COMMUNITY BANK SYSTEM, INC.
Form 10-K
March 01, 2019

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

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

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)

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

Title of each class	Name of each exchange on which registered.
Common Stock, Par Value $1.00 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No .

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K. .

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

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 Act). Yes . No .

The aggregate market value of the common stock, $1.00 par value per share, held by non-affiliates of the registrant computed by reference to the closing price as of the close of business on June 30, 2018 (the registrant's most recently completed second fiscal quarter): $2,967,005,765.

The number of shares of the common stock, $1.00 par value per share, outstanding as of the close of business on January 31, 2019: 51,318,005

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the Definitive Proxy Statement for the Annual Meeting of the Shareholders to be held on May 15, 2019 (the "Proxy Statement") is incorporated by reference in Part III of this Annual Report on Form 10-K.

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Part I

This Annual Report on Form 10-K contains certain forward-looking statements with respect to the financial condition, results of operations and business of Community Bank System, Inc. These forward-looking statements by their nature address matters that involve certain risks and uncertainties. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements are set forth herein under the caption "Forward-Looking Statements."

Item 1. Business

Community Bank System, Inc. (the "Company") was incorporated on April 15, 1983, under the Delaware General Corporation Law. Its principal office is located at 5790 Widewaters Parkway, DeWitt, New York 13214. The Company is a registered financial holding company which wholly-owns two significant subsidiaries: Community Bank, N.A. (the "Bank" or "CBNA"), and Benefit Plans Administrative Services, Inc. ("BPAS"). As of December 31, 2018, BPAS owns five subsidiaries: Benefit Plans Administrative Services, LLC ("BPA"), a provider of defined contribution plan administration services; Northeast Retirement Services, LLC ("NRS"), a provider of institutional transfer agency, master recordkeeping services, fund administration, trust and retirement plan services; BPAS Actuarial & Pension Services, LLC ("BPAS-APS"), a provider of actuarial and benefit consulting services; BPAS Trust Company of Puerto Rico, a Puerto Rican trust company; and Hand Benefits & Trust Company ("HB&T"), a provider of collective investment fund administration and institutional trust services. NRS owns one subsidiary, Global Trust Company, Inc. ("GTC"), a non-depository trust company which provides fiduciary services for collective investment trusts and other products. HB&T owns one subsidiary, Hand Securities, Inc. ("HSI"), an introducing broker-dealer. The Company also sponsors two unconsolidated subsidiary business trusts formed for the purpose of issuing mandatorily-redeemable preferred securities which are considered Tier I capital under regulatory capital adequacy guidelines.

The Bank's business philosophy is to operate as a diversified financial services enterprise providing a broad array of banking and other financial services to retail, commercial and municipal customers. As of December 31, 2018, the Bank operates 224 full-service branches operating as Community Bank, N.A. throughout 35 counties of Upstate New York, six counties of Northeastern Pennsylvania, 12 counties of Vermont and one county of Western Massachusetts, offering a range of commercial and retail banking services. The Bank owns the following operating subsidiaries: The Carta Group, Inc. ("Carta Group"), CBNA Preferred Funding Corporation ("PFC"), CBNA Treasury Management Corporation ("TMC"), Community Investment Services, Inc. ("CISI"), NOTCH Investment Fund, LLC ("NOTCH"), Nottingham Advisors, Inc. ("Nottingham"), OneGroup NY, Inc. ("OneGroup"), and Oneida Preferred Funding II LLC ("OPFC II"). OneGroup is a full-service insurance agency offering personal and commercial property insurance and other risk management products and services. NOTCH, PFC and OPFC II primarily act as investors in residential and commercial real estate activities. TMC provides cash management, investment, and treasury services to the Bank. CISI and Carta Group provide broker-dealer and investment advisory services. Nottingham provides asset management services to individuals, corporations, corporate pension and profit sharing plans, and foundations.

The Company maintains a website at cbna.com. Annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports, are available on the Company's website free of charge as soon as reasonably practicable after such reports or amendments are electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). The information posted on the website is not incorporated into or a part of this filing. Copies of all documents filed with the SEC can also be obtained by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, by calling the SEC at 1-800-SEC-0330 or by accessing the SEC's website at https://www.sec.gov.

Acquisition History (2014-2018)

Kinderhook Bank Corp. - Subsequent Event/ Pending Acquisition

On January 22, 2019, the Company announced that it had entered into a definitive agreement to acquire Kinderhook Bank Corp. ("Kinderhook"), parent company of The National Union Bank of Kinderhook headquartered in Kinderhook, New York, for approximately $93.4 million in cash. The acquisition will extend the Company's footprint into the Capital District of Upstate New York. Upon the completion of the merger, the Bank will add 11 branch locations across a five county area in the Capital District of Upstate New York with approximately $640 million in assets, and deposits of $560 million. The acquisition is expected to close during the third quarter of 2019, pending both customary regulatory and Kinderhook shareholder approval. The Company expects to incur certain one-time, transaction-related costs in 2019.

Wealth Resources Network, Inc. - Subsequent Event

On January 2, 2019, the Company, through its subsidiary, CISI, completed its acquisition of certain assets of Wealth Resources Network, Inc. ("Wealth Resources"), a financial services business headquartered in Liverpool, New York. The Company paid $1.2 million in cash to acquire the assets of Wealth Resources and recorded a $1.2 million customer list intangible asset in conjunction with the acquisition.

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HR Consultants, LLC

On April 2, 2018, the Company, through its subsidiary, BPAS, acquired certain assets of HR Consultants (SA), LLC (“HR Consultants”), a provider of actuarial and benefit consulting services headquartered in Puerto Rico. The Company paid $0.3 million in cash to acquire the assets of HR Consultants and recorded intangible assets of $0.3 million in conjunction with the acquisition.

Penna & Associates Agency, Inc.

On January 2, 2018, the Company, through its subsidiary, 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 $0.3 million and a customer list intangible asset of $0.3 million in conjunction with the acquisition.

Styles Bridges Associates

On January 2, 2018, the Company, through its subsidiary, 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.

Gordon B. Roberts Agency, Inc.

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, $0.6 million of other liabilities, goodwill in the amount of $2.1 million and other intangible assets of $1.6 million.

Northeast Capital Management, Inc.

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 to acquire a customer list from NECM, and recorded a $1.2 million customer list intangible asset in conjunction with the acquisition.

Merchants Bancshares, Inc.

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 extended 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.

Dryfoos Insurance Agency, Inc.

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.

Northeast Retirement Services, Inc.

On February 3, 2017, the Company completed its acquisition of NRS and its subsidiary 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, strengthens and complements 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 over 10 years, the creation of a $23.0 million deferred tax liability associated with the customer list intangible and $75.3 million in goodwill.

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Benefits Advisory Service, Inc.

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.

WJL Agencies, Inc.

On January 4, 2016, the Company, through its subsidiary, CBNA Insurance Agency, Inc., completed its acquisition of WJL Agencies, Inc. doing business as The Clark Insurance Agencies ("WJL"), an insurance agency operating in Canton, 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. On August 19, 2016, the Company merged together its insurance subsidiaries and as of that date, CBNA Insurance Agency, Inc. was merged into OneGroup.

Oneida Financial Corp.

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 $158.5 million in Company stock and cash, comprised of $56.3 million of cash and the issuance of 2.38 million common shares. Upon the completion of the merger, the Bank added 12 branch locations in Oneida and Madison counties and approximately $769.4 million of assets, including approximately $399.4 million of loans and $225.7 million of investment securities, along with $699.2 million of deposits. Through the acquisition of Oneida, the Company acquired 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. On April 22, 2016, the activities of OWM were merged into CISI.

EBS-RMSCO, Inc.

On January 1, 2014, BPAS-APS, formerly known as Harbridge Consulting Group LLC, completed its acquisition of a professional services practice from EBS-RMSCO, Inc., a subsidiary of The Lifetime Healthcare Companies ("EBS-RMSCO"). This professional services practice, which provides actuarial valuation and consulting services to clients who sponsor pension and post-retirement medical and welfare plans, enhanced the Company's participation in the Western New York marketplace.

Services

Banking

The Bank is a community bank committed to the philosophy of serving the financial needs of customers in local communities. The Bank's branches are generally located in smaller towns and cities within its geographic market areas of Upstate New York, Northeastern Pennsylvania, Vermont and Western Massachusetts. The Company believes that the local character of its business, knowledge of the customers and their needs, and its comprehensive retail and business products, together with responsive decision-making at the branch and regional levels, enable the Bank to compete effectively in its geographic market. The Bank is a member of the Federal Reserve System, the Federal Home Loan Bank of New York and the Federal Home Loan Bank of Boston (collectively referred to as "FHLB"), and its deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits.

Employee Benefit Services

Through BPAS and its subsidiaries, the Company operates a national practice that provides employee benefit trust, collective investment fund, retirement plan administration, fund administration, transfer agency, actuarial, VEBA/HRA and health and welfare consulting services to a diverse array of clients spanning the United States and Puerto Rico.

Wealth Management

Through the Bank, CISI, Carta Group, and Nottingham, the Company provides wealth management, retirement planning, higher educational planning, fiduciary, risk management, trust services and personal financial planning services. The Company offers investment alternatives including stocks, bonds, mutual funds and advisory products.

Insurance Agency

Through OneGroup, the Company offers personal and commercial property insurance and other risk management products and services. In addition, OneGroup offers employee benefit related services. OneGroup represents many leading insurance companies.

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Segment Information

The Company has identified three reportable operating business segments: Banking, Employee Benefit Services, and All Other. Included in the All Other segment are the smaller Wealth Management and Insurance operations. Information about the Company's reportable business segments is included in Note U of the "Notes to Consolidated Financial Statements" filed herewith in Part II.

Competition

The banking and financial services industry is highly competitive in the New York, Pennsylvania, Vermont and Massachusetts markets. The Company competes actively for loans, deposits, and financial services relationships with other national and state banks, thrift institutions, credit unions, retail brokerage firms, mortgage bankers, finance companies, insurance agencies, and other regulated and unregulated providers of financial services. In order to compete with other financial service providers, the Company stresses the community nature of its operations and the development of profitable customer relationships across all lines of business.

