,741
Basic earnings per share	\$0.61	\$0.61	\$1.75	\$1.74
Net income	\$27,160	\$25,022	\$77,420	\$71,159
Income attributable to unvested stock-based compensation awards	(157)	(129)	(398)	(352)
Income available to common shareholders	\$27,003	\$24,893	\$77,022	\$70,807
Weighted-average common shares outstanding – basic	44,184	40,873	44,023	40,741
Assumed exercise of stock options	394	386	359	400
Weighted-average common shares outstanding – diluted	44,578	41,259	44,382	41,141
Diluted earnings per share	\$0.61	\$0.60	\$1.74	\$1.72

Stock Repurchase Program

At its December 2015 meeting, the Company's Board of Directors (the "Board") approved a new repurchase program authorizing the repurchase of up to 2.2 million shares of the Company's common stock, in accordance with securities laws and regulations, through December 31, 2016. Any repurchased shares will be used for general corporate purposes, including those related to stock plan activities. The timing and extent of repurchases will depend on market conditions and other corporate considerations as determined at the Company's discretion. The Company did not

repurchase any shares under the authorized plan during the first nine months of 2016, compared to 265,230 shares repurchased during 2015.

NOTE J: COMMITMENTS, CONTINGENT LIABILITIES AND RESTRICTIONS

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. These commitments consist principally of unused commercial and consumer credit lines. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of an underlying contract with a third party. The credit risks associated with commitments to extend credit and standby letters of credit are essentially the same as that involved with extending loans to customers and are subject to the Company's normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness. The fair value of the standby letters of credit is immaterial for disclosure.

The contract amounts of commitments and contingencies are as follows:

	September 30, 2016	December 31, 2015
(000's omitted)		
Commitments to extend credit	\$ 769,448	\$ 811,442
Standby letters of credit	21,618	19,053
Total	\$ 791,066	\$ 830,495

The Company and its subsidiaries are subject in the normal course of business to various pending and threatened legal proceedings in which claims for monetary damages are asserted. As of September 30, 2016, management, after consultation with legal counsel, does not anticipate that the aggregate ultimate liability arising out of litigation pending or threatened against the Company or its subsidiaries will be material to the Company's consolidated financial position. On at least a quarterly basis, the Company assesses its liabilities and contingencies in connection with such legal proceedings. For those matters where it is probable that the Company will incur losses and the amounts of the losses can be reasonably estimated, the Company records an expense and corresponding liability in its consolidated financial statements. To the extent the pending or threatened litigation could result in exposure in excess of that liability, the amount of such excess is not currently estimable. The range of reasonably possible losses for matters where an exposure is not currently estimable or considered probable, beyond the existing recorded liabilities, is between \$0 and \$1 million in the aggregate. Although the Company does not believe that the outcome of pending litigation will be material to the Company's consolidated financial position, it cannot rule out the possibility that such outcomes will be material to the consolidated results of operations for a particular reporting period in the future.

NOTE K: FAIR VALUE

Accounting standards establish a framework for measuring fair value and require certain disclosures about such fair value instruments. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. exit price). Inputs used to measure fair value are classified into the following hierarchy:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
- Level 2 - Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3 - Significant valuation assumptions not readily observable in a market.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables set forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis. There were no transfers between any of the levels for the periods presented.

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(000's omitted)	September 30, 2016			Level 3	Total Fair Value
	Level 1	Level 2			
Available-for-sale investment securities:					
U.S. Treasury and agency securities	\$1,976,612	\$0	\$0		\$ 1,976,612
Obligations of state and political subdivisions	0	624,222	0		624,222
Government agency mortgage-backed securities	0	224,733	0		224,733
Corporate debt securities	0	5,774	0		5,774
Government agency collateralized mortgage obligations	0	10,504	0		10,504
Marketable equity securities	410	0	0		410
Total available-for-sale investment securities	1,977,022	865,233	0		2,842,255
Mortgage loans held for sale	0	633	0		633
Commitments to originate real estate loans for sale	0	0	474		474
Forward sales commitments	0	(30)	0		(30)
Total	\$1,977,022	\$865,836	\$474		\$2,843,332

(000's omitted)	December 31, 2015			Level 3	Total Fair Value
	Level 1	Level 2			
Available-for-sale investment securities:					
U.S. Treasury and agency securities	\$1,899,978	\$0	\$0		\$1,899,978
Obligations of state and political subdivisions	0	666,883	0		666,883
Government agency mortgage-backed securities	0	210,865	0		210,865
Corporate debt securities	0	16,680	0		16,680
Government agency collateralized mortgage obligations	0	13,308	0		13,308
Marketable equity securities	399	0	0		399
Total available-for-sale investment securities	1,900,377	907,736	0		2,808,113
Mortgage loans held for sale	0	932	0		932
Commitments to originate real estate loans for sale	0	0	117		117
Forward sales commitments	0	(37)	0		(37)
Total	\$1,900,377	\$908,631	\$117		\$2,809,125

The valuation techniques used to measure fair value for the items in the table above are as follows:

Available-for-sale investment securities – The fair values of available-for-sale investment securities are based upon quoted prices, if available. If quoted prices are not available, fair values are measured using quoted market prices for similar securities or model-based valuation techniques. Level 1 securities include U.S. Treasury obligations and marketable equity securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include U.S. agency securities, mortgage-backed securities issued by government-sponsored entities, municipal securities and corporate debt securities that are valued by reference to prices for similar securities or through model-based techniques in which all significant inputs, such as reported trades, trade execution data, LIBOR swap yield curve, market prepayment speeds, credit information, market spreads, and security's terms and conditions, are observable. See Note D for further disclosure of the fair value of investment securities.

Mortgage loans held for sale –The Company has elected to value loans held for sale at fair value in order to more closely match the gains and losses associated with loans held for sale with the gains and losses on forward sales contracts. Accordingly, the impact on the valuation will be recognized in the Company's consolidated statement of income. All mortgage loans held for sale are current and in performing status. The fair value of mortgage loans held for sale is determined using quoted secondary-market prices of loans with similar characteristics and, as such, has been classified as a Level 2 valuation. The unpaid principal value of mortgage loans held for sale at September 30,

2016 was approximately \$0.6 million. The unrealized gain on mortgage loans held for sale was recognized in mortgage banking and other income in the consolidated statement and is immaterial.

Forward sales commitments – The Company enters into forward sales commitments to sell certain residential real estate loans. Such commitments are considered to be derivative financial instruments and, therefore, are carried at estimated fair value in the other asset or other liability section of the consolidated balance sheet. The fair value of these forward sales commitments is primarily measured by obtaining pricing from certain government-sponsored entities and reflects the underlying price the entity would pay the Company for an immediate sale on these mortgages. As such, these instruments are classified as Level 2 in the fair value hierarchy.

Commitments to originate real estate loans for sale – The Company enters into various commitments to originate residential real estate loans for sale. Such commitments are considered to be derivative financial instruments and, therefore, are carried at estimated fair value in the other asset or other liability section of the consolidated balance sheet. The estimated fair value of these commitments is determined using quoted secondary market prices obtained from certain government-sponsored entities. Additionally, accounting guidance requires the expected net future cash flows related to the associated servicing of the loan to be included in the fair value measurement of the derivative. The expected net future cash flows are based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. Such assumptions include estimates of the cost of servicing loans, appropriate discount rate and prepayment speeds. The determination of expected net cash flows is considered a significant unobservable input contributing to the Level 3 classification of commitments to originate real estate loans for sale.

The changes in Level 3 assets measured at fair value on a recurring basis are summarized in the following tables:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
(000's omitted)				
Beginning balance	\$361	\$ 195	\$117	\$ 185
Total losses included in earnings ⁽¹⁾	(361)	(195)	(760)	(532)
Commitments to originate real estate loans held for sale, net	474	276	1,117	623
Ending balance	\$474	\$ 276	\$474	\$ 276

⁽¹⁾ Amounts included in earnings associated with the commitments to originate real estate loans for sale are reported as a component of other banking services in the Consolidated Statement of Income

The fair value information of assets and liabilities measured on a non-recurring basis presented below is not as of the period-end, but rather as of the date the fair value adjustment was recorded closest to the date presented.

	September 30, 2016				December 31, 2015			
	Level 1	Level 2	Level 3	Total Fair Value	Level 1	Level 2	Level 3	Total Fair Value
(000's omitted)								
Impaired loans	\$0	\$ 0	\$769	\$769	\$0	\$ 0	\$1,765	\$1,765
Mortgage servicing rights	0	0	573	573	0	0	0	0
Other real estate owned	0	0	2,060	2,060	0	0	2,088	2,088
Total	\$0	\$ 0	\$3,402	\$3,402	\$0	\$ 0	\$3,853	\$3,853

Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral-dependent loans calculated when establishing the allowance for credit losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated

valuation amount does not necessarily represent the fair value of the loan. Real estate collateral is typically valued using independent appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace, adjusted for non-observable inputs. Thus, the resulting nonrecurring fair value measurements are generally classified as Level 3. Estimates of fair value used for other collateral supporting commercial loans generally are based on assumptions not observable in the marketplace and, therefore, such valuations classify as Level 3.

Other real estate owned ("OREO") is valued at the time the loan is foreclosed upon and the asset is transferred to OREO. The value is based primarily on third party appraisals, less costs to sell. The appraisals are sometimes further discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the customer and customer's business. Such discounts are significant, ranging from 9% to 71% at September 30, 2016 and result in a Level 3 classification of the inputs for determining fair value. OREO is reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above. The Company recovers the carrying value of OREO through the sale of the property. The ability to affect future sales prices is subject to market conditions and factors beyond the Company's control and may impact the estimated fair value of a property.

Originated mortgage servicing rights are recorded at their fair value at the time of sale of the underlying loan, and are amortized in proportion to and over the estimated period of net servicing income. The fair value of mortgage servicing rights is based on a valuation model incorporating inputs that market participants would use in estimating future net servicing income. Such inputs include estimates of the cost of servicing loans, appropriate discount rate and prepayment speeds and are considered to be unobservable and contribute to the Level 3 classification of mortgage servicing rights. In accordance with GAAP, the Company must record impairment charges, on a nonrecurring basis, when the carrying value of a stratum exceeds its estimated fair value. Impairment is recognized through a valuation allowance. There is a valuation allowance at September 30, 2016 of approximately \$0.2 million.

The Company determines fair values based on quoted market values, where available, estimates of present values, or other valuation techniques. Those techniques are significantly affected by the assumptions used, including, but not limited to, the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, may not be realized in immediate settlement of the instrument. The significant unobservable inputs used in the determination of fair value of assets classified as Level 3 on a recurring or non-recurring basis are as follows:

(000's omitted)	Fair Value at September 30, 2016	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Range (Weighted Average)
Other real estate owned	\$ 2,060	Fair Value of Collateral	Estimated cost of disposal/market adjustment	9.0% - 71.0% (23.4 %)
Impaired loans	769	Fair Value of Collateral	Estimated cost of disposal/market adjustment	15.0% - 17.6% (16.3 %)
Commitments to originate real estate loans for sale	474	Discounted cash flow	Embedded servicing value	1 %
Mortgage servicing rights	573	Discounted cash flow	Weighted average constant prepayment rate	11.8 %
			Weighted average discount rate	2.24 %
			Adequate compensation	\$7/loan

(000's omitted)	Fair Value at December 31, 2015	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Range (Weighted Average)
Other real estate owned	\$ 2,088	Fair value of collateral	Estimated cost of disposal/market adjustment	5.3% - 74.0% (27.7 %)
Impaired loans	1,765	Fair value of collateral	Estimated cost of disposal/market adjustment	9.0% - 20.0% (17.9 %)
Commitments to originate real estate loans for sale	117	Discounted cash flow	Embedded servicing value	1 %

Certain financial instruments and all nonfinancial instruments are excluded from fair value disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company. The carrying amounts and estimated fair values of the Company's other financial instruments that are not accounted for at fair value at September 30, 2016 and December 31, 2015 are as follows:

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(000's omitted)	September 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
Net loans	\$4,893,832	\$4,958,819	\$4,755,974	\$4,808,856
Financial liabilities:				
Deposits	7,077,419	7,074,685	6,873,474	6,871,098
Borrowings	133,900	133,900	301,300	301,300
Subordinated debt held by unconsolidated subsidiary trusts	102,164	82,380	102,146	84,680

The following is a further description of the principal valuation methods used by the Company to estimate the fair values of its financial instruments.

