

CHEMUNG FINANCIAL CORP
Form 10-Q
August 02, 2017

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 Quarterly period ended June 30, 2017
Or

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

Commission File No.

000-13888

CHEMUNG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York

16-1237038

(State or other jurisdiction of
incorporation or organization)

I.R.S. Employer Identification No.

One Chemung Canal Plaza,
Elmira, NY

14901

(Address of principal executive
offices)

(Zip Code)

(607) 737-3711 or (800) 836-3711

(Registrant's telephone number, including area code)

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES: NO:

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

YES: NO:

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

Large

~~accelerated~~ accelerated filer

filer

Accelerated
 Smaller reporting company

filer

Emerging growth company

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

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

YES: NO:

The number of shares of the registrant's common stock, \$.01 par value, outstanding on August 1, 2017 was 4,737,840.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

INDEX

	PAGES
<u>Glossary of Abbreviations and Terms</u>	<u>3</u>
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1: Financial Statements – Unaudited</u>	
<u>Consolidated Balance Sheets</u>	<u>6</u>
<u>Consolidated Statements of Income</u>	<u>7</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>8</u>
<u>Consolidated Statements of Shareholders’ Equity</u>	<u>9</u>
<u>Consolidated Statements of Cash Flows</u>	<u>10</u>
<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>12</u>
<u>Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>44</u>
<u>Item 3: Quantitative and Qualitative Disclosures About Market Risk</u>	<u>73</u>
<u>Item 4: Controls and Procedures</u>	<u>74</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1: Legal Proceedings</u>	<u>75</u>
<u>Item 1A: Risk Factors</u>	<u>75</u>
<u>Item 2: Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>75</u>
<u>Item 3: Defaults Upon Senior Securities</u>	<u>75</u>
<u>Item 4: Mine Safety Disclosures</u>	<u>75</u>
<u>Item 5: Other Information</u>	<u>75</u>
<u>Item 6: Exhibits</u>	<u>76</u>
<u>SIGNATURES</u>	<u>77</u>
<u>EXHIBIT INDEX</u>	

GLOSSARY OF ABBREVIATIONS AND TERMS

To assist the reader the Corporation has provided the following list of commonly used abbreviations and terms included in the Notes to the Unaudited Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

Abbreviations

ALCO	Asset-Liability Committee
ASU	Accounting Standards Update
Bank	Chemung Canal Trust Company
Basel III	The Third Basel Accord of the Basel Committee on Banking Supervision
Board of Directors	Board of Directors of Chemung Financial Corporation
CDARS	Certificate of Deposit Account Registry Service
CDO	Collateralized Debt Obligation
CECL	Current expected credit loss
CFS	CFS Group, Inc.
Corporation	Chemung Financial Corporation
CRM	Chemung Risk Management, Inc.
Dodd-Frank Act	The Dodd-Frank Wall Street Reform and Consumer Protection Act
EPS	Earnings per share
Exchange Act	Securities Exchange Act of 1934
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
FHLBNY	Federal Home Loan Bank of New York
FRB	Board of Governors of the Federal Reserve System
FRBNY	Federal Reserve Bank of New York
Freddie Mac	Federal Home Loan Mortgage Corporation
GAAP	U.S. Generally Accepted Accounting Principles
ICS	Insured Cash Sweep Service
IFRS	International Financial Reporting Standards
MD&A	Management's Discussion and Analysis of Financial Condition and Results of Operations
NAICS	North American Industry Classification System
N/M	Not meaningful
OPEB	Other postemployment benefits
OREO	Other real estate owned
OTTI	Other-than-temporary impairment
PCI	Purchased credit impaired
ROA	Return on average assets
ROE	Return on average equity
RWA	Risk-weighted assets
SBA	Small Business Administration
SEC	Securities and Exchange Commission
Securities Act	Securities Act of 1933
TDRs	Troubled debt restructurings
WMG	Wealth Management Group

Terms

Allowance for loan losses to total loans Represents period-end allowance for loan losses divided by retained loans.

Assets under administration	Represents assets that are beneficially owned by clients and all investment decisions pertaining to these assets are also made by clients.
Assets under management	Represents assets that are managed on behalf of clients.
Basel III	A comprehensive set of reform measures designed to improve the regulation, supervision, and risk management within the banking sector. The reforms require banks to maintain proper leverage ratios and meet certain capital requirements.
Benefit obligation	Refers to the projected benefit obligation for pension plans and the accumulated postretirement benefit obligation for OPEB plans.
Capital Bank	Division of Chemung Canal Trust Company located in the “Capital Region” of New York State and includes the counties of Albany and Saratoga.
CDARS	Product involving a network of financial institutions that exchange certificates of deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution.
Captive insurance company	A company that provides risk-mitigation services for its parent company.
Collateralized debt obligation	A structured financial product that pools together cash flow-generating assets, such as mortgages, bonds, and loans.
Collateralized mortgage obligations	A type of mortgage-backed security with principal repayments organized according to their maturities and into different classes based on risk. The mortgages serve as collateral and are organized into classes based on their risk profile.
Dodd-Frank Act	The Dodd-Frank Act was enacted on July 21, 2010 and significantly changed the bank regulatory landscape and has impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress.
Fully taxable equivalent basis	Income from tax-exempt loans and investment securities that have been increased by an amount equivalent to the taxes that would have been paid if this income were taxable at statutory rates; the corresponding income tax impact related to tax-exempt items is recorded within income tax expense.
GAAP	Accounting principles generally accepted in the United States of America.
Holding company	Consists of the operations for Chemung Financial Corporation (parent only).
ICS	Product involving a network of financial institutions that exchange interest-bearing money market deposits among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution.
Loans held for sale	Residential real estate loans originated for sale on the secondary market with maturities from 15-30 years.
Long term lease obligation	An obligation extending beyond the current year, which is related to a long term capital lease that is considered to have the economic characteristics of asset ownership.
Mortgage-backed securities	A type of asset-backed security that is secured by a collection of mortgages.
Municipal clients	A political unit, such as a city, town, or village, incorporated for local self-government.
N/A	Data is not applicable or available for the period presented.
N/M	Not meaningful.
Non-GAAP	A calculation not made according to GAAP.