The Company's employee benefit trust and plan administration business competes on a national scale and provides geographic diversification for the Company. Certain lines of business are marketed primarily through unaffiliated financial advisors, while others are marketed directly to plan sponsors and fund companies. In order to compete with large national firms, the Company stresses its consultative approach to complex engagements.

The table below summarizes the Bank's deposits and market share by the fifty-four counties of New York, Pennsylvania, Vermont, and Massachusetts in which it has customer facilities. Market share is based on deposits of all commercial banks, credit unions, savings and loan associations, and savings banks.

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County	State	Deposits as of 6/30/2018[1] (000's omitted)	Market Share [1]	Number of Branches	ATM's	Towns/ Cities	Towns Where Company Has 1st or 2nd Market Position
Grand Isle	VT	$37,681	100.00%	1	1	1	1
Lewis	NY	201,318	73.46%	4	4	3	3
Hamilton	NY	59,541	56.52%	2	2	2	2
Franklin	NY	344,894	52.83%	6	6	5	5
Madison	NY	418,397	45.71%	8	8	5	5
Allegany	NY	280,196	44.50%	9	10	8	8
Cattaraugus	NY	432,515	33.45%	10	11	7	6
Otsego	NY	344,457	29.82%	10	9	6	5
Schuyler	NY	53,185	24.97%	1	1	1	1
Seneca	NY	127,217	24.94%	4	3	4	4
Saint Lawrence	NY	456,884	24.58%	13	13	11	10
Yates	NY	97,185	23.36%	3	2	2	1
Clinton	NY	385,880	23.34%	4	7	2	2
Jefferson	NY	440,124	23.29%	7	9	6	6
Wyoming	PA	136,249	20.98%	4	4	4	3
Livingston	NY	190,211	19.59%	5	6	5	4
Chautauqua	NY	368,106	18.81%	12	12	10	7
Essex	NY	130,903	15.74%	5	5	4	3
Orange	VT	50,659	15.08%	2	2	2	2
Oswego	NY	202,165	13.59%	4	5	4	3
Caledonia	VT	69,740	10.92%	2	2	2	1
Wayne	NY	133,223	10.52%	3	4	2	2
Ontario	NY	236,577	10.33%	8	13	5	3
Addison	VT	57,973	9.48%	2	2	2	2
Delaware	NY	138,152	9.39%	5	5	5	4
Bennington	VT	77,389	9.18%	2	4	2	0
Chittenden	VT	589,812	8.90%	9	10	6	4
Tioga	NY	38,382	8.53%	2	2	2	1
Franklin	VT	50,716	7.88%	2	2	2	1
Rutland	VT	107,221	7.46%	3	3	2	1
Chemung	NY	75,227	6.88%	2	2	1	0
Susquehanna	PA	59,611	6.72%	3	1	3	2
Herkimer	NY	47,578	6.71%	1	1	1	1
Luzerne	PA	463,068	6.68%	10	13	8	4
Lackawanna	PA	405,557	6.40%	11	11	8	4
Steuben	NY	193,545	6.29%	8	9	7	4
Schoharie	NY	21,777	4.72%	1	1	1	0
Lamoille	VT	27,326	4.68%	1	1	1	1
Windham	VT	47,652	4.57%	2	3	2	1
Carbon	PA	45,025	4.55%	2	2	2	0
Oneida	NY	256,782	4.28%	6	8	5	3
Windsor	VT	58,462	4.20%	2	1	2	0
Washington	VT	87,601	3.63%	3	5	3	1
Cayuga	NY	43,880	3.60%	2	2	2	1
Bradford	PA	43,259	3.36%	2	2	2	1

Chenango	NY	22,822	2.56%	2	2	1	0
Washington	NY	19,569	2.53%	1	0	1	1
Warren	NY	37,977	1.96%	1	1	1	1
Onondaga	NY	206,535	1.65%	4	5	4	1
Ulster	NY	31,046	0.73%	1	1	1	1
Broome	NY	32,672	0.52%	1	1	1	0
Erie	NY	138,335	0.33%	4	4	3	2
Hampden	MA	37,223	0.29%	1	1	1	0
Tompkins	NY	4,867	0.16%	1	0	1	0
		8,664,348	5.67%	224	244	184	129

(1) Deposits and Market Share data as of June 30, 2018, the most recent information available from SNL Financial LLC. Deposit amounts include $150.4 million of intercompany balances that are eliminated upon consolidation.

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Employees

As of December 31, 2018, the Company employed 2,661 full-time employees and 272 part-time and temporary employees. None of the Company's employees are represented by a collective bargaining agreement. The Company offers a variety of employment benefits and considers its relationship with its employees to be good.

Supervision and Regulation

General
The banking industry is highly regulated with numerous statutory and regulatory requirements that are designed primarily for the protection of depositors and the financial system, and not for the purpose of protecting shareholders. Set forth below is a description of the material laws and regulations applicable to the Company and the Bank. This summary is not complete and the reader should refer to these laws and regulations for more detailed information. The Company's and the Bank's failure to comply with applicable laws and regulations could result in a range of sanctions and administrative actions imposed upon the Company and/or the Bank, including the imposition of civil money penalties, formal agreements and cease and desist orders. Changes in applicable law or regulations, and in their interpretation and application by regulatory agencies, cannot be predicted, and may have a material effect on the Company's business and results.

The Company and its subsidiaries are subject to the laws and regulations of the federal government and the states and jurisdictions in which they conduct business. The Company, as a bank holding company, is subject to extensive regulation, supervision and examination by the Board of Governors of the Federal Reserve System ("FRB") as its primary federal regulator. The Bank is a nationally-chartered bank and is subject to extensive regulation, supervision and examination by the Office of the Comptroller of the Currency ("OCC") as its primary federal regulator, and as to certain matters, the FRB, the Consumer Financial Protection Bureau ("CFPB"), and the Federal Deposit Insurance Corporation ("FDIC").

The Company is also subject to the jurisdiction of the SEC and is subject to disclosure and regulatory requirements under the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. The Company's common stock is listed on the New York Stock Exchange ("NYSE") and it is subject to NYSE's rules for listed companies. Affiliated entities, including BPAS, NRS, HB&T, HSI, BPAS Trust Company of Puerto Rico, Nottingham, CISI, OneGroup, and Carta Group are subject to the jurisdiction of certain state and federal regulators and self-regulatory organizations including, but not limited to, the SEC, the Texas Department of Banking, the State of Maine Bureau of Financial Institutions, the Financial Industry Regulatory Authority ("FINRA"), Puerto Rico Office of the Commissioner of Financial Institutions, and state securities and insurance regulators.

Federal Bank Holding Company Regulation
The Company was a bank holding company under the Bank Holding Company Act of 1956, (the "BHC Act"), and became a financial holding company effective September 30, 2015. As a bank holding company that has elected to become a financial holding company, the Company can affiliate with securities firms and insurance companies and engage in other activities that are "financial in nature" or "incidental" or "complementary" to activities that are financial in nature, as long as it continues to meet the eligibility requirements for financial holding companies (including requirements that the financial holding company and its depository institution subsidiary maintain their status as "well capitalized" and "well managed").

Generally, FRB approval is not required for the Company to acquire a company (other than a bank holding company, bank or savings association) engaged in activities that are financial in nature or incidental to activities that are financial in nature, as determined by the FRB. Prior notice to the FRB may be required, however, if the company to be acquired has total consolidated assets of $10 billion or more. Prior FRB approval is required before the Company may acquire the beneficial ownership or control of more than 5% of the voting shares or substantially all of the assets

of a bank holding company, bank or savings association.

Because the Company is a financial holding company, if the Bank were to receive a rating under the Community Reinvestment Act of 1977, as amended ("CRA"), of less than Satisfactory, the Company will be prohibited, until the rating is raised to Satisfactory or better, from engaging in new activities or acquiring companies other than bank holding companies, banks or savings associations, except that the Company could engage in new activities, or acquire companies engaged in activities, that are considered "closely related to banking" under the BHC Act. In addition, if the FRB determines that the Company or the Bank is not well capitalized or well managed, the Company would be required to enter into an agreement with the FRB to comply with all applicable capital and management requirements and may contain additional limitations or conditions. Until corrected, the Company could be prohibited from engaging in any new activity or acquiring companies engaged in activities that are not closely related to banking, absent prior FRB approval.

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Federal Reserve System Regulation

Because the Company is a financial holding company, it is subject to regulatory capital requirements and required by the FRB to, among other things, maintain cash reserves against its deposits. The Bank is under similar capital requirements administered by the OCC as discussed below. FRB policy has historically required a financial holding company to act as a source of financial and managerial strength to its subsidiary banks. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") codifies this historical policy as a statutory requirement. To the extent the Bank is in need of capital, the Company could be expected to provide additional capital, including borrowings from the FRB for such purpose. Both the Company and the Bank are subject to extensive supervision and regulation, which focus on, among other things, the protection of depositors' funds.

The FRB also regulates the national supply of bank credit in order to influence general economic conditions. These policies have a significant influence on overall growth and distribution of loans, investments and deposits, and affect the interest rates charged on loans or paid for deposits.

Fluctuations in interest rates, which may result from government fiscal policies and the monetary policies of the FRB, have a strong impact on the income derived from loans and securities, and interest paid on deposits and borrowings. While the Company and the Bank strive to model various interest rate changes and adjust our strategies for such changes, the level of earnings can be materially affected by economic circumstances beyond our control.