Loans have been classified as a Level 3 valuation. Fair values for variable rate loans that reprice frequently are based on carrying values. Fair values for fixed rate loans are estimated using discounted cash flows and interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Deposits have been classified as a Level 2 valuation. The fair value of demand deposits, interest-bearing checking deposits, savings accounts, and money market deposits is the amount payable on demand at the reporting date. The fair value of time deposit obligations are based on current market rates for similar products.

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Borrowings have been classified as a Level 2 valuation. The fair value of FHLB overnight advances is the amount payable on demand at the reporting date. Fair values for long-term borrowings are estimated using discounted cash flows and interest rates currently being offered on similar borrowings, and are immaterial as of the reporting dates.

Subordinated debt held by unconsolidated subsidiary trusts have been classified as a Level 2 valuation. The fair value of subordinated debt held by unconsolidated subsidiary trusts are estimated using discounted cash flows and interest rates currently being offered on similar securities.

Other financial assets and liabilities – Cash and cash equivalents have been classified as a Level 1 valuation, while accrued interest receivable and accrued interest payable have been classified as a Level 2 valuation. The fair values of each approximate the respective carrying values because the instruments are payable on demand or have short-term maturities and present relatively low credit risk and interest rate risk.

NOTE L: DERIVATIVE INSTRUMENTS

The Company is party to derivative financial instruments in the normal course of its business to meet the financing needs of its customers and to manage its own exposure to fluctuations in interest rates. These financial instruments have been limited to commitments to originate real estate loans held for sale and forward sales commitments. The Company does not hold or issue derivative financial instruments for trading or other speculative purposes.

The Company enters into forward sales commitments for the future delivery of residential mortgage loans, and interest rate lock commitments to fund loans at a specified interest rate. The forward sales commitments are utilized to reduce interest rate risk associated with interest rate lock commitments and loans held for sale. Changes in the estimated fair value of the forward sales commitments and interest rate lock commitments subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time. At inception and during the life of the interest rate lock commitment, the Company includes the expected net future cash flows related to the associated servicing of the loan as part of the fair value measurement of the interest rate lock commitments. These derivatives are recorded at fair value, which were immaterial at September 30, 2016. The effect of the changes to these derivatives for the three and nine months then ended was also immaterial.

NOTE M: SEGMENT INFORMATION

Operating segments are components of an enterprise, which are evaluated regularly by the "chief operating decision maker" in deciding how to allocate resources and assess performance. The Company's chief operating decision maker is the President and Chief Executive Officer of the Company. The Company has identified Banking and Employee Benefit Services as its reportable operating business segments. CBNA operates the Banking segment that provides full-service banking to consumers, businesses, and governmental units in northern, central, and western New York as well as northeastern Pennsylvania. Employee Benefit Services, which includes Benefit Plans Administrative Services LLC, BPAS Actuarial and Pension Services, LLC (formerly Harbridge Consulting Group, LLC), and Hand Benefits & Trust Company, provides employee benefit trust, collective investment fund, retirement plan administration, actuarial, VEBA/HRA, and health and welfare consulting services. The All Other segment is comprised of; (a) wealth management services including trust services provided by the personal trust unit within the Bank, broker-dealer and investment advisory services provided by Community Investment Services, Inc. ("CISI"), OWM, and The Carta Group, Inc., as well as asset management provided by Nottingham Advisors, Inc., and (b) full-service insurance, risk management and employee benefit services provided by OneGroup. The accounting policies used in the disclosure of business segments are the same as those described in the summary of significant accounting policies (See Note A, Summary of Significant Accounting Policies of the most recent Form 10-K for the year ended December 31, 2015 filed with the SEC on February 29, 2016).

Information about reportable segments and reconciliation of the information to the consolidated financial statements follows:

(000's omitted)	Banking	Employee Benefit Services	All Other	Eliminations	Consolidated Total
Three Months Ended September 30, 2016					
Net interest income	\$68,375	\$ 39	\$49	\$ 0	\$ 68,463
Provision for loan losses	1,790	0	0	0	1,790
Noninterest revenues	17,756	11,680	11,139	(623)	39,952
Amortization of intangible assets	665	96	598	0	1,359
Other operating expenses	47,738	9,020	8,732	(623)	64,867
Income before income taxes	\$35,938	\$ 2,603	\$1,858	\$ 0	\$ 40,399
Assets	\$8,658,308	\$ 36,706	\$72,147	\$ (39,415)	\$ 8,727,746
Goodwill	\$440,870	\$ 8,019	\$16,253	\$ 0	\$ 465,142
Three Months Ended September 30, 2015					
Net interest income	\$62,295	\$ 37	\$31	\$ 0	\$ 62,363
Provision for loan losses	1,906	0	0	0	1,906
Noninterest revenues	15,503	11,674	4,735	(526)	31,386
Amortization of intangible assets	680	125	38	0	843
Other operating expenses	43,790	8,644	3,328	(526)	55,236
Income before income taxes	\$31,422	\$ 2,942	\$1,400	\$ 0	\$ 35,764
Assets	\$7,970,345	\$ 30,958	\$18,921	\$ (23,058)	\$ 7,997,166
Goodwill	\$364,495	\$ 8,019	\$2,660	\$ 0	\$ 375,174
Nine Months Ended September 30, 2016					
Net interest income	\$203,394	\$ 117	\$139	\$ 0	\$ 203,650
Provision for loan losses	5,436	0	0	0	5,436
Noninterest revenues	49,663	36,137	32,989	(1,784)	117,005
Amortization of intangible assets	2,075	326	1,803	0	4,204

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Other operating expenses	143,882	27,899	26,050	(1,784)	196,047
Income before income taxes	\$ 101,664	\$ 8,029	\$ 5,275	\$ 0		\$ 114,968

Nine Months Ended September 30, 2015

Net interest income	\$ 183,243	\$ 102	\$ 86	\$ 0		\$ 183,431
Provision for loan losses	3,120	0	0	0		3,120
Noninterest revenues	43,037	34,633	13,943	(1,462)	90,151
Amortization of intangible assets	2,129	391	122	0		2,642
Other operating expenses	131,002	26,052	9,841	(1,462)	165,433
Income before income taxes	\$ 90,029	\$ 8,292	\$ 4,066	\$ 0		\$ 102,387

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") primarily reviews the financial condition and results of operations of Community Bank System, Inc. (the "Company" or "CBSI") as of and for the three and nine months ended September 30, 2016 and 2015, although in some circumstances the second quarter of 2016 is also discussed in order to more fully explain recent trends. The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and related notes that appear on pages 3 through 27. All references in the discussion of the financial condition and results of operations refer to the consolidated position and results of the Company and its subsidiaries taken as a whole. Unless otherwise noted, the term "this year" and equivalent terms refers to results in calendar year 2016, "third quarter" refers to the three months ended September 30, 2016, "YTD" refers to the nine months ended September 30, 2016, and earnings per share ("EPS") figures refer to diluted EPS.

This MD&A contains certain forward-looking statements with respect to the financial condition, results of operations, and business of the Company. These forward-looking statements involve certain risks and uncertainties. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements are set herein under the caption, "Forward-Looking Statements," on page 44.

Critical Accounting Policies

As a result of the complex and dynamic nature of the Company's business, management must exercise judgment in selecting and applying the most appropriate accounting policies for its various areas of operations. The policy decision process not only ensures compliance with the latest generally accepted accounting principles ("GAAP"), but also reflects management's discretion with regard to choosing the most suitable methodology for reporting the Company's financial performance. It is management's opinion that the accounting estimates covering certain aspects of the business have more significance than others due to the relative importance of those areas to overall performance, or the level of subjectivity in the selection process. These estimates affect the reported amounts of assets and liabilities as well as disclosures of revenues and expenses during the reporting period. Actual results could differ from these estimates. Management believes that the critical accounting estimates include:

· Acquired loans – Acquired loans are initially recorded at their acquisition date fair values based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, prepayment risk, liquidity risk, default rates, loss severity, payment speeds, collateral values, and discount rate.

Acquired loans deemed impaired at acquisition are recorded in accordance with ASC 310-30. The excess of undiscounted cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount. The difference between contractually required payments at acquisition and the undiscounted cash flows expected to be collected at acquisition is referred to as the non-accretable discount, which represents estimated future credit losses and other contractually required payments that the Company does not expect to collect. Subsequent decreases in expected cash flows are recognized as impairments through a charge to the provision for loan losses resulting in an increase in the allowance for loan losses. Subsequent improvements in expected cash flows result in a recovery of previously recorded allowance for loan losses or a reversal of a corresponding amount of the non-accretable discount, which the Company then reclassifies as an accretable discount that is recognized into interest income over the remaining life of the loans using the interest method.

For acquired loans that are not deemed impaired at acquisition, the difference between the acquisition date fair value and the outstanding balance represents the fair value adjustment for a loan, and includes both credit and interest rate considerations. Subsequent to the purchase date, the methods used to estimate the allowance for loan losses for the acquired non-impaired loans is consistent with the policy described below. However, for loans collectively evaluated for impairment, the Company compares the net realizable value of the loans to the carrying value. The carrying value represents the net of the loan's unpaid principal balance and the remaining purchase discount (or premium) that has

yet to be accreted into interest income. When the carrying value exceeds the net realizable value, an allowance for loan losses is recognized. For loans individually evaluated for impairment, a provision is recorded when the required allowance exceeds any remaining discount on the loan.

Allowance for loan losses – The allowance for loan losses reflects management's best estimate of probable loan losses in the Company's loan portfolio. Determination of the allowance for loan losses is inherently subjective. It requires significant estimates, including the amounts and timing of expected future cash flows on impaired loans, appraisal values of underlying collateral for collateralized loans, and the amount of estimated losses on pools of homogeneous loans which is based on historical loss experience and consideration of current economic trends, all of which may be susceptible to significant change.

Investment securities – Investment securities are classified as held-to-maturity, available-for-sale, or trading. The appropriate classification is based partially on the Company's ability to hold the securities to maturity and largely on management's intentions with respect to either holding or selling the securities. The classification of investment securities is significant since it directly impacts the accounting for unrealized gains and losses on securities. Unrealized gains and losses on available-for-sale securities are recorded in accumulated other comprehensive income or loss, as a separate component of shareholders' equity, and do not affect earnings until realized. The fair values of investment securities are generally determined by reference to quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, or a discounted cash flow model using market estimates of interest rates and volatility. Investment securities with significant declines in fair value are evaluated to determine whether they should be considered other-than-temporarily impaired ("OTTI"). An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an other-than-temporary impairment write-down is recorded in earnings, while the remaining portion of the impairment loss is recognized in other comprehensive income (loss), provided the Company does not intend to sell the underlying debt security, and it is not more likely than not that the Company will be required to sell the debt security prior to recovery of the full value of its amortized cost basis.

