

CHEMUNG FINANCIAL CORP  
Form 10-K  
March 08, 2017

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, 2016 OR  
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-13888

CHEMUNG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

NEW YORK

16-123703-8

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

One Chemung Canal Plaza, Elmira, New York

14901

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (607) 737-3711

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

Title of each class	Name of each exchange on which registered
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Common Stock, Par Value \$0.01 Per Share	Nasdaq Stock Market, LLC
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Securities registered pursuant to Section 12(g) of the Act:

(Title of Class)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES NO

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Based upon the closing price of the registrant's Common Stock as of June 30, 2016, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$106,886,844.

As of March 7, 2017, there were 4,731,487 shares of Common Stock, \$0.01 par value, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on May 11, 2017 are incorporated by reference into Part III, Items 10, 11, 12, 13, and 14 of this Form 10-K.

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CHEMUNG FINANCIAL CORPORATION

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Some of the information contained in this report concerning the markets and industry in which we operate is derived from publicly available information and from industry sources. Although we believe that this publicly available information and information provided by these industry sources are reliable, we have not independently verified the accuracy of any of this information.

To assist the reader, the Corporation has provided the following list of commonly used abbreviations and terms included in Parts I through IV.

Abbreviations

ALCO	Asset-Liability Committee
ASU	Accounting Standards Update
Bank	Chemung Canal Trust Company
Basel I	The First Basel Accord of the Basel Committee on Banking Supervision
Basel III	The Third Basel Accord of the Basel Committee on Banking Supervision
BHCA	Bank Holding Company Act of 1956
Board of Directors	Board of Directors of Chemung Financial Corporation
BOLI	Bank Owned Life Insurance
CAPM	Capital Asset Pricing Model
CDARS	Certificate of Deposit Account Registry Service
CDO	Collateralized Debt Obligation
CFPB	Consumer Financial Protection Bureau
CFS	CFS Group, Inc.
Corporation	Chemung Financial Corporation
CRA	Community Reinvestment Act
CRM	Chemung Risk Management, Inc.
DIF	Deposit Insurance Fund
Dodd-Frank Act	The Dodd-Frank Wall Street Reform and Consumer Protection Act
ECOA	Equal Credit Opportunity Act
EPS	Earnings per share
Exchange Act	Securities Exchange Act of 1934
FACT Act	Fair and Accurate Credit Transactions Act of 2003
FASB	Financial Accounting Standards Board
FCRA	Fair Credit Reporting Act
FDIA	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institution Examination Council
FHLBNY	Federal Home Loan Bank of New York
FICO	Financing Corporation
FINRA	Financial Industry Regulatory Authority
FOFC	Fort Orange Financial Corporation
FRB	Board of Governors of the Federal Reserve System
FRBNY	Federal Reserve Bank of New York
Freddie Mac	Federal Home Loan Mortgage Corporation
FTC	Federal Trade Commission
GAAP	U.S. Generally Accepted Accounting Principles
GLB Act	Gramm-Leach-Bliley Act
ICS	Insured Cash Sweep Service
IPS	Investment Policy Statement
LIBOR	London Interbank Offered Rate

MD&A  
NAICS

Management's Discussion and Analysis of Financial Condition and Results of Operations  
North American Industry Classification System

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N/M	Not meaningful
NYSDFS	New York State Department of Financial Services
OCC	Office of the Comptroller of the Currency
OPEB	Other postemployment benefits
OREO	Other real estate owned
OTTI	Other-than-temporary impairment
PCI	Purchased credit impaired
RESPA	Real Estate Settlement Procedures Act
ROA	Return on average assets
ROE	Return on average equity
RWA	Risk-weighted assets
SBA	Small Business Administration
SEC	Securities and Exchange Commission
Security Guidelines	Interagency Guidelines Establishing Information Security Standards
Securities Act	Securities Act of 1933
Sarbanes-Oxley	Sarbanes-Oxley Act of 2002
TDRs	Troubled debt restructurings
TILA	Truth in Lending Act
TRID Rule	TILA-RESPA Integrated Disclosure Rule
USA PATRIOT Act	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001
WMG	Wealth Management Group

#### Terms

Accumulated benefit obligation	An approximate measure of the pension plan liability, which is based on the assumption that the pension plan is to be terminated immediately and does not consider any future salary increases.
Allowance for loan losses to total loans	Represents period-end allowance for loan losses divided by retained loans.
Assets under administration	Represents assets that are beneficially owned by clients and all investment decisions pertaining to these assets are also made by clients.
Assets under management	Represents assets that are managed on behalf of clients.
Basel I	A set of international banking regulations, which set out the minimum capital requirements of financial institutions with the goal of minimizing credit risk. The main focus was mainly on credit risk by creating a bank asset classification system.
Basel III	A comprehensive set of reform measures designed to improve the regulation, supervision, and risk management within the banking sector. The reforms require banks to maintain proper leverage ratios and meet certain capital requirements.
Benefit obligation	Refers to the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for OPEB plans.
Capital Bank	Division of Chemung Canal Trust Company located in the “Capital Region” of New York State and includes the counties of Albany and Saratoga.
Captive insurance company	A company that provides risk-mitigation services for its parent company.
CDARS	Product involving a network of financial institutions that exchange certificates of deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a

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dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution.

Collateralized debt obligation      A structured financial product that pools together cash flow-generating assets, such as mortgages, bonds, and loans.

Collateralized mortgage obligations      A type of mortgage-backed security with principal repayments organized according to their maturities and into different classes based on risk. The mortgages serve as collateral and are organized into classes based on their risk profile.



Dodd-Frank Act	The Dodd-Frank Act was enacted on July 21, 2010 and significantly changed the bank regulatory landscape and has impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress.
Fully taxable equivalent basis	Income from tax-exempt loans and investment securities that have been increased by an amount equivalent to the taxes that would have been paid if this income were taxable at statutory rates; the corresponding income tax impact related to tax-exempt items is recorded within income tax expense.
GAAP	Accounting principles generally accepted in the United States of America.
Holding company	Consists of the operations for Chemung Financial Corporation (parent only). Product involving a network of financial institutions that exchange interest-bearing money market deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution.
ICS	Residential real estate loans originated for sale on the secondary market with maturities from 15-30 years.
Loans held for sale	An obligation extending beyond the current year, which is related to a long term capital lease that is considered to have the economic characteristics of asset ownership.
Long term lease obligation	A type of asset-backed security that is secured by a collection of mortgages.
Mortgage-backed securities	A political unit, such as a city, town, or village, incorporated for local self-government.
Municipal clients	Data is not applicable or available for the period presented.
N/A	Data is not meaningful in context presented.
N/M	A calculation not made according to GAAP.
Non-GAAP	An obligation that is guaranteed by the full faith and credit of a state or political subdivision that has the power to tax.
Obligations of state and political subdivisions	A federally guaranteed obligation backed by the full power of the U.S. government, including Treasury bills, Treasury notes and Treasury bonds.
Obligations of U.S. Government	Obligations of agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.
Obligations of U.S. Government sponsored enterprise obligations	Represents real property owned by the Corporation, which is not directly related to its business and is most frequently the result of a foreclosure on real property.
OREO	Impairment charge taken on a security whose fair value has fallen below the carrying value on the balance sheet and whose value is not expected to recover through the holding period of the security.
OTTI	Represents loans that were acquired in the Fort Orange Financial Corp. transaction and deemed to be credit-impaired on the acquisition date in accordance with the guidance of FASB.
PCI loans	A county, city, town, or other municipal corporation, a public authority, or a publicly-owned entity that is an instrumentality of a state or a municipal corporation.
Political subdivision	Represents total net revenue less noninterest expense, before income tax expense (benefit).
Pre-provision profit/(loss)	The Corporation believes that this financial measure is useful in assessing the ability of a bank to generate income in excess of its provision for credit losses.
Projected benefit obligation	An approximate measure of the pension plan liability, which is based on the assumption that the plan will not terminate in the near future and that employees will continue to work and

receive future salary increases.

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RWA	Risk-weighted assets, which is used to calculate regulatory capital ratios, consist of on- and off-balance sheet assets that are assigned to one of several broad risk categories and weighted by factors representing their risk and potential for default. On-balance sheet assets are risk-weighted based on the perceived credit risk associated with the obligor or counterparty, the nature of any collateral, and the guarantor, if any. Off-balance sheet assets such as lending-related commitments, guarantees, derivatives and other applicable off-balance sheet positions are risk-weighted by multiplying the contractual amount by the appropriate credit conversion factor to determine the on-balance sheet credit equivalent amount, which is then risk-weighted based on the same factors used for on-balance sheet assets. Risk-weighted assets also incorporate a measure for market risk related to applicable trading assets-debt and equity instruments. The resulting risk-weighted values for each of the risk categories are then aggregated to determine total risk-weighted assets.
SBA loan pools	Business loans partially guaranteed by the SBA.
Securities sold under agreements to repurchase	Sale of securities together with an agreement for the seller to buy back the securities at a later date.
TDR	A TDR is deemed to occur when the Corporation modifies the original terms of a loan agreement by granting a concession to a borrower that is experiencing financial difficulty.
Trust preferred securities	A hybrid security with characteristics of both subordinated debt and preferred stock which allows for early redemption by the issuer, makes fixed or variable payments, and matures at face value.
Unaudited	Financial statements and information that have not been subjected to auditing procedures sufficient to permit an independent certified public accountant to express an opinion.
WMG	Provides services as executor and trustee under wills and agreements, and guardian, custodian, trustee and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, financial planning, pension, estate planning and employee benefit administration services.

## PART I

### ITEM 1. BUSINESS

#### General

The Corporation was incorporated on January 2, 1985 under the laws of the State of New York and is headquartered in Elmira, NY. The Corporation was organized for the purpose of acquiring the Bank. The Bank was established in 1833 under the name Chemung Canal Bank, and was subsequently granted a New York State bank charter in 1895. In 1902, the Bank was reorganized as a New York State trust company under the name Elmira Trust Company, and its name was changed to Chemung Canal Trust Company in 1903.

The Corporation became a financial holding company in June 2000. Financial holding company status provided the Corporation with the flexibility to offer an array of financial services, such as insurance products, mutual funds, and brokerage services, which provide additional sources of fee based income and allow the Corporation to better serve its customers. The Corporation established a financial services subsidiary, CFS, in September 2001 which offers non-banking financial services such as mutual funds, annuities, brokerage services, insurance and tax preparation services. The Corporation established a captive insurance subsidiary, CRM, based in the State of Nevada in May 2016, which insures gaps in commercial coverage and uninsured exposures in the Corporation's current insurance coverages and allows the Corporation to strengthen its overall risk management program.

The Corporation's Board of Directors has concluded that the expansion of the franchise's geographic footprint, an increase in the Bank's earning assets, and the generation of new sources of non-interest income are important components of its strategic plan. Towards that end, in recent years it has completed the following transactions:

• On May 3, 2007, the Bank acquired the trust business of Partners Trust Bank, Utica, New York. At the time of the acquisition, the Bank acquired \$351.0 million in trust assets.

On March 14, 2008, the Bank acquired three branches from Manufacturers and Traders Trust Company in the New York counties of Broome and Tioga. At the time of the acquisition, the Bank assumed \$64.4 million in deposits and acquired \$12.6 million in loans.

On May 29, 2009, the Corporation acquired Canton Bancorp, Inc., the holding company of Bank of Canton based in Canton, Pennsylvania. At the time of the merger, Canton Bancorp, Inc. had \$81.1 million in assets, \$58.8 million in loans and \$72.9 million in deposits.

- On April 8, 2011, the Corporation acquired FOFC, the holding company of Capital Bank & Trust Company based in Albany, New York. At the time of the merger, Capital Bank had \$254.4 million in assets, \$170.7 million in loans and \$199.2 million in deposits.

- On November 23, 2013, the Bank completed the acquisition of six branch offices from Bank of America located in Cayuga, Cortland, Seneca, and Tompkins counties in New York. As part of the transaction, the Corporation acquired \$177.7 million in deposits and \$1.2 million in loans.

As a result of these transactions and organic growth, the Corporation had \$1.657 billion in assets, \$1.200 billion in loans, \$1.456 billion in deposits and \$143.7 million in shareholders' equity at December 31, 2016.

### Growth Strategy

The Corporation's growth strategy is to leverage its expanding branch network in current or new markets to build client relationships and grow loans and deposits. Consistent with the Corporation's community banking model, emphasis is placed on acquiring stable, low-cost deposits, primarily checking account deposits and other low interest-bearing deposits to fund high-quality loans. Expanding the branch network involves branch purchases or opening de novo branches in contiguous markets and acquiring other financial institutions in the Northeast. The Corporation evaluates acquisition targets based on the economic viability of the markets they are in, the degree to which they can be effectively integrated into the Corporation's current operations and the degree to which they are accretive to capital and earnings.

### Description of Business

The Corporation, through the Bank and CFS, provides a wide range of financial services, including demand, savings and time deposits, commercial, residential and consumer loans, interest rate swaps, letters of credit, wealth management services, employee benefit plans, insurance products, mutual funds and brokerage services. The Bank derives its income primarily from interest and fees on loans, interest on investment securities, WMG fee income, and fees received in connection with deposit and other services. The Bank's operating expenses are interest expense paid on deposits and borrowings, salaries and employee benefit plans and general operating expenses.

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

In order to compete with other financial services companies, the Corporation relies upon personal relationships established with clients by its officers, employees, and directors. The Corporation has maintained a strong community orientation by supporting the active participation of officers and employees in local charitable, civic, school, religious, and community development activities. The Corporation believes that its emphasis on local relationship banking together with a prudent approach to lending are important factors in its success and growth.



## Lending Activities

### Lending Strategy

The Corporation's objective is to channel deposits gathered locally into high-quality, market-yielding loans without taking unacceptable credit and/or interest rate risk. The Corporation seeks to have a diversified loan portfolio consisting of commercial and agricultural loans, commercial mortgages, residential mortgages, home equity lines of credit and home equity term loans, consumer and indirect auto loans. The Bank operates with a traditional community bank model where the relationship manager possesses credit skills and has significant influence over credit decisions. This creates value since clients and prospects know they are dealing with a decision maker.

### Lending Authority

The Board of Directors establishes the lending policies, underwriting standards, and loan approval limits of the Bank. In accordance with those policies, the Board of Directors has designated certain officers to consider and approve loans within their designated authority. These officers exercise substantial authority over credit and pricing decisions, subject to loan committee approval for larger credits. The Bank recognizes that exceptions to the lending policies may occasionally occur and has established procedures for approving exceptions to these policies.

In underwriting loans, primary emphasis is placed on the borrower's financial condition, including ability to generate cash flow to support the debt and other cash expenses. In addition, substantial consideration is given to collateral value and marketability as well as the borrower's character, reputation and other relevant factors. Interest rates charged by the Bank vary with degree of risk, type, size, complexity, repricing frequency, and other relevant factors associated with the loans. Competition from other financial services companies also impacts interest rates charged on loans.

The Corporation has also implemented reporting systems to monitor loan originations, loan quality, concentration of credit, loan delinquencies, non-performing loans and potential problem loans.

### Lending Segments

The Corporation segments its loan portfolio into the following major lending categories: (i) commercial and agricultural, (ii) commercial mortgages, (iii) residential mortgages, and (iv) consumer loans.

Commercial and agricultural loans primarily consist of loans to small to mid-sized businesses in the Corporation's market area in a diverse range of industries. These loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flow of the borrower's business. Further, the collateral securing the loans may depreciate over time, may be difficult to appraise and may fluctuate in value. The credit risk related to commercial loans is largely influenced by general economic conditions and the resulting impact on a borrower's operations or on the value of underlying collateral, if any.

Commercial mortgage loans generally have larger balances and involve a greater degree of risk than residential mortgage loans, and they, therefore, pose higher potential losses on an individual customer basis. Loan repayment is often dependent on the successful operation and management of the properties and/or the businesses occupying the properties, as well as on the collateral securing the loan. Economic events or conditions in the real estate market could have an adverse impact on the cash flows generated by properties securing the Corporation's commercial real estate loans and on the value of such properties.

The Corporation offers interest rate swaps to certain larger commercial mortgage borrowers. These swaps allow the Corporation to originate a mortgage based on short-term LIBOR rates and allow the borrower to swap into a longer term fixed rate. The Corporation simultaneously sells an offsetting back-to-back swap to an investment grade national bank so that it does not retain this fixed-rate risk. The swap agreements are free-standing derivatives and are recorded at fair value in the Corporation's consolidated balance sheets, which typically involves a day one gain.

Residential mortgage loans are generally made on the basis of the borrower's ability to make repayment from his or her employment and other income, but are secured by real property whose value tends to be more easily ascertainable. Credit risk for these types of loans is generally influenced by general economic conditions, the characteristics of individual borrowers and the nature of the loan collateral.



The consumer loan segment includes home equity lines of credit and home equity loans, which exhibit many of the same risk characteristics as residential mortgages. Indirect and other consumer loans may entail greater credit risk than residential mortgage and home equity loans, particularly in the case of other consumer loans which are unsecured or, in the case of indirect consumer loans, secured by depreciable assets, such as automobiles, recreational vehicles, or boats. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, thus are more likely to be affected by adverse personal circumstances such as job loss, illness, or personal bankruptcy. Furthermore, the application of various federal and state laws, including bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans.

#### Funding Activities

#### Funding Strategy

The Corporation's deposit strategy is to fund the Bank with stable, low-cost deposits, primarily checking account deposits and low interest-bearing deposit accounts. A checking account is the driver of a banking relationship and consumers consider the bank where they have their checking account as their primary bank. These customers will typically turn to their primary bank first when in need of other financial services. The Corporation also considers brokered deposits to be an element of its deposit strategy and anticipates that it will continue using brokered deposits as a secondary source of funding to support growth. Borrowings may be used on a short-term basis for liquidity purposes or on a long-term basis to fund asset growth.

#### Funding Sources

The Corporation's primary sources of funds are deposits, principal and interest payments on loans and securities, borrowings and funds generated from operations of the Bank. The Bank also has access to advances from the FHLBNY, other financial institutions, and the FRBNY. Contractual loan payments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are significantly influenced by general market interest rates and economic conditions.

The Corporation considers core deposits, consisting of non-interest-bearing and interest-bearing checking accounts, savings accounts, and insured money market accounts, to be a significant component of its deposits. The Corporation monitors the activity on these core deposits and, based on historical experience and pricing strategy, believes it will continue to retain a large portion of such accounts. The Bank is currently not limited with respect to the rates that it may offer on deposit products. The Bank believes it is competitive in the types of accounts and interest rates it has offered on its deposit products. The Bank regularly evaluates the internal cost of funds, surveys rates offered by competitors, reviews cash flow requirements for lending and liquidity, and executes rate changes when necessary as part of its asset/liability management, profitability and growth strategies.

The flow of deposits is influenced significantly by general economic conditions, changes in prevailing interest rates and competition. The Bank's deposits are obtained predominantly from the areas in which its retail offices are located. The Bank relies primarily on customer service, long-standing relationships and other banking services, including loans and wealth management services, to attract and retain these deposits. However, market interest rates and rates offered by competing financial institutions affect the Bank's ability to attract and retain deposits. The Bank utilizes a combination of traditional media, such as print, television, and radio, as well as digital advertising, such as social media and eBlasts, when advertising its deposit products.

#### Derivative Financial Instruments

The Corporation offers interest rate swaps to commercial loan customers who wish to fix the interest rates on their loans, and the Corporation matches these swaps with offsetting swaps with national bank counterparties. These swaps are considered free standing derivatives and are carried at fair value on the consolidated balance sheet in other assets and other liabilities, with gains and losses recorded through other non-interest income. The swaps are not designated as hedging derivatives. Additionally, the Corporation participates in risk participation agreements with dealer banks on commercial loans in which it participates. The Corporation receives an upfront fee for participating in the credit exposure of the interest rate swap associated with the commercial loan in which it is a participant and the fee received is recognized immediately in other non-interest income. The Corporation is exposed to its share of the credit loss equal to the fair value of the interest rate swap in the event of nonperformance by the counterparty of the interest rate swap.

The Corporation has a policy for managing its derivative financial instruments, and the policy and program activity are overseen by ALCO. Under the policy, derivative financial instruments with counterparties, who are not customers, are limited to a national financial institution. Cash and/or certain qualified securities are required to serve as collateral when exposures exceed \$100 thousand, with a minimum collateral coverage of \$150 thousand. The credit worthiness of the counterparty is reviewed internally by the Bank's credit department.

### Wealth Management Strategy

With \$1.721 billion of assets under management or administration at year-end 2016, including \$294.9 million of assets held under management or administration for the Corporation, WMG is responsible for the largest component of non-interest income. Wealth management services provided by the Bank include services as executor and trustee under wills and agreements, and guardian, custodian, trustee, and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, pension, estate planning, and employee benefit administrative services. The Corporation's growth strategy also includes the acquisition of trust businesses to generate new sources of fee income.

The Corporation offers an array of financial services including mutual funds, securities and insurance brokerage, tax preparation and other services through CFS, its wholly owned subsidiary

For additional information, including information concerning the results of operations of the Corporation and its subsidiaries, see Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7.

Except for the formation of CRM, the Corporation's Nevada-based captive insurance subsidiary, there were no material changes in the manner of doing business by the Corporation or its subsidiaries during the fiscal year ended December 31, 2016.

### Market Area and Competition

The Bank operates 33 branch offices located in 11 counties in New York and Bradford County in Pennsylvania. Bank branch offices are located in the following New York counties: Chemung, where the Bank is headquartered, Broome, Cayuga, Cortland, Schuyler, Seneca, Steuben, Tioga and Tompkins. The Bank also operates under the name "Capital Bank, a division of Chemung Canal Trust Company," with branch offices located in Albany and Saratoga counties in New York.

Albany and Saratoga counties rely heavily on business related to New York State government activities, the nanotechnology industry, and colleges located within these counties. Tompkins County is dominated by the presence of Cornell University and Ithaca College. The world headquarters of Corning Incorporated, the region's largest employer, is located in Steuben County. The remaining New York counties have a combination of service, small manufacturing and tourism related businesses, with colleges located in Broome, Chemung, and Cortland counties.

Within all these market areas, the Bank encounters intense competition in the lending and deposit gathering aspects of its business from local, regional and national commercial banks and thrift institutions, credit unions and other providers of financial services, such as brokerage firms, investment companies, insurance companies and internet banking entities. The Bank also competes with non-financial institutions, including retail stores and certain utilities that maintain their own credit programs, as well as governmental agencies that make loans to certain borrowers. Many of these competitors are not subject to regulation as extensive as that affecting the Bank and, as a result, may have a competitive advantage over the Bank in certain respects. This is particularly true of credit unions because their pricing structure is not encumbered by the payment of income taxes.

Similarly, the competition for the Bank's wealth management services is primarily from local offices of national brokerage firms, independent investment advisors, national and regional banks as well as internet based brokerage and advisory firms. The Bank operates full-service wealth management centers in Chemung, Broome and Albany counties in New York.

## Employees

As of December 31, 2016, the Corporation and its subsidiaries employed 368 persons on a full-time equivalent basis. None of the Corporation's employees are covered by collective bargaining agreements. The Corporation provides its employees with a comprehensive benefit program, some of which is contributory. The Corporation believes that its relationship with its employees is good.

