

2016
ANNUAL REPORT



**Chemung
Financial**
Corporation

Financial Highlights

(in thousands, except per share data)

Operating Results – Year Ended December 31:	2016	2015	% of Change
Net interest income	\$52,329	\$50,642	3.33%
Provision for loan losses	2,437	1,571	55.12%
Other operating income:			
Securities gains, net	987	372	165.32%
Wealth Management Group fee income	8,316	8,522	(2.42)%
Other income	11,846	11,553	2.54%
Other operating expenses:			
Legal accruals and settlements	1,200	—	N/A
Other expenses	55,410	55,427	(0.03)%
Income tax expense	4,404	4,658	(5.45)%
Net income	10,027	9,433	6.30%

At Year End:

Assets	\$1,657,179	\$1,619,964	2.30%
Loans, net	1,200,290	1,168,633	2.71%
Allowance for loan losses	14,253	14,260	(0.05)%
Deposits	1,456,343	1,400,295	4.00%
Shareholders' equity	143,748	137,242	4.74%
Employees (full-time equivalent)	368	377	(2.39)%

Share and Per Share Data:

Net income	2.11	2.00	5.50%
Book value, at year end	30.07	28.96	3.83%
Tangible book value, at year end	24.89	23.53	5.78%
Dividends declared	1.04	1.04	—
Shares outstanding (average)	4,762	4,719	0.91%

Ratios:

Allowance for loan losses to total loans	1.19%	1.22%
Return on average assets	0.60%	0.60%
Return on average equity	7.02%	6.84%
Return on average tangible equity	8.52%	8.45%

Trust Assets Under Administration (market value):

as Fiduciary	\$1,340,362	\$1,392,017	(3.71)%
as Custodian	380,787	463,543	(17.85)%
	<u>\$1,721,149</u>	<u>\$1,855,560</u>	(7.24)%

Common Stock Market Prices & Dividends Paid During Past Two Years:

December 31, 2016

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

December 31, 2015

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

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



Dear Fellow Shareholders:

2016 was a successful and significant year for our Corporation. We delivered solid financial results which are highlighted in detail below. These results were achieved while managing significant leadership transitions at the Bank. Change is pervasive and ever-present. Because of a solid foundation and steadfast focus on our core community banking principles, we were successful in navigating these transitions without diminished client service or shareholder value.



This year, we successfully installed new leadership across our three core business lines: Retail Client Services, Business Client Services and our Wealth Management Group. In addition, we instituted a transition plan anticipating the impending retirement of our tenured CEO, Ronald Bentley. We are pleased that these transitions were completed thoughtfully and without disruption.

We continued our long tradition of providing excellent client service and investing in our communities, a proven formula that provides strong and sustainable results over the long term. Indeed, 2016 was another year that validated our community banking value paradigm of local control, efficient management and specialized execution.

As we know too well, the business climate for community banking remains challenging. However, we have started to see some movement in long- and short-term interest rates. The prospect for continued interest rate increases appears likely. Our share price reacted quickly after the November election with the discussion of lower corporate tax rates and regulatory relief for the financial services sector. We are hopeful that the current dialogue in Washington will translate into much needed action in these key areas. Regardless of these events, we remain optimistic and believe that our Corporation is well positioned for the future.

Financial Results

As stated, the year was one of change but also of positive results. The combination of organic asset growth and cost-saving measures contributed to an improvement of 6.3% in net income year over year. Net income for the year was \$10.0 million and earnings per share (EPS) were \$2.11, up from \$9.4 million and \$2.00, respectively, from the prior year.

Tangible book value grew to \$24.89 at year-end, an increase of 5.8% from a year earlier. In 2016, \$4.9 million in dividends were declared, continuing our long history of uninterrupted dividend payments. Our return on average assets was 0.60% for 2016 and 2015, and return on average equity was 7.02% for 2016, up from 6.84% for 2015.

Organic asset growth continued to drive increases in interest income. Total interest income increased 3.5% from the prior year to \$56.2 million. This improvement was largely the result of an increase in average earning assets of \$94.0 million. Interest rate compression has slowed but continues to negatively impact earnings. Our fully taxable equivalent net interest margin declined by 9 basis points from 3.46% to 3.37%. In spite of intense competition, we were able to grow assets while maintaining the strong credit quality of our portfolios. This is evidenced by the ratio of non-performing assets to total assets of 0.75% at year-end.

