

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

**FORM 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended June 30, 2018

**OR**

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-13695



(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

16-1213679

(I.R.S. Employer Identification No.)

5790 Widewaters Parkway, DeWitt, New York

(Address of principal executive offices)

13214-1883

(Zip Code)

(315) 445-2282

(Registrant's telephone number, including area code)

NONE

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

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

Indicate by check mark whether the registrant has submitted electronically and posted to its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐.

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

Large accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Emerging growth company ☐

Accelerated filer ☐

Smaller reporting company ☐

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 51,107,725 shares of Common Stock, \$1.00 par value per share, were outstanding on July 31, 2018.

## TABLE OF CONTENTS

| <b>Part I.</b>  | <b>Financial Information</b>                                                                                             | <b>Page</b> |
|-----------------|--------------------------------------------------------------------------------------------------------------------------|-------------|
| Item 1.         | Financial Statements (Unaudited)                                                                                         |             |
|                 | <a href="#"><u>Consolidated Statements of Condition June 30, 2018 and December 31, 2017</u></a>                          | 3           |
|                 | <a href="#"><u>Consolidated Statements of Income Three and six months ended June 30, 2018 and 2017</u></a>               | 4           |
|                 | <a href="#"><u>Consolidated Statements of Comprehensive Income Three and six months ended June 30, 2018 and 2017</u></a> | 5           |
|                 | <a href="#"><u>Consolidated Statement of Changes in Shareholders' Equity Six months ended June 30, 2018</u></a>          | 6           |
|                 | <a href="#"><u>Consolidated Statements of Cash Flows Six months ended June 30, 2018 and 2017</u></a>                     | 7           |
|                 | <a href="#"><u>Notes to the Consolidated Financial Statements June 30, 2018</u></a>                                      | 8           |
| Item 2.         | <a href="#"><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></a>             | 31          |
| Item 3.         | <a href="#"><u>Quantitative and Qualitative Disclosures about Market Risk</u></a>                                        | 50          |
| Item 4.         | <a href="#"><u>Controls and Procedures</u></a>                                                                           | 51          |
| <b>Part II.</b> | <b>Other Information</b>                                                                                                 |             |
| Item 1.         | <a href="#"><u>Legal Proceedings</u></a>                                                                                 | 51          |
| Item 1A.        | <a href="#"><u>Risk Factors</u></a>                                                                                      | 52          |
| Item 2.         | <a href="#"><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></a>                                       | 52          |
| Item 3.         | <a href="#"><u>Defaults Upon Senior Securities</u></a>                                                                   | 52          |
| Item 4.         | <a href="#"><u>Mine Safety Disclosures</u></a>                                                                           | 52          |
| Item 5.         | <a href="#"><u>Other Information</u></a>                                                                                 | 52          |
| Item 6.         | <a href="#"><u>Exhibits</u></a>                                                                                          | 53          |

**Part I. Financial Information**
**Item 1. Financial Statements**
**COMMUNITY BANK SYSTEM, INC.**
**CONSOLIDATED STATEMENTS OF CONDITION (Unaudited)**
**(In Thousands, Except Share Data)**

|                                                                                                                                                                                                                                                          | June 30 ,<br>2018    | December 31,<br>2017 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| <b>Assets:</b>                                                                                                                                                                                                                                           |                      |                      |
| Cash and cash equivalents                                                                                                                                                                                                                                | \$ 250,154           | \$ 221,038           |
| Available-for-sale investment securities (cost of \$2,972,889 and \$3,007,148, respectively)                                                                                                                                                             | 2,939,944            | 3,031,088            |
| Equity and other securities (cost of \$43,155 and \$50,291, respectively)                                                                                                                                                                                | 43,408               | 50,291               |
| Loans held for sale, at fair value                                                                                                                                                                                                                       | 1,281                | 461                  |
| Loans                                                                                                                                                                                                                                                    | 6,238,009            | 6,256,757            |
| Allowance for loan losses                                                                                                                                                                                                                                | (49,618)             | (47,583)             |
| Net loans                                                                                                                                                                                                                                                | 6,188,391            | 6,209,174            |
| Goodwill, net                                                                                                                                                                                                                                            | 733,479              | 734,430              |
| Core deposit intangibles, net                                                                                                                                                                                                                            | 21,646               | 25,025               |
| Other intangibles, net                                                                                                                                                                                                                                   | 61,002               | 65,633               |
| Intangible assets, net                                                                                                                                                                                                                                   | 816,127              | 825,088              |
| Premises and equipment, net                                                                                                                                                                                                                              | 120,715              | 123,393              |
| Accrued interest and fees receivable                                                                                                                                                                                                                     | 34,921               | 36,177               |
| Other assets                                                                                                                                                                                                                                             | 238,153              | 249,488              |
| <b>Total assets</b>                                                                                                                                                                                                                                      | <b>\$ 10,633,094</b> | <b>\$ 10,746,198</b> |
| <b>Liabilities:</b>                                                                                                                                                                                                                                      |                      |                      |
| Noninterest-bearing deposits                                                                                                                                                                                                                             | \$ 2,332,745         | \$ 2,293,057         |
| Interest-bearing deposits                                                                                                                                                                                                                                | 6,181,248            | 6,151,363            |
| Total deposits                                                                                                                                                                                                                                           | 8,513,993            | 8,444,420            |
| Short-term borrowings                                                                                                                                                                                                                                    | 0                    | 24,000               |
| Securities sold under agreement to repurchase, short-term                                                                                                                                                                                                | 181,765              | 337,011              |
| Other long-term debt                                                                                                                                                                                                                                     | 2,020                | 2,071                |
| Subordinated debt held by unconsolidated subsidiary trusts                                                                                                                                                                                               | 122,826              | 122,814              |
| Accrued interest and other liabilities                                                                                                                                                                                                                   | 155,531              | 180,567              |
| <b>Total liabilities</b>                                                                                                                                                                                                                                 | <b>8,976,135</b>     | <b>9,110,883</b>     |
| <b>Commitments and contingencies (See Note J)</b>                                                                                                                                                                                                        |                      |                      |
| <b>Shareholders' equity:</b>                                                                                                                                                                                                                             |                      |                      |
| Preferred stock, \$1.00 par value, 500,000 shares authorized, 0 shares issued                                                                                                                                                                            | 0                    | 0                    |
| Common stock, \$1.00 par value, 75,000,000 shares authorized; 51,511,992 and 51,263,841 shares issued, respectively                                                                                                                                      | 51,512               | 51,264               |
| Additional paid-in capital                                                                                                                                                                                                                               | 904,913              | 894,879              |
| Retained earnings                                                                                                                                                                                                                                        | 750,779              | 700,557              |
| Accumulated other comprehensive loss                                                                                                                                                                                                                     | (46,491)             | (3,699)              |
| Treasury stock, at cost (426,118 shares, including 205,017 shares held by deferred compensation arrangements at June 30, 2018 and 567,764 shares including 237,494 shares held by deferred compensation arrangements at December 31, 2017, respectively) | (15,334)             | (21,014)             |
| Deferred compensation arrangements (205,017 and 237,494 shares, respectively)                                                                                                                                                                            | 11,580               | 13,328               |
| <b>Total shareholders' equity</b>                                                                                                                                                                                                                        | <b>1,656,959</b>     | <b>1,635,315</b>     |
| <b>Total liabilities and shareholders' equity</b>                                                                                                                                                                                                        | <b>\$ 10,633,094</b> | <b>\$ 10,746,198</b> |

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

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

|                                                                        | Three Months Ended<br>June 30 , |           | Six Months Ended<br>June 30 , |            |
|------------------------------------------------------------------------|---------------------------------|-----------|-------------------------------|------------|
|                                                                        | 2018                            | 2017      | 2018                          | 2017       |
| Interest income:                                                       |                                 |           |                               |            |
| Interest and fees on loans                                             | \$ 71,152                       | \$ 62,351 | \$ 140,593                    | \$ 114,735 |
| Interest and dividends on taxable investments                          | 16,517                          | 15,175    | 32,041                        | 28,741     |
| Interest on nontaxable investments                                     | 3,336                           | 3,896     | 6,775                         | 7,904      |
| Total interest income                                                  | 91,005                          | 81,422    | 179,409                       | 151,380    |
| Interest expense:                                                      |                                 |           |                               |            |
| Interest on deposits                                                   | 2,381                           | 2,065     | 4,513                         | 3,795      |
| Interest on borrowings                                                 | 446                             | 392       | 926                           | 541        |
| Interest on subordinated debt held by unconsolidated subsidiary trusts | 1,332                           | 936       | 2,500                         | 1,741      |
| Total interest expense                                                 | 4,159                           | 3,393     | 7,939                         | 6,077      |
| Net interest income                                                    | 86,846                          | 78,029    | 171,470                       | 145,303    |
| Provision for loan losses                                              | 2,448                           | 1,461     | 6,127                         | 3,289      |
| Net interest income after provision for loan losses                    | 84,398                          | 76,568    | 165,343                       | 142,014    |
| Noninterest revenues:                                                  |                                 |           |                               |            |
| Deposit service fees                                                   | 18,964                          | 16,655    | 38,141                        | 31,362     |
| Other banking services                                                 | 1,163                           | 1,407     | 2,406                         | 2,566      |
| Employee benefit services                                              | 22,542                          | 20,662    | 45,548                        | 37,851     |
| Insurance services                                                     | 7,415                           | 6,965     | 14,774                        | 13,365     |
| Wealth management services                                             | 6,496                           | 5,537     | 13,202                        | 10,398     |
| Unrealized loss on equity securities                                   | (21)                            | 0         | (21)                          | 0          |
| Gain on sales of investment securities                                 | 0                               | 0         | 0                             | 2          |
| Total noninterest revenues                                             | 56,559                          | 51,226    | 114,050                       | 95,544     |
| Noninterest expenses:                                                  |                                 |           |                               |            |
| Salaries and employee benefits                                         | 52,402                          | 46,564    | 104,261                       | 89,471     |
| Occupancy and equipment                                                | 9,437                           | 8,637     | 19,968                        | 16,833     |
| Data processing and communications                                     | 10,212                          | 10,395    | 18,954                        | 18,916     |
| Amortization of intangible assets                                      | 4,555                           | 4,263     | 9,353                         | 7,031      |
| Legal and professional fees                                            | 2,745                           | 2,619     | 5,525                         | 5,033      |
| Business development and marketing                                     | 2,654                           | 2,451     | 4,714                         | 4,532      |
| Acquisition expenses                                                   | 71                              | 22,896    | 63                            | 24,612     |
| Other expenses                                                         | 4,036                           | 5,054     | 9,605                         | 10,026     |
| Total noninterest expenses                                             | 86,112                          | 102,879   | 172,443                       | 176,454    |
| Income before income taxes                                             | 54,845                          | 24,915    | 106,950                       | 61,104     |
| Income taxes                                                           | 10,239                          | 7,724     | 22,238                        | 17,656     |
| Net income                                                             | \$ 44,606                       | \$ 17,191 | \$ 84,712                     | \$ 43,448  |
| Basic earnings per share                                               |                                 |           |                               |            |
| Basic earnings per share                                               | \$ 0.87                         | \$ 0.35   | \$ 1.65                       | \$ 0.92    |
| Diluted earnings per share                                             |                                 |           |                               |            |
| Diluted earnings per share                                             | \$ 0.86                         | \$ 0.35   | \$ 1.63                       | \$ 0.91    |
| Cash dividends declared per share                                      |                                 |           |                               |            |
| Cash dividends declared per share                                      | \$ 0.34                         | \$ 0.32   | \$ 0.68                       | \$ 0.64    |

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

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

|                                                                                                                       | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|-----------------------------------------------------------------------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                                                                                       | 2018                           | 2017      | 2018                         | 2017      |
| <b>Pension and other post retirement obligations:</b>                                                                 |                                |           |                              |           |
| Amortization of actuarial losses included in net periodic pension cost, gross                                         | \$ 303                         | \$ 211    | \$ 606                       | \$ 476    |
| Tax effect                                                                                                            | (74)                           | (80)      | (147)                        | (182)     |
| Amortization of actuarial losses included in net periodic pension cost, net                                           | 229                            | 131       | 459                          | 294       |
| Amortization of prior service cost included in net periodic pension cost, gross                                       | (127)                          | (28)      | (254)                        | (59)      |
| Tax effect                                                                                                            | 31                             | 10        | 62                           | 22        |
| Amortization of prior service cost included in net periodic pension cost, net                                         | (96)                           | (18)      | (192)                        | (37)      |
| Unamortized actuarial gain due to plan merger, gross (See Note H)                                                     | 0                              | 1,857     | 0                            | 1,857     |
| Tax effect                                                                                                            | 0                              | (710)     | 0                            | (710)     |
| Unamortized actuarial gain due to plan merger, net                                                                    | 0                              | 1,147     | 0                            | 1,147     |
| Other comprehensive income related to pension and other post retirement obligations, net of taxes                     | 133                            | 1,260     | 267                          | 1,404     |
| <b>Unrealized (losses) gains on available-for-sale securities:</b>                                                    |                                |           |                              |           |
| Net unrealized holding (losses)/gains arising during period, gross                                                    | (14,816)                       | 9,760     | (56,632)                     | 13,653    |
| Tax effect                                                                                                            | 3,625                          | (3,732)   | 13,781                       | (5,258)   |
| Net unrealized holding (losses)/gains arising during period, net                                                      | (11,191)                       | 6,028     | (42,851)                     | 8,395     |
| Reclassification of other comprehensive income due to change in accounting principle – equity securities              | (208)                          | 0         | (208)                        | 0         |
| Other comprehensive (loss)/income related to unrealized (losses)/gains on available-for-sale securities, net of taxes | (11,399)                       | 6,028     | (43,059)                     | 8,395     |
| Other comprehensive (loss)/income, net of tax                                                                         | (11,266)                       | 7,288     | (42,792)                     | 9,799     |
| Net income                                                                                                            | 44,606                         | 17,191    | 84,712                       | 43,448    |
| Comprehensive income                                                                                                  | \$ 33,340                      | \$ 24,479 | \$ 41,920                    | \$ 53,247 |

| As of            |                      |
|------------------|----------------------|
| June 30,<br>2018 | December 31,<br>2017 |

**Accumulated Other Comprehensive Income By Component:**

|                                                                                                          |             |             |
|----------------------------------------------------------------------------------------------------------|-------------|-------------|
| Unrealized loss for pension and other post-retirement obligations                                        | \$ (28,325) | \$ (28,677) |
| Tax effect                                                                                               | 6,959       | 7,044       |
| Net unrealized loss for pension and other post-retirement obligations                                    | (21,366)    | (21,633)    |
| Unrealized (loss) gain on available-for-sale securities                                                  | (32,692)    | 23,940      |
| Tax effect                                                                                               | 7,775       | (6,006)     |
| Reclassification of other comprehensive income due to change in accounting principle – equity securities | (208)       | 0           |
| Net unrealized (loss) gain on available-for-sale securities                                              | (25,125)    | 17,934      |
| Accumulated other comprehensive loss                                                                     | \$ (46,491) | \$ (3,699)  |

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

**COMMUNITY BANK SYSTEM, INC.**  
**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)**  
**Six months ended June 30, 2018**  
**(In Thousands, Except Share Data)**

|                                                                         | Common Stock |           | Additional |            | Accumulated   |             | Deferred     |              |
|-------------------------------------------------------------------------|--------------|-----------|------------|------------|---------------|-------------|--------------|--------------|
|                                                                         | Shares       | Amount    | Paid-In    | Retained   | Other         | Treasury    | Compensation | Total        |
|                                                                         | Outstanding  | Issued    | Capital    | Earnings   | Comprehensive | Stock       | Arrangements |              |
|                                                                         |              |           |            |            | Loss          |             |              |              |
| Balance at December 31, 2017                                            | 50,696,077   | \$ 51,264 | \$ 894,879 | \$ 700,557 | \$ (3,699)    | \$ (21,014) | \$ 13,328    | \$ 1,635,315 |
| Net income                                                              |              |           |            | 84,712     |               |             |              | 84,712       |
| Other comprehensive loss, net of tax                                    |              |           |            |            | (42,584)      |             |              | (42,584)     |
| Cumulative effect of change in accounting principle – equity securities |              |           |            | 208        | (208)         |             |              | 0            |
| Cash dividends declared: Common, \$0.68 per share                       |              |           |            | (34,698)   |               |             |              | (34,698)     |
| Common stock issued under employee stock ownership plan                 | 248,151      | 248       | 4,396      |            |               |             |              | 4,644        |
| Stock-based compensation                                                |              |           | 3,396      |            |               |             |              | 3,396        |
| Distribution of stock under deferred compensation arrangements          | 35,233       |           |            |            |               | 1,898       | (1,898)      | 0            |
| Treasury stock issued to benefit plans, net                             | 106,413      |           | 2,242      |            |               | 3,782       | 150          | 6,174        |
| Balance at June 30, 2018                                                | 51,085,874   | \$ 51,512 | \$ 904,913 | \$ 750,779 | \$ (46,491)   | \$ (15,334) | \$ 11,580    | \$ 1,656,959 |

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

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

|                                                                                     | Six Months Ended<br>June 30, |            |
|-------------------------------------------------------------------------------------|------------------------------|------------|
|                                                                                     | 2018                         | 2017       |
| <b>Operating activities:</b>                                                        |                              |            |
| Net income                                                                          | \$ 84,712                    | \$ 43,448  |
| Adjustments to reconcile net income to net cash provided by operating activities:   |                              |            |
| Depreciation                                                                        | 7,959                        | 7,775      |
| Amortization of intangible assets                                                   | 9,353                        | 7,031      |
| Net accretion on securities, loans and borrowings                                   | (4,784)                      | (2,345)    |
| Stock-based compensation                                                            | 3,396                        | 2,730      |
| Provision for loan losses                                                           | 6,127                        | 3,289      |
| Amortization of mortgage servicing rights                                           | 229                          | 248        |
| Income from bank-owned life insurance policies                                      | (784)                        | (746)      |
| Net (gain) loss on sale of loans and other assets                                   | (146)                        | 257        |
| Change in other assets and other liabilities                                        | 5,558                        | 30,397     |
| Net cash provided by operating activities                                           | 111,620                      | 92,084     |
| <b>Investing activities:</b>                                                        |                              |            |
| Proceeds from maturities of available-for-sale investment securities                | 69,637                       | 73,770     |
| Proceeds from maturities of other investment securities                             | 7,408                        | 10,006     |
| Purchases of available-for-sale investment securities                               | (31,669)                     | (34,842)   |
| Purchases of other securities                                                       | (21)                         | (1,447)    |
| Net change in loans                                                                 | 13,647                       | 70,094     |
| Cash paid for acquisitions, net of cash acquired of \$16 and \$51,793, respectively | (1,737)                      | (105,402)  |
| Settlement of bank-owned life insurance policies                                    | 0                            | 1,779      |
| Purchases of premises and equipment, net                                            | (5,298)                      | (5,390)    |
| Net cash provided by investing activities                                           | 51,967                       | 8,568      |
| <b>Financing activities:</b>                                                        |                              |            |
| Net increase in deposits                                                            | 69,573                       | 101,243    |
| Net change in borrowings                                                            | (179,297)                    | (134,838)  |
| Issuance of common stock                                                            | 4,644                        | 2,829      |
| Purchases of treasury stock                                                         | (150)                        | (3,078)    |
| Sales of treasury stock                                                             | 6,174                        | 6,169      |
| Increase in deferred compensation arrangements                                      | 150                          | 3,078      |
| Cash dividends paid                                                                 | (34,611)                     | (28,849)   |
| Withholding taxes paid on share-based compensation                                  | (954)                        | (1,368)    |
| Net cash used in financing activities                                               | (134,471)                    | (54,814)   |
| Change in cash and cash equivalents                                                 | 29,116                       | 45,838     |
| Cash and cash equivalents at beginning of period                                    | 221,038                      | 173,857    |
| Cash and cash equivalents at end of period                                          | \$ 250,154                   | \$ 219,695 |
| <b>Supplemental disclosures of cash flow information:</b>                           |                              |            |
| Cash paid for interest                                                              | \$ 7,896                     | \$ 6,010   |
| Cash paid for income taxes                                                          | 12,681                       | 20,154     |
| <b>Supplemental disclosures of noncash financing and investing activities:</b>      |                              |            |
| Dividends declared and unpaid                                                       | 17,547                       | 16,331     |
| Transfers from loans to other real estate                                           | 1,845                        | 2,048      |
| <b>Acquisitions:</b>                                                                |                              |            |
| Common stock issued                                                                 | 0                            | 340,737    |
| Fair value of assets acquired, excluding acquired cash and intangibles              | 115                          | 1,960,935  |
| Fair value of liabilities assumed                                                   | 31                           | 1,869,876  |

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

**COMMUNITY BANK SYSTEM, INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**  
**JUNE 30, 2018**

**NOTE A: BASIS OF PRESENTATION**

The interim financial data as of and for the three and six months ended June 30, 2018 is unaudited; however, in the opinion of Community Bank System, Inc. (the “Company”), the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in conformity with generally accepted accounting principles (“GAAP”). The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period.

**NOTE B: ACQUISITIONS**

On April 2, 2018, the Company, through its subsidiary, Benefit Plans Administrative Services, Inc. (“BPAS”), acquired certain assets of HR Consultants (SA), LLC (“HR Consultants”), a benefits consulting group headquartered in Puerto Rico. The Company paid \$0.3 million in cash to acquire the assets of HR Consultants and recorded intangible assets of \$0.3 million in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

On January 2, 2018, the Company, through its subsidiary, OneGroup NY, Inc. (“OneGroup”), completed its acquisition of certain assets of Penna & Associates Agency, Inc. (“Penna”), an insurance agency headquartered in Johnson City, New York. The Company paid \$0.8 million in cash to acquire the assets of Penna, and recorded goodwill in the amount of \$0.3 million and a customer list intangible asset of \$0.3 million in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

On January 2, 2018, the Company, through its subsidiary, Community Investment Services, Inc. (“CISI”), completed its acquisition of certain assets of Styles Bridges Associates (“Styles Bridges”), a financial services business headquartered in Canton, New York. The Company paid \$0.7 million in cash to acquire a customer list from Styles Bridges, and recorded a \$0.7 million customer list intangible asset in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

On December 4, 2017, the Company, through its subsidiary, OneGroup, completed its acquisition of Gordon B. Roberts Agency, Inc. (“GBR”), an insurance agency headquartered in Oneonta, New York for \$3.7 million in Company stock and cash, comprised of \$1.35 million in cash and the issuance of 0.04 million shares of common stock. The transaction resulted in the acquisition of \$0.6 million of assets, \$0.6 million of other liabilities, goodwill in the amount of \$2.1 million and other intangible assets of \$1.6 million. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date.