### Available Information

The SEC maintains a web site at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding the Corporation. You may also read and copy materials we file with the SEC at the SEC's Public Reference Room at 100 F St., NE, Washington, D.C. 20549. You may obtain information concerning the operation of the Public Reference Room by calling 1-800-SEC-0330. In addition, the Corporation maintains a corporate web site at [www.chemungcanal.com](http://www.chemungcanal.com). The Corporation makes available free of charge through Bank's web site its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed with the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act. These items are available as soon as reasonably practicable after we electronically file or furnish such material with the SEC. These items are also available on the Bank's web site as Interactive Data Files as required pursuant to Rule 405 of Regulation S-T (§232.405). The contents of the Bank's web site are not a part of this report. These materials are also available free of charge by written request to: Kathleen S. McKillip, Corporate Secretary, Chemung Financial Corporation, One Chemung Canal Plaza, Elmira, NY 14901.

### Supervision and Regulation

The Corporation and the Bank are subject to comprehensive regulation, supervision and examination by regulatory authorities. Numerous statutes and regulations apply to the Corporation's and, to a greater extent, the Bank's operations, including required reserves, investments, loans, deposits, issuances of securities, payments of dividends and establishment of branches. Set forth below is a brief description of some of these laws and regulations. The description does not purport to be complete, and is qualified in its entirety by reference to the text of the applicable laws and regulations.

### The Corporation

#### Bank Holding Company Act

The Corporation is a bank holding company registered with, and subject to regulation and examination by, the FRB pursuant to the BHCA, as amended. The FRB regulates and requires the filing of reports describing the activities of bank holding companies, and conducts periodic examinations to test compliance with applicable regulatory requirements. The FRB has enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders, and to require a bank holding company to divest subsidiaries.

The Corporation generally may engage in the activities permissible for a bank holding company, which includes banking, managing or controlling banks, performing certain servicing activities for subsidiaries, and engaging in other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto, as set forth in the FRB's Regulation Y. As the Corporation has elected financial holding company status, it may also engage in a broader range of activities that are determined by the FRB and the Secretary of the Treasury to be financial in nature or incidental to financial activities or, with the prior approval of the FRB, activities that are determined by the FRB to be complementary to a financial activity and that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The BHCA prohibits a bank holding company from acquiring direct or indirect ownership or control of more than 5% of the voting shares of any bank, or increasing such ownership or control of any bank, without the prior approval of the FRB.

### Interstate Banking and Branching

Under the Riegle-Neal Interstate Banking and Branching Efficiency Act ("Riegle-Neal"), subject to certain concentration limits and other requirements, adequately capitalized bank holding companies, such as the Corporation, are permitted to acquire banks and bank holding companies located in any state. Any bank that is a subsidiary of a bank holding company is permitted to receive deposits, renew time deposits, close loans, service loans, and receive loan payments as an agent for any other bank subsidiary of that bank holding company. Subject to certain conditions, bank are permitted to acquire branch offices outside of their home states by merging with out-of-state banks, purchasing branches in other states, and establishing de novo branch offices in other states.

In April 2008, banking regulators in the states of New Jersey, New York, and Pennsylvania entered into a Memorandum of Understanding (the "Interstate MOU") to clarify their respective roles, as home and host state regulators, regarding interstate branching activity on a regional basis pursuant to the Riegle-Neal Amendments Act of 1997. The Interstate MOU established the regulatory responsibilities of the respective state banking regulators regarding bank regulatory examinations and is intended to reduce the regulatory burden on state-chartered banks branching within the region by elimination duplicative host state compliance exams.

Under the Interstate MOU, the activities of branches the Corporation established in Pennsylvania would be governed by New York state law to the same extent that the Federal law governs the activities of the branch of an out-of-state national bank in such host states. Issues regarding whether a particular host state law is preempted are to be determined in the first instance by the NYSDFS. In the event that the NYSDFS and the applicable host state regulator disagree regarding whether a particular host state law is pre-empted, the NYSDFS and the applicable host state regulator would use their reasonable best efforts to consider all points of view to resolve the disagreement.

#### New York Law

The Corporation is organized under New York law and is subject to the New York Business Corporation Law, which governs the rights and obligations of directors and shareholders and other corporate matters.

The Corporation is also a bank holding company as defined in the New York Banking Law by virtue of its ownership and control of the Bank. Generally, this means that the NYSDFS must approve the Corporation's acquisition of control of other banking institutions and similar transactions.

#### Federal Securities Law

The Corporation is subject to the information, reporting, proxy solicitation, insider trading, and other rules contained in the Exchange Act, the disclosure requirements of the Securities Act and the regulations of the SEC thereunder. In addition, the Corporation must comply with the corporate governance and listing standards of the Nasdaq Stock Market to maintain the listing of its common stock on the exchange. These standards include rules relating to a listed company's board of directors, audit committees and independent director oversight of executive compensation, the director nomination process, a code of conduct and shareholder meetings.

The SEC has adopted certain proxy disclosure rules regarding executive compensation and corporate governance, with which the Corporation must comply. They include: (i) disclosure of total compensation of key officers of the Corporation, including disclosure of restricted and unrestricted stock awards compensation; (ii) disclosure regarding any potential conflict of interest of any compensation consultants of the Corporation; (iii) disclosure regarding compensation committee independence and experience, qualifications, skills and diversity of its directors and any director nominees; (iv) "say-on-pay" disclosure; and (v) information relating to the leadership structure of the Corporation's Board of Directors and the Board of Directors' role in the risk management process. Additionally, these rules require the Corporation to report the voting results of annual meetings in a much more timely manner on Form 8-K, rather than on a quarterly or annual report.

#### Sarbanes-Oxley

The Corporation is also subject to Sarbanes-Oxley. Sarbanes-Oxley established laws affecting public companies' corporate governance, accounting obligations, and corporate reporting by: (i) creating a federal accounting oversight body; (ii) revamping auditor independence rules; (iii) enacting new corporate responsibility and governance measures; (iv) enhancing disclosures by public companies, their directors, and their executive officers; (v) strengthening the powers and resources of the SEC; and (vi) imposing new criminal and civil penalties for securities fraud and related wrongful conduct.

The SEC has adopted regulations under Sarbanes-Oxley, including: (i) executive compensation disclosure rules; (ii) standards of independence for directors who serve on the Corporation's audit committee; (iii) disclosure requirements as to whether at least one member of the Corporation's audit committee qualifies as a "financial expert" as defined in SEC regulations; (iv) whether the Corporation has adopted a code of ethics applicable to its chief executive officer, chief financial officer, or those persons performing similar functions; (v) and disclosure requirements regarding the

operations of Board of Directors' nominating committees and the means, if any, by which security holders may communicate with directors.

#### Support of Subsidiary Banks

The Dodd-Frank Act, discussed in the section of this document entitled “Additional Important Legislation and Regulation,” codifies the FRB’s long-standing policy of requiring bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. Accordingly, the Corporation is expected to commit resources to support its banking subsidiaries, including at times when it may not be advantageous for the Corporation to do so.



## The Bank

### General

The Bank is a commercial bank chartered under the laws of New York State and is supervised by the NYSDFS. The Bank also is a member bank of the FRB and, therefore, the FRB serves as its primary federal regulator. The FDIC insures the Bank's deposit accounts up to applicable limits. The Bank must file reports with the FFIEC, the FRB and the FDIC concerning its activities and financial condition and must obtain regulatory approval before commencing certain activities or engaging in transactions such as mergers and other business combinations or the establishment, closing, purchase or sale of branch offices. This regulatory structure gives the regulatory authorities extensive discretion in the enforcement of laws and regulations and the supervision of the Bank.

### Loans to One Borrower

The Bank generally may not make a loan or extend credit to a single or related group of borrowers in excess of 15% of its unimpaired capital and surplus. Up to an additional 10% of unimpaired capital and surplus can be lent if the additional amount is fully secured by readily marketable collateral. At December 31, 2016, the Bank's legal lending limit on loans to one borrower was \$22.4 million for loans not fully secured by readily marketable collateral and \$24.6 million for loans secured by readily marketable collateral. The Bank's internal limit on loans is set at \$15.0 million. At December 31, 2016, the Bank did not have any loans or agreements to extend credit to a single or related group of borrowers in excess of its legal lending limit.

### Branching

Subject to the approval of the NYSDFS, New York-chartered commercial banks may establish branch offices anywhere within New York State, except in communities having populations of less than 50,000 inhabitants in which another New York-chartered commercial bank or a national bank has its principal office. Additionally, under the Dodd-Frank Act, state-chartered banks may generally branch into other states to the same extent as commercial banks chartered under the laws of that state may branch.

### Payment of Dividends

The Bank is subject to substantial regulatory restrictions affecting its ability to pay dividends to the Corporation. Under FRB and NYSDFS regulations, the Bank may not pay a dividend without prior approval of the FRB and the NYSDFS if the total amount of all dividends declared during such calendar year, including the proposed dividend, exceeds the sum of its retained net income to date during the calendar year and its retained net income over the preceding two calendar years. As of December 31, 2016, approximately \$15.2 million was available for the payment of dividends by the Bank to the Corporation without prior approval. The Bank's ability to pay dividends also is subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements.

### Federal Reserve System

FRB member banks must maintain, with a Federal Reserve bank, reserves against their transaction accounts (primarily checking, NOW, and Super NOW accounts) and non-personal time accounts. As of December 31, 2016, the Bank was in compliance with applicable reserve requirements. In all years preceding 2008, these reserves were maintained as vault cash or noninterest-bearing accounts, thereby reducing the Bank's earnings potential. In the fourth quarter of 2008, the FRB announced that they would begin to pay interest on member banks' required reserve balances, as well as excess reserve balances.

### Standards for Safety and Soundness

The FRB has adopted guidelines prescribing safety and soundness standards. These guidelines establish general standards relating to capital adequacy, asset quality, management, earnings performance, liquidity and sensitivity to market risk. In evaluating these safety and soundness standards, the FRB considers internal controls and information systems, internal audit systems, loan documentation, credit underwriting, exposure to changes in interest rates, asset growth, compensation, fees, and benefits. In general, the guidelines require appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines. The FRB may order an institution that has been given notice that it is not satisfying these safety and soundness standards to submit a compliance plan, and if an institution fails to do so, the FRB must issue an order directing action to correct the deficiency and may issue an order directing other action. If an institution fails to comply with such an order, the FRB may seek to enforce such order in judicial proceedings and to impose civil money penalties.

### Real Estate Lending Standards

The FRB has adopted guidelines that generally require each FRB state member bank to establish and maintain written internal real estate lending standards that are consistent with safe and sound banking practices and appropriate to the size of the bank and the nature and scope of its real estate lending activities. The standards also must be consistent with accompanying FRB guidelines, which include loan-to-value ratios for the different types of real estate loans.

### Transactions with Related Parties

The Federal Reserve Act governs transactions between the Bank and its affiliates, specifically the Corporation, CFS, and CRM. In general, an affiliate of the Bank is any company that controls, is controlled by, or is under common control with the Bank. Generally, the Federal Reserve Act limits the extent to which the Bank or its subsidiaries may engage in "covered transactions" with any one affiliate to 10% of the Bank's capital stock and surplus, and contains an aggregate limit of 20% of capital stock and surplus for covered transactions with all affiliates. Covered transactions include loans, asset purchases, the issuance of guarantees, and similar transactions. Section 22(h) of the Federal Reserve Act and its implementing Regulation O restricts loans to directors, executive officers, and principal stockholders ("Insiders"). Loans to Insiders (and their related entities) may not exceed, together with all other outstanding loans to such persons and affiliated entities, the Bank's total capital and surplus. Loans to Insiders above specified amounts must receive the prior approval of the Bank's Board of Directors. The loans must be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features, except that such Insiders may receive preferential loans made under a benefit or compensation program that is widely available to the Bank's employees and does not give preference to the Insider over the employees. The loans are also subject to maximum dollar limits and must generally be approved by the Board of Directors.

### Deposit Insurance

The FDIC insures the deposits of the Bank up to regulatory limits and the deposits are subject to the deposit insurance premium assessments of the DIF. The FDIC currently maintains a risk-based assessment system under which assessment rates vary based on the level of risk posed by the institution to the DIF. Therefore, the assessment rate may change if any of these measurements change.

The FDIC has adopted a final rule making certain changes to the deposit insurance assessment system. Among other things, the rule revised the assessment rate schedule effective April 1, 2011, and adopted additional rate schedules that will go into effect when the DIF reserve ratio reaches various milestones. The rule changed the deposit insurance assessment system from one that was based on domestic deposits to one that is based on average consolidated total assets minus average tangible equity. In addition, the rule provides that FDIC dividend payments will be suspended if the DIF reserve ratio exceeds 1.5 percent but that assessment rates will decrease when the DIF reserve ratio reaches certain thresholds.

All institutions with deposits insured by the FDIC are required to pay assessments to fund interest payments on bonds issued by FICO, an agency of the federal government established to recapitalize the former Savings Association Insurance Fund. These assessments will continue until the FICO bonds mature in 2017 through 2019. The FDIC's FICO assessment authority is separate from its authority to assess risk-based premiums for deposit insurance. The FICO assessment rate is adjusted quarterly to reflect changes in the assessment bases of the fund and is not risk-based by institution. The FICO assessment rate for the third quarter of 2016, due December 31, 2016, was 0.14 basis points, or an annual rate of 0.56 basis points, of the Bank's assessment base, or average total assets less average tangible equity and allowable deductions.

## Regulatory Capital Requirements

On October 11, 2013, the FRB approved a final rule that amends the regulatory capital rules for state member banks effective January 1, 2015. The FRB approved the new capital rules in coordination with substantially identical final rules approved by the FDIC and the Office of the Comptroller of the Currency for other types of banking organizations. The revisions make the capital rules consistent with agreements that were reached by Basel III and certain provisions of the Dodd-Frank Act. In general, the new capital rules revise regulatory capital definitions and minimum ratios; redefine Tier 1 Capital as two components (common equity Tier 1 capital and additional Tier 1 capital); create a new “common equity Tier 1 risk-based capital ratio”; implement a capital conservation buffer; revise prompt corrective action thresholds; and change risk weights for certain assets and off-balance sheet exposures.

The new capital rules implement a revised definition of regulatory capital, a new common equity Tier 1 minimum capital requirement of 4.5%, and a higher minimum Tier 1 capital requirement of 6.0% (which is an increase from 4.0%). Under the new rules, the total capital ratio remains at 8.0%, and the minimum leverage ratio (Tier 1 capital to total assets) for all banking organizations, regardless of supervisory rating, is 4.0%. Additionally, under the new capital rules, in order to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers, a banking organization must hold a capital conservation buffer composed of common equity Tier 1 capital above its minimum risk-based capital requirements. The buffer is measured relative to risk-weighted assets. The final rules also enhance risk sensitivity and address weaknesses identified by the regulators over recent years with the measure of risk-weighted assets, including through new measures of creditworthiness to replace references to credit ratings, consistent with the requirements of the Dodd-Frank Act. Effective January 1, 2016, the additional capital conservation buffer of 0.625% will be added to the minimum requirements for capital adequacy purposes, subject to a multi-year phase-in period, and will be fully phased-in on January 1, 2019 at 2.5%.

The new capital requirements also include changes in the risk-weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and the unsecured portion of non-residential mortgage loans that are 90 days past due or otherwise on non-accrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital; and increased risk weights (from 0% to up to 600%) for equity exposures.

The new minimum capital requirements became effective for all banking organizations (except for the largest internationally active banking organizations) on January 1, 2015, whereas the capital conservation buffer and the deductions from common equity Tier 1 capital phase in over time, beginning on January 1, 2016.

The Corporation is subject to FRB capital requirements applicable to bank holding companies, which are similar to those applicable to the Bank.

In assessing a state member bank's capital adequacy, the FRB takes into consideration not only these numeric factors but also qualitative factors, and has the authority to establish higher capital requirements for individual banks where necessary. Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. The Bank, in accordance with its internal prudential standards, targets as its goal the maintenance of capital ratios which exceed these minimum requirements and that are consistent with its risk profile. As of December 31, 2016, the Bank exceeded all regulatory capital ratios necessary to be considered well capitalized.

#### Prompt Corrective Action

The FDIA requires the federal banking agencies to resolve the problems of insured banks at the least possible loss to the DIF. The FRB has adopted prompt corrective action regulations to carry out this statutory mandate. The FRB's regulations authorize, and in some situations, require, the FRB to take certain supervisory actions against undercapitalized state member banks, including the imposition of restrictions on asset growth and other forms of expansion. The prompt corrective action regulations place state member banks in one of the following five categories based on the bank's capital:

- well capitalized

- adequately capitalized
- undercapitalized
- significantly undercapitalized
- critically undercapitalized

The capital rules described above under “Regulatory Capital Requirements” maintained the existing general structure of the current prompt corrective action framework and increased some of the thresholds for the prompt corrective action capital categories. For example, an adequately capitalized bank is required to maintain a Tier 1 risk-based capital ratio of 6.0% (increased from the current level of 4.0%). The rule also introduced the common equity Tier 1 capital ratio as a new prompt corrective action capital category threshold.

As an institution's capital decreases within the three undercapitalized categories listed above, the severity of the action that is authorized or required to be taken by the FRB for state member banks under the prompt corrective action regulations increases. All banks are prohibited from paying dividends or other capital distributions or paying management fees to any controlling person if, following such distribution, the bank would be undercapitalized. The FRB is required to monitor closely the condition of an undercapitalized institution and to restrict the growth of its assets.

An undercapitalized state member bank is required to file a capital restoration plan with the FRB within 45 days (or other timeframe prescribed by the FRB) of the date the bank receives notice that it is within any of the three undercapitalized categories, and the plan must be guaranteed by its parent holding company, subject to a cap on the guarantee that is the lesser of: (i) an amount equal to 5.0% of the bank's total assets at the time it was notified that it became undercapitalized; and (ii) the amount that is necessary to restore the bank's capital ratios to the levels required to be classified as "adequately classified," as those ratios and levels are defined as of the time the bank failed to comply with the plan. If the bank fails to submit an acceptable plan, it is treated as if it were "significantly undercapitalized." Banks that are significantly or critically undercapitalized are subject to a wider range of regulatory requirements and restrictions.

#### Federal Home Loan Bank

The Bank is also a member of the FHLBNY, 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 FHLBNY, including the requirement to acquire and hold shares of capital stock in the FHLBNY. The Bank was in compliance with the rules and requirements of the FHLBNY at December 31, 2016.

#### Community Reinvestment Act

Under the federal CRA, the Bank, consistent with its safe and sound operation, must help meet the credit needs of its entire community, including low and moderate income neighborhoods. The FRB periodically assesses the Bank's compliance with CRA requirements. The Bank received a "satisfactory" rating for CRA on its last performance evaluation conducted by the FRB as of May 19, 2014.

#### Fair Lending and Consumer Protection Laws

The Bank must also comply with the federal Equal Credit Opportunity Act and the New York Executive Law, which prohibit creditors from discrimination in their lending practices on bases specified in these statutes. In addition, the Bank is subject to a number of federal statutes and regulations implementing them, which are designed to protect the general public, borrowers, depositors, and other customers of depository institutions. These include the Bank Secrecy Act, the Truth in Lending Act, the Home Ownership and Equity Protection Act, the Truth in Savings Act, the Home Mortgage Disclosure Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Electronic Funds Transfers Act, the FCRA, the Right to Financial Privacy Act, the Expedited Funds Availability Act, the Flood Disaster Protection Act, the Fair Debt Collection Practices Act, Helping Families Save Their Homes Act, and the Consumer Protection for Depository Institutions Sales of Insurance regulation. The FRB and, in some instances, other regulators, including the U.S. Department of Justice, the FTC, the CFPB and state Attorneys General, may take enforcement action against institutions that fail to comply with these laws.

#### Prohibitions against Tying Arrangements

Subject to some exceptions, regulations under the BHCA and the Federal Reserve Act prohibit banks from extending credit to or offering any other service, or fixing or varying the consideration for such extension of credit or service, on

the condition that the customer obtain some additional service from the bank or its affiliates or not obtain services of a competitor of the bank.

#### Privacy Regulations

Regulations under the Federal Reserve Act generally require the Bank to disclose its privacy policy. The policy must identify with whom the Bank shares its customers' "nonpublic personal information," at the time of establishing the customer relationship and annually thereafter. In addition, the Bank must provide its customers with the ability to "opt out" of having their personal information shared with unaffiliated third parties and not to disclose account numbers or access codes to non-affiliated third parties for marketing purposes. The Bank's privacy policy complies with Federal Reserve Act regulations.



## The USA PATRIOT Act

The Bank is subject to the USA PATRIOT Act, which gives the federal government powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing, and broadened anti-money laundering requirements. The USA PATRIOT Act imposes affirmative obligations on financial institutions, including the Bank, to establish anti-money laundering programs which require: (i) the establishment of internal policies, procedures, and controls; (ii) the designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program. The FRB must consider the Bank's effectiveness in combating money laundering when ruling on merger and other applications.

## CFS

CFS is subject to supervision by other regulatory authorities as determined by the activities in which it is engaged. Insurance activities are supervised by the NYSDFS, and brokerage activities are subject to supervision by the SEC and FINRA.

## CRM

CRM is subject to regulations of the State of Nevada and undergoes periodic examinations by the Nevada Division of Insurance.

## Additional Important Legislation and Regulation

### The Dodd-Frank Act

The Dodd-Frank Act, enacted on July 21, 2010, significantly changed the bank regulatory landscape and has impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. We have summarized below significant rules adopted by the federal agencies pursuant to the Dodd-Frank Act.

### Consumer Financial Protection Bureau Rules

The Dodd-Frank Act created the CFPB, with wide-ranging powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. The Dodd-Frank Act also weakened the federal preemption rules that had been applicable to national banks and federal savings associations, especially with respect to the applicability of state consumer protection laws, and gives state attorneys general certain powers to enforce federal consumer protection regulations.

The CFPB has issued several new rules pursuant to the Dodd-Frank Act concerning the regulation of mortgage markets in the U.S. The rules amend several existing regulations, including Regulation Z, which implements the Truth in Lending Act, Regulation X, which implements the Real Estate Settlement Procedures Act and Regulation B, which implements the Equal Credit Opportunity Act. The CFPB has also issued amendments to Regulation P, which governs information privacy and Regulation E, which implements the Electronic Funds Transfers Act. The CFPB may from time to time issue additional amendments or new rules that will affect the Corporation's business practices.

In December 2013, the FRB and the SEC released final rules to implement certain provisions of the Dodd-Frank Act, commonly known as the “Volcker Rule.” The Volcker Rule, among other things, prohibits banking entities from engaging in proprietary trading and from sponsoring, having an ownership interest in or having certain relationships with a hedge fund or private equity fund, subject to certain exemptions. At December 31, 2016, the Corporation was not engaged in any activities and it did not have any ownership interests in any funds that are not permitted under the Volcker Rule.