The Office of Comptroller of the Currency Regulation

The Bank is supervised and regularly examined by the OCC. The various laws and regulations administered by the OCC affect the Company's practices such as payment of dividends, incurring debt, and acquisition of financial institutions and other companies. It also affects the Bank's business practices, such as payment of interest on deposits, the charging of interest on loans, types of business conducted and the location of its offices. The OCC generally prohibits a depository institution from making any capital distributions, including the payment of a dividend, or paying any management fee to its parent holding company if the depository institution would become undercapitalized due to the payment. Undercapitalized institutions are subject to growth limitations and are required to submit a capital restoration plan to the OCC. The Bank is well capitalized under regulatory standards administered by the OCC. For additional information on our capital requirements see "Management's Discussion and Analysis of Financial Condition and Results of Operations – Shareholders' Equity" and Note P to the Financial Statements.

Federal Home Loan Bank

The Bank is a member of the FHLB, which provides a central credit facility primarily for member institutions for home mortgage and neighborhood lending. The Bank is subject to the rules and requirements of the FHLB, including the purchase of shares of FHLB activity-based stock in the amount of 4.5% of the dollar amount of outstanding advances and FHLB capital stock in an amount equal to the greater of $1,000 or the sum of 0.15% of the mortgage-related assets held by the Bank based upon the previous year-end financial information. The Bank was in compliance with the rules and requirements of the FHLB at December 31, 2018.

Deposit Insurance

Deposits of the Bank are insured up to the applicable limits by the Deposit Insurance Fund ("DIF") and are subject to deposit insurance assessments to maintain the DIF. The Dodd-Frank Act permanently increased the maximum amount of deposit insurance to $250,000 per deposit category, per depositor, per institution. A depository institution's DIF assessment is calculated by multiplying its assessment rate by the assessment base, which is defined as the average consolidated total assets less the average tangible equity of the depository institution. The initial base assessment rate is based on its capital level and supervisory ratings (its "CAMELS ratings"), certain financial measures to assess an institution's ability to withstand asset related stress and funding related stress and, in some cases, additional discretionary adjustments by the FDIC to reflect additional risk factors. The Bank's adjusted average consolidated total assets for 4 consecutive quarters exceeded $10.0 billion in 2018, which resulted in a deposit insurance assessment based on a large institution classification, rather than the small institution classification for years

prior to 2018.

For large insured depository institutions, generally defined as those with at least $10 billion in total assets, the FDIC has eliminated risk categories when calculating the initial base assessment rates and now combine CAMELS ratings and financial measures into two scorecards to calculate assessment rates, one for most large insured depository institutions and another for highly complex insured depository institutions (which are generally those with more than $50 billion in total assets that are controlled by a parent company with more than $500 billion in total assets). Each scorecard has two components - a performance score and loss severity score, which are combined and converted to an initial assessment rate. The FDIC has the ability to adjust a large or highly complex insured depository institution's total score by a maximum of 15 points, up or down, based upon significant risk factors that are not captured by the scorecard. Under the current assessment rate schedule, the initial base assessment rate for large and highly complex insured depository institutions ranges from three to 30 basis points, and the total base assessment rate, after applying the unsecured debt and brokered deposit adjustments, ranges from one and one-half to 40 basis points. The Bank's FDIC insurance for 2018 was based on an assessment rate of three basis points.

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In October 2010, the FDIC adopted a DIF restoration plan to ensure that the fund reserve ratio reached 1.35% by September 30, 2020, as required by the Dodd-Frank Act. In September 2018, the DIF reserve ratio reached 1.36%, exceeding the required reserve ratio of 1.35% ahead of the September 30, 2020 deadline. FDIC insurance expense totaled $3.2 million, $3.5 million and $3.7 million in 2018, 2017 and 2016, respectively.

Under the Federal Deposit Insurance Act, if the FDIC finds that an institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC, the FDIC may determine that such violation or unsafe or unsound practice or condition require the termination of deposit insurance.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

On July 21, 2010, the Dodd-Frank Act was signed into law, which resulted in significant changes to the banking industry. As discussed further throughout this section, certain aspects of the Dodd-Frank Act are subject to implementing rules that have been taking effect over several years.

The Dodd-Frank Act contains numerous provisions that affect all banks and bank holding companies and impacts how the Company and the Bank handle their operations. The Dodd-Frank Act requires various federal agencies, including those that regulate the Company and the Bank, to promulgate new rules and regulations and to conduct various studies and reports for Congress. The federal agencies have either completed or are in the process of completing these rules and regulations and have been given significant discretion in drafting such rules and regulations. Several of the provisions of the Dodd-Frank Act may have the consequence of increasing the Bank's expenses, decreasing its revenues, and changing the activities in which it chooses to engage. The specific impact of the Dodd-Frank Act on the Company's current activities or new financial activities the Company may consider in the future, the Company's financial performance, and the markets in which the Company operates depends on the manner in which the relevant agencies continue to develop and implement the required rules and regulations and the reaction of market participants to these regulatory developments.

Pursuant to FRB regulations mandated by the Dodd-Frank Act, interchange fees on debit card transactions are limited to a maximum of $0.21 per transaction plus 5 basis points of the transaction amount. A debit card issuer may recover an additional one cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements prescribed by the FRB. The FRB also adopted requirements in the final rule that issuers include two unaffiliated networks for routing debit transactions that are applicable to the Company and the Bank. The Company became subject to the interchange fee cap mandated by the Dodd-Frank Act beginning on July 1, 2018. As such, the fees the Company may receive for an electronic debit transaction will be capped at the statutory limit. Prior to July 1, 2018, the Company was exempt from the interchange fee cap under the "small issuer" exemption, which applies to any debit card issuer with total worldwide assets (including those of its affiliates) of less than $10 billion as of the end of the previous calendar year.

The Dodd-Frank Act established the CFPB and empowered it to exercise broad rulemaking, supervision, and enforcement authority for a wide range of consumer protection laws. Since the Company's total consolidated assets exceed $10 billion the Company is subject to the direct supervision of the CFPB. The CFPB has issued and continues to issue numerous regulations under which the Company and the Bank will continue to incur additional expense in connection with its ongoing compliance obligations. Significant recent CFPB developments that may affect operations and compliance costs include:

- positions taken by the CFPB on fair lending, including applying the disparate impact theory which could make it more difficult for lenders to charge different rates or to apply different terms to loans to different customers;
- the CFPB's final rule amending Regulation C, which implements the Home Mortgage Disclosure Act, requiring most lenders to report expanded information in order for the CFPB to more effectively monitor fair lending concerns and other information shortcomings identified by the CFPB;

- positions taken by the CFPB regarding the Electronic Fund Transfer Act and Regulation E, which require companies to obtain customer authorizations before automatically debiting a consumer's account for pre-authorized electronic funds transfers; and
- focused efforts on enforcing certain compliance obligations the CFPB deems a priority, such as automobile loan servicing, debt collection, mortgage origination and servicing, remittances, and fair lending, among others.

The final rules issued by the FRB, SEC, OCC, FDIC, and Commodity Futures Trading Commission implementing Section 619 of the Dodd-Frank Act (commonly known as the Volcker Rule) prohibit insured depository institutions and companies affiliated with insured depository institutions from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures and options on these instruments, for their own account. The final rules also impose limits on banking entities' investments in, and other relationships with, hedge funds or private equity funds.

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In May of 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act ("Economic Growth Act") was enacted to amend the Dodd-Frank Act and modify certain post-crisis regulatory requirements, including a variety of provisions intended to promote economic growth, provide tailored regulatory relief for smaller and less complex financial institutions, and enhance consumer protections. Among other things, the law raised the asset size threshold for the filing of required company-run stress tests that the Dodd-Frank Act had applied to the Company and the Bank, from $10 billion to $250 billion in total assets. As implemented by the federal banking agencies, these changes became effective in 2018 for banking organizations with total assets of less than $100 billion, such as the Bank.

The ongoing effects of the Dodd-Frank Act, as well as the recent and possible future changes to the regulatory framework as a result of the Economic Growth Act and future proposals make it difficult to assess the overall financial impact of the Dodd-Frank Act and related regulatory developments on the Company and the banking industry. As a result, the Company cannot predict the ultimate impact of the Dodd-Frank Act on the Company or the Bank, including the extent to which it could increase costs or limit the Company's ability to pursue business opportunities in an efficient manner, or otherwise adversely affect its business, financial condition and results of operations. Nor can the Company predict the impact or substance of other future legislation or regulation. However, it is expected that future legislation or regulation at a minimum will increase the Company's and the Bank's operating and compliance costs. As rules and regulations continue to be implemented or issued, the Company may need to dedicate additional resources to ensure compliance, which may increase its costs of operations and adversely impact its earnings.

Capital Requirements

The Company and the Bank are required to comply with applicable capital adequacy standards established by the federal banking agencies. The risk-based capital standards that were applicable to the Company and the Bank through December 31, 2014 were based on the 1988 Capital Accord, known as Basel I ("Basel I"), of the Basel Committee on Banking Supervision (the "Basel Committee"). However, in July 2013, the FRB, the OCC and the FDIC approved final rules (the "Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. These rules went into effect for the Company and the Bank on January 1, 2015, subject to phase-in periods for certain components.

The Capital Rules implement the Basel Committee's December 2010 capital framework (known as "Basel III") for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, including the Company and the Bank, compared to the previous U.S. Basel I risk-based capital rules. The Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions regulatory capital ratios and replace the Basel I risk-weighting approach, with a more risk-sensitive one, based in part, on the standardized approach set forth in "Basel II". The Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the Federal banking agencies' rules.

The Capital Rules, among other things: (i) introduces as a capital measure "Common Equity Tier 1," ("CET1"), (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified revised requirements, (iii) defines CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and (iv) expands the scope of the deductions from and adjustments to capital as compared to existing regulations. Under the Capital Rules, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock, and the most common form of Tier 2 capital is subordinated notes and a portion of the allowance for loan and lease losses, in each case, subject to the Capital Rules specific requirements.