One important aspect of our franchise is our Wealth Management

Group. With \$1.7 billion in assets under management or administration, the level of non-interest income generated by this business unit is significant, compared to many of our peers. During 2016, our Wealth Management line of business generated \$8.3 million in revenue, amounting to nearly 40% of the Corporation's total non-interest income. Our Wealth Management products provide a unique opportunity to create deep client service relationships as a trusted financial partner for individuals, families, businesses and organizations that desire a high level of personal attention from a team of experts.

The Corporation remains disciplined in maintaining its operating costs. Absent the establishment of a \$1.2 million legal reserve related to a reconfiguration of our retail footprint, non-interest expense was held to 2015 levels. As importantly, the Corporation reduced its effective tax rate from 33.1% for 2015 to 30.5% for 2016. The decrease in the effective tax rate can be attributed to the increased utilization of the Bank's real estate investment trust and the formation of Chemung Risk Management, a captive insurance subsidiary of the company.

The Corporation continues to refine our personnel and compensation models to ensure that we can attract and retain the most qualified banking professionals in support of an increasingly competitive and complex business climate. To that end, we felt 2016 was the right time to evaluate certain long-standing retirement and health-care benefit programs. The Corporation amended its noncontributory defined benefit pension plan to freeze future retirement benefits and amended its defined benefit health care plan to not allow new retirees into the plan. Both changes were effective on December 31, 2016.

These two significant modifications will enhance shareholder value. We have replaced these programs with competitive benefit packages that are less costly and more predictable for the Corporation. The new plans align compensation based on client experience and results, and diminish those benefits that are earned solely by years of service.

We are proud of the collective efforts of our staff in generating positive financial results for our company. At the same time, we take great pride in the significant level of civic engagement provided by our employees. In every area of our footprint you will find members of our staff donating their time, talent and treasures to hundreds of organizations. In many instances you'll find these employees in leadership positions, helping make the communities we serve great places to live, work and play.

Important Initiatives

A primary focus of any community bank is gathering low-cost, stable deposits and investing in low risk assets that support the communities we serve. At Chemung Canal, this strategy continues across a broad territory of 12 counties in New York and Pennsylvania. We are pleased to report the continued success of this effort as our funding base in our Southern Tier and Finger Lakes regions expands while, at the same time, the Capital Region continues to be a reliable source of commercial loan growth. Commercial loan balances in the Capital Region grew to \$497.7 million in 2016, which represented an annual growth rate of 16.8%. This growth was funded largely by increased deposits in the Southern Tier and Finger Lakes regions. In 2016, commercial and municipal deposits grew to \$543.6 million, resulting in an annual growth rate of 15.0%. These trends are a continuation of the strong results that we've experienced in the six years since we entered the Capital Region market with the acquisition of Capital Bank and Trust.

Our industry continues to see bank consolidation in all sectors. This disruption has created significant opportunities for us. In many

Letter to Shareholders

of our markets, local businesses and community organizations have been impacted by the merger of Key Bank and First Niagara. This disruption has reinforced the stability of our community banking platform. Indeed, we have benefited from this disruption and were pleased to welcome several new clients and colleagues to the Bank who didn't believe that bigger always meant better.

The digital interface is becoming more and more vital each day. What was once called an alternate delivery channel is now affirmed as a primary delivery channel for so many of our clients. To this end, the Bank has committed to a new three-year strategic technology plan and remains committed to investing in our digital platform. We remain focused on insuring that our services, products and people provide the most current and relevant digital experience in the industry. It is increasingly imperative that we provide our clients the essential banking tools they need to thrive in today's digitized world. At Chemung Canal, we believe that a digital banking experience is a personal banking experience. Our model of personal service extends to all of our clients. This is true whether they visit any of our 33 branch locations or log onto one of our online banking platforms.