In 2013, the CFPB issued a final rule amending Regulation Z (which implements TILA) and Regulation X (which implements RESPA). In 2015, the CFPB issued a final rule, effective October 3, 2015, specifying mandatory new procedures for the making of these disclosures. The purpose of the new rule, known as the TRID Rule, is to integrate certain disclosures for closed-end credit extended against real property, the appraisal notice required under the ECOA, and the servicing notice required under RESPA in two new forms: a Loan Estimate that must be provided to a consumer within a specified time after receiving his or her application, and a Closing Disclosure that must be provided at least three days before the loan is closed. The TRID Rule general applies to all lenders, including the Bank, that extended credit to consumers 25 or more times in the preceding or current year.

### Securities and Exchange Commission Rules

As discussed above under “Federal Securities Law,” pursuant to the Dodd-Frank Act, the SEC issued regulations that provide the shareholders of public companies with an advisory vote on: i) executive compensation (“say-on-pay”); ii) the desired frequency of say-on-pay; and iii) compensation arrangements and understandings in connection with merger transactions, known as “golden parachute” arrangements. Additionally, the SEC has issued regulations effective January 1, 2017 requiring companies subject to the reporting rules of the SEC to disclose to shareholders the ratio of compensation of the chief executive officer to the median compensation of employees. The SEC has also adopted corporate governance regulations that provide to shareholders of companies subject to the SEC’s proxy rules: i) the opportunity to nominate directors at a shareholder meeting and to have their nominees included in the company proxy materials sent to all shareholders; and ii) the ability to use the shareholder proposal process to establish procedures for the inclusion of shareholder director nominations in company proxy materials.

### Banking Agency Rules

As discussed above under “Regulatory Capital Requirements,” pursuant to the Dodd-Frank Act, the FRB and the other federal banking agencies have established minimum leverage and risk-based capital requirements for insured depository institutions and bank holding companies.

The Dodd-Frank Act directs the federal banking regulators to promulgate rules requiring the reporting of incentive-based compensation and prohibiting excessive incentive-based compensation paid to executives of depository institutions and their holding companies with total assets in excess of \$1.0 billion that encourages excessive risk-taking that could lead to a material financial loss. In April 2011, the FRB, along with other federal banking supervisors, issued a joint notice of proposed rulemaking implementing those requirements.

Many other provisions of the Dodd-Frank Act still require extensive rulemaking, guidance and interpretation by regulatory agencies. Accordingly, in many respects, the ultimate impact of the legislation and its effects on the Corporation and the Bank remain uncertain. The Corporation continues to closely monitor and evaluate regulatory developments. Such developments could adversely affect its financial condition and results of operations through significant increases in its regulatory compliance costs.

### Gramm-Leach-Bliley Act

Under the privacy and data security provisions of the Financial Modernization Act of 1999, also known as the GLB Act, and rules promulgated thereunder, all financial institutions, including the Corporation, the Bank and CFS are required to establish policies and procedures to restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer’s request and to protect customer data from unauthorized access. In addition, the FCRA, as amended by the FACT Act, includes many provisions affecting the Corporation, Bank, and/or CFS 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. For instance, the FCRA requires persons subject to the 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 FTC have extensive rulemaking authority under the FACT Act, and the Corporation and the Bank are subject to the rules that have been promulgated by the FRB and FTC thereunder, including recent rules regarding limitations on affiliate marketing and implementation of programs to identify, detect and mitigate the risk of identity theft through red flags. The Corporation has developed policies and procedures for itself and its subsidiaries to maintain compliance and believes it is in compliance with all privacy, information sharing and notification provisions of the GLB Act and the FCRA.

The GLB Act and the FCRA also impose requirements regarding data security and the safeguarding of customer information. The Bank is subject to the Security Guidelines, which implement section 501(b) of the GLB Act and section 216 of the FACT Act. The Security Guidelines establish standards relating to administrative, technical, and physical safeguards to ensure the security, confidentiality, integrity and the proper disposal of customer information. The Bank believes it is in compliance with all such standards.

## ITEM 1A. RISK FACTORS

The Corporation's business is subject to many risks and uncertainties. Although the Corporation seeks ways to manage these risks and develop programs to control those that management can control, the Corporation ultimately cannot predict the extent to which these risks and uncertainties could affect the Corporation's results. Actual results may differ materially from management's expectations. The following discussion sets forth what the Corporation currently believes could be the most significant factors of which it is currently aware that could affect the Corporation's business, results of operations or financial condition. You should consider all of the following risks together with all of the other information in this Annual Report on Form 10-K.

Economic conditions may adversely affect the Corporation's financial performance.

The Corporation's businesses and results of operation are affected by the financial markets and general economic conditions in the United States, and particularly to adverse conditions in New York and Pennsylvania. Key economic factors affecting the Corporation include the level and volatility of short-term and long-term interest rates, inflation, home prices, unemployment and under-employment levels, bankruptcies, household income, consumer spending, fluctuations in both debt and equity capital markets and currencies, liquidity of the financial markets, the availability and the cost of capital and credit, investor sentiment, confidence in the financial markets, and the sustainability of economic growth. The deterioration of any of these conditions could adversely affect the Corporation's consumer and commercial businesses, its securities and derivatives portfolios, its level of charge-offs and provision for credit losses, the carrying value of the Corporation's deferred tax assets, its capital levels, its capital levels and liquidity, and the Corporation's results of operations.

A decline or prolonged weakness in business and economic conditions generally or specifically in the principal markets in which the Corporation does business could have one or more of the following adverse effects on the Corporation's business: (i) a decrease in the demand for loans and other products and services; (ii) a decrease in the value of the Corporation's loans or other assets secured by consumer or commercial real estate; (iii) an impairment of certain of the Corporation's intangible assets, such as goodwill; and (iv) an increase in the number of borrowers and counter-parties who become delinquent, file for protection under bankruptcy laws or default on their loans or other obligations to the Corporation. Additionally, in light of economic conditions, the Corporation's ability to assess the creditworthiness of its customers may be impaired if the models and approaches that it uses to select, manage and underwrite loans become less predictive of future behaviors. Further, competition in the Corporation's industry may intensify as a result of consolidation of financial services companies in response to market conditions and the Corporation may face increased regulatory scrutiny, which may increase its costs and limit its ability to pursue business opportunities.

Commercial real estate and business loans increase the Corporation's exposure to credit risks.

At December 31, 2016, the Corporation's portfolio of commercial real estate and business loans totaled \$745.2 million or 62.1% of total loans. The Corporation plans to continue to emphasize the origination of these types of loans, which generally expose the Corporation to a greater risk of nonpayment and loss than residential real estate or consumer loans because repayment of commercial real estate and business loans often depends on the successful operations and income stream of the borrower's business. Additionally, such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate and consumer loans. Also, some of the Corporation's borrowers have more than one commercial loan outstanding. Consequently, an adverse development with respect to one loan or one credit relationship can expose the Corporation to a significantly greater risk of loss compared to an adverse development with respect to residential real estate and consumer loans. The Corporation targets its business lending and marketing strategy towards small to medium-sized businesses. These small to medium-sized businesses generally have fewer financial resources in terms of capital or borrowing capacity than

larger entities. If general economic conditions negatively impact these businesses, the Corporation's results of operations and financial condition may be adversely affected.

The allowance for loan losses may prove to be insufficient to absorb losses in the loan portfolio.

The Corporation's customers may not repay their loans according to the original terms, and the collateral securing the payment of those loans may be insufficient to pay any remaining loan balance. Hence, the Corporation may experience significant loan losses, which could have a material adverse effect on the Corporation's operating results. Management makes various assumptions and judgments about the collectability of its loan portfolio, including the creditworthiness of its borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. In determining the amount of the allowance for loan losses, management relies on loan quality reviews, past loss experience, and an evaluation of economic conditions, among other factors. If these assumptions prove to be incorrect, the allowance for loan losses may not be sufficient to cover losses inherent in the Corporation's loan portfolio, resulting in additions to the allowance. Material additions to the allowance would materially decrease net income.

The Corporation's emphasis on the origination of commercial loans is one of the more significant factors in evaluating its allowance for loan losses. As the Corporation continues to increase the amount of these loans, additional or increased provisions for loan losses may be necessary, which could result in a decrease in earnings.

Bank regulators periodically review the Corporation's allowance for loan losses and may require the Corporation to increase its provision for loan losses or loan charge-offs. Any increase in the allowance for loan losses or loan charge-offs as required by these regulatory authorities could have a material adverse effect on the Corporation's results of operations and/or financial condition.

Changes in interest rates could adversely affect the Corporation's results of operations and financial condition.

The Corporation's results of operations and financial condition are significantly affected by changes in interest rates. The Corporation's financial results depend substantially on net interest income, which is the difference between the interest income that it earns on interest-earning assets and the interest expense paid on interest-bearing liabilities. If the Corporation's interest-earning assets mature or reprice more quickly than its interest-bearing liabilities in a given period as a result of decreasing interest rates, net interest income may decrease. Likewise, net interest income may decrease if interest-bearing liabilities mature or reprice more quickly than interest-earning assets in a given period as a result of increasing interest rates. The Corporation has taken steps to mitigate this risk, such as holding fewer longer-term residential mortgages, as well as investing excess funds in shorter-term investments.

Changes in interest rates also affect the fair value of the Corporation's interest-earning assets and, in particular, its investment securities available for sale. Generally, the fair value of investment securities fluctuates inversely with changes in interest rates. Decreases in the fair value of investment securities available for sale, therefore, could have an adverse effect on its shareholders' equity or earnings if the decrease in fair value is deemed to be other than temporary.

Changes in interest rates may also affect the average life of loans and mortgage-related securities. Decreases in interest rates can result in increased prepayments of loans and mortgage-related securities, as borrowers refinance to reduce borrowing costs. Under these circumstances, the Corporation is subject to reinvestment risk to the extent that it is unable to reinvest the cash received from such prepayments at rates that are comparable to the rates on its existing loans and securities. Additionally, increases in interest rates may decrease loan demand and make it more difficult for borrowers to repay adjustable rate loans.

Municipal deposits are generally more sensitive to interest rates and may require competitive rates at placement and subsequent rollover dates, which may make it more difficult for the Bank to attract and retain public and municipal deposits. Additionally, when municipal deposits exceed FDIC coverage, any amounts not insured under the FDIC must be properly secured through a pledge of eligible securities. The requirement that the Bank collateralize municipal deposits above FDIC insurance may have an adverse effect on the Corporation's liquidity.

Strong competition within the Corporation's industry and market area could limit its growth and profitability.

The Corporation faces substantial competition in all phases of its operations from a variety of different competitors. Future growth and success will depend on the ability to compete effectively in this highly competitive environment. The Corporation competes for deposits, loans and other financial services with a variety of banks, thrifts, credit unions and other financial institutions as well as other entities, which provide financial services. Some of the financial institutions and financial services organizations with which the Corporation competes with are not subject to the same degree of regulation as the Corporation. Many competitors have been in business for many years, have established customer bases, are larger, and have substantially higher lending limits. The financial services industry is also likely

to become more competitive as further technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties.

The Corporation's growth strategy may not prove to be successful and its market value and profitability may suffer.

As part of the Corporation's strategy for continued growth, it may open additional branches. New branches do not initially contribute to operating profits due to the impact of overhead expenses and the start-up phase of generating loans and deposits. To the extent that additional branches are opened, the Corporation may experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse effect on the Corporation's levels of net income, return on average equity and return on average assets.



In addition, the Corporation may acquire banks and related businesses that it believes provide a strategic fit with its business, such as the 2011 acquisition of FOFC and the 2013 acquisition of six branches from Bank of America. To the extent that the Corporation grows through acquisitions, it cannot provide assurance that such strategic decisions will be accretive to earnings.

Compliance with the Dodd-Frank Act may increase the Corporation's costs of operations and adversely affect the Corporation's earnings and financial condition.

The Dodd-Frank Act represents a significant overhaul of many aspects of the regulation of the financial-services industry. Among other things, the Dodd-Frank Act created the CFPB, tightened capital standards, imposed clearing and margining requirements on many derivatives activities, and generally increases oversight and regulation of financial institutions and financial activities.

In addition to the self-implementing provisions of the statute, the Dodd-Frank Act calls for many administrative rulemakings by various federal agencies to implement various parts of the legislation. While regulators have adopted a number of new rules required by the Dodd-Frank Act, others have not been proposed or if proposed, not been adopted in final form. The Corporation cannot be certain when final rules affecting it will be issued through such rulemakings, and what the specific content of such rules will be. The financial reform legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and the Corporation's ability to conduct business. The Corporation will have to apply resources to ensure that it is in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase the Corporation's costs of operations and adversely impact its earnings.

The Corporation operates in a highly regulated environment and may be adversely affected by changes in laws and regulations.

Currently, the Corporation and its subsidiaries are subject to extensive regulation, supervision, and examination by regulatory authorities. For example, the FRB regulates the Corporation, the FRB, the FDIC and the NYSDFS regulate the Bank, and CRM is regulated by the Nevada Division of Insurance. Such regulators govern the activities in which the Corporation 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, or legislation, could have a material impact on the Corporation and its operations. The Corporation believes that it is in substantial compliance with applicable federal, state and local laws, rules and regulations. As the Corporation's business is highly regulated, the laws, rules and applicable regulations are subject to regular modification and change. There can be no assurance that proposed laws, rules and regulations, or any other law, rule or regulation, will not be adopted in the future, which could make compliance more difficult or expensive or otherwise adversely affect the Corporation's business, financial condition or prospects.

The capital requirement changes from Basel III discussed in Item 1 - "Business-Supervision and Regulation," could have a material adverse impact on the Corporation. Even though the Bank exceeds current and proposed minimum regulatory capital levels, adverse changes to residential mortgage risk weights, new requirements for common equity capital, inclusion of accumulated other comprehensive income in regulatory capital, the phase out of trust preferred securities, along with the adoption of new capital conservation buffers would reduce the Bank's current capital position and over time could cause the Bank to fail to meet minimum regulatory requirements. These capital positions are subject to volatility due to changes in interest rates and credit spreads. Although there is a phase-in period in the proposed rules, other factors such as the low interest rate environment, slow economic recovery, and further constraints on profitability by regulators could impact the Bank's ability to meet the new regulatory minimums once

the phase-in periods have ended.

Changes in tax rates could adversely affect the Corporation's results of operations and financial condition.

The Corporation is subject to the income tax laws of the United States, its states, and municipalities. The income tax laws of the jurisdictions in which the Corporation operates are complex and subject to different interpretations by the taxpayer and the relevant government taxing authorities. In establishing a provision for income tax expense, the Corporation must make judgments and interpretations about the application of these inherently complex tax laws to its business activities, as well as the timing of when certain items may affect taxable income.

The provision for income taxes is composed of current and deferred taxes. Deferred taxes arise from differences between assets and liabilities measured for financial reporting versus income tax return purposes. Deferred tax assets are recognized if, in the Corporation's judgment, their realizability is determined to be more likely than not. The Corporation performs regular reviews to ascertain the realizability of its deferred tax assets. These reviews include the Corporation's estimates and assumptions regarding future taxable income, which are incorporates various tax planning strategies. Changes in the Federal corporate tax rates, particularly rate reductions, can create a negative effect on the Corporation's reported earnings depending on the Corporation's then deferred tax position.

The Corporation is a holding company and depends on its subsidiaries for dividends, distributions and other payments.

The Corporation is a legal entity separate and distinct from the Bank and other subsidiaries. Its principal source of cash flow, including cash flow to pay dividends to its shareholders, is dividends from the Bank. There are statutory and regulatory limitations on the payment of dividends by the Bank to the Corporation, as well as by the Corporation to its shareholders. FRB regulations affect the ability of the Bank to pay dividends and other distributions and to make loans to the Corporation. If the Bank is unable to make dividend payments to the Corporation and sufficient capital is not otherwise available, it may not be able to make dividend payments to the Corporation's common shareholders.

The Corporation holds certain intangible assets that could be classified as impaired in the future. If these assets are considered to be either partially or fully impaired in the future, its earnings and the book values of these assets would decrease.

The Corporation is required to test its goodwill and core deposit intangible assets for impairment on a periodic basis. The impairment testing process considers a variety of factors, including the current market price of its common stock, the estimated net present value of its assets and liabilities, and information concerning the terminal valuation of similarly situated insured depository institutions. If an impairment determination is made in a future reporting period, its earnings and the book value of these intangible assets would be reduced by the amount of the impairment. If an impairment loss is recorded, it will have little or no impact on the tangible book value of the Corporation's common shares or its regulatory capital levels, but such an impairment loss could significantly restrict the Bank from paying a dividend to the Corporation.

Financial counterparties expose the Corporation to risks.

The Corporation has increased its use of derivative financial instruments, primarily interest rate swaps, which exposes it to financial and contractual risks with counterparty banks. The Corporation maintains correspondent bank relationships, manages certain loan participations, engages in securities transactions, and engages in other activities with financial counterparties that are customary to its industry. Financial risks are inherent in these counterparty relationships.

The Corporation may not be able to attract and retain skilled people.

The Corporation's success depends, in large part, on its ability to attract and retain key people. Competition for the best people in most activities in which the Corporation engages can be intense and it may not be able to hire people or to retain them. A key component of employee retention is providing a fair compensation base combined with the opportunity for additional compensation for above average performance. In this regard, the Corporation uses a stock-based compensation program that aligns the interest of the Corporation's executives and senior managers with the interests of the Corporation, and its shareholders.

The Corporation's compensation practices are designed to be competitive and comparable to those of its peers, however, the unexpected loss of services of one or more of the Corporation's key personnel could have a material

adverse impact on the business because it would lose the employees' skills, knowledge of the market, and years of industry experience and may have difficulty promptly finding qualified replacement personnel.

The Corporation's controls and procedures may fail or be circumvented, which may result in a material adverse effect on its business.

Management regularly reviews and updates its internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met.

The Corporation continually encounters technological change and the failure to understand and adapt to these changes could adversely affect its business.

The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. Technology has lowered barriers to entry and made it possible for "non-banks" to offer traditional bank products and services using innovative technological platforms such as Fintech and Blockchain. These "digital banks" may be able to achieve economies of scale and offer better pricing for banking products and services than the Corporation can. The Corporation's future success will depend, in part, on the ability to address the needs of customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in operations. Many competitors have substantially greater resources to invest in technological improvements. There can be no assurance that the Corporation will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Corporation's business and, in turn, its financial condition and results of operations.

The Corporation is subject to security and operational risks relating to its use of technology.

Despite instituted safeguards, the Corporation cannot be certain that all of its systems are entirely free from vulnerability to attack or other technological difficulties or failures, such as cyber-attacks. The Corporation relies on the services of a variety of vendors to meet its data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and the Corporation could be exposed to claims from customers. Any of these results could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity.

Provisions of the Corporation's certificate of incorporation, bylaws, as well as New York law and certain banking laws, could delay or prevent a takeover of the Corporation by a third party.

Provisions of the Corporation's certificate of incorporation and bylaws, New York law, and state and federal banking laws, including regulatory approval requirements, could delay, defer or prevent a third party from acquiring the Corporation, despite the possible benefit to the Corporation's shareholders, or otherwise adversely affect the market price of the Corporation's common stock. These provisions include: a two-thirds affirmative vote of all outstanding shares of Corporation stock for certain business combinations; a supermajority shareholder vote of 75% of outstanding stock for business combinations involving 10% shareholders; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to the Corporation's Board of Directors and for proposing matters that shareholders may act on at a shareholder meeting. In addition, the Corporation is subject to New York law, which among other things prohibits the Corporation from engaging in a business combination with any interested stockholder for a period of five years from the date the person became an interested stockholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discouraging bids for the Corporation's common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of the Corporation's common stock. These provisions could also discourage proxy contests and make it more difficult for shareholders to elect directors other than candidates nominated by the Board of Directors.

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

The business strategy of the Corporation has included and may continue to include growth through acquisition from time to time. Any future acquisitions will be accompanied by the risks commonly encountered in acquisitions. These risks may include, among other things: its ability to realize anticipated cost savings, the difficulty of integrating operations and personnel, the loss of key employees, the potential disruption of its or the acquired company's ongoing business in such a way that could result in decreased revenues, the inability of its management to maximize its financial and strategic position, the inability to maintain uniform standards, controls, procedures and policies, and the impairment of relationships with the acquired company's employees and customers as a result of changes in ownership and management.

Severe weather and other natural disasters can affect the Corporation's business.

The Corporation's main office and its branch offices can be affected by natural disasters such as severe storms and flooding. These kinds of events could interrupt the Corporation's operations, particularly its ability to deliver deposit and other retail banking services to its customers and as a result, the Corporation's business could suffer serious harm. While the Corporation maintains adequate insurance against property and casualty losses arising from most natural disasters, and it has successfully overcome the challenges caused by past flooding in Central New York, there can be no assurance that it will be as successful if and when disasters occur.

The Corporation's accounting policies and estimates are critical to how the Corporation reports its financial condition and results of operations, and any changes to such accounting policies and estimates could materially affect how the Corporation reports its financial condition and results of operations.

Management has identified certain accounting policies as being critical because they require management's judgment to ascertain the valuations of assets, liabilities, commitments and contingencies. A variety of factors could affect the ultimate value that is obtained either when earning income, recognizing an expense, recovering an asset, valuing an asset or liability or reducing a liability. The Corporation has established detailed policies and control procedures that are intended to ensure that these critical accounting estimates and judgments are well controlled and applied consistently. In addition, these policies and procedures are intended to ensure that the process for changing methodologies occurs in an appropriate manner. Because of the uncertainty surrounding its judgments and the estimates pertaining to these matters, actual outcomes may be materially different from amounts previously estimated. For example, because of the inherent uncertainty of estimates, management cannot provide any assurance that the Bank will not significantly increase its allowance for loan losses if actual losses are more than the amount reserved. Any increase in its allowance for loan losses or loan charge-offs could have a material adverse effect on the Corporation's financial condition and results of operations. In addition, the Corporation cannot guarantee that it will not be required to adjust accounting policies or restate prior financial statements.

Further, from time to time, the FASB and SEC change the financial accounting and reporting standards that govern the preparation of the Corporation's financial statements. The ongoing economic recession has resulted in increased scrutiny of accounting standards by legislators and the Corporation's regulators, particularly as they relate to fair value accounting principles. In addition, ongoing efforts to achieve convergence between GAAP and International Financial Reporting Standards may result in changes to GAAP. These changes can be hard to predict and can materially impact how it records and reports its financial condition and results of operations. In some cases, the Corporation could be required to apply a new or revised standard retroactively, resulting in its restating prior period financial statements or otherwise adversely affecting its financial condition or results of operations.

Specifically, in June of 2016, FASB issued a new accounting standard, ASU 2016-13, Financial Instruments - Credit Losses (Topic 326) that will substantially change the accounting for credit losses under GAAP. Under GAAP's current standards, credit losses are not reflected in the Corporation's financial statements until it is probable that the credit losses has been incurred. This methodology has the effect of delaying the recognition of credit losses on loans. Under the new credit loss standard, the allowance for credit losses will be an estimate of the "expected" credit losses on loans. The new credit loss standard may have a negative impact on the reporting of results of operations and financial condition of the Corporation. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2019, though entities may adopt the amendments earlier for fiscal years beginning after December 15, 2018.

There may be claims and litigation pertaining to fiduciary responsibility.