Retirement benefits – The Company provides defined benefit pension benefits to eligible employees and post-retirement health and life insurance benefits to certain eligible retirees. The Company also provides deferred compensation and supplemental executive retirement plans for selected current and former employees. Expense under these plans is charged to current operations and consists of several components of net periodic benefit cost based on various actuarial assumptions regarding future experience under the plans, including, but not limited to, discount rate, rate of future compensation increases, mortality rates, future health care costs, and the expected return on plan assets.

Intangible assets – As a result of acquisitions, the Company carries goodwill and identifiable intangible assets. Goodwill represents the cost of acquired companies in excess of the fair value of net assets at the acquisition date. Goodwill is evaluated at least annually, or when business conditions suggest impairment may have occurred. Should impairment occur, goodwill will be reduced to its carrying value through a charge to earnings. Core deposits and other identifiable intangible assets are amortized to expense over their estimated useful lives. The determination of whether or not impairment exists is based upon discounted cash flow modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires them to select a discount rate that reflects the current return requirements of the market in relation to present risk-free interest rates, required equity market premiums, and company-specific performance and risk metrics, all of which are susceptible to change based on changes in economic and market conditions and other factors. Future events or changes in the estimates used to determine the carrying value of goodwill and identifiable intangible assets could have a material impact on the Company's results of operations.

A summary of the accounting policies used by management is disclosed in Note A, "Summary of Significant Accounting Policies" on pages 56-61 of the most recent Form 10-K (fiscal year ended December 31, 2015) filed with the Securities and Exchange Commission ("SEC") on February 29, 2016.

Supplemental Reporting of Non-GAAP Results of Operations

The Company consistently provides supplemental reporting of its results on a "net operating" or "tangible" basis, from which the amortization of core deposits and other intangible assets (and the related goodwill, core deposit intangible and other intangible asset balances, net of applicable deferred tax amounts) and acquisition expenses are excluded. Reconciliations of GAAP amounts with corresponding non-GAAP amounts are presented in Table 11.

Executive Summary

The Company's business philosophy is to operate as a community bank with local decision-making, principally in non-metropolitan markets, providing a broad array of banking and financial services to retail, commercial and municipal customers. The Company's banking subsidiary is Community Bank, N.A. (the "Bank" or "CBNA").

The Company's core operating objectives are: (i) grow the branch network, primarily through a disciplined acquisition strategy, and certain selective de novo expansions, (ii) build profitable loan and deposit volume using both organic and acquisition strategies, (iii) increase the noninterest component of total revenues through development of banking-related fee income, growth in existing financial services business units, and the acquisition of additional financial services and banking businesses, and (iv) utilize technology to deliver customer-responsive products and services and improve efficiencies.

Significant factors reviewed by management to evaluate achievement of the Company's operating objectives and its operating results and financial condition include, but are not limited to: net income and earnings per share, return on assets and equity, net interest margins, noninterest revenues, noninterest expenses, asset quality, loan and deposit growth, capital management, performance of individual banking and financial services units, performance of specific product lines and customers, liquidity and interest rate sensitivity, enhancements to customer products and services and their underlying performance characteristics, technology advancements, market share, peer comparisons, and the performance of recently acquired businesses.

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On December 4, 2015, the Company completed its acquisition of Oneida Financial Corp. ("Oneida"), parent company of Oneida Savings Bank, headquartered in Oneida, New York for approximately \$158 million in Company stock and cash, comprised of \$56.3 million of cash and the issuance of 2.38 million shares of common stock. Upon the completion of the merger, the Bank added 12 branch locations in the New York State counties of Oneida and Madison and approximately \$769 million of assets, including approximately \$399 million of loans and \$226 million of investment securities, and \$699 million of deposits. Through the acquisition of Oneida, the Company acquired, among others, OneGroup NY, Inc. ("OneGroup") and Oneida Wealth Management, Inc. ("OWM"), wholly-owned subsidiaries primarily engaged in offering insurance and investment advisory services. These subsidiaries complement the Company's other non-banking financial services businesses.

Third quarter and year-to-date net income increased compared to the comparable 2015 timeframes by \$2.1 million and \$6.3 million, respectively. Earnings per share of \$0.61 for the third quarter of 2016 was \$0.01 higher than the third quarter of 2015, while 2016 year-to-date earnings per share of \$1.74 exceeded 2015 year-to-date earnings per share by \$0.02. The higher net income was due to increases in net interest income and noninterest revenues, partially offset by increases in noninterest expenses, and a higher effective income tax rate. The increase in net interest income was generated as a result of an increase in average earning assets, with quarterly results also benefiting from a two basis point increase in the net interest margin from the prior year quarter, while year-to-date results were adversely impacted by a five basis point decline in the net interest margin. The increase in quarterly noninterest revenues was a result of continued acquired and organic growth, combined with \$1.0 million of nonrecurring insurance-related gains.

The growth in loans and deposits was evident as balances showed increases on both an average and ending basis as compared to the corresponding prior year period and the fourth quarter of 2015. The increases were a result of the Oneida acquisition late in the fourth quarter of 2015 and solid organic growth.

The trends of declining yields on interest-earning assets and lower rates on interest-bearing liabilities continued. The continued low-rate environment has generally meant that higher rate interest-earning assets continue to be replaced with lower rate assets, although that has moderated somewhat over the last year. The continued modest decline in the cost of funds is a result of a larger proportion of funding coming from lower rate and noninterest-bearing accounts, instead of higher cost time deposits and borrowings.

The current quarter provision for loan losses was lower than that recorded in the third quarter of 2015, reflective of slightly lower levels of net charge-offs and a change in the overall portfolio mix related to commercial loan payoffs in the third quarter. Asset quality in the third quarter of 2016 remained stable and favorable. Third quarter nonperforming and delinquent loan ratios were lower than those experienced in the third quarter of 2015.

Pending Acquisition – Merchants Bancshares, Inc.

On October 24, 2016, the Company announced that it had entered into a definitive agreement to acquire Merchants Bancshares, Inc. ("Merchants"), parent company of Merchants Bank headquartered in South Burlington, Vermont, for approximately \$304 million in Company stock and cash. The acquisition will extend the Company's footprint into the Vermont and Western Massachusetts markets. Upon the completion of the merger, Community Bank will add 31 branch locations in Vermont and one location in Massachusetts with approximately \$1.9 billion of assets, and deposits of \$1.5 billion. The acquisition is expected to close during the second quarter of 2017, pending both customary regulatory and Merchants shareholder approvals. The Company expects to incur certain one-time, transaction-related costs in 2016 and 2017.

Net Income and Profitability

As shown in Table 1, net income for the third quarter and September YTD of \$27.2 million and \$77.4 million, respectively, was up \$2.1 million, or 8.5%, as compared to the third quarter of 2015 and up \$6.3 million, or 8.8%,

compared to September YTD 2015. Earnings per share of \$0.61 for the third quarter was one cent higher than the third quarter of 2015, while earnings per share for the first nine months of 2016 of \$1.74 was two cents greater than the first nine months of 2015. The increases in net income are primarily due to the effect of the Oneida acquisition and incremental nonrecurring insurance-related gains, with earnings per share impacted by an increase in outstanding shares principally related to the shares issued as consideration in the Oneida acquisition.

As reflected in Table 1, third quarter net interest income of \$68.5 million was up \$6.1 million, or 9.8%, from the comparable prior year period. Net interest income for the first nine months of 2016 increased \$20.2 million, or 11.0%, versus the first nine months of 2015. The quarterly and year-to-date improvement resulted from an increase in interest-earning assets, primarily from the Oneida acquisition, as well as solid organic loan growth combined with incremental commercial lending income related to early termination fees, which more than offset a decline in investment yields.

The provision for loan losses for the third quarter of 2016 decreased \$0.1 million compared to the third quarter of 2015, reflective of a slightly lower level of net charge-offs and a change in the overall portfolio mix related to commercial loan payoffs in the third quarter of 2016. The provision for loan losses for the September YTD period increased \$2.3 million as compared to the first nine months of 2015 reflective of slightly higher level of net charge-offs for the year-to-date period and solid organic loan growth.

Third quarter and year-to-date noninterest revenues were \$40.0 million and \$117.0 million, respectively, up \$8.6 million, or 27.3%, from the third quarter of 2015 and up \$26.9 million, or 29.8%, from the first nine months of 2015. The increases were a result of increases in wealth management and insurance revenue primarily related to the Oneida acquisition, as well as revenue growth generated by the Company's other financial services subsidiaries, nonrecurring insurance-related gains, and increased revenues from banking sources as a result of the expanded branch network and customer base.

Noninterest expenses of \$66.2 million and \$200.3 million for the third quarter and September YTD periods reflected an increase of \$10.1 million, or 18.1%, from the third quarter of 2015 and an increase of \$32.2 million, or 19.1%, from the first nine months of 2015. Excluding acquisition-related expenses, 2016 operating expenses were \$10.7 million higher for the third quarter and \$33.2 million higher for the year-to-date timeframe. The increases in noninterest expenses were mostly a result of operating a larger franchise, primarily due to the Oneida acquisition.

A condensed income statement is as follows:

Table 1: Condensed Income Statements

(000's omitted, except per share data)	Three Months		Nine Months Ended	
	Ended September 30, 2016	2015	September 30, 2016	2015
Net interest income	\$68,463	\$62,363	\$203,650	\$183,431
Provision for loan losses	1,790	1,906	5,436	3,120
Noninterest revenues	39,952	31,386	117,005	90,151
Noninterest expenses	66,226	56,079	200,251	168,075
Income before income taxes	40,399	35,764	114,968	102,387
Income taxes	13,239	10,742	37,548	31,228
Net income	\$27,160	\$25,022	\$77,420	\$71,159
Diluted weighted average common shares outstanding	44,835	41,470	44,609	41,343
Diluted earnings per share	\$0.61	\$0.60	\$1.74	\$1.72

Net Interest Income

Net interest income is the amount by which interest and fees on earning assets (loans, investments, and cash equivalents) exceeds the cost of funds, which consists primarily of interest paid to the Company's depositors and interest on external borrowings. Net interest margin is the difference between the yield on earning assets and the cost of interest-bearing funds as a percentage of earning assets.

As shown in Table 2a, net interest income (with nontaxable income converted to a fully tax-equivalent basis) for the third quarter was \$70.9 million, a \$5.4 million, or 8.2%, increase from the same period last year. The increase resulted from an increase in interest-earning assets of \$560.1 million from the third quarter of 2015, primarily related to the Oneida acquisition and solid organic loan growth, partially offset by a \$317.3 million increase in average interest-bearing liabilities. As reflected in Table 3, the third quarter volume increase in interest-earning assets combined with a rate decrease on interest-bearing liabilities had a \$5.6 million favorable impact on net interest income, while the change in rate on interest-earning assets and volume increase on interest-bearing liabilities had a \$0.2 million unfavorable impact on net interest income. September YTD net interest income, as reflected in Table 2b, of \$211.2 million increased \$18.4 million, or 9.6%, from the year-earlier period. The September YTD increase resulted from an increase in interest-earning assets of \$764.1 million from the prior year, partially offset by a six basis point decrease in earning asset yields and a \$528.9 million increase in average interest-bearing liabilities. The volume increase in interest-earning assets combined with modestly lower funding costs on interest-bearing liabilities had a

\$22.4 million favorable impact on September YTD net interest income, while the rate decrease on interest-earning assets and volume increase on interest-bearing liabilities had a \$4.0 million unfavorable impact on net interest income.

