COMMUNITY BANK SYSTEM, INC.
Form 10-Q
May 10, 2018

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 March 31, 2018

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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company .	Emerging growth company

(Do not check if a smaller reporting company)

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 50,974,640 shares of Common Stock, $1.00 par value per share, were outstanding on April 30, 2018.

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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)

	March 31, 2018	December 31, 2017
Assets:		
Cash and cash equivalents	$543,899	$221,038
Available-for-sale investment securities (cost of $3,005,165 and $3,007,148, respectively)	2,987,290	3,031,088
Other securities, at cost	45,352	50,291
Loans held for sale, at fair value	628	461
Loans	6,227,030	6,256,757
Allowance for loan losses	(48,103)	(47,583)
Net loans	6,178,927	6,209,174
Goodwill, net	733,625	734,430
Core deposit intangibles, net	23,281	25,025
Other intangibles, net	63,678	65,633
Intangible assets, net	820,584	825,088
Premises and equipment, net	120,953	123,393
Accrued interest and fees receivable	33,555	36,177
Other assets	235,367	249,488
Total assets	$10,966,555	$10,746,198
Liabilities:		
Noninterest-bearing deposits	$2,372,824	$2,293,057
Interest-bearing deposits	6,398,268	6,151,363
Total deposits	8,771,092	8,444,420
Short-term borrowings	0	24,000
Securities sold under agreement to repurchase, short-term	279,702	337,011
Other long-term debt	2,042	2,071
Subordinated debt held by unconsolidated subsidiary trusts	122,820	122,814
Accrued interest and other liabilities	159,433	180,567
Total liabilities	9,335,089	9,110,883
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; 51,374,254 and 51,263,841 shares issued, respectively	51,374	51,264
Additional paid-in capital	898,036	894,879

Retained earnings	723,404	700,557
Accumulated other comprehensive loss	(35,226)	(3,699)
Treasury stock, at cost (490,651 shares, including 203,730 shares held by deferred compensation arrangements at March 31, 2018 and 567,764 shares including 237,494 shares held by deferred compensation arrangements at December 31, 2017, respectively)	(17,633)	(21,014)
Deferred compensation arrangements (203,730 and 237,494 shares, respectively)	11,511	13,328
Total shareholders’ equity	1,631,466	1,635,315
Total liabilities and shareholders’ equity	$10,966,555	$10,746,198

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 March 31,	
	2018	2017
Interest income:		
Interest and fees on loans	$ 69,441	$ 52,384
Interest and dividends on taxable investments	15,525	13,566
Interest on nontaxable investments	3,438	4,008
Total interest income	88,404	69,958
Interest expense:		
Interest on deposits	2,132	1,730
Interest on borrowings	480	149
Interest on subordinated debt held by unconsolidated subsidiary trusts	1,168	805
Total interest expense	3,780	2,684
Net interest income	84,624	67,274
Provision for loan losses	3,679	1,828
Net interest income after provision for loan losses	80,945	65,446
Noninterest revenues:		
Deposit service fees	19,177	14,707
Other banking services	1,243	1,159
Employee benefit services	23,006	17,189
Insurance revenues	7,359	6,400
Wealth management services	6,706	4,861
Gain on sales of investment securities	0	2
Total noninterest revenues	57,491	44,318
Noninterest expenses:		
Salaries and employee benefits	51,859	42,907
Occupancy and equipment	10,531	8,196
Data processing and communications	8,742	8,521
Amortization of intangible assets	4,798	2,768
Legal and professional fees	2,781	2,414
Office supplies and postage	1,879	1,674
Business development and marketing	2,059	2,081
FDIC insurance premiums	752	753
Acquisition expenses	(8)	1,716
Other expenses	2,938	2,545
Total noninterest expenses	86,331	73,575
Income before income taxes	52,105	36,189
Income taxes	11,999	9,932
Net income	$ 40,106	$ 26,257
Basic earnings per share	$ 0.78	$ 0.58

Diluted earnings per share	$ 0.78	$ 0.57
Cash dividends declared per share	$ 0.34	$ 0.32

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 March 31,	
	2018	2017
Pension and other post-retirement obligations:		
Amortization of actuarial losses included in net periodic pension cost, gross	$ 303	$ 265
Tax effect	(74)	(102)
Amortization of actuarial losses included in net periodic pension cost, net	229	163
Amortization of prior service cost included in net periodic pension cost, gross	(127)	(31)
Tax effect	31	12
Amortization of prior service cost included in net periodic pension cost, net	(96)	(19)
Other comprehensive income related to pension and other post-retirement obligations, net of taxes	133	144
Unrealized (losses) gains on available-for-sale securities:		
Net unrealized holding (losses) gains arising during period, gross	(41,815)	3,893
Tax effect	10,155	(1,526)
Net unrealized holding (losses) gains arising during period, net	(31,660)	2,367
Other comprehensive (loss)/income related to unrealized (losses) gains on available-for-sale securities, net of taxes	(31,660)	2,367
Other comprehensive (loss) income, net of tax	(31,527)	2,511
Net income	40,106	26,257
Comprehensive income	$ 8,579	$ 28,768