In addition to investing in our digital platform, we continue to refine our branch distribution strategy. This year, we consolidated our oversized branch on the Ithaca Commons into our three other Ithaca locations. I'm pleased to report that this consolidation was completed with minimal client disruption or loss of business. We also announced the relocation of our existing downtown Auburn branch to a more efficient and cost-effective facility. The new facility is located next to our existing branch and will have more client amenities in just 25% of the space contained in our previous office. As exciting, the Bank announced our intentions to develop a sixth branch within the Capital Region. Under consideration is the newly developed Mohawk Harbor community in the City of Schenectady. Consisting of more than 1 million square feet, Mohawk Harbor is the home of the newly developed Rivers Casino and its 1,100 employees. When completed, this 60 acre, master planned, riverfront community will contain newly developed offices, retail stores, restaurants, apartments and condominiums, multiple hotels and a dynamic waterfront.

As a result of New York State awarding significant development grants, we are optimistic for the continued economic growth throughout our footprint. As part of the Governor's "Upstate Revitalization Initiative," three regions within our footprint were separately awarded a commitment of \$500 million in development grants. In addition, the State awarded the City of Elmira a \$10 million grant to further downtown development under its "Downtown Revitalization Initiative." These grants will be leveraged with public and private capital, and deployed over a five-year timeframe. This is a great opportunity for the region and the Corporation is committed to prudently supporting these initiatives as we benefit from the economic activity and vitality that these funds will provide.

In Memoriam

We mourned the passing of four former members of our Board of Directors during this past year. We are grateful for their many years of leadership and support, and we extend our condolences to their families and friends.

Dr. Donald L. Brooks Jr.
William V.M. Iszard

Dr. Thomas K. Meier
William A. Tryon II

Board & Executive Management Developments

One of the great responsibilities of management is to recruit new members to our Executive Team as the needs of the Corporation evolve. Toward that end, we are pleased to recognize that Kimberly A. Hazelton joined the Corporation in 2016 as Executive Vice President of Retail Client Services. Ms. Hazelton has over 30 years of banking experience as a senior manager in regional and community bank institutions. We are pleased that Kim has injected new energy into our retail division, and is making important and foundational improvements to our franchise.

We are also pleased to welcome a new independent director to Chemung Financial Corporation. In 2016, we announced the appointment of Kevin Tully to the Boards of Chemung Financial Corporation and Chemung Canal Trust Company. Mr. Tully is a licensed Certified Public Accountant (CPA) and a partner in the firm of Teal, Becker & Chiaramonte, a regional accounting firm headquartered in Albany, NY. We thank Kevin for his commitment and look forward to his contributions to the Corporation.

On a personal note, I am honored and humbled to have been chosen by the Board of Directors to serve as President and CEO, and a Board member of Chemung Financial Corporation and Chemung Canal Trust Company. I look forward to working with the Board and my banking colleagues to continue the long record of financial successes within our operation.

Final Thoughts

In closing, we are very pleased with our results for 2016. We have validated that our strong community banking platform can endure and thrive in spite of intense competition, a challenging regulatory climate and stubbornly low interest rates. Looking forward, we have set another aggressive plan of initiatives that is focused on providing exceptional client service, finding efficiencies in our banking platform, executing on our long-term strategic technology plan, as well as always prudently managing risk.

2016 was also especially meaningful for the retirement of Ronald Bentley. The impact that Ron, as President and CEO, has had on this Corporation and with the communities and clients we are privileged to serve has been tremendous. We are thankful for his contributions and are focused on maintaining the very high standards he set for the Corporation every day of his tenure. We certainly wish him well in retirement and appreciate his willingness to continue to serve the Corporation on the Boards of Chemung Financial Corporation and Chemung Canal Trust Company.

This has been a year of tremendous activity. We are pleased with the results and are committed to continuing our initiatives to support the clients and communities we serve. Our success is the direct result of our hard-working and committed staff, and the guidance and dedication of our Board of Directors. We are grateful for their assistance and support.

On behalf of the Board, management and staff, thank you for your commitment to our company.



Anders M. Tomson
Chief Executive Officer



David J. Dalrymple
Chairman of the Board

Board of Directors



Anders M. Tomson
President & CEO,
Chemung Financial Corporation,
Chemung Canal Trust Company
and CFS Group, Inc.



David J. Dalrymple
Chairman of the Board, Chemung
Financial Corporation, Chemung
Canal Trust Company, and President,
Dalrymple Gravel & Contracting



Larry H. Becker
COO, Windsor
Development Group, Inc.