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Obligations of state and political subdivisions	An obligation that is guaranteed by the full faith and credit of a state or political subdivision that has the power to tax.
Obligations of U.S. Government	A federally guaranteed obligation backed by the full power of the U.S. government, including Treasury bills, Treasury notes and Treasury bonds.
Obligations of U.S. Government sponsored enterprise obligations	Obligations of agencies originally established or chartered by the U.S. government to serve public purposes as specified by the U.S. Congress; these obligations are not explicitly guaranteed as to the timely payment of principal and interest by the full faith and credit of the U.S. government.

OREO	Represents real property owned by the Corporation, which is not directly related to its business and is most frequently the result of a foreclosure on real property.
OTTI	Impairment charge taken on a security whose fair value has fallen below the carrying value on the balance sheet and whose value is not expected to recover through the holding period of the security.
PCI loans	Represents loans that were acquired in the Fort Orange Financial Corp. transaction and deemed to be credit-impaired on the acquisition date in accordance with the guidance of FASB.
Political subdivision	A county, city, town, or other municipal corporation, a public authority, or a publicly-owned entity that is an instrumentality of a state or a municipal corporation.
Pre-provision profit/(loss)	Represents total net revenue less noninterest expense, before income tax expense (benefit). The Corporation believes that this financial measure is useful in assessing the ability of a bank to generate income in excess of its provision for credit losses.
RWA	Risk-weighted assets consist of on- and off-balance sheet assets that are assigned to one of several broad risk categories and weighted by factors representing their risk and potential for default. On-balance sheet assets are risk-weighted based on the perceived credit risk associated with the obligor or counterparty, the nature of any collateral, and the guarantor, if any. Off-balance sheet assets such as lending-related commitments, guarantees, derivatives and other applicable off-balance sheet positions are risk-weighted by multiplying the contractual amount by the appropriate credit conversion factor to determine the on-balance sheet credit equivalent amount, which is then risk-weighted based on the same factors used for on-balance sheet assets. Risk-weighted assets also incorporate a measure for market risk related to applicable trading assets—debt and equity instruments. The resulting risk-weighted values for each of the risk categories are then aggregated to determine total risk-weighted assets.
SBA loan pools	Business loans partially guaranteed by the SBA.
Securities sold under agreements to repurchase	Sale of securities together with an agreement for the seller to buy back the securities at a later date.
TDR	A TDR is deemed to occur when the Corporation modifies the original terms of a loan agreement by granting a concession to a borrower that is experiencing financial difficulty.
Trust preferred securities	A hybrid security with characteristics of both subordinated debt and preferred stock which allows for early redemption by the issuer, makes fixed or variable payments, and matures at face value.
Unaudited	Financial statements and information that have not been subjected to auditing procedures sufficient to permit an independent certified public accountant to express an opinion.
WMG	Provides services as executor and trustee under wills and agreements, and guardian, custodian, trustee and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, financial planning, pension, estate planning and employee benefit administration services.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in thousands, except share and per share data)	June 30, 2017	December 31, 2016
ASSETS		
Cash and due from financial institutions	\$26,684	\$28,205
Interest-bearing deposits in other financial institutions	37,862	45,957
Total cash and cash equivalents	64,546	74,162
Trading assets, at fair value	877	774
Securities available for sale, at estimated fair value	324,293	303,402
Securities held to maturity, estimated fair value of \$5,117 at June 30, 2017 and \$4,912 at December 31, 2016	4,928	4,705
FHLB NY and FRB NY Stock, at cost	3,764	4,041
Loans, net of deferred loan fees	1,252,647	1,200,290
Allowance for loan losses	(15,104)	(14,253)
Loans, net	1,237,543	1,186,037
Loans held for sale	386	412
Premises and equipment, net	27,836	28,923
Goodwill	21,824	21,824
Other intangible assets, net	2,506	2,945
Bank-owned life insurance	2,947	2,912
Accrued interest receivable and other assets	27,122	27,042
Total assets	\$1,718,572	\$1,657,179
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	\$436,017	\$417,812
Interest-bearing	1,089,020	1,038,531
Total deposits	1,525,037	1,456,343
Securities sold under agreements to repurchase	11,937	27,606
FHLB NY term advances	9,038	9,093
Long term capital lease obligation	4,620	4,722
Dividends payable	1,231	1,225
Accrued interest payable and other liabilities	14,747	14,442
Total liabilities	1,566,610	1,513,431
Shareholders' equity:		
Common stock, \$0.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at June 30, 2017 and December 31, 2016	53	53
Additional paid-in capital	45,966	45,603
Retained earnings	127,585	124,111

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Treasury stock, at cost; 574,015 shares at June 30, 2017 and 597,843 shares at December 31, 2016	(14,670	)	(15,265)
Accumulated other comprehensive loss	(6,972	)	(10,754)
Total shareholders' equity	151,962		143,748	
Total liabilities and shareholders' equity	\$1,718,572		\$1,657,179	

See accompanying notes to unaudited consolidated financial statements.