Under the Capital Rules, the minimum capital ratios as of January 1, 2016 are as follows:

- 4.5% CET1 to total risk-weighted assets;
- 6.0% Tier 1 capital (CET1 plus Additional Tier 1 capital) to total risk-weighted assets;

· 8.0% Total capital (Tier 1 Capital plus Tier 2 capital) to total risk-weighted assets;
· 4.0% Tier 1 capital to total adjusted quarterly average assets (known as “leverage ratio”)

Beginning in 2016, the Capital Rules required the Company and the Bank to maintain a “capital conservation buffer” composed entirely of CET1. When it is fully phased-in by the beginning of 2019, banking organizations will be required to maintain a minimum capital conservation buffer of 2.5% (CET1 to Total risk-weighted assets), in addition to the minimum risk-based capital ratios. Therefore, to satisfy both the minimum risk-based capital ratios and the capital conservation buffer, a banking organization will be required to maintain the following: (i) CET1 to total risk-weighted assets of at least 7%, (ii) Tier 1 capital to total risk-weighted assets of at least 8.5%, and (iii) Total capital (Tier 1 capital plus Tier 2 capital) to total risk-weighted assets of at least 10.5% by January 1, 2019, upon full phase-in of the capital conservation buffer. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions that do not maintain a capital conservation buffer of 2.5% or more will face constraints on dividends, common share repurchases and incentive compensation based on the amount of the shortfall.

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The Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Under the general Basel I risk-based capital rules, the effects of accumulated other comprehensive income or loss items included in shareholders' equity (for example, marks-to-market of securities held in the available for sale portfolio) were reversed for the purposes of determining regulatory capital. Under the Capital Rules, the effects of certain accumulated other comprehensive income or loss items are not excluded; however, banks not using the advanced approach, including the Company and the Bank, were permitted to, and in the case of the Company and the Bank they did, make a one-time permanent election to continue to exclude these items.

Consistent with the section 171 of the Dodd-Frank Act, the Capital Rules allow certain bank holding companies to include certain hybrid securities, such as trust preferred securities, in Tier 1 capital if they had less than $15 billion in assets as of December 31, 2009 and the securities were issued before May 19, 2010. Accordingly, the trust preferred securities on the Company's balance sheet will be included as Tier 1 capital while they are outstanding, unless the Company completes an acquisition of a depository institution holding company that did not meet this criteria, or are acquired by such an organization, after January 1, 2014, at which time they would be subject to the stated phase-out requirements of the Capital Rules and would be included as Tier 2 capital.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

With respect to the Bank, the Capital Rules also revise the prompt corrective action ("PCA") regulations established pursuant to Section 38 of the Federal Deposit Insurance Act, by (i) introducing a CET1 ratio requirement for each capital category other than critically undercapitalized, with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each capital category, with the minimum Tier 1 capital ratio for well-capitalized status being 8.0%; and (iii) eliminating the current provision that allows certain highly-rated banking organizations to maintain a 3.0% leverage ratio and still be adequately capitalized. The Capital Rules do not change the Total risk-based PCA capital requirement for any capital category.

The Capital Rules prescribe a standardized approach for risk weighted-assets that expands the risk-weight categories from the four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, depending on the nature of the asset. The risk-weight categories generally range from 0% for U.S. government and agency securities, to 1,250% for certain securitized exposures, and result in higher risk weights for a variety of asset categories. The standardized approach requires financial institutions to transition assets that are 90 days or more past due or on nonaccrual from their original risk weight to 150 percent. Additionally, loans designated as high volatility commercial real estate ("HVCRE") are assigned a risk-weighting of 150 percent.

Requirements to maintain higher levels of capital or to maintain higher levels of liquid assets could adversely impact the Company's net income and return on equity. The current requirements and the Company's actual capital levels are detailed in Note P of "Notes to Consolidated Financial Statements" filed in Part II, Item 8, "Financial Statements and Supplementary Data."

Consumer Protection Laws

In connection with its banking activities, the Bank is subject to a number of federal and state laws designed to protect borrowers and promote lending to various sectors of the economy. These laws include the Equal Credit Opportunity Act, the Gramm-Leach-Bliley Act ("GLB Act"), the Fair Credit Reporting Act ("FCRA"), the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"), Electronic Funds Transfer Act, the Truth in Lending Act, the Home Mortgage

Disclosure Act, the Dodd-Frank Act, the Real Estate Settlement Procedures Act, the Secure and Fair Enforcement for Mortgage Licensing Act ("SAFE"), the Servicemembers Civil Relief Act ("SCRA"), the Military Lending Act ("MLA"), and various state law counterparts.

The Dodd-Frank Act created the CFPB with broad powers to supervise and enforce consumer protection laws, including laws that apply to banks in order to prohibit unfair, deceptive or abusive acts or practices. The CFPB has examination authority over all banks and savings institutions with more than $10 billion in assets. The Dodd-Frank Act also weakens the federal preemption rules that are applicable to national banks and gives attorney generals for the states certain powers to enforce federal consumer protection laws. Further, under the Dodd-Frank Act, it is unlawful for any provider of consumer financial products or services to engage in any unfair, deceptive, or abusive acts or practices ("UDAAP"). A violation of the consumer protection and privacy laws, and in particular UDAAP, could have serious legal, financial, and reputational consequences.

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In addition, the GLB Act requires all financial institutions to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties and establishes procedures and practices to protect customer data from unauthorized access. In addition, the FCRA, as amended by the FACT Act, includes provisions affecting the Company, the Bank, and their affiliates, including provisions concerning obtaining consumer reports, furnishing information to consumer reporting agencies, maintaining a program to prevent identity theft, sharing of certain information among affiliated companies, and other provisions. The FACT Act requires persons subject to FCRA to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The FRB and the Federal Trade Commission have extensive rulemaking authority under the FACT Act, and the Company and the Bank are subject to the rules that have been created under the FACT Act, including rules regarding limitations on affiliate marketing and implementation of programs to identify, detect and mitigate certain identity theft red flags. The SCRA protects persons called to active military service and their dependents from undue hardship resulting from their military service, and the MLA extends specific protections if an accountholder, at the time of account opening, is a covered active duty member of the military or certain family members thereof. The SCRA applies to all debts incurred prior to the commencement of active duty and limits the amount of interest, including service and renewal charges and any other fees or charges (other than bona fide insurance) that are related to the obligation or liability. The MLA applies to certain consumer loans and extends specific protections if an accountholder, at the time of account opening, is a covered active duty member of the military or certain family members thereof. The Bank is also subject to data security standards and data breach notice requirements issued by the OCC and other regulatory agencies. The Bank has created policies and procedures to comply with these consumer protection requirements.

The CFPB issued the final rules implementing the ability-to-repay and qualified mortgage (QM) provisions of the Truth in Lending Act (the “QM Rule”). The ability-to-repay provision requires creditors to make reasonable, good faith determinations that borrowers are able to repay their mortgages before extending the credit based on a number of factors and consideration of financial information about the borrower derived from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of “qualified mortgage” are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for loans meeting the QM requirements, and a rebuttable presumption for higher-priced loans meeting the QM requirements. The definition of a “qualified mortgage” incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43% debt-to-income ratio for borrowers if the loan is to meet the QM definition, though some mortgages that meet government-sponsored enterprises, Federal Housing Administration, and Veterans Administration underwriting guidelines may, for a period not to exceed seven years, meet the QM definition without being subject to the 43% debt-to-income limits. The Bank has created policies and procedures to comply with these consumer protection requirements.

USA Patriot Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (“USA Patriot Act”) imposes obligations on U.S. financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. In addition, provisions of the USA Patriot Act require the federal financial institution regulatory agencies to consider the effectiveness of a financial institution’s anti-money laundering activities when reviewing bank mergers and bank holding company acquisitions. The USA Patriot Act also encourages information-sharing among financial institutions, regulators, and law enforcement authorities by providing an exemption from the privacy provisions of the GLB Act for financial institutions that comply with the provision of the Act. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences for the institution. The Company has approved policies and procedures that are designed to comply with the USA Patriot Act and its regulations.

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others administrated by the Treasury's Office of Foreign Assets Control ("OFAC"). The OFAC administered sanctions can take many different forms; however, they generally contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, entity or individual, including prohibitions against direct or indirect imports and exports and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments, or providing investment related advice or assistance; and (ii) a blocking of assets in which the government or specially designated nationals have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal, financial, and reputational consequences.

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Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”) implemented a broad range of corporate governance, accounting and reporting reforms for companies that have securities registered under the Securities Exchange Act of 1934, as amended. In particular, the Sarbanes-Oxley Act established, among other things: (i) new requirements for audit and other key Board of Directors committees involving independence, expertise levels, and specified responsibilities; (ii) additional responsibilities regarding the oversight of financial statements by the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) the creation of an independent accounting oversight board for the accounting industry; (iv) new standards for auditors and the regulation of audits, including independence provisions which restrict non-audit services that accountants may provide to their audit clients; (v) increased disclosure and reporting obligations for the reporting company and its directors and executive officers including accelerated reporting of company stock transactions; (vi) a prohibition of personal loans to directors and officers, except certain loans made by insured financial institutions on non-preferential terms and in compliance with other bank regulator requirements; and (vii) a range of new and increased civil and criminal penalties for fraud and other violations of the securities laws.

Electronic Fund Transfer Act

Among other provisions, the federal banking rule under the Electronic Fund Transfer Act prohibits financial institutions from charging consumers fees for paying overdrafts on automated teller machines and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. The rule does not govern overdraft fees on the payment of checks and certain other forms of bill payments.

Community Reinvestment Act of 1977

Under the CRA, the Bank is required to help meet the credit needs of its communities, including low- and moderate-income neighborhoods. Although the Bank must follow the requirements of CRA, it does not limit the Bank’s discretion to develop products and services that are suitable for a particular community or establish lending requirements or programs. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibits discrimination in lending practices. The Bank’s failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities and the activities of the Company. The Bank’s failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions against it by its regulators as well as other federal regulatory agencies and the Department of Justice. The Bank’s latest CRA rating was “Satisfactory”.

The Bank Secrecy Act

The Bank Secrecy Act (“BSA”) requires all financial institutions, including banks and securities broker-dealers, to, among other things, establish a risk-based system of internal controls reasonably designed to prevent money laundering and the financing of terrorism. The BSA includes a variety of recordkeeping and reporting requirements (such as currency transaction and suspicious activity reporting), as well as due diligence/know-your-customer documentation requirements. The Company has established a bank secrecy act /anti-money laundering program and taken other appropriate measures in order to comply with BSA requirements.