Ronald M. Bentley
Retired President & CEO,
Chemung Financial Corporation,
Chemung Canal Trust Company
and CFS Group, Inc.



Robert H. Dalrymple
Vice President & Secretary
Dalrymple Holding Corporation



Clover M. Drinkwater
Partner
Sayles & Evans



Bruce W. Boyea
Chairman, President & CEO,
Security Mutual Life Insurance
Company of New York



Stephen M. Lounsbury III
President, Applied
Technology Manufacturing



John F. Potter
President, Seneca
Beverage Corporation



Richard W. Swan
Retired Chairman of the Board,
Swan and Sons-Morss Co., Inc.



G. Thomas Tranter Jr.
President
Corning Enterprises



Kevin Tully
Partner, Teal, Becker &
Chiaramonte, CPA's PC



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Capital Bank Division Advisory Board

Carl Becker
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MVP Healthcare

Gerald D. Jennings
Former Mayor
City of Albany

Spencer Jones
Dawn Homes Management

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Raymond J. Kinley Jr.
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& Chief Executive Officer
Clough Harbour & Associates

Dr. Lee McElroy
Director of Athletics
Rensselaer Polytechnic
Institute

Jim Menzies
Founder
Leontine Consulting LLC

Gregory Oberting
President
Interstate Commodities, Inc.

Joseph A. Reilly
President
Empire Broadcasting

Mark J. Rosen
President
Dawn Homes Management

Dean A. Rueckert
President
Rueckert Advertising
and Public Relations

Eugene M. Sneeringer Jr.
Principal
Sneeringer Monahan
Provost Redgrave

Edward J. Trombly
Partner
Hiscock & Barclay



EXECUTIVE MANAGEMENT TEAM

Anders M. Tomson President & Chief Executive Officer	Louis C. DiFabio Executive Vice President Business Client Services	Karen R. Makowski Executive Vice President Chief Administrative & Risk Officer	Thomas W. Wirth Executive Vice President Wealth Management Group (WMG)
Pamela D. Burns Senior Vice President Human Resources	Kimberly A. Hazelton Executive Vice President Retail Client Services	Brendan P. McCormick Senior Vice President & Auditor	Michael J. Wayne Senior Vice President, Marketing
Michael J. Crimmins Senior Vice President Support Services	Karl F. Krebs Executive Vice President Chief Financial Officer & Treasurer	Kathleen S. McKillip Assistant Treasurer, Corporate Secretary	

SENIOR VICE PRESIDENTS

Catherine B. Crandall WMG Estate Administration	Marianne T. Kalec Retail Lending	Robert M. Pichette Commercial Lending	Joseph J. Tascone WMG Investment Services
Daniel D. Fariello Commercial Lending	J. Edmond Morton IV WMG Regional Manager	Timothy P. Rubery Commercial Lending	Thomas J. Whitaker Finance

VICE PRESIDENTS

Yvonne L. Albee Regulatory Risk	Marci L. Cartwright WMG Business Development	Victoria A. Harkins WMG Prestige Banking	Christopher Kennedy Commercial Lending	Nino J. Pellegrino Business Development	John E. Shea WMG Relationship Manager
Dawn L. Aubin Genesee St./Grant Ave.	Matthew R. Crabtree Finance	Kevin Harrigan Commercial Lending	John T. Kite Commercial Lending	Ronald W. Poole Commercial Lending	Michael R. Smith Cortland/Seneca Falls
Judy L. Barton Bank Operations	Gary K. Earley WMG Estate Administration	James S. Hartle Branch Administration	Michael S. Lares WMG Investment Services	Robert A. Roemmelt Jr. Arnot Road/Elmira Heights	George R. Spencer Business Development
Roberta Bastow Commercial Lending	Mark J. Fife Commercial Lending	Scott T. Heffner Marketing	Eileen M. McCarthy WMG Support Services	Jennifer Sczepanski Branch Administration	Gregory Stewart WMG Relationship Manager
Michael J. Battersby Branch Administration	Yvette M. Francisco Loan Review	Mary Keefe Business Services	D. Tavis McKeon Branch Administration	John J. Sentigar Information Technology	Theresa A. Wagner Deposit Operations
Michael D. Blatt WMG Investment Services	Thomas E. Funk Finance	Christopher K. Kelly WMG Retirement Services Group	Mary Anne Narosky Business Client Services	Andrea L. Seymour Logistical Support	Sheila A. Washburn Bank Operations