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

On May 12, 2017, the Company completed its acquisition of Merchants Bancshares, Inc. (“Merchants”), parent company of Merchants Bank, headquartered in South Burlington, Vermont, for \$345.2 million in Company stock and cash, comprised of \$82.9 million in cash and the issuance of 4.68 million shares of common stock. The acquisition extends the Company’s footprint into the Vermont and Western Massachusetts markets with the addition of 31 branch locations in Vermont and one location in Massachusetts. This transaction resulted in the acquisition of \$2.0 billion of assets, including \$1.49 billion of loans and \$370.6 million of investment securities, as well as \$1.45 billion of deposits and \$189.0 million in goodwill. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date. Revenues of approximately \$16.1 million and \$32.2 million from Merchants were included in the consolidated income statement for the three and six months ended June 30, 2018, respectively. Direct expenses, which may not include certain shared expenses, of approximately \$7.6 million and \$15.4 million from Merchants were included in the consolidated income statement for the three and six months ended June 30, 2018, respectively. Revenues of approximately \$8.9 million and direct expenses, which may not include certain shared expenses, of approximately \$4.0 million from Merchants were included in the consolidated income statement for the three and six months ended June 30, 2017.

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

On February 3, 2017, the Company completed its acquisition of Northeast Retirement Services, Inc. (“NRS”) and its subsidiary Global Trust Company (“GTC”), headquartered in Woburn, Massachusetts, for \$148.6 million in Company stock and cash. NRS was a privately held corporation focused on providing institutional transfer agency, master recordkeeping services, custom target date fund administration, trust product administration and customized reporting services to institutional clients. Its wholly-owned subsidiary, GTC, is chartered in the State of Maine as a non-depository trust company and provides fiduciary services for collective investment trusts and other products. The acquisition of NRS and GTC, hereafter referred to collectively as NRS, will strengthen and complement the Company’s existing employee benefit services businesses. Upon the completion of the merger, NRS became a wholly-owned subsidiary of BPAS and operates as Northeast Retirement Services, LLC, a Delaware limited liability company. This transaction resulted in the acquisition of \$36.1 million in net tangible assets, principally cash and certificates of deposit, \$60.2 million in customer list intangibles that will be amortized using the 150% declining balance method over 10 years, a \$23.0 million deferred tax liability associated with the customer list intangible, and \$75.3 million in goodwill. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date. Revenues of \$9.7 million and \$19.8 million from NRS were included in the consolidated statement of income for the three and six months ended June 30, 2018, respectively. Expenses of \$6.0 million and \$12.0 million from NRS were included in the consolidated statement of income for the three and six months ended June 30, 2018, respectively. Revenues of \$8.4 million and \$13.4 million from NRS were included in the consolidated income statement for the three and six months ended June 30, 2017, respectively. Expenses of \$5.7 million and \$9.3 million from NRS were included in the consolidated income statement for the three and six months ended June 30, 2017, respectively.

On January 1, 2017, the Company, through its subsidiary, OneGroup, acquired certain assets of Benefits Advisory Service, Inc. (“BAS”), a benefits consulting group headquartered in Forest Hills, New York. The Company paid \$1.2 million in cash to acquire the assets of BAS and recorded intangible assets of \$1.2 million in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

The assets and liabilities assumed in the acquisitions were recorded at their estimated fair values based on management’s best estimates using information available at the dates of the acquisition, and were subject to adjustment based on updated information not available at the time of acquisition. During the first quarter of 2018, the carrying amount of other liabilities associated with the NRS acquisition decreased by \$1.2 million as a result of an adjustment to deferred taxes. Goodwill associated with the NRS acquisition decreased \$1.2 million as a result of this adjustment. During the second quarter of 2018, the carrying amount of other liabilities associated with the GBR acquisition decreased by \$0.09 million as a result of updated information not available at the time of acquisition. Goodwill associated with the GBR acquisition decreased \$0.09 million as a result of this adjustment.

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

[Table of Contents](#)

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

| (000s omitted)                                                              | 2018      |           | 2017        |           |             |
|-----------------------------------------------------------------------------|-----------|-----------|-------------|-----------|-------------|
|                                                                             | Other (1) | NRS       | Merchants   | Other (2) | Total       |
| Consideration paid :                                                        |           |           |             |           |             |
| Cash                                                                        | \$ 1,753  | \$ 70,073 | \$ 82,898   | \$ 6,775  | \$ 159,746  |
| Community Bank System, Inc. common stock                                    | 0         | 78,483    | 262,254     | 2,395     | 343,132     |
| Total net consideration paid                                                | 1,753     | 148,556   | 345,152     | 9,170     | 502,878     |
| Recognized amounts of identifiable assets acquired and liabilities assumed: |           |           |             |           |             |
| Cash and cash equivalents                                                   | 16        | 11,063    | 40,730      | 339       | 52,132      |
| Investment securities                                                       | 0         | 20,294    | 370,648     | 0         | 390,942     |
| Loans                                                                       | 0         | 0         | 1,488,157   | 0         | 1,488,157   |
| Premises and equipment                                                      | 10        | 411       | 16,608      | 27        | 17,046      |
| Accrued interest receivable                                                 | 0         | 72        | 4,773       | 0         | 4,845       |
| Other assets                                                                | 105       | 8,088     | 51,585      | 583       | 60,256      |
| Core deposit intangibles                                                    | 0         | 0         | 23,214      | 0         | 23,214      |
| Other intangibles                                                           | 1,343     | 60,200    | 2,857       | 5,626     | 68,683      |
| Deposits                                                                    | 0         | 0         | (1,448,406) | 0         | (1,448,406) |
| Other liabilities                                                           | (31)      | (26,828)  | (11,750)    | (1,131)   | (39,709)    |
| Short-term advances                                                         | 0         | 0         | (80,000)    | 0         | (80,000)    |
| Securities sold under agreement to repurchase, short-term                   | 0         | 0         | (278,076)   | 0         | (278,076)   |
| Long-term debt                                                              | 0         | 0         | (3,615)     | 0         | (3,615)     |
| Subordinated debt held by unconsolidated subsidiary trusts                  | 0         | 0         | (20,619)    | 0         | (20,619)    |
| Total identifiable assets, net                                              | 1,443     | 73,300    | 156,106     | 5,444     | 234,850     |
| Goodwill                                                                    | \$ 310    | \$ 75,256 | \$ 189,046  | \$ 3,726  | \$ 268,028  |

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

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

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

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

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

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

The core deposit intangibles and other intangibles related to the HR Consultants, Penna, Styles Bridges, GBR, NECM, Merchants, Dryfoos, and BAS acquisitions are being amortized using an accelerated method over their estimated useful life of eight years. The goodwill, which is not amortized for book purposes, was assigned to the Banking segment for the Merchants acquisition, the Employee Benefit Services segment for NRS, and All Other segments for the Penna, GBR, and Dryfoos acquisitions. Goodwill arising from the Merchants, NRS and GBR acquisitions is not deductible for tax purposes. Goodwill arising from the Penna and Dryfoos acquisitions is deductible for tax purposes.

Direct costs related to the acquisitions were expensed as incurred. Merger and acquisition integration-related expenses amount to \$22.9 million and \$24.6 million during the three and six months ended June 30, 2017 and have been separately stated in the Consolidated Statements of Income. Merger and acquisition integration-related expenses for the three and six months ended June 30, 2018 were immaterial.

#### **NOTE C: ACCOUNTING POLICIES**

The accounting policies of the Company, as applied in the consolidated interim financial statements presented herein, are substantially the same as those followed on an annual basis as presented on pages 63 through 71 of the Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission (“SEC”) on March 1, 2018.

##### ***Investment Securities***

The Company can classify its investments in debt securities as held-to-maturity, available-for-sale, or trading. Held-to-maturity securities are those for which the Company has the positive intent and ability to hold until maturity, and are reported at cost, which is adjusted for amortization of premiums and accretion of discounts. Available-for-sale debt securities are reported at fair value with net unrealized gains and losses reflected as a separate component of shareholders’ equity, net of applicable income taxes. Equity securities with a readily determinable fair value are reported at fair value with net unrealized gains and losses recognized in the consolidated statement of income. None of the Company’s investment securities have been classified as trading securities at June 30, 2018. Certain equity securities are stated at cost and include restricted stock of the Federal Reserve Bank of New York (“Federal Reserve”), the Federal Home Loan Bank of New York and the Federal Home Loan Bank of Boston (collectively referred to as “FHLB”).

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

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

An OTTI loss must be recognized for a debt security in an unrealized loss position if there is intent to sell the security or it is more likely than not the Company will be required to sell the security prior to recovery of its amortized cost basis. In this situation, the amount of loss recognized in income is equal to the difference between the fair value and the amortized cost basis of the security. Even if management does not have the intent, and it is not more likely than not that the Company will be required to sell the securities, an evaluation of the expected cash flows to be received is performed to determine if a credit loss has occurred. For debt securities, a critical component of the evaluation for OTTI is the identification of credit-impaired securities, where the Company does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. In the event of a credit loss, only the amount of impairment associated with the credit loss would be recognized in income. The portion of the unrealized loss relating to other factors, such as liquidity conditions in the market or changes in market interest rates, is recorded in accumulated other comprehensive loss.

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

### **Revenue Recognition**

On January 1, 2018, the Company adopted ASU No. 2014-09 *Revenue from Contracts with Customers (Topic 606)* and all subsequent ASUs that modified Topic 606. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the newly adopted guidance. Topic 606 is applicable to the Company's noninterest revenue streams including its deposit related fees, electronic payment interchange fees, merchant income, trust, asset management and other wealth management revenues, insurance commissions and benefit plan services income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Noninterest revenue streams in-scope of Topic 606 are discussed below.

### **Deposit Service Fees**

Deposit service fees consist of account activity fees, monthly service fees, check orders, debit and credit card income, ATM fees, Merchant services income and other revenues from processing wire transfers, bill pay service, cashier's checks and foreign exchange. Debit and credit card income is primarily comprised of interchange fees earned at the time the Company's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. The Company's performance obligation for deposit service fees is generally satisfied, and the related revenue recognized, when the services are rendered or the transaction has been completed. Payment for deposit service fees is typically received at the time it is assessed through a direct charge to customers' accounts or on a monthly basis. Deposit service fees revenue primarily relates to the Company's Banking operating segment.

### **Other Banking Services**

Other banking services consists of other recurring revenue streams such as commissions from sales of credit life insurance, safe deposit box rental fees, mortgage banking income, bank owned life insurance income and other miscellaneous revenue streams. Commissions from the sale of credit life insurance are recognized at the time of sale of the policies. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation. Mortgage banking income and bank owned life insurance income are not within the scope of Topic 606. Other banking services revenue primarily relates to the Company's Banking operating segment.

### **Employee Benefit Services**

Employee benefit services income consists of revenue received from retirement plan services, collective investment fund services, fund administration, transfer agency, consulting and actuarial services. The Company's performance obligation that relates to plan services are satisfied over time and the resulting fees are recognized monthly or quarterly, based upon the market value of the assets under management and the applicable fee rate or on a time expended basis. Payment is generally received a few days after month end or quarter end. The Company does not earn performance-based incentives. Transactional services such as consulting services, mailings, or other adhoc services are provided to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered. Employee benefit services revenue primarily relates to the Company's Employee Benefit Services operating segment.

### **Insurance Services**

Insurance services primarily consists of commissions received on insurance product sales and consulting services. The Company acts in the capacity of a broker or agent between the Company's customer and the insurance carrier. The Company's performance obligation related to insurance sales for both property and casualty insurance and employee benefit plans is generally satisfied upon the later of the issuance or effective date of the policy. The Company's performance obligation related to consulting services is considered transactional in nature and is generally satisfied when the services have been completed and related revenue recognized at a point in time. Payment is received at the time services are rendered. The Company earns performance based incentives, commonly known as contingency payments, which usually are based on certain criteria established by the insurance carrier such as premium volume, growth and insured loss ratios. Contingent payments are accrued for based upon management's expectations for the year. Commission expense associated with sales of insurance products is expensed as incurred. Insurance services revenue primarily relates to the Company's All Other operating segment.

### **Wealth Management Services**

Wealth management services income is primarily comprised of fees earned from the management and administration of trusts and other customer assets. The Company generally has two types of performance obligations related to these services. The Company's performance obligation that relates to advisory and administration services are satisfied over time and the resulting fees are recognized monthly, based upon the market value of the assets under management and the applicable fee rate. Payment is generally received soon after month end or quarter end through a direct charge to customers' accounts. The Company does not earn performance-based incentives. Transactional services such as tax return preparation services, purchases and sales of investments and insurance products are also available to existing trust and asset management customers. The Company's performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e. as incurred). Payment is generally received on a monthly basis. Wealth management services revenue primarily relates to the Company's All Other operating segment.

### **Contract Balances**

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The Company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of June 30, 2018, \$25.7 million of accounts receivable, including \$7.4 million of unbilled fee revenue, and \$3.0 million of unearned revenue was recorded in the Consolidated Statements of Condition. As of December 31, 2017, \$29.8 million of accounts receivable, including \$6.5 million of unbilled fee revenue, and \$3.9 million of unearned revenue was recorded in the Consolidated Statements of Condition.

### **Contract Acquisition Costs**

In connection with the adoption of Topic 606, an entity is required to capitalize, and subsequently amortize into expense, certain incremental costs of obtaining a contract with a customer if these costs are expected to be recovered. The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, sales commission). The Company utilizes the practical expedient method which allows entities to immediately expense contract acquisition costs when the asset that would have resulted from capitalizing these costs would have been amortized in one year or less. Upon adoption of Topic 606, the Company did not capitalize any contract acquisition costs.

### **Recently Adopted Accounting Pronouncements**

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This new guidance supersedes the revenue recognition requirements in ASC 605, Revenue Recognition, and is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects consideration to which the entity expects to be entitled in exchange for those goods and services. In doing so, companies generally will be required to use more judgment and make more estimates than under prior guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income, interest expense and mortgage banking income. The Company completed a comprehensive assessment of the revenue streams and reviewed related contracts potentially affected by the ASU for all segments of its business. Based on this assessment, the Company concluded that ASU 2014-09 did not materially change the manner in which the Company recognized revenue for these revenue streams. The Company also completed its evaluation of certain costs related to these revenue streams to determine whether such costs should be presented as expenses or contra-revenue (i.e. gross versus net) and timing of compensatory payments to producers. Based on the Company's evaluation, it was determined that changes in the presentation of expenses and timing of the recognition of compensation expense did not materially affect noninterest income or expense. The Company adopted this guidance on January 1, 2018 utilizing the modified retrospective approach. Since there was no net income impact upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not deemed necessary.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The primary focus of this guidance is to supersede the guidance to classify equity securities with readily determinable fair values into different categories (trading or available-for-sale) and requires equity securities to be measured at fair value with changes in the fair value recognized through net income. This guidance requires adoption through a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this guidance on January 1, 2018. The impact of the adoption of this guidance resulted in the reclassification of \$0.2 million of other comprehensive income to retained earnings. See the Consolidated Statements of Comprehensive Income and Consolidated Statement of Changes in Shareholders' Equity.

In August 2016, the FASB issued ASU No. 2016-15, *Statement of Cash Flows (Topic 230)*. The amendments provide guidance on the following eight specific cash flow issues: 1) debt prepayment or debt extinguishment costs; 2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; 3) contingent consideration payments made after a business combination; 4) proceeds from the settlement of insurance claims; 5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; 6) distributions received from equity method investees; 7) beneficial interests in securitization transactions; and 8) separately identifiable cash flows and application of the predominance principle. This ASU is effective for fiscal years beginning after December 31, 2017, including interim periods within those fiscal years. The Company adopted this guidance on January 1, 2018 on a retrospective basis. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This new guidance requires the service cost component of net periodic pension and postretirement benefit costs to be presented separately from other components of net benefit cost in the statement of income. This ASU is effective for the Company for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this guidance on January 1, 2018 and applied the guidance on a modified retrospective basis for the presentation of other components of net periodic benefit cost in the Consolidated Statements of Income. The impact of the adoption of this guidance resulted in the reclassification of net periodic benefit income of \$1.8 million and \$3.3 million from salaries and employee benefits to other expenses in the Consolidated Statement of Income for the three and six months ended June 30, 2017, respectively.

#### ***New Accounting Pronouncements***

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This new guidance supersedes the lease requirements in *Topic 840, Leases* and is based on the principle that a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The accounting applied by a lessor is largely unchanged from that applied under the previous guidance. In addition, the guidance requires an entity to separate the lease components from the nonlease components in a contract. The ASU requires disclosures about the amount, timing, and judgments related to a reporting entity's accounting for leases and related cash flows. The standard is required to be applied to all leases in existence as of the date of adoption using a modified retrospective transition approach. This guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted for all companies in any interim or annual period. The Company occupies certain offices and uses certain equipment under non-cancelable operating lease agreements, which currently are not reflected in its consolidated statement of condition. The Company expects to recognize lease liabilities and right of use assets associated with these lease agreements; however, the extent of the impact on the Company's consolidated financial statements is currently under evaluation. The Company is in the process of a system implementation to facilitate the change in accounting.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This new guidance significantly changes how entities will measure credit losses for most financial assets and certain other instruments that are not measured at fair value through net income. This ASU will replace the "incurred loss" model under existing guidance with an "expected loss" model for instruments measured at amortized cost, and require entities to record allowances for available-for-sale debt securities rather than reduce the carrying amount, as they do today under the other-than-temporary impairment model. This ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. This guidance requires adoption through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for all companies as of fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact the guidance will have on the Company's consolidated financial statements, and expects a change in the allowance for loan losses resulting from the change to expected losses for the estimated life of the financial asset. The amount of the change in the allowance for loan losses resulting from the new guidance will be impacted by the portfolio composition and asset quality at the adoption date, as well as economic conditions and forecasts at the time of adoption. Implementation efforts include evaluation of data requirements, segmentation of the Company's loan portfolio, guidance interpretation and consideration of relevant internal processes and controls.

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

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

#### Subsequent Event

On July 31, 2018, the Company exercised its right to redeem all of the Community Statutory Trust III ("CST III") debentures and associated preferred securities for a total of \$25.2 million. See note G.

#### NOTE D: INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities as of June 30, 2018 and December 31, 2017 are as follows:

|                                                       | June 30, 2018     |                              |                               |               | December 31, 2017 |                              |                               |               |
|-------------------------------------------------------|-------------------|------------------------------|-------------------------------|---------------|-------------------|------------------------------|-------------------------------|---------------|
|                                                       | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
| (000's omitted)                                       |                   |                              |                               |               |                   |                              |                               |               |
| <i>Available-for-Sale Portfolio:</i>                  |                   |                              |                               |               |                   |                              |                               |               |
| U.S. Treasury and agency securities                   | \$ 2,042,116      | \$ 477                       | \$ 28,631                     | \$ 2,013,962  | \$ 2,043,023      | \$ 15,886                    | \$ 4,838                      | \$ 2,054,071  |
| Obligations of state and political subdivisions       | 485,099           | 7,825                        | 1,440                         | 491,484       | 514,949           | 14,064                       | 57                            | 528,956       |
| Government agency mortgage-backed securities          | 364,919           | 1,724                        | 10,746                        | 355,897       | 358,180           | 3,121                        | 3,763                         | 357,538       |
| Corporate debt securities                             | 2,618             | 0                            | 55                            | 2,563         | 2,648             | 0                            | 25                            | 2,623         |
| Government agency collateralized mortgage obligations | 78,137            | 52                           | 2,151                         | 76,038        | 88,097            | 155                          | 878                           | 87,374        |
| Marketable equity securities                          | 0                 | 0                            | 0                             | 0             | 251               | 275                          | 0                             | 526           |
| Total available-for-sale portfolio                    | \$ 2,972,889      | \$ 10,078                    | \$ 43,023                     | \$ 2,939,944  | \$ 3,007,148      | \$ 33,501                    | \$ 9,561                      | \$ 3,031,088  |
| <i>Equity and other Securities:</i>                   |                   |                              |                               |               |                   |                              |                               |               |
| Equity securities, at fair value                      | \$ 251            | \$ 253                       | \$ 0                          | \$ 504        | \$ 0              | \$ 0                         | \$ 0                          | \$ 0          |
| Federal Home Loan Bank common stock                   | 6,371             | 0                            | 0                             | 6,371         | 9,896             | 0                            | 0                             | 9,896         |
| Federal Reserve Bank common stock                     | 30,690            | 0                            | 0                             | 30,690        | 30,690            | 0                            | 0                             | 30,690        |
| Certificates of deposit                               | 0                 | 0                            | 0                             | 0             | 3,865             | 0                            | 0                             | 3,865         |
| Other equity securities, at cost                      | 5,843             | 0                            | 0                             | 5,843         | 5,840             | 0                            | 0                             | 5,840         |
| Total equity and other securities                     | \$ 43,155         | \$ 253                       | \$ 0                          | \$ 43,408     | \$ 50,291         | \$ 0                         | \$ 0                          | \$ 50,291     |

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

#### As of June 30, 2018

|                                                       | Less than 12 Months |               |                               | 12 Months or Longer |               |                               | Total |               |                               |
|-------------------------------------------------------|---------------------|---------------|-------------------------------|---------------------|---------------|-------------------------------|-------|---------------|-------------------------------|
|                                                       | #                   | Fair<br>Value | Gross<br>Unrealized<br>Losses | #                   | Fair<br>Value | Gross<br>Unrealized<br>Losses | #     | Fair<br>Value | Gross<br>Unrealized<br>Losses |
| (000's omitted)                                       |                     |               |                               |                     |               |                               |       |               |                               |
| <i>Available-for-Sale Portfolio:</i>                  |                     |               |                               |                     |               |                               |       |               |                               |
| U.S. Treasury and agency securities                   | 77                  | \$ 1,924,896  | \$ 28,567                     | 3                   | \$ 14,945     | \$ 64                         | 80    | \$ 1,939,841  | \$ 28,631                     |
| Obligations of state and political subdivisions       | 224                 | 111,946       | 1,440                         | 0                   | 0             | 0                             | 224   | 111,946       | 1,440                         |
| Government agency mortgage-backed securities          | 135                 | 213,903       | 5,885                         | 77                  | 85,735        | 4,861                         | 212   | 299,638       | 10,746                        |
| Corporate debt securities                             | 1                   | 2,563         | 55                            | 0                   | 0             | 0                             | 1     | 2,563         | 55                            |
| Government agency collateralized mortgage obligations | 32                  | 58,808        | 1,868                         | 9                   | 11,419        | 283                           | 41    | 70,227        | 2,151                         |
| Total available-for-sale investment portfolio         | 469                 | \$ 2,312,116  | \$ 37,815                     | 89                  | \$ 112,099    | \$ 5,208                      | 558   | \$ 2,424,215  | \$ 43,023                     |

As of December 31, 2017

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

The unrealized losses reported pertaining to securities issued by the U.S. government and its sponsored entities, include treasuries, agencies, and mortgage-backed securities issued by Ginnie Mae, Fannie Mae, and Freddie Mac, which are currently rated AAA by Moody's Investor Services, AA+ by Standard & Poor's and are guaranteed by the U.S. government. The majority of the obligations of state and political subdivisions and corporations carry a credit rating of A or better. Additionally, a majority of the obligations of state and political subdivisions carry a secondary level of credit enhancement. The Company does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell these securities prior to recovery of the amortized cost. The unrealized losses in the portfolios are primarily attributable to changes in interest rates. As such, management does not believe any individual unrealized loss as of June 30, 2018 represents OTTI.