Item 1A. Risk Factors

There are risks inherent in the Company’s business. The material risks and uncertainties that management believes affect the Company are described below. Adverse experience with these could have a material impact on the Company’s financial condition and results of operations.

Changes in interest rates affect our profitability, assets and liabilities.

The Company’s income and cash flow depends to a great extent on the difference between the interest earned on loans and investment securities, and the interest paid on deposits and borrowings. Interest rates are highly sensitive to many

factors that are beyond the Company's control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the FRB. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Company receives on loans and securities and the amount of interest it pays on deposits and borrowings, but such changes could also affect (1) its ability to originate loans and obtain deposits, which could reduce the amount of fee income generated, (2) the fair value of its financial assets and liabilities and (3) the average duration of the Company's various categories of earning assets. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, the Company's net interest income could be adversely affected, which in turn could negatively affect its earnings. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings. Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the financial condition and results of operations.

The Company operates in a highly regulated environment and may be adversely affected by changes in laws and regulations or the interpretation and examination of existing laws and regulations.

The Company and its subsidiaries are subject to extensive state and federal regulation, supervision and legislation that govern nearly every aspect of its operations. The Company, as a financial holding company, is subject to regulation by the FRB and its banking subsidiary is subject to regulation by the OCC. These regulations affect deposit and lending practices, capital levels and structure, investment practices, dividend policy and growth. In addition, the non-bank subsidiaries are engaged in providing services including, but not limited to, retirement plan administration, fiduciary services to collective investment funds, investment management and insurance brokerage services, which industries are also heavily regulated at both a state and federal level. Such regulators govern the activities in which the Company and its subsidiaries may engage. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of a bank, the classification of assets by a bank and the adequacy of a bank's allowance for loan losses. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation, interpretation or application, could have a material impact on the Company and its operations. Changes to the regulatory laws governing these businesses could affect the Company's ability to deliver or expand its services and adversely impact its operating and financial condition.

The Dodd-Frank Act, as amended by the Economic Growth Act, instituted major changes to the banking and financial institutions regulatory regimes based upon the performance of, and ultimate government intervention in, the financial services sector. The ongoing effects of the Dodd-Frank Act, as well as continued rule-making and possible future changes to the regulatory requirements make it difficult to assess the overall impact of the Dodd-Frank Act and related regulatory developments on the Company and the Bank. The implications of the Dodd-Frank Act for the Company's businesses continue to depend to a large extent on the implementation of the legislation by the FRB and other agencies as well as how market practices and structures change in response to the requirements of the Dodd-Frank Act. All of these changes in regulations could subject the Company, among other things, to additional costs and limit the types of financial services and products it can offer and/or increase the ability of non-banks to offer competing financial services and products.

The Company is also directly subject to the requirements of entities that set and interpret the accounting standards such as the Financial Accounting Standards Board, and indirectly subject to the actions and interpretations of the Public Company Accounting Oversight Board, which establishes auditing and related professional practice standards for registered public accounting firms and inspects registered firms to assess their compliance with certain laws, rules, and professional standards in public company audits. These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies and interpretations, control the methods by which financial institutions and their holding companies conduct business, engage in strategic and tax planning, implement strategic initiatives, and govern financial reporting.

The Company's failure to comply with laws, regulations or policies could result in civil or criminal sanctions, restrictions to its business model, and money penalties by state and federal agencies, and/or reputation damage, which could have a material adverse effect on the Company's business, financial condition and results of operations. See "Supervision and Regulation" for more information about the regulations to which the Company is subject.

The Company's total consolidated assets exceeded $10 billion and is therefore subject to additional regulation and increased supervision including the CFPB.

The Dodd-Frank Act imposes additional regulatory requirement on institutions with $10 billion or more in assets. The Company is now subject to the following: (1) supervision, examination and enforcement by the CFPB with respect to consumer financial protection laws, (2) a modified methodology for calculating FDIC insurance assessments and potentially higher assessment rates, (3) limitations on interchange fees for debit card transactions, (4) heightened

compliance standards under the Volcker Rule, and (5) enhanced supervision as a larger financial institution. The imposition of these regulatory requirements and increased supervision may continue to require additional commitment of financial resources to regulatory compliance and may increase the Company’s cost of operations.

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Basel III capital rules generally require insured depository institutions and their holding companies to hold more capital, which could limit our ability to pay dividends, engage in share repurchases and pay discretionary bonuses.

The Federal Reserve, the FDIC and the OCC adopted final rules for the Basel III capital framework which substantially amended the regulatory risk-based capital rules applicable to the Company. The rules phase in over time becoming fully effective in 2019. Beginning in 2016, a capital conservation buffer will phase in over three years, ultimately resulting in a requirement of 2.5% on top of the common Tier 1, Tier 1 and total capital requirements, resulting in a required common Tier 1 equity ratio of 7%, a Tier 1 ratio of 8.5%, and a total capital ratio of 10.5%. Failure to satisfy any of these three capital requirements will result in limits on paying dividends, engaging in share repurchases and paying discretionary bonuses. These limitations will establish a maximum percentage of eligible retained income that could be utilized for such actions.

Regional economic factors may have an adverse impact on the Company's business.

The Company's main markets are located in the states of New York, Pennsylvania, Vermont and Massachusetts. Most of the Company's customers are individuals and small and medium-sized businesses which are dependent upon the regional economy. Accordingly, the local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources. A prolonged economic downturn in these markets could negatively impact the Company.

The Company is subject to a variety of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, which may adversely affect the Company's business and results of operations.

The Company is exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees, or operational errors, including clerical or record keeping errors or those resulting from faulty or disabled computer or telecommunications systems or disclosure of confidential proprietary information of its customers. Negative public opinion can result from actual or alleged conduct in any number of activities, including lending practices, sales practices, customer treatment, corporate governance and acquisitions and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect the Company's ability to attract and keep customers and can expose the Company to litigation and regulatory action. Actual or alleged conduct by the Company can result in negative public opinion about its business.

If personal, nonpublic, confidential, or proprietary information of customers in the Company's possession were to be mishandled or misused, the Company could suffer significant regulatory consequences, reputational damage, and financial loss. Such mishandling or misuse could include, for example, if such information were erroneously provided to parties who are not permitted to have the information, either by fault of its systems, employees, or counterparties, or where such information is intercepted or otherwise inappropriately taken by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. The Company's necessary dependence upon automated systems to record and process transactions and the large transaction volumes may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. The Company also may be subject to disruptions of its operating systems arising from events that are wholly or partially beyond its control (for example, computer viruses or electrical or telecommunications outages), which may give rise to disruption of service to customers and to financial loss or liability. The Company is further exposed to the risk that external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees) and to the risk that business continuity and data

security systems prove to be inadequate. The occurrence of any of these risks could result in a diminished ability to operate the Company’s business, potential liability to clients, reputational damage, and regulatory intervention, which could adversely affect our business, financial condition, and results of operations, perhaps materially.

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The financial services industry is highly competitive and creates competitive pressures that could adversely affect the Company's revenue and profitability.

The financial services industry in which the Company operates is highly competitive. The Company competes not only with commercial and other banks and thrifts, but also with insurance companies, mutual funds, hedge funds, securities brokerage firms and other companies offering financial services in the U.S., globally and over the Internet. The Company competes on the basis of several factors, including capital, access to capital, revenue generation, quality customer service, products, services, transaction execution, innovation, reputation and price. Over time, certain sectors of the financial services industry have become more concentrated, as institutions involved in a broad range of financial services have been acquired by or merged into other firms. These developments could result in the Company's competitors gaining greater capital and other resources, such as a broader range of products and services and geographic diversity. The Company may experience pricing pressures as a result of these factors and as some of its competitors seek to increase market share by reducing prices or paying higher rates of interest on deposits. Finally, technological change is influencing how individuals and firms conduct their financial affairs and changing the delivery channels for financial services, with the result that the Company may have to contend with a broader range of competitors including many that are not located within the geographic footprint of its banking office network.

Conditions in the insurance market could adversely affect the Company's earnings.

Revenue from insurance fees and commissions could be negatively affected by fluctuating premiums in the insurance markets or other factors beyond the Company's control. Other factors that affect insurance revenue are the profitability and growth of the Company's clients, the renewal rate of the current insurance policies, continued development of new product and services as well as access to new markets. The Company's insurance revenues and profitability may also be adversely affected by new laws and regulatory developments impacting the healthcare and insurance markets.

The allowance for loan losses may be insufficient.

The Company's business depends on the creditworthiness of its customers. The Company reviews the allowance for loan losses quarterly for adequacy considering economic conditions and trends, collateral values and credit quality indicators, including past charge-off experience and levels of past due loans and nonperforming assets. If the Company's assumptions prove to be incorrect, the Company's allowance for loan losses may not be sufficient to cover losses inherent in the Company's loan portfolio, resulting in additions to the allowance. Material additions to the allowance would materially decrease its net income. It is possible that over time the allowance for loan losses will be inadequate to cover credit losses in the portfolio because of unanticipated adverse changes in the economy, market conditions or events adversely affecting specific customers, industries or markets.

A new accounting standard may require us to increase the allowance for loan losses and may have a material adverse effect on the Company's financial condition and results of operations.

The Financial Accounting Standards Board has released a new accounting standard that will be effective for the Company and the Bank for fiscal years beginning after December 15, 2019. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This will change the current method of providing allowances for loan losses that are probable, which would likely require the Bank to increase the allowance for loan losses, and to increase the types of data the Bank would need to collect and review to determine the appropriate level of the allowance for loan losses. The extent of the increase to the allowance for loan losses will continue to be evaluated and will depend on economic conditions and the composition of the Company's loan portfolio at the time of adoption.

Changes in the equity markets could materially affect the level of assets under management and the demand for other fee-based services.