6

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share data)	2017	2016	2017	2016
Interest and dividend income:				
Loans, including fees	\$12,817	\$12,321	\$25,316	\$24,567
Taxable securities	1,398	1,281	2,820	2,718
Tax exempt securities	276	240	514	494
Interest-bearing deposits	193	83	348	95
Total interest and dividend income	14,684	13,925	28,998	27,874
Interest expense:				
Deposits	549	539	1,087	1,046
Securities sold under agreements to repurchase	95	211	288	422
Borrowed funds	90	207	179	413
Total interest expense	734	957	1,554	1,881
Net interest income	13,950	12,968	27,444	25,993
Provision for loan losses	421	388	1,461	983
Net interest income after provision for loan losses	13,529	12,580	25,983	25,010
Non-interest income:				
WMG fee income	2,269	2,201	4,378	4,213
Service charges on deposit accounts	1,225	1,285	2,409	2,420
Interchange revenue from debit card transactions	964	939	1,884	1,832
Net gains on securities transactions	12	—	12	908
Net gains on sales of loans held for sale	53	97	122	158
Net gains (losses) on sales of other real estate owned	(9	) (11	) 8	(16
Income from bank-owned life insurance	18	18	35	36
Other	490	687	1,021	1,266
Total non-interest income	5,022	5,216	9,869	10,817
Non-interest expenses:				
Salaries and wages	5,422	5,182	10,697	10,365
Pension and other employee benefits	1,207	1,646	2,425	3,321
Net occupancy expenses	1,702	1,878	3,308	3,784
Furniture and equipment expenses	781	829	1,462	1,601
Data processing expense	1,587	1,720	3,191	3,434
Professional services	417	575	717	916
Legal accruals and settlements	850	1,200	850	1,200
Amortization of intangible assets	213	245	439	503
Marketing and advertising expenses	118	325	367	547
Other real estate owned expenses	11	57	31	109
FDIC insurance	309	277	634	571
Loan expense	166	188	282	300
Other	1,549	1,448	2,974	2,927
Total non-interest expenses	14,332	15,570	27,377	29,578
Income before income tax expense	4,219	2,226	8,475	6,249

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Income tax expense	1,263	605	2,540	1,921
Net income	\$2,956	\$1,621	5,935	\$4,328
Weighted average shares outstanding	4,797	4,760	4,793	4,754
Basic and diluted earnings per share	\$0.62	\$0.34	\$1.24	\$0.91

See accompanying notes to unaudited consolidated financial statements.

7

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$2,956	\$1,621	\$5,935	\$4,328
Other comprehensive income				
Unrealized holding gains on securities available for sale	2,854	2,523	6,020	5,632
Reclassification adjustment for gains realized in net income	(12)	—	(12)	(908)
Net unrealized gains	2,842	2,523	6,008	4,724
Tax effect	1,078	952	2,267	1,782
Net of tax amount	1,764	1,571	3,741	2,942
Change in funded status of defined benefit pension plan and other benefit plans:				
Reclassification adjustment for amortization of prior service costs	(55)	(23)	(110)	(45)
Reclassification adjustment for amortization of net actuarial loss	88	396	176	792
Total before tax effect	33	373	66	747
Tax effect	13	141	25	282
Net of tax amount	20	232	41	465
Total other comprehensive income	1,784	1,803	3,782	3,407
Comprehensive income	\$4,740	\$3,424	\$9,717	\$7,735

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(UNAUDITED)

(in thousands, except share and per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total
Balances at January 1, 2016	\$ 53	\$ 45,537	\$ 118,973	\$(16,379)	\$ (10,942)	\$ 137,242
Net income	—	—	4,328	—	—	4,328
Other comprehensive income	—	—	—	—	3,407	3,407
Restricted stock awards	—	96	—	—	—	96
Restricted stock units for directors' deferred compensation plan	—	48	—	—	—	48
Cash dividends declared (\$0.52 per share)	—	—	(2,441)	—	—	(2,441)
Distribution of 9,532 shares of treasury stock for directors' compensation	—	19	—	243	—	262
Distribution of 7,661 shares of treasury stock for employee compensation	—	15	—	195	—	210
Distribution of 3,740 shares of treasury stock for deferred directors' compensation	—	(92)	—	95	—	3
Sale of 9,269 shares of treasury stock (a)	—	16	—	238	—	254
Balances at June 30, 2016	\$ 53	\$ 45,639	\$ 120,860	\$(15,608)	\$ (7,535)	\$ 143,409
Balances at January 1, 2017	\$ 53	\$ 45,603	\$ 124,111	\$(15,265)	\$ (10,754)	\$ 143,748
Net income	—	—	5,935	—	—	5,935
Other comprehensive income	—	—	—	—	3,782	3,782
Restricted stock awards	—	107	—	—	—	107
Restricted stock units for directors' deferred compensation plan	—	49	—	—	—	49
Cash dividends declared (\$0.52 per share)	—	—	(2,461)	—	—	(2,461)
Distribution of 7,880 shares of treasury stock for directors' compensation	—	68	—	201	—	269
Distribution of 5,861 shares of treasury stock for employee compensation	—	50	—	150	—	200
Distribution of 2,438 shares of treasury stock for deferred directors' compensation	—	(51)	—	62	—	11
Sale of 8,788 shares of treasury stock (a)	—	97	—	225	—	322
Forfeiture of 1,139 shares of restricted stock awards	—	43	—	(43)	—	—
Balances at June 30, 2017	\$ 53	\$ 45,966	\$ 127,585	\$(14,670)	\$ (6,972)	\$ 151,962

(a) All treasury stock sales were completed at the prevailing market price with the Chemung Canal Trust Company Profit Sharing, Savings, and Investment Plan which is a defined contribution plan sponsored by the Bank.

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(in thousands)	Six Months Ended June 30,	
	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$5,935	\$4,328
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	439	503
Provision for loan losses	1,461	983
Losses on disposal of fixed assets	31	—
Depreciation and amortization of fixed assets	1,946	2,374
Amortization of premiums on securities, net	736	911
Gains on sales of loans held for sale, net	(122)	(158)
Proceeds from sales of loans held for sale	6,204	7,265
Loans originated and held for sale	(6,056)	(6,840)
Net gains on trading assets	(64)	(19)
Net gains on securities transactions	(12)	(908)
Net (gains) losses on sales of other real estate owned	(8)	16
Purchase of trading assets	(39)	(47)
Expense related to restricted stock units for directors' deferred compensation plan	49	48
Expense related to employee stock compensation	200	210
Expense related to employee restricted stock awards	107	96
Income from bank-owned life insurance	(35)	(36)
(Increase)/decrease in other assets and accrued interest receivable	(132)	1,923
(Increase)/decrease in accrued interest payable	(47)	4
Increase/(decrease) in other liabilities	(1,594)	793
Net cash provided by operating activities	8,999	11,446
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and calls of securities available for sale	1,075	15,422
Proceeds from maturities and principal collected on securities available for sale	24,624	34,302
Proceeds from maturities and principal collected on securities held to maturity	1,544	1,873
Purchases of securities available for sale	(41,306)	(460)
Purchases of securities held to maturity	(1,767)	(825)
Purchase of FHLB NY and FRB NY stock	(173)	(5,458)
Redemption of FHLB NY and FRB NY stock	450	5,764
Purchases of premises and equipment	(890)	(648)
Proceeds from sales of other real estate owned	176	1,463
Net increase in loans	(53,083)	(33,440)
Net cash (used in) provided by investing activities	(69,350)	17,993
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts	79,997	75,049
Net decrease in time deposits	(11,303)	(7,424)
Net increase (decrease) in securities sold under agreements to repurchase	(15,669)	325
Net change in FHLB NY overnight advances, net	—	(13,900)
Repayments of FHLB NY long term advances	(55)	(55)