The amortized cost and estimated fair value of debt securities at June 30, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

| (000's omitted)                                       | Available-for-Sale |              |
|-------------------------------------------------------|--------------------|--------------|
|                                                       | Amortized Cost     | Fair Value   |
| Due in one year or less                               | \$ 63,241          | \$ 63,194    |
| Due after one through five years                      | 1,884,323          | 1,861,933    |
| Due after five years through ten years                | 414,137            | 412,375      |
| Due after ten years                                   | 168,132            | 170,507      |
| Subtotal                                              | 2,529,833          | 2,508,009    |
| Government agency mortgage-backed securities          | 364,919            | 355,897      |
| Government agency collateralized mortgage obligations | 78,137             | 76,038       |
| Total                                                 | \$ 2,972,889       | \$ 2,939,944 |

As of June 30, 2018, \$181.8 million of U.S. Treasury securities were pledged as collateral for securities sold under agreement to repurchase. All securities sold under agreement to repurchase as of June 30, 2018 have an overnight and continuous maturity.

#### NOTE E: LOANS

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

- Consumer mortgages consist primarily of fixed rate residential instruments, typically 10 – 30 years in contractual term, secured by first liens on real property.
- Business lending is comprised of general purpose commercial and industrial loans including, but not limited to, municipal lending, agricultural-related and dealer floor plans, as well as mortgages on commercial properties.
- Consumer indirect consists primarily of installment loans originated through selected dealerships and are secured by automobiles, marine and other recreational vehicles.
- Consumer direct consists of all other loans to consumers such as personal installment loans and lines of credit.
- Home equity products are consumer purpose installment loans or lines of credit most often secured by a first or second lien position on residential real estate with terms up to 30 years.

The balances of these classes are summarized as follows:

| (000's omitted)                                   | June 30,<br>2018 | December 31,<br>2017 |
|---------------------------------------------------|------------------|----------------------|
| Business lending                                  | \$ 2,384,629     | \$ 2,424,223         |
| Consumer mortgage                                 | 2,210,051        | 2,220,298            |
| Consumer indirect                                 | 1,063,679        | 1,011,978            |
| Consumer direct                                   | 181,217          | 179,929              |
| Home equity                                       | 398,433          | 420,329              |
| Gross loans, including deferred origination costs | 6,238,009        | 6,256,757            |
| Allowance for loan losses                         | (49,618)         | (47,583)             |
| Loans, net of allowance for loan losses           | \$ 6,188,391     | \$ 6,209,174         |

The outstanding balance related to credit impaired acquired loans was \$7.9 million and \$13.4 million at June 30, 2018 and December 31, 2017, respectively. The changes in the accretable discount related to the credit impaired acquired loans are as follows:

|                                                            |        |
|------------------------------------------------------------|--------|
| (000's omitted)                                            |        |
| Balance at December 31, 2017                               | \$ 976 |
| Accretion recognized, year-to-date                         | (688)  |
| Net reclassification between accretable and non-accretable | 326    |
| Balance at June 30, 2018                                   | \$ 614 |

#### Credit Quality

Management monitors the credit quality of its loan portfolio on an ongoing basis. Measurement of delinquency and past due status are based on the contractual terms of each loan. Past due loans are reviewed on a monthly basis to identify loans for non-accrual status. The following is an aged analysis of the Company's past due loans, by class as of June 30, 2018:

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

| (000's omitted)   | Past Due<br>30 – 89<br>Days | 90+ Days Past<br>Due and<br>Still Accruing | Nonaccrual | Total<br>Past Due | Current      | Total Loans  |
|-------------------|-----------------------------|--------------------------------------------|------------|-------------------|--------------|--------------|
| Business lending  | \$ 1,185                    | \$ 3,789                                   | \$ 3,830   | \$ 8,804          | \$ 1,483,884 | \$ 1,492,688 |
| Consumer mortgage | 9,066                       | 1,992                                      | 9,526      | 20,584            | 1,762,980    | 1,783,564    |
| Consumer indirect | 10,254                      | 124                                        | 5          | 10,383            | 1,038,385    | 1,048,768    |
| Consumer direct   | 1,297                       | 20                                         | 0          | 1,317             | 175,977      | 177,294      |
| Home equity       | 1,156                       | 318                                        | 1,283      | 2,757             | 311,071      | 313,828      |
| Total             | \$ 22,958                   | \$ 6,243                                   | \$ 14,644  | \$ 43,845         | \$ 4,772,297 | \$ 4,816,142 |

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

| (000's omitted)   | Past Due<br>30 – 89<br>Days | 90+ Days Past<br>Due and<br>Still Accruing | Nonaccrual | Total<br>Past Due | Acquired<br>Impaired (1) | Current      | Total Loans  |
|-------------------|-----------------------------|--------------------------------------------|------------|-------------------|--------------------------|--------------|--------------|
| Business lending  | \$ 784                      | \$ 0                                       | \$ 3,821   | \$ 4,605          | \$ 6,004                 | \$ 881,332   | \$ 891,941   |
| Consumer mortgage | 1,444                       | 110                                        | 3,069      | 4,623             | 0                        | 421,864      | 426,487      |
| Consumer indirect | 94                          | 35                                         | 0          | 129               | 0                        | 14,782       | 14,911       |
| Consumer direct   | 80                          | 0                                          | 0          | 80                | 0                        | 3,843        | 3,923        |
| Home equity       | 580                         | 144                                        | 1,273      | 1,997             | 0                        | 82,608       | 84,605       |
| Total             | \$ 2,982                    | \$ 289                                     | \$ 8,163   | \$ 11,434         | \$ 6,004                 | \$ 1,404,429 | \$ 1,421,867 |

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

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

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

| (000's omitted)   | Past Due<br>30 – 89<br>Days | 90+ Days Past<br>Due and<br>Still Accruing | Nonaccrual | Total<br>Past Due | Current      | Total Loans  |
|-------------------|-----------------------------|--------------------------------------------|------------|-------------------|--------------|--------------|
| Business lending  | \$ 2,283                    | \$ 571                                     | \$ 3,944   | \$ 6,798          | \$ 1,369,801 | \$ 1,376,599 |
| Consumer mortgage | 13,564                      | 1,500                                      | 10,722     | 25,786            | 1,728,823    | 1,754,609    |
| Consumer indirect | 14,197                      | 295                                        | 0          | 14,492            | 977,344      | 991,836      |
| Consumer direct   | 1,875                       | 48                                         | 0          | 1,923             | 172,556      | 174,479      |
| Home equity       | 1,116                       | 94                                         | 1,354      | 2,564             | 319,576      | 322,140      |
| Total             | \$ 33,035                   | \$ 2,508                                   | \$ 16,020  | \$ 51,563         | \$ 4,568,100 | \$ 4,619,663 |

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

| (000's omitted)   | Past Due<br>30 – 89<br>Days | 90+ Days Past<br>Due and<br>Still Accruing | Nonaccrual | Total<br>Past Due | Acquired<br>Impaired (1) | Current      | Total Loans  |
|-------------------|-----------------------------|--------------------------------------------|------------|-------------------|--------------------------|--------------|--------------|
| Business lending  | \$ 4,661                    | \$ 0                                       | \$ 4,328   | \$ 8,989          | \$ 10,115                | \$ 1,028,520 | \$ 1,047,624 |
| Consumer mortgage | 2,603                       | 26                                         | 3,066      | 5,695             | 0                        | 459,994      | 465,689      |
| Consumer indirect | 245                         | 8                                          | 0          | 253               | 0                        | 19,889       | 20,142       |
| Consumer direct   | 100                         | 0                                          | 0          | 100               | 0                        | 5,350        | 5,450        |
| Home equity       | 634                         | 170                                        | 1,326      | 2,130             | 0                        | 96,059       | 98,189       |
| Total             | \$ 8,243                    | \$ 204                                     | \$ 8,720   | \$ 17,167         | \$ 10,115                | \$ 1,609,812 | \$ 1,637,094 |

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

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

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

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

| (000's omitted)   | June 30, 2018 |            |              | December 31, 2017 |              |              |
|-------------------|---------------|------------|--------------|-------------------|--------------|--------------|
|                   | Legacy        | Acquired   | Total        | Legacy            | Acquired     | Total        |
| Pass              | \$ 1,302,009  | \$ 805,098 | \$ 2,107,107 | \$ 1,170,156      | \$ 963,981   | \$ 2,134,137 |
| Special mention   | 114,305       | 47,412     | 161,717      | 129,076           | 37,321       | 166,397      |
| Classified        | 76,147        | 31,829     | 107,976      | 77,367            | 34,628       | 111,995      |
| Doubtful          | 227           | 1,598      | 1,825        | 0                 | 1,579        | 1,579        |
| Acquired impaired | 0             | 6,004      | 6,004        | 0                 | 10,115       | 10,115       |
| Total             | \$ 1,492,688  | \$ 891,941 | \$ 2,384,629 | \$ 1,376,599      | \$ 1,047,624 | \$ 2,424,223 |

[Table of Contents](#)

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or nonperforming. Performing loans include loans classified as current as well as those classified as 30 - 89 days past due. Nonperforming loans include 90+ days past due and still accruing and nonaccrual loans. The following table details the balances in all other loan categories at June 30, 2018:

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

| (000's omitted) | Consumer<br>Mortgage | Consumer<br>Indirect | Consumer<br>Direct | Home<br>Equity    | Total               |
|-----------------|----------------------|----------------------|--------------------|-------------------|---------------------|
| Performing      | \$ 1,772,046         | \$ 1,048,639         | \$ 177,274         | \$ 312,227        | \$ 3,310,186        |
| Nonperforming   | 11,518               | 129                  | 20                 | 1,601             | 13,268              |
| <b>Total</b>    | <b>\$ 1,783,564</b>  | <b>\$ 1,048,768</b>  | <b>\$ 177,294</b>  | <b>\$ 313,828</b> | <b>\$ 3,323,454</b> |

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

| (000's omitted) | Consumer<br>Mortgage | Consumer<br>Indirect | Consumer<br>Direct | Home<br>Equity   | Total             |
|-----------------|----------------------|----------------------|--------------------|------------------|-------------------|
| Performing      | \$ 423,308           | \$ 14,876            | \$ 3,923           | \$ 83,188        | \$ 525,295        |
| Nonperforming   | 3,179                | 35                   | 0                  | 1,417            | 4,631             |
| <b>Total</b>    | <b>\$ 426,487</b>    | <b>\$ 14,911</b>     | <b>\$ 3,923</b>    | <b>\$ 84,605</b> | <b>\$ 529,926</b> |

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

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

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

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

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

All loan classes are collectively evaluated for impairment except business lending. A summary of individually evaluated impaired loans as of June 30, 2018 and December 31, 2017 follows:

| (000's omitted)                    | June 30,<br>2018 | December 31,<br>2017 |
|------------------------------------|------------------|----------------------|
| Loans with allowance allocation    | \$ 4,496         | \$ 5,125             |
| Loans without allowance allocation | 1,173            | 884                  |
| Carrying balance                   | 5,669            | 6,009                |
| Contractual balance                | 10,225           | 9,165                |
| Specifically allocated allowance   | 1,094            | 804                  |

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

In accordance with the clarified guidance issued by the Office of the Comptroller of the Currency ("OCC"), loans that have been discharged in Chapter 7 bankruptcy but not reaffirmed by the borrower, are classified as TDRs, irrespective of payment history or delinquency status, even if the repayment terms for the loan have not been otherwise modified. The Company's lien position against the underlying collateral remains unchanged. Pursuant to that guidance, the Company records a charge-off equal to any portion of the carrying value that exceeds the net realizable value of the collateral. The amount of loss incurred in the three and six months ended June 30, 2018 and 2017 was immaterial.

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

Information regarding TDRs as of June 30, 2018 and December 31, 2017 is as follows:

| (000's omitted)   | June 30, 2018 |          |          |          |       |          | December 31, 2017 |          |          |          |       |          |
|-------------------|---------------|----------|----------|----------|-------|----------|-------------------|----------|----------|----------|-------|----------|
|                   | Nonaccrual    |          | Accruing |          | Total |          | Nonaccrual        |          | Accruing |          | Total |          |
|                   | #             | Amount   | #        | Amount   | #     | Amount   | #                 | Amount   | #        | Amount   | #     | Amount   |
| Business lending  | 5             | \$ 210   | 4        | \$ 346   | 9     | \$ 556   | 8                 | \$ 218   | 7        | \$ 501   | 15    | \$ 719   |
| Consumer mortgage | 47            | 2,264    | 43       | 1,689    | 90    | 3,953    | 51                | 2,265    | 44       | 1,750    | 95    | 4,015    |
| Consumer indirect | 0             | 0        | 70       | 796      | 70    | 796      | 0                 | 0        | 71       | 883      | 71    | 883      |
| Consumer direct   | 0             | 0        | 26       | 73       | 26    | 73       | 0                 | 0        | 25       | 69       | 25    | 69       |
| Home equity       | 11            | 226      | 8        | 284      | 19    | 510      | 13                | 245      | 7        | 204      | 20    | 449      |
| Total             | 63            | \$ 2,700 | 151      | \$ 3,188 | 214   | \$ 5,888 | 72                | \$ 2,728 | 154      | \$ 3,407 | 226   | \$ 6,135 |

The following table presents information related to loans modified in a TDR during the three months and six months ended June 30, 2018 and 2017. Of the loans noted in the table below, all loans for the three months and six months ended June 30, 2018 and 2017 were modified due to a Chapter 7 bankruptcy as described previously. The financial effects of these restructurings were immaterial.

| (000's omitted)   | Three Months Ended<br>June 30, 2018 |                        | Three Months Ended<br>June 30, 2017 |                        |
|-------------------|-------------------------------------|------------------------|-------------------------------------|------------------------|
|                   | Number of<br>loans modified         | Outstanding<br>Balance | Number of<br>loans modified         | Outstanding<br>Balance |
|                   |                                     |                        |                                     |                        |
| Business lending  | 0                                   | \$ 0                   | 3                                   | \$ 363                 |
| Consumer mortgage | 4                                   | 452                    | 1                                   | 43                     |
| Consumer indirect | 8                                   | 70                     | 8                                   | 80                     |
| Consumer direct   | 3                                   | 12                     | 1                                   | 0                      |
| Home equity       | 1                                   | 86                     | 0                                   | 0                      |
| Total             | 16                                  | \$ 620                 | 13                                  | \$ 486                 |

  

| (000's omitted)   | Six Months Ended<br>June 30, 2018 |                        | Six Months Ended<br>June 30, 2017 |                        |
|-------------------|-----------------------------------|------------------------|-----------------------------------|------------------------|
|                   | Number of<br>loans modified       | Outstanding<br>Balance | Number of<br>loans modified       | Outstanding<br>Balance |
|                   |                                   |                        |                                   |                        |
| Business lending  | 1                                 | \$ 93                  | 3                                 | \$ 363                 |
| Consumer mortgage | 4                                 | 452                    | 8                                 | 545                    |
| Consumer indirect | 11                                | 92                     | 14                                | 156                    |
| Consumer direct   | 5                                 | 14                     | 4                                 | 14                     |
| Home equity       | 1                                 | 86                     | 2                                 | 98                     |
| Total             | 22                                | \$ 737                 | 31                                | \$ 1,176               |

#### Allowance for Loan Losses

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

| (000's omitted)   | Three Months Ended June 30, 2018 |                   |                   |                 |             |             |                   |           |
|-------------------|----------------------------------|-------------------|-------------------|-----------------|-------------|-------------|-------------------|-----------|
|                   | Business Lending                 | Consumer Mortgage | Consumer Indirect | Consumer Direct | Home Equity | Unallocated | Acquired Impaired | Total     |
| Beginning balance | \$ 17,607                        | \$ 10,382         | \$ 13,698         | \$ 2,984        | \$ 2,040    | \$ 1,084    | \$ 308            | \$ 48,103 |
| Charge-offs       | (260)                            | (245)             | (1,383)           | (364)           | (47)        | 0           | (323)             | (2,622)   |
| Recoveries        | 114                              | 54                | 1,347             | 167             | 7           | 0           | 0                 | 1,689     |
| Provision         | 978                              | 282               | 762               | 377             | 15          | (14)        | 48                | 2,448     |
| Ending balance    | \$ 18,439                        | \$ 10,473         | \$ 14,424         | \$ 3,164        | \$ 2,015    | \$ 1,070    | \$ 33             | \$ 49,618 |

| Three Months Ended June 30, 2017 |                  |                   |                   |                 |             |             |                   |           |
|----------------------------------|------------------|-------------------|-------------------|-----------------|-------------|-------------|-------------------|-----------|
| (000's omitted)                  | Business Lending | Consumer Mortgage | Consumer Indirect | Consumer Direct | Home Equity | Unallocated | Acquired Impaired | Total     |
| Beginning balance                | \$ 16,857        | \$ 10,149         | \$ 13,996         | \$ 2,852        | \$ 2,359    | \$ 773      | \$ 110            | \$ 47,096 |
| Charge-offs                      | (245)            | (258)             | (1,695)           | (470)           | (190)       | 0           | (183)             | (3,041)   |
| Recoveries                       | 283              | 11                | 1,452             | 182             | 7           | 0           | 0                 | 1,935     |
| Provision                        | 335              | 295               | 165               | 381             | 66          | 83          | 136               | 1,461     |
| Ending balance                   | \$ 17,230        | \$ 10,197         | \$ 13,918         | \$ 2,945        | \$ 2,242    | \$ 856      | \$ 63             | \$ 47,451 |

| Six Months Ended June 30, 2018 |                  |                   |                   |                 |             |             |                   |           |
|--------------------------------|------------------|-------------------|-------------------|-----------------|-------------|-------------|-------------------|-----------|
| (000's omitted)                | Business Lending | Consumer Mortgage | Consumer Indirect | Consumer Direct | Home Equity | Unallocated | Acquired Impaired | Total     |
| Beginning balance              | \$ 17,257        | \$ 10,465         | \$ 13,468         | \$ 3,039        | \$ 2,107    | \$ 1,100    | \$ 147            | \$ 47,583 |
| Charge-offs                    | (1,928)          | (444)             | (3,667)           | (860)           | (103)       | 0           | (367)             | (7,369)   |
| Recoveries                     | 312              | 62                | 2,498             | 389             | 16          | 0           | 0                 | 3,277     |
| Provision                      | 2,798            | 390               | 2,125             | 596             | (5)         | (30)        | 253               | 6,127     |
| Ending balance                 | \$ 18,439        | \$ 10,473         | \$ 14,424         | \$ 3,164        | \$ 2,015    | \$ 1,070    | \$ 33             | \$ 49,618 |

| Six Months Ended June 30, 2017 |                  |                   |                   |                 |             |             |                   |           |
|--------------------------------|------------------|-------------------|-------------------|-----------------|-------------|-------------|-------------------|-----------|
| (000's omitted)                | Business Lending | Consumer Mortgage | Consumer Indirect | Consumer Direct | Home Equity | Unallocated | Acquired Impaired | Total     |
| Beginning balance              | \$ 17,220        | \$ 10,094         | \$ 13,782         | \$ 2,979        | \$ 2,399    | \$ 651      | \$ 108            | \$ 47,233 |
| Charge-offs                    | (938)            | (343)             | (3,642)           | (888)           | (228)       | 0           | (184)             | (6,223)   |
| Recoveries                     | 354              | 18                | 2,321             | 427             | 32          | 0           | 0                 | 3,152     |
| Provision                      | 594              | 428               | 1,457             | 427             | 39          | 205         | 139               | 3,289     |
| Ending balance                 | \$ 17,230        | \$ 10,197         | \$ 13,918         | \$ 2,945        | \$ 2,242    | \$ 856      | \$ 63             | \$ 47,451 |

#### NOTE F: GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

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

| (000's omitted)                      | June 30, 2018         |                          |                     | December 31, 2017     |                          |                     |
|--------------------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                                      | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| <i>Amortizing intangible assets:</i> |                       |                          |                     |                       |                          |                     |
| Core deposit intangibles             | \$ 62,902             | \$ (41,256)              | \$ 21,646           | \$ 62,902             | \$ (37,877)              | \$ 25,025           |
| Other intangibles                    | 87,616                | (26,614)                 | 61,002              | 86,535                | (20,902)                 | 65,633              |
| Total amortizing intangibles         | \$ 150,518            | \$ (67,870)              | \$ 82,648           | \$ 149,437            | \$ (58,779)              | \$ 90,658           |

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

| (000's omitted) |           |
|-----------------|-----------|
| Jul - Dec 2018  | \$ 8,802  |
| 2019            | 15,296    |
| 2020            | 12,722    |
| 2021            | 10,853    |
| 2022            | 9,317     |
| Thereafter      | 25,658    |
| Total           | \$ 82,648 |

Shown below are the components of the Company's goodwill at December 31, 2017 and June 30, 2018:

| (000's omitted)        | December 31, 2017 | Activity | June 30, 2018 |
|------------------------|-------------------|----------|---------------|
| Goodwill               | \$ 739,254        | \$ (951) | \$ 738,303    |
| Accumulated impairment | (4,824)           | 0        | (4,824)       |
| Goodwill, net          | \$ 734,430        | \$ (951) | \$ 733,479    |

**NOTE G: MANDATORILY REDEEMABLE PREFERRED SECURITIES**

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

| Trust   | Issuance Date | Par Amount     | Interest Rate                    | Maturity Date | Call Price |
|---------|---------------|----------------|----------------------------------|---------------|------------|
| CST III | 7/31/2001     | \$24.5 million | 3 month LIBOR plus 3.58% (5.94%) | 7/31/2031     | Par        |
| CCT IV  | 12/8/2006     | \$75.0 million | 3 month LIBOR plus 1.65% (3.99%) | 12/15/2036    | Par        |
| MBVT I  | 12/15/2004    | \$20.6 million | 3 month LIBOR plus 1.95% (4.29%) | 12/31/2034    | Par        |

On July 31, 2018, the Company exercised its right to redeem all of the CST III debentures and associated preferred securities for a total of \$25.2 million.