	As of March 31, 2018	December 31, 2017
Accumulated Other Comprehensive Income By Component:		
Unrealized loss for pension and other post-retirement obligations	$ (28,501)	$ (28,677)
Tax effect	7,001	7,044
Net unrealized loss for pension and other post-retirement obligations	(21,500)	(21,633)
Unrealized (loss)/gain on available-for-sale securities	(17,875)	23,940
Tax effect	4,149	(6,006)
Net unrealized (loss)/gain on available-for-sale securities	(13,726)	17,934
Accumulated other comprehensive loss	$ (35,226)	$ (3,699)

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)
Three months ended March 31, 2018
(In Thousands, Except Share Data)

	Common Stock		Additional		Accumulated Other		Deferred	
	Shares Outstanding	Amount Issued	Paid-In Capital	Retained Earnings	Comprehensive Loss	Treasury Stock	Compensation Arrangements	Total
Balance at December 31, 2017	50,696,077	$51,264	$894,879	$700,557	$ (3,699)	$ (21,014)	$ 13,328	$1,635,315
Net income				40,106				40,106
Other comprehensive loss, net of tax					(31,527)			(31,527)
Cash dividends declared: Common, $0.34 per share				(17,259)				(17,259)
Common stock issued under employee stock ownership plan	110,413	110	460					570
Stock-based compensation			1,715					1,715
Distribution of stock under deferred compensation arrangements	35,233					1,898	(1,898)	0
Treasury stock issued to benefit plans, net	41,880		982			1,483	81	2,546
Balance at March 31, 2018	50,883,603	$51,374	$898,036	$723,404	$ (35,226)	$ (17,633)	$ 11,511	$1,631,466

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

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

	Three Months Ended March 31, 2018	2017
Operating activities:		
Net income	$ 40,106	$ 26,257
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	4,001	3,669
Amortization of intangible assets	4,798	2,768
Net accretion on securities, loans and borrowings	(2,214)	(406)
Stock-based compensation	1,715	1,410
Provision for loan losses	3,679	1,828
Amortization of mortgage servicing rights	117	126
Income from bank-owned life insurance policies	(388)	(368)
Net gain on sale of loans and other assets	(80)	(53)
Change in other assets and other liabilities	9,174	7,430
Net cash provided by operating activities	60,908	42,661
Investing activities:		
Proceeds from maturities of available-for-sale investment securities	27,363	33,479
Proceeds from maturities of other investment securities	4,960	8,709
Purchases of available-for-sale investment securities	(23,434)	(16,784)
Purchases of other securities	(21)	(505)
Net change in loans	25,900	12,197
Cash paid for acquisitions, net of cash acquired of $16 and $11,063, respectively	(1,464)	(63,517)
Purchases of premises and equipment, net	(1,556)	(2,088)
Net cash provided by/(used in) investing activities	31,748	(28,509)
Financing activities:		
Net increase in deposits	326,672	260,923
Net change in borrowings	(81,338)	(146,200)
Issuance of common stock	570	1,809
Purchases of treasury stock	(81)	0
Sales of treasury stock	2,546	2,151
Increase in deferred compensation arrangements	81	0
Cash dividends paid	(17,281)	(14,186)
Withholding taxes paid on share-based compensation	(964)	(1,320)
Net cash provided by financing activities	230,205	103,177
Change in cash and cash equivalents	322,861	117,329
Cash and cash equivalents at beginning of period	221,038	173,857
Cash and cash equivalents at end of period	$ 543,899	$ 291,186
Supplemental disclosures of cash flow information:		
Cash paid for interest	$ 3,757	$ 2,707
Cash paid for income taxes	564	9,044
Supplemental disclosures of noncash financing and investing activities:		
Dividends declared and unpaid	17,438	14,773
Transfers from loans to other real estate	942	920

Acquisitions:		
Common stock issued	0	78,483
Fair value of assets acquired, excluding acquired cash and intangibles	27	31,599
Fair value of liabilities assumed	31	30,500

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

NOTE A: BASIS OF PRESENTATION

The interim financial data as of and for the three months ended March 31, 2018 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

On January 2, 2018, the Company, through its subsidiary, OneGroup NY, Inc. ("OneGroup"), completed its acquisition of certain assets of Penna & Associates Agency, Inc. ("Penna"), an insurance agency headquartered in Johnson City, New York. The Company paid $0.8 million in cash to acquire the assets of Penna, and recorded goodwill in the amount of $0.4 million and a $0.4 million customer list intangible asset 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 January 2, 2018, the Company, through its subsidiary, Community Investment Services, Inc. ("CISI"), completed its acquisition of certain assets of Styles Bridges Associates ("Styles Bridges"), a financial services business headquartered in Canton, New York. The Company paid $0.7 million in cash to acquire a customer list from Styles Bridges, and recorded a $0.7 million customer list intangible asset 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 December 4, 2017, the Company, through its subsidiary, OneGroup, completed its acquisition of Gordon B. Roberts Agency, Inc. ("GBR"), an insurance agency headquartered in Oneonta, New York for $3.7 million in Company stock and cash, comprised of $1.35 million in cash and the issuance of 0.04 million shares of common stock. The transaction resulted in the acquisition of $0.6 million of assets, $0.7 million of other liabilities, goodwill in the amount of $2.2 million and other intangible assets of $1.6 million. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date.