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Payments made on capital lease	(102)	(86)
Sale of treasury stock	322	254
Cash dividends paid	(2,455)	(2,433)
Net cash provided by financing activities	50,735	51,730
Net increase (decrease) in cash and cash equivalents	(9,616)	81,169
Cash and cash equivalents, beginning of period	74,162	26,185
Cash and cash equivalents, end of period	\$64,546	\$107,354

(continued)

See accompanying notes to unaudited consolidated financial statements.

10

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED
(UNAUDITED)

(in thousands)	Six Months Ended June 30,	
	2017	2016
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest	\$1,601	\$1,877
Income taxes	\$4,050	\$1,830
Supplemental disclosure of non-cash activity:		
Transfer of loans to other real estate owned	\$116	\$342
Dividends declared, not yet paid	\$1,231	\$1,222
Distribution of treasury stock for directors' compensation	\$269	\$262
Distribution of treasury stock for deferred directors' compensation	\$11	\$3
Assets acquired through long term capital lease obligations	\$—	\$2,035

See accompanying notes to unaudited consolidated financial statements.

11

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The Corporation, through its wholly-owned subsidiaries, the Bank and CFS, provides a wide range of banking, financing, fiduciary and other financial services to its clients. The Corporation and the Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

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

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP for interim financial information and pursuant to the requirements for reporting on Form 10-Q and Article 10 of Regulation S-X of the Exchange Act. These financial statements include the accounts of the Corporation and its subsidiaries, and all significant intercompany balances and transactions are eliminated in consolidation. Amounts in the prior periods' consolidated financial statements are reclassified whenever necessary to conform to the current period's presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures necessary for the fair presentation of the accompanying consolidated financial statements have been included. The unconsolidated financial statements should be read in conjunction with the Corporation's 2016 Annual Report on Form 10-K for the year ended December 31, 2016. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, an amendment to Revenue from Contracts with Customers (Topic 606). The objective of this amendment is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRS. This update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are in the scope of other standards. In August 2015, the FASB issued ASU 2015-14 to defer for one year the effective date of the new revenue standard. The requirements are effective for annual periods and interim periods within fiscal years beginning after December 15, 2017. During 2016, the FASB issued further implementation guidance regarding revenue recognition. This additional guidance included clarification on certain principal versus agent considerations within the implementation of the guidance as well as clarification related to identifying performance obligations and licensing, assessing collectability, presenting sales taxes, measuring noncash consideration, and certain transition

matters. The Corporation intends to adopt the new revenue guidance as of January 1, 2018 and does not expect a significant change upon adoption of the standard, as the new standard will not materially change the way the Corporation currently records revenue for its WMG and fee income from mortgage servicing fees, financial guarantees, and deposit related fees.

In January 2016, the FASB issued ASU 2016-01, an amendment to Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10). The objectives of the ASU are to (1) require equity investments to be measured at fair value, with changes in fair value recognized in net income, (2) simplify the impairment assessment of equity investments without readily determinable fair values, (3) eliminate the requirement to disclose methods and significant assumptions used to estimate fair value for financial instruments measured at amortized cost on the balance sheet, (4) require the use of the exit price notion when measuring the fair value of financial instruments, and (5) clarify the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. The Corporation intends to adopt the new guidance as of January 1, 2018 and believes the ASU will not have a material impact on its consolidated financial statements, as the Corporation's equity investment portfolio is less than \$1.0 million as of June 30, 2017.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires companies that lease valuable assets to recognize on their balance sheets the assets and liabilities generated by contracts longer than a year. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, though early adoption is permitted. The Corporation intends to adopt the new lease guidance as of January 1, 2019 and is currently evaluating the impact that adoption of these updates will have on its consolidated financial statements. Currently, the Corporation believes the implementation of this ASU will create a right of use asset of less than \$5.0 million for the Corporation's 13 leased facilities and a related capital obligation of the same amount as of January 1, 2019.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The objectives of the ASU are to simplify accounting for a stock payment's tax consequences and amend how excess tax benefits and a business's payments to cover the tax bills for the shares' recipients should be classified. The amendments allow companies to estimate the number of stock awards they expect to vest, and they revise the withholding requirements for classifying stock awards as equity. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2016, though early adoption is permitted. The adoption of ASU 2016-09 did not have a significant impact on the Corporation's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The objective of the ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date by replacing the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to form credit loss estimates. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2019, though entities may adopt the amendments earlier for fiscal year beginning after December 15, 2018. The Corporation is currently evaluating the impact of the adoption of this guidance on its consolidated financial statements. The Corporation anticipates that the adoption of the CECL model will result in an increase to the Corporation's allowance for loan losses. The Corporation has established a committee to oversee the implementation of CECL. This committee is currently assessing the data and system requirements necessary for adoption. The Corporation plans to run its current incurred loss model and a CECL model concurrently for 12 months prior to the adoption of this guidance on January 1, 2020.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The objective of the ASU is to reduce the existing diversity in practice relating to 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 principal. The amendments in this ASU are effective for public companies for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, though early adoption is permitted. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The objective of the ASU is to simplify the manner in which an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Additionally, the ASU removes the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails such qualitative test, to perform Step 2 of the goodwill impairment test. The amendments in this ASU are effective for annual, or any interim, goodwill impairment tests in fiscal years beginning after December 15, 2019. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, Compensation - Retirement Benefits (Topic 715) - Improving the Presentation of Net Periodic Cost and Net Periodic Postretirement Benefit Cost. The objective of the ASU is to improve guidance related to the presentation of defined benefit costs in the income statement. Specifically, the ASU requires that an employer report the service cost component in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. Additionally, the ASU allows only the service cost component to be eligible for capitalization, when applicable. The amendments in this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The objective of the ASU is to align the amortization period of premiums and discounts to expectations incorporated in market pricing on the underlying securities. The amendment requires that the premium be amortized to the earliest call date, but does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The amendments in this ASU are effective for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. The adoption of the ASU is not expected to have a significant impact on the Corporation's consolidated financial statements.