From time to time as part of the Corporation's normal course of business, customers make claims and take legal action against the Corporation based on its actions or inactions related to the fiduciary responsibilities of the Wealth Management Group segment. If such claims and legal actions are not resolved in a manner favorable to the Corporation, they may result in financial liability and/or adversely affect the market perception of the Corporation and its products and services. This may also impact customer demand for the Corporation's products and services. Any financial liability or reputation damage could have a material adverse effect on the Corporation's business, which, in turn, could have a material adverse effect on its financial condition and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

All properties owned or leased by the Bank are considered to be in good condition. For additional information about the Corporation's facilities, including rental expenses, see "Note 5 Premises and Equipment" in Notes to Consolidated Financial Statements in Part IV, Item 15. Exhibits and Financial Statement Schedules of this report. The Corporation holds no real estate in its own name.

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Corporate Headquarters  
Executive and Administrative Offices  
One Chemung Canal Plaza, Elmira, NY 14901

New York

Albany County

\*132 State St., Albany, NY 12207  
\*65 Wolf Rd., Albany, NY 12205  
\*581 Loudon Rd., Latham, NY 12110  
\*1365 New Scotland Rd., Slingerlands, NY 12159

Broome County

\*127 Court St., Binghamton, NY 13901  
\*601-635 Harry L. Dr., Johnson City, NY 13790 (Oakdale Mall)  
\*100 Rano Blvd., Vestal, NY 13850

Cayuga County

\*120 Genesee St., Auburn, NY 13021  
185 Grant Ave., Auburn, NY 13021

Chemung County

One Chemung Canal Plaza, Elmira, NY 14901  
628 W. Church St., Elmira, NY 14905  
437 Maple St., Big Flats, NY 14814  
951 Pennsylvania Ave., Elmira, NY 14904  
100 W. McCann's Blvd., Elmira Heights, NY 14903  
29 Arnot Rd., Horseheads, NY 14845  
602 S. Main St., Horseheads, NY 14845

Cortland County

\*1094 State Rte. 222, Cortland, NY 13045

Pennsylvania

Bradford County

5 West Main St., Canton, PA 17724  
304 Main St., Towanda, PA 18848  
159 Canton St., Troy, PA 16947

CFS Group

\*136 State St., Albany, NY 12207  
One Chemung Canal Plaza, Elmira, NY 14901  
628 W. Church St., Elmira, NY 14905

\* Leased facilities and/or property

Saratoga County

\*25 Park Ave., Clifton Park, NY 12065

Schuyler County

318 N. Franklin St., Watkins Glen, NY 14891  
303 W. Main St., Montour Falls, NY 14865

Seneca County

54 Fall St., Seneca Falls, NY 13148

Steuben County

\*410 West Morris St., Bath, NY 14810  
149 West Market St., Corning, NY 14830  
243 North Hamilton St., Painted Post, NY 14870

Tioga County

203 Main St., Owego, NY 13827  
\*1054 State Route 17C, Owego, NY 13827  
405 Chemung St., Waverly, NY 14892

Tompkins County

806 W. Buffalo St., Ithaca, NY 14850  
304 Elmira Rd., Ithaca, NY 14850  
\*909 Hanshaw Rd., Ithaca, NY 14850



Leased Off-Site ATM Locations	
Times Union Center	Albany, NY
Elmira-Corning Regional Airport	Big Flats, NY
Corning Community College	Corning, NY
Elmira College	Elmira, NY
E-Z Food Mart	Elmira, NY
Hardinge Inc. (employees only)	Elmira, NY
Quality Beverage	Elmira, NY
Collegetown Bagels	Ithaca, NY
Ithaca College	Ithaca, NY
Lansing Market	Lansing, NY
Schuyler Hospital	Montour Falls, NY

### ITEM 3. LEGAL PROCEEDINGS

In the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. Except for the legal matter discussed in Footnote 15, the Corporation believes that it is not a party to any pending legal, arbitration, or regulatory proceedings that could have a material adverse impact on its financial results or liquidity.

### ITEM 4. MINE SAFETY DISCLOSURES

None.

## PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation's stock is traded on the Nasdaq Global Market under the symbol "CHMG."

The table below shows the price ranges for the Corporation's common stock during each of the indicated quarters. The information is based upon the high and low closing sale prices reported by the Nasdaq Global Market.

Common Stock Market Prices and Dividends Paid  
During the Past Two Years

December 31, 2016	High	Low	Dividends
4th Quarter	\$36.74	\$28.29	\$ 0.26
3rd Quarter	32.19	27.47	0.26
2nd Quarter	32.95	26.20	0.26
1st Quarter	28.03	26.25	0.26

December 31, 2015	High	Low	Dividends
4th Quarter	\$28.44	\$26.31	\$ 0.26
3rd Quarter	28.50	26.07	0.26
2nd Quarter	27.68	26.01	0.26
1st Quarter	28.74	26.93	0.26

Under New York law, the Corporation may pay dividends on its common stock either: (i) out of surplus, so that the Corporation's net assets remaining after such payment equal the amount of its stated capital, or (ii) if there is no surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. The payment of dividends on the Corporation's common stock is dependent, in large part, upon receipt of dividends from the Bank, which is subject to certain restrictions which may limit its ability to pay us dividends. See Item 1, "Business – Supervision and Regulation-The Bank-Payment of Dividends" for an explanation of legal limitations on the Bank's ability to pay dividends.

As of February 28, 2017, there were 2,435 holders of record of the Corporation's stock, which includes 750 Non-Objecting Beneficial Owners held in street name.

The table below sets forth the information with respect to purchases made by the Corporation of our common stock during the quarter ended December 31, 2016:

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
10/1/16-10/31/16	—	\$ —	—	121,906
11/1/16-11/30/16	—	\$ —	—	121,906
12/1/16-12/31/16	612	\$ 35.38	—	121,906
Quarter ended 12/31/16	612	\$ 35.38	—	121,906

On December 19, 2012, the Corporation's Board of Directors approved a stock repurchase plan authorizing the purchase of up to 125,000 shares of the Corporation's outstanding common stock. Purchases may be made from time to time on the open market or in private negotiated transactions and will be at the discretion of management. For the year ending December 31, 2016, no shares had been purchased under this plan. Since inception of the plan, a total of 3,094 shares have been purchased under the plan.

Included above are 612 shares purchased in December 2016, at an average cost of \$35.38, from employees who participate in the Corporation's restricted stock plan to cover related employee payroll taxes associated with those participants' vesting in shares granted under the plan.

## STOCK PERFORMANCE GRAPH

The following graph compares the yearly change in the cumulative total shareholder return on the Corporation's common stock against the cumulative total return of the NASDAQ Stock Market (U.S. Companies), NASDAQ Bank Stocks Index, SNL U.S. Bank NASDAQ, and SNL \$1B - \$5B Bank Index for the period of five years commencing December 31, 2011.

Index	Period Ending					
	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
Chemung Financial Corporation	100.00	137.02	161.72	135.78	140.24	191.87
NASDAQ Composite	100.00	117.45	164.57	188.84	201.98	219.89
NASDAQ Bank	100.00	118.69	168.21	176.48	192.08	265.02
SNL U.S. Bank NASDAQ	100.00	119.19	171.31	177.42	191.53	265.56
SNL Bank \$1B-\$5B	100.00	123.31	179.31	187.48	209.86	301.92

The cumulative total return includes (1) dividends paid and (2) changes in the share price of the Corporation's common stock and assumes that all dividends were reinvested. The above graph assumes that the value of the investment in Chemung Financial Corporation and each index was \$100 on December 31, 2011.

The Total Returns Index for NASDAQ Stock Market (U.S. Companies) and Bank Stocks indices were obtained from S&P Global Market Intelligence, New York, NY.

## ITEM 6. SELECTED FINANCIAL DATA

The following tables present selected financial data as of and for the years ended December 31, 2016, 2015, 2014, 2013 and 2012. The selected financial data is derived from our audited consolidated financial statements. The selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our audited consolidated financial statements and related notes.

	SUMMARIZED BALANCE SHEET DATA AT DECEMBER 31,				
(in thousands)	2016	2015	2014	2013	2012
Total assets	\$1,657,179	\$1,619,964	\$1,524,539	\$1,476,143	\$1,248,160
Loans, net of deferred fees	1,200,290	1,168,633	1,121,574	995,866	893,517
Investment securities	308,107	349,386	286,338	352,511	245,434
FHLBNY and FRBNY stock	4,041	4,797	5,535	4,482	4,710
Deposits	1,456,343	1,400,295	1,280,014	1,266,256	1,047,497
Securities sold under agreements to repurchase	27,606	28,453	29,652	32,701	32,711
FHLBNY advances	9,093	33,103	50,140	25,243	27,225
Long term capital lease obligation	4,722	2,873	2,976	—	—
Shareholders' equity	143,748	137,242	133,628	138,578	131,115

	SUMMARIZED EARNINGS DATA FOR THE YEARS ENDED DECEMBER 31,				
(in thousands)	2016	2015	2014	2013	2012
Net interest income	\$52,329	\$50,642	\$49,568	\$46,631	\$46,842
Provision for loan losses	2,437	1,571	3,981	2,755	828
Net interest income after provision for loan losses	49,892	49,071	45,587	43,876	46,014
Wealth management group fee income	8,316	8,522	7,747	7,344	6,827
Service charges on deposit accounts	5,089	4,886	5,281	4,706	4,241
Interchange revenue from debit card transactions	4,027	3,307	3,360	2,562	2,385
Securities gains, net	987	372	6,869	16	301
Other income	2,730	3,360	3,499	3,449	3,434
Total non-interest income	21,149	20,447	26,756	18,077	17,188
Legal accruals and settlements	1,200	—	4,250	—	—
Merger and acquisition related expenses	—	—	115	1,387	30
Other operating expenses	55,410	55,427	56,112	48,013	46,765
Total non-interest expense	56,610	55,427	60,477	49,400	46,795
Income before income tax expense	14,431	14,091	11,866	12,553	16,407
Income tax expense	4,404	4,658	3,709	3,822	5,385
Net income	\$10,027	\$9,433	\$8,157	\$8,731	\$11,022

SELECTED PER SHARE DATA ON SHARES OF  
COMMON STOCK AT OR FOR THE YEARS ENDED  
DECEMBER 31,

	2016	2015	2014	2013	2012	2011	% Change To 2016	Compounded Annual Growth 5 Years	
Earnings per share (1)	\$2.11	\$2.00	\$1.74	\$1.87	\$2.38	\$2.40	5.5 %	(2.1 %)	
Dividends declared	1.04	1.04	1.04	1.04	1.00	1.00	— %	0.7 %	
Tangible book value (2)	24.89	23.53	22.71	23.63	22.40	21.07	5.8 %	2.8 %	
Book Value	30.07	28.96	28.44	29.67	28.20	27.14	3.8 %	1.7 %	
Market price at 12/31	36.35	27.50	27.66	34.17	29.89	22.75	32.2 %	8.1 %	
Common shares outstanding at period end (in thousands) (3)	4,781	4,739	4,699	4,671	4,649	4,641	0.9 %	0.5 %	
Weighted average shares outstanding (in thousands)	4,762	4,719	4,683	4,660	4,641	4,383	0.9 %	1.4 %	

(1) Earnings per share is computed by dividing net income by the weighted average number of common shares outstanding. There is no difference between basic and diluted earnings per share.

(2) Tangible book value is total shareholders' equity less goodwill and other intangible assets divided by common shares outstanding.

(3) All issuable shares including those related to directors' restricted stock units and directors' stock compensation.

SELECTED RATIOS AT OR FOR THE YEARS  
ENDED DECEMBER 31,

	2016	2015	2014	2013	2012
Return on average assets	0.60 %	0.60 %	0.54 %	0.67 %	0.88 %
Return on average equity	7.02 %	6.84 %	5.74 %	6.50 %	8.41 %
Dividend yield at year end	2.86 %	3.78 %	3.76 %	3.08 %	4.20 %
Dividend payout	48.76 %	51.34 %	58.80 %	41.04 %	51.84 %
Total capital to risk adjusted assets	12.14 %	12.26 %	11.84 %	12.10 %	13.10 %
Tier I capital to risk adjusted assets	10.94 %	11.01 %	10.59 %	10.57 %	11.68 %
Tier I leverage ratio	7.81 %	7.83 %	7.78 %	8.08 %	8.74 %
Average equity to average assets	8.57 %	8.74 %	9.43 %	10.28 %	10.46 %
Year-end equity to year-end assets ratio	8.67 %	8.47 %	8.77 %	9.39 %	10.50 %
Loans to deposits	82.42 %	83.46 %	87.62 %	78.65 %	85.30 %
Allowance for loan losses to total loans	1.19 %	1.22 %	1.22 %	1.28 %	1.17 %
Allowance for loan losses to non-performing loans	118.35 %	116.58 %	175.96 %	150.11 %	172.96 %
Non-performing assets to total assets	0.75 %	0.85 %	0.71 %	0.61 %	0.53 %
Net interest rate spread	3.26 %	3.36 %	3.48 %	3.78 %	3.96 %
Net interest margin	3.37 %	3.46 %	3.59 %	3.91 %	4.14 %
Efficiency ratio (1)	74.43 %	76.18 %	78.75 %	72.52 %	70.92 %

(1) Efficiency ratio is non-interest expense less merger and acquisition related expenses less amortization of intangible assets less legal settlement divided by the total of fully taxable equivalent net interest income plus non-interest income less net gain on securities transactions less gain from bargain purchase less gain on liquidation of trust preferred securities.



The following tables summarize the Corporation's unaudited net income and basic earnings per share at each quarter end for the years 2016 and 2015:

(in thousands, except per share data) UNAUDITED QUARTERLY DATA	2016			
	Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
Interest and dividend income	\$13,949	\$13,925	\$14,025	\$14,269
Interest expense	924	957	985	973
Net interest income	13,025	12,968	13,040	13,296
Provision for loan losses	595	388	1,050	404
Net interest income after provision for loan losses	12,430	12,580	11,990	12,892
Total other operating income	5,601	5,216	5,435	4,897
Total other operating expenses	14,008	15,570	13,471	13,561
Income before income tax expense	4,023	2,226	3,954	4,228
Income tax expense	1,316	605	1,209	1,274
Net income (1)	\$2,707	\$1,621	\$2,745	\$2,954
Basic and diluted earnings per share	\$0.57	\$0.34	\$0.58	\$0.62

(1) The quarter ended June 30, 2016 included a \$1.2 million legal reserve. Please refer to Footnote 15 for further discussion.

(in thousands, except per share data) UNAUDITED QUARTERLY DATA	2015			
	Quarter Ended			
	Mar. 31	June 30	Sept. 30	Dec. 31
Interest and dividend income	\$13,234	\$13,519	\$13,595	\$13,896
Interest expense	892	872	904	934
Net interest income	12,342	12,647	12,691	12,962
Provision for loan losses	390	259	307	615
Net interest income after provision for loan losses	11,952	12,388	12,384	12,347
Total other operating income	5,186	5,326	4,912	5,023
Total other operating expenses	13,736	13,823	13,634	14,234
Income (loss) before income tax expense (benefit)	3,402	3,891	3,662	3,136
Income tax expense (benefit)	1,126	1,314	1,211	1,007
Net income (loss)	\$2,276	\$2,577	\$2,451	\$2,129
Basic and diluted earnings (loss) per share	\$0.48	\$0.55	\$0.52	\$0.45

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following is the MD&A of the Corporation in this Form 10-K for the years ended December 31, 2016 and 2015. The purpose of this discussion is to focus on information about the financial condition and results of operations of the Corporation. Reference should be made to the accompanying audited consolidated financial statements and footnotes for an understanding of the following discussion and analysis. See the list of commonly used abbreviations and terms on pages 1-4.

The MD&A included in this Form 10-K contains statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on the current beliefs and expectations of the Corporation's management and are subject to significant risks and uncertainties. Actual results may differ from those set forth in the forward-looking statements. For a discussion of those risks and uncertainties and the factors that could cause the Corporation's actual results to differ materially from those risks and uncertainties, see Forward-looking Statements below.

The Corporation has been a financial holding company since 2000, and the Bank was established in 1833, CFS in 2001, and CRM in 2016. Through the Bank and CFS, the Corporation provides a wide range of financial services, including demand, savings and time deposits, commercial, residential and consumer loans, interest rate swaps, letters of credit, wealth management services, employee benefit plans, insurance products, mutual funds and brokerage services. The Bank relies substantially on a foundation of locally generated deposits. The Corporation, on a stand-alone basis, has minimal results of operations. The Bank derives its income primarily from interest and fees on loans, interest on investment securities, WMG fee income and fees received in connection with deposit and other services. The Bank's operating expenses are interest expense paid on deposits and borrowings, salaries and employee benefit plans and general operating expenses.

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

### Forward-looking Statements

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act, Section 21E of the Exchange Act, and the Private Securities Litigation Reform Act of 1995. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing the Corporation's growth, competition, changes in law or the regulatory environment, including the Dodd-Frank Act, and changes in general business and economic trends. Information concerning these and other factors can be found in the Corporation's periodic filings with the SEC, including the discussion under the heading "Item 1A. Risk Factors" of this Form 10-K. The Corporation's quarterly filings are available publicly on the SEC's web site at <http://www.sec.gov>, on the Corporation's web site at <http://www.chemungcanal.com> or by written request to:

Kathleen S. McKillip, Corporate Secretary, Chemung Financial Corporation, One Chemung Canal Plaza, Elmira, NY 14901. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

## Consolidated Financial Highlights

(in thousands, except per share data)	As of or for the Years Ended			
	December 31, 2016	December 31, 2015	December 31, 2014	
<b>RESULTS OF OPERATIONS</b>				
Interest income	\$56,168	\$54,244	\$53,213	
Interest expense	3,839	3,602	3,645	
Net interest income	52,329	50,642	49,568	
Provision for loan losses	2,437	1,571	3,981	
Net interest income after provision for loan losses	49,892	49,071	45,587	
Non-interest income	21,149	20,447	26,756	
Non-interest expense	56,610	55,427	60,477	
Income before income tax expense	14,431	14,091	11,866	
Income tax expense	4,404	4,658	3,709	
Net income	\$10,027	\$9,433	\$8,157	
Basic and diluted earnings per share	\$2.11	\$2.00	\$1.74	
Average basic and diluted shares outstanding	4,762	4,719	4,683	
<b>PERFORMANCE RATIOS</b>				
Return on average assets	0.60	% 0.60	% 0.54	%
Return on average equity	7.02	% 6.84	% 5.74	%
Return on average tangible equity (a)	8.52	% 8.45	% 7.12	%
Efficiency ratio (b)	74.43	% 76.18	% 78.75	%
Non-interest expense to average assets (c)	3.32	% 3.51	% 3.73	%
Loans to deposits	82.42	% 83.46	% 87.62	%
<b>YIELDS / RATES - Fully Taxable Equivalent</b>				
Yield on loans	4.18	% 4.24	% 4.43	%
Yield on investments	1.83	% 1.91	% 1.98	%
Yield on interest-earning assets	3.61	% 3.71	% 3.85	%
Cost of interest-bearing deposits	0.21	% 0.20	% 0.22	%
Cost of borrowings	3.01	% 2.85	% 2.83	%
Cost of interest-bearing liabilities	0.35	% 0.35	% 0.37	%
Interest rate spread	3.26	% 3.36	% 3.48	%
Net interest margin, fully taxable equivalent	3.37	% 3.46	% 3.59	%
<b>CAPITAL</b>				
Total equity to total assets at end of period	8.67	% 8.47	% 8.77	%
Tangible equity to tangible assets at end of period (a)	7.29	% 6.99	% 7.13	%
Book value per share	\$30.07	\$28.96	\$28.44	
Tangible book value per share	24.89	23.53	22.71	
Period-end market value per share	36.35	27.50	27.66	
Dividends declared per share	1.04	1.04	1.04	



## AVERAGE BALANCES

Loans (d)	\$1,194,589	\$1,141,992	\$1,066,379
Earning assets	1,571,513	1,477,529	1,399,285
Total assets	1,667,184	1,577,831	1,506,324
Deposits	1,450,520	1,367,717	1,297,443
Total equity	142,906	137,891	142,046
Tangible equity (a)	117,656	111,583	114,492

## ASSET QUALITY

Net charge-offs (recoveries)	\$2,444	\$997	\$3,071
Non-performing loans (e)	12,043	12,232	7,778
Non-performing assets (f)	12,431	13,762	10,843
Allowance for loan losses	14,253	14,260	13,686

Annualized net charge-offs to average loans	0.20	% 0.09	% 0.29	%
Non-performing loans to total loans	1.00	% 1.05	% 0.69	%
Non-performing assets to total assets	0.75	% 0.85	% 0.71	%
Allowance for loan losses to total loans	1.19	% 1.22	% 1.22	%
Allowance for loan losses to non-performing loans	118.35	% 116.58	% 175.96	%

(a) See the GAAP to Non-GAAP reconciliations.

(b) Efficiency ratio is non-interest expense less merger and acquisition expenses less amortization of intangible assets less legal settlement divided by the total of fully taxable equivalent net interest income plus non-interest income less net gains on securities transactions less gain from bargain purchase less gain on liquidation of trust preferred securities.

(c) For the non-interest expense to average assets ratio, non-interest expense does not include legal accrual and legal settlement expense. See footnote 15 for further discussion.

(d) Loans include loans held for sale. Loans do not reflect the allowance for loan losses.

(e) Non-performing loans include non-accrual loans only.

(f) Non-performing assets include non-performing loans plus other real estate owned.

## Executive Summary

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

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

	Years Ended December 31,		Change	Percentage Change	
	2016	2015			
Net interest income	\$52,329	\$50,642	\$1,687	3.3	%
Non-interest income	21,149	20,447	702	3.4	%
Non-interest expense	56,610	55,427	1,183	2.1	%
Pre-provision income	16,868	15,662	1,206	7.7	%
Provision for loan losses	2,437	1,571	866	55.1	%
Income tax expense	4,404	4,658	(254)	(5.5)	%
Net income	\$10,027	\$9,433	\$594	6.3	%
Basic and diluted earnings per share	\$2.11	\$2.00	\$0.11	5.5	%
Selected financial ratios					
Return on average assets	0.60	% 0.60	%		
Return on average equity	7.02	% 6.84	%		
Net interest margin, fully taxable equivalent	3.37	% 3.46	%		
Efficiency ratio	74.43	% 76.18	%		
Non-interest expense to average assets	3.32	% 3.51	%		

Net income for the year ended December 31, 2016 was \$10.0 million, or \$2.11 per share, compared with net income of \$9.4 million, or \$2.00 per share, for the prior year. Return on equity for the year was 7.02%, compared with 6.84% for the prior year. The increase in net income from the prior year was driven by increases in net interest income and non-interest income and a reduction in income tax expense, partially offset by a increases in non-interest expense and the provision for loan losses.

#### Net interest income

Net interest income increased \$1.7 million, or 3.3%, compared with the prior year. The increase was due primarily to an increase of \$94.0 million in average interest-earning assets, offset by a nine basis point decline in net interest margin.

#### Non-interest income

Non-interest income increased \$0.7 million, or 3.4%, compared to the prior year. The increase was due primarily to increases in service charges on deposit accounts, interchange revenue from debit card transactions, and net gains on security transactions, offset by decreases in WMG fee income and other non-interest income.