On November 17, 2017, the Company, through its subsidiary, CISI, completed its acquisition of certain assets of Northeast Capital Management, Inc. ("NECM"), a financial services business headquartered in Wilkes Barre, Pennsylvania. The Company paid $1.2 million in cash, including a $0.2 million contingent payment based on certain customer retention objectives, to acquire a customer list from NECM, and recorded a $1.2 million customer list intangible asset in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

On May 12, 2017, the Company completed its acquisition of Merchants Bancshares, Inc. ("Merchants"), parent company of Merchants Bank, headquartered in South Burlington, Vermont, for $345.2 million in Company stock and cash, comprised of $82.9 million in cash and the issuance of 4.68 million shares of common stock. The acquisition extends the Company's footprint into the Vermont and Western Massachusetts markets with the addition of 31 branch locations in Vermont and one location in Massachusetts. This transaction resulted in the acquisition of $2.0 billion of assets, including $1.49 billion of loans and $370.6 million of investment securities, as well as $1.45 billion of deposits and $189.0 million in goodwill. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date. Revenues of approximately $16.1 million and direct expenses, which may not include certain shared expenses, of approximately $7.8 million from Merchants were included in the consolidated statement of income for the three months ended March 31, 2018.

On March 1, 2017, the Company, through its subsidiary, OneGroup, completed its acquisition of certain assets of Dryfoos Insurance Agency, Inc. ("Dryfoos"), an insurance agency headquartered in Hazleton, Pennsylvania. The Company paid $3.0 million in cash to acquire the assets of Dryfoos, and recorded goodwill in the amount of $1.7 million and other intangible assets of $1.7 million in conjunction with the acquisition. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date.

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On February 3, 2017, the Company completed its acquisition of Northeast Retirement Services, Inc. ("NRS") and its subsidiary Global Trust Company ("GTC"), headquartered in Woburn, Massachusetts, for $148.6 million in Company stock and cash. NRS was a privately held corporation focused on providing institutional transfer agency, master recordkeeping services, custom target date fund administration, trust product administration and customized reporting services to institutional clients. Its wholly-owned subsidiary, GTC, is chartered in the State of Maine as a non-depository trust company and provides fiduciary services for collective investment trusts and other products. The acquisition of NRS and GTC, hereafter referred to collectively as NRS, will strengthen and complement the Company's existing employee benefit services businesses. Upon the completion of the merger, NRS became a wholly-owned subsidiary of BPAS and operates as Northeast Retirement Services, LLC, a Delaware limited liability company. This transaction resulted in the acquisition of $36.1 million in net tangible assets, principally cash and certificates of deposit, $60.2 million in customer list intangibles that will be amortized using the 150% declining balance method over 10 years, a $23.0 million deferred tax liability associated with the customer list intangible, and $75.3 million in goodwill. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date. Revenues of $10.1 million and expenses of $6.0 million from NRS were included in the consolidated statement of income for the three months ended March 31, 2018. Revenues of $5.1 million and expenses of $3.6 million from NRS were included in the consolidated statement of income for the three months ended March 31, 2017.

On January 1, 2017, the Company, through its subsidiary, OneGroup, acquired certain assets of Benefits Advisory Service, Inc. ("BAS"), a benefits consulting group headquartered in Forest Hills, New York. The Company paid $1.2 million in cash to acquire the assets of BAS and recorded intangible assets of $1.2 million in conjunction with the acquisition. 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 dates of the acquisition, and were subject to adjustment based on updated information not available at the time of acquisition. During the first quarter of 2018, the carrying amount of other liabilities associated with the NRS acquisition decreased by $1.2 million as a result of an adjustment to deferred taxes. Goodwill associated with the NRS acquisition decreased $1.2 million as a result of this adjustment.

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

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)	2018 Other [1]	2017 NRS	Merchants	Other [2]	Total
Consideration paid :					
Cash [3]	$ 1,480	$ 70,073	$ 82,898	$ 6,775	$ 159,746
Community Bank System, Inc. common stock	0	78,483	262,254	2,395	343,132
Total net consideration paid	1,480	148,556	345,152	9,170	502,878
Recognized amounts of identifiable assets acquired and liabilities assumed:					
Cash and cash equivalents	16	11,063	40,730	339	52,132
Investment securities	0	20,294	370,648	0	390,942
Loans	0	0	1,488,157	0	1,488,157
Premises and equipment	10	411	16,608	27	17,046
Accrued interest receivable	0	72	4,773	0	4,845