The higher net interest margin for the third quarter of 2016 as compared to the third quarter of 2015 was the result of the average yield on interest-earning assets increasing one basis point, while the average rate on interest-bearing liabilities decreased one basis point from the prior year period. The net interest margin of 3.69% for the first nine months of 2016 was five basis points lower than the comparable period of 2015. The yield on interest-earning assets declined six basis points and the rate on interest-bearing liabilities declined one basis point for the first nine months of 2016 as compared to the prior year period. Declining asset yields outweighed the positive effect of modestly lower funding costs on the net interest margin.

The higher average yield on earning assets was the result of incremental commercial lending income related to certain early loan termination fees and an increase in interest on funds held at the Federal Reserve, offset by a continued decrease in the average yields on certain loans as well as the average yield on investments. For the third quarter, the average yield on loans decreased by four basis points compared to the prior year period while the average yield on investments, including cash equivalents, declined seven basis points. For the first nine months of 2016, the average yield on loans decreased seven basis points from the comparable period of 2015, and the average yield on investments, including cash equivalents, declined 13 basis points. The decline in the loan yield was due to yields on new longer term fixed loan volume being generally below rates on the overall portfolio in the continued low-rate environment, partially offset by incremental commercial lending income related to early loan termination fees and higher short-term rates on adjustable rate loans. The lower average yield of investments was the result of maturing higher rate investments being replaced with lower rate instruments, as well as the effect certain changes in state tax rates had on the fully tax-equivalent rate adjustment.

The average rate on interest-bearing liabilities for the quarter and year-to-date periods decreased by one basis point from the equivalent prior year periods, as a slight decline in the average rate of interest-bearing deposits was partially offset by an increase in the average interest rate paid on external borrowings. The average rate on interest-bearing deposits decreased one basis point for the third quarter, while the average rate on borrowings increased 59 basis points compared to the prior year third quarter. For the first nine months of 2016, the average rate on interest-bearing deposits decreased one basis point and the average rate on borrowings increased 55 basis points from the comparable prior year period. The increase in the average cost of borrowings for both periods was the result of lower-rate overnight FHLB borrowings becoming a smaller proportion of this funding component, as well as increased costs resulting from the 25 basis-point rate increase in the Federal Funds rate in late 2015.

The third quarter average balance of investments, including cash equivalents, decreased \$66.4 million, primarily related to maturities, calls and principal payments on the nontaxable municipal investment portfolio. The year-to-date average balance of investments, including cash equivalents, increased \$130.0 million. The growth in the year-to-date average balance relates to securities purchased during the late first quarter and second quarter 2015 in anticipation of the Oneida transaction. Average loan balances increased \$626.5 million for the quarter and \$634.1 million year-to-date as compared to the prior year, with \$390.5 million of the year-to-date increase due to the Oneida acquisition, with the remainder coming from solid organic loan growth across all lending portfolios.

The quarterly and year-to-date increases in average interest-bearing deposits of \$665.7 million and \$719.7 million, respectively, was primarily a result of the Oneida transaction, which added \$572.2 million of the year-to-date increase, as well as the addition of new customers and growth in the balances of existing accounts. The average borrowing balance decreased \$348.4 million for the quarter and \$190.8 million year-to-date compared to corresponding prior year periods, reflective of the decrease in overnight FHLB borrowings due to the net liquidity from the Oneida transaction and additional funding from organic deposit growth.

Tables 2a and 2b below sets forth information related to average interest-earning assets and interest-bearing liabilities and their associated yields and rates for the periods indicated. Interest income and yields are on a fully tax-equivalent basis ("FTE") using marginal income tax rates of 38.2% and 38.4% in 2016 and 2015, respectively. Average balances are computed by totaling the daily ending balances in a period and dividing by the number of days in that period. Loan interest income and yields include amortization of deferred loan fees and costs as well as accretion of acquired loan marks. Average loan balances include nonaccrual loans and loans held for sale.

Table 2a: Quarterly Average Balance Sheet

(000's omitted except yields and rates)	Three Months Ended September 30, 2016			Three Months Ended September 30, 2015				
	Average Balance	Interest	Avg. Yield/Rate Paid	Average Balance	Interest	Avg. Yield/Rate Paid		
Interest-earning assets:								
Cash equivalents	\$ 19,110	\$ 22	0.46 %	\$ 12,395	\$ 7	0.22 %		
Taxable investment securities ⁽¹⁾	2,179,044	13,322	2.43 %	2,187,818	13,586	2.46 %		
Nontaxable investment securities ⁽¹⁾	571,327	6,565	4.57 %	635,627	7,360	4.59 %		
Loans (net of unearned discount) ⁽²⁾	4,913,517	53,863	4.36 %	4,287,062	47,493	4.40 %		
Total interest-earning assets	7,682,998	73,772	3.82 %	7,122,902	68,446	3.81 %		
Noninterest-earning assets	1,029,760			797,064				
Total assets	\$ 8,712,758			\$ 7,919,966				
Interest-bearing liabilities:								
Interest checking, savings, and money market deposits	\$ 4,667,593	1,006	0.09 %	\$ 4,020,155	891	0.09 %		
Time deposits	737,587	770	0.42 %	719,358	803	0.44 %		
FHLB borrowings	225,417	337	0.59 %	573,822	587	0.41 %		
Subordinated debt held by unconsolidated subsidiary trusts	102,161	746	2.90 %	102,136	640	2.48 %		
Total interest-bearing liabilities	5,732,758	2,859	0.20 %	5,415,471	2,921	0.21 %		
Noninterest-bearing liabilities:								
Noninterest checking deposits	1,569,960			1,363,022				
Other liabilities	170,113			125,025				
Shareholders' equity	1,239,927			1,016,448				
Total liabilities and shareholders' equity	\$ 8,712,758			\$ 7,919,966				
Net interest earnings		\$ 70,913			\$ 65,525			
Net interest spread			3.62 %			3.60 %		
Net interest margin on interest-earning assets			3.67 %			3.65 %		
Fully tax-equivalent adjustment		\$ 2,450			\$ 3,162			

Averages for investment securities are based on historical cost basis and the yields do not give effect to changes in (1) fair value that is reflected as a component of noninterest-earning assets, shareholders' equity, and deferred taxes.

(2) Includes nonaccrual loans. The impact of interest and fees not recognized on nonaccrual loans was immaterial.

Table 2b: Quarterly Average Balance Sheet

(000's omitted except yields and rates)	Nine Months Ended September 30, 2016			Nine Months Ended September 30, 2015				
	Average Balance	Interest	Avg. Yield/Rate Paid	Average Balance	Interest	Avg. Yield/Rate Paid		
Interest-earning assets:								
Cash equivalents	\$20,303	\$70	0.46	%	\$13,912	\$24	0.23	%
Taxable investment securities ⁽¹⁾	2,176,833	40,886	2.51	%	2,022,704	39,089	2.58	%
Nontaxable investment securities ⁽¹⁾	587,780	20,543	4.67	%	618,270	22,116	4.78	%
Loans (net of unearned discount) ⁽²⁾	4,864,402	158,267	4.35	%	4,230,301	139,751	4.42	%
Total interest-earning assets	7,649,318	219,766	3.84	%	6,885,187	200,980	3.90	%
Noninterest-earning assets	1,008,774				812,346			
Total assets	\$8,658,092				\$7,697,533			
Interest-bearing liabilities:								
Interest checking, savings, and money market deposits	\$4,696,564	3,096	0.09	%	\$3,999,234	2,658	0.09	%
Time deposits	763,481	2,446	0.43	%	741,133	2,567	0.46	%
FHLB borrowings	189,246	835	0.59	%	380,039	1,081	0.38	%
Subordinated debt held by unconsolidated subsidiary trusts	102,156	2,161	2.83	%	102,130	1,881	2.46	%
Total interest-bearing liabilities	5,751,447	8,538	0.20	%	5,222,536	8,187	0.21	%
Noninterest-bearing liabilities:								
Noninterest checking deposits	1,543,387				1,334,913			
Other liabilities	155,299				127,617			
Shareholders' equity	1,207,959				1,012,467			
Total liabilities and shareholders' equity	\$8,658,092				\$7,697,533			
Net interest earnings		\$211,228				\$192,793		
Net interest spread			3.64	%			3.69	%
Net interest margin on interest-earning assets			3.69	%			3.74	%
Fully tax-equivalent adjustment		\$7,578				\$9,362		

⁽¹⁾ Averages for investment securities are based on historical cost basis and the yields do not give effect to changes in fair value that is reflected as a component of noninterest-earning assets, shareholders' equity, and deferred taxes.

⁽²⁾ Includes nonaccrual loans. The impact of interest and fees not recognized on nonaccrual loans was immaterial.

As discussed above and disclosed in Table 3 below, the change in net interest income (fully tax-equivalent basis) may be analyzed by segregating the volume and rate components of the changes in interest income and interest expense for each underlying category.

Table 3: Rate/Volume

	Three months ended September 30, 2016 versus September 30, 2015			Nine months ended September 30, 2016 versus September 30, 2015		
	Increase (Decrease) Due to Change in ⁽¹⁾			Increase (Decrease) Due to Change in ⁽¹⁾		
(000's omitted)	Volume	Rate	Net Change	Volume	Rate	Net Change
Interest earned on:						
Cash equivalents	\$5	\$10	\$15	\$14	\$32	\$46
Taxable investment securities	(54)	(210)	(264)	2,917	(1,120)	1,797
Nontaxable investment securities	(738)	(57)	(795)	(1,073)	(500)	(1,573)
Loans	6,873	(503)	6,370	20,660	(2,144)	18,516
Total interest-earning assets ⁽²⁾	5,379	(53)	5,326	21,998	(3,212)	18,786
Interest paid on:						
Interest checking, savings and money market deposits	140	(25)	115	460	(22)	438
Time deposits	20	(53)	(33)	75	(196)	(121)
FHLB borrowings	(449)	199	(250)	(686)	440	(246)
Subordinated debt held by unconsolidated subsidiary trusts	0	106	106	0	280	280
Total interest-bearing liabilities ⁽²⁾	166	(228)	(62)	801	(450)	351
Net interest earnings ⁽²⁾	5,169	219	5,388	21,133	(2,698)	18,435

(1) The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of such change in each component.

(2) Changes due to volume and rate are computed from the respective changes in average balances and rates of the totals; they are not a summation of the changes of the components.

Noninterest Revenues

The Company's sources of noninterest revenues are of four primary types: 1) general banking services related to loans, deposits, and other core customer activities typically provided through the branch network and electronic banking channels (performed by CBNA); 2) employee benefit services (performed by Benefit Plans Administrative Services, Inc. and its subsidiaries); 3) wealth management services, comprised of trust services (performed by the trust unit within CBNA), investment products and services (performed by Community Investment Services, Inc. ("CISI") and OWM) and asset management services (performed by Nottingham Advisors, Inc.); and 4) insurance products and services (performed by OneGroup). Additionally, the Company has periodic transactions, most often net gains or losses from the sale of investment securities and prepayment of debt instruments.

Table 4: Noninterest Revenues

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	Three Months		Nine Months Ended	
	Ended		September 30,	
(000's omitted)	September 30,	September 30,	2016	2015
	2016	2015	2016	2015
Deposit service fees	\$14,894	\$13,459	\$43,636	\$39,142
Employee benefit services	11,267	11,330	34,949	33,727
Insurance revenues	5,702	367	17,340	1,091
Wealth management services	5,226	4,185	15,041	12,292
Other banking services	2,201	1,436	4,448	2,618
Mortgage banking	662	609	1,591	1,281
Total noninterest revenues	\$39,952	\$31,386	\$117,005	\$90,151

Noninterest revenues/operating revenues (FTE basis) ⁽¹⁾ 36.0 % 32.4 % 35.6 % 31.9 %

⁽¹⁾ Operating revenues is defined as net interest income on a fully-tax equivalent basis plus noninterest revenue.