NOTE 2 EARNING PER COMMON SHARE (shares in thousands)

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities and are considered outstanding at grant date. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,797 and 4,760 weighted average shares outstanding for the three-month periods ended June 30, 2017 and 2016, respectively. Earnings per share were computed by dividing net income by 4,793 and 4,754 weighted average shares outstanding for the six-month periods ended June 30, 2017 and 2016, respectively. There were no common stock equivalents during the three and six-month periods ended June 30, 2017 or 2016.

NOTE 3 SECURITIES

Amortized cost and estimated fair value of securities available for sale are as follows (in thousands):

	June 30, 2017			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 16,245	\$ 115	\$ —	\$ 16,360
Mortgage-backed securities, residential	249,163	617	2,803	246,977
Obligations of states and political subdivisions	54,751	846	20	55,577
Corporate bonds and notes	248	4	—	252
SBA loan pools	4,612	4	5	4,611

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Corporate stocks	265	251	—	516
Total	\$325,284	\$ 1,837	\$ 2,828	\$324,293

14

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

	December 31, 2016			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$17,300	\$ 155	\$ —	\$17,455
Mortgage-backed securities, residential	253,156	202	7,492	245,866
Obligations of states and political subdivisions	38,843	209	312	38,740
Corporate bonds and notes	249	1	—	250
SBA loan pools	568	3	1	570
Corporate stocks	285	236	—	521
Total	\$310,401	\$ 806	\$ 7,805	\$303,402

Amortized cost and estimated fair value of securities held to maturity are as follows (in thousands):

	June 30, 2017			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of states and political subdivisions	\$3,048	\$ 193	\$ —	\$ 3,241
Time deposits with other financial institutions	1,880	—	4	1,876
Total	\$4,928	\$ 193	\$ 4	\$ 5,117

	December 31, 2016			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of states and political subdivisions	\$3,725	\$ 206	\$ —	\$ 3,931
Time deposits with other financial institutions	980	1	—	981
Total	\$4,705	\$ 207	\$ —	\$ 4,912

The amortized cost and estimated fair value of debt securities are shown below by expected maturity. Expected maturities may differ from contractual maturities if borrowers 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 (in thousands):

	June 30, 2017		Held to Maturity	
	Available for Sale		Amortized Cost	Fair Value
Within one year	\$9,604	\$9,696	\$1,531	\$1,538
After one, but within five years	30,400	30,704	3,125	3,266
After five, but within ten years	29,868	30,398	272	313
After ten years	1,372	1,391	—	—
	71,244	72,189	4,928	5,117
Mortgage-backed securities, residential	249,163	246,977	—	—
SBA loan pools	4,612	4,611	—	—
Total	\$325,019	\$323,777	\$4,928	\$5,117

The proceeds from sales and calls of securities resulting in gains or losses for the three months ended June 30, 2017 and 2016 are listed below (in thousands):

	2017	2016
Proceeds	\$540	\$ —
Gross gains	12	—
Tax expense	4	—

The proceeds from sales and calls of securities resulting in gains or losses for the six months ended June 30, 2017 and 2016 are listed below (in thousands):

	2017	2016
Proceeds	\$ 540	\$ 15,422
Gross gains	12	908
Tax expense	4	343

The following tables summarize the investment securities available for sale with unrealized losses at June 30, 2017 and December 31, 2016 by aggregated major security type and length of time in a continuous unrealized loss position (in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
June 30, 2017						
Mortgage-backed securities, residential	\$ 182,029	\$ 2,803	\$ —	\$ —	\$ 182,029	\$ 2,803
Obligations of states and political subdivisions	3,872	20	—	—	3,872	20
SBA loan pools	1,988	5	—	—	1,988	5
Total temporarily impaired securities	\$ 187,889	\$ 2,828	\$ —	\$ —	\$ 187,889	\$ 2,828

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2016						
Mortgage-backed securities, residential	\$ 233,843	\$ 7,492	\$ —	\$ —	\$ 233,843	\$ 7,492
Obligations of states and political subdivisions	25,724	312	—	—	25,724	312
SBA loan pools	—	—	225	1	225	1
Total temporarily impaired securities	\$ 259,567	\$ 7,804	\$ 225	\$ 1	\$ 259,792	\$ 7,805

Other-Than-Temporary Impairment

As of June 30, 2017, the majority of the Corporation's unrealized losses in the investment securities portfolio related to mortgage-backed securities. At June 30, 2017, all of the unrealized losses related to mortgage-backed securities were issued by U.S. government sponsored entities, Fannie Mae and Freddie Mac. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because it is not likely that the Corporation will be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at June 30, 2017.

NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio, net of deferred origination fees and costs, is summarized as follows (in thousands):

	June 30, 2017	December 31, 2016
Commercial and agricultural:		
Commercial and industrial	\$ 188,930	\$ 176,201
Agricultural	531	360
Commercial mortgages:		
Construction	57,549	46,387
Commercial mortgages, other	547,165	522,269
Residential mortgages	200,629	198,493
Consumer loans:		
Credit cards	1,403	1,476
Home equity lines and loans	97,273	98,590
Indirect consumer loans	142,791	139,572
Direct consumer loans	16,376	16,942
Total loans, net of deferred origination fees and costs	\$ 1,252,647	\$ 1,200,290
Interest receivable on loans	3,149	3,192
Total recorded investment in loans	\$ 1,255,796	\$ 1,203,482

The Corporation's concentrations of credit risk by loan type are reflected in the preceding table. The concentrations of credit risk with standby letters of credit, committed lines of credit and commitments to originate new loans generally follow the loan classifications in the table above.