Other assets	17	8,088	51,585	583	60,256
Core deposit intangibles	0	0	23,214	0	23,214
Other intangibles	1,099	60,200	2,857	5,626	68,683
Deposits	0	0	(1,448,406)	0	(1,448,406)
Other liabilities	(31)	(26,828)	(11,750)	(1,217)	(39,795)
Short-term advances	0	0	(80,000)	0	(80,000)
Securities sold under agreement to repurchase, short-term	0	0	(278,076)	0	(278,076)
Long-term debt	0	0	(3,615)	0	(3,615)
Subordinated debt held by unconsolidated subsidiary trusts	0	0	(20,619)	0	(20,619)
Total identifiable assets, net	1,111	73,300	156,106	5,358	234,764
Goodwill	$ 369	$ 75,256	$ 189,046	$ 3,812	$ 268,114

(1) Includes amounts related to the Penna and Styles Bridges acquisitions.

(2) Includes amounts related to the BAS, Dryfoos, NECM and GBR acquisitions.

(3) Includes NECM $0.2 million contingent cash payment consideration.

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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 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 Merchants at the date of acquisition:

(000s omitted)	Acquired Impaired Loans	Acquired Non-impaired Loans	Total Acquired Loans
Contractually required principal and interest at acquisition	$ 15,454	$ 1,872,574	$ 1,888,028
Contractual cash flows not expected to be collected	(5,385)	(14,753)	(20,138)
Expected cash flows at acquisition	10,069	1,857,821	1,867,890
Interest component of expected cash flows	(793)	(378,940)	(379,733)
Fair value of acquired loans	$ 9,276	$ 1,478,881	$ 1,488,157

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 Penna, Styles Bridges, GBR, NECM, Merchants, Dryfoos, and BAS acquisitions 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 segment for the Merchants acquisition, the Employee Benefit Services segment for NRS, and All Other segments for the Penna, GBR, and Dryfoos acquisitions. Goodwill arising from the Merchants, NRS and GBR acquisitions is not deductible for tax purposes. Goodwill arising from the Penna and Dryfoos acquisitions is deductible for tax purposes.

Direct costs related to the acquisitions were expensed as incurred. Merger and acquisition integration-related expenses amount to $1.7 million during the three months ended March 31, 2017 and have been separately stated in the Consolidated Statements of Income. Merger and acquisition integration-related expenses for the three months ended March 31, 2018 were immaterial.

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 63 through 71 of the Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission ("SEC") on March 1, 2018.

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 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.

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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 March 31, 2018. Certain equity securities are stated at cost and include restricted stock of the Federal Reserve Bank of New York ("Federal Reserve"), the Federal Home Loan Bank of New York and the Federal Home Loan Bank of Boston (collectively referred to as "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.

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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 such 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.

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Recently Adopted 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. In doing so, companies generally will be required to use more judgment and make more estimates than under prior guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income, interest expense and mortgage banking income. The Company completed a comprehensive assessment of the revenue streams and reviewed related contracts potentially affected by the ASU for all segments of its business. Based on this assessment, the Company concluded that ASU 2014-09 did not materially change the manner in which the Company recognized revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e. gross versus net) and timing of compensatory payments to producers. Based on the Company's evaluation, it was determined that changes in the presentation of expenses and timing of the recognition of compensation expense did not materially affect noninterest income or expense. The Company adopted this guidance on January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary. See Note N: Revenue Recognition for more information.

In January 2016, the FASB issued ASU 2016-01, 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. The Company adopted this guidance on January 1, 2018. The adoption of this ASU did not have a material impact 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. The Company adopted this guidance on January 1, 2018 on a retrospective basis. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. This new guidance requires the service cost component of net periodic pension and postretirement benefit costs to be presented separately from other components of net benefit cost in the statement of income. This ASU is effective for the Company for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this guidance on January 1, 2018 and applied the guidance on a modified retrospective basis for the presentation of

other components of net periodic benefit cost in the Consolidated Statements of Income. The impact of the adoption of this guidance resulted in the reclassification of net periodic benefit income of $1.5 million from salaries and employee benefits to other expenses in the Consolidated Statement of Income for the three months ended March 31, 2017.

New Accounting Pronouncements

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 occupies certain offices and uses certain equipment under non-cancelable operating lease agreements, which currently are not reflected in its consolidated statement of condition. The Company expects to recognize lease liabilities and right of use assets associated with these lease agreements; however, the extent of the impact on the Company's consolidated financial statements is currently under evaluation.