#### Non-interest expense

Non-interest expense increased \$1.2 million, or 2.1%, compared to the prior year. The increase was due primarily to the establishment of a \$1.2 million legal reserve associated with the Fane v. Chemung Canal Trust Company case, along with increases in pension and other employee benefits and professional services, offset by decreases in salaries and wages, net occupancy expenses, amortization of intangible assets, and other real estate owned expenses. Please refer to Footnote 15 for further discussion of the Fane v. Chemung Canal case. For the years ended December 31, 2016 and 2015, non-interest expense to average assets was 3.32% and 3.51%, respectively.

#### Provision for loan losses

The provision for loan losses increased \$0.9 million, or 55.1%, compared to the prior year. The increase was the result of an increase in net charge-offs and growth in the commercial loan portfolio, compared to the prior year. Net charge-offs were \$2.4 million, compared with \$1.0 million for the prior year.





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

	Years Ended December 31,		Change	Percentage Change	
	2015	2014			
Net interest income	\$50,642	\$49,568	\$1,074	2.2	%
Non-interest income	20,447	26,756	(6,309 )	(23.6 )	%
Non-interest expense	55,427	60,477	(5,050 )	(8.4 )	%
Pre-provision income	15,662	15,847	(185 )	(1.2 )	%
Provision for loan losses	1,571	3,981	(2,410 )	(60.5 )	%
Income tax expense	4,658	3,709	949	25.6	%
Net income	\$9,433	\$8,157	\$1,276	15.6	%
Basic and diluted earnings per share	\$2.00	\$1.74	\$0.26	14.9	%
Selected financial ratios					
Return on average assets	0.60	% 0.54	%		
Return on average equity	6.84	% 5.74	%		
Net interest margin, fully taxable equivalent	3.46	% 3.59	%		
Efficiency ratio	76.18	% 78.75	%		
Non-interest expense to average assets	3.51	% 3.73	%		

Net income for the year ended December 31, 2015 was \$9.4 million, or \$2.00 per share, compared with \$8.2 million, or \$1.74 per share, for the same period in the prior year. Return on equity for the year ended December 31, 2015 was 6.84%, compared with 5.74% for the same period in the prior year. The increase in net income from the prior year was driven by a reduction in non-interest expense, mostly due to the \$4.3 million WMG legal settlement in 2014, and higher net interest income and a reduction in the provision for loan losses, partially offset by a reduction in non-interest income, mostly due to the gain on the sale of securities, and an increase in income tax expense.

#### Net interest income

Net interest income increased \$1.1 million, or 2.2%, compared with the same period in the prior year. The increase was due primarily to an increase of \$78.2 million in average interest-earning assets, offset by a 13 basis point decline in net interest margin.

#### Non-interest income

Non-interest income decreased \$6.3 million, or 23.6%, compared to the same period in the prior year. The decrease was due primarily to decreases in net gains on securities transactions, service charges on deposit accounts and other non-interest income, offset by an increase in WMG fee income.

#### Non-interest expense

Non-interest expense decreased \$5.1 million, or 8.4%, compared to the same period in the prior year. The decrease was due primarily to the \$4.3 million legal settlement that occurred in 2014, relating to WMG, and a decline in professional services, amortization of intangibles, marketing and advertising, and other non-interest expense. These items were offset by increases in pension and other employee benefits, data processing expense and other real estate owned expenses. For the years ended December 31, 2015 and 2014, non-interest expense to average assets was 3.51% and 3.73%, respectively.

Provision for loan losses

The provision for loan losses decreased \$2.4 million, or 60.5%, compared to the same period in the prior year. The decrease was the result of lower specific allocations for PCI loans and lower net charge-offs during the year. Net charge-offs were \$1.0 million, compared with \$3.1 million for the same period in the prior year.

### Consolidated Results of Operations

The following section of the MD&A provides a comparative discussion of the Corporation's Consolidated Results of Operations on a reported basis for the years ended December 31, 2016 and 2015. For a discussion of the Critical Accounting Policies, Estimates and Risks and Uncertainties that affect the Consolidated Results of Operations, see page 60.

### Net Interest Income

The following table presents net interest income for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change	
	2016	2015			
Interest and dividend income	\$56,168	\$54,244	\$1,924	3.5	%
Interest expense	3,839	3,602	237	6.6	%
Net interest income	\$52,329	\$50,642	\$1,687	3.3	%

Net interest income, which is the difference between the interest income earned on interest-earning assets, such as loans and securities and the interest expense accrued on interest-bearing liabilities, such as deposits and borrowings, is the largest contributor to the Corporation's earnings.

Net interest income for the year ended December 31, 2016 totaled \$52.3 million, an increase of \$1.7 million, or 3.3%, compared with \$50.6 million for the same period in the prior year. Fully taxable equivalent net interest margin was 3.37% for the year ended December 31, 2016 compared with 3.46% for the same period in the prior year. The increase in net interest income was due primarily to interest income from the loan portfolio, as the year-to-date average commercial loan balance increased \$77.6 million when compared to the prior year. The decline in interest margin was a result of the commercial loan portfolio repricing to current market rates. The yield on average interest-earning assets decreased 10 basis points, while the cost of interest-bearing deposits remained flat. The decline in the yield of interest-earning assets can be mostly attributed to declines of 23 basis points in the yield of commercial loans and 17 basis points in the yield of mortgage loans, due to new production at lower competitive rates, offset by a 33 basis point increase in consumer loans, due to the indirect loan portfolio and increasing the portfolio toward higher yielding used car loans. Average interest-earning assets increased \$94.0 million compared to the prior year, primarily in commercial loans.

The following table presents net interest income for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change	
	2015	2014			
Interest and dividend income	\$54,244	\$53,213	\$1,031	1.9	%
Interest expense	3,602	3,645	(43)	(1.2)	%
Net interest income	\$50,642	\$49,568	\$1,074	2.2	%

Net interest income for the year ended December 31, 2015 totaled \$50.6 million, an increase of \$1.1 million, or 2.2%, compared with \$49.6 million for the same period in the prior year. Fully taxable equivalent net interest margin was 3.46% for the year ended December 31, 2015 compared with 3.59% for the same period in the prior year. The increase in net interest income was due primarily to interest income from the commercial loan portfolio, as the year-to-date

average commercial loan balance increased \$88.6 million when compared to the prior year. The decline in interest margin was a result of the commercial loan portfolio repricing to current market rates. The yield on average interest-earning assets and cost of average interest-bearing liabilities decreased 14 and two basis points, respectively. Average interest-earning assets increased \$78.2 million compared to the prior year, primarily in commercial loans.

## Average Consolidated Balance Sheet and Interest Analysis

The following tables present certain information related to the Corporation's average consolidated balance sheets and its consolidated statements of income for the years ended December 31, 2016, 2015 and 2014. It also reflects the average yield on interest-earning assets and average cost of interest-bearing liabilities for the years ended December 31, 2016, 2015 and 2014. For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding. Daily balances were used for average balance computations. Investment securities are stated at amortized cost. Tax equivalent adjustments have been made in calculating yields on obligations of states and political subdivisions, tax-free commercial loans and dividends on equity investments.

## AVERAGE CONSOLIDATED BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS

(in thousands)	Year Ended December 31,								
	2016			2015			2014		
	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
<b>Interest-earning assets:</b>									
Commercial loans	\$734,628	\$31,682	4.31%	\$657,038	\$29,824	4.54%	\$568,448	\$28,181	4.96%
Mortgage loans	197,132	7,689	3.90%	198,332	8,063	4.07%	195,266	8,134	4.17%
Consumer loans	262,829	10,512	4.00%	286,622	10,516	3.67%	302,665	10,947	3.62%
Taxable securities	274,401	5,245	1.91%	262,181	4,963	1.89%	267,117	5,122	1.92%
Tax-exempt securities	45,127	1,364	3.02%	43,081	1,356	3.15%	39,890	1,415	3.55%
Interest-bearing deposits	57,396	307	0.53%	30,275	76	0.25%	25,899	64	0.25%
Total interest-earning assets	1,571,513	56,799	3.61%	1,477,529	54,798	3.71%	1,399,285	53,863	3.85%
<b>Non-earning assets:</b>									
Cash and due from banks	26,708			26,959			26,653		
Premises and equipment, net	29,525			30,953			30,447		
Other assets	51,590			53,153			52,014		
Allowance for loan losses	(14,771)			(14,103)			(13,082)		
AFS valuation allowance	2,619			3,340			11,007		
Total assets	\$1,667,184			\$1,577,831			\$1,506,324		
<b>Interest-bearing liabilities:</b>									
Interest-bearing demand deposits	\$135,874	136	0.10%	\$129,442	113	0.09%	\$126,593	101	0.08%
Savings and insured money market deposits	752,489	1,457	0.19%	671,829	1,214	0.18%	585,616	988	0.17%
Time deposits	156,737	577	0.37%	182,177	676	0.37%	223,841	954	0.43%
FHLB/BNY advances, securities sold under agreements to repurchase, and other	55,472	1,669	3.01%	56,202	1,599	2.85%	56,625	1,602	2.83%

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debt									
Total interest-bearing liabilities	1,100,572	3,839	0.35%	1,039,650	3,602	0.35%	992,675	3,645	0.37%
Non-interest-bearing liabilities:									
Demand deposits	405,420			384,268			361,393		
Other liabilities	18,286			16,022			10,210		
Total liabilities	1,524,278			1,439,940			1,364,278		
Shareholders' equity	142,906			137,891			142,046		
Total liabilities and shareholders' equity	\$1,667,184			\$1,577,831			\$1,506,324		
Fully taxable equivalent net interest income		52,960			51,196			50,218	
Net interest rate spread (1)			3.26%			3.36%			3.48%
Net interest margin, fully taxable equivalent (2)			3.37%			3.46%			3.59%
Taxable equivalent adjustment		(631 )			(554 )			(650 )	
Net interest income		\$52,329			\$50,642			\$49,568	

(1) Net interest rate spread is the difference in the average yield on interest-earning assets less the average rate on interest-bearing liabilities.

(2) Net interest margin is the ratio of fully taxable equivalent net interest income divided by average interest-earning assets.

## Changes Due to Rate and Volume

Net interest income can be analyzed in terms of the impact of changes in rates and volumes. The table belows illustrates the extent to which changes in interest rates and in the volume of average interest-earning assets and interest-bearing liabilities have affected the Corporation's interest income and interest expense during the periods indicated. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rates (changes in rates multiplied by prior volume); and (iii) the net changes. For purposes of this table, changes that are not due solely to volume or rate changes have been allocated to these categories based on the respective percentage changes in average volume and rate. Due to the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes between volume and rates. In addition, average earning assets include non-accrual loans and taxable equivalent adjustments were made.

## RATE/VOLUME ANALYSIS OF NET INTEREST INCOME

(in thousands)	2016 vs. 2015			2015 vs. 2014		
	Increase/(Decrease)			Increase/(Decrease)		
	Total Change	Due to Volume	Due to Rate	Total Change	Due to Volume	Due to Rate
<b>Interest income</b>						
Commercial, agricultural and commercial mortgage loans	\$1,858	\$3,421	\$(1,563)	\$1,643	\$4,158	\$(2,515)
Mortgage loans	(374 )	(47 )	(327 )	(71 )	126	(197 )
Consumer loans	(4 )	(913 )	909	(431 )	(582 )	151
Taxable investment securities	282	230	52	(159 )	(86 )	(73 )
Tax-exempt investment securities	8	64	(56 )	(59 )	108	(167 )
Interest-bearing deposits	231	103	128	12	12	—
Total interest income	2,001	2,858	(857 )	935	3,736	(2,801 )
<b>Interest expense</b>						
Interest-bearing demand deposits	23	7	16	12	2	10
Savings and insured money market deposits	243	167	76	226	161	65
Time deposits	(99 )	(99 )	—	(278 )	(159 )	(119 )
FHLB NY advances, securities sold under agreements to repurchase and other debt	70	(21 )	91	(3 )	(13 )	10
Total interest expense	237	54	183	(43 )	(9 )	(34 )
Net interest income	\$1,764	\$2,804	\$(1,040)	\$978	\$3,745	\$(2,767)

## Provision for loan losses

Management performs an ongoing assessment of the adequacy of the allowance for loan losses based upon a number of factors including an analysis of historical loss factors, collateral evaluations, recent charge-off experience, credit quality of the loan portfolio, current economic conditions and loan growth. Based on this analysis, the provision for loan losses for the years ended December 31, 2016, 2015 and 2014 were \$2.4 million, \$1.6 million and \$4.0 million, respectively. Net charge-offs for the years ended December 31, 2016, 2015 and 2014 were \$2.4 million, \$1.0 million and \$3.1 million, respectively.





## Non-interest income

The following table presents non-interest income for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change
	2016	2015		
WMG fee income	\$8,316	\$8,522	\$(206)	(2.4)%
Service charges on deposit accounts	5,089	4,886	203	4.2%
Interchange revenue from debit card transactions	4,027	3,307	720	21.8%
Net gains on securities transactions	987	372	615	165.3%
Net gains on sales of loans held for sale	326	294	32	10.9%
Net gains (losses) on sales of other real estate owned	21	84	(63)	(75.0)%
Income from bank owned life insurance	73	75	(2)	(2.7)%
CFS fee and commission income	544	906	(362)	(40.0)%
Other	1,766	2,001	(235)	(11.7)%
Total non-interest income	\$21,149	\$20,447	\$702	3.4%

Total non-interest income for the year ended December 31, 2016 increased \$0.7 million compared to the same period in the prior year. The increase was primarily due to increases in services charges on deposit accounts, interchange revenue from debit card transactions, and net gains on securities transactions, offset by decreases in WMG fee income, CFS fee and commission income, and other non-interest income.

## WMG fee income

WMG fee income decreased compared to the same period in the prior year due to a decline in assets under management or administration from the loss of one large non-profit customer during 2016.

## Service charges on deposit accounts

Service charges on deposit accounts increased compared to the same period in the prior year due to an increase in overdraft fees.

## Net gains (losses) on securities transactions

Net gains (losses) on securities transactions increased compared to the same period in the prior year due to the sale of \$14.5 million in U.S. Treasuries and \$25.0 million in obligations of U.S. Government sponsored enterprises.

## CFS fee and commission income

CFS fee and commission income decreased compared to the same period in the prior year due to a decrease in commissions from insurance annuity products.

## Other

Other non-interest income decreased due to rental income from OREO properties, which were sold in 2016.



The following table presents non-interest income for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change	
	2015	2014			
WMG fee income	\$8,522	\$7,747	\$775	10.0	%
Service charges on deposit accounts	4,886	5,281	(395)	(7.5)	%
Interchange from debit card transactions	3,307	3,360	(53)	(1.6)	%
Net gains on securities transactions	372	6,869	(6,497)	(94.6)	%
Net gains on sales of loans held for sale	294	301	(7)	(2.3)	%
Net gains (losses) on sales of other real estate owned	84	(64)	148	N/M	
Income from bank owned life insurance	75	78	(3)	(3.8)	%
CFS fee and commission income	906	830	76	9.2	%
Other	2,001	2,354	(353)	(15.0)	%
Total non-interest income	\$20,447	\$26,756	\$(6,309)	(23.6)	%

Total non-interest income for year ended December 31, 2015 decreased \$6.3 million compared with the same period in the prior year. The decrease was primarily due to decreases in service charges on deposit accounts, net gains on securities transactions, and other non-interest income, offset by an increase in WMG fee income and net gains on sales of other real estate owned.

#### WMG fee income

WMG fee income increased compared to the same period in the prior year due to an increase in fee levels, as fees were adjusted to reflect current market fee levels, offset by a decline in total assets under management or administration.

#### Service charges on deposit accounts

Service charges on deposit accounts decreased compared to the same period in the prior year due to a decline in overdraft fees.

#### Net gains (losses) on securities transactions

Net gains (losses) on securities transactions decreased compared to the same period in the prior year due to the \$6.4 million gain on the sale of equity securities during the prior year.

#### CFS fee and commission income

CFS fee and commission income increased compared to the same period in the prior year due to an increase in commissions from insurance annuity products.

#### Other

Other non-interest income decreased due to a decline in gains on stock donations to charitable organizations and other non-interest income, offset by additional rental income in 2015 from properties included within OREO.



## Non-interest expense

The following table presents non-interest expense for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change	
	2016	2015			
Compensation expense:					
Salaries and wages	\$20,954	\$21,223	\$(269 )	(1.3 )	%
Pension and other employee benefits	6,132	5,908	224	3.8	%
Total compensation expense	27,086	27,131	(45 )	(0.2 )	%
Non-compensation expense:					
Net occupancy	6,837	7,006	(169 )	(2.4 )	%
Furniture and equipment	2,967	2,979	(12 )	(0.4 )	%
Data processing	6,593	6,586	7	0.1	%
Professional services	2,175	1,293	882	68.2	%
Legal accruals and settlements	1,200	—	1,200	N/M	
Amortization of intangible assets	986	1,136	(150 )	(13.2 )	%
Marketing and advertising	877	899	(22 )	(2.4 )	%
Other real estate owned expense	180	812	(632 )	(77.8 )	%
FDIC insurance	1,193	1,075	118	11.0	%
Loan expense	669	693	(24 )	(3.5 )	%
Other	5,847	5,817	30	0.5	%
Total non-compensation expense	29,524	28,296	1,228	4.3	%
Total non-interest expense	\$56,610	\$55,427	\$1,183	2.1	%

Total non-interest expense for the year ended December 31, 2016 increased \$1.2 million compared with the prior year. The increase was primarily due to an increase in non-compensation expense related to the establishment of a \$1.2 million legal reserve in the current year.

## Compensation expense

Compensation expense decreased compared to the same period in the prior year due to a decrease in salaries and wages, offset by an increase in pension and other employee benefits. The decrease in salaries and wages was primarily due to a reduction in full-time equivalent employees. The \$0.2 million increase in pension and other employee benefits was primarily due to an increase in health insurance costs, offset by a \$0.3 million curtailment gain related to the amendment of the defined benefit health care plan during the fourth quarter of the current year.

## Non-compensation expense

Non-compensation expense increased compared to the same period in the prior year primarily due increases in professional services and legal accruals and settlements, offset by decreases in net occupancy expenses, amortization of intangible assets, and other real estate owned expenses. The increase in professional services can be mostly attributed to expenses incurred related to the feasibility and implementation of CRM, consulting costs associated with the conversion of the Corporation's debit cards to MasterCard, and legal costs associated with the appeal of the Fane v. Chemung Canal Trust Company decision. The increase in legal accruals and settlements can be attributed to the establishment of a \$1.2 million legal reserve associated with the Fane v. Chemung Canal Trust Company case. Please

refer to Footnote 15 for further discussion of the Fane v. Chemung Canal case. The decrease in net occupancy expenses can be attributed to the closure of the branch office at 202 East State Street in Ithaca, NY during the second quarter of 2016. The decrease in other real estate owned expenses can be attributed to the sale of properties in 2016.

The following table presents non-interest expense for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change	
	2015	2014			
Compensation expense:					
Salaries and wages	\$21,223	\$21,315	\$(92)	(0.4)	%
Pension and other employee benefits	5,908	5,733	175	3.1	%
Total compensation expense	27,131	27,048	83	0.3	%
Non-compensation expense:					
Net occupancy	7,006	7,098	(92)	(1.3)	%
Furniture and equipment	2,979	2,972	7	0.2	%
Data processing	6,586	6,393	193	3.0	%
Professional services	1,293	1,597	(304)	(19.0)	%
Legal settlements	—	4,250	(4,250)	(100.0)	%
Amortization of intangible assets	1,136	1,310	(174)	(13.3)	%
Marketing and advertising	899	1,079	(180)	(16.7)	%
Other real estate owned expense	812	247	565	228.7	%
FDIC insurance	1,075	1,116	(41)	(3.7)	%
Loan expense	693	811	(118)	(14.5)	%
Merger and acquisition expenses	—	115	(115)	(100.0)	%
Other	5,817	6,441	(624)	(9.7)	%
Total non-compensation expense	28,296	33,429	(5,133)	(15.4)	%
Total non-interest expense	\$55,427	\$60,477	\$(5,050)	(8.4)	%

Total non-interest expense for the year ended December 31, 2015 decreased \$5.1 million compared with the same period in the prior year. The decrease was primarily due to a decrease in non-compensation expense related to the \$4.3 million legal settlement in the the prior year.

#### Compensation expense

Compensation expense increased compared to the same period in the prior year due to an increase in pension and other employee benefits, offset by a decrease in salaries and wages. The \$0.2 million increase in pension and other employee benefits was due to the adoption of updated mortality tables in 2015, which reflected improved life expectancies of employees and a reduced discount rate for determining pension costs. The decrease in salaries and wages was due to a reduction in full-time equivalent employees.

#### Non-compensation expense

Non-compensation expense decreased compared to the same period in the prior year primarily due to the legal settlement that occurred in 2014, related to the Bank's WMG, offset by increases in data processing expense and OREO expenses. The increase in data processing expense was primarily due to check card expense and data communication lines expense, while the increase in OREO expenses was due to two properties being carried in OREO for the entire year, along with a fair market value adjustment to one property.





## Income tax expense

The following table presents income tax expense and the effective tax rate for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change	
	2016	2015			
Income before income tax expense	\$ 14,431	\$ 14,091	\$ 340	2.4	%
Income tax expense	\$ 4,404	\$ 4,658	\$ (254 )	(5.5 )	%
Effective tax rate	30.5	% 33.1	%		

The decrease in the effective tax rate can be attributed to the formation of CRM in 2016 and increasing the utilization of the the Bank's real estate investment trust during the current year.

The following table presents income tax expense and the effective tax rate for the periods indicated, and the dollar and percent change (in thousands):

	Years Ended December 31,		Change	Percentage Change	
	2015	2014			
Income before income tax expense	\$ 14,091	\$ 11,866	\$ 2,225	18.8	%
Income tax expense	\$ 4,658	\$ 3,709	\$ 949	25.6	%
Effective tax rate	33.1	% 31.3	%		

The increase in the effective tax rate can be attributed to higher pre-tax income and changes in the mix of income and expense subject to U.S. federal, state, and local income taxes.

## Financial Condition

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

	December 31, 2016	December 31, 2015	Change	Percentage Change	
<b>Assets</b>					
Total cash and cash equivalents	\$74,162	\$26,185	\$47,977	183.2	%
Total investment securities, FHLB, and FRB stock	312,148	354,183	(42,035 )	(11.9 )	%
<b>Loans, net of deferred loan fees</b>					
Loans, net of deferred loan fees	1,200,290	1,168,633	31,657	2.7	%
Allowance for loan losses	(14,253 )	(14,260 )	7	—	%
Loans, net	1,186,037	1,154,373	31,664	2.7	%
<b>Goodwill and other intangible assets, net</b>					
Goodwill and other intangible assets, net	24,769	25,755	(986 )	(3.8 )	%
Other assets	60,063	59,468	595	1.0	%
Total assets	\$1,657,179	\$1,619,964	\$37,215	2.3	%
<b>Liabilities and Shareholders' Equity</b>					
Total deposits	\$1,456,343	\$1,400,295	\$56,048	4.0	%
FHLBNY advances and other debt	41,421	64,429	(23,008 )	(35.7 )	%
Other liabilities	15,667	17,998	(2,331 )	(13.0 )	%
Total liabilities	1,513,431	1,482,722	30,709	2.1	%
Total shareholders' equity	143,748	137,242	6,506	4.7	%
Total liabilities and shareholders' equity	\$1,657,179	\$1,619,964	\$37,215	2.3	%

## Cash and cash equivalents

The increase in cash and cash equivalents can be attributed to maturities, pay-downs, and the sale of available for sale securities and an increase in deposits, offset by an increase in total loans and the pay down of FHLB overnight advances.