The following tables present the activity in the allowance for loan losses by portfolio segment for the three and six-month periods ended June 30, 2017 and 2016 (in thousands):

Allowance for loan losses	Three Months Ended June 30, 2017				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Beginning balance	\$ 1,650	\$ 7,749	\$ 1,512	\$ 4,049	\$ 14,960
Charge-offs	(2)	—	(48)	(397)	(447)
Recoveries	36	2	13	119	170
Net recoveries (charge-offs)	34	2	(35)	(278)	(277)
Provision	199	27	40	155	421
Ending balance	\$ 1,883	\$ 7,778	\$ 1,517	\$ 3,926	\$ 15,104
Allowance for loan losses	Three Months Ended June 30, 2016				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Beginning balance	\$ 1,795	\$ 7,532	\$ 1,482	\$ 3,718	\$ 14,527
Charge-offs	(9)	—	(58)	(272)	(339)
Recoveries	18	2	—	72	92
Net recoveries (charge-offs)	9	2	(58)	(200)	(247)
Provision	(33)	220	80	121	388
Ending balance	\$ 1,771	\$ 7,754	\$ 1,504	\$ 3,639	\$ 14,668

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Allowance for loan losses	Six Months Ended June 30, 2017				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Beginning balance:	\$1,589	\$ 7,270	\$ 1,523	\$ 3,871	\$14,253
Charge-offs:	(7)	—	(60)	(825)	(892)
Recoveries:	61	3	30	188	282
Net recoveries (charge-offs)	54	3	(30)	(637)	(610)
Provision	240	505	24	692	1,461
Ending balance	\$1,883	\$ 7,778	\$ 1,517	\$ 3,926	\$15,104

Allowance for loan losses	Six Months Ended June 30, 2016				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Beginning balance:	\$1,831	\$ 7,112	\$ 1,464	\$ 3,853	\$14,260
Charge-offs:	(17)	—	(58)	(715)	(790)
Recoveries:	50	9	—	156	215
Net recoveries (charge-offs)	33	9	(58)	(559)	(575)
Provision	(93)	633	98	345	983
Ending balance	\$1,771	\$ 7,754	\$ 1,504	\$ 3,639	\$14,668

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of June 30, 2017 and December 31, 2016 (in thousands):

Allowance for loan losses:	June 30, 2017				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$84	\$ 886	\$ —	\$ —	\$970
Collectively evaluated for impairment	1,799	6,862	1,517	3,926	14,104
Loans acquired with deteriorated credit quality	—	30	—	—	30
Total ending allowance balance	\$1,883	\$ 7,778	\$ 1,517	\$ 3,926	\$15,104

Allowance for loan losses:	December 31, 2016				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$—	\$ 735	\$ —	\$ 141	\$876
Collectively evaluated for impairment	1,589	6,476	1,498	3,730	13,293
Loans acquired with deteriorated credit quality	—	59	25	—	84
Total ending allowance balance	\$1,589	\$ 7,270	\$ 1,523	\$ 3,871	\$14,253

Loans:	June 30, 2017				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Loans individually evaluated for impairment	\$772	\$ 11,823	\$ 443	\$ 70	\$13,108
Loans collectively evaluated for impairment	189,167	593,413	200,674	258,428	1,241,682
Loans acquired with deteriorated credit quality	—	1,006	—	—	1,006
Total ending loans balance	\$189,939	\$ 606,242	\$ 201,117	\$ 258,498	\$1,255,796

Loans:	December 31, 2016				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Loans individually evaluated for impairment	\$693	\$ 10,382	\$ 396	\$455	\$11,926
Loans collectively evaluated for impairment	176,334	558,451	198,474	256,879	1,190,138
Loans acquired with deteriorated credit quality	—	1,323	95	—	1,418
Total ending loans balance	\$177,027	\$ 570,156	\$ 198,965	\$257,334	\$1,203,482

The following table presents loans individually evaluated for impairment recognized by class of loans as of June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017			December 31, 2016		
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:						
Commercial and agricultural:						
Commercial and industrial	\$602	\$ 604	\$ —	\$690	\$ 693	\$ —
Commercial mortgages:						
Construction	1,550	1,551	—	277	278	—
Commercial mortgages, other	5,641	5,615	—	8,792	7,857	—
Residential mortgages	466	443	—	395	396	—
Consumer loans:						
Home equity lines and loans	69	70	—	93	95	—
With an allowance recorded:						
Commercial and agricultural:						
Commercial and industrial	168	168	84	—	—	—
Commercial mortgages:						
Commercial mortgages, other	5,595	4,657	886	2,245	2,247	735
Consumer loans:						
Home equity lines and loans	—	—	—	360	360	141
Total	\$14,091	\$ 13,108	\$ 970	\$12,852	\$ 11,926	\$ 876

The following table presents the average recorded investment and interest income of loans individually evaluated for impairment recognized by class of loans as of the three and six-month periods ended June 30, 2017 and 2016 (in thousands):

	Three Months Ended June 30, 2017		Three Months Ended June 30, 2016		Six Months Ended June 30, 2017		Six Months Ended June 30, 2016	
	Average Recorded Investment	Interest Income Recognized (1)	Average Recorded Investment	Interest Income Recognized (1)	Average Recorded Investment	Interest Income Recognized (1)	Average Recorded Investment	Interest Income Recognized (1)
With no related allowance recorded:								
Commercial and agricultural:								
Commercial and industrial	\$626	\$ 8	\$1,048	\$ 12	\$649	\$ 17	\$1,195	\$ 25
Commercial mortgages:								
Construction	1,555	3	340	3	1,130	6	343	7
Commercial mortgages, other	5,879	32	6,733	59	6,538	90	7,014	121
Residential mortgages	417	2	399	1	410	4	344	1
Consumer loans:								
Home equity lines & loans	71	1	104	1	79	1	105	3
With an allowance recorded:								
Commercial and agricultural:								
Commercial and industrial	84	1	4	—	56	1	6	—
Commercial mortgages:								
Commercial mortgages, other	4,461	4	4,942	1	3,723	7	4,910	3
Consumer loans:								
Home equity lines and loans	180	—	362	—	240	—	363	—
Total	\$13,273	\$ 51	\$13,932	\$ 77	\$12,825	\$ 126	\$14,280	\$ 160

(1)Cash basis interest income approximates interest income recognized.