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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 impact the guidance will have on the Company's consolidated financial statements, and expects a change in the allowance for loan losses resulting from the change to expected losses for the estimated life of the financial asset, including an allowance for debt securities. The amount of the change in the allowance for loan losses resulting from the new guidance will be impacted by the portfolio composition and asset quality at the adoption date, as well as economic conditions and forecasts at the time of adoption.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other (Topic 350). The amendments simplify how an entity is required to test goodwill for impairment by eliminating the requirement to measure a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, an entity will perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, and recognize an impairment charge for the amount by which the carrying amount of the reporting unit exceeds its fair value. Impairment loss recognized under this new guidance will be limited to the goodwill allocated to the reporting unit. This ASU is effective prospectively for the Company for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. This ASU is not expected to have a material impact on the Company's consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This new guidance amends current guidance to better align hedge accounting with risk management activities and reduce the complexity involved in applying hedge accounting. Under this new guidance, the concept of hedge ineffectiveness will be eliminated. Ineffective income generated by cash flow and net investment hedges will be recognized in the same financial reporting period and income statement line item as effective income, so as to reflect the full cost of hedging at one time and in one place. Ineffective income generated by fair value hedges will continue to be reflected in current period earnings; however, it will be recognized in the same income statement line item as effective income. The guidance will also allow any contractually specified variable rate to be designated as the hedged risk in a cash flow hedge. With respect to fair value hedges of interest rate risk, the guidance will allow changes in the fair value of the hedged item to be calculated solely using changes in the benchmark interest rate component of the instrument's total contractual coupon cash flows. This ASU is effective for the Company for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. This ASU is not expected to have a material impact on the Company's consolidated financial statements.

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NOTE D: INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities as of March 31, 2018 and December 31, 2017 are as follows:

	March 31, 2018				December 31, 2017			
(000's omitted)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale Portfolio:								
U.S. Treasury and agency securities	$2,044,795	$1,962	$18,843	$2,027,914	$2,043,023	$15,886	$4,838	$2,054,071
Obligations of state and political subdivisions	502,517	9,126	1,335	510,308	514,949	14,064	57	528,956
Government agency mortgage-backed securities	371,857	2,132	9,450	364,539	358,180	3,121	3,763	357,538
Corporate debt securities	2,633	0	54	2,579	2,648	0	25	2,623
Government agency collateralized mortgage obligations	83,113	89	1,773	81,429	88,097	155	878	87,374
Marketable equity securities	250	271	0	521	251	275	0	526
Total available-for-sale portfolio	$3,005,165	$13,580	$31,455	$2,987,290	$3,007,148	$33,501	$9,561	$3,031,088
Other Securities:								
Federal Home Loan Bank common stock	$8,801			$8,801	$9,896			$9,896
Federal Reserve Bank common stock	30,690			30,690	30,690			30,690
Certificates of deposit	0			0	3,865			3,865
Other equity securities	5,861			5,861	5,840			5,840
Total other securities	$45,352			$45,352	$50,291			$50,291

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

As of March 31, 2018

	Less than 12 Months			12 Months or Longer			Total		
(000's omitted)	#	Fair Value	Gross Unrealized	#	Fair Value	Gross Unrealized	#	Fair Value	Gross Unrealized

			Losses			Losses			Losses
Available-for-Sale Portfolio:									
U.S. Treasury and agency securities	69	$1,316,113	$ 18,843	0	$0	$ 0	69	$1,316,113	$ 18,843
Obligations of state and political subdivisions	224	110,119	1,335	0	0	0	224	110,119	1,335
Government agency mortgage-backed securities	148	225,378	5,310	58	75,599	4,140	206	300,977	9,450
Corporate debt securities	1	2,579	54	0	0	0	1	2,579	54
Government agency collateralized mortgage obligations	40	75,150	1,773	1	1	0	41	75,151	1,773
Total available-for-sale investment portfolio	482	$1,729,339	$ 27,315	59	$75,600	$ 4,140	541	$1,804,939	$ 31,455

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As of December 31, 2017

(000's omitted)	Less than 12 Months #	Fair Value	Gross Unrealized Losses	12 Months or Longer #	Fair Value	Gross Unrealized Losses	Total #	Fair Value	Gross Unrealized Losses
Available-for-Sale Portfolio:									
U.S. Treasury and agency securities	44	$699,709	$ 4,838	0	$0	$ 0	44	$699,709	$ 4,838
Obligations of state and political subdivisions	45	23,432	57	0	0	0	45	23,432	57
Government agency mortgage-backed securities	120	185,716	1,433	55	75,712	2,330	175	261,428	3,763
Corporate debt securities	1	2,623	25	0	0	0	1	2,623	25
Government agency collateralized mortgage obligations	39	80,041	878	1	1	0	40	80,042	878
Total available-for-sale investment portfolio	249	$991,521	$ 7,231	56	$75,713	$ 2,330	305	$1,067,234	$ 9,561

The unrealized losses reported pertaining to securities issued by the U.S. government and its sponsored entities, include treasuries, agencies, and mortgage-backed securities issued by Ginnie Mae, Fannie Mae, and Freddie Mac, 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 March 31, 2018 represents OTTI.

The amortized cost and estimated fair value of debt securities at March 31, 2018, 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.

(000's omitted)	Available-for-Sale Amortized Cost	Fair Value
Due in one year or less	$53,102	$53,115
Due after one through five years	1,557,644	1,546,876
Due after five years through ten years	789,557	788,557
Due after ten years	149,642	152,253
Subtotal	2,549,945	2,540,801
Government agency mortgage-backed securities	371,857	364,539
Government agency collateralized mortgage obligations	83,113	81,429
Total	$3,004,915	$2,986,769

As of March 31, 2018, $279.7 million of U.S. Treasury securities were pledged as collateral for securities sold under agreement to repurchase. All securities sold under agreement to repurchase as of March 31, 2018 have an overnight

and continuous maturity.