As displayed in Table 4, noninterest revenues were \$40.0 million in the third quarter of 2016 and \$117.0 million for the first nine months of 2016. This represents an increase of \$8.6 million, or 27.3%, for the quarter and \$26.9 million, or 29.8%, for the YTD period in comparison to 2015, as the Oneida acquisition helped produce growth in both financial services revenues and banking revenues.

General banking noninterest revenue of \$17.1 million for the third quarter and \$48.1 million for the first nine months of 2016 were up \$2.2 million, or 14.8%, and \$6.3 million, or 15.1%, respectively, as compared to the corresponding prior year periods. This year-over-year increase was primarily driven by an expanded customer base following the Oneida transaction, an increase in deposit service fees resulting from increased debit card-related revenue as well as certain non-recurring insurance-related gains, partially offset by the continuing trend of lower utilization of overdraft protection programs and a decline in certain other deposit-related services.

Mortgage banking income totaled \$0.7 million for the third quarter of 2016 and \$1.6 million for the first nine months of 2016, an increase of \$0.1 million, or 8.7%, and \$0.3 million, or 24.2%, respectively, as compared to the corresponding prior year periods. Mortgage banking income consists of realized gains or losses from the sale of residential mortgage loans and the origination of mortgage loan servicing rights, unrealized gains and losses on residential mortgage loans held for sale and related commitments, mortgage loan servicing fees and other residential mortgage loan-related fee income. Residential mortgage loans sold to investors, primarily Fannie Mae, totaled \$12.0 million in the third quarter of 2016 and \$28.6 million for the first nine months of 2016 compared to \$10.9 million and \$27.1 million in the respective comparable prior year periods. Residential mortgage loans held for sale at September 30, 2016 totaled \$0.6 million. Realization of the unrealized gains or losses on mortgage loans held for sale and the related commitments, as well as future revenue generation from mortgage banking activities, are dependent on market conditions and long-term interest rate trends.

Employee benefit services revenue decreased slightly as compared to the prior year quarter and increased \$1.2 million, or 3.6%, as compared to the nine months ended September 30, 2015. Wealth management and insurance revenues were up \$6.4 million for the third quarter of 2016 and up \$19.0 million for September 2016 YTD as compared to the comparable time periods of 2015, primarily due to acquiring OneGroup and OWM in the Oneida transaction.

The ratio of noninterest revenues to total revenues (FTE basis) was 36.0% for the quarter and 35.6% for the nine months ended September 30, 2016, respectively, versus 32.4% and 31.9% for the comparable periods of 2015. The increase for the year-to-date period is a function of a 29.8% increase in non-interest income while net interest income (FTE basis) increased at a lesser 9.6% rate, impacted by both the mix of business acquired in the Oneida transaction as well as the decline in net interest margin for the year-to-date period.

Noninterest Expenses

Table 5 below sets forth the quarterly results of the major noninterest expense categories for the current and prior year, as well as efficiency ratios (defined below), a standard measure of expense utilization effectiveness commonly used in the banking industry.

Table 5: Noninterest Expenses

(000's omitted)	Three Months		Nine Months Ended	
	Ended September 30,		September 30,	
	2016	2015	2016	2015
Salaries and employee benefits	\$38,300	\$31,179	\$115,388	\$93,218
Occupancy and equipment	7,373	6,652	22,445	20,891
Data processing and communications	8,744	7,643	25,886	22,106
Amortization of intangible assets	1,359	843	4,204	2,642

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Legal and professional fees	1,928	1,564	6,302	4,952				
Office supplies and postage	1,713	1,636	5,336	4,733				
Business development and marketing	2,004	1,889	6,167	5,711				
FDIC insurance premiums	707	968	2,899	2,920				
Acquisition expenses	2	562	342	1,318				
Other	4,096	3,143	11,282	9,584				
Total noninterest expenses	\$66,226	\$56,079	\$200,251	\$168,075				
Operating expenses ⁽¹⁾ /average assets	2.96	%	2.74	%	3.02	%	2.85	%
Efficiency ratio ⁽²⁾	58.5	%	56.4	%	59.6	%	58.0	%

Operating expenses, a non-GAAP measure, is calculated as total noninterest expenses less acquisition expenses, and (1) amortization of intangibles. See Table 11 for Reconciliation of Quarterly GAAP to Non-GAAP Measures.

Efficiency ratio, a non-GAAP measure, is calculated as operating expenses as defined in (1) divided by net interest income on a fully tax-equivalent basis plus noninterest revenues. See Table 11 for Reconciliation of Quarterly (2) GAAP to Non-GAAP Measures.

As shown in Table 5, noninterest expenses were \$66.2 million and \$200.3 million for the third quarter and YTD periods of 2016, respectively, an increase of \$10.1 million, or 18.1%, and \$32.2 million, or 19.1%, from the comparable prior year periods. Included in the third quarter and YTD 2016 noninterest expenses are \$0.6 million and \$1.0 million less acquisition-related expenses, respectively, than the corresponding 2015 periods. Salaries and employee benefits increased \$7.1 million, or 22.8%, and \$22.2 million, or 23.8%, for the third quarter and YTD periods of 2016, respectively, as compared to the corresponding periods of 2015. The main drivers of the increases were an increase in average full-time equivalent employees due to the Oneida acquisition, annual merit-based personnel cost increases, and higher retirement plan benefits costs caused by lower pension discount rates. The remaining change to operating expenses can be attributed to increases in occupancy and equipment (up \$0.7 million for the quarter and \$1.5 million YTD), data processing and communications (up \$1.1 million for the quarter and \$3.8 million YTD), amortization of intangible assets (up \$0.5 million for quarter and \$1.6 million YTD), legal and professional (up \$0.4 million for the quarter and up \$1.3 million YTD), office supplies and postage (up \$0.1 million for quarter and \$0.6 million YTD), business development and marketing (up \$0.1 million for the quarter and \$0.5 million YTD), and other expenses (up \$1.0 million for the quarter and \$1.7 million YTD), all primarily a result of additional costs associated with acquired Oneida business activities, partially offset by a decrease in FDIC insurance premiums (down \$0.3 million for the quarter and down slightly YTD) resulting from a change in the structure of the FDIC assessment rate schedule in the third quarter.

The Company's efficiency ratio (total operating expenses excluding intangible amortization and acquisition expenses divided by the sum of FTE net interest income and noninterest revenues) was 58.5% for the third quarter, 2.1 percentage points unfavorable to the comparable quarter of 2015. This resulted from operating expenses (as described above) increasing 18.6% while operating income increased by only 14.4%, due to FTE net interest income growing at a slower 8.2% pace. The efficiency ratio of 59.6% for the first nine months of 2016 was 1.6 percentage points unfavorable as compared to the first nine months of 2015 due to operating expenses (as described above) increasing 19.2% while an increase in FTE-adjusted net interest income of 9.6% and a 29.8% increase in noninterest revenues resulted in an increase in operating income of a lesser 16.0%. Current year operating expenses, excluding intangible amortization and acquisition expenses, as a percentage of average assets increased 22 basis points and 17 basis points versus the prior year quarter and year-to-date periods, respectively. Operating expenses (as defined above) increased 18.6% for the quarter and 19.2% for the year-to-date period, while average assets increased at a slower 10.0% for the quarter and 12.5% for the year-to-date period. Both ratios were impacted by the Oneida acquisition, whose business operations are more heavily weighted towards financial services which, by their nature, carry higher costs in relation to their asset levels.

Income Taxes

The third quarter and YTD 2016 effective income tax rates were 32.8% and 32.7%, respectively, as compared to the 30.0% and 30.5% for the comparable periods of 2015, reflective of a higher proportion of income being generated from fully taxable sources, as well as certain statutory changes to state tax rates and structures, including those related to the Company's overall asset size being above \$8 billion on a consolidated basis.

Investments

The carrying value of investments (including unrealized gains and losses on available-for-sale securities) was \$2.88 billion at the end of the third quarter, an increase of \$29.7 million from December 31, 2015 and \$39.6 million decrease from September 30, 2015. The book value (excluding unrealized gains and losses) of investments decreased \$44.6 million from December 31, 2015 and decreased \$78.9 million from September 30, 2015. During the first nine months of 2016, the Company purchased \$7.0 million of obligations of state and political subdivisions with an average yield of 4.28%, and \$31.7 million of government agency mortgage-backed securities with an average yield of 2.21%. The Company also received \$86.7 million of investment maturities, calls, and principal payments during the first nine months of 2016.

The change in the carrying value of investments is also impacted by the amount of net unrealized gains in the available-for-sale portfolio. At September 30, 2016, the portfolio had a \$140.2 million net unrealized gain, an increase of \$74.3 million from the unrealized gain at December 31, 2015 and a \$39.3 million increase from the unrealized gain at September 30, 2015. These changes in the net unrealized gain were principally driven by the downward movement in longer-term interest rates.

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Table 6: Investment Securities

(000's omitted)	September 30, 2016		December 31, 2015		September 30, 2015	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available-for-Sale Portfolio:						
U.S. Treasury and agency securities	\$1,873,698	\$1,976,612	\$1,866,819	\$1,899,978	\$1,864,199	\$1,933,270
Obligations of state and political subdivisions	595,376	624,222	640,455	666,883	662,774	686,627
Government agency mortgage-backed securities	216,942	224,733	205,220	210,865	208,817	215,936
Corporate debt securities	5,735	5,774	16,672	16,680	16,705	16,782
Government agency collateralized mortgage obligations	10,086	10,504	12,862	13,308	13,836	14,418
Marketable equity securities	251	410	250	399	250	406
Total available-for-sale portfolio	2,702,088	2,842,255	2,742,278	2,808,113	2,766,581	2,867,439
Other Securities:						
Federal Home Loan Bank common stock	11,682	11,682	19,317	19,317	29,500	29,500
Federal Reserve Bank common stock	19,781	19,781	16,050	16,050	16,050	16,050
Other equity securities	3,926	3,926	4,460	4,460	4,274	4,274
Total other securities	35,389	35,389	39,827	39,827	49,824	49,824
Total investments	\$2,737,477	\$2,877,644	\$2,782,105	\$2,847,940	\$2,816,405	\$2,917,263

Loans

As shown in Table 7, loans ended the third quarter at \$4.9 billion, up \$627.1 million, or 14.5%, from one year earlier and up \$139.2 million, or 2.9%, from the end of 2015. The growth during the last twelve months was primarily attributable to the Oneida transaction which represented \$388.0 million of the increase, combined with productive organic growth in all portfolios, particularly in the consumer lending portfolios. The increase during the first nine months of 2016 occurred primarily from consumer indirect lending and consumer mortgage lending, partially offset by a slight decrease in the home equity portfolio.

Table 7: Loans

(000's omitted)	September 30, 2016		December 31, 2015		September 30, 2015	
Consumer mortgage	\$1,798,748	36.4 %	\$1,769,754	36.8 %	\$1,621,862	37.6 %
Business lending	1,506,878	30.5 %	1,497,271	31.2 %	1,288,772	29.9 %
Consumer indirect	1,037,077	21.0 %	935,760	19.5 %	872,988	20.2 %
Consumer direct	196,134	4.0 %	195,076	4.1 %	184,479	4.3 %
Home equity	401,784	8.1 %	403,514	8.4 %	345,446	8.0 %
Total loans	\$4,940,621	100.0 %	\$4,801,375	100.0 %	\$4,313,547	100.0 %

Consumer mortgages increased \$176.9 million, or 10.9%, from one year ago, with \$129.3 million of the increase related to the Oneida acquisition. The portfolio increased \$29.0 million, or 1.6%, from December 31, 2015.