**NOTE H: BENEFIT PLANS**

The Company provides a qualified defined benefit pension to eligible employees and retirees, other post-retirement health and life insurance benefits to certain retirees, an unfunded supplemental pension plan for certain key executives, and an unfunded stock balance plan for certain of its nonemployee directors. The Company accrues for the estimated cost of these benefits through charges to expense during the years that employees earn these benefits.

Effective May 12, 2017, the Merchants Bank Pension Plan was merged into the Community Bank System, Inc. Pension Plan and the combined plan was revalued resulting in an additional unamortized actuarial gain of approximately \$1.9 million, due primarily to a gain on plan assets that was partially offset by a decrease in the discount rate from 4.50% to 4.40% as of the valuation date.

The net periodic benefit cost for the three and six months ended June 30, 2018 and 2017 is as follows:

|                                       | Pension Benefits   |          |                  |            | Post-retirement Benefits |         |                  |         |
|---------------------------------------|--------------------|----------|------------------|------------|--------------------------|---------|------------------|---------|
|                                       | Three Months Ended |          | Six Months Ended |            | Three Months Ended       |         | Six Months Ended |         |
|                                       | June 30,           |          | June 30,         |            | June 30,                 |         | June 30,         |         |
| (000's omitted)                       | 2018               | 2017     | 2018             | 2017       | 2018                     | 2017    | 2018             | 2017    |
| Service cost                          | \$ 1,121           | \$ 1,067 | \$ 2,242         | \$ 2,106   | \$ 0                     | \$ 0    | \$ 0             | \$ 0    |
| Interest cost                         | 1,415              | 1,449    | 2,829            | 2,812      | 17                       | 19      | 34               | 38      |
| Expected return on plan assets        | (3,705)            | (3,407)  | (7,410)          | (6,529)    | 0                        | 0       | 0                | 0       |
| Amortization of unrecognized net loss | 298                | 209      | 596              | 472        | 5                        | 2       | 10               | 4       |
| Amortization of prior service cost    | (83)               | 17       | (165)            | 30         | (44)                     | (45)    | (89)             | (89)    |
| Net periodic benefit cost (income)    | \$ (954)           | \$ (665) | \$ (1,908)       | \$ (1,109) | \$ (22)                  | \$ (24) | \$ (45)          | \$ (47) |

**NOTE I: EARNINGS PER SHARE**

The two class method is used in the calculations of basic and diluted earnings per share. Under the two class method, earnings available to common shareholders for the period are allocated between common shareholders and participating securities according to dividends declared and participation rights in undistributed earnings. The Company has determined that all of its outstanding non-vested stock awards are participating securities as of June 30, 2018.

Basic earnings per share are computed based on the weighted-average of the common shares outstanding for the period. Diluted earnings per share are based on the weighted-average of the shares outstanding and the assumed exercise of stock options during the year. The dilutive effect of options is calculated using the treasury stock method of accounting. The treasury stock method determines the number of common shares that would be outstanding if all the dilutive options (those where the average market price is greater than the exercise price) were exercised and the proceeds were used to repurchase common shares in the open market at the average market price for the applicable time period. There were approximately 0.4 million weighted-average anti-dilutive stock options outstanding for the three months and six months ended June 30, 2018, compared to 0.2 million weighted-average anti-dilutive stock options outstanding for the three months and six months ended June 30, 2017 that were not included in the computation below.

The following is a reconciliation of basic to diluted earnings per share for the three and six months ended June 30, 2018 and 2017:

|                                                                 | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|-----------------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                                 | 2018                           | 2017      | 2018                         | 2017      |
| <i>(000's omitted, except per share data)</i>                   |                                |           |                              |           |
| Net income                                                      | \$ 44,606                      | \$ 17,191 | \$ 84,712                    | \$ 43,448 |
| Income attributable to unvested stock-based compensation awards | (188)                          | (83)      | (353)                        | (219)     |
| Income available to common shareholders                         | \$ 44,418                      | \$ 17,108 | \$ 84,359                    | \$ 43,229 |
| Weighted-average common shares outstanding – basic              | 51,140                         | 48,525    | 51,037                       | 46,913    |
| Basic earnings per share                                        | \$ 0.87                        | \$ 0.35   | \$ 1.65                      | \$ 0.92   |
| Net income                                                      | \$ 44,606                      | \$ 17,191 | \$ 84,712                    | \$ 43,448 |
| Income attributable to unvested stock-based compensation awards | (188)                          | (83)      | (353)                        | (219)     |
| Income available to common shareholders                         | \$ 44,418                      | \$ 17,108 | \$ 84,359                    | \$ 43,229 |
| Weighted-average common shares outstanding – basic              | 51,140                         | 48,525    | 51,037                       | 46,913    |
| Assumed exercise of stock options                               | 583                            | 626       | 576                          | 665       |
| Weighted-average common shares outstanding – diluted            | 51,723                         | 49,151    | 51,613                       | 47,578    |
| Diluted earnings per share                                      | \$ 0.86                        | \$ 0.35   | \$ 1.63                      | \$ 0.91   |

#### Stock Repurchase Program

At its December 2017 meeting, the Company's Board of Directors (the "Board") approved a stock repurchase program authorizing the repurchase of up to 2.5 million shares of the Company's common stock in accordance with securities laws and regulations, through December 31, 2018. Any repurchased shares will be used for general corporate purposes, including those related to stock plan activities. The timing and extent of repurchases will depend on market conditions and other corporate considerations as determined at the Company's discretion. The Company did not repurchase any shares under the authorized plan during the first six months of 2018.

#### NOTE J: COMMITMENTS, CONTINGENT LIABILITIES AND RESTRICTIONS

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

The contract amounts of commitments and contingencies are as follows:

|                              | June 30,<br>2018 | December 31,<br>2017 |
|------------------------------|------------------|----------------------|
| <i>(000's omitted)</i>       |                  |                      |
| Commitments to extend credit | \$ 1,072,858     | \$ 1,080,004         |
| Standby letters of credit    | 33,636           | 23,782               |
| Total                        | \$ 1,106,494     | \$ 1,103,786         |

The Company and its subsidiaries are subject in the normal course of business to various pending and threatened legal proceedings in which claims for monetary damages are asserted. As of June 30, 2018, management, after consultation with legal counsel, does not anticipate that the aggregate ultimate liability arising out of litigation pending or threatened against the Company or its subsidiaries will be material to the Company's consolidated financial position. On at least a quarterly basis, the Company assesses its liabilities and contingencies in connection with such legal proceedings. For those matters where it is probable that the Company will incur losses and the amounts of the losses can be reasonably estimated, the Company records an expense and corresponding liability in its consolidated financial statements. To the extent the pending or threatened litigation could result in exposure in excess of that liability, the amount of such excess is not currently estimable. The range of reasonably possible losses for matters where an exposure is not currently estimable or considered probable, beyond the existing recorded liabilities, is between \$0 and \$1 million in the aggregate. Although the Company does not believe that the outcome of pending litigation will be material to the Company's consolidated financial position, it cannot rule out the possibility that such outcomes will be material to the consolidated results of operations for a particular reporting period in the future.

#### NOTE K: FAIR VALUE

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

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

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

| (000's omitted)                                       | June 30, 2018 |              |         |                  |
|-------------------------------------------------------|---------------|--------------|---------|------------------|
|                                                       | Level 1       | Level 2      | Level 3 | Total Fair Value |
| Available-for-sale investment securities:             |               |              |         |                  |
| U.S. Treasury and agency securities                   | \$ 1,876,745  | \$ 137,217   | \$ 0    | \$ 2,013,962     |
| Obligations of state and political subdivisions       | 0             | 491,484      | 0       | 491,484          |
| Government agency mortgage-backed securities          | 0             | 355,897      | 0       | 355,897          |
| Corporate debt securities                             | 0             | 2,563        | 0       | 2,563            |
| Government agency collateralized mortgage obligations | 0             | 76,038       | 0       | 76,038           |
| Total available-for-sale investment securities        | 1,876,745     | 1,063,199    | 0       | 2,939,944        |
| Equity securities                                     | 504           | 0            | 0       | 504              |
| Mortgage loans held for sale                          | 0             | 1,281        | 0       | 1,281            |
| Commitments to originate real estate loans for sale   | 0             | 0            | 128     | 128              |
| Forward sales commitments                             | 0             | 64           | 0       | 64               |
| Interest rate swap agreements asset                   | 0             | 1,107        | 0       | 1,107            |
| Interest rate swap agreements liability               | 0             | (1,113)      | 0       | (1,113)          |
| Total                                                 | \$ 1,877,249  | \$ 1,064,538 | \$ 128  | \$ 2,941,915     |

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

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

- Available-for-sale investment securities and equity securities – The fair values of available-for-sale investment securities and equity securities are based upon quoted prices, if available. If quoted prices are not available, fair values are measured using quoted market prices for similar securities or model-based valuation techniques. Level 1 securities include U.S. Treasury obligations and equity securities that are traded by dealers or brokers in active over-the-counter markets. Level 2 securities include U.S. agency securities, mortgage-backed securities issued by government-sponsored entities, municipal securities and corporate debt securities that are valued by reference to prices for similar securities or through model-based techniques in which all significant inputs, such as reported trades, trade execution data, LIBOR swap yield curve, market prepayment speeds, credit information, market spreads, and security's terms and conditions, are observable. See Note D for further disclosure of the fair value of investment securities.
- Mortgage loans held for sale –The Company has elected to value loans held for sale at fair value in order to more closely match the gains and losses associated with loans held for sale with the gains and losses on forward sales contracts. Accordingly, the impact on the valuation will be recognized in the Company's consolidated statement of income. All mortgage loans held for sale are current and in performing status. The fair value of mortgage loans held for sale is determined using quoted secondary-market prices of loans with similar characteristics and, as such, has been classified as a Level 2 valuation. The unpaid principal value of mortgage loans held for sale at June 30, 2018 was approximately \$1.3 million. The unrealized gain on mortgage loans held for sale was recognized in mortgage banking and other income in the consolidated statement and is immaterial.
- Forward sales commitments – The Company enters into forward sales commitments to sell certain residential real estate loans. Such commitments are considered to be derivative financial instruments and, therefore, are carried at estimated fair value in the other asset or other liability section of the consolidated statement of condition. The fair value of these forward sales commitments is primarily measured by obtaining pricing from certain government-sponsored entities and reflects the underlying price the entity would pay the Company for an immediate sale on these mortgages. As such, these instruments are classified as Level 2 in the fair value hierarchy.
- Commitments to originate real estate loans for sale – The Company enters into various commitments to originate residential real estate loans for sale. Such commitments are considered to be derivative financial instruments and, therefore, are carried at estimated fair value in the other asset or other liability section of the consolidated statement of condition. The estimated fair value of these commitments is determined using quoted secondary market prices obtained from certain government-sponsored entities. Additionally, accounting guidance requires the expected net future cash flows related to the associated servicing of the loan to be included in the fair value measurement of the derivative. The expected net future cash flows are based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. Such assumptions include estimates of the cost of servicing loans, appropriate discount rate and prepayment speeds. The determination of expected net cash flows is considered a significant unobservable input contributing to the Level 3 classification of commitments to originate real estate loans for sale.
- Interest rate swaps – The interest rate swaps are reported at their fair value utilizing Level 2 inputs from third parties. The fair value of the interest rate swaps are determined using prices obtained from a third party advisor. The fair value measurement of the interest rate swap is determined by netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on the expectation of future interest rates derived from observed market interest rate curves.

The changes in Level 3 assets measured at fair value on a recurring basis are immaterial.

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

| (000's omitted)         | June 30, 2018 |         |          |                  | December 31, 2017 |         |          |                  |
|-------------------------|---------------|---------|----------|------------------|-------------------|---------|----------|------------------|
|                         | Level 1       | Level 2 | Level 3  | Total Fair Value | Level 1           | Level 2 | Level 3  | Total Fair Value |
| Other real estate owned | \$ 0          | \$ 0    | \$ 1,310 | \$ 1,310         | \$ 0              | \$ 0    | \$ 1,915 | \$ 1,915         |

Loans are generally not recorded at fair value on a recurring basis. Periodically, the Company records nonrecurring adjustments to the carrying value of loans based on fair value measurements for partial charge-offs of the uncollectible portions of those loans. Nonrecurring adjustments also include certain impairment amounts for collateral-dependent loans calculated when establishing the allowance for loan losses. Such amounts are generally based on the fair value of the underlying collateral supporting the loan and, as a result, the carrying value of the loan less the calculated valuation amount does not necessarily represent the fair value of the loan. Real estate collateral is typically valued using independent appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace, adjusted for non-observable inputs. Thus, the resulting nonrecurring fair value measurements are generally classified as Level 3. Estimates of fair value used for other collateral supporting commercial loans generally are based on assumptions not observable in the marketplace and, therefore, such valuations classify as Level 3.

Other real estate owned ("OREO") is valued at the time the loan is foreclosed upon and the asset is transferred to OREO. The value is based primarily on third party appraisals, less costs to sell. The appraisals are sometimes further discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the customer and customer's business. Such discounts are significant, ranging from 9% to 60.0% at June 30, 2018 and result in a Level 3 classification of the inputs for determining fair value. OREO is reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above. The Company recovers the carrying value of OREO through the sale of the property. The ability to affect future sales prices is subject to market conditions and factors beyond the Company's control and may impact the estimated fair value of a property.

Originated mortgage servicing rights are recorded at their fair value at the time of sale of the underlying loan, and are amortized in proportion to and over the estimated period of net servicing income. The fair value of mortgage servicing rights is based on a valuation model incorporating inputs that market participants would use in estimating future net servicing income. Such inputs include estimates of the cost of servicing loans, appropriate discount rate and prepayment speeds and are considered to be unobservable and contribute to the Level 3 classification of mortgage servicing rights. In accordance with GAAP, the Company must record impairment charges, on a nonrecurring basis, when the carrying value of a stratum exceeds its estimated fair value. Impairment is recognized through a valuation allowance. There is no valuation allowance at June 30, 2018.

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

| (000's omitted)                                     | Fair Value at June 30, 2018     | Valuation Technique      | Significant Unobservable Inputs              | Significant Unobservable Input Range (Weighted Average) |
|-----------------------------------------------------|---------------------------------|--------------------------|----------------------------------------------|---------------------------------------------------------|
| Other real estate owned                             | \$ 1,310                        | Fair Value of Collateral | Estimated cost of disposal/market adjustment | 9.0% - 60.0% (25.1%)                                    |
| Commitments to originate real estate loans for sale | 128                             | Discounted cash flow     | Embedded servicing value                     | 1%                                                      |
| (000's omitted)                                     | Fair Value at December 31, 2017 | Valuation Technique      | Significant Unobservable Inputs              | Significant Unobservable Input Range (Weighted Average) |
| Other real estate owned                             | \$ 1,915                        | Fair value of collateral | Estimated cost of disposal/market adjustment | 9.0% - 99.0% (38.5%)                                    |
| Commitments to originate real estate loans for sale | 89                              | Discounted cash flow     | Embedded servicing value                     | 1%                                                      |

Certain financial instruments and all nonfinancial instruments are excluded from fair value disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company. The carrying amounts and estimated fair values of the Company's other financial instruments that are not accounted for at fair value at June 30, 2018 and December 31, 2017 are as follows:

|                                                            | June 30, 2018  |              | December 31, 2017 |              |
|------------------------------------------------------------|----------------|--------------|-------------------|--------------|
|                                                            | Carrying Value | Fair Value   | Carrying Value    | Fair Value   |
| <i>(000's omitted)</i>                                     |                |              |                   |              |
| Financial assets:                                          |                |              |                   |              |
| Net loans                                                  | \$ 6,188,391   | \$ 6,149,955 | \$ 6,209,174      | \$ 6,244,941 |
| Financial liabilities:                                     |                |              |                   |              |
| Deposits                                                   | 8,513,993      | 8,494,971    | 8,444,420         | 8,431,481    |
| Short-term borrowings                                      | 0              | 0            | 24,000            | 24,000       |
| Securities sold under agreement to repurchase, short-term  | 181,765        | 181,765      | 337,011           | 337,011      |
| Other long-term debt                                       | 2,020          | 1,948        | 2,071             | 2,021        |
| Subordinated debt held by unconsolidated subsidiary trusts | 122,826        | 122,826      | 122,814           | 122,814      |

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

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

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

Borrowings and subordinated debt held by unconsolidated subsidiary trusts have been classified as a Level 2 valuation. The fair value of short-term borrowings and securities sold under agreement to repurchase, short-term, is the amount payable on demand at the reporting date. Fair values for long-term debt and subordinated debt held by unconsolidated subsidiary trusts are estimated using discounted cash flows and interest rates currently being offered on similar securities. The difference between the carrying values of long-term borrowings and subordinated debt held by unconsolidated subsidiary trusts, and their fair values, are not material as of the reporting dates.

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

#### NOTE L: DERIVATIVE INSTRUMENTS

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

The Company enters into forward sales commitments for the future delivery of residential mortgage loans, and interest rate lock commitments to fund loans at a specified interest rate. The forward sales commitments are utilized to reduce interest rate risk associated with interest rate lock commitments and loans held for sale. Changes in the estimated fair value of the forward sales commitments and interest rate lock commitments subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time. At inception and during the life of the interest rate lock commitment, the Company includes the expected net future cash flows related to the associated servicing of the loan as part of the fair value measurement of the interest rate lock commitments. These derivatives are recorded at fair value, which were immaterial at June 30, 2018. The effect of the changes to these derivatives for the three and six months then ended was also immaterial.

The Company acquired interest rate swaps from the Merchants acquisition with notional amounts with certain commercial customers which totaled \$38.0 million at June 30, 2018. In order to minimize the Company's risk, these customer derivatives (pay floating/receive fixed swaps) have been offset with essentially matching interest rate swaps (pay fixed/receive floating swaps) with the Company's counterparty totaling \$38.0 million. The weighted average receive rate of these interest rate swaps was 3.95%, the weighted average pay rate was 3.84% and the weighted average maturity was 6.0 years. The fair values of \$1.1 million and \$1.1 million were reflected in other assets and other liabilities, respectively, in the accompanying consolidated statement of condition at June 30, 2018. Hedge accounting has not been applied for these derivatives. Since the terms of the swaps with the customer and the other financial institution offset each other, with the only difference being counterparty credit risk, changes in the fair value of the underlying derivative contracts are not materially different and do not significantly impact our results of operations.

The Company also acquired interest rate swaps from the Merchants acquisition with notional amounts totaling \$6.7 million at June 30, 2018 that were designated as fair value hedges of certain fixed rate loans with municipalities. At June 30, 2018, the weighted average receive rate of these interest rate swaps was 2.67%, the weighted average pay rate was 3.11% and the weighted average maturity was 15.0 years. The fair value of \$0.01 million at June 30, 2018, was reflected as an increase to loans and an increase to other liabilities. The ineffective portion of the interest swaps was immaterial and is not recorded in earnings.

The Company assessed its counterparty risk at June 30, 2018 and determined any credit risk inherent in our derivative contracts was not material. Information about the fair value of derivative financial instruments can be found in Note K to these consolidated financial statements.

**NOTE M: SEGMENT INFORMATION**

Operating segments are components of an enterprise, which are evaluated regularly by the “chief operating decision maker” in deciding how to allocate resources and assess performance. The Company’s chief operating decision maker is the President and Chief Executive Officer of the Company. The Company has identified Banking, Employee Benefit Services and All Other as its reportable operating business segments. Community Bank, N.A. (the “Bank” or “CBNA”) operates the Banking segment that provides full-service banking to consumers, businesses, and governmental units in Upstate New York as well as Northeastern Pennsylvania, Vermont and Western Massachusetts. Employee Benefit Services, which includes the operating subsidiaries Benefit Plans Administrative Services, LLC, BPAS Actuarial and Pension Services, LLC, BPAS Trust Company of Puerto Rico, NRS, GTC, and Hand Benefits & Trust Company, provides employee benefit trust, collective investment fund, retirement plan administration, fund administration, transfer agency, actuarial, VEBA/HRA, and health and welfare consulting services. The All Other segment is comprised of: (a) wealth management services including trust services provided by the personal trust unit within the Bank, broker-dealer and investment advisory services provided by CISI and The Carta Group, Inc., as well as asset management provided by Nottingham Advisors, Inc., and (b) full-service insurance, risk management and employee benefit services provided by OneGroup. The accounting policies used in the disclosure of business segments are the same as those described in the summary of significant accounting policies (See Note A: *Summary of Significant Accounting Policies* of the most recent Form 10-K for the year ended December 31, 2017 filed with the SEC on March 1, 2018).