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, municipal lending, 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.

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The balances of these classes are summarized as follows:

(000's omitted)	March 31, 2018	December 31, 2017
Business lending	$2,426,086	$ 2,424,223
Consumer mortgage	2,211,882	2,220,298
Consumer indirect	1,008,198	1,011,978
Consumer direct	173,032	179,929
Home equity	407,832	420,329
Gross loans, including deferred origination costs	6,227,030	6,256,757
Allowance for loan losses	(48,103)	(47,583)
Loans, net of allowance for loan losses	$6,178,927	$ 6,209,174

The outstanding balance related to credit impaired acquired loans was $11.1 million and $13.4 million at March 31, 2018 and December 31, 2017, respectively. The changes in the accretable discount related to the credit impaired acquired loans are as follows:

(000’s omitted)	
Balance at December 31, 2017	$976
Accretion recognized, year-to-date	(278)
Net reclassification between accretable and non-accretable	300
Balance at March 31, 2018	$998

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 March 31, 2018:

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
Business lending	$5,062	$ 4,069	$ 3,831	$12,962	$1,437,044	$1,450,006
Consumer mortgage	10,236	1,437	10,086	21,759	1,744,105	1,765,864
Consumer indirect	8,664	182	5	8,851	981,915	990,766
Consumer direct	1,091	30	0	1,121	167,396	168,517
Home equity	1,404	176	1,239	2,819	313,908	316,727
Total	$26,457	$ 5,894	$ 15,161	$47,512	$4,644,368	$4,691,880

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
Business lending	$ 4,119	$ 0	$ 3,967	$8,086	$ 8,496	$959,498	$976,080
Consumer mortgage	1,991	282	2,855	5,128	0	440,890	446,018
Consumer indirect	106	35	0	141	0	17,291	17,432
Consumer direct	105	0	0	105	0	4,410	4,515

Home equity	522	214	1,256	1,992	0	89,113	91,105
Total	$ 6,843	$ 531	$ 8,078	$ 15,452	$ 8,496	$ 1,511,202	$ 1,535,150

(1) Acquired impaired loans were not classified as nonperforming assets as the loans are considered to be performing 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.

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The following is an aged analysis of the Company's past due loans by class as of December 31, 2017:

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
Business lending	$ 2,283	$ 571	$ 3,944	$ 6,798	$ 1,369,801	$ 1,376,599
Consumer mortgage	13,564	1,500	10,722	25,786	1,728,823	1,754,609
Consumer indirect	14,197	295	0	14,492	977,344	991,836
Consumer direct	1,875	48	0	1,923	172,556	174,479
Home equity	1,116	94	1,354	2,564	319,576	322,140
Total	$ 33,035	$ 2,508	$ 16,020	$ 51,563	$4,568,100	$ 4,619,663

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
Business lending	$ 4,661	$ 0	$ 4,328	$ 8,989	$ 10,115	$ 1,028,520	$ 1,047,624
Consumer mortgage	2,603	26	3,066	5,695	0	459,994	465,689
Consumer indirect	245	8	0	253	0	19,889	20,142
Consumer direct	100	0	0	100	0	5,350	5,450
Home equity	634	170	1,326	2,130	0	96,059	98,189
Total	$ 8,243	$ 204	$ 8,720	$ 17,167	$ 10,115	$ 1,609,812	$ 1,637,094

(1) Acquired impaired loans were not classified as nonperforming assets as the loans are considered to be performing 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:

	March 31, 2018			December 31, 2017		
(000's omitted)	Legacy	Acquired	Total	Legacy	Acquired	Total
Pass	$ 1,253,688	$ 891,639	$ 2,145,327	$ 1,170,156	$ 963,981	$ 2,134,137
Special mention	120,881	43,034	163,915	129,076	37,321	166,397

Classified	75,283	31,313	106,596	77,367	34,628	111,995
Doubtful	154	1,598	1,752	0	1,579	1,579
Acquired impaired	0	8,496	8,496	0	10,115	10,115
Total	$1,450,006	$976,080	$2,426,086	$1,376,599	$1,047,624	$2,424,223

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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 March 31, 2018:

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

(000's omitted)	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
Performing	$1,754,341	$990,579	$168,487	$315,312	$3,228,719
Nonperforming	11,523	187	30	1,415	13,155
Total	$1,765,864	$990,766	$168,517	$316,727	$3,241,874

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

(000's omitted)	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
Performing	$442,881	$ 17,397	$ 4,515	$89,635	$554,428
Nonperforming	3,137	35	0	1,470	4,642
Total	$446,018	$ 17,432	$ 4,515	$91,105	$559,070

The following table details the balances in all other loan categories at December 31, 2017:

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

(000's omitted)	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
Performing	$1,742,387	$991,541	$174,431	$320,692	$3,229,051
Nonperforming	12,222	295	48	1,448	14,013
Total	$1,754,609	$991,836	$174,479	$322,140	$3,243,064

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

(000's omitted)	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
Performing	$462,597	$ 20,134	$ 5,450	$96,693	$584,874
Nonperforming	3,092	8	0	1,496	4,596
Total	$465,689	$ 20,142	$ 5,450	$98,189	$589,470

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 March 31, 2018 and December 31, 2017 follows:

(000's omitted)	March 31, 2018	December 31, 2017
Loans with allowance allocation	$ 4,510	$ 5,125
Loans without allowance allocation	1,422	884
Carrying balance	5,932	6,009
Contractual balance	10,146	9,165

Specifically allocated allowance	878	804

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 months ended March 31, 2018 and 2017 was immaterial.

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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 March 31, 2018 and December 31, 2017 is as follows:

	March 31, 2018						December 31, 2017					
(000's omitted)	Nonaccrual		Accruing		Total		Nonaccrual		Accruing		Total	
	#	Amount	#	Amount	#	Amount	#	Amount	#	Amount	#	Amount
Business lending	8	$ 312	3	$ 280	11	$ 592	8	$ 218	7	$ 501	15	$ 719
Consumer mortgage	48	1,976	43	1,651	91	3,627	51	2,265	44	1,750	95	4,015
Consumer indirect	0	0	68	847	68	847	0	0	71	883	71	883
Consumer direct	0	0	23	65	23	65	0	0	25	69	25	69
Home equity	11	234	7	201	18	435	13	245	7	204	20	449
Total	67	$ 2,522	144	$ 3,044	211	$ 5,566	72	$ 2,728	154	$ 3,407	226	$ 6,135

The following table presents information related to loans modified in a TDR during the three months ended March 31, 2018 and 2017. Of the loans noted in the table below, all loans for the three months ended March 31, 2018 and 2017 were modified due to a Chapter 7 bankruptcy as described previously. The financial effects of these restructurings were immaterial.

	Three Months Ended March 31, 2018		Three Months Ended March 31, 2017	
(000's omitted)	Number of loans modified	Outstanding Balance	Number of loans modified	Outstanding Balance
Business lending	1	$ 93	0	$ 0
Consumer mortgage	0	0	7	502
Consumer indirect	4	41	8	106
Consumer direct	2	2	4	15
Home equity	0	0	2	98
Total	7	$ 136	21	$ 721

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:

	Three Months Ended March 31, 2018							
(000's omitted)	Business Lending	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Unallocated	Acquired Impaired	Total
Beginning balance	$17,257	$ 10,465	$ 13,468	$ 3,039	$2,107	$ 1,100	$ 147	$47,583
Charge-offs	(1,669)	(199)	(2,284)	(496)	(56)	0	(43)	(4,747)
Recoveries	198	8	1,151	222	9	0	0	1,588
Provision	1,821	108	1,363	219	(20)	(16)	204	3,679
Ending balance	$17,607	$ 10,382	$ 13,698	$ 2,984	$2,040	$ 1,084	$ 308	$48,103

Three Months Ended March 31, 2017

(000's omitted)	Business Lending	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Unallocated	Acquired Impaired	Total
Beginning balance	$17,220	$ 10,094	$ 13,782	$ 2,979	$2,399	$ 651	$ 108	$47,233
Charge-offs	(695)	(85)	(1,947)	(417)	(38)	0	0	(3,182)
Recoveries	71	7	869	245	25	0	0	1,217
Provision	261	133	1,292	45	(27)	122	2	1,828
Ending balance	$16,857	$ 10,149	$ 13,996	$ 2,852	$2,359	$ 773	$ 110	$47,096

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NOTE F: GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

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

	March 31, 2018			December 31, 2017		
(000's omitted)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortizing intangible assets:						
Core deposit intangibles	$62,902	$ (39,621)	$23,281	$62,902	$ (37,877)	$25,025
Other intangibles	87,372	$ (23,694)	63,678	86,535	(20,902)	65,633
Total amortizing intangibles	$150,274	$ (63,315)	$86,959	$149,437	$ (58,779)	$90,658

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

(000's omitted)	
Apr - Dec 2018	$13,318
2019	15,247
2020	12,680
2021	10,817
2022	9,288
Thereafter	25,609
Total	$86,959

Shown below are the components of the Company's goodwill at December 31, 2017 and March 31, 2018:

(000's omitted)	December 31, 2017	Activity	March 31, 2018
Goodwill	$ 739,254	$ (805)	$ 738,449
Accumulated impairment	(4,824)	0	(4,824)
Goodwill, net	$ 734,430	$ (805)	$ 733,625

NOTE G: MANDATORILY REDEEMABLE PREFERRED SECURITIES

The Company sponsors three business trusts, Community Statutory Trust III ("CST III"), Community Capital Trust IV ("CCT IV") and MBVT Statutory Trust I ("MBVT I"), of which 100% of the common stock is owned by the Company. The common stock of MBVT Statutory Trust I was acquired in the Merchants acquisition. 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 such 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:

Trust	Issuance Date	Par Amount	Interest Rate	Maturity Date	Call Price
CST III	7/31/2001	$24.5 million	3 month LIBOR plus 3.58% (5.35%)	7/31/2031	Par

CCT IV	12/8/2006	$75.0 million	3 month LIBOR plus 1.65% (3.77%)	12/15/2036	Par
MBVT I	12/15/2004	$20.6 million	3 month LIBOR plus 1.95% (4.07%)	12/31/2034	Par

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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.