Economic downturns could affect the volume of income from and demand for fee-based services. Revenue from the wealth management and employee benefit trust businesses depends in large part on the level of assets under management and administration. Market volatility and the potential to lead customers to liquidate investments, as well as lower asset values, can reduce the level of assets under management and administration and thereby decrease the Company's investment management and employee benefit trust revenues.

Mortgage banking income may experience significant volatility.

Mortgage banking income is highly influenced by the level and direction of mortgage interest rates, and real estate and refinancing activity. In lower interest rate environments, the demand for mortgage loans and refinancing activity will tend to increase. This has the effect of increasing fee income, but could adversely impact the estimated fair value of the Company's mortgage servicing rights as the rate of loan prepayments increase. In higher interest rate environments, the demand for mortgage loans and refinancing activity will generally be lower. This has the effect of decreasing fee income opportunities.

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The Company depends on dividends from its banking subsidiary for cash revenues to support common dividend payments and other uses, but those dividends are subject to restrictions.

The ability of the Company to satisfy its obligations and pay cash dividends to its shareholders is primarily dependent on the earnings of and dividends from the subsidiary bank. However, payment of dividends by the bank subsidiary is limited by dividend restrictions and capital requirements imposed by bank regulations. The ability to pay dividends is also subject to the continued payment of interest that the Company owes on its subordinated junior debentures. As of December 31, 2018, the Company had $97.9 million of subordinated junior debentures outstanding. The Company has the right to defer payment of interest on the subordinated junior debentures for a period not exceeding 20 quarters, although the Company has not done so to date. If the Company defers interest payments on the subordinated junior debentures, it will be prohibited, subject to certain exceptions, from paying cash dividends on the common stock until all deferred interest has been paid and interest payments on the subordinated junior debentures resumes.

The risks presented by acquisitions could adversely affect the Company's financial condition and result of operations.

The business strategy of the Company includes growth through acquisition. Recently completed and future acquisitions will be accompanied by the risks commonly encountered in acquisitions. These risks include among other things: obtaining timely regulatory approval, the difficulty of integrating operations and personnel, the potential disruption of the Company's ongoing business, the inability of the Company's management to maximize its financial and strategic position, the inability to maintain uniform standards, controls, procedures and policies, and the impairment of relationships with employees and customers as a result of changes in ownership and management. Further, the asset quality or other financial characteristics of a company may deteriorate after the acquisition agreement is signed or after the acquisition closes.

A portion of the Company's loan portfolio is acquired and was not underwritten by the Company at origination.

At December 31, 2018, 20% of the loan portfolio was acquired and was not underwritten by the Company at origination, and therefore is not necessarily reflective of the Company's historical credit risk experience. The Company performed extensive credit due diligence prior to each acquisition and marked the loans to fair value upon acquisition, with such fair valuation considering expected credit losses that existed at the time of acquisition. Additionally, the Company evaluates the expected cash flows of these loans on a quarterly basis. However, there is a risk that credit losses could be larger than currently anticipated, thus adversely affecting earnings.

The Company may be required to record impairment charges related to goodwill, other intangible assets and the investment portfolio.

The Company may be required to record impairment charges in respect to goodwill, other intangible assets and the investment portfolio. Numerous factors, including lack of liquidity for resale of certain investment securities, absence of reliable pricing information for investment securities, the economic condition of state and local municipalities, adverse changes in the business climate, adverse actions by regulators, unanticipated changes in the competitive environment or a decision to change the operations or dispose of an operating unit could have a negative effect on the investment portfolio, goodwill or other intangible assets in future periods.

The Company's financial statements are based, in part, on assumptions and estimates, which, if conditions change, could cause unexpected losses in the future.

Pursuant to accounting principles generally accepted in the United States, the Company is required to use certain assumptions and estimates in preparing its financial statements, including in determining credit loss reserves, mortgage repurchase liability and reserves related to litigation, among other items. Certain of the Company's financial instruments, including available-for-sale securities and certain loans, among other items, require a determination of

their fair value in order to prepare the Company's financial statements. Where quoted market prices are not available, the Company may make fair value determinations based on internally developed models or other means which ultimately rely to some degree on management judgment. Some of these and other assets and liabilities may have no direct observable price levels, making their valuation particularly subjective, as they are based on significant estimation and judgment. In addition, sudden illiquidity in markets or declines in prices of certain loans and securities may make it more difficult to value certain balance sheet items, which may lead to the possibility that such valuations will be subject to further change or adjustment. If assumptions or estimates underlying the Company's financial statements are incorrect, it may experience material losses.

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Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, the Company may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. The Company may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other information could have a material adverse impact on business and, in turn, the Company's financial condition and results of operations.

The Company's information systems may experience an interruption or security breach.

The Company relies heavily on communications and information systems to conduct its business. The Company may be the subject of sophisticated and targeted attacks intended to obtain unauthorized access to assets or confidential information, destroy data, disable or degrade service, or sabotage systems, often through the introduction of computer viruses or malware, cyber-attacks and other means. Any failure, interruption or breach in security of these systems could result in failures or disruptions in the Company's online banking system, its general ledger, and its deposit and loan servicing and origination systems or other systems. Furthermore, if personal, confidential or proprietary information of customers or clients in the Company's possession were to be mishandled or misused, the Company could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include circumstances where, for example, such information was erroneously provided to parties who are not permitted to have the information, either by fault of the Company's systems, employees, or counterparties, or where such information was intercepted or otherwise inappropriately taken by third parties. The Company has policies and procedures designed to prevent or limit the effect of the possible failure, interruption or security breach of its information systems; however, any such failure, interruption or security breach could adversely affect the Company's business and results of operations through loss of assets or by requiring it to expend significant resources to correct the defect, as well as exposing the Company to customer dissatisfaction and civil litigation, regulatory fines or penalties or losses not covered by insurance.

The Company relies on third party vendors, which could expose the Company to additional cybersecurity risks.

Third party vendors provide key components of the Company's business infrastructure, including certain data processing and information services. On behalf of the Company, third parties may transmit confidential, propriety information. Although the Company requires third party providers to maintain certain levels of information security, such providers may remain vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious attacks that could ultimately compromise sensitive information. While the Company may contractually limit liability in connection with attacks against third party providers, the Company remains exposed to the risk of loss associated with such vendors. In addition, a number of the Company's vendors are large national entities with dominant market presence in their respective fields. Their services could prove difficult to replace in a timely manner if a failure or other service interruption were to occur. Failures of certain vendors to provide contracted services could adversely affect the Company's ability to deliver products and services to customers and cause the Company to incur significant expense.

The Company is exposed to fraud in many aspects of the services and products that it provides.

The Company offers a wide variety of products and services. When account credentials and other access tools are not adequately protected by its customers, risks and potential costs may increase. As (a) sales of these services and products expand, (b) those who are committing fraud become more sophisticated and more determined, and (c) banking services and product offerings expand, the Company's operational losses could increase.

The Company may be adversely affected by the soundness of other financial institutions.

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

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The Company is or may become involved in lawsuits, legal proceedings, information-gathering requests, investigations, and proceedings by governmental agencies or other parties that may lead to adverse consequences.

As a participant in the financial services industry, many aspects of the Company's business involve substantial risk of legal liability. The Company and its subsidiaries have been named or threatened to be named as defendants in various lawsuits arising from its or its subsidiaries' business activities (and in some cases from the activities of acquired companies). In addition, from time to time, the Company is, or may become, the subject of governmental and self-regulatory agency information-gathering requests, reviews, investigations and proceedings and other forms of regulatory inquiry, including by bank regulatory agencies, the SEC and law enforcement authorities. The results of such proceedings could lead to delays in or prohibition to acquire other companies, significant penalties, including monetary penalties, damages, adverse judgments, settlements, fines, injunctions, restrictions on the way in which the Company conducts its business, or reputational harm.

Although the Company establishes accruals for legal proceedings when information related to the loss contingencies represented by those matters indicates both that a loss is probable and that the amount of loss can be reasonably estimated, the Company does not have accruals for all legal proceedings where it faces a risk of loss. In addition, due to the inherent subjectivity of the assessments and unpredictability of the outcome of legal proceedings, amounts accrued may not represent the ultimate loss to the Company from the legal proceedings in question. Thus, the Company's ultimate losses may be higher than the amounts accrued for legal loss contingencies, which could adversely affect the Company's financial condition and results of operations.

The Company continually encounters technological change and the failure to understand and adapt to these changes could have a negative impact on the business.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company's operations. Many of the Company's competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological changes affecting the financial services industry could have a material adverse impact on the Company's financial condition and results of operations.

Trading activity in the Company's common stock could result in material price fluctuations.

The market price of the Company's common stock may fluctuate significantly in response to a number of other factors including, but not limited to:

- Changes in securities analysts' expectations of financial performance;
- Volatility of stock market prices and volumes;
- Incorrect information or speculation;
- Changes in industry valuations;
- Variations in operating results from general expectations;
- Actions taken against the Company by various regulatory agencies;
- Changes in authoritative accounting guidance by the Financial Accounting Standards Board or other regulatory agencies;
- Changes in general domestic economic conditions such as inflation rates, tax rates, unemployment rates, oil prices, labor and healthcare cost trend rates, recessions, and changing government policies, laws and regulations; and
- Severe weather, natural disasters, acts of war or terrorism and other external events.

The Company’s ability to attract and retain qualified employees is critical to the success of its business, and failure to do so may have a materially adverse effect on the Company’s performance.

The Company’s employees are its most important resource, and in many areas of the financial services industry, competition for qualified personnel is intense. The imposition on the Company or its employees of certain existing and proposed restrictions or taxes on executive compensation may adversely affect the Company’s ability to attract and retain qualified senior management and employees. If the Company provides inadequate succession planning, is unable to continue to retain and attract qualified employees, the Company’s performance, including its competitive position, could have a materially adverse effect.