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

| (000’s omitted)                         | Banking       | Employee<br>Benefit Services | All Other | Eliminations | Consolidated<br>Total |
|-----------------------------------------|---------------|------------------------------|-----------|--------------|-----------------------|
| <b>Three Months Ended June 30, 2018</b> |               |                              |           |              |                       |
| Net interest income                     | \$ 86,723     | \$ 93                        | \$ 30     | \$ 0         | \$ 86,846             |
| Provision for loan losses               | 2,448         | 0                            | 0         | 0            | 2,448                 |
| Noninterest revenues                    | 20,040        | 23,051                       | 14,168    | (700)        | 56,559                |
| Amortization of intangible assets       | 1,635         | 1,989                        | 931       | 0            | 4,555                 |
| Acquisition expenses                    | 65            | 0                            | 6         | 0            | 71                    |
| Other operating expenses                | 57,464        | 14,204                       | 10,518    | (700)        | 81,486                |
| Income before income taxes              | \$ 45,151     | \$ 6,951                     | \$ 2,743  | \$ 0         | \$ 54,845             |
| Assets                                  | \$ 10,415,083 | \$ 207,114                   | \$ 64,560 | \$ (53,663)  | \$ 10,633,094         |
| Goodwill                                | \$ 629,916    | \$ 83,275                    | \$ 20,288 | \$ 0         | \$ 733,479            |
| <b>Three Months Ended June 30, 2017</b> |               |                              |           |              |                       |
| Net interest income                     | \$ 77,872     | \$ 94                        | \$ 63     | \$ 0         | \$ 78,029             |
| Provision for loan losses               | 1,461         | 0                            | 0         | 0            | 1,461                 |
| Noninterest revenues                    | 18,062        | 21,118                       | 12,733    | (687)        | 51,226                |
| Amortization of intangible assets       | 1,170         | 2,343                        | 750       | 0            | 4,263                 |
| Acquisition expenses                    | 22,729        | 117                          | 50        | 0            | 22,896                |
| Other operating expenses                | 53,890        | 13,068                       | 9,449     | (687)        | 75,720                |
| Income before income taxes              | \$ 16,684     | \$ 5,684                     | \$ 2,547  | \$ 0         | \$ 24,915             |
| Assets                                  | \$ 10,635,177 | \$ 217,020                   | \$ 75,382 | \$ (43,533)  | \$ 10,884,046         |
| Goodwill                                | \$ 631,148    | \$ 84,552                    | \$ 17,904 | \$ 0         | \$ 733,604            |

| (000's omitted)                       | Banking    | Employee<br>Benefit Services | All Other | Eliminations | Consolidated<br>Total |
|---------------------------------------|------------|------------------------------|-----------|--------------|-----------------------|
| <b>Six Months Ended June 30, 2018</b> |            |                              |           |              |                       |
| Net interest income                   | \$ 171,253 | \$ 163                       | \$ 54     | \$ 0         | \$ 171,470            |
| Provision for loan losses             | 6,127      | 0                            | 0         | 0            | 6,127                 |
| Noninterest revenues                  | 40,397     | 46,500                       | 28,548    | (1,395)      | 114,050               |
| Amortization of intangible assets     | 3,379      | 4,077                        | 1,897     | 0            | 9,353                 |
| Acquisition expenses                  | 50         | 7                            | 6         | 0            | 63                    |
| Other operating expenses              | 114,418    | 27,914                       | 22,090    | (1,395)      | 163,027               |
| Income before income taxes            | \$ 87,676  | \$ 14,665                    | \$ 4,609  | \$ 0         | \$ 106,950            |
| <b>Six Months Ended June 30, 2017</b> |            |                              |           |              |                       |
| Net interest income                   | \$ 145,006 | \$ 172                       | \$ 125    | \$ 0         | \$ 145,303            |
| Provision for loan losses             | 3,289      | 0                            | 0         | 0            | 3,289                 |
| Noninterest revenues                  | 33,929     | 38,754                       | 24,212    | (1,351)      | 95,544                |
| Amortization of intangible assets     | 1,724      | 3,933                        | 1,374     | 0            | 7,031                 |
| Acquisition expenses                  | 23,250     | 1,179                        | 183       | 0            | 24,612                |
| Other operating expenses              | 103,383    | 24,438                       | 18,341    | (1,351)      | 144,811               |
| Income before income taxes            | \$ 47,289  | \$ 9,376                     | \$ 4,439  | \$ 0         | \$ 61,104             |

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") primarily reviews the financial condition and results of operations of Community Bank System, Inc. (the "Company" or "CBSI") as of and for the three and six months ended June 30, 2018 and 2017, although in some circumstances the first quarter of 2018 is also discussed in order to more fully explain recent trends. The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and related notes that appear on pages 3 through 30. All references in the discussion of the financial condition and results of operations refer to the consolidated position and results of the Company and its subsidiaries taken as a whole. Unless otherwise noted, the term "this year" and equivalent terms refers to results in calendar year 2018, "second quarter" refers to the three months ended June 30, 2018, "YTD" refers to the six months ended June 30, 2018, and earnings per share ("EPS") figures refer to diluted EPS.

This MD&A contains certain forward-looking statements with respect to the financial condition, results of operations, and business of the Company. These forward-looking statements involve certain risks and uncertainties. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements are set herein under the caption, "Forward-Looking Statements," on page 48.

### **Critical Accounting Policies**

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

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

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

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

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

- **Investment securities** – Investment securities are classified as held-to-maturity, available-for-sale, or trading. The appropriate classification is based partially on the Company’s ability to hold the securities to maturity and largely on management’s intentions with respect to either holding or selling the securities. The classification of investment securities is significant since it directly impacts the accounting for unrealized gains and losses on securities. Unrealized gains and losses on available-for-sale debt securities are recorded in accumulated other comprehensive income or loss, as a separate component of shareholders’ equity, and do not affect earnings until realized. Unrealized gains and losses on equity securities with a readily determinable fair value are recognized in the consolidated statement of income. The fair values of investment securities are generally determined by reference to quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments, or a discounted cash flow model using market estimates of interest rates and volatility. Investment securities with significant declines in fair value are evaluated to determine whether they should be considered other-than-temporarily impaired (“OTTI”). An unrealized loss is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value of the expected future cash flows is less than the amortized cost basis of the debt security. The credit loss component of an OTTI write-down is recorded in earnings, while the remaining portion of the impairment loss is recognized in other comprehensive income (loss), provided the Company does not intend to sell the underlying debt security, and it is not more likely than not that the Company will be required to sell the debt security prior to recovery of the full value of its amortized cost basis.
- **Retirement benefits** – The Company provides defined benefit pension benefits to eligible employees and post-retirement health and life insurance benefits to certain eligible retirees. The Company also provides deferred compensation and supplemental executive retirement plans for selected current and former employees. Expense under these plans is charged to current operations and consists of several components of net periodic benefit cost based on various actuarial assumptions regarding future experience under the plans, including, but not limited to, discount rate, rate of future compensation increases, mortality rates, future health care costs, and the expected return on plan assets.
- **Intangible assets** – As a result of acquisitions, the Company carries goodwill and identifiable intangible assets. Goodwill represents the cost of acquired companies in excess of the fair value of net assets at the acquisition date. Goodwill is evaluated at least annually, or when business conditions suggest impairment may have occurred. Should impairment occur, goodwill will be reduced to its carrying value through a charge to earnings. Core deposits and other identifiable intangible assets are amortized to expense over their estimated useful lives. The determination of whether or not impairment exists is based upon discounted cash flow modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires them to select a discount rate that reflects the current return requirements of the market in relation to current credit risk-free interest rates, required equity market premiums, and company-specific performance and risk metrics, all of which are susceptible to change based on changes in economic and market conditions and other factors. Future events or changes in the estimates used to determine the carrying value of goodwill and identifiable intangible assets could have a material impact on the Company’s results of operations.

A summary of the accounting policies used by management is disclosed in Note A, “Summary of Significant Accounting Policies” on pages 63-71 of the most recent Form 10-K (fiscal year ended December 31, 2017) filed with the Securities and Exchange Commission (“SEC”) on March 1, 2018.

#### **Supplemental Reporting of Non-GAAP Results of Operations**

The Company also provides supplemental reporting of its results on a “net adjusted” or “tangible” basis, from which it excludes the after-tax effect of amortization of core deposit and other intangible assets (and the related goodwill, core deposit intangible and other intangible asset balances, net of applicable deferred tax amounts), accretion on non-impaired purchased loans, and expenses associated with acquisitions. Although “adjusted net income” as defined by the Company is a non-GAAP measure, the Company’s management believes this information helps investors understand the effect of acquisition activity in its reported results. Reconciliations of GAAP amounts with corresponding non-GAAP amounts are presented in Table 11.

#### **Executive Summary**

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

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

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

On January 2, 2018, the Company, through its subsidiary, OneGroup NY, Inc. ("OneGroup"), completed its acquisition of certain assets of Penna & Associates Agency, Inc. ("Penna"), an insurance agency headquartered in Johnson City, New York. The Company paid \$0.8 million in cash to acquire the assets of Penna, and recorded goodwill in the amount of \$0.3 million and a customer list intangible asset of \$0.3 million in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

On January 2, 2018, the Company, through its subsidiary, Community Investment Services, Inc. ("CISI"), completed its acquisition of certain assets of Styles Bridges Associates ("Styles Bridges"), a financial services business headquartered in Canton, New York. The Company paid \$0.7 million in cash to acquire a customer list from Styles Bridges, and recorded a \$0.7 million customer list intangible asset in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

On April 2, 2018, the Company, through its subsidiary, Benefit Plans Administrative Services, Inc. ("BPAS"), acquired certain assets of HR Consultants (SA), LLC ("HR Consultants"), a benefits consulting group headquartered in Puerto Rico. The Company paid \$0.3 million in cash to acquire the assets of HR Consultants and recorded intangible assets of \$0.3 million in conjunction with the acquisition. The effects of the acquired assets have been included in the consolidated financial statements since that date.

Second quarter and year-to-date net income increased compared to the 2017 timeframes by \$27.4 million, or 159%, and \$41.3 million, or 95%, respectively. Earnings per share of \$0.86 for the second quarter of 2018 increased \$0.51 from the second quarter of 2017, and 2018 year-to-date earnings per share of \$1.63 was \$0.72 higher than 2017 year-to-date earnings per share. The increase in net income and earnings per share for the quarter and year-to-date were primarily due to increases in net interest income, higher noninterest revenues, lower acquisition expenses attributable to the Merchants Bancshares, Inc. ("Merchants") and Northeast Retirement Services, Inc. ("NRS") acquisitions and a lower effective tax rate, partially offset by a higher provision for loan losses, higher noninterest expenses and an increase in diluted shares outstanding. Second quarter and year-to-date net income adjusted to exclude acquisition expenses, amortization of intangibles and acquired non-impaired loan accretion, increased \$11.9 million, or 34.2%, as compared to the second quarter of 2017 and \$24.9 million, or 39.0%, compared to June YTD 2017. Earnings per share adjusted to exclude acquisition expenses, amortization of intangibles and acquired non-impaired loan accretion of \$0.90 for the second quarter increased \$0.19, or 26.8%, compared to the second quarter of 2017. Earnings per share adjusted for acquisition expenses, amortization of intangibles and acquired non-impaired loan accretion of \$1.71 for the first six months of 2018 increased \$0.38, or 28.5%, compared to the first six months of 2017.

Loans and deposits increased on an average basis as compared to the corresponding prior year periods, due primarily to the Merchants acquisition completed in May 2017. On an ending basis, both loans and deposits decreased compared to the prior year, with the decreases due primarily to seasonal fluctuations and decreases in loans outstanding in the Company's New England market.

The trends of declining yields on interest-earning assets and rates of interest-bearing liabilities have moderated recently. U.S. market interest rates have generally increased over the past year. The total cost of funds increased slightly from the prior year period, as the increase in the rate paid on interest-bearing deposits was moderated by the change in mix of the Company's funding base and the continued shift toward lower cost core funding sources. Due to the Merchants acquisition, the majority of the Company's borrowings are customer repurchase agreements, rather than wholesale borrowings obtained through capital markets and correspondent banks. Customer repurchase agreements have deposit like features and typically bear lower rates of interest than other types of wholesale borrowings.

The second quarter 2018 provision for loan losses was \$1.0 million higher than the second quarter of 2017, driven by growth in certain non-acquired loan portfolios. Second quarter 2018 nonperforming loan ratios were up slightly compared to the second quarter of 2017. Net charge-offs were \$0.9 million for the second quarter of 2018, compared to \$1.1 million of net charge-offs for the second quarter of 2017.

## Net Income and Profitability

As shown in Table 1, net income for the second quarter and June YTD of \$44.6 million and \$84.7 million, respectively, increased \$27.4 million, or 159.5%, as compared to the second quarter of 2017 and increased \$41.3 million, or 95.0%, compared to June YTD 2017. Earnings per share of \$0.86 for the second quarter increased \$0.51 compared to the second quarter of 2017, while earnings per share for the first six months of 2018 of \$1.63 was \$0.72 higher than the first six months of 2017. The increase in net income and earnings per share for the quarter and YTD period are primarily the result of higher net interest income, higher noninterest revenues, significantly lower acquisition expenses and a lower effective tax rate, partially offset by higher noninterest expenses, a higher provision for loan losses and an increase in diluted shares outstanding. Net income adjusted to exclude acquisition expenses, amortization of intangibles and acquired non-impaired loan accretion of \$46.7 million and \$88.9 million for the second quarter and June YTD, respectively, increased \$11.9 million, or 34.2%, as compared to the second quarter of 2017 and increased \$24.9 million, or 39.0%, compared to June YTD 2017. Earnings per share adjusted to exclude acquisition expenses, amortization of intangibles and acquired non-impaired loan accretion of \$0.90 for the second quarter, was up \$0.19 compared to the second quarter of 2017, while earnings per share adjusted to exclude acquisition expenses, amortization of intangibles and acquired non-impaired loan accretion of \$1.71 for the first six months of 2018, was up \$0.38 compared to the first six months of 2017. See Table 11 for Reconciliation of GAAP to Non-GAAP Measures.

As reflected in Table 1, second quarter net interest income of \$86.8 million was up \$8.8 million, or 11.3%, from the comparable prior year period. Net interest income for the first six months of 2018 increased \$26.2 million, or 18.0%, versus the first six months of 2017. The quarterly and year-over-year improvement resulted from an increase in interest-earning assets and an increase in the yield on interest-earning assets, primarily from the Merchants acquisition, partially offset by an increase in interest-bearing liabilities and an increase in the average rate paid on interest-bearing liabilities.

The provision for loan losses for the second quarter and June YTD increased \$1.0 million and \$2.8 million as compared to the second quarter and first six months of 2017, respectively, primarily driven by growth in certain non-acquired loan portfolios.

Second quarter and year-to-date noninterest revenues were \$56.6 million and \$114.1 million, respectively, up \$5.3 million, or 10.4%, from the second quarter of 2017 and up \$18.5 million, or 19.4%, from the first six months of 2017. The increase was primarily a result of the Merchants acquisition completed in May 2017 and the NRS acquisition completed in February 2017.

Noninterest expenses of \$86.1 million and \$172.4 million for the second quarter and June YTD periods reflected a decrease of \$16.8 million, or 16.3%, from the second quarter of 2017 and a decrease of \$4.0 million, or 2.3%, from the first six months of 2017. Excluding acquisition-related expenses, 2018 operating expenses were \$6.1 million, or 7.6%, higher for the second quarter and \$20.5 million, or 13.5%, higher for the year-to-date timeframe. The increases in noninterest expenses were largely the result of operating a larger franchise, including the impact of the Merchants and NRS acquisitions.

The effective income tax rates were 18.7% and 20.8% for the second quarter and YTD 2018, respectively, as compared to 31.0% and 28.9% for the comparable prior year periods. The decrease in effective income tax rates between the periods is primarily attributable to the impact of the Tax Cuts and Jobs Act signed into law in December 2017, combined with the impact of the windfall tax benefit associated with accounting for share-based transactions. The Tax Cuts and Jobs Act permanently lowered the corporate tax rate from 35% to 21% for tax years including or commencing January 1, 2018. The windfall tax benefit reduced income taxes by \$1.2 million and \$1.9 million for the second quarter and YTD 2018, respectively, as compared to a reduction of \$0.3 million and \$2.5 million for the comparable prior year periods.

A condensed income statement is as follows:

**Table 1: Condensed Income Statements**

| (000's omitted, except per share data)             | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |            |
|----------------------------------------------------|--------------------------------|-----------|------------------------------|------------|
|                                                    | 2018                           | 2017      | 2018                         | 2017       |
| Net interest income                                | \$ 86,846                      | \$ 78,029 | \$ 171,470                   | \$ 145,303 |
| Provision for loan losses                          | 2,448                          | 1,461     | 6,127                        | 3,289      |
| Noninterest revenues                               | 56,559                         | 51,226    | 114,050                      | 95,544     |
| Noninterest expenses                               | 86,112                         | 102,879   | 172,443                      | 176,454    |
| Income before income taxes                         | 54,845                         | 24,915    | 106,950                      | 61,104     |
| Income taxes                                       | 10,239                         | 7,724     | 22,238                       | 17,656     |
| Net income                                         | \$ 44,606                      | \$ 17,191 | \$ 84,712                    | \$ 43,448  |
| Diluted weighted average common shares outstanding | 51,939                         | 49,386    | 51,827                       | 47,815     |
| Diluted earnings per share                         | \$ 0.86                        | \$ 0.35   | \$ 1.63                      | \$ 0.91    |

## **Net Interest Income**

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

As shown in Table 2a, net interest income (with nontaxable income converted to a fully tax-equivalent basis) for the second quarter was \$87.9 million, a \$7.5 million, or 9.4%, increase from the same period last year. The increase resulted from an increase in interest-earning assets of \$771.0 million from the second quarter of 2017, primarily related to the Merchants acquisition, and a four basis point increase in the average yield on earning assets, partially offset by a \$310.5 million increase in average interest-bearing liabilities and a four basis point increase in the average rate paid on interest-bearing liabilities. As reflected in Table 3, the second quarter volume increase in interest-earning assets and the increase in the average yield on earning assets had an \$8.3 million favorable impact on net interest income, while the volume increase on interest-bearing liabilities and rate increase on interest-bearing liabilities had a \$0.8 million unfavorable impact on net interest income. June YTD net interest income, as reflected in Table 2b, of \$173.7 million, increased \$23.7 million, or 15.8%, from the year-earlier period. The June YTD increase resulted from an increase in interest-earning assets of \$1.21 billion from the prior year, reflective of the Merchants acquisition and a six basis point increase in the earning asset yield, partially offset by a \$629.3 million increase in average interest-bearing liabilities and a four basis point increase in the rate paid on interest-bearing liabilities. The volume increase in interest-earning assets and increase in yield had a \$25.6 million favorable impact on June YTD net interest income, while the volume increase on interest-bearing liabilities and rate increase on interest-bearing liabilities had a \$1.9 million unfavorable impact on net interest income.

The higher net interest margin for the second quarter of 2018 as compared to the second quarter of 2017 was the result of a four basis point increase in the earning asset yield, partially offset by a four basis point increase in the average rate on interest-bearing liabilities. The net interest margin of 3.72% for the first six months of 2018 was three basis points higher than the comparable period of 2017. The yield on interest-earning assets increased six basis points, while the rate on interest-bearing liabilities increased by four basis points for the first six months of 2018 as compared to the prior year period.

The higher average yield on earning assets for the quarter was the result of an increase in the average yield on loans, partially offset by a decrease in the average yield on investments. For the second quarter, the average yield on loans increased by 17 basis points, while the average yield on investments, including cash equivalents, decreased 24 basis points compared to the prior year. The six basis point increase in the yield on earning assets for the first six months of 2018 was the result of an 18 basis point increase in the average yield on loans compared to the comparable period of 2017, partially offset by a 27 basis point decrease in the average yield on investments, including cash equivalents. The increase in the loan yield was due primarily to an increase in acquired loan accretion on the acquired Merchants portfolio, including \$0.5 million in the second quarter of 2018 related to the successful resolution of an acquired impaired business loan relationship. The lower average yield of investments was the result of maturing higher interest rate investments being replaced with lower rate instruments or being used to pay down external borrowings.

The average rate on interest-bearing liabilities increased by four basis points compared to the prior year quarter as the average rate paid on external borrowings increased 26 basis points and the rate paid on interest-bearing deposits increased one basis point from the prior year quarter. For the first six months of 2018, the average rate on interest-bearing deposits increased two basis points from the comparable prior year period, while the average rate on external borrowings decreased 12 basis points. The decrease in the average cost of external borrowings was primarily the result of lower-rate customer repurchase agreements contributing to a higher proportion of average external borrowings as compared to the prior year period.

The second quarter and year-to-date average balance of investments, including cash equivalents, increased \$216.0 million and \$287.0 million, respectively, as compared to the corresponding prior year periods. This growth was principally the result of securities acquired in the Merchants transaction. Average loan balances increased \$555.0 million for the quarter and \$924.8 million year-to-date as compared to the prior year, with \$516.7 million for the quarter and \$926.5 million year-to-date a result of the Merchants acquisition.