The net periodic benefit cost for the three months ended March 31, 2018 and 2017 is as follows:

	Pension Benefits Three Months Ended March 31,		Post-retirement Benefits Three Months Ended March 31,	
(000's omitted)	2018	2017	2018	2017
Service cost	$ 1,121	$ 1,039	$ 0	$ 0
Interest cost	1,415	1,361	17	19
Expected return on plan assets	(3,705)	(3,121)	0	0
Amortization of unrecognized net loss	298	263	5	2
Amortization of prior service cost	(83)	14	(44)	(45)
Net periodic benefit	$ (954)	$ (444)	$ (22)	$ (24)

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 March 31, 2018.

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 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 approximately 0.4 million weighted-average anti-dilutive stock options outstanding for the three months ended March 31, 2018, compared to approximately 0.2 million weighted-average anti-dilutive stock options outstanding for the three months ended March 31, 2017 that were not included in the computation below.

The following is a reconciliation of basic to diluted earnings per share for the three months ended March 31, 2018 and 2017:

	Three Months Ended March 31,	
(000's omitted, except per share data)	2018	2017
Net income	$ 40,106	$ 26,257
Income attributable to unvested stock-based compensation awards	(141)	(138)
Income available to common shareholders	$ 39,965	$ 26,119
Weighted-average common shares outstanding – basic	50,934	45,284
Basic earnings per share	$ 0.78	$ 0.58

Net income	$ 40,106	$ 26,257
Income attributable to unvested stock-based compensation awards	(141)	(138)
Income available to common shareholders	$ 39,965	$ 26,119
Weighted-average common shares outstanding – basic	50,934	45,284
Assumed exercise of stock options	563	703
Weighted-average common shares outstanding – diluted	51,497	45,987
Diluted earnings per share	$ 0.78	$ 0.57

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Stock Repurchase Program

At its December 2017 meeting, the Company's Board of Directors (the "Board") approved a stock repurchase program authorizing the repurchase of up to 2.5 million shares of the Company's common stock in accordance with securities laws and regulations, through December 31, 2018. 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 three months of 2018.

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:

(000's omitted)	March 31, 2018	December 31, 2017
Commitments to extend credit	$1,095,696	$ 1,080,004
Standby letters of credit	33,574	23,782
Total	$1,129,270	$ 1,103,786

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 March 31, 2018, 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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	March 31, 2018			
(000's omitted)	Level 1	Level 2	Level 3	Total Fair Value
Available-for-sale investment securities:				
U.S. Treasury and agency securities	$1,885,015	$142,899	$ 0	$2,027,914
Obligations of state and political subdivisions	0	510,308	0	510,308
Government agency mortgage-backed securities	0	364,539	0	364,539
Corporate debt securities	0	2,579	0	2,579
Government agency collateralized mortgage obligations	0	81,429	0	81,429
Marketable equity securities	521	0	0	521
Total available-for-sale investment securities	1,885,536	1,101,754	0	2,987,290
Mortgage loans held for sale	0	628	0	628
Commitments to originate real estate loans for sale	0	0	55	55
Forward sales commitments	0	10	0	10
Interest rate swap agreements asset	0	937	0	937
Interest rate swap agreements liability	0	(893)	0	(893)
Total	$1,885,536	$1,102,436	$ 55	$2,988,027

	December 31, 2017			
(000's omitted)	Level 1	Level 2	Level 3	Total Fair Value
Available-for-sale investment securities:				
U.S. Treasury and agency securities	$1,909,290	$144,781	$ 0	$2,054,071
Obligations of state and political subdivisions	0	528,956	0	528,956
Government agency mortgage-backed securities	0	357,538	0	357,538
Corporate debt securities	0	2,623	0	2,623
Government agency collateralized mortgage obligations	0	87,374	0	87,374
Marketable equity securities	526	0	0	526
Total available-for-sale investment securities	1,909,816	1,121,272	0	3,031,088
Mortgage loans held for sale	0	461	0	461
Commitments to originate real estate loans for sale	0	0	89	89
Forward sales commitments	0	4	0	4
Interest rate swap agreements asset	0	1,064	0	1,064
Interest rate swap agreements liability	0	(904)	0	(904)
Total	$1,909,816	$1,121,897	$ 89	$3,031,802

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 March 31, 2018 was approximately $0.6 million. The unrealized gain on mortgage loans held for sale