Consumer mortgage volume has been strong over the last several years due to continued historically low long-term

rates and comparatively stable real estate valuations in the Company's primary markets. Interest rate levels and expected duration continue to be the most significant factors in determining whether the Company chooses to retain, versus sell and service, portions of its new mortgage production.

The combined total of general-purpose business lending to commercial and industrial customers, mortgages on commercial property and dealer floor plan financing is characterized as the Company's business lending activity. The business lending portfolio increased \$218.1 million, or 16.9%, from September 30, 2015, with the Oneida transaction contributing \$163.1 million of the increase. In addition, the portfolio increased \$9.6 million, or 0.6%, from December 31, 2015, as 2016 loan generation outpaced contractual and unscheduled principal reductions. Highly competitive conditions continue to prevail in the small and middle market commercial segments in which the Company primarily operates. The Company maintains its commitment to generating growth in its business portfolio in a manner that adheres to its twin goals of maintaining strong asset quality and producing profitable margins. The Company continues to invest in additional personnel, technology, and business development resources to further strengthen its capabilities in this important product category.

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Consumer installment loans, both those originated directly (such as personal installment and lines of credit), and indirectly (originated predominantly in automobile, marine, and recreational vehicle dealerships), increased \$175.7 million, or 16.6%, on a year-over-year basis, with \$45.2 million relating to the Oneida transaction, as well as strong organic growth in the indirect portfolio consistent with regional market conditions. Additionally, the portfolio increased \$102.4 million, or 9.1%, as compared to December 31, 2015, again reflective of strong organic growth. The volume of new and used vehicle sales to upper tier credit profile customers in the Company's primary markets has continued to expand in recent years. The Company is focused on maintaining the solid profitability produced by its in-market and contiguous market indirect portfolio, while continuing to pursue its disciplined, long-term approach to expanding its dealer network.

Home equity loans increased \$56.3 million, or 16.3%, from one year ago primarily due to the \$50.4 million acquired in the Oneida transaction, as well as organic growth driven by proactive marketing efforts and competitive rate offerings. The portfolio decreased \$1.7 million, or 0.4%, from December 31, 2015, due in part to home equity loans being paid off or down as part of the heightened level of consumer deleveraging that has occurred in response to continued low rate environment.

Asset Quality

Table 8 below exhibits the major components of nonperforming loans and assets and key asset quality metrics for the periods ending September 30, 2016 and 2015 and December 31, 2015.

Table 8: Nonperforming Assets

	September 30, 2016	December 31, 2015	September 30, 2015		
(000's omitted)					
Nonaccrual loans					
Consumer mortgage	\$ 14,127	\$ 12,790	\$ 13,581		
Business lending	5,234	6,567	7,112		
Consumer indirect	0	0	0		
Consumer direct	0	15	15		
Home equity	1,940	2,356	2,425		
Total nonaccrual loans	21,301	21,728	23,133		
Accruing loans 90+ days delinquent					
Consumer mortgage	988	1,805	1,481		
Business lending	390	126	135		
Consumer indirect	177	102	58		
Consumer direct	86	51	41		
Home equity	374	111	360		
Total accruing loans 90+ days delinquent	2,015	2,195	2,075		
Nonperforming loans					
Consumer mortgage	15,115	14,595	15,062		
Business lending	5,624	6,693	7,247		
Consumer indirect	177	102	58		
Consumer direct	86	66	56		
Home equity	2,314	2,467	2,785		
Total nonperforming loans	23,316	23,923	25,208		
Other real estate owned (OREO)	2,060	2,088	2,531		
Total nonperforming assets	\$ 25,376	\$ 26,011	\$ 27,739		
Nonperforming loans / total loans	0.47	% 0.50	% 0.58	%	
Nonperforming assets / total loans and other real estate	0.51	% 0.54	% 0.64	%	

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Delinquent loans (30 days old to nonaccruing) to total loans	1.06	%	1.16	%	1.19	%
Net charge-offs to average loans outstanding (quarterly)	0.12	%	0.31	%	0.15	%
Legacy net charge-offs to average legacy loans outstanding (quarterly)	0.13	%	0.34	%	0.14	%
Provision for loan losses to net charge-offs (quarterly)	117	%	95	%	119	%
Legacy provision for loan losses to net charge-offs (quarterly) ⁽¹⁾	124	%	62	%	127	%

⁽¹⁾Legacy loans exclude loans acquired after January 1, 2009. These ratios are included for comparative purposes to prior periods.

As displayed in Table 8, nonperforming assets at September 30, 2016 were \$25.4 million, a \$0.6 million decrease versus the level at the end of 2015 and a \$2.4 million decrease as compared to one year earlier. Nonperforming loans decreased \$0.6 million from year-end 2015 and were down \$1.9 million from September 30, 2015. Other real estate owned ("OREO") at September 30, 2016 of \$2.1 million was consistent with December 31, 2015 and decreased \$0.5 million from September 30, 2015. At September 30, 2016, OREO consisted of three commercial properties with a total value of \$0.7 million and 24 residential properties with a total value of \$1.4 million. This compares to four commercial properties with a total value of \$0.6 million and 27 residential properties with a total value of \$1.5 million at December 31, 2015 and five commercial properties with a total value of \$0.5 million and 32 residential properties with a total value of \$2.1 million at September 30, 2015. Nonperforming loans were 0.47% of total loans outstanding at the end of the third quarter, three basis points lower than the level at December 31, 2015 and an 11 basis point improvement from the level at September 30, 2015.

Approximately 65% of nonperforming loans at September 30, 2016 are related to the consumer mortgage portfolio. Collateral values of residential properties within the Company's market area have generally remained relatively stable over the past several years. Additionally, improved process efficiency and economic conditions including lower unemployment levels, have positively impacted consumers and have resulted in generally improving nonperforming mortgage levels in 2015 and 2016. Approximately 24% of the nonperforming loans at September 30, 2016 were related to the business lending portfolio, which is comprised of business loans broadly diversified by industry type. The remaining 11% of nonperforming loans relate to consumer installment and home equity loans, with home equity non-performing loan levels being driven by the same factors identified for consumer mortgages. The allowance for loan losses to nonperforming loans ratio, a general measure of coverage adequacy, was 201% at the end of the third quarter, as compared to 190% at year-end 2015 and 181% at September 30, 2015.

Members of the Company's senior management, special asset officers, and lenders review all delinquent and nonaccrual loans and OREO regularly in order to identify deteriorating situations, monitor known problem credits, and discuss any needed changes to collection efforts, if warranted. Based on the group's consensus, a relationship may be assigned a special assets officer or other senior lending officer to review the loan, meet with the borrowers, assess the collateral and recommend an action plan. This plan could include foreclosure, restructuring loans, issuing demand letters or other actions. The Company's larger criticized credits are also reviewed on a quarterly basis by senior credit administration management, as well as special assets officers and senior commercial lending management to monitor their status and discuss relationship management plans. Commercial lending management reviews the criticized loan portfolio on a monthly basis.

Delinquent loans (30 days past due through nonaccruing) as a percent of total loans was 1.06% at the end of the third quarter, 10 basis points below the 1.16% ratio at year-end 2015 and 13 basis points below the 1.19% ratio at September 30, 2015. The business lending delinquency ratio at the end of the third quarter was 19 basis points below the level at December 31, 2015 and 16 basis points below the level at September 30, 2015. The delinquency rate for consumer direct loans decreased as compared to the level at December 31, 2015, but increased over the level at September 30, 2015. The consumer indirect loan delinquency level decreased as compared to both December 31, 2015 and September 30, 2015. The delinquency ratio for consumer mortgages was below the level at December 31, 2015 and September 30, 2015. The delinquency ratio for the home equity portfolio increased as compared to both December 31, 2015 and September 30, 2015. The Company's success at keeping the nonperforming and delinquency ratios at favorable levels has been the result of its continued focus on maintaining strict underwriting standards, as well as the effective utilization of its collection and recovery capabilities.

Table 9: Allowance for Loan Losses Activity

(000's omitted)	Three Months		Nine Months Ended	
	Ended September 30, 2016	2015	September 30, 2016	2015
Allowance for loan losses at beginning of period	\$46,526	\$45,282	\$45,401	\$45,341
Charge-offs:				
Consumer mortgage	202	276	445	917
Business lending	284	293	1,289	769
Consumer indirect	2,037	1,597	5,439	4,421
Consumer direct	395	427	1,246	1,066
Home equity	6	66	142	188
Total charge-offs	2,924	2,659	8,561	7,361
Recoveries:				
Consumer mortgage	12	9	96	75
Business lending	220	107	511	715
Consumer indirect	892	740	3,146	3,077
Consumer direct	246	174	705	566
Home equity	27	29	55	55
Total recoveries	1,397	1,059	4,513	4,488
Net charge-offs	1,527	1,600	4,048	2,873
Provision for loans losses	1,790	1,906	5,436	3,120
Allowance for loan losses at end of period	\$46,789	\$45,588	\$46,789	\$45,588
Allowance for loan losses / total loans	0.95 %	1.06 %	0.95 %	1.06 %
Allowance for legacy loan losses / total legacy loans ⁽¹⁾	1.02 %	1.10 %	1.02 %	1.10 %
Allowance for loan losses / nonperforming loans	201 %	181 %	201 %	181 %
Allowance for legacy loan losses / legacy nonperforming loans ⁽¹⁾	238 %	201 %	238 %	201 %
Net charge-offs (annualized) to average loans outstanding:				
Consumer mortgage	0.04 %	0.07 %	0.03 %	0.07 %
Business lending	0.02 %	0.06 %	0.07 %	0.01 %
Consumer indirect	0.45 %	0.40 %	0.32 %	0.22 %
Consumer direct	0.29 %	0.53 %	0.36 %	0.36 %
Home equity	-0.02 %	0.04 %	0.03 %	0.05 %
Total loans	0.12 %	0.15 %	0.11 %	0.09 %

Legacy loans exclude loans acquired after January 1, 2009. These ratios are included for comparative purposes to ⁽¹⁾prior periods.

As displayed in Table 9, net charge-offs during the third quarter of 2016 were \$1.5 million, \$0.1 million less than the third quarter of 2015. Net charge-offs for the nine months ended September 30, 2016 were \$4.0 million, a \$1.2 million increase from the first nine months of 2015. All portfolios except consumer mortgage and home equity experienced higher levels of net charge-offs through the first nine months of 2016 as compared to the same period in 2015, reflective of historically low net charge off levels in the comparable prior year period. The net charge-off ratio (net charge-offs as a percentage of average loans outstanding) for the third quarter of 2016 was 0.12%, 19 basis points lower than the fourth quarter of 2015 and three basis points lower than the third quarter of 2015. Net charge-offs and the corresponding net charge-off ratios continue to be below average long-term historical levels.

The provision for loan losses was \$1.8 million in the third quarter, all of which related to legacy loans. The provision was \$0.1 million lower than the equivalent prior year period, reflective of a change in the overall portfolio mix as a result of commercial loan payoffs in the third quarter. The third quarter 2016 loan loss provision was \$0.3 million more than the level of net charge-offs for the quarter, reflective of an overall increase in loan balances. The allowance for loan losses of \$46.8 million as of September 30, 2016 was an increase of \$1.2 million from the level one year ago, reflective of an increase in the size of the loan portfolio. Stable asset quality metrics have resulted in an allowance for loan loss to total loans ratio of 0.95% at September 30, 2016, 11 basis points lower than September 30, 2015 and equal to the level reported at December 31, 2015.