The quarterly and year-to-date increases in average interest-bearing deposits of \$260.4 million and \$467.1 million, respectively, were primarily a result of the Merchants transaction. The Merchants transaction was responsible for a \$308.9 million increase in quarterly average interest-bearing deposits and a \$519.1 million increase in year-to-date average interest-bearing deposits. The average borrowing balance, including FHLB borrowings, subordinated debt held by unconsolidated subsidiary trusts, and securities sold under agreement to repurchase (customer repurchase agreements), increased \$50.1 million for the quarter and \$162.2 million for the year-to-date period.

Tables 2a and 2b below sets forth information related to average interest-earning assets and interest-bearing liabilities and their associated yields and rates for the periods indicated. Interest income and yields are on a fully tax-equivalent basis (“FTE”) using marginal income tax rates of 24.3% and 37.9% in 2018 and 2017, respectively. Average balances are computed by totaling the daily ending balances in a period and dividing by the number of days in that period. Loan interest income and yields include amortization of deferred loan income and costs and the accretion of acquired loan marks. Average loan balances include nonaccrual loans and loans held for sale.

**Table 2a: Quarterly Average Balance Sheet**

|                                                               | Three Months Ended<br>June 30, 2018 |           |                            | Three Months Ended<br>June 30, 2017 |           |                            |
|---------------------------------------------------------------|-------------------------------------|-----------|----------------------------|-------------------------------------|-----------|----------------------------|
|                                                               | Average<br>Balance                  | Interest  | Avg.<br>Yield/Rate<br>Paid | Average<br>Balance                  | Interest  | Avg.<br>Yield/Rate<br>Paid |
| <i>(000's omitted except yields and rates)</i>                |                                     |           |                            |                                     |           |                            |
| Interest-earning assets:                                      |                                     |           |                            |                                     |           |                            |
| Cash equivalents                                              | \$ 170,745                          | \$ 735    | 1.73%                      | \$ 52,956                           | \$ 130    | 0.99%                      |
| Taxable investment securities (1)                             | 2,575,962                           | 15,782    | 2.46%                      | 2,408,020                           | 15,045    | 2.51%                      |
| Nontaxable investment securities (1)                          | 457,254                             | 4,221     | 3.70%                      | 526,962                             | 5,966     | 4.54%                      |
| Loans (net of unearned discount) (2)                          | 6,250,739                           | 71,361    | 4.58%                      | 5,695,781                           | 62,655    | 4.41%                      |
| Total interest-earning assets                                 | 9,454,700                           | 92,099    | 3.91%                      | 8,683,719                           | 83,796    | 3.87%                      |
| Noninterest-earning assets                                    | 1,297,503                           |           |                            | 1,274,834                           |           |                            |
| Total assets                                                  | \$ 10,752,203                       |           |                            | \$ 9,958,553                        |           |                            |
| Interest-bearing liabilities:                                 |                                     |           |                            |                                     |           |                            |
| Interest checking, savings, and money<br>market deposits      | \$ 5,530,267                        | 1,440     | 0.10%                      | \$ 5,257,721                        | 1,283     | 0.10%                      |
| Time deposits                                                 | 751,831                             | 941       | 0.50%                      | 763,975                             | 782       | 0.41%                      |
| Customer repurchase agreements                                | 267,452                             | 410       | 0.61%                      | 128,712                             | 79        | 0.25%                      |
| FHLB borrowings                                               | 6,827                               | 36        | 2.13%                      | 105,435                             | 313       | 1.19%                      |
| Subordinated debt held by unconsolidated<br>subsidiary trusts | 122,822                             | 1,332     | 4.35%                      | 112,828                             | 936       | 3.33%                      |
| Total interest-bearing liabilities                            | 6,679,199                           | 4,159     | 0.25%                      | 6,368,671                           | 3,393     | 0.21%                      |
| Noninterest-bearing liabilities:                              |                                     |           |                            |                                     |           |                            |
| Noninterest checking deposits                                 | 2,287,722                           |           |                            | 1,948,434                           |           |                            |
| Other liabilities                                             | 145,206                             |           |                            | 185,601                             |           |                            |
| Shareholders' equity                                          | 1,640,076                           |           |                            | 1,455,847                           |           |                            |
| Total liabilities and shareholders' equity                    | \$ 10,752,203                       |           |                            | \$ 9,958,553                        |           |                            |
| Net interest earnings                                         |                                     | \$ 87,940 |                            |                                     | \$ 80,403 |                            |
| Net interest spread                                           |                                     |           | 3.66%                      |                                     |           | 3.66%                      |
| Net interest margin on interest-earning assets                |                                     |           | 3.73%                      |                                     |           | 3.72%                      |
| Fully tax-equivalent adjustment                               |                                     | \$ 1,094  |                            |                                     | \$ 2,374  |                            |

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

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

**Table 2b: Year-to-Date Average Balance Sheet**

|                                                               | Six Months Ended<br>June 30, 2018 |                   |                            | Six Months Ended<br>June 30, 2017 |                   |                            |
|---------------------------------------------------------------|-----------------------------------|-------------------|----------------------------|-----------------------------------|-------------------|----------------------------|
|                                                               | Average<br>Balance                | Interest          | Avg.<br>Yield/Rate<br>Paid | Average<br>Balance                | Interest          | Avg.<br>Yield/Rate<br>Paid |
| <i>(000's omitted except yields and rates)</i>                |                                   |                   |                            |                                   |                   |                            |
| Interest-earning assets:                                      |                                   |                   |                            |                                   |                   |                            |
| Cash equivalents                                              | \$ 130,797                        | \$ 1,079          | 1.66%                      | \$ 46,618                         | \$ 209            | 0.90%                      |
| Taxable investment securities (1)                             | 2,579,683                         | 30,962            | 2.42%                      | 2,306,163                         | 28,532            | 2.49%                      |
| Nontaxable investment securities (1)                          | 462,981                           | 8,571             | 3.73%                      | 533,702                           | 12,104            | 4.57%                      |
| Loans (net of unearned discount) (2)                          | 6,244,317                         | 141,009           | 4.55%                      | 5,319,527                         | 115,194           | 4.37%                      |
| Total interest-earning assets                                 | 9,417,778                         | 181,621           | 3.89%                      | 8,206,010                         | 156,039           | 3.83%                      |
| Noninterest-earning assets                                    | 1,316,190                         |                   |                            | 1,150,246                         |                   |                            |
| Total assets                                                  | <u>\$ 10,733,968</u>              |                   |                            | <u>\$ 9,356,256</u>               |                   |                            |
| Interest-bearing liabilities:                                 |                                   |                   |                            |                                   |                   |                            |
| Interest checking, savings, and money<br>market deposits      | \$ 5,491,849                      | 2,763             | 0.10%                      | \$ 5,053,785                      | 2,311             | 0.09%                      |
| Time deposits                                                 | 758,900                           | 1,750             | 0.47%                      | 729,908                           | 1,484             | 0.41%                      |
| Customer repurchase agreements                                | 286,691                           | 799               | 0.56%                      | 64,712                            | 79                | 0.25%                      |
| FHLB borrowings                                               | 15,443                            | 127               | 1.66%                      | 90,508                            | 462               | 1.03%                      |
| Subordinated debt held by unconsolidated<br>subsidiary trusts | 122,819                           | 2,500             | 4.10%                      | 107,530                           | 1,741             | 3.26%                      |
| Total interest-bearing liabilities                            | 6,675,702                         | 7,939             | 0.24%                      | 6,046,443                         | 6,077             | 0.20%                      |
| Noninterest-bearing liabilities:                              |                                   |                   |                            |                                   |                   |                            |
| Noninterest checking deposits                                 | 2,278,302                         |                   |                            | 1,785,360                         |                   |                            |
| Other liabilities                                             | 146,911                           |                   |                            | 167,536                           |                   |                            |
| Shareholders' equity                                          | 1,633,053                         |                   |                            | 1,356,917                         |                   |                            |
| Total liabilities and shareholders' equity                    | <u>\$ 10,733,968</u>              |                   |                            | <u>\$ 9,356,256</u>               |                   |                            |
| Net interest earnings                                         |                                   |                   |                            |                                   |                   |                            |
|                                                               |                                   | <u>\$ 173,682</u> |                            |                                   | <u>\$ 149,962</u> |                            |
| Net interest spread                                           |                                   |                   |                            |                                   |                   |                            |
|                                                               |                                   |                   | 3.65%                      |                                   |                   | 3.63%                      |
| Net interest margin on interest-earning assets                |                                   |                   |                            |                                   |                   |                            |
|                                                               |                                   |                   | 3.72%                      |                                   |                   | 3.69%                      |
| Fully tax-equivalent adjustment                               |                                   |                   |                            |                                   |                   |                            |
|                                                               |                                   | \$ 2,212          |                            |                                   | \$ 4,659          |                            |

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

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

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

**Table 3: Rate/Volume**

| (000's omitted)                                            | Three months ended June 30, 2018<br>versus June 30, 2017 |         |            | Six months ended June 30, 2018<br>versus June 30, 2017 |         |            |
|------------------------------------------------------------|----------------------------------------------------------|---------|------------|--------------------------------------------------------|---------|------------|
|                                                            | Increase (Decrease) Due to Change in (1)                 |         |            | Increase (Decrease) Due to Change in (1)               |         |            |
|                                                            | Volume                                                   | Rate    | Net Change | Volume                                                 | Rate    | Net Change |
| Interest earned on:                                        |                                                          |         |            |                                                        |         |            |
| Cash equivalents                                           | \$ 452                                                   | \$ 153  | \$ 605     | \$ 593                                                 | \$ 277  | \$ 870     |
| Taxable investment securities                              | 1,033                                                    | (296)   | 737        | 3,303                                                  | (873)   | 2,430      |
| Nontaxable investment securities                           | (729)                                                    | (1,016) | (1,745)    | (1,480)                                                | (2,053) | (3,533)    |
| Loans                                                      | 6,271                                                    | 2,435   | 8,706      | 20,714                                                 | 5,101   | 25,815     |
| Total interest-earning assets (2)                          | 7,502                                                    | 801     | 8,303      | 23,339                                                 | 2,243   | 25,582     |
| Interest paid on:                                          |                                                          |         |            |                                                        |         |            |
| Interest checking, savings and money market deposits       | 69                                                       | 88      | 157        | 209                                                    | 243     | 452        |
| Time deposits                                              | (12)                                                     | 171     | 159        | 61                                                     | 205     | 266        |
| Customer repurchase agreements                             | 139                                                      | 192     | 331        | 525                                                    | 195     | 720        |
| FHLB borrowings                                            | (419)                                                    | 142     | (277)      | (518)                                                  | 183     | (335)      |
| Subordinated debt held by unconsolidated subsidiary trusts | 89                                                       | 307     | 396        | 270                                                    | 489     | 759        |
| Total interest-bearing liabilities (2)                     | 172                                                      | 594     | 766        | 674                                                    | 1,188   | 1,862      |
| Net interest earnings (2)                                  | 7,167                                                    | 370     | 7,537      | 22,335                                                 | 1,385   | 23,720     |

- (1) The change in interest due to both rate and volume has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of such change in each component.
- (2) Changes due to volume and rate are computed from the respective changes in average balances and rates of the totals; they are not a summation of the changes of the components.

#### **Noninterest Revenues**

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

**Table 4: Noninterest Revenues**

|                                                         | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|---------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                         | 2018                           | 2017      | 2018                         | 2017      |
| <i>(000's omitted)</i>                                  |                                |           |                              |           |
| Deposit service fees                                    | \$ 18,964                      | \$ 16,655 | \$ 38,141                    | \$ 31,362 |
| Employee benefit services                               | 22,542                         | 20,662    | 45,548                       | 37,851    |
| Insurance services                                      | 7,415                          | 6,965     | 14,774                       | 13,365    |
| Wealth management services                              | 6,496                          | 5,537     | 13,202                       | 10,398    |
| Other banking services                                  | 697                            | 724       | 1,602                        | 1,511     |
| Mortgage banking                                        | 466                            | 683       | 804                          | 1,055     |
| Subtotal                                                | 56,580                         | 51,226    | 114,071                      | 95,542    |
| Unrealized loss on equity securities                    | (21)                           | 0         | (21)                         | 0         |
| Gain on sales of investment securities, net             | 0                              | 0         | 0                            | 2         |
| Total noninterest revenues                              | \$ 56,559                      | \$ 51,226 | \$ 114,050                   | \$ 95,544 |
| Noninterest revenues/operating revenues (FTE basis) (1) | 39.7%                          | 39.4%     | 40.2%                        | 39.2%     |

(1) For purposes of this ratio noninterest revenues exclude gains and losses on sales of investment securities and unrealized gains (losses) on equity securities. Operating revenues, a non-GAAP measure, is defined as net interest income on a fully-tax equivalent basis plus noninterest revenue, excluding gains and losses on sales of investment securities, unrealized gains (losses) on equity securities and acquired non-impaired loan accretion. See Table 11 for Reconciliation of GAAP to Non-GAAP Measures.

As displayed in Table 4, noninterest revenues were \$56.6 million for the second quarter of 2018 and \$114.1 million for the first six months of 2018. This represents an increase of \$5.3 million, or 10.4%, for the quarter and \$18.5 million, or 19.4%, for the YTD period in comparison to 2017, with the increase primarily related to incremental banking revenues from the Merchants acquisition and financial services revenues from the NRS, Dryfoos Insurance Agency, Inc. ("Dryfoos"), Northeast Capital Management, Inc. ("NECM"), Gordon B. Roberts Agency, Inc. ("GBR"), Styles Bridges, Penna and HR Consulting acquisitions.

General recurring banking noninterest revenue, including deposit service fees and other banking services, of \$19.7 million for the second quarter and \$39.7 million for the first six months of 2018 were up \$2.3 million, or 13.1%, and \$6.9 million, or 20.9%, respectively, as compared to the corresponding prior year periods. This year-over-year increase was primarily driven by an expanded customer base following the Merchants transaction, which was completed in May 2017, and an increase in deposit service fees resulting from increased electronic banking revenue. Beginning in the third quarter of 2018, the Company will be subject to the limitation on interchange fees for debit card transactions established by the Durbin amendment of the Dodd-Frank Act for financial institutions with total assets greater than \$10.0 billion. The Company estimates that its deposit service fees will decrease \$2.5 million to \$3.5 million during the third quarter of 2018 due to Durbin interchange limitations.

Mortgage banking income totaled \$0.5 million for the second quarter of 2018 and \$0.8 million for the first six months of 2018, a decrease of \$0.2 million and \$0.3 million, respectively, as compared to the corresponding prior periods. Mortgage banking income consists of realized gains or losses from the sale of residential mortgage loans and the origination of mortgage loan servicing rights, unrealized gains and losses on residential mortgage loans held for sale and related commitments, mortgage loan servicing fees and other residential mortgage loan-related fee income. Mortgage loans sold to investors, primarily Fannie Mae, totaled \$3.5 million in the second quarter of 2018 and \$7.7 million for the first six months of 2018 compared to \$7.5 million and \$15.3 million in the respective comparable prior year periods. Realization of the unrealized gains or losses on mortgage loans held for sale and the related commitments, as well as future revenue generation from mortgage banking activities, are dependent on market conditions and long-term interest rate trends.

Employee benefit services revenue increased \$1.9 million, or 9.1%, and \$7.7 million, or 20.3%, for the three and six months ended June 30, 2018, respectively, as compared to the prior year periods, primarily related to the NRS acquisition completed in February 2017. Wealth management and insurance services revenues were up \$1.4 million, or 11.3%, for the second quarter of 2018 and up \$4.2 million, or 17.7%, for 2018 YTD as compared to the same time periods of 2017 due to both organic and acquired revenue growth from OneGroup and CISI.

The ratio of noninterest revenues to total revenues (FTE basis) was 39.7% for the quarter and 40.2% for the six months ended June 30, 2018, respectively, versus 39.4% and 39.2% for the comparable periods of 2017. The increase for the year-to-date period is a function of a 19.4% increase in noninterest income while adjusted net interest income (FTE basis) increased at a lesser 15.8% rate, primarily the result of the mix of business acquired in the NRS and Merchants transactions.

## Noninterest Expenses

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

**Table 5: Noninterest Expenses**

| (000's omitted)                                    | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|----------------------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                                    | 2018                           | 2017       | 2018                         | 2017       |
| Salaries and employee benefits (1)                 | \$ 52,402                      | \$ 46,564  | \$ 104,261                   | \$ 89,471  |
| Occupancy and equipment                            | 9,437                          | 8,637      | 19,968                       | 16,833     |
| Data processing and communications                 | 10,212                         | 10,395     | 18,954                       | 18,916     |
| Amortization of intangible assets                  | 4,555                          | 4,263      | 9,353                        | 7,031      |
| Legal and professional fees                        | 2,745                          | 2,619      | 5,525                        | 5,033      |
| Business development and marketing                 | 2,654                          | 2,451      | 4,714                        | 4,532      |
| Acquisition expenses                               | 71                             | 22,896     | 63                           | 24,612     |
| Other                                              | 4,036                          | 5,054      | 9,605                        | 10,026     |
| Total noninterest expenses                         | \$ 86,112                      | \$ 102,879 | \$ 172,443                   | \$ 176,454 |
| Noninterest operating expenses (2) /average assets | 3.04%                          | 3.05%      | 3.06%                        | 3.12%      |
| Efficiency ratio (3)                               | 57.2%                          | 58.3%      | 57.5%                        | 59.5%      |

- (1) In accordance with ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, \$1.8 million and \$3.3 million of income from components of net periodic benefit income other than service cost was reclassified from Salaries and employee benefits to Other noninterest expenses for the three and six months ended June 30, 2017, respectively.
- (2) Operating expenses, a non-GAAP measure, is calculated as total noninterest expenses less acquisition expenses and amortization of intangibles. See Table 11 for Reconciliation of GAAP to Non-GAAP Measures.
- (3) Efficiency ratio, a non-GAAP measure, is calculated as operating expenses as defined in (2) divided by net interest income on a fully tax-equivalent basis excluding acquired non-impaired loan accretion plus noninterest revenues excluding gains and losses on investment sales and unrealized gains and losses on equity securities. See Table 11 for Reconciliation of GAAP to Non-GAAP Measures.

As shown in Table 5, noninterest expenses were \$86.1 million and \$172.4 million for the second quarter and YTD periods of 2018, respectively, representing a decrease of \$16.8 million, or 16.3%, and \$4.0 million, or 2.3%, from the prior year periods. Acquisition expenses are \$22.8 million and \$24.5 million less in the second quarter and YTD 2018 periods, respectively, as compared to the corresponding 2017 periods. Salaries and employee benefits increased \$5.8 million, or 12.5%, and \$14.8 million, or 16.5%, for the second quarter and YTD periods of 2018, respectively, as compared to the corresponding periods of 2017. The main drivers of the increase were more full-time equivalent employees due to the Merchants and NRS acquisitions and annual merit-based and incentive-based personnel cost increases. The remaining change to noninterest expenses can be attributed to occupancy and equipment (up \$0.8 million for the quarter and \$3.1 million YTD), data processing and communications (down \$0.2 million for the quarter and YTD consistent with the prior year period), amortization of intangible assets (up \$0.3 million for the quarter and \$2.3 million YTD), legal and professional fees (up \$0.1 million for the quarter and \$0.5 million YTD), business development and marketing (up \$0.2 million for the quarter and \$0.2 million YTD), and other expenses (down \$1.0 million for the quarter and down \$0.4 million YTD); all of which were primarily driven by the additional costs that are associated with the acquired Merchants and NRS business activities.

The Company's efficiency ratio (total operating expenses excluding intangible amortization and acquisition expenses divided by FTE net interest income excluding acquired non-impaired loan accretion and noninterest revenues excluding realized and unrealized gains and losses on investments) was 57.2% for the second quarter, 1.1% favorable to the comparable quarter of 2017. This resulted from operating income as described above increasing by 9.6% from higher FTE-adjusted net interest income and growth in noninterest revenues, while operating expenses (as described above) increased by a lesser 7.6%. The efficiency ratio of 57.5% for the first six months of 2018 was 2.0% favorable compared to the first six months of 2017 due to 14.7% higher FTE-adjusted net interest income excluding acquired non-impaired loan accretion and a 19.4% increase in noninterest revenues excluding realized and unrealized gains and losses on investments resulting in an increase in operating income of 16.5%, while operating expenses (as described above) increased at a lesser 12.6%. Current year operating expenses, excluding intangible amortization and acquisition expenses, as a percentage of average assets decreased one basis point versus the prior year quarter and was six basis points lower than the prior year-to-date period. Operating expenses (as defined above) increased 7.6% for the quarter and 12.6% for the year-to-date period, while average assets increased 8.0% for the quarter and 14.7% for the year-to-date period, impacted by asset growth related to the Merchants acquisition, partially offset by additional operating costs associated with operating a larger enterprise.

## Income Taxes

The second quarter and YTD 2018 effective income tax rates were 18.7% and 20.8%, respectively, as compared to the 31.0% and 28.9% for the comparable periods of 2017. The decline in the rate is primarily attributable to the impact of the Tax Cuts and Jobs Act signed into law in December 2017, combined with the impact of the windfall tax benefit associated with accounting for share-based transactions. The Tax Cuts and Jobs Act lowered the corporate tax rate from 35% to 21% for tax years including or commencing January 1, 2018. Excluding the reduction in income tax expense associated with the windfall tax benefit from share-based transactions, the second quarter and YTD 2018 effective income tax rates were 20.9% and 22.6%, respectively, as compared to 32.3% and 33.0% for the comparable periods of 2017.

## Investment Securities

The carrying value of investments (including unrealized gains and losses on available-for-sale securities) was \$2.98 billion at the end of the second quarter, a decrease of \$98.0 million from December 31, 2017 and \$161.7 million lower than June 30, 2017. The book value (excluding unrealized gains and losses) of investments decreased \$41.4 million from December 31, 2017 and decreased \$73.5 million from June 30, 2017. During the first six months of 2018, the Company purchased \$31.7 million of government agency mortgage-backed securities with an average yield of 3.25%. The Company also received \$69.6 million of investment maturities, calls, and principal payments during the first six months of 2018.