Item 1B. Unresolved Staff Comments

None

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Item 2. Properties

The Company's primary headquarters are located at 5790 Widewaters Parkway, Dewitt, New York, which is leased. In addition, the Company has 265 properties located in the counties identified in the table on page 7, of which 161 are owned and 104 are under lease arrangements. With respect to the Banking segment, the Company operates 224 full-service branches and 11 facilities for back office banking operations. With respect to the Employee Benefit Services segment, the Company operates 11 customer service facilities, all of which are leased. With respect to the All Other segment, the Company operates 19 customer service facilities, all of which are leased. Some properties contain tenant leases or subleases.

Real property and related banking facilities owned by the Company at December 31, 2018 had a net book value of $80.5 million and none of the properties were subject to any material encumbrances. For the year ended December 31, 2018, the Company paid $9.0 million of rental fees for facilities leased for its operations. Effective January 1, 2019, the Company adopted new lease accounting guidance in accordance with Accounting Standards Update 2016-02, Leases (Topic 842) that requires recognition of a liability associated with future payments under lease agreements and a right-of-use asset representing the right to use the underlying assets. The adoption of this new guidance resulted in the recognition of a lease liability of approximately $33.5 million and corresponding right-of-use asset of approximately $33.5 million. See the "New Accounting Pronouncements" Section of Note A on page 74 of the Notes to the Consolidated Financial Statements for further information about this guidance. The Company believes that its facilities are suitable and adequate for the Company's current operations.

Item 3. 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 December 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.

Item 4. Mine Safety Disclosures

Not Applicable

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Item 4A. Executive Officers of the Registrant

The executive officers of the Company and the Bank who are elected by the Board of Directors are as follows:

Name	Age	Position
Mark E. Tryniski	58	Director, President and Chief Executive Officer. Mr. Tryniski assumed his current position in August 2006. He served as Executive Vice President and Chief Operating Officer from March 2004 to July 2006 and as the Treasurer and Chief Financial Officer from June 2003 to March 2004. He previously served as a partner in the Syracuse office of PricewaterhouseCoopers LLP.
Scott Kingsley	54	Executive Vice President and Chief Operating Officer. Mr. Kingsley assumed his current position in June 2018. He served as Executive Vice President and Chief Financial Officer from August 2004 to June 2018. He previously served as Vice President and Chief Financial Officer of Carlisle Engineered Products, Inc., a subsidiary of the Carlisle Companies, Inc., from 1997 until joining the Company.
George J. Getman	62	Executive Vice President and General Counsel. Mr. Getman assumed his current position in January 2008. Prior to joining the Company, he was a partner with Bond, Schoeneck & King, PLLC and served as corporate counsel to the Company.
Joseph E. Sutaris	51	Executive Vice President and Chief Financial Officer. Mr. Sutaris assumed his current position in June 2018. He served as Senior Vice President, Finance and Accounting from November 2017 to June 2018, as the Bank's Director of Municipal Banking from September 2016 to November 2017 and as the Senior Vice President of the Central Region of the Bank from April 2011 to September 2016. Mr. Sutaris joined the Company in April 2011 as part of the acquisition of Wilber National Bank where he served as the Executive Vice President, Chief Financial Officer, Treasurer and Secretary.
Joseph F. Serbun	58	Executive Vice President and Chief Credit Officer. Mr. Serbun assumed his current position in June 2018. He served as the Bank's Senior Vice President and Chief Credit Officer from June 2010 to June 2018 and as Vice President and Commercial Team Leader of the Bank from January 2008 until June 2010. Prior to joining the Company, he served as Vice President at JPMorgan Chase Bank, N.A.

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Part II

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

The Company's common stock has been trading on the New York Stock Exchange under the symbol "CBU" since December 31, 1997. Prior to that, the common stock traded over-the-counter on the NASDAQ National Market under the symbol "CBSI" beginning on September 16, 1986. There were 51,318,005 shares of common stock outstanding on January 31, 2019, held by approximately 3,514 registered shareholders of record. The following table sets forth the high and low closing prices for the common stock, and the cash dividends declared with respect thereto, for the periods indicated. The prices do not include retail mark-ups, mark-downs or commissions.

Year / Qtr	High Price	Low Price	Quarterly Dividend
2018			
4th	$ 65.66	$ 54.72	$ 0.38
3rd	$ 66.52	$ 60.04	$ 0.38
2nd	$ 61.98	$ 52.61	$ 0.34
1st	$ 57.00	$ 51.22	$ 0.34
2017			
4th	$ 56.80	$ 51.38	$ 0.34
3rd	$ 57.30	$ 49.11	$ 0.34
2nd	$ 58.03	$ 51.66	$ 0.32
1st	$ 62.32	$ 51.71	$ 0.32

The Company has historically paid regular quarterly cash dividends on its common stock, and declared a cash dividend of $0.38 per share for the first quarter of 2019. The Board of Directors of the Company presently intends to continue the payment of regular quarterly cash dividends on the common stock, as well as to make payment of regularly scheduled dividends on the trust preferred stock when due, subject to the Company's need for those funds. However, because the substantial majority of the funds available for the payment of dividends by the Company are derived from the subsidiary Bank, future dividends will depend largely upon the earnings of the Bank, its financial condition, its need for funds and applicable governmental policies and regulations.

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The following graph compares cumulative total shareholders returns on the Company's common stock over the last five fiscal years to the S&P 600 Commercial Banks Index, the NASDAQ Bank Index, the S&P 500 Index, and the KBW Regional Banking Index. Total return values were calculated as of December 31 of each indicated year assuming a $100 investment on December 31, 2013 and reinvestment of dividends.

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Equity Compensation Plan Information

The following table provides information as of December 31, 2018 with respect to shares of common stock that may be issued under the Company's existing equity compensation plans.

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights [(1)]	Weighted-average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available For Future Issuance Under Equity Compensation Plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders:			
2004 Long-term Incentive Plan	750,032	$ 29.20	52,847
2014 Long-term Incentive Plan	1,115,392	36.91	1,401,817
Equity compensation plans not approved by security holders	0	0	0
Total	1,865,424	$ 33.81	1,454,664

(1) The number of securities includes 221,063 shares of unvested restricted stock.

Stock Repurchase Program

At its December 2017 meeting, the Board approved a stock repurchase program authorizing the repurchase, at the discretion of senior management, of up to 2,500,000 shares of the Company's common stock, in accordance with securities laws and regulations, during a twelve-month period starting January 1, 2018. There were no treasury stock purchases made under this authorization in 2018. At its December 2018 meeting, the Board approved a new stock repurchase program authorizing the repurchase, at the discretion of senior management, of up to 2,500,000 shares of the Company's common stock, in accordance with securities laws and regulations, during a twelve-month period starting January 1, 2019. 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 fourth quarter of 2018:

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid Per share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet be Purchased Under the Plans or Programs
October 1-31, 2018	0	$ 0.00	0	2,500,000
November 1-30, 2018[(1)]	498	63.28	0	2,500,000
December 1-31, 2018 [(1)]	334	57.21	0	2,500,000
Total	832	$ 60.84		

(1) Included in the common shares repurchased were shares acquired by the Company in connection with satisfaction of tax obligations on vested restricted stock issued pursuant to the employee benefit plan of 498 shares and 334 shares in November 2018 and December 2018, respectively. These shares were not repurchased as part of the publicly announced repurchase plan described above.

Item 6. Selected Financial Data

The following table sets forth selected consolidated historical financial data of the Company as of and for each of the years in the five-year period ended December 31, 2018. The historical information set forth under the captions "Income Statement Data" and "Balance Sheet Data" is derived from the audited financial statements while the information under the captions "Capital and Related Ratios", "Selected Performance Ratios" and "Asset Quality Ratios" for all periods is unaudited. All financial information in this table should be read in conjunction with the information contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and with the Consolidated Financial Statements and the related notes thereto included elsewhere in this Annual Report on Form 10-K.

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SELECTED CONSOLIDATED FINANCIAL INFORMATION

	Years Ended December 31,				
(In thousands except per share data and ratios)	2018	2017	2016	2015	2014
Income Statement Data:					
Loan interest income	$286,165	$253,949	$211,467	$187,743	$185,527
Investment interest income	76,568	75,506	73,720	71,879	70,693
Interest expense	17,678	13,780	11,291	11,202	11,792
Net interest income	345,055	315,675	273,896	248,420	244,428
Provision for loan losses	10,837	10,984	8,076	6,447	7,178
Noninterest income	223,720	202,421	155,625	123,303	119,020
Gain (loss) on investment securities & loss on debt extinguishment, net	339	2	0	(4)	0
Acquisition expenses and litigation settlement	(769)	25,986	1,706	7,037	2,923
Other noninterest expenses	346,058	321,163	265,142	226,018	223,657
Income before income taxes	212,988	159,965	154,597	132,217	129,690
Net income	168,641	150,717	103,812	91,230	91,353
Diluted earnings per share	3.24	3.03	2.32	2.19	2.22
Balance Sheet Data:					
Cash equivalents	$29,083	$19,652	$24,243	$21,931	$12,870
Investment securities	2,981,658	3,081,379	2,784,392	2,847,940	2,512,974
Loans	6,281,121	6,256,757	4,948,562	4,801,375	4,236,206
Allowance for loan losses	(49,284)	(47,583)	(47,233)	(45,401)	(45,341)
Intangible assets	807,349	825,088	480,844	484,146	386,973
Total assets	10,607,295	10,746,198	8,666,437	8,552,669	7,489,440
Deposits	8,322,371	8,444,420	7,075,954	6,873,474	5,935,264
Borrowings	413,682	485,896	248,370	403,446	440,122
Shareholders’ equity	1,713,783	1,635,315	1,198,100	1,140,647	987,904
Capital and Related Ratios:					
Cash dividends declared per share	$1.44	$1.32	$1.26	$1.22	$1.16
Book value per share	33.43	32.26	26.96	26.06	24.24
Tangible book value per share [1]	18.59	16.94	17.12	15.90	15.63
Market capitalization (in millions)	2,988	2,725	2,746	1,748	1,554
Tier 1 leverage ratio	11.08%	10.00%	10.55%	10.32%	9.96%
Total risk-based capital to risk-adjusted assets	19.06%	17.45%	19.10%	18.08%	18.75%
Tangible equity to tangible assets [1]	9.68%	8.61%	9.24%	8.59%	8.92%
Dividend payout ratio	43.8%	43.5%	53.7%	55.5%	51.6%
Period end common shares outstanding	51,258	50,696	44,437	43,775	40,748
Diluted weighted-average shares outstanding	51,975	49,665	44,720	41,605	41,232
Selected Performance Ratios:					
Return on average assets	1.58%	1.49%	1.20%	1.17%	1.23%
Return on average equity	10.20%	10.21%	8.57%	8.87%	9.65%
Net interest margin	3.73%	3.69%	3.71%	3.73%	3.91%