As of September 30, 2016, the purchase discount related to the \$533.5 million of remaining non-impaired loan balances acquired from Oneida, HSBC Bank USA, N.A., First Niagara Bank, N.A. and Wilber National Bank was approximately \$8.3 million, or 1.6% of that portfolio, with \$1.8 million included in the allowance for loan losses for acquired loans where the carrying value exceeded the estimated net recoverable value.

Deposits

As shown in Table 10, average deposits of \$7.0 billion in the third quarter were up \$872.6 million, or 14.3%, compared to the third quarter of 2015, with \$672.3 million of the increase relating to the Oneida transaction. Average deposits increased \$626.5 million, or 9.9%, from the fourth quarter of last year, with \$461.5 million of the increase relating to acquired Oneida deposit relationships. The mix of average deposits continues to change as the weightings of core deposits (noninterest checking, interest checking, savings and money markets accounts) have increased from prior year levels. Conversely, the proportion of time deposits decreased, consistent with the last several years. This change in deposit mix reflects the Company's goal of expanding core account relationships and reducing higher cost time deposit balances, as well as the preference of certain customers to hold a higher proportion of their funds in liquid accounts in the low interest rate environment. This shift in product mix has moderated recently and this resulted in the average cost of deposits of 0.11% for the first nine months of 2016 remaining consistent with the first nine months of 2015. The Company continues to focus heavily on growing its core deposit relationships through its proactive marketing efforts, competitive product offerings, and high quality customer service.

The average nonpublic fund deposits for the third quarter of 2016 increased \$473.3 million, or 8.4%, versus the fourth quarter of 2015, \$346.0 million of which is attributable to the Oneida transaction. Compared to the third quarter of 2015, average nonpublic deposits increased \$630.3 million, or 11.6%, with \$503.0 million attributable to the Oneida transaction. Average public fund deposits for the third quarter increased \$153.2 million, or 20.5%, from the fourth quarter of 2015 and \$242.3 million, or 36.9%, from the third quarter of 2015. The Oneida transaction was responsible for \$115.5 million of the increase from the fourth quarter and \$169.4 million of the increase from the prior year third quarter. Public fund deposits as a percentage of total deposits increased from 10.8% in the third quarter of 2015 to 12.9% in the third quarter of 2016, as the Company has been able to expand its municipal deposit relationships in its markets, and the acquired Oneida deposit relationships were more heavily weighted toward municipal balances.

Table 10: Quarterly Average Deposits

	September 30, 2016	December 31, 2015	September 30, 2015
(000's omitted)			
Noninterest checking deposits	\$1,569,960	\$1,405,416	\$1,363,022
Interest checking deposits	1,614,964	1,459,811	1,410,825
Regular savings deposits	1,320,877	1,154,110	1,117,855
Money market deposits	1,731,752	1,601,641	1,491,475
Time deposits	737,587	727,648	719,358
Total deposits	\$6,975,140	\$6,348,626	\$6,102,535
Nonpublic fund deposits	\$6,076,131	\$5,602,822	\$5,445,848
Public fund deposits	899,009	745,804	656,687
Total deposits	\$6,975,140	\$6,348,626	\$6,102,535

Borrowings

The third quarter 2016 ending external borrowings of \$236.1 million were \$167.4 million, or 41.5%, lower than borrowings at December 31, 2015, and \$424.2 million, or 64.2%, less than the end of the third quarter of 2015. This decrease was a result of utilizing the net liquidity from the Oneida transaction and additional liquidity from organic deposit growth to reduce overnight borrowing at the FHLB.

Shareholders' Equity

Total shareholders' equity of \$1.24 billion at the end of the third quarter represents an increase of \$99.9 million from the balance at December 31, 2015. This increase consisted of net income of \$77.4 million, a \$46.9 million increase in other comprehensive income, \$6.2 million from treasury stock issued to the Company's 401(k) plan, \$7.5 million from shares issued under the employee stock plan and \$3.4 million from employee stock options earned, partially offset by dividends declared of \$41.5 million. The change in other comprehensive income was comprised of a \$46.2 million increase in the after-tax market value adjustment on the available-for-sale investment portfolio and a positive \$0.7 million adjustment to the funded status of the Company's retirement plans. Over the past 12 months, total shareholders' equity increased by \$195.6 million, as net income, a higher market value adjustment on investments, and the issuance of common stock, including the \$102 million issued as consideration in the Oneida transaction, more than offset dividends declared, and the change in the funded status of the Company's defined benefit pension and other postretirement plans.

The Company's Tier 1 leverage ratio, a primary measure of regulatory capital for which 5% is the requirement to be "well-capitalized", was 10.35% at the end of the third quarter, up three basis points from year-end 2015 and 26 basis points above its level one year earlier. The increase in the Tier 1 leverage ratio in comparison to December 31, 2015 is the result of ending shareholders' equity excluding intangibles and other comprehensive income items increasing 6.6%, primarily from net earnings retention, while average assets excluding intangibles and the market value adjustment on investments increased 6.3%, in part due to the fourth quarter of 2015 including the Oneida acquisition for less than a month. The Tier 1 leverage ratio increased as compared to the prior year's third quarter as shareholders' equity, excluding intangibles and other comprehensive income, increased 10.9% due to strong earnings retention and issuance of shares in connection with the Oneida transaction, while average assets excluding intangibles and the market value adjustment increased 8.2%, driven by solid organic loan growth, investment purchases, and the Oneida acquisition. The net tangible equity-to-assets ratio (a non-GAAP measure) of 9.66% increased 1.07% percentage points from December 31, 2015 and increased 52 basis points versus September 30, 2015 (See Table 11 for Reconciliation of Quarterly GAAP to Non-GAAP Measures). The increase in the tangible equity ratio during 2016 is primarily attributable to proportionally larger increases in tangible equity levels than the increases in tangible assets due to earnings retention and the increase in the investment market value adjustment outpacing tangible asset growth.

The dividend payout ratio (dividends declared divided by net income) for the first nine months of 2016 was 53.6%, compared to 52.2% for the nine months ended September 30, 2015. Dividends declared increased 11.8% as the Company's quarterly dividend per share was raised from \$0.31 to \$0.32 in August 2016, while net income for September YTD 2016 increased 8.8% over the prior year period. The 2016 dividend increase marked the Company's 24th consecutive year of increased dividend payouts to common shareholders. Additionally, the number of common shares outstanding increased 8.1% over the last twelve months including the impact of the 2.38 million shares issued in the Oneida transaction that accounted for 5.8% of the total increase.

Liquidity

Liquidity risk is a measure of the Company's ability to raise cash when needed at a reasonable cost and minimize any loss. The Bank maintains appropriate liquidity levels in both normal operating environments as well as stressed environments. The Company must be capable of meeting all obligations to its customers at any time and, therefore, the active management of its liquidity position remains an important management objective. The Bank has appointed the Asset Liability Committee ("ALCO") to manage liquidity risk using policy guidelines and limits on indicators of potential liquidity risk. The indicators are monitored using a scorecard with three risk level limits. These risk indicators measure core liquidity and funding needs, capital at risk and change in available funding sources. The risk indicators are monitored using such statistics as the core basic surplus ratio, unencumbered securities to average assets, free loan collateral to average assets, loans to deposits, deposits to total funding and borrowings to total funding ratios.

Given the uncertain nature of our customers' demands as well as the Company's desire to take advantage of earnings enhancement opportunities, the Company must have adequate sources of on- and off-balance sheet funds available that can be acquired in time of need. Accordingly, in addition to the liquidity provided by balance sheet cash flows, liquidity must be supplemented with additional sources such as credit lines from correspondent banks and borrowings from the FHLB and the Federal Reserve Bank of New York ("Federal Reserve"). Other funding alternatives may also be appropriate from time to time, including wholesale and retail repurchase agreements, large certificates of deposit and the brokered CD market. The primary source of non-deposit funds is FHLB overnight advances, of which \$133.9 million was outstanding at September 30, 2016.

The Bank's primary sources of liquidity are its liquid assets, as well as unencumbered securities that can be used to collateralize additional funding. At September 30, 2016, the Bank had \$161.5 million of cash and cash equivalents of which \$13.8 million are interest-earning deposits held at the Federal Reserve, FHLB and other correspondent banks. The Bank also had \$1.2 billion in unused FHLB borrowing capacity based on the Company's quarter-end collateral

levels. Additionally, the Company has \$1.6 billion of unencumbered securities that could be pledged at the FHLB or Federal Reserve to obtain additional funding. There is \$25 million available in unsecured lines of credit with other correspondent banks.

The Company's primary approach to measuring short-term liquidity is known as the Basic Surplus/Deficit model. It is used to calculate liquidity over two time periods: first, the amount of cash that could be made available within 30 days (calculated as liquid assets less short-term liabilities as a percentage of average assets); and second, a projection of subsequent cash availability over an additional 60 days. As of September 30, 2016, this ratio was 16.8% for 30-days and 16.7% for 90-days, excluding the Company's capacity to borrow additional funds from the FHLB and other sources. There is a sufficient amount of liquidity based on the Company's internal policy requirement of 7.5%.

A sources and uses statement is used by the Company to measure intermediate liquidity risk over the next twelve months. As of September 30, 2016, there is more than enough liquidity available during the next year to cover projected cash outflows. In addition, stress tests on the cash flows are performed in various scenarios ranging from high probability events with a low impact on the liquidity position to low probability events with a high impact on the liquidity position. The results of the stress tests as of September 30, 2016 indicate the Bank has sufficient sources of funds for the next year in all simulated stressed scenarios.

To measure longer-term liquidity, a baseline projection of loan and deposit growth for five years is made to reflect how liquidity levels could change over time. This five-year measure reflects ample liquidity for loan and other asset growth over the next five years.

Though remote, the possibility of a funding crisis exists at all financial institutions. Accordingly, management has addressed this issue by formulating a Liquidity Contingency Plan, which has been reviewed and approved by both the Company's Board of Directors (the "Board") and the Company's ALCO. The plan addresses the actions that the Company would take in response to both a short-term and long-term funding crisis.

A short-term funding crisis would most likely result from a shock to the financial system, either internal or external, which disrupts orderly short-term funding operations. Such a crisis would likely be temporary in nature and would not involve a change in credit ratings. A long-term funding crisis would most likely be the result of drastic credit deterioration at the Company. Management believes that both potential circumstances have been fully addressed through detailed action plans and the establishment of trigger points for monitoring such events.

Forward-Looking Statements

This document contains comments or information that constitute forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995), which involve significant risks and uncertainties.

Forward-looking statements often use words such as "anticipate," "target," "expect," "estimate," "intend," "plan," "goal," "forecast," "projection," "project," "believe," or other words of similar meaning. Actual results may differ materially from the results discussed in the forward-looking statements. Moreover, the Company's plans, objectives and intentions are subject to change based on various factors (some of which are beyond the Company's control). Factors that could cause actual results to differ from those discussed in the forward-looking statements include: (1) risks related to credit quality, interest rate sensitivity and liquidity; (2) the strength of the U.S. economy in general and the strength of the local economies where the Company conducts its business; (3) the effect of, and changes in, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; (4) inflation, interest rate, market and monetary fluctuations; (5) the timely development of new products and services and customer perception of the overall value thereof (including, but not limited to, features, pricing and quality) compared to competing products and services; (6) changes in consumer spending, borrowing and savings habits; (7) technological changes and implementation and financial risks associated with transitioning to new technology-based systems involving large multi-year contracts; (8) the ability of the Company to maintain the security of its financial, accounting, technology, data processing and other operating systems and facilities; (9) any acquisitions or mergers that might be considered or consummated by the Company and the costs and factors associated therewith, including differences in the actual financial results of the acquisition or merger compared to expectations and the realization of anticipated cost savings and revenue enhancements; (10) the ability to maintain and increase market share and control expenses; (11) the nature, timing and effect of changes in banking regulations or other regulatory or legislative requirements affecting the respective businesses of the Company and its subsidiaries, including changes in laws and regulations concerning taxes, accounting, banking, risk management, securities and other aspects of the financial services industry, specifically the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; (12) changes in the Company's organization, compensation and benefit plans and in the availability of, and compensation levels for, employees in its geographic markets; (13) the outcome of pending or future litigation and government proceedings; (14) other risk factors outlined in the Company's filings with the SEC from time to time; and (15) the success of the Company at managing the risks of the foregoing.