The change in the carrying value of investments is also impacted by the amount of net unrealized gains and losses in the available-for-sale portfolio. At June 30, 2018, the portfolio had a \$32.7 million net unrealized loss, a decrease of \$56.6 million from the unrealized gain at December 31, 2017 and an \$88.1 million decrease from the unrealized gain at June 30, 2017. These changes in the net unrealized gains were principally driven by the movement in longer-term interest rates.

**Table 6: Investment Securities**

|                                                       | June 30, 2018     |               | December 31, 2017 |               | June 30, 2017     |               |
|-------------------------------------------------------|-------------------|---------------|-------------------|---------------|-------------------|---------------|
|                                                       | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost | Fair<br>Value | Amortized<br>Cost | Fair<br>Value |
| (000's omitted)                                       |                   |               |                   |               |                   |               |
| <i>Available-for-Sale Portfolio:</i>                  |                   |               |                   |               |                   |               |
| U.S. Treasury and agency securities                   | \$ 2,042,116      | \$ 2,013,962  | \$ 2,043,023      | \$ 2,054,071  | \$ 2,039,313      | \$ 2,075,798  |
| Obligations of state and political subdivisions       | 485,099           | 491,484       | 514,949           | 528,956       | 556,459           | 573,472       |
| Government agency mortgage-backed securities          | 364,919           | 355,897       | 358,180           | 357,538       | 331,925           | 333,447       |
| Corporate debt securities                             | 2,618             | 2,563         | 2,648             | 2,623         | 2,678             | 2,671         |
| Government agency collateralized mortgage obligations | 78,137            | 76,038        | 88,097            | 87,374        | 100,252           | 100,439       |
| Marketable equity securities                          | 0                 | 0             | 251               | 526           | 251               | 497           |
| Total available-for-sale portfolio                    | 2,972,889         | 2,939,944     | 3,007,148         | 3,031,088     | 3,030,878         | 3,086,324     |
| <i>Equity and other Securities:</i>                   |                   |               |                   |               |                   |               |
| Equity securities, at fair value                      | 251               | 504           | 0                 | 0             | 0                 | 0             |
| Federal Home Loan Bank common stock                   | 6,371             | 6,371         | 9,896             | 9,896         | 18,439            | 18,439        |
| Federal Reserve Bank common stock                     | 30,690            | 30,690        | 30,690            | 30,690        | 19,806            | 19,806        |
| Certificates of deposit                               | 0                 | 0             | 3,865             | 3,865         | 14,450            | 14,450        |
| Other equity securities, at cost                      | 5,843             | 5,843         | 5,840             | 5,840         | 5,994             | 5,994         |
| Total equity and other securities                     | 43,155            | 43,408        | 50,291            | 50,291        | 58,689            | 58,689        |
| Total investments                                     | \$ 3,016,044      | \$ 2,983,352  | \$ 3,057,439      | \$ 3,081,379  | \$ 3,089,567      | \$ 3,145,013  |

## Loans

As shown in Table 7, loans ended the second quarter at \$6.24 billion, down \$123.3 million, or 1.9%, from one year earlier and down \$18.7 million, or 0.3%, from the end of 2017. The decrease in loans outstanding is primarily related to a decrease in loans outstanding in the Company's New England region, partially offset by loan growth in the New York and Pennsylvania markets.

**Table 7: Loans**

| <i>(000's omitted)</i> | June 30, 2018 |           | December 31, 2017 |    | June 30, 2017 |        |
|------------------------|---------------|-----------|-------------------|----|---------------|--------|
| Business lending       | \$            | 2,384,629 | 38.2%             | \$ | 2,424,223     | 39.0%  |
| Consumer mortgage      |               | 2,210,051 | 35.4%             |    | 2,220,298     | 34.8%  |
| Consumer indirect      |               | 1,063,679 | 17.1%             |    | 1,011,978     | 16.6%  |
| Consumer direct        |               | 181,217   | 2.9%              |    | 179,929       | 2.9%   |
| Home equity            |               | 398,433   | 6.4%              |    | 420,329       | 6.7%   |
| Total loans            | \$            | 6,238,009 | 100.0%            | \$ | 6,256,757     | 100.0% |

The combined total of general-purpose business lending to commercial and industrial customers, municipal lending, mortgages on commercial property, and dealer floor plan financing is characterized as the Company's business lending activity. The business lending portfolio decreased \$94.5 million, or 3.8%, from June 30, 2017 and decreased \$39.6 million, or 1.6%, from December 31, 2017, as contractual and unscheduled principal reductions outpaced loan originations. Highly competitive conditions continue to prevail in the small and middle market segments in which the Company operates. The Company strives to generate growth in its business portfolio in a manner that adheres to its goals of maintaining strong asset quality and producing profitable margins. The Company continues to invest in additional personnel, technology and business development resources to further strengthen its capabilities in this important product category.

Consumer mortgages decreased \$1.4 million, or 0.1%, from one year ago and decreased \$10.2 million, or 0.5%, from December 31, 2017. Consumer mortgage volume has been relatively strong over the last several years due to historically low long-term rates and comparatively stable real estate valuations in the Company's primary markets. However, recent increases in mortgage rates have altered the primary loan purpose to predominately purchase money transactions, while negatively impacting refinance origination volumes. Interest rate levels and expected duration continue to be the most significant factors in determining whether the Company chooses to retain, versus sell and service, portions of its new mortgage production.

Consumer installment loans, both those originated directly in the branches (referred to as "consumer direct") and indirectly in automobile, marine, and recreational vehicle dealerships (referred to as "consumer indirect"), increased \$1.6 million, or 0.1%, from one year ago and increased \$53.0 million, or 4.4%, from December 31, 2017. The Company is focused on maintaining a profitable and in-market and contiguous market indirect portfolio, while continuing to pursue the expansion of its dealer network. However, the competitive nature of this market has resulted in aggressive pricing and incentives that have caused some compression of indirect loan spreads particularly for new automobile loans.

Home equity loans decreased \$29.1 million, or 6.8%, from one year ago and decreased \$21.9 million, or 5.2%, from December 31, 2017.

## Asset Quality

Table 8 below exhibits the major components of nonperforming loans and assets and key asset quality metrics for the periods ending June 30, 2018 and 2017 and December 31, 2017.

**Table 8: Nonperforming Assets**

| <i>(000's omitted)</i>                                                         | June 30,<br>2018 | December 31,<br>2017 | June 30,<br>2017 |
|--------------------------------------------------------------------------------|------------------|----------------------|------------------|
| <i>Nonaccrual loans</i>                                                        |                  |                      |                  |
| Business lending                                                               | \$ 7,651         | \$ 8,272             | \$ 4,365         |
| Consumer mortgage                                                              | 12,595           | 13,788               | 14,130           |
| Consumer indirect                                                              | 5                | 0                    | 0                |
| Consumer direct                                                                | 0                | 0                    | 0                |
| Home equity                                                                    | 2,556            | 2,680                | 2,538            |
| Total nonaccrual loans                                                         | 22,807           | 24,740               | 21,033           |
| <i>Accruing loans 90+ days delinquent</i>                                      |                  |                      |                  |
| Business lending                                                               | 3,789            | 571                  | 527              |
| Consumer mortgage                                                              | 2,102            | 1,526                | 1,141            |
| Consumer indirect                                                              | 159              | 303                  | 118              |
| Consumer direct                                                                | 20               | 48                   | 31               |
| Home equity                                                                    | 462              | 264                  | 65               |
| Total accruing loans 90+ days delinquent                                       | 6,532            | 2,712                | 1,882            |
| <i>Nonperforming loans</i>                                                     |                  |                      |                  |
| Business lending                                                               | 11,440           | 8,843                | 4,892            |
| Consumer mortgage                                                              | 14,697           | 15,314               | 15,271           |
| Consumer indirect                                                              | 164              | 303                  | 118              |
| Consumer direct                                                                | 20               | 48                   | 31               |
| Home equity                                                                    | 3,018            | 2,944                | 2,603            |
| Total nonperforming loans                                                      | 29,339           | 27,452               | 22,915           |
| Other real estate owned (OREO)                                                 | 1,310            | 1,915                | 2,491            |
| Total nonperforming assets                                                     | \$ 30,649        | \$ 29,367            | \$ 25,406        |
| Nonperforming loans / total loans                                              | 0.47%            | 0.44%                | 0.36%            |
| Nonperforming assets / total loans and other real estate                       | 0.49%            | 0.47%                | 0.40%            |
| Delinquent loans (30 days old to nonaccruing) to total loans                   | 0.89%            | 1.10%                | 0.99%            |
| Net charge-offs to average loans outstanding (quarterly)                       | 0.06%            | 0.37%                | 0.08%            |
| Legacy net charge-offs to average legacy loans outstanding (quarterly)         | 0.05%            | 0.20%                | 0.06%            |
| Provision for loan losses to net charge-offs (quarterly)                       | 262%             | 93%                  | 132%             |
| Legacy provision for loan losses to net charge-offs (quarterly) <sup>(1)</sup> | 364%             | 67%                  | 153%             |

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

As displayed in Table 8, nonperforming assets at June 30, 2018 were \$30.6 million, a \$1.3 million increase versus the level at the end of 2017 and a \$5.2 million increase as compared to one year earlier. Nonperforming loans increased \$1.9 million from year-end 2017 and increased \$6.4 million from June 30, 2017. Other real estate owned (“OREO”) at June 30, 2018 of \$1.3 million decreased \$0.6 million from December 31, 2017 and decreased \$1.2 million from June 30, 2017. At June 30, 2018, OREO consisted of no commercial properties and 26 residential properties. This compares to three commercial properties with a total value of \$0.6 million and 27 residential OREO properties with a total value of \$1.3 million at December 31, 2017 and six commercial properties with a total value of \$1.2 million and 29 residential properties with a total value of \$1.3 million at June 30, 2017. Nonperforming loans were 0.47% of total loans outstanding at the end of the second quarter; three basis points higher than the level at December 31, 2017 and an 11 basis point increase from the level at June 30, 2017.

Approximately 50% of nonperforming loans at June 30, 2018 are related to the consumer mortgage portfolio. Collateral values of residential properties within the Company’s market area have generally remained stable over the past several years. Additionally, improved process efficiency and economic conditions, including lower unemployment levels, have positively impacted consumers. Approximately 39% of the nonperforming loans at June 30, 2018 were related to the business lending portfolio, which is comprised of business loans broadly diversified by industry type. The level of nonperforming business loans increased from the prior year and December 31, 2017 due primarily to two commercial relationships that added \$7.3 million to nonperforming loans at the end of the second quarter of 2018. The remaining 11% of nonperforming loans relate to consumer installment and home equity loans, with home equity non-performing loan levels being driven by the same factors identified for consumer mortgages. The allowance for loan losses to nonperforming loans ratio, a general measure of coverage adequacy, was 169% at the end of the second quarter, as compared to 173% at year-end 2017 and 207% at June 30, 2017.

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

Delinquent loans (30 days past due through nonaccruing) as a percent of total loans was 0.89% at the end of the second quarter, 21 basis points below the 1.10% at year-end 2017 and 10 basis points below the 0.99% at June 30, 2017. The business lending delinquency ratio at the end of the second quarter was nine basis points below the level at December 31, 2017 and 12 basis points below the level at June 30, 2017. The delinquency ratios for consumer direct and consumer indirect loans decreased as compared to the levels at December 31, 2017 and June 30, 2017. The delinquency ratio for the consumer mortgage portfolio decreased as compared to both December 31, 2017 and the level one year ago. The delinquency ratio for the home equity portfolio increased as compared to both December 31, 2017 and the level one year ago. The Company’s success at keeping the nonperforming and delinquency ratios at favorable levels has been the result of its continued focus on maintaining strict underwriting standards, as well as the effective utilization of its collection and recovery capabilities.

**Table 9: Allowance for Loan Losses Activity**

|                                                                              | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|------------------------------------------------------------------------------|--------------------------------|-----------|------------------------------|-----------|
|                                                                              | 2018                           | 2017      | 2018                         | 2017      |
| (000's omitted)                                                              |                                |           |                              |           |
| Allowance for loan losses at beginning of period                             | \$ 48,103                      | \$ 47,096 | \$ 47,583                    | \$ 47,233 |
| Charge-offs:                                                                 |                                |           |                              |           |
| Business lending                                                             | 583                            | 428       | 2,295                        | 1,122     |
| Consumer mortgage                                                            | 245                            | 258       | 444                          | 343       |
| Consumer indirect                                                            | 1,383                          | 1,695     | 3,667                        | 3,642     |
| Consumer direct                                                              | 364                            | 470       | 860                          | 888       |
| Home equity                                                                  | 47                             | 190       | 103                          | 228       |
| Total charge-offs                                                            | 2,622                          | 3,041     | 7,369                        | 6,223     |
| Recoveries:                                                                  |                                |           |                              |           |
| Business lending                                                             | 114                            | 283       | 312                          | 354       |
| Consumer mortgage                                                            | 54                             | 11        | 62                           | 18        |
| Consumer indirect                                                            | 1,347                          | 1,452     | 2,498                        | 2,321     |
| Consumer direct                                                              | 167                            | 182       | 389                          | 427       |
| Home equity                                                                  | 7                              | 7         | 16                           | 32        |
| Total recoveries                                                             | 1,689                          | 1,935     | 3,277                        | 3,152     |
| Net charge-offs                                                              | 933                            | 1,106     | 4,092                        | 3,071     |
| Provision for loans losses                                                   | 2,448                          | 1,461     | 6,127                        | 3,289     |
| Allowance for loan losses at end of period                                   | \$ 49,618                      | \$ 47,451 | \$ 49,618                    | \$ 47,451 |
| Allowance for loan losses / total loans                                      | 0.80%                          | 0.75%     | 0.80%                        | 0.75%     |
| Allowance for legacy loan losses / total legacy loans <sup>(1)</sup>         | 0.98%                          | 1.01%     | 0.98%                        | 1.01%     |
| Allowance for loan losses / nonperforming loans                              | 169%                           | 207%      | 169%                         | 207%      |
| Allowance for legacy loan losses / legacy nonperforming loans <sup>(1)</sup> | 225%                           | 284%      | 225%                         | 284%      |
| Net charge-offs (annualized) to average loans outstanding:                   |                                |           |                              |           |
| Business lending                                                             | 0.08%                          | 0.03%     | 0.17%                        | 0.09%     |
| Consumer mortgage                                                            | 0.03%                          | 0.05%     | 0.03%                        | 0.03%     |
| Consumer indirect                                                            | 0.01%                          | 0.09%     | 0.23%                        | 0.25%     |
| Consumer direct                                                              | 0.43%                          | 0.61%     | 0.52%                        | 0.49%     |
| Home equity                                                                  | 0.04%                          | 0.18%     | 0.04%                        | 0.10%     |
| Total loans                                                                  | 0.06%                          | 0.08%     | 0.13%                        | 0.12%     |

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

As displayed in Table 9, net charge-offs during the second quarter of 2018 were \$0.9 million, \$0.2 million lower than the second quarter of 2017. Net charge-offs for the six months ended June 30, 2018 were \$4.1 million, a \$1.0 million increase from the first six months of 2017. The business lending, consumer mortgage and consumer direct portfolios experienced higher levels of net charge-offs through the first six months of 2018, as compared to the first six months of 2017, while the consumer indirect and home equity portfolios experienced lower net charge-offs than the prior year-to-date period. The annualized net charge-off ratio (net charge-offs as a percentage of average loans outstanding) for the second quarter of 2018 was 0.06%, two basis points lower than the second quarter of 2017. Net charge-off ratios for the second quarter of 2018 for all portfolios except consumer mortgage and home equity were below the Company's average long-term historical levels, while the consumer mortgage and home equity portfolios were consistent with long-term historical levels. The June YTD annualized net charge-off ratio of 0.13% for total loans was one basis point higher than the equivalent prior year period.

The provision for loan losses was \$2.4 million in the second quarter, with \$2.0 million related to legacy loans and \$0.4 million related to acquired loans. The second quarter provision was \$1.0 million higher than the equivalent prior year period. The second quarter 2018 loan loss provision was \$1.5 million more than the level of net charge-offs for the quarter. The allowance for loan losses of \$49.6 million as of June 30, 2018 increased \$2.2 million from the level one year ago, reflective of an increase in the size of the loan portfolio. Stable asset quality metrics have resulted in an allowance for loan losses to total loans ratio of 0.80% at June 30, 2018, five basis points higher than the level at June 30, 2017 and four basis points above the level at December 31, 2017.

As of June 30, 2018, the purchase discount related to the \$1.42 billion of remaining non-impaired loan balances acquired from Merchants, Oneida Savings Bank, HSBC Bank USA, N.A., First Niagara Bank, N.A., and Wilber National Bank was approximately \$27.7 million, or 1.9% of that portfolio, with \$2.6 million included in the allowance for loan losses for acquired loans where the carrying value exceeded the estimated net recoverable value.

## Deposits

As shown in Table 10, average deposits of \$8.57 billion in the second quarter were up \$599.7 million, or 7.5%, compared to the second quarter of 2017, and increased \$56.0 million, or 0.7%, from the fourth quarter of last year, with \$576.3 million of the increase from the second quarter of 2017 relating to the Merchants transaction. The mix of average deposit balances continues to change as the weightings of core deposits (noninterest checking, interest checking, savings and money markets) have increased from the prior year levels. Conversely, the proportion of time deposits decreased over the past 12 months, consistent with the last several years. This change in deposit mix reflects the Company's goal of expanding core account relationships and reducing higher cost time deposit balances. This shift in product mix helped contain the Company's cost of deposits at 0.11% in spite of significant increases in market interest rates between the periods, one basis point higher than the second quarter of 2017.

Average nonpublic fund deposits for the second quarter of 2018 increased \$8.5 million, or 0.1%, versus the fourth quarter of 2017 and increased \$594.6 million, or 8.7%, versus the year-earlier period, with \$573.4 million of the increase over the second quarter of 2017 attributable to the Merchants acquisition. Average public fund deposits for the second quarter increased \$47.5 million, or 4.5%, from the fourth quarter of 2017 and \$5.1 million, or 0.5%, from the second quarter of 2017. The Merchants acquisition was responsible for \$2.9 million of the increase in public fund deposits from the second quarter of 2017. Public fund deposits as a percentage of total deposits decreased from 13.9% in the second quarter of 2017 to 12.9% in the second quarter of 2018.

**Table 10: Quarterly Average Deposits**

| <i>(000's omitted)</i>        | June 30,<br>2018 | December 31,<br>2017 | June 30,<br>2017 |
|-------------------------------|------------------|----------------------|------------------|
| Noninterest checking deposits | \$ 2,287,722     | \$ 2,307,155         | 1,948,434        |
| Interest checking deposits    | 1,950,652        | 1,823,552            | 1,799,830        |
| Savings deposits              | 1,474,730        | 1,419,703            | 1,384,295        |
| Money market deposits         | 2,104,885        | 2,181,141            | 2,073,596        |
| Time deposits                 | 751,831          | 782,267              | 763,975          |
| Total deposits                | \$ 8,569,820     | \$ 8,513,818         | \$ 7,970,130     |
| Nonpublic fund deposits       | \$ 7,460,329     | \$ 7,451,849         | \$ 6,865,687     |
| Public fund deposits          | 1,109,491        | 1,061,969            | 1,104,443        |
| Total deposits                | \$ 8,569,820     | \$ 8,513,818         | \$ 7,970,130     |

## Borrowings

External borrowings at the end of the second quarter of \$124.8 million, including subordinated debt held by unconsolidated subsidiary trusts and other long-term debt. This was \$24.0 million, or 16.1%, lower than external borrowings at December 31, 2017 and \$180.6 million, or 59.1%, below the end of the second quarter of 2017. The decrease was primarily due to a decrease in overnight FHLB borrowings.

Securities sold under agreement to repurchase, which represent collateralized municipal and commercial customer accounts that price and operate similar to a deposit instrument, were \$181.8 million at the end of the second quarter of 2018, a decrease of \$155.2 million from December 31, 2017 due primarily to the seasonal characteristics of this portfolio and \$8.7 million below June 30, 2017.

On July 31, 2018, the Company exercised its right to redeem all of the subordinated debt held by Community Statutory Trust III, an unconsolidated subsidiary trust, and associated preferred securities for a total of \$25.2 million.

## **Shareholders' Equity**

Total shareholders' equity was \$1.66 billion at the end of the second quarter. This was up \$21.6 million from the balance at December 31, 2017. During the first six months of 2018, we recorded net income of \$84.7 million, issued \$6.2 million from treasury stock to the Company's benefit plans, issued \$4.6 million from shares under the employee stock plan and \$3.4 million from employee stock options earned. These amounts were partially offset by a \$42.6 million decrease in other comprehensive income and dividends declared of \$34.7 million. The change in other comprehensive income was comprised of a \$42.9 million decrease in the after-tax market value adjustment on the available-for-sale investment portfolio and a positive \$0.3 million adjustment to the funded status of the Company's retirement plans. Over the past 12 months, total shareholders' equity increased by \$84.1 million, as net income and the issuance of common stock in association with the employee stock plan and the Company's benefit plans more than offset a lower market value adjustment on investments, dividends declared and the change in the funded status of the Company's defined benefit pension and other postretirement plans.

The Company's Tier 1 leverage ratio, a primary measure of regulatory capital for which 5% is the requirement to be "well-capitalized", was 10.53% at the end of the second quarter, up 53 basis points from year-end 2017 and 34 basis points above its level one year earlier. The increase in the Tier 1 leverage ratio in comparison to December 31, 2017 was primarily due to an increase in ending shareholders' equity, excluding intangibles and other comprehensive income items, increasing 3.4%, primarily from net earnings retention, while average assets, excluding intangibles and the market value adjustment on investments, decreased 1.1%. The Tier 1 leverage ratio increased compared to the prior year's second quarter as shareholders' equity, excluding intangibles and other comprehensive income, increased 8.5% primarily due to earnings retention, while average assets excluding intangibles and the market value adjustment, decreased 2.6%. The net tangible equity-to-assets ratio (a non-GAAP measure) of 9.00% increased 0.39% from December 31, 2017 and increased 0.92% versus June 30, 2017 (See Table 11 for Reconciliation of Quarterly GAAP to Non-GAAP Measures). The increase in the tangible equity ratio over the past 12 months was due to a proportionally larger increase in tangible equity levels than the increase in tangible assets.