Noninterest revenues/operating revenues (FTE) [(2)]	39.6	%	38.8	%	35.5	%	32.3	%	31.7	%
Efficiency ratio [(3)]	58.0	%	58.3	%	59.6	%	58.2	%	58.4	%
Asset Quality Ratios:										
Allowance for loan losses/total loans	0.78	%	0.76	%	0.95	%	0.95	%	1.07	%
Nonperforming loans/total loans	0.40	%	0.44	%	0.48	%	0.50	%	0.56	%
Allowance for loan losses/nonperforming loans	197	%	173	%	199	%	190	%	190	%
Loan loss provision/net charge-offs	119	%	103	%	129	%	101	%	117	%
Net charge-offs/average loans	0.15	%	0.18	%	0.13	%	0.15	%	0.15	%

(1) The tangible book value per share and the tangible equity to tangible asset ratio excludes goodwill and identifiable intangible assets, adjusted for deferred tax liabilities generated from tax deductible goodwill and other intangible assets. The ratio is not a financial measurement required by accounting principles generally accepted in the United States of America. However, management believes such information is useful to analyze the relative strength of the Company's capital position and is useful to investors in evaluating Company performance (See Table 20 for Reconciliation of GAAP to Non-GAAP Measures).

(2) For purposes of this ratio, noninterest revenues excludes unrealized gain on equity securities, loss on debt extinguishment and insurance-related recoveries. Operating revenues, a non-GAAP measure, is defined as net interest income on a fully-tax equivalent basis, plus noninterest revenues, excluding unrealized gain on equity securities, loss on debt extinguishment, insurance-related recoveries and acquired non-impaired loan accretion (See Table 20 for Reconciliation of GAAP to Non-GAAP measures).

(3) Efficiency ratio provides a ratio of operating expenses to operating income. It excludes intangible amortization, acquisition expenses, and litigation settlement from expenses and acquired non-impaired loan accretion, insurance-related recoveries, gains and losses on investment securities, and loss on debt extinguishment from income while adding a fully-taxable equivalent adjustment. The efficiency ratio is not a financial measurement required by accounting principles generally accepted in the United States of America. However, the efficiency ratio is used by management in its assessment of financial performance specifically as it relates to noninterest expense control. Management also believes such information is useful to investors in evaluating Company performance (See Table 20 for Reconciliation of GAAP to Non-GAAP Measures).

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Item 7.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 the Company for the past two years, although in some circumstances a period longer than two years is covered in order to comply with SEC disclosure requirements or to more fully explain long-term trends. The following discussion and analysis should be read in conjunction with the Selected Consolidated Financial Information beginning on page 26 and the Company's Consolidated Financial Statements and related notes that appear on pages 60 through 109. All references in the discussion to 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, all earnings per share ("EPS") figures disclosed in the MD&A refer to diluted EPS; interest income, net interest income, and net interest margin are presented on a fully tax-equivalent ("FTE") basis, which is a non-GAAP measure. The term "this year" and equivalent terms refer to results in calendar year 2018, "last year" and equivalent terms refer to calendar year 2017, and all references to income statement results correspond to full-year activity unless otherwise noted.

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 54.

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 current accounting principles generally accepted in the United States of America ("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 the allowance for loan losses, actuarial assumptions associated with the pension, post-retirement and other employee benefit plans, the provision for income taxes, investment valuation and other-than-temporary impairment, the carrying value of goodwill and other intangible assets, and acquired loan valuations. A summary of the accounting policies used by management is disclosed in Note A, "Summary of Significant Accounting Policies", starting on page 65.

Supplemental Reporting of Non-GAAP Results of Operations

The Company also provides supplemental reporting of its results on an "operating," "net adjusted" or "tangible" basis, from which it excludes the after-tax effect of amortization of core deposit and other intangible assets (and the related goodwill, core deposit intangible and other intangible asset balances, net of applicable deferred tax amounts), accretion on non-impaired purchased loans, acquisition expenses, the unrealized gain (loss) on equity securities, loss on debt extinguishment and the one-time benefit from the revaluation of net deferred tax liabilities. Although "adjusted net income" as defined by the Company is a non-GAAP measure, the Company's management believes this information helps investors understand the effect of acquisition and other non-recurring activity in its reported results. Reconciliations of GAAP amounts with corresponding non-GAAP amounts are presented in Table 20.

Executive Summary

The Company’s business philosophy is to operate as a diversified financial services enterprise providing a broad array of banking and other financial services to retail, commercial and municipal customers. The Company’s banking subsidiary is Community Bank, N.A. (the “Bank” or “CBNA”). The Company also provides employee benefit and trust related services via its Benefit Plans Administrative Services, Inc. (“BPAS”) subsidiary, and wealth management and insurance-related services.

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) manage an investment securities portfolio to complement the Company’s loan and deposit strategies and optimize interest rate risk, yield and liquidity, (iv) 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 (v) utilize technology to deliver customer-responsive products and services and improve efficiencies.

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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.

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 $0.3 million and a customer list intangible asset of $0.3 million in conjunction with the acquisition.

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.

On April 2, 2018, the Company, through its subsidiary, Benefit Plans Administrative Services, Inc. ("BPAS"), acquired certain assets of HR Consultants (SA), LLC ("HR Consultants"), a provider of actuarial and benefit consulting services headquartered in Puerto Rico. The Company paid $0.3 million in cash to acquire the assets of HR Consultants and recorded intangible assets of $0.3 million in conjunction with the acquisition.

The Company reported net income and earnings per share for the year ended December 31, 2018 that were 11.9% and 6.9%, respectively, above the prior year amounts. The increase in net income was due primarily to the earnings generated by a full year of expanded business activities from the Merchants and NRS acquisitions. Contributing to the increase in net income was an increase in net interest income, higher noninterest revenues and lower noninterest expenses. Partially offsetting these items were an increase in weighted average diluted shares outstanding; attributable to shares issued in the Merchants and NRS transactions and shares issued in connection with the administration of the Company's 401(k) plan and employee stock plan and higher income taxes. Net income adjusted to exclude acquisition expenses, the one-time impact of the adjustment of net deferred tax liabilities associated with the enactment of the Tax Cuts and Jobs Act of 2017 ("Tax Cuts and Jobs Act"), unrealized gain on equity securities, loss on debt extinguishment, amortization of intangibles, and acquired non-impaired loan accretion ("Adjusted Net Income"), increased $37.1 million, or 26.7%, compared to the prior year. Earnings per share adjusted to exclude acquisition expenses, the one-time impact of the Tax Cuts and Jobs Act, unrealized gain on equity securities, loss on debt extinguishment, amortization of intangibles and acquired non-impaired loan accretion ("Adjusted Earnings Per Share"), of $3.39 increased $0.59, or 21.1%, compared to the prior year. See Table 20 for Reconciliation of GAAP to Non-GAAP Measures.

The Company experienced year-over-year growth in average interest-earning assets, primarily reflective of the Merchants acquisition completed in May 2017. Average deposits increased in 2018 as compared to 2017, reflective of organic growth in core deposits and the impact of the Merchants acquisition, partially offset by a decrease in time deposits. Average external borrowings in 2018 increased from 2017 reflective of the subordinated debt held by an unconsolidated subsidiary and long-term debt acquired in the Merchants transaction and an increase in securities sold under an agreement to repurchase ("customer repurchase agreements"), partially offset by the redemption of trust preferred subordinated debt held by Community Statutory Trust III, an unconsolidated subsidiary trust, during the third quarter of 2018. Asset quality in 2018 remained stable and favorable in comparison to the end of 2017, with nonperforming loan ratios, the delinquency ratio and the full year net charge-off ratio at December 31, 2018 all improved from the prior year.

Net Income and Profitability

Net income for 2018 was $168.6 million, an increase of $17.9 million, or 11.9%, from 2017's earnings. Earnings per share for 2018 was $3.24, up $0.21, or 6.9%, from 2017's results. The 2018 results included a $0.8 million recovery of vendor contract termination charges, which were recorded as an acquisition expense during the second quarter of 2017. The 2017 results included $26.0 million, or $0.37 per share, of acquisition expenses primarily related to the Merchants and NRS acquisitions. Adjusted Net Income increased $37.1 million, or 26.7%, compared to the prior year. Adjusted Earnings Per Share of $3.39 increased $0.59, or 21.1%, compared to the prior year. See Table 20 for Reconciliation of GAAP to Non-GAAP Measures.

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Net income for 2017 was $150.7 million, an increase of $46.9 million, or 45.2%, from 2016's earnings, while earnings per share for 2017 was $3.03, up $0.71, or 30.6%, from 2016's results due primarily to the Merchants and NRS acquisitions, as well as the one-time impact of the Tax Cuts and Jobs Act. The 2017 results included the aforementioned acquisition expenses.

Table 1: Condensed Income Statements

	Years Ended December 31,				
(000's omitted, except per share data)	2018	2017	2016	2015	2014
Net interest income	$345,055	$315,675	$273,896	$248,420	$244,428
Provision for loan losses	10,837	10,984	8,076	6,447	7,178
Gain/(Loss) on sales of investment securities, net	0	2	0	(4)	0
Unrealized gain on equity securities	657	0	0	0	0
Loss on debt extinguishment	(318)	0	0	0	0