ASSISTANT VICE PRESIDENTS

Sherry L. Armstrong Community Corners	Gregory J. Bruno Clifton Park	Joel A. Crimmins Commercial Lending	Michael L. Hart WMG Estate Administration	Jack D. Narosky Business Development	Sheryl J. Scott Big Flats
Kimberly A. Bailey Canton	David E. Carlson Troy	Constance L. English Corning	Matthew Keefe Regulatory Risk	Brenda S. Praszchunas Horseheads	David Wakeman Resource Recovery
Larisa A. Benderskaya Latham/Wolf Rd.	Pamela L. Colomaio Bath	Jennifer L. Fulton Finance	Lashonda R. Love State Street/Slingerlands	Randi Richer Commercial Loan Operations	Sue A. Williams Waverly
Bruce E. Boughton Montour Falls	Alison J. Conklin-DeVita Main Office/Southport	Sandra L. Grooms Elmira Rd./The Station			

ASSISTANT TREASURERS

Laura L. Bennett, Real Estate Lending	Cheryl A. DeBlock, Binghamton	Patrick J. McFarland, Regulatory Risk	Allison A. Strife, Human Resources
Marcia L. Boor, Business Services	Karen A. Dimmick, Westside	Julianne E. Meeker, Computer Operations	Todd N. Trencansky, Vestal
Amy S. Chervinsky, Commercial Lending	Matthew T. Howard, Audit	Michael J. Novotny, Retail Lending	Charolette R. Truxal, Oakdale Mall
Elizabeth M. Courtright, Regulatory Risk	Tara J. Humphrey, Retail Loan Operations	Aimee G. O'Connor, Towanda	Devin E. Wandell, WMG Estate Administration
Jennifer J. Cruise, WMG Support Services	Barbara L. Keller, Indirect Lending	Jessica L. Ryan, Watkins Glen	Jean A. Wise-Wicks, Painted Post
Sarah A. Darling, Owego	Megan J. Kozdemba, Real Estate Lending	Thomas E. Smith, Regulatory Risk	Kristen E. Wolowitz, Real Estate Lending
			Kristen N. Woodward, Contact Center

CFS GROUP, INC.

Sean F. Beliles, Vice President Joseph M. Cascio, Vice President

Effective as of February 28, 2017.

Other Information

Forward-looking Statements: This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act, Section 21E of the Exchange Act, and the Private Securities Litigation Reform Act of 1995. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing the Corporation's growth, competition, changes in law or the regulatory environment, including the Dodd-Frank Act, and changes in general business and economic trends. Information concerning these and other factors can be found in the Corporation's periodic filings with the SEC, including the discussion under the heading "Item 1A. Risk Factors" in the Corporation's 2016 Annual Report on Form 10-K. These filings are available publicly on the SEC's website at www.sec.gov, on the Corporation's website at chemungcanal.com or upon request from the Corporate Secretary at (607) 737-3746. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

Dividend Reinvestment and Stock Purchase Plan: Registered shareholders of Chemung Financial Corporation, through The Dividend Reinvestment and Stock Purchase Plan, may reinvest their dividends or make quarterly cash payments to purchase additional stock of the Corporation. Shareholders not enrolled in the plan may view and print a descriptive brochure and enrollment form at www.amstock.com or receive the plan documents upon written request to the Corporation's secretary at the following address: Chemung Financial Corporation, Attn: Corporate Secretary, P.O. Box 1522, Elmira, NY 14902-1522.

Form 10-K Annual Report: A copy of the Corporation's Form 10-K Annual Report is available without charge to shareholders after March 31, 2017, upon written request to the Corporation's secretary. A copy is also available on our Transfer Agent, American Stock Transfer & Trust Company's website at www.astproxyportal.com/ast/01079.

Annual Meeting: The Annual Meeting of Shareholders will be held on Thursday, May 11, 2017, at 2:00 p.m. at the downtown Holiday Inn, Elmira – Riverview.