The dividend payout ratio (dividends declared divided by net income) for the first six months of 2018 was 41.0%, compared to 71.1% for the six months ended June 30, 2017. Net income increased 95.0% over the prior year period due to the impact of one-time costs incurred in association with the Merchants and NRS acquisitions on prior year earnings, while dividends declared increased 12.2% as the Company's quarterly dividend per share was raised from \$0.32 to \$0.34 in August 2017. The 2017 dividend increase marked the Company's 25<sup>th</sup> consecutive year of increased dividend payouts to common shareholders. Additionally, the number of common shares outstanding increased 1.1% over the last twelve months.

## **Liquidity**

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

Given the uncertain nature of our customers' demands as well as the Company's desire to take advantage of earnings enhancement opportunities, the Company must have adequate sources of on- and off-balance sheet funds available that can be acquired in time of need. Accordingly, in addition to the liquidity provided by balance sheet cash flows, liquidity must be supplemented with additional sources such as credit lines from correspondent banks and borrowings from the FHLB and the Federal Reserve Bank of New York ("Federal Reserve"). Other funding alternatives may also be appropriate from time to time, including wholesale and retail repurchase agreements, large certificates of deposit and the brokered CD market. The primary source of non-deposit funds is FHLB overnight advances, of which there were no outstanding borrowings at June 30, 2018.

The Bank's primary sources of liquidity are its liquid assets, as well as unencumbered securities that can be used to collateralize additional funding. At June 30, 2018, the Bank had \$250.2 million of cash and cash equivalents of which \$73.1 million are interest-earning deposits held at the Federal Reserve, FHLB and other correspondent banks. The Bank also had \$1.7 billion in unused FHLB borrowing capacity based on the Company's quarter-end collateral levels. Additionally, the Company has \$1.7 billion of unencumbered securities that could be pledged at the FHLB or Federal Reserve to obtain additional funding. There is \$25 million available in unsecured lines of credit with other correspondent banks.

The Company's primary approach to measuring short-term liquidity is known as the Basic Surplus/Deficit model. It is used to calculate liquidity over two time periods: first, the amount of cash that could be made available within 30 days (calculated as liquid assets less short-term liabilities as a percentage of average assets); and second, a projection of subsequent cash availability over an additional 60 days. As of June 30, 2018, this ratio was 15.0% for 30-days and 15.1% for 90-days, excluding the Company's capacity to borrow additional funds from the FHLB and other sources. There is a sufficient amount of liquidity based on the Company's internal policy requirement of 7.5%.

A sources and uses statement is used by the Company to measure intermediate liquidity risk over the next twelve months. As of June 30, 2018, there is more than enough liquidity available during the next year to cover projected cash outflows. In addition, stress tests on the cash flows are performed in various scenarios ranging from high probability events with a low impact on the liquidity position to low probability events with a high impact on the liquidity position. The results of the stress tests as of June 30, 2018 indicate the Bank has sufficient sources of funds for the next year in all simulated stressed scenarios.

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

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

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

### **Forward-Looking Statements**

This document contains comments or information that constitute forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995), which involve significant risks and uncertainties. Forward-looking statements often use words such as "anticipate," "target," "expect," "estimate," "intend," "plan," "goal," "forecast," "believe," or other words of similar meaning. Actual results may differ materially from the results discussed in the forward-looking statements. Moreover, the Company's plans, objectives and intentions are subject to change based on various factors (some of which are beyond the Company's control). Factors that could cause actual results to differ from those discussed in the forward-looking statements include: (1) risks related to credit quality, interest rate sensitivity and liquidity; (2) the strength of the U.S. economy in general and the strength of the local economies where the Company conducts its business; (3) the effect of, and changes in, monetary and fiscal policies and laws, including interest rate policies of the Board of Governors of the Federal Reserve System; (4) inflation, interest rate, market and monetary fluctuations; (5) the timely development of new products and services and customer perception of the overall value thereof (including, but not limited to, features, pricing and quality) compared to competing products and services; (6) changes in consumer spending, borrowing and savings habits; (7) technological changes and implementation and financial risks associated with transitioning to new technology-based systems involving large multi-year contracts; (8) the ability of the Company to maintain the security of its financial, accounting, technology, data processing and other operating systems and facilities; (9) any acquisitions or mergers that might be considered or consummated by the Company and the costs and factors associated therewith, including differences in the actual financial results of the acquisition or merger compared to expectations and the realization of anticipated cost savings and revenue enhancements; (10) the ability to maintain and increase market share and control expenses; (11) the nature, timing and effect of changes in banking regulations or other regulatory or legislative requirements affecting the respective businesses of the Company and its subsidiaries, including changes in laws and regulations concerning taxes, accounting, banking, risk management, securities and other aspects of the financial services industry, specifically the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; (12) changes in the Company's organization, compensation and benefit plans and in the availability of, and compensation levels for, employees in its geographic markets; (13) the outcome of pending or future litigation and government proceedings; (14) other risk factors outlined in the Company's filings with the SEC from time to time; and (15) the success of the Company at managing the risks of the foregoing.

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

**Reconciliation of GAAP to Non-GAAP Measures**
**Table 11: GAAP to Non-GAAP Reconciliations**

|                                                      | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|------------------------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                                      | 2018                           | 2017       | 2018                         | 2017       |
| (000's omitted)                                      |                                |            |                              |            |
| <b>Income statement data</b>                         |                                |            |                              |            |
| <b>Net income</b>                                    |                                |            |                              |            |
| Net income (GAAP)                                    | \$ 44,606                      | \$ 17,191  | \$ 84,712                    | \$ 43,448  |
| Acquisition expenses                                 | 71                             | 22,896     | 63                           | 24,612     |
| Tax effect of acquisition expenses                   | (13)                           | (7,098)    | (11)                         | (7,570)    |
| Subtotal (non-GAAP)                                  | 44,664                         | 32,989     | 84,764                       | 60,490     |
| Amortization of intangibles                          | 4,555                          | 4,263      | 9,353                        | 7,031      |
| Tax effect of amortization of intangibles            | (850)                          | (1,322)    | (1,955)                      | (2,081)    |
| Subtotal (non-GAAP)                                  | 48,369                         | 35,930     | 92,162                       | 65,440     |
| Acquired non-impaired loan accretion                 | (2,040)                        | (1,642)    | (4,103)                      | (2,079)    |
| Tax effect of acquired non-impaired loan accretion   | 381                            | 509        | 856                          | 629        |
| Adjusted net income (non-GAAP)                       | \$ 46,710                      | \$ 34,797  | \$ 88,915                    | \$ 63,990  |
| <b>Return on average assets</b>                      |                                |            |                              |            |
| Adjusted net income (non-GAAP)                       | \$ 46,710                      | \$ 34,797  | \$ 88,915                    | \$ 63,990  |
| Average total assets                                 | 10,752,203                     | 9,958,553  | 10,733,968                   | 9,356,256  |
| Adjusted return on average assets (non-GAAP)         | 1.74%                          | 1.40%      | 1.67%                        | 1.38%      |
| <b>Return on average equity</b>                      |                                |            |                              |            |
| Adjusted net income (non-GAAP)                       | \$ 46,710                      | \$ 34,797  | \$ 88,915                    | \$ 63,990  |
| Average total equity                                 | 1,640,076                      | 1,455,847  | 1,633,053                    | 1,356,917  |
| Adjusted return on average equity (non-GAAP)         | 11.42%                         | 9.59%      | 10.98%                       | 9.51%      |
| <b>Earnings per common share</b>                     |                                |            |                              |            |
| Diluted earnings per share (GAAP)                    | \$ 0.86                        | \$ 0.35    | \$ 1.63                      | \$ 0.91    |
| Acquisition expenses                                 | 0.00                           | 0.46       | 0.00                         | 0.50       |
| Tax effect of acquisition expenses                   | 0.00                           | (0.14)     | 0.00                         | (0.15)     |
| Subtotal (non-GAAP)                                  | 0.86                           | 0.67       | 1.63                         | 1.26       |
| Amortization of intangibles                          | 0.09                           | 0.09       | 0.18                         | 0.14       |
| Tax effect of amortization of intangibles            | (0.02)                         | (0.03)     | (0.04)                       | (0.04)     |
| Subtotal (non-GAAP)                                  | 0.93                           | 0.73       | 1.77                         | 1.36       |
| Acquired non-impaired loan accretion                 | (0.04)                         | (0.03)     | (0.08)                       | (0.04)     |
| Tax effect of acquired non-impaired loan accretion   | 0.01                           | 0.01       | 0.02                         | 0.01       |
| Diluted adjusted net earnings per share (non-GAAP)   | \$ 0.90                        | \$ 0.71    | \$ 1.71                      | \$ 1.33    |
| <b>Noninterest operating expenses</b>                |                                |            |                              |            |
| Noninterest expenses (GAAP)                          | \$ 86,112                      | \$ 102,879 | \$ 172,443                   | \$ 176,454 |
| Amortization of intangibles                          | (4,555)                        | (4,263)    | (9,353)                      | (7,031)    |
| Acquisition expenses                                 | (71)                           | (22,896)   | (63)                         | (24,612)   |
| Total adjusted noninterest expenses (non-GAAP)       | \$ 81,486                      | \$ 75,720  | \$ 163,027                   | \$ 144,811 |
| <b>Efficiency ratio</b>                              |                                |            |                              |            |
| Adjusted noninterest expenses (non-GAAP) - numerator | \$ 81,486                      | \$ 75,720  | \$ 163,027                   | \$ 144,811 |
| Fully tax-equivalent net interest income             | 87,940                         | 80,403     | 173,682                      | 149,962    |
| Noninterest revenues                                 | 56,559                         | 51,226     | 114,050                      | 95,544     |
| Acquired non-impaired loan accretion                 | (2,040)                        | (1,642)    | (4,103)                      | (2,079)    |
| Unrealized loss on equity securities                 | 21                             | 0          | 21                           | 0          |
| Gain on sales of investments                         | 0                              | 0          | 0                            | (2)        |
| Operating revenues (non-GAAP) - denominator          | \$ 142,480                     | \$ 129,987 | \$ 283,650                   | \$ 243,425 |
| Efficiency ratio (non-GAAP)                          | 57.2%                          | 58.3%      | 57.5%                        | 59.5%      |

| (000's omitted)                                               | June 30,<br>2018 | December 31,<br>2017 | June 30,<br>2017 |
|---------------------------------------------------------------|------------------|----------------------|------------------|
| <b>Balance sheet data – at end of quarter</b>                 |                  |                      |                  |
| <b>Total assets</b>                                           |                  |                      |                  |
| Total assets (GAAP)                                           | \$ 10,633,094    | \$ 10,746,198        | \$ 10,884,046    |
| Intangible assets                                             | (816,127)        | (825,088)            | (831,403)        |
| Deferred taxes on intangible assets                           | 47,334           | 48,419               | 77,097           |
| Total tangible assets (non-GAAP)                              | \$ 9,864,301     | \$ 9,969,529         | \$ 10,129,740    |
| <b>Total common equity</b>                                    |                  |                      |                  |
| Shareholders' Equity (GAAP)                                   | 1,656,959        | 1,635,315            | 1,572,900        |
| Intangible assets                                             | (816,127)        | (825,088)            | (831,403)        |
| Deferred taxes on intangible assets                           | 47,334           | 48,419               | 77,097           |
| Total tangible common equity (non-GAAP)                       | \$ 888,166       | \$ 858,646           | \$ 818,594       |
| <b>Net tangible equity-to-assets ratio at quarter end</b>     |                  |                      |                  |
| Total tangible common equity (non-GAAP) - numerator           | \$ 888,166       | \$ 858,646           | \$ 818,594       |
| Total tangible assets (non-GAAP) - denominator                | \$ 9,864,301     | \$ 9,969,529         | \$ 10,129,740    |
| Net tangible equity-to-assets ratio at quarter end (non-GAAP) | 9.00%            | 8.61%                | 8.08%            |

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates, prices or credit risk. Credit risk associated with the Company's loan portfolio has been previously discussed in the asset quality section of the MD&A. Management believes that the tax risk of the Company's municipal investments associated with potential future changes in statutory, judicial and regulatory actions is minimal. Treasury, agency, mortgage-backed and CMO securities issued by government agencies comprise 83% of the total portfolio and are currently rated AAA by Moody's Investor Services and AA+ by Standard & Poor's. Municipal and corporate bonds account for 16% of the total portfolio, of which, 99% carry a minimum rating of A-. The remaining 1% of the portfolio is comprised of other investment grade securities. The Company does not have material foreign currency exchange rate risk exposure. Therefore, almost all the market risk in the investment portfolio is related to interest rates.

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

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

- Asset and liability levels using June 30, 2018 as a starting point.
- There are assumed to be conservative levels of balance sheet growth, low-to-mid single digit growth in loans and deposits, while using the cash flows from investment contractual maturities and prepayments to repay short-term capital market borrowings or reinvest into securities or cash equivalents.
- The prime rate and federal funds rates are assumed to move up or down over a 12-month period while moving the long end of the treasury curve to spreads over the three month treasury that are more consistent with historical norms (normalized yield curve). Deposit rates are assumed to move in a manner that reflects the historical relationship between deposit rate movement and changes in the federal funds rate.
- Cash flows are based on contractual maturity, optionality, and amortization schedules along with applicable prepayments derived from internal historical data and external sources.

**Net Interest Income Sensitivity Model**

| Change in interest rates | Calculated annualized increase<br>(decrease) in projected net interest<br>income at June 30, 2018 |
|--------------------------|---------------------------------------------------------------------------------------------------|
| +200 basis points        | \$ (2,370,000)                                                                                    |
| +100 basis points        | \$ (783,000)                                                                                      |
| -100 basis points        | \$ (6,191,000)                                                                                    |

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

In the falling rate environment scenario, the Bank shows interest rate risk exposure to lower short term rates. Net interest income declines during the first twelve months largely due to lower assumed rates on new loans, including adjustable and variable rate assets. Corresponding deposit rates are assumed to remain constant.

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

**Item 4. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures, as defined in Rule 13a -15(e) and 15d – 15(e) under the Securities Exchange Act of 1934 as amended (the “Exchange Act”), designed to ensure information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is: (i) recorded, processed, summarized, and reported within the time periods specified in the SEC rules and forms, and (ii) accumulated and communicated to management, including the principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure. Based on management’s evaluation of the effectiveness of the Company’s disclosure controls and procedures, with the participation of the Chief Executive Officer and the Chief Financial Officer, it has concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, these disclosure controls and procedures were effective as of June 30, 2018.

**Changes in Internal Control over Financial Reporting**

The Company regularly assesses the adequacy of its internal controls over financial reporting. There have been no changes in the Company’s internal controls over financial reporting in connection with the evaluation referenced in the paragraph above that occurred during the Company’s quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

**Part II. Other Information****Item 1. Legal Proceedings**

The Company and its subsidiaries are subject in the normal course of business to various pending and threatened legal proceedings in which claims for monetary damages are asserted. As of June 30, 2018, management, after consultation with legal counsel, does not anticipate that the aggregate ultimate liability arising out of litigation pending or threatened against the Company or its subsidiaries will be material to the Company’s consolidated financial position. On at least a quarterly basis, the Company assesses its liabilities and contingencies in connection with such legal proceedings. For those matters where it is probable that the Company will incur losses and the amounts of the losses can be reasonably estimated, the Company records an expense and corresponding liability in its consolidated financial statements. To the extent the pending or threatened litigation could result in exposure in excess of that liability, the amount of such excess is not currently estimable. The range of reasonably possible losses for matters where an exposure is not currently estimable or considered probable, beyond the existing recorded liabilities, is between \$0 and \$1 million in the aggregate. Although the Company does not believe that the outcome of pending litigation will be material to the Company’s consolidated financial position, it cannot rule out the possibility that such outcomes will be material to the consolidated results of operations for a particular reporting period in the future.

**Item 1A. Risk Factors**

There has not been any material change in the risk factors disclosure from that contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the SEC on March 1, 2018.

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

a) Not applicable.

b) Not applicable.

c) At its December 2017 meeting, the Board approved a new stock repurchase program authorizing the repurchase, at the discretion of senior management, of up to 2,500,000 shares of the Company's common stock, in accordance with securities laws and regulations, during a twelve-month period beginning January 1, 2018. Any repurchased shares will be used for general corporate purposes, including those related to stock plan activities. The timing and extent of repurchases will depend on market conditions and other corporate considerations as determined at the Company's discretion.

The following table presents stock purchases made during the second quarter of 2018:

| Period                         | Total<br>Number of<br>Shares<br>Purchased | <b><u>Issuer Purchases of Equity Securities</u></b> |                                                                                           |                                                                                         |
|--------------------------------|-------------------------------------------|-----------------------------------------------------|-------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------|
|                                |                                           | Average<br>Price Paid<br>Per Share                  | Total Number of Shares<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs | Maximum Number of<br>Shares That May Yet Be<br>Purchased Under the Plans<br>or Programs |
| April 1-30, 2018               | 0                                         | \$ 0                                                | 0                                                                                         | 2,500,000                                                                               |
| May 1-31, 2018 <sup>(1)</sup>  | 3,063                                     | \$ 59.75                                            | 0                                                                                         | 2,500,000                                                                               |
| June 1-30, 2018 <sup>(1)</sup> | 149                                       | \$ 60.18                                            | 0                                                                                         | 2,500,000                                                                               |
| Total                          | 3,212                                     | \$ 59.77                                            |                                                                                           |                                                                                         |

<sup>(1)</sup> Included in the common shares repurchased were shares acquired by the Company in connection with satisfaction of tax obligations on vested restricted stock issued pursuant to the employee benefit plan of 3,063 shares and 149 shares in May 2018 and June 2018, respectively. These shares were not repurchased as part of the publicly announced repurchase plan described above.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

Not applicable.

**Item 6. Exhibits**

| <b><u>Exhibit No.</u></b>   | <b><u>Description</u></b>                                                                                                                                                                                                                                                                                                                                                                                                                   |
|-----------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <a href="#"><u>10.1</u></a> | Amendment to Employment Agreement, dated May 21, 2018, by and among Community Bank System, Inc., Community Bank, N.A. and Scott Kingsley. Incorporated by reference to Exhibit No. 10.1 to the Current Report on Form 8-K filed on May 21, 2018 (Registration No. 001-13695). (1)                                                                                                                                                           |
| <a href="#"><u>10.2</u></a> | Employment Agreement, dated as of May 21, 2018, by and between Community Bank System, Inc., Community Bank, N.A., and Joseph E. Sutaris. Incorporated by reference to Exhibit No. 10.2 to the Current Report on Form 8-K filed on May 21, 2018 (Registration No. 001-13695). (1)                                                                                                                                                            |
| <a href="#"><u>10.3</u></a> | Amendment to Employment Agreement, dated May 21, 2018, by and among Community Bank System, Inc., Community Bank, N.A. and Joseph F. Serbun. Incorporated by reference to Exhibit No. 10.3 to the Current Report on Form 8-K filed on May 21, 2018 (Registration No. 001-13695). (1)                                                                                                                                                         |
| <a href="#"><u>10.4</u></a> | Community Bank System, Inc. Restoration Plan, effective June 1, 2018. Incorporated by reference to Exhibit No. 10.4 to the Current Report on Form 8-K filed on May 21, 2018 (Registration No. 001-13695). (1)                                                                                                                                                                                                                               |
| <a href="#"><u>31.1</u></a> | Certification of Mark E. Tryniski, President and Chief Executive Officer of the Registrant, pursuant to Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (2)                                                                                                                                                                               |
| <a href="#"><u>31.2</u></a> | Certification of Joseph E. Sutaris, Treasurer and Chief Financial Officer of the Registrant, pursuant to Rule 13a-15(e) or Rule 15d-15(e) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (2)                                                                                                                                                                              |
| <a href="#"><u>32.1</u></a> | Certification of Mark E. Tryniski, President and Chief Executive Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (3)                                                                                                                                                                                                                                   |
| <a href="#"><u>32.2</u></a> | Certification of Joseph E. Sutaris, Treasurer and Chief Financial Officer of the Registrant, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. (3)                                                                                                                                                                                                                                  |
| 101                         | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Statements of Condition, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Changes in Shareholders' Equity, (v) the Consolidated Statements of Cash Flows, and (vi) the Notes to Consolidated Financial Statements tagged as blocks of text and in detail. (4) |

(1) Denotes management contract or compensatory plan or arrangement.

(2) Filed herewith.

(3) Furnished herewith.

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

**SIGNATURES**

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

**Community Bank System, Inc.**

Date: August 9, 2018

/s/ Mark E. Tryniski

Mark E. Tryniski, President and Chief Executive Officer

Date: August 9, 2018

/s/ Joseph E. Sutaris

Joseph E. Sutaris, Treasurer and Chief  
Financial Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Mark E. Tryniski, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Community Bank System, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2018

/s/ Mark E. Tryniski

Mark E. Tryniski

President and Chief Executive Officer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Joseph E. Sutaris, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Community Bank System, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: August 9, 2018

/s/ Joseph E. Sutaris

Joseph E. Sutaris

Treasurer and Chief Financial Officer

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Community Bank System, Inc. (the “Company”) on Form 10-Q for the quarter ended June 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Mark E. Tryniski, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This certification accompanies this Form 10-Q and shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section.

/s/ Mark E. Tryniski

Mark E. Tryniski  
President and Chief Executive Officer  
August 9, 2018

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CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Community Bank System, Inc. (the “Company”) on Form 10-Q for the quarter ended June 30, 2018 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Joseph E. Sutaris, Treasurer and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This certification accompanies this Form 10-Q and shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section.

/s/ Joseph E. Sutaris

Joseph E. Sutaris  
Treasurer and Chief Financial Officer  
August 9, 2018

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