## Investment securities

The decrease in investment securities can be mostly attributed to the sale of \$14.5 million in U.S. treasuries in the first quarter and \$25.0 million obligations of U.S. Government sponsored enterprises in the third and fourth quarters, along with \$89.8 million in calls and maturities of U.S. Government sponsored enterprises and pay-downs on mortgage-backed securities, and an unrealized loss of \$7.2 million for year-to-date 2016, offset by additional purchases of \$1.8 million in obligations of states and political subdivisions and \$94.7 million in mortgaged-backed securities.

## Loans, net

The increase in total loans can be attributed to increases of \$62.2 million in commercial mortgages and \$2.7 million in residential mortgages, offset by decreases in commercial and agriculture of \$16.7 million, indirect consumer of \$11.8 million, and other consumer of \$4.8 million. The increase in the commercial loan portfolio is primarily from the Capital Bank Division, while the decline in the indirect loan portfolio can be attributed to the run off of promotional interest rates.

Goodwill and other intangible assets, net

The decrease in goodwill and other intangible assets, net can be attributed to amortization of other intangible assets. There were no impairments of goodwill or other intangible assets during the years ended December 31, 2016 and 2015.

#### Other assets

The increase in other assets can be mostly attributed to the amendment of the noncontributory defined benefit pension plan and defined benefit health care plan, which resulted in a pension asset of \$1.8 million, compared to a pension liability of \$3.8 million in the prior year, offset by the sale of one OREO property in 2016 for \$1.5 million.

#### Deposits

The increase in deposits can be attributed to increases of \$51.3 million in money market accounts, \$15.6 million in non-interest-bearing demand deposits, \$6.2 million in interest-bearing demand deposits, and \$4.9 million in savings deposits. These items were offset by a \$22.0 million decrease in time deposits. The changes in money market accounts and demand deposits can be attributed to the net inflow of deposits from municipal clients, as well as new municipal client relationships.

#### FHLBNY advances and other debt

FHLBNY overnight advances were paid off with the increase in deposits received from municipal clients and FHLBNY term advances were reduced by normal scheduled payments. Offsetting the reduction in advances was an additional capital lease obligation related to the relocation of the Clifton Park, NY branch to a new location.

#### Other liabilities

The decrease in other liabilities can be mostly attributed to the amendment of the noncontributory defined benefit pension plan and defined benefit health care plan, which resulted in a pension asset of \$1.8 million, compared to a pension liability of \$3.8 million in the prior year, offset by the establishment of a \$1.2 million legal reserve associated with the Fane v. Chemung Canal Trust Company case. Please refer to Footnote 15 for further discussion of the Fane v. Chemung Canal case.

#### Shareholders' equity

The increase in shareholders' equity was primarily due to earnings of \$10.0 million, a reduction of \$1.1 million in treasury stock, and a decrease of \$0.2 million in accumulated other comprehensive loss, offset by \$4.9 million in dividends declared.

#### Assets under management or administration

The market value of total assets under management or administration in our WMG was \$1.721 billion, including \$294.9 million of assets held under management or administration for the Corporation, at December 31, 2016 compared with \$1.856 billion, including \$304.1 million of assets held under management or administration for the Corporation, at December 31, 2015, a decrease of \$134.5 million, or 7.3%. The decrease in market value can be mostly attributed to the loss of one large non-profit customer during the first quarter of 2016.

## Balance Sheet Comparisons

The table below contains selected average balance sheet information for each year in the six-year period ended December 31, 2016 (in millions):

## SELECTED AVERAGE BALANCE SHEET INFORMATION

Average Balance Sheet	2016	2015	2014	2013	2012	2011	% Change 2015 to 2016	Compounded Annual Growth 5 Years
Total Assets	\$1,667.2	\$1,577.8	\$1,506.3	\$1,306.4	\$1,253.7	\$1,175.0	5.7 %	7.2 %
Earning Assets (1)	1,571.5	1,477.5	1,399.3	1,209.7	1,150.4	1,078.4	6.4 %	7.8 %
Loans (2)	1,194.6	1,142.0	1,066.4	942.9	844.2	741.0	4.6 %	10.0 %
Investments (3)	376.9	335.5	332.9	266.8	306.2	337.4	12.3 %	2.2 %
Deposits	1,450.5	1,367.7	1,297.4	1,092.8	1,045.0	967.1	6.1 %	8.4 %
Borrowings (4)	55.5	56.2	56.7	69.5	70.7	81.3	(1.2) %	(7.4) %
Shareholders' Equity	142.9	137.9	142.0	134.3	131.1	120.2	3.6 %	3.5 %

(1) Average earning assets include securities available for sale and securities held to maturity based on amortized cost, loans and loans held for sale net of deferred loan fees, interest-bearing deposits, FHLB NY stock, FRB NY stock and federal funds sold.

(2) Average loans and loans held for sale, net of deferred loan fees.

(3) Average balances for investments include securities available for sale and securities held to maturity, based on amortized cost, FHLB NY stock, FRB NY stock, federal funds sold and interest-bearing deposits.

(4) Average borrowings include FHLB NY advances, securities sold under agreements to repurchase and capitalized lease obligations.

The table below contains selected period-end balance sheet information for each year in the six-year period ended December 31, 2016 (in millions):

## SELECTED PERIOD-END BALANCE SHEET INFORMATION

Ending Balance Sheet	2016	2015	2014	2013	2012	2011	% Change 2015 to 2016	Compounded Annual Growth 5 Years
Total Assets	\$1,657.2	\$1,620.0	\$1,524.5	\$1,476.1	\$1,248.2	\$1,216.3	2.3 %	6.4 %
Earning Assets (1)	1,558.8	1,525.2	1,415.1	1,373.6	1,155.7	1,116.3	2.2 %	6.9 %
Loans (2)	1,200.7	1,169.7	1,122.2	996.6	894.6	797.3	2.7 %	8.5 %
Allowance for loan losses	14.3	14.3	13.7	12.8	10.4	9.7	— %	8.1 %
Investments (3)	358.1	355.5	292.9	377.0	261.2	319.4	0.7 %	2.3 %
Deposits	1,456.3	1,400.3	1,280.0	1,266.3	1,047.5	1,001.1	4.0 %	7.8 %
Borrowings (4)	41.4	64.4	82.8	57.9	59.9	80.5	(35.7) %	(12.5) %
Shareholders' Equity	143.7	137.2	133.6	138.6	131.1	125.9	4.7 %	2.7 %

(1) Earning assets include securities available for sale, at estimated fair value and securities held to maturity based on amortized cost, loans and loans held for sale net of deferred loan fees, interest-bearing deposits, FHLB NY stock, FRB NY stock and federal funds sold.

(2) Loans and loans held for sale, net of deferred loan fees.

- (3) Investments include securities available for sale, at estimated fair value, securities held to maturity, at amortized cost, FHLBNY stock, FRBNY stock, federal funds sold and interest-bearing deposits.
- (4) Borrowings include FHLBNY advances, securities sold under agreements to repurchase and capitalized lease obligations.

## Cash and Cash Equivalents

Total cash and cash equivalents increased \$48.0 million since December 31, 2015, due to increases of \$3.3 million in cash and due from financial institutions and \$44.7 million in interest-bearing deposits in other financial institutions.

## Securities

The Corporation's Funds Management Policy includes an investment policy that in general, requires debt securities purchased for the bond portfolio to carry a minimum agency rating of "A". After an independent credit analysis is performed, the policy also allows the Corporation to purchase local municipal obligations that are not rated. The Corporation intends to maintain a reasonable level of securities to provide adequate liquidity and in order to have securities available to pledge to secure public deposits, repurchase agreements and other types of transactions. Fluctuations in the fair value of the Corporation's securities relate primarily to changes in interest rates.

Marketable securities are classified as Available for Sale, while investments in local municipal obligations are generally classified as Held to Maturity. The composition of the available for sale segment of the securities portfolio is summarized in the table as follows (in thousands):

## SECURITIES AVAILABLE FOR SALE

	December 31, 2016				December 31, 2015			
	Amortized Cost	Unrealized Gains (Losses)	Estimated Fair Value	Percent of Total Estimated Fair Value	Amortized Cost	Unrealized Gains (Losses)	Estimated Fair Value	Percent of Total Estimated Fair Value
Obligations of U.S. Government	\$—	\$—	\$—	— %	\$14,507	\$ 277	\$14,784	4.3 %
Obligations of U.S. Government sponsored enterprises	17,300	155	17,455	5.8 %	84,923	459	85,382	24.8 %
Mortgage-backed securities, residential and collateralized mortgage obligations	253,156	(7,290 )	245,866	81.0 %	199,680	(1,314 )	198,366	57.5 %
Obligations of states and political subdivisions	38,843	(103 )	38,740	12.8 %	43,695	731	44,426	12.9 %
Other securities	1,102	239	1,341	0.4 %	1,675	187	1,862	0.5 %
Totals	\$310,401	\$(6,999 )	\$303,402	100.0 %	\$344,480	\$ 340	\$344,820	100.0 %

The available for sale segment of the securities portfolio totaled \$303.4 million at December 31, 2016, a decrease of \$41.4 million, or 12.0%, from \$344.8 million at December 31, 2015. The decrease resulted primarily from the sale of \$14.5 million in U.S. treasuries in the first quarter and \$25.0 million obligations of U.S. Government sponsored enterprises in the third and fourth quarters, along with \$89.8 million in calls and maturities of U.S. Government sponsored enterprises and pay-downs on mortgage-backed securities, and an unrealized loss of \$7.2 million for year-to-date 2016, offset by additional purchases of \$1.8 million in obligations of states and political subdivisions and \$94.7 million in mortgaged-backed securities.

The held to maturity segment of the securities portfolio consists of obligations of political subdivisions in the Corporation's market areas. These securities totaled \$4.7 million at December 31, 2016, an increase of \$0.1 million from December 31, 2015, due primarily to additional purchases, offset by maturities and principal collected.





Non-marketable equity securities at December 31, 2016 include shares of FRBNY stock and FHLBNY stock, carried at their cost of \$1.7 million and \$2.3 million, respectively. The fair value of these securities is assumed to approximate their cost. The investment in these stocks is regulated by regulatory policies of the respective institutions.

The table below sets forth the carrying amounts and maturities of available for sale and held to maturity debt securities at December 31, 2016 and the weighted average yields of such securities (all yields are calculated on the basis of the amortized cost and weighted for the scheduled maturity of each security, except mortgage-backed securities which are based on the average life at the projected prepayment speed of each security) (in thousands):

#### MATURITIES AND YIELDS OF AVAILABLE FOR SALE AND HELD TO MATURITY SECURITIES

	Within One Year		After One, But Within Five Years		After Five, But Within Ten Years		After Ten Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$1,822	3.08%	\$15,633	1.74%	\$—	N/A	\$—	N/A
Mortgage-backed securities, residential	273	3.32%	164,933	1.83%	75,858	2.26%	4,802	2.59%
Obligations of states and political subdivisions	7,961	2.12%	22,409	2.09%	11,735	2.12%	360	2.21%
Time deposits with other institutions	245	0.80%	735	1.05%	—	N/A	—	N/A
Corporate bonds and notes	—	N/A	250	3.25%	—	N/A	—	N/A
SBA loan pools	—	N/A	570	2.10%	—	N/A	—	N/A
Total	\$10,301	2.29%	\$204,530	1.85%	\$87,593	2.24%	\$5,162	2.56%

Management evaluates securities for OTTI on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For the years ended December 31, 2016 and 2015, the Corporation had no OTTI charges. For the year ended December 31, 2013, the Corporation had less than \$0.1 million in OTTI charges. During the fourth quarter of 2013, the Corporation sold one CDO consisting of a pool of trust preferred securities that had an amortized cost of \$0.6 million. The CDO was sold for \$0.6 million, resulting in a slight loss. In addition to the CDO that was sold in the fourth quarter of 2013, the remaining CDO was liquidated and the Corporation recorded \$0.5 million in other income during the first quarter of 2014. The Corporation does not own any other CDOs in its investment securities portfolio. For more detailed information on OTTI, see Footnote 3, "Securities" in the Notes to Consolidated Financial Statements.

#### Loans

The Corporation has reporting systems to monitor: (i) loan originations and concentrations, (ii) delinquent loans, (iii) non-performing assets, including non-performing loans, troubled debt restructurings, other real estate owned, (iv) impaired loans, and (v) potential problem loans. Management reviews these systems on a regular basis.

The table below presents the Corporation's loan composition by segment and percentage of total loans at the end of each of the last five years (in thousands):

	LOANS									
	December 31, 2016		2015		2014		2013		2012	
	\$	%	\$	%	\$	%	\$	%	\$	%
Commercial and agricultural	\$176,561	14.7	\$193,233	16.5	\$166,406	14.8	\$145,363	14.6	\$133,851	15.0
Commercial mortgages	568,656	47.4	506,478	43.3	452,593	40.4	373,147	37.5	320,198	35.9
Residential mortgages	198,493	16.6	195,778	16.8	196,809	17.5	195,997	19.7	200,475	22.4
Indirect consumer loans	139,572	11.6	151,327	13.0	184,763	16.5	164,846	16.5	130,573	14.6
Consumer loans	117,008	9.7	121,817	10.4	121,003	10.8	116,513	11.7	108,420	12.1
Total	\$1,200,290	100.0	\$1,168,633	100.0	\$1,121,574	100.0	\$995,866	100.0	\$893,517	100.0

Portfolio loans totaled \$1.200 billion at December 31, 2016, an increase of \$31.7 million, or 2.7%, from \$1.169 billion at December 31, 2015. The increase in portfolio loans was due to strong growth of \$45.5 million, or 6.5%, in commercial loans, offset by a decrease of \$11.8 million, or 7.8%, in indirect consumer loans. The growth in commercial loans was due primarily to an increase in commercial mortgages in the Capital Bank division in the Albany, New York region. The decline in indirect consumer loans was a result of the Corporation's decision to focus the portfolio toward higher yielding indirect used car loans.

Residential mortgage loans totaled \$198.5 million at December 31, 2016, an increase of \$2.7 million, or 1.4%, from December 31, 2015. In addition, during 2016, \$13.9 million of residential mortgages were sold in the secondary market to Freddie Mac, with an additional \$1.3 million of residential mortgages sold to the State of New York Mortgage Agency.

The Corporation anticipates that future growth in portfolio loans will continue to be in commercial mortgages and commercial and industrial loans, especially within the Capital Bank division of the Bank. The table below presents the Corporation's outstanding loan balance by bank division (in thousands):

#### LOANS BY DIVISION

	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013	December 31, 2012
Chemung Canal Trust Company*	\$636,836	\$683,137	\$724,099	\$687,256	\$645,808
Capital Bank Division	563,454	485,496	397,475	308,610	247,709
Total loans	\$1,200,290	\$1,168,633	\$1,121,574	\$995,866	\$893,517

\*All loans, excluding those originated by the Capital Bank Division.

Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by changes in economic or other conditions. The Corporation's concentration policy limits consider the volume of commercial loans to any one specific industry, sponsor, and by collateral type and location. In addition, the Corporation's policy limits the volume of non-owner occupied commercial mortgages to four times total risk based capital. At December 31, 2016 and 2015, total non-owner occupied commercial real estate loans divided by total risk based capital was 351.1% and 334.7% respectively.

The Corporation also monitors specific NAICS industry classifications of commercial loans to identify concentrations greater than 10.0% of total loans. At December 31, 2016 and 2015, commercial loans to borrowers involved in the real estate, and real estate rental and leasing businesses were 43.9% and 40.6% of total loans, respectively. No other

concentration of loans existed in the commercial loan portfolio in excess of 10.0% of total loans as of December 31, 2016 and 2015.

The table below shows the maturity of only commercial and agricultural loans and commercial mortgages outstanding as of December 31, 2016. Also provided are the amounts due after one year, classified according to the sensitivity to changes in interest rates (in thousands):

	LOAN AMOUNTS CONTRACTUALLY DUE AFTER DECEMBER 31, 2016			
	After			Total
	Within	One But	After	
	One	Within	Five	
Year	Five	Years		
	Years			
Commercial and agricultural and commercial mortgages	\$68,823	\$246,650	\$429,744	\$745,217
Loans maturing with:				
Fixed interest rates	\$49,441	\$78,156	\$347,010	\$474,607
Variable interest rates	19,382	168,494	82,734	270,610
Total	\$68,823	\$246,650	\$429,744	\$745,217

#### Non-Performing Assets

Non-performing assets consist of non-accrual loans, non-accrual troubled debt restructurings and other real estate owned that has been acquired in partial or full satisfaction of loan obligations or upon foreclosure.

Past due status on all loans is based on the contractual terms of the loan. It is generally the Corporation's policy that a loan 90 days past due be placed in non-accrual status unless factors exist that would eliminate the need to place a loan in this status. A loan may also be designated as non-accrual at any time if payment of principal or interest in full is not expected due to deterioration in the financial condition of the borrower. At the time loans are placed in non-accrual status, the accrual of interest is discontinued and previously accrued interest is reversed. All payments received on non-accrual loans are applied to principal. Loans are considered for return to accrual status when they become current as to principal and interest and remain current for a period of six consecutive months or when, in the opinion of management, the Corporation expects to receive all of its contractual principal and interest. In the case of non-accrual loans where a portion of the loan has been charged off, the remaining balance is kept in non-accrual status until the entire principal balance has been recovered.

The following table summarizes the Corporation's non-performing assets, excluding purchased credit impaired loans (in thousands):

NON-PERFORMING ASSETS						
December 31,	2016	2015	2014	2013	2012	
Non-accrual loans	\$7,649	\$7,821	\$6,798	\$7,456	\$5,667	
Non-accrual troubled debt restructurings	4,394	4,411	980	1,061	365	
Total non-performing loans	12,043	12,232	7,778	8,517	6,032	
Other real estate owned	388	1,530	3,065	538	565	
Total non-performing assets	\$12,431	\$13,762	\$10,843	\$9,055	\$6,597	
Ratio of non-performing loans to total loans	1.00	% 1.05	% 0.69	% 0.86	% 0.68	%
Ratio of non-performing assets to total assets	0.75	% 0.85	% 0.71	% 0.61	% 0.53	%
Ratio of allowance for loan losses to non-performing loans	118.35	% 116.58	% 175.96	% 150.01	% 172.96	%

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Accruing loans past due 90 days or more (1)	\$ 13	\$ 18	\$ 1,454	\$ 1,473	\$ 4,484
Accruing troubled debt restructurings (1)	\$ 5,839	\$ 7,609	\$ 8,705	\$ 6,831	\$ 5,364

(1) These loans are not included in nonperforming assets above.

The table below shows interest income on non-accrual and troubled debt restructured loans for the indicated years ended December 31 (in thousands):

INTEREST INCOME ON NON-ACCRUAL AND TROUBLED DEBT RESTRUCTURED LOANS			
	2016	2015	2014
Interest income that would have been recorded under original terms	\$657	\$578	\$463
Interest income recorded during the period	\$312	\$424	\$367

#### Non-Performing Loans

Non-performing loans totaled \$12.0 million at December 31, 2016, or 1.00% of total loans, compared with \$12.2 million at December 31, 2015, or 1.05% of total loans. The decrease in non-performing loans at December 31, 2016 was primarily due to a \$1.8 million decrease in non-accruing commercial mortgages, offset by increases of \$1.0 million in non-accruing consumer loans and \$0.6 million in non-accruing residential mortgages. Non-performing assets, which are comprised of non-performing loans and other real estate owned, was \$12.4 million, or 0.75% of total assets, at December 31, 2016, compared with \$13.8 million, or 0.85% of total assets, at December 31, 2015.

The recorded investment in accruing loans past due 90 days or more totaled less than \$0.1 million at December 31, 2016, consistent with the prior year.

Not included in non-performing loan totals are \$1.4 million and \$2.1 million of acquired loans which the Corporation has identified as PCI loans at December 31, 2016 and 2015, respectively. The PCI loans are accounted for under separate accounting guidance, Accounting Standards Codification (“ASC”) Subtopic 310-30, “Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality” as disclosed in Note 4 of the financial statements.

#### Troubled Debt Restructurings

The Corporation works closely with borrowers that have financial difficulties to identify viable solutions that minimize the potential for loss. In that regard, the Corporation modified the terms of select loans to maximize their collectability. The modified loans are considered TDRs under current accounting guidance. Modifications generally involve short-term deferrals of principal and/or interest payments, reductions of scheduled payment amounts, interest rates or principal of the loan, and forgiveness of accrued interest. As of December 31, 2016, the Corporation had \$4.4 million of non-accrual TDRs compared with \$4.4 million as of December 31, 2015. As of December 31, 2016, the Corporation had \$5.8 million of accruing TDRs compared with \$7.6 million as of December 31, 2015.

#### Impaired Loans

A loan is classified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect both the principal and interest due under the contractual terms of the loan agreement. Impaired loans at December 31, 2016 totaled \$12.9 million, including TDRs of \$10.2 million, compared to \$15.0 million at December 31, 2015, including TDRs of \$12.0 million. Not included in the impaired loan totals are acquired loans which the Corporation has identified as PCI loans, as these loans are accounted for under ASC Subtopic 310-30 as noted under the above discussion of non-performing loans. The decrease in impaired loans was primarily in the commercial loan segment of the loan portfolio. Included in the recorded investment of impaired loans at December 31, 2016, are loans totaling \$2.6 million for which impairment allowances of \$0.9 million have been specifically allocated to the allowance for loan losses. As of December 31, 2015, the impaired loan total included \$5.2 million of loans for which specific impairment allowances of \$1.6 million were allocated to the allowance for loan losses. The decrease in the amount of impaired loans for which specific allowances were allocated to the allowance for loan losses was due primarily to a decrease in impaired commercial loans.



The majority of the Corporation's impaired loans are secured and measured for impairment based on collateral evaluations. It is the Corporation's policy to obtain updated appraisals, by independent third parties, on loans secured by real estate at the time a loan is determined to be impaired. An impairment measurement is performed based upon the most recent appraisal on file to determine the amount of any specific allocation or charge-off. In determining the amount of any specific allocation or charge-off, the Corporation will make adjustments to reflect the estimated costs to sell the property. Upon receipt and review of the updated appraisal, an additional measurement is performed to determine if any adjustments are necessary to reflect the proper provisioning or charge-off. Impaired loans are reviewed on a quarterly basis to determine if any changes in credit quality or market conditions would require any additional allocation or recognition of additional charge-offs. Real estate values in the Corporation's market area have been holding steady. Non-real estate collateral may be valued using (i) an appraisal, (ii) net book value of the collateral per the borrower's financial statements, or (iii) accounts receivable aging reports, that may be adjusted based on management's knowledge of the client and client's business. If market conditions warrant, future appraisals are obtained for both real estate and non-real estate collateral.