The following tables present the recorded investment in non-accrual and loans past due 90 days or more and still accruing by class of loans as of June 30, 2017 and December 31, 2016 (in thousands):

	Non-accrual		Loans Past Due 90 Days or More and Still Accruing	
	June 30, 2017	December 31, 2016	June 30, 2017	December 31, 2016
	Commercial and agricultural:			
Commercial and industrial	\$—	\$—	\$9	\$ 2
Commercial mortgages:				
Construction	1,307	19	—	—
Commercial mortgages, other	8,752	5,454	—	—
Residential mortgages	3,278	4,201	—	—
Consumer loans:				
Credit cards	—	—	27	11
Home equity lines and loans	1,181	1,670	—	—
Indirect consumer loans	673	654	—	—
Direct consumer loans	17	45	—	—
Total	\$15,208	\$12,043	\$36	\$ 13

The following tables present the aging of the recorded investment in loans as of June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017			Total Past Due	Loans Acquired with Deteriorated Credit Quality	Loans Not Past Due	Total
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due				
Commercial and agricultural:							
Commercial and industrial	\$6	\$16	\$9	\$31	\$ —	\$189,376	\$189,407
Agricultural	—	—	—	—	—	532	532
Commercial mortgages:							
Construction	—	—	1,288	1,288	—	56,406	57,694
Commercial mortgages, other	493	3,208	2,547	6,248	1,006	541,294	548,548
Residential mortgages	1,373	485	1,766	3,624	—	197,493	201,117
Consumer loans:							
Credit cards	6	13	27	46	—	1,357	1,403
Home equity lines and loans	257	98	760	1,115	—	96,409	97,524
Indirect consumer loans	1,616	165	384	2,165	—	140,967	143,132
Direct consumer loans	51	3	—	54	—	16,385	16,439
Total	\$3,802	\$3,988	\$6,781	\$14,571	\$ 1,006	\$1,240,219	\$1,255,796

	December 31, 2016			Total Past Due	Loans Acquired with Deteriorated Credit Quality	Loans Not Past Due	Total
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due				
Commercial and agricultural:							
Commercial and industrial	\$ 160	\$ 7	\$ 2	\$ 169	\$ —	\$ 176,497	\$ 176,666
Agricultural	—	—	—	—	—	361	361
Commercial mortgages:							
Construction	—	1,177	—	1,177	—	45,333	46,510
Commercial mortgages, other	652	4,460	2,412	7,524	1,323	514,799	523,646
Residential mortgages	2,100	436	2,383	4,919	95	193,951	198,965
Consumer loans:							
Credit cards	3	9	11	23	—	1,453	1,476
Home equity lines and loans	227	—	1,149	1,376	—	97,477	98,853
Indirect consumer loans	1,773	287	542	2,602	—	137,391	139,993
Direct consumer loans	54	7	22	83	—	16,929	17,012
Total	\$ 4,969	\$ 6,383	\$ 6,521	\$ 17,873	\$ 1,418	\$ 1,184,191	\$ 1,203,482

Troubled Debt Restructurings:

A modification of a loan may result in classification as a TDR when a borrower is experiencing financial difficulty and the modification constitutes a concession. The Corporation offers various types of modifications which may involve a change in the schedule of payments, a reduction in the interest rate, an extension of the maturity date, extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, requesting additional collateral, releasing collateral for consideration, substituting or adding a new borrower or guarantor, a permanent reduction of the recorded investment in the loan or a permanent reduction of the interest on the loan.

As of June 30, 2017 and December 31, 2016, the Corporation has a recorded investment in TDRs of \$10.0 million and \$10.2 million, respectively. There were specific reserves of \$0.9 million allocated for TDRs at both June 30, 2017 and December 31, 2016. As of June 30, 2017, TDRs totaling \$2.8 million were accruing interest under the modified terms and \$7.2 million were on non-accrual status. As of December 31, 2016, TDRs totaling \$5.8 million were accruing interest under the modified terms and \$4.4 million were on non-accrual status. The Corporation had committed no additional amounts as of both June 30, 2017 and December 31, 2016, to customers with outstanding loans that are classified as TDRs.

During the three-month periods ended June 30, 2017 and 2016, the terms of certain loans were modified as TDRs. The modification of the terms of two commercial & industrial term loans and one commercial line of credit during the three months ended June 30, 2017 included consolidating the loans into one commercial & industrial loan, extending the maturity date by approximately two years and lowering the monthly payment. An additional piece of equipment was taken as collateral but was not considered to be of greater value than the concessions given. The modification of the terms of a residential mortgage loan during the three months ended June 30, 2017 included an extension of the maturity date by approximately five years and a postponement of the scheduled amortized past due payments to the end of the loan.

The modification of the terms of a residential mortgage loan during the three months ended June 30, 2016 included an extension of the maturity date by thirteen years at a stated interest rate lower than the current market rate for new debt with similar risk and a corresponding reduction of the scheduled amortized payments of the loan due to the longer term. The modification of the terms of five commercial real estate loans and one residential home equity loan during the three months ended June 30, 2016 included consolidating the loans into one commercial real estate loan and extending the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk.

During the six months ended June 30, 2017 and 2016, the terms of certain loans were modified as TDRs. In addition to the modifications noted above, the modification of the terms of a commercial mortgage loan during the six months ended June 30, 2017 included a reduction of the scheduled amortized payments of the loan for greater than a three month period.