The foregoing list of important factors is not all-inclusive. Such forward-looking statements speak only as of the date on which they are made and the Company does not undertake any obligation to update any forward-looking statement, whether written or oral, to reflect events or circumstances after the date on which such statement is made. If the Company does update or correct one or more forward-looking statements, investors and others should not conclude that the Company would make additional updates or corrections with respect thereto or with respect to other forward-looking statements.

Reconciliation of Quarterly GAAP to Non-GAAP Measures

Table 11: Quarterly GAAP to Non-GAAP Reconciliations

(000's omitted)	Three Months Ended		Nine Months Ended	
	September 30, 2016	2015	September, 2016	2015
Income statement data				
Operating expenses				
Noninterest expenses (GAAP)	\$66,226	\$56,079	\$200,251	\$168,075
Acquisition expenses	(2)	(562)	(342)	(1,318)
Amortization of intangibles	(1,359)	(843)	(4,204)	(2,642)
Operating expenses (non-GAAP)	\$64,865	\$54,674	\$195,705	\$164,115
Efficiency ratio				
Operating expenses (non-GAAP) - numerator	\$64,865	\$54,674	\$195,705	\$164,115
Tax-equivalent net interest income	70,913	65,525	211,228	192,793
Noninterest revenues	39,952	31,386	117,005	90,151
Operating revenues (non-GAAP) - denominator	\$110,865	\$96,911	\$328,233	\$282,944
Efficiency ratio (non-GAAP)	58.5 %	56.4 %	59.6 %	58.0 %
	September	December	September	
	30,	31,	30,	
(000's omitted)	2016	2015	2015	
Balance sheet data				
Net tangible equity-to-assets ratio at period end				
Shareholders' equity (GAAP)	\$1,240,582	\$1,140,647	\$1,045,026	
Intangible assets	(482,119)	(484,146)	(384,525)	
Deferred taxes on goodwill	42,523	39,724	38,728	
Tangible common equity (non-GAAP) - numerator	\$800,986	\$696,225	\$699,229	
Total assets (GAAP)	\$8,727,746	\$8,552,669	\$7,997,166	
Intangible assets	(482,119)	(484,146)	(384,525)	
Deferred taxes on goodwill	42,523	39,724	38,728	
Tangible assets (non-GAAP) - denominator	\$8,288,150	\$8,108,247	\$7,651,369	
Net tangible equity-to-assets ratio at period end (non-GAAP)	9.66 %	8.59 %	9.14 %	

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates, prices or credit risk. Credit risk associated with the Company's loan portfolio has been previously discussed in the asset quality section of the MD&A. Management believes that the tax risk of the Company's municipal investments associated with potential future changes in statutory, judicial and regulatory actions is minimal. Treasury, agency, mortgage-backed and CMO securities issued by government agencies comprise 78% of the total portfolio and are currently rated AAA by Moody's Investor Services and AA+ by Standard & Poor's. Municipal and corporate bonds account for 22% of the total portfolio, of which, 98% carry a minimum rating of A-. The remaining 2% of the portfolio is comprised of other investment grade securities. The Company does not have material foreign currency exchange rate risk exposure. Therefore, almost all the market risk in the investment portfolio is related to interest rates.

The ongoing monitoring and management of both interest rate risk and liquidity, in the short and long term time horizons is an important component of the Company's asset/liability management process, which is governed by limits established in the policies reviewed and approved annually by the Company's Board. The Board delegates responsibility for carrying out the policies to the ALCO, which meets each month. The committee is made up of the Company's senior management as well as regional and line-of-business managers who oversee specific earning asset classes and various funding sources. As the Company does not believe it is possible to reliably predict future interest rate movements, it has maintained an appropriate process and set of measurement tools, which enables it to identify and quantify sources of interest rate risk in varying rate environments. The primary tool used by the Company in managing interest rate risk is income simulation.

While a wide variety of strategic balance sheet and treasury yield curve scenarios are tested on an ongoing basis, the following reflects the Company's projected net interest income sensitivity over the subsequent twelve months based on:

· Asset and liability levels using September 30, 2016 as a starting point.

There are assumed to be conservative levels of balance sheet growth, low-to-mid single digit growth in loans and deposits, while using the cash flows from investment contractual maturities and prepayments to repay short-term capital market borrowings or reinvest into securities or cash equivalents.

The prime rate and federal funds rates are assumed to move up over a 12-month period while moving the long end of the treasury curve to spreads over the three month treasury that are more consistent with historical norms (normalized yield curve). In the -25 basis point model, the prime and federal funds rates move lower in the first quarter of year one while moving the long end of the curve to levels over the three month treasury using spreads at a time when the yield curve was flat. Deposit rates are assumed to move in a manner that reflects the historical relationship between deposit rate movement and changes in the federal funds rate.

Cash flows are based on contractual maturity, optionality, and amortization schedules along with applicable prepayments derived from internal historical data and external sources.

Net Interest Income Sensitivity Model

	Calculated annualized increase (decrease) in projected net interest income at September 30, 2016
Change in interest rates	
+200 basis points	(\$2,925,000)
+100 basis points	(\$998,000)
-25 basis points	(\$654,000)

The modeled net interest income ("NII") decreases in rising rate environments from the flat rate scenario. The decrease is largely a result of assumed deposit and funding costs increasing faster than the repricing of corresponding assets. In the short term (year one) the assumed increase of deposit rates in the rising rate environment temporarily outweighs the benefit of earning asset yields increasing to higher levels. However, over a longer time period (years two and beyond), the growth in NII improves in the rising rate environments as lower yielding assets mature and are replaced at higher rates.

In the falling rate environment scenario, the Bank shows interest rate risk exposure to lower short term rates and also a flatter yield curve. Net interest income declines during the first twelve months largely due to lower assumed rates on adjustable and variable rate assets. Corresponding deposit rates are assumed to remain constant. Despite federal funds trading between 0.25% and 0.50%, the Company believes long-term treasury rates could potentially fall further in this scenario, and thus, the model includes the impact of this lower treasury rate scenario.

The analysis does not represent a Company forecast and should not be relied upon as being indicative of expected operating results. These hypothetical estimates are based upon numerous assumptions: the nature and timing of interest rate levels (including yield curve shape), prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment/replacement of asset and liability cash flows, and other factors. While the assumptions are developed based upon current economic and local market conditions, the Company cannot make any assurances as to the predictive nature of these assumptions, including how customer preferences or competitor influences might change. Furthermore, the sensitivity analysis does not reflect actions that the ALCO might take in responding to or anticipating changes in interest rates.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures, as defined in Rule 13a -15(e) and 15d – 15(e) under the Securities Exchange Act of 1934 as amended (the "Exchange Act"), designed to ensure information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is: (i) recorded, processed, summarized, and reported within the time periods specified in the SEC rules and forms, and (ii) accumulated and communicated to management, including the principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. Based on management's evaluation of the effectiveness of the Company's disclosure controls and procedures, with the participation of the Chief Executive Officer and the Chief Financial Officer, it has concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, these disclosure controls and procedures were effective as of September 30, 2016.

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Changes in Internal Control over Financial Reporting

The Company regularly assesses the adequacy of its internal controls over financial reporting. There have been no changes in the Company's internal controls over financial reporting in connection with the evaluation referenced in the paragraph above that occurred during the Company's quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Part II. Other Information

Item 1. Legal Proceedings

The Company and its subsidiaries are subject in the normal course of business to various pending and threatened legal proceedings in which claims for monetary damages are asserted. As of September 30, 2016, management, after consultation with legal counsel, does not anticipate that the aggregate ultimate liability arising out of litigation pending or threatened against the Company or its subsidiaries will be material to the Company's consolidated financial position. On at least a quarterly basis, the Company assesses its liabilities and contingencies in connection with such legal proceedings. For those matters where it is probable that the Company will incur losses and the amounts of the losses can be reasonably estimated, the Company records an expense and corresponding liability in its consolidated financial statements. To the extent the pending or threatened litigation could result in exposure in excess of that liability, the amount of such excess is not currently estimable. The range of reasonably possible losses for matters where an exposure is not currently estimable or considered probable, beyond the existing recorded liabilities, is between \$0 and \$1 million in the aggregate. Although the Company does not believe that the outcome of pending litigation will be material to the Company's consolidated financial position, it cannot rule out the possibility that such outcomes will be material to the consolidated results of operations for a particular reporting period in the future.

Item 1A. Risk Factors

There has not been any material change in the risk factors disclosure from that contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015 filed with the SEC on February 29, 2016.

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

a) Not applicable.

b) Not applicable.

c) At its December 2015 meeting, the Board approved a new stock repurchase program authorizing the repurchase, at the discretion of senior management, of up to 2,200,000 shares of the Company's common stock, in accordance with securities laws and regulations, during a twelve-month period starting January 1, 2016. Any repurchased shares will be used for general corporate purposes, including those related to stock plan activities. The timing and extent of repurchases will depend on market conditions and other corporate considerations as determined at the Company's discretion.

The following table presents stock purchases made during the third quarter of 2016:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of	Maximum Number of Shares That May Yet Be
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			Publicly Announced Plans or Programs	Purchased Under the Plans or Programs
July 1-31, 2016 ⁽¹⁾	305	\$ 41.23	0	2,200,000
August 1-31, 2016 ⁽¹⁾	50	\$ 44.13	0	2,200,000
September 1-30, 2016 ⁽¹⁾	859	\$ 45.64	0	2,200,000
Total	1,214	\$ 44.77		

⁽¹⁾ Included in the common shares repurchased were shares acquired by the Company in connection with satisfaction of tax withholding obligations on vested restricted stock issued pursuant to the employee benefit plan of 305 shares, 50 shares and 859 shares in July 2016, August 2016 and September 2016, respectively. These shares were not repurchased as part of the publicly announced repurchase plan described above.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 5. Other Information
Not applicable.

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of Mark E. Tryniski, President and Chief Executive Officer of the Registrant, pursuant to Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. ⁽¹⁾
31.2	Certification of Scott Kingsley, Treasurer and Chief Financial Officer of the Registrant, pursuant to Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. ⁽¹⁾
32.1	Certification of Mark E. Tryniski, President and Chief Executive Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ⁽²⁾
32.2	Certification of Scott Kingsley, Treasurer and Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ⁽²⁾
101	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements tagged as blocks of text and in detail. ⁽³⁾

⁽¹⁾ Filed herewith.

⁽²⁾ Furnished herewith.

⁽³⁾ XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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Signatures

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

Community Bank System, Inc.

Date: November 9, 2016 /s/ Mark E. Tryniski
Mark E. Tryniski, President and Chief Executive
Officer

Date: November 9, 2016 /s/ Scott Kingsley
Scott Kingsley, Treasurer and Chief
Financial Officer