#### Allowance for Loan Losses

The allowance is an amount that management believes will be adequate to absorb probable incurred losses on existing loans. The allowance is established based on management's evaluation of the probable inherent losses in our portfolio in accordance with GAAP, and is comprised of both specific valuation allowances and general valuation allowances.

A loan is classified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect both the principal and interest due under the contractual terms of the loan agreement. Specific valuation allowances are established based on management's analyses of individually impaired loans. Factors considered by management in determining impairment include payment status, evaluations of the underlying collateral, expected cash flows, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. If a loan is determined to be impaired and is placed on non-accrual status, all future payments received are applied to principal and a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. Loans not impaired but classified as substandard and special mention use a historical loss factor on a rolling five year history of net losses. For all other unclassified loans, the historical loss experience is determined by portfolio class and is based on the actual loss history experienced by the Corporation over the most recent two years. This actual loss experience is supplemented with other qualitative factors based on the risks present for each portfolio class. These qualitative factors include consideration of the following: (1) lending policies and procedures, including underwriting standards and collection, charge-off and recovery policies, (2) national and local economic and business conditions and developments, including the condition of various market segments, (3) loan profiles and volume of the portfolio, (4) the experience, ability, and depth of lending management and staff, (5) the volume and severity of past due, classified and watch-list loans, non-accrual loans, troubled debt restructurings, and other modifications (6) the quality of the Bank's loan review system and the degree of oversight by the Bank's Board of Directors, (7) collateral related issues: secured vs. unsecured, type, declining valuation environment and trend of other related factors, (8) the existence and effect of any concentrations of credit, and changes in the level of such concentrations, (9) the effect of external factors, such as competition and legal and regulatory requirements, on the level of estimated credit losses in the Bank's current portfolio and (10) the impact of the global economy.



The allowance for loan losses is increased through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses when management believes that the collectability of all or a portion of the principal is unlikely. Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as the credit risk grade assigned to the loan, historical loan loss experience and review of specific impaired loans. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

The allowance for loan losses was \$14.3 million at December 31, 2016, compared to \$14.3 million at December 31, 2015. The ratio of allowance for loan losses to total loans was 1.19% at December 31, 2016 and 1.22% at December 31, 2015, respectively. Net charge-offs for the years ended December 31, 2016 and 2015 were \$2.4 million and \$1.0 million, respectively.

The table below summarizes the Corporation's allocation of the allowance for loan losses and percent of loans by category to total loans for each year in the five-year period ended December 31, 2016 (in thousands):

## ALLOCATION OF ALLOWANCE FOR LOAN LOSSES

Balance at end of period applicable to:	2016	%	2015	%	2014	%	2013	%	2012	%
Commercial and agricultural	\$1,589	14.7	\$1,831	16.5	\$1,460	14.8	\$1,979	14.6	\$1,708	15.0
Commercial mortgages	7,270	47.4	7,112	43.3	6,326	40.4	6,243	37.5	4,428	35.9
Residential mortgages	1,523	16.6	1,464	16.8	1,572	17.5	1,517	19.7	1,565	22.4
Consumer loans	3,871	21.3	3,853	23.4	4,328	27.3	3,037	28.2	2,706	26.7
	14,253	100.0	14,260	100.0	13,686	100.0	12,776	100.0	10,407	100.0
Unallocated	—		—		—		—		26	
Total	\$14,253		\$14,260		\$13,686		\$12,776		\$10,433	

The table below summarizes the Corporation's loan loss experience for each year in the five-year period ended December 31, 2016 (in thousands, except ratio data):

## SUMMARY OF LOAN LOSS EXPERIENCE

	Years Ended December 31,					
	2016	2015	2014	2013	2012	
Allowance for loan losses at beginning of year	\$14,260	\$13,686	\$12,776	\$10,433	\$9,659	
Reclassification of acquired loan discount	—	—	—	—	124	
Charge-offs:						
Commercial and agricultural	217	186	444	186	181	
Commercial mortgages	911	104	2,229	44	335	
Residential mortgages	65	47	97	124	83	
Consumer loans	1,637	1,294	1,508	1,139	674	
Total	2,830	1,631	4,278	1,493	1,273	
Recoveries:						
Commercial and agricultural	92	96	385	537	802	
Commercial mortgages	10	131	156	98	55	
Residential mortgages	—	—	32	65	—	
Consumer loans	284	407	634	381	238	
Total	386	634	1,207	1,081	1,095	
Net charge-offs	2,444	997	3,071	412	178	
Provision charged to operations	2,437	1,571	3,981	2,755	828	
Allowance for loan losses at end of year	\$14,253	\$14,260	\$13,686	\$12,776	\$10,433	
Ratio of net charge-offs during year to average loans outstanding	0.20	% 0.09	% 0.29	% 0.04	% 0.02	%
Ratio of allowance for loan losses to total loans outstanding	1.19	% 1.22	% 1.22	% 1.28	% 1.17	%

Net charge-offs for December 31, 2016 were \$2.4 million compared with \$1.0 million for December 31, 2015. The ratio of net charge-offs to average loans outstanding was 0.20% for 2016 compared to 0.09% for 2015. The increase in net charge-offs can be attributed to the write-off of specifically reserved commercial loans during the current year.



## Other Real Estate Owned

At December 31, 2016, OREO totaled \$0.4 million compared to \$1.5 million at December 31, 2015. The decrease in other real estate owned was due primarily to the sale of one commercial property for \$1.5 million.

## Other Assets

The \$0.6 million increase in other assets was due primarily to the amendment of the noncontributory defined benefit pension plan and defined benefit health care plan, which resulted in a pension asset of \$1.8 million, compared to a pension liability of \$3.8 million in the prior year, offset by the sale of one OREO property in 2016 for \$1.5 million.

## Deposits

The table below summarizes the Corporation's deposit composition by segment for the periods indicated, and the dollar and percent change from December 31, 2015 to December 31, 2016 (in thousands):

## DEPOSITS

	December 31, 2016	December 31, 2015	Dollar Change	Percentage Change	
Non-interest-bearing demand deposits	\$417,812	\$402,236	\$15,576	3.9	%
Interest-bearing demand deposits	136,826	130,573	6,253	4.8	%
Insured money market accounts	548,963	497,658	51,305	10.3	%
Savings deposits	208,636	203,749	4,887	2.4	%
Time deposits	144,106	166,079	(21,973)	(13.2)	%
Total	\$1,456,343	\$1,400,295	\$56,048	4.0	%

Deposits totaled \$1.456 billion at December 31, 2016, compared with \$1.400 billion at December 31, 2015, an increase of \$56.0 million, or 4.0%. At December 31, 2016, demand deposit and money market accounts comprised 75.8% of total deposits compared with 73.6% at December 31, 2015. Sorted by public, commercial, consumer and broker sources, the growth in deposits was due primarily to increases of \$38.7 million in brokered, \$5.0 million in commercial deposits, and \$25.5 million in consumer, offset by a decrease of \$13.2 million in public deposit accounts.

The table below presents the Corporation's deposits balance by bank division (in thousands):

## DEPOSITS BY DIVISION

	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013	December 31, 2012
Chemung Canal Trust Company*	\$1,249,870	\$1,219,282	\$1,119,377	\$1,097,920	\$888,181
Capital Bank Division	206,473	181,013	160,637	168,336	159,316
Total loans	\$1,456,343	\$1,400,295	1,280,014	\$1,266,256	\$1,047,497

\*All deposits, excluding those originated by the Capital Bank Division.

Brokered deposits include funds obtained through brokers, and the Bank's participation in CDARS and ICS programs. The CDARS and ICS programs involve a network of financial institutions that exchange funds among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution. The Corporation had no deposits obtained through brokers as of December 31, 2016 and 2015. Deposits obtained through the CDARS and ICS programs were \$203.7 million and \$165.0 million as of December 31, 2016 and 2015, respectively. The increase in CDARS and ICS deposits was due to

the Corporation offering the programs to local municipalities.

The Corporation's deposit strategy is to fund the Bank with stable, low-cost deposits, primarily checking account deposits and other low interest-bearing deposit accounts. A checking account is the driver of a banking relationship and consumers consider the bank where they have their checking account as their primary bank. These customers will typically turn to their primary bank first when in need of other financial services. Strategies that have been developed and implemented to generate these deposits include: (i) acquire deposits by entering new markets through de novo branching, (ii) an annual checking account marketing campaign, (iii) training branch employees to identify and meet client financial needs with Bank products and services, (iv) link business and consumer loans to a primary checking account at the Bank, (v) aggressively promote direct deposit of client's payroll checks or benefit checks and (vi) constantly monitor the Corporation's pricing strategies to ensure competitive products and services.

The Corporation also considers brokered deposits to be an element of its deposit strategy and anticipates that it will continue using brokered deposits as a secondary source of funding to support growth.

Information regarding deposits is included in Note 7 to the consolidated financial statements appearing elsewhere in this report.

#### Borrowings

FHLB NY advances decreased \$24.0 million to \$9.1 million at December 31, 2016 from \$33.1 million at December 31, 2015. FHLB NY overnight advances decreased \$13.9 million during 2016 while FHLB NY term advances decreased \$10.1 million.

For each of the three years ended December 31, 2016, 2015 and 2014, respectively, the average outstanding balance of borrowings that mature in one year or less did not exceed 30% of shareholders' equity.

Information regarding securities sold under agreements to repurchase and FHLB NY advances is included in Footnotes 8 and 9 to the consolidated financial statements appearing elsewhere in this report.

#### Derivatives

The Corporation offers interest rate swap agreements to qualified commercial loan customers. These agreements allow the Corporation's customers to effectively fix the interest rate on a variable rate loan by entering into a separate agreement. Simultaneous with the execution of such an agreement with a customer, the Corporation enters into a matching interest rate swap agreement with an unrelated third party provider, which allows the Corporation to continue to receive the variable rate under the loan agreement with the customer. The agreement with the third party is not designated as a hedge contract, therefore changes in fair value are recorded through other non-interest income. Assets and liabilities associated with the agreements are recorded in other assets and other liabilities on the balance sheet. Gains and losses are recorded as other non-interest income. The Corporation is exposed to credit loss equal to the fair value of the interest rate swaps, not the notional amount of the derivatives, in the event of nonperformance by the counterparty to the interest rate swap agreements. Additionally, the swap agreements are free-standing derivatives and are recorded at fair value in the Corporation's consolidated balance sheets, which typically involves a day one gain. Since the terms of the two interest rate swap agreements are identical, the income statement impact to the Corporation is limited to the day one gain and an allowance for credit loss exposure, in the event of nonperformance. The Corporation recognized \$0.1 million in swap fee income for the years ended in December 31, 2016 and 2015. The Corporation also participates in the credit exposure of certain interest rate swaps in which it participates in the related commercial loan. The Corporation receives an upfront fee for participating in the credit exposure of the interest rate swap and recognizes the fee to other non-interest income immediately. The Corporation is exposed to its share of the credit loss equal to the fair value of the derivatives in the event of nonperformance by the counterparty of the interest rate swap. The Corporation determines the fair value of the credit loss exposure using historical losses of the

loan category associated with the credit exposure.

Information regarding derivatives is included in Note 10 to the consolidated financial statements appearing elsewhere in this report.

#### Shareholders' Equity

Total shareholders' equity was \$143.7 million at December 31, 2016, compared with \$137.2 million at December 31, 2015, a increase of \$6.5 million, or 4.7%. The increase was due primarily to earnings of \$10.0 million, a reduction of \$1.1 million in treasury stock, and a decrease of \$0.2 million in accumulated other comprehensive income, offset \$4.9 million in dividends declared. The total shareholders' equity to total assets ratio was 8.67% at December 31, 2016 compared with 8.47% at December 31, 2015. Tangible equity to tangible assets ratio increased to 7.29% at December 31, 2016, from 6.99% at December 31, 2015.

The Corporation and the Bank are subject to capital adequacy guidelines of the Federal Reserve which establish a framework for the classification of financial holding companies and financial institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. As of December 31, 2016, both the Corporation's and the Bank's capital ratios were in excess of those required to be considered well-capitalized under regulatory capital guidelines. A comparison of the Corporation's and the Bank's actual capital ratios to the ratios required to be adequately or well-capitalized at December 31, 2016 and 2015, is included in Footnote 18 to the consolidated financial statements appearing elsewhere in this report. For more information regarding current capital regulations see Part I—"Business-Supervision and Regulation-Regulatory Capital Requirements."

Cash dividends declared during 2016 totaled \$4.9 million or \$1.04 per share, and cash dividends declared during both 2015 and 2014 totaled \$4.8 million, or \$1.04 per share. Dividends declared during 2016 amounted to 48.76% of net income compared to 51.34%, and 58.80% of net income for 2015 and 2014, respectively. Management seeks to continue generating sufficient capital internally, while continuing to pay dividends to the Corporation's shareholders.

When shares of the Corporation become available in the market, the Corporation may purchase them after careful consideration of the Corporation's liquidity and capital positions. Purchases may be made from time to time on the open market or in privately negotiated transactions at the discretion of management. On December 19, 2012, the Board of Directors approved a new stock repurchase plan under which the Corporation may repurchase up to 125,000 shares. No shares were purchased under the new plan in 2016 and 2015. The Corporation has purchased 3,094 shares at a total cost of \$93 thousand under the new plan since its inception.

#### Off-balance Sheet Arrangements

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

The table below shows the Corporation's off-balance sheet arrangements as of December 31, 2016 (in thousands):

#### COMMITMENT MATURITY BY PERIOD

	Total	2017	2018 - 2019	2020 - 2021	2022 and thereafter
Standby letters of credit	\$ 14,241	\$ 12,609	\$ 293	\$ 1,339	\$ —
Unused portions of lines of credit (1)	143,576	143,576	—	—	—
Commitments to fund new loans	71,435	71,435	—	—	—
Total	\$ 229,252	\$ 227,620	\$ 293	\$ 1,339	\$ —

(1) Not included in this total are unused portions of home equity lines of credit, credit card lines and consumer overdraft protection lines of credit, since no contractual maturity dates exist for these types of loans. Commitments to outside parties under these lines of credit were \$46.3 million, \$12.5 million and \$6.3 million, respectively, at December 31, 2016.





## Contractual Obligations

The table below shows the Corporation's contractual obligations under long-term agreements as of December 31, 2016 (in thousands). Note references are to the Notes of the Consolidated Financial Statements:

## CONTRACTUAL OBLIGATIONS

	Total	Payments Due by Period			
		2017	2018 - 2019	2020 - 2021	2022 and thereafter
Time Deposits (Note 7)	\$144,106	\$97,706	\$35,840	\$8,565	\$ 1,995
FHLBNY advances (Note 9)	9,000	7,000	2,000	—	—
Securities sold under agreements to repurchase (Note 8)	27,606	17,606	10,000	—	—
Operating leases (Note 5)	7,641	1,193	2,028	1,022	3,398
Capital leases (Note 5)	6,287	367	734	764	4,422
Data processing services and other	4,274	1,525	2,393	356	—
Total (1)	\$198,914	\$125,397	\$52,995	\$10,707	\$ 9,815

(1) Not included in the above total is the Corporation's obligation regarding the Pension Plan and Other Benefit Plans. Please refer to Part IV Item 15 Note 12 for information regarding these obligations at December 31, 2016.

## Liquidity

Liquidity management involves the ability to meet the cash flow requirements of deposit clients, borrowers, and the operating, investing and financing activities of the Corporation. The Corporation uses a variety of resources to meet its liquidity needs. These include short term investments, cash flow from lending and investing activities, core-deposit growth and non-core funding sources, such as time deposits of \$100,000 or more, securities sold under agreements to repurchase and other borrowings.

The Corporation is a member of the FHLBNY which allows it to access borrowings which enhance management's ability to satisfy future liquidity needs. Based on available collateral and current advances outstanding, the Corporation was eligible to borrow up to a total of \$131.6 million and \$106.2 million at December 31, 2016 and 2015, respectively. The Corporation also had a total of \$28.0 million of unsecured lines of credit with four different financial institutions, all of which was available at December 31, 2016 and 2015.

## Consolidated Cash Flows Analysis

The table below summarizes the Corporation's cash flows for the periods indicated (in thousands):

## CONSOLIDATED SUMMARY OF CASH FLOWS

(in thousands)	Years Ended	
	2016	2015
Net cash provided by operating activities	\$22,141	\$14,123
Net cash used by investing activities	(729 )	(114,648)
Net cash provided by financing activities	26,565	97,547
Net decrease in cash and cash equivalents	\$47,977	\$(2,978 )

Operating activities

The Corporation believes cash flows from operations, available cash balances and its ability to generate cash through short- and long-term borrowings are sufficient to fund the Corporation's operating liquidity needs.

Cash provided by operating activities in years ended 2016 and 2015 predominantly resulted from net income after non-cash operating adjustments.

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### Investing activities

Cash used in investing activities during the years ended 2016 and 2015 predominantly resulted from purchases of securities available for sale and a net increase in loans, offset by sales, calls, maturities, and principal collected on securities available for sale.

### Financing activities

Cash provided by financing activities during the years ended 2016 and 2015 predominantly resulted from an increase in deposits. The increase in deposits reflected the seasonable inflow of funds from municipal clients into demand and money market accounts. Cash inflows in 2016 were offset by a reduction of FHLB NY overnight advances and repayment of FHLB advances.

### Capital Resources

The Corporation and the Bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel III rules became effective for the Corporation on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under Basel III rules, the Corporation must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or loss on available for sale securities and changes in the funded status of the defined benefit pension plan and other benefit plans are not included in computing regulatory capital. Management believes as of December 31, 2016, the Corporation and the Bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. Management believes that, as of December 31, 2016 and 2015, the Corporation and the Bank met all capital adequacy requirements to which they were subject.

As of December 31, 2016, the most recent notification from the Federal Reserve Bank of New York categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There have been no conditions or events since that notification that management believes have changed the Bank's or the Corporation's capital category.

The regulatory capital ratios as of December 31, 2016 and 2015 were calculated under Basel III rules. There is no threshold for well-capitalized status for bank holding companies.

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The Corporation's and the Bank's actual and required regulatory capital ratios were as follows (in thousands, except ratio data):

	Actual		Minimal Capital Adequacy		Minimal Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2016								
Total Capital (to Risk Weighted Assets):								
Consolidated	\$145,269	12.14%	\$95,748	8.00%	\$103,229	8.625%	N/A	N/A
Bank	\$140,020	11.71%	\$95,640	8.00%	\$103,112	8.625%	\$119,550	10.00%
Tier 1 Capital (to Risk Weighted Assets):								
Consolidated	\$130,911	10.94%	\$71,811	6.00%	\$79,292	6.625%	N/A	N/A
Bank	\$125,736	10.52%	\$71,730	6.00%	\$79,202	6.625%	\$95,640	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets):								
Consolidated	\$130,911	10.94%	\$53,858	4.50%	\$61,339	5.125%	N/A	N/A
Bank	\$125,736	10.52%	\$53,798	4.50%	\$61,270	5.125%	\$77,708	6.50%
Tier 1 Capital (to Average Assets):								
Consolidated	\$130,911	7.81%	\$67,031	4.00%	N/A	N/A	N/A	N/A
Bank	\$125,736	7.52%	\$66,919	4.00%	N/A	N/A	\$83,649	5.00%

	Actual		Minimum Capital Adequacy		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2015						
Total Capital (to Risk Weighted Assets):						
Consolidated	\$139,049	12.26%	\$90,704	8.00%	N/A	N/A
Bank	\$135,058	11.93%	\$90,548	8.00%	\$113,185	10.00%
Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$124,787	11.01%	\$68,028	6.00%	N/A	N/A
Bank	\$120,881	10.68%	\$67,911	6.00%	\$90,548	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets):						
Consolidated	\$124,787	11.01%	\$51,021	4.50%	N/A	N/A
Bank	\$120,881	10.68%	\$50,933	4.50%	\$73,571	6.50%
Tier 1 Capital (to Average Assets):						
Consolidated	\$124,787	7.83%	\$63,772	4.00%	N/A	N/A
Bank	\$120,881	7.59%	\$63,701	4.00%	\$79,626	5.00%

#### Dividend Restrictions

The Corporation's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net income, combined with the retained net income of the preceding two years, subject to the capital requirements in the table above. At December 31, 2016, the Bank could, without prior approval, declare dividends of approximately \$15.2 million.

Adoption of New Accounting Standards

For a discussion of the impact of recently issued accounting standards, please see Note 1 to the Corporation's consolidated financial statements which begins on page F-9.

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### Critical Accounting Policies, Estimates and Risks and Uncertainties

Critical accounting policies include the areas where the Corporation has made what it considers to be particularly difficult, subjective or complex judgments concerning estimates, and where these estimates can significantly affect the Corporation's financial results under different assumptions and conditions. The Corporation prepares its financial statements in conformity with GAAP. As a result, the Corporation is required to make certain estimates, judgments and assumptions that it believes are reasonable based upon the information available at that time. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover probable incurred credit losses inherent in the loan portfolio, and the material effect that such judgments can have on the Corporation's results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under adversely different conditions or assumptions the allowance would need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Corporation's non-performing loans and potential problem loans, and the associated evaluation of the related collateral coverage for these loans, has a significant impact on the overall analysis of the adequacy of the allowance for loan losses. Real estate values in the Corporation's market area did not increase dramatically in the prior several years, and, as a result, any declines in real estate values have been modest. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral evaluations were significantly lowered, the Corporation's allowance for loan losses policy would also require additional provisions for loan losses.

### Explanation and Reconciliation of the Corporation's Use of Non-GAAP Measures

The Corporation prepares its Consolidated Financial Statements in accordance with GAAP; these financial statements appear on pages F-2 through F-8. That presentation provides the reader with an understanding of the Corporation's results that can be tracked consistently from year-to-year and enables a comparison of the Corporation's performance with other companies' GAAP financial statements.

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

The SEC has adopted Regulation G, which applies to all public disclosures, including earnings releases, made by registered companies that contain "non-GAAP financial measures." Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure and a statement of the Corporation's reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. The SEC has exempted from the definition of "non-GAAP financial measures" certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. The following measures used in this Report, which are commonly utilized by financial institutions, have not been specifically exempted by the SEC

and may constitute "non-GAAP financial measures" within the meaning of the SEC's new rules, although we are unable to state with certainty that the SEC would so regard them.



## Fully Taxable Equivalent Net Interest Income, Net Interest Margin, and Efficiency Ratio

Net interest income is commonly presented on a tax-equivalent basis. That is, to the extent that some component of the institution's net interest income, which is presented on a before-tax basis, is exempt from taxation (e.g., is received by the institution as a result of its holdings of state or municipal obligations), an amount equal to the tax benefit derived from that component is added to the actual before-tax net interest income total. This adjustment is considered helpful in comparing one financial institution's net interest income to that of other institutions or in analyzing any institution's net interest income trend line over time, to correct any analytical distortion that might otherwise arise from the fact that financial institutions vary widely in the proportions of their portfolios that are invested in tax-exempt securities, and that even a single institution may significantly alter over time the proportion of its own portfolio that is invested in tax-exempt obligations. Moreover, net interest income is itself a component of a second financial measure commonly used by financial institutions, net interest margin, which is the ratio of net interest income to average interest-earning assets. For purposes of this measure as well, fully taxable equivalent net interest income is generally used by financial institutions, as opposed to actual net interest income, again to provide a better basis of comparison from institution to institution and to better demonstrate a single institution's performance over time. The Corporation follows these practices.

The efficiency ratio is a non-GAAP financial measure which represents the Corporation's ability to turn resources into revenue and is calculated as non-interest expense divided by total revenue (fully taxable equivalent net interest income and non-interest income), adjusted for one-time occurrences and amortization. This measure is meaningful to the Corporation, as well as investors and analysts, in assessing the Corporation's productivity measured by the amount of revenue generated for each dollar spent.

	As of or for the Years Ended		
	December 31, 2016	December 31, 2015	December 31, 2014
(in thousands, except ratio data)			
<b>NET INTEREST MARGIN - FULLY TAXABLE EQUIVALENT AND EFFICIENCY RATIO</b>			
Net interest income (GAAP)	\$52,329	\$50,642	\$49,568
Fully taxable equivalent adjustment	631	554	650
Fully taxable equivalent net interest income (non-GAAP)	\$52,960	\$51,196	\$50,218
Non-interest income (GAAP)	\$21,149	\$20,447	\$26,756
Less: net (gains) losses on security transactions	(987 )	(372 )	(6,869 )
Less: recoveries from other-than-temporary impairments	—	—	(515 )
Adjusted non-interest income (non-GAAP)	\$20,162	\$20,075	\$19,372
Non-interest expense (GAAP)	\$56,610	\$55,427	\$60,477
Less: merger and acquisition expenses	—	—	(115 )
Less: amortization of intangible assets	(986 )	(1,136 )	(1,310 )
Less: legal accruals and settlements	(1,200 )	—	(4,250 )
Adjusted non-interest expense (non-GAAP)	\$54,424	\$54,291	\$54,802
Average interest-earning assets (GAAP)	\$1,571,513	\$1,477,529	\$1,399,285
Net interest margin - fully taxable equivalent (non-GAAP)	3.37	% 3.46	% 3.59
		%	%

Efficiency ratio (non-GAAP)	74.43	%	76.18	%	78.75	%
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Tangible Equity and Tangible Assets (Period-End)

Tangible equity, tangible assets, and tangible book value per share are each non-GAAP financial measures. Tangible equity represents the Corporation's stockholders' equity, less goodwill and intangible assets. Tangible assets represents the Corporation's total assets, less goodwill and other intangible assets. Tangible book value per share represents the Corporation's equity divided by common shares at period-end. These measures are meaningful to the Corporation, as well as investors and analysts, in assessing the Corporation's use of equity.

(in thousands, except per share and ratio data)	As of or for the Years Ended			
	December 31, 2016	December 31, 2015	December 31, 2014	
<b>TANGIBLE EQUITY AND TANGIBLE ASSETS</b>				
<b>(PERIOD END)</b>				
Total shareholders' equity (GAAP)	\$ 143,748	\$ 137,242	\$ 133,628	
Less: intangible assets	(24,769 )	(25,755 )	(26,891 )	
Tangible equity (non-GAAP)	\$ 118,979	\$ 111,487	\$ 106,737	
Total assets (GAAP)	\$ 1,657,179	\$ 1,619,926	\$ 1,524,539	
Less: intangible assets	(24,769 )	(25,755 )	(26,891 )	
Tangible assets (non-GAAP)	\$ 1,632,410	\$ 1,594,171	\$ 1,497,648	
Total equity to total assets at end of period (GAAP)	8.67	% 8.47	% 8.77	%
Book value per share (GAAP)	\$30.07	\$28.96	\$28.44	
Tangible equity to tangible assets at end of period (non-GAAP)	7.29	% 6.99	% 7.13	%
Tangible book value per share (non-GAAP)	\$24.89	\$23.53	\$22.71	

#### Tangible Equity (Average)

Average tangible equity and return on average tangible equity are each non-GAAP financial measures. Average tangible equity represents the Corporation's average stockholders' equity, less average goodwill and intangible assets for the period. Return on average tangible equity measures the Corporation's earnings as a percentage of average tangible equity. These measures are meaningful to the Corporation, as well as investors and analysts, in assessing the Corporation's use of equity.

(in thousands, except ratio data)	As of or for the Years Ended			
	December 31, 2016	December 31, 2015	December 31, 2014	
<b>TANGIBLE EQUITY (AVERAGE)</b>				
Total average shareholders' equity (GAAP)	\$ 142,906	\$ 137,891	\$ 142,046	
Less: average intangible assets	(25,250 )	(26,308 )	(27,554 )	
Average tangible equity (non-GAAP)	\$ 117,656	\$ 111,583	\$ 114,492	
Return on average equity (GAAP)	7.02	% 6.84	% 5.74	%
Return on average tangible equity (non-GAAP)	8.52	% 8.45	% 7.12	%

#### Adjustments for Certain Items of Income or Expense

In addition to disclosures of certain GAAP financial measures, including net income, EPS, ROA, and ROE, we may also provide comparative disclosures that adjust these GAAP financial measures for a particular period by removing from the calculation thereof the impact of certain transactions or other material items of income or expense occurring during the period, including certain nonrecurring items. The Corporation believes that the resulting non-GAAP financial measures may improve an understanding of its results of operations by separating out any such transactions or items that may have had a disproportionate positive or negative impact on the Corporation's financial results during

the particular period in question. In the Corporation's presentation of any such non-GAAP (adjusted) financial measures not specifically discussed in the preceding paragraphs, the Corporation supplies the supplemental financial information and explanations required under Regulation G.

(in thousands, except per share and ratio data)	As of or for the Years Ended		
	December 31, 2016	December 31, 2015	December 31, 2014
<b>CORE NET INCOME</b>			
Reported net income (loss) (GAAP)	\$ 10,027	\$ 9,433	\$ 8,157
Net (gains) losses on security transactions (net of tax)	(614 )	(230 )	(4,229 )
Legal accruals and settlements (net of tax)	747	—	2,617
Merger and acquisition related expenses (net of tax)	—	—	71
Core net income (non-GAAP)	\$ 10,160	\$ 9,203	\$ 6,616
Average basic and diluted shares outstanding	4,762	4,719	4,683
Reported basic and diluted earnings (loss) per share (GAAP)	\$ 2.11	\$ 2.00	\$ 1.74
Reported return on average assets (GAAP)	0.60 %	0.60 %	0.54 %
Reported return on average equity (GAAP)	7.02 %	6.84 %	5.74 %
Core basic and diluted earnings per share (non-GAAP)	\$ 2.13	\$ 1.95	\$ 1.41
Core return on average assets (non-GAAP)	0.61 %	0.58 %	0.44 %
Core return on average equity (non-GAAP)	7.11 %	6.67 %	4.66 %

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Interest Rate Risk

Management considers interest rate risk to be the most significant market risk for the Corporation. Market risk is the risk of loss from adverse changes in market prices and rates. Interest rate risk is the exposure to adverse changes in the net income of the Corporation as a result of changes in interest rates.

The Corporation's primary earnings source is net interest income, which is affected by changes in the level of interest rates, the relationship between rates, the impact of interest rate fluctuations on asset prepayments, the level and composition of deposits and liabilities, and credit quality of earning assets.

The Corporation's objectives in its asset and liability management are to maintain a strong, stable net interest margin, to utilize its capital effectively without taking undue risks, to maintain adequate liquidity, and to reduce vulnerability of its operations to changes in interest rates. The Corporation's ALCO has the strategic responsibility for setting the policy guidelines on acceptable exposure to interest rate risk. These guidelines contain specific measures and limits regarding the risks, which are monitored on a regular basis. The ALCO is made up of the Chief Executive Officer, the Chief Financial Officer, the Asset Liability Management Officer, and other officers representing key functions.

Interest rate risk is the risk that net interest income will fluctuate as a result of a change in interest rates. It is the assumption of interest rate risk, along with credit risk, that drives the net interest margin of a financial institution. For that reason, the ALCO has established tolerance limits based upon a 200-basis point change in interest rates, with appropriate floors set for interest-bearing liabilities. At December 31, 2016, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the next 12 months net interest income by 11.42% and an immediate 200-basis point increase would negatively impact the next 12 months net interest income by 9.20%. Both are within the Corporation's policy guideline of 15%. Given the overall low level of current interest rates and the unlikely event of a 200-basis point decline from this point, management additionally modeled an immediate 100-basis

point decline and an immediate 300-basis point increase in interest rates. When applied, it is estimated these scenarios would result in negative impacts to net interest income of 5.36% and 13.90%, respectively.

A related component of interest rate risk is the expectation that the market value of the Corporation's capital account will fluctuate with changes in interest rates. This component is a direct corollary to the earnings-impact component: an institution exposed to earnings erosion is also exposed to shrinkage in market value. At December 31, 2016, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the market value of the Corporation's capital account by 9.24% and an immediate 200-basis point increase in interest rates would negatively impact the market value by 6.05%. Both are within the Corporation's policy guideline of 15%. Management also modeled the impact to the market value of the Corporation's capital with an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates, based on the current interest rate environment. When applied, it is estimated these scenarios would result in negative impacts to the market value of the Corporation's capital of 3.62% and 9.01%, respectively.

Management does recognize the need for certain hedging strategies during periods of anticipated higher fluctuations in interest rates and the Funds Management Policy provides for limited use of certain derivatives in asset liability management.

#### Credit Risk

The Corporation manages credit risk consistent with state and federal laws governing the making of loans through written policies and procedures; loan review to identify loan problems at the earliest possible time; collection procedures (continued even after a loan is charged off); an adequate allowance for loan losses; and continuing education and training to ensure lending expertise. Diversification by loan product is maintained through offering commercial loans, 1-4 family mortgages, and a full range of consumer loans.

The Corporation monitors its loan portfolio carefully. The Loan Committee of the Corporation's Board of Directors is designated to receive required loan reports, oversee loan policy, and approve loans above authorized individual and Senior Loan Committee lending limits. The Senior Loan Committee, consisting of the President and Chief Executive Officer, Chief Financial Officer and Treasurer (non-voting member), Chief Risk Officer (non-voting member), Business Client Division Manager, Retail Client Division Manager, Retail Loan Manager, Senior Commercial Real Estate Lender, and Commercial Loan Managers, implements the Board-approved loan policy.

#### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements listed in Part IV, Item 15 are filed as part of this report and appear on pages F-1 through F-65.

#### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

#### Item 9A. CONTROLS AND PROCEDURES

##### (a) Evaluation of Disclosure Controls and Procedures

The Corporation's management, with the participation of our Chief Executive Officer, who is the Corporation's principal executive officer, and our Chief Financial Officer and Treasurer, who is the Corporation's principal financial officer, evaluated the effectiveness of the Corporation's disclosure controls and procedures (as defined in Rules

13a-15(e) or 15d-15(e) promulgated under the Exchange Act) as of December 31, 2016. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer and Treasurer have concluded that the Corporation's disclosure controls and procedures are effective as of December 31, 2016.



(b) Management's Report on Internal Control over Financial Reporting

We, as members of management of the Corporation, are responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. The Corporation's internal control over financial reporting is a process designed to provide reasonable assurance to the Corporation's management and Board of Directors regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external purposes in accordance with U.S. generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the Corporation are being made only in accordance with authorizations of management and directors of the Corporation, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Corporation's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

As of December 31, 2016 management assessed the effectiveness of the Corporation's internal control over financial reporting based on criteria established in the 2013 Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The objective of this assessment was to determine whether the Corporation's internal control over financial reporting was effective as of December 31, 2016. Based on the assessment, we assert that the Corporation maintained effective internal control over financial reporting as of December 31, 2016 based on the specified criteria.

Crowe Horwath LLP, an independent registered public accounting firm, which audited the Corporation's 2016 consolidated financial statements included in the Annual Report, has issued an audit report on the effectiveness of the Corporation's internal control over financial reporting.

(c) Changes in Internal Control over Financial Reporting

During the fourth quarter, there have been no changes in the Corporation's internal control over financial reporting that have materially affected, or that are reasonably likely to material affect, the Corporation's internal control over financial reporting.

/s/ Anders M. Tomson

Anders M. Tomson

President and Chief Executive Officer

March 8, 2017

/s/ Karl F. Krebs

Karl F. Krebs

Chief Financial Officer and Treasurer

March 8, 2017

Item 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information responsive to this Item 10 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2017 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days after the Corporation's 2016 fiscal year end.

ITEM 11. EXECUTIVE COMPENSATION

Information responsive to this Item 11 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2017 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days after the Corporation's 2016 fiscal year end.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT, AND RELATED STOCKHOLDER MATTERS

Information responsive to this Item 12 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2017 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days after the Corporation's 2016 fiscal year end.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information responsive to this Item 13 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2017 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days after the Corporation's 2016 fiscal year end.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information responsive to this Item 14 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2017 Annual Meeting of Shareholders, which will be filed with the SEC within 120 days after the Corporation's 2016 fiscal year end.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) The following consolidated financial statements of the Corporation appear on pages F-1 through F-65 of this report and are incorporated in Part II, Item 8:

Report of Independent Registered Public Accounting Firm-Crowe Horwath LLP

Consolidated Financial Statements

Consolidated Balance Sheets as of December 31, 2016 and 2015

Consolidated Statements of Income for the three years ended December 31, 2016

Consolidated Statements of Comprehensive Income for the three years ended December 31, 2016

Consolidated Statements of Shareholders' Equity for the three years ended December 31, 2016

Consolidated Statements of Cash Flows for the three years ended December 31, 2016

Notes to Consolidated Financial Statements

Financial statement schedules have been omitted because they are not applicable or the required information is (2) shown in the Consolidated Financial Statements or the Notes thereto under Item 8, "Financial Statements and Supplementary Data".

(b) The following exhibits are either filed with this Form 10-K or are incorporated herein by reference. The Corporation's Securities Exchange Act file number is 000-13888.

- Exhibit The following exhibits are either filed with this Form 10-K or are incorporated herein by reference. The Corporation's Securities Exchange Act file number is 000-13888.
- 3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984 (as incorporated by reference to Exhibit 3.1 to Registrant's Form 10-K for the year ended December 31, 2007 filed with the Commission on March 13, 2008).
  - 3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988 (as incorporated by reference to Exhibit 3.2 to Registrant's Form 10-K for the year ended December 31, 2007 filed with the Commission on March 13, 2008).
  - 3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998 (as incorporated by reference to Exhibit 3.4 to Registrant's Form 10-K for the year ended December 31, 2005 and filed with the Commission on March 15, 2006).
  - 3.4 Amended and Restated Bylaws of Chemung Financial Corporation, as amended to June 17, 2015 (as incorporated by reference to Exhibit 3.1 to Registrant's Form 8-K filed with the Commission on June 18, 2015).
  - 4.1 Specimen Stock Certificate (filed as Exhibit 4.1 to Registrant's Form 10-K for the year ended December 31, 2002 and incorporated herein by reference).
  - 10.1 Change of Control Agreement dated September 20, 2006 between Chemung Canal Trust Company and Ronald M. Bentley, President & COO (filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended September 30, 2006 and incorporated herein by reference). Mr. Bentley retired as of December 31, 2016.
  - 10.2

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Executive Severance Agreement dated September 20, 2006 between Chemung Canal Trust Company and Ronald M. Bentley, President & COO (filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended September 30, 2006 and incorporated herein by reference). Mr. Bentley retired as of December 31, 2016.

- 10.3 Chemung Financial Corporation 2014 Omnibus Plan and Component Plans (Chemung Financial Corporation Restricted Stock Plan, Chemung Financial Corporation Incentive Compensation Plan, Chemung Financial Corporation Directors' Compensation Plan and Chemung Financial Corporation/Chemung Canal Trust Company Directors' Deferred Fee Plan). (Filed as Exhibits 10.1, 10.2, 10.3, 10.4 and 10.5 to Registrant's Form S-8 filed with the SEC on January 27, 2015 and incorporated herein by reference).
- 10.4 Change of Control Agreement dated September 1, 2015 between Chemung Canal Trust Company and Thomas W. Wirth, Executive Vice President. (Filed as Exhibit 10.1 to Registrant's Form 8-K filed with the SEC on September 3, 2015 and incorporated herein by reference).
- 10.5 Change of Control Agreement dated January 19, 2011 between Chemung Canal Trust Company and Louis C. DiFabio, Executive Vice President. (Filed as Exhibit 10.12 to Registrant's Form 10-K filed with the SEC on March 16, 2011 and incorporated herein by reference).
- 10.6 Change of Control Agreement dated August 28, 2015 between Chemung Canal Trust Company and Anders M. Tomson, President and Chief Operating Officer. (Filed as Exhibit 10.1 to Registrant's Form 8-K filed with the SEC on September 1, 2015 and incorporated herein by reference).
- 10.7 Change of Control Agreement dated November 7, 2011 between Chemung Canal Trust Company and Karen R. Makowski, Executive Vice President and Chief Administration and Risk Officer (filed as Exhibit 10.16 to Registrant's Form 10-K on March 28, 2012 and incorporated herein by reference).
- 10.8 Change of Control Agreement dated October 16, 2013 between Chemung Canal Trust Company and Karl F. Krebs, Executive Vice President and Chief Financial Officer (filed as Exhibit 10.1 to Registrant's Form 8-K filed with the SEC on October 17, 2013 and incorporated herein by reference).
- 10.9 Change of Control Agreement dated August 17, 2016 between Chemung Canal Trust Company and Kimberly A. Hazelton, Executive Vice President (filed as Exhibit 10.1 to Registrant's Form 8-K filed with the SEC on August 17, 2016 and incorporated herein by reference).
- 21.0 Subsidiaries of the Registrant.\*
- 23.0 Consent of Crowe Horwath LLP, Independent Registered Public Accounting Firm.\*
- 31.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*
- 31.2 Certification of Treasurer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*
- 32.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 19 U.S.C. §1350.\*
- 32.2 Certification of Treasurer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 19 U.S.C. §1350.\*
- 101.INS Instance Document
- 101.SCH XBRL Taxonomy Schema\*
- 101.CAL XBRL Taxonomy Calculation Linkbase\*
- 101.DEF XBRL Taxonomy Definition Linkbase\*
- 101.LAB XBRL Taxonomy Label Linkbase\*
- 101.PRE XBRL Taxonomy Presentation Linkbase\*
- \* Filed herewith.

CHEMUNG FINANCIAL CORPORATION

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders  
Chemung Financial Corporation  
Elmira, New York

We have audited the accompanying consolidated balance sheets of Chemung Financial Corporation as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income (loss), shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2016. We also have audited Chemung Financial Corporation's internal control over financial reporting as of December 31, 2016, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Chemung Financial Corporation's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting as disclosed in Item 9A. Our responsibility is to express an opinion on these financial statements and an opinion on Chemung Financial Corporation's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Chemung Financial Corporation as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2016, in conformity

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with accounting principles generally accepted in the United States of America. Also, in our opinion, Chemung Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016 based on criteria established in the 2013 Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ Crowe Horwath LLP  
Livingston, New Jersey  
March 8, 2017

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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)	DECEMBER 31	
	2016	2015
<b>ASSETS</b>		
Cash and due from financial institutions	\$28,205	\$24,886
Interest-bearing deposits in other financial institutions	45,957	1,299
Total cash and cash equivalents	74,162	26,185
Trading assets, at fair value	774	701
Securities available for sale, at estimated fair value	303,402	344,820
Securities held to maturity, estimated fair value of \$4,912 at December 31, 2016 and \$4,822 at December 31, 2015	4,705	4,566
FHLBNY and FRBNY Stock, at cost	4,041	4,797
Loans, net of deferred loan fees	1,200,290	1,168,633
Allowance for loan losses	(14,253)	(14,260)
Loans, net	1,186,037	1,154,373
Loans held for sale	412	1,076
Premises and equipment, net	28,923	29,397
Goodwill	21,824	21,824
Other intangible assets, net	2,945	3,931
Bank owned life insurance	2,912	2,839
Accrued interest and other assets	27,042	25,455
Total assets	\$1,657,179	\$1,619,964
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Deposits:		
Non-interest-bearing	\$417,812	\$402,236
Interest-bearing	1,038,531	998,059
Total deposits	1,456,343	1,400,295
FHLBNY overnight advances	—	13,900
Securities sold under agreements to repurchase	27,606	28,453
FHLBNY term advances	9,093	19,203
Long term capital lease obligation	4,722	2,873
Dividends payable	1,225	1,214
Accrued interest payable and other liabilities	14,442	16,784
Total liabilities	1,513,431	1,482,722
Shareholders' equity:		
Common stock, \$.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at December 31, 2016 and December 31, 2015	53	53
Additional-paid-in capital	45,603	45,537
Retained earnings	124,111	118,973
Treasury stock, at cost (597,843 shares at December 31, 2016; 641,721	(15,265)	(16,379)

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shares at December 31, 2015)		
Accumulated other comprehensive loss	(10,754 )	(10,942 )
Total shareholders' equity	143,748	137,242
Total liabilities and shareholders' equity	\$1,657,179	\$1,619,964

See accompanying notes to consolidated financial statements.

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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)	YEARS ENDED		
	DECEMBER 31		
	2016	2015	2014
<b>Interest and Dividend Income:</b>			
Loans, including fees	\$49,677	\$48,271	\$47,139
Taxable securities	5,239	4,958	5,043
Tax exempt securities	945	939	967
Interest-bearing deposits	307	76	64
Total interest and dividend income	56,168	54,244	53,213
<b>Interest Expense:</b>			
Deposits	2,170	2,003	2,043
Securities sold under agreements to repurchase	849	848	848
Borrowed funds	820	751	754
Total interest expense	3,839	3,602	3,645
Net interest income	52,329	50,642	49,568
Provision for loan losses	2,437	1,571	3,981
Net interest income after provision for loan losses	49,892	49,071	45,587
<b>Other operating income:</b>			
Wealth management group fee income	8,316	8,522	7,747
Service charges on deposit accounts	5,089	4,886	5,281
Interchange revenue from debit card transactions	4,027	3,307	3,360
Net gains on securities transactions	987	372	6,869
Net gain on sales of loans held for sale	326	294	301
Net gains (losses) on sales of other real estate owned	21	84	(64)
Income from bank owned life insurance	73	75	78
Other	2,310	2,907	3,184
Total other operating income	21,149	20,447	26,756
<b>Other operating expenses:</b>			
Salaries and wages	20,954	21,223	21,315
Pension and other employee benefits	6,132	5,908	5,733
Net occupancy expenses	6,837	7,006	7,098
Furniture and equipment expenses	2,967	2,979	2,972
Data processing expense	6,593	6,586	6,393
Professional services	2,175	1,293	1,597
Legal accruals and settlements	1,200	—	4,250
Amortization of intangible assets	986	1,136	1,310
Marketing and advertising expense	877	899	1,079
Other real estate owned expenses	180	812	247
FDIC insurance	1,193	1,075	1,116
Loan expense	669	693	811
Merger and acquisition related expenses	—	—	115