In addition to the modifications noted above, the modification of the terms of a residential mortgage loan performed during the six months ended June 30, 2016 included a reduction in the stated interest rate for three years and a corresponding reduction of the scheduled amortized payments of the loan due to the lower interest rate. Additionally, \$4 thousand of interest and past due escrow payments were capitalized on the restructured loan.

The following table presents loans by class modified as TDRs that occurred during the three months ended June 30, 2017 and June 30, 2016 (dollars in thousands):

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
June 30, 2017			
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	3	\$ 171	\$ 171
Residential mortgages	1	105	105
Total	4	\$ 276	\$ 276

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
June 30, 2016			
Troubled debt restructurings:			
Commercial mortgages:			
Commercial mortgages	5	\$ 312	\$ 310
Residential mortgages	1	174	182
Consumer loans:			
Home equity lines and loans	1	74	74
Total	7	\$ 560	\$ 566

The TDRs described above increased the allowance for loan losses by \$0.1 million and resulted in no charge-offs during the three month period ended June 30, 2017. The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the three months ended June 30, 2016.

The following tables presents loans by class modified as TDRs that occurred during the six months ended June 30, 2017 and 2016 (dollars in thousands):

June 30, 2017	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	3	\$ 171	\$ 171
Commercial mortgages:			
Commercial mortgages	1	166	166
Residential mortgages	1	105	105
Total	5	\$ 442	\$ 442
June 30, 2016	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial mortgages:			
Commercial mortgages	5	\$ 312	\$ 310
Residential mortgages	2	295	307
Consumer loans:			
Home equity lines and loans	1	74	74
Total	8	\$ 681	\$ 691

The TDRs described above increased the allowance for loan losses by \$0.1 million and resulted in no charge-offs during the six months ended June 30, 2017. The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the six months ended June 30, 2016.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no payment defaults on any loans previously modified as TDRs within twelve months following the modification during the three and six month periods ended June 30, 2017.

There were no payment defaults on any loans previously modified as TDRs within twelve months following the modification during the three months ended June 30, 2016. The following table presents loans by class modified as TDRs for which there was a payment default within twelve months following the modification during the six months ended June 30, 2016:

	Number of Loans	Recorded Investment
Commercial mortgages:		
Commercial mortgages, other	2	\$ 2,120
Total	2	\$ 2,120

The TDRs that subsequently defaulted described above did not increase the allowance for loan losses and resulted in no charge offs during the three and six-month periods ended June 30, 2016.

Credit Quality Indicators

The Corporation establishes a risk rating at origination for all commercial loans. The main factors considered in assigning risk ratings include, but are not limited to: historic and future debt service coverage, collateral position, operating performance, liquidity, leverage, payment history, management ability, and the customer's industry. Commercial relationship managers monitor all loans in their respective portfolios for any changes in the borrower's ability to service its debt and affirm the risk ratings for the loans at least annually.

For the retail loans, which include residential mortgages, indirect and direct consumer loans, home equity lines and loans, and credit cards, once a loan is properly approved and closed, the Corporation evaluates credit quality based upon loan repayment.

The Corporation uses the risk rating system to identify criticized and classified loans. Commercial relationships within the criticized and classified risk ratings are analyzed quarterly. The Corporation uses the following definitions for criticized and classified loans (which are consistent with regulatory guidelines):

Special Mention – Loans classified as special mention have a potential weakness that deserves management’s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or the institution’s credit position at some future date.

Substandard – Loans classified as substandard are inadequately protected by the current net worth and paying capability of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Doubtful – Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Commercial loans not meeting the criteria above to be considered criticized or classified are considered to be pass rated loans. Loans listed as not rated are included in groups of homogeneous loans performing under terms of the loan notes. Based on the analyses performed as of June 30, 2017 and December 31, 2016, the risk category of the recorded investment of loans by class of loans is as follows (in thousands):

June 30, 2017

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loans acquired with deteriorated credit quality	Total
Commercial and agricultural:							
Commercial and industrial	\$—	\$182,211	\$5,321	\$1,875	\$—	\$—	\$189,407
Agricultural	—	532	—	—	—	—	532
Commercial mortgages:							
Construction	—	56,388	—	1,306	—	—	57,694
Commercial mortgages	—	522,740	8,058	15,325	1,419	1,006	548,548
Residential mortgages	197,839	—	—	3,278	—	—	201,117
Consumer loans:							
Credit cards	1,403	—	—	—	—	—	1,403
Home equity lines and loans	96,343	—	—	1,181	—	—	97,524
Indirect consumer loans	142,459	—	—	673	—	—	143,132
Direct consumer loans	16,422	—	—	17	—	—	16,439
Total	\$454,466	\$761,871	\$13,379	\$23,655	\$1,419	\$1,006	\$1,255,796

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

December 31, 2016

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loans acquired with deteriorated credit quality	Total
Commercial and agricultural:							
Commercial and industrial	\$—	\$172,873	\$2,277	\$ 1,516	\$ —	\$ —	\$176,666
Agricultural	—	361	—	—	—	—	361
Commercial mortgages:							
Construction	—	45,055	259	1,196	—	—	46,510
Commercial mortgages	—	496,723	8,574	15,566	1,460	1,323	523,646
Residential mortgages	194,669	—	—	4,201	—	95	198,965
Consumer loans:							
Credit cards	1,476	—	—	—	—	—	1,476
Home equity lines and loans	97,183	—	—	1,670	—	—	98,853
Indirect consumer loans	139,339	—	—	654	—	—	139,993
Direct consumer loans	16,967	—	—	45	—	—	17,012
Total	\$449,634	\$715,012	\$11,110	\$ 24,848	\$ 1,460	\$ 1,418	\$1,203,482

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of June 30, 2017 and December 31, 2016 (in thousands):

June 30, 2017

Consumer Loans

	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	\$197,839	\$1,403	\$96,343	\$142,459	\$16,422
Non-Performing	3,278	—	1,181	673	17
	\$201,117	\$1,403	\$97,524	\$143,132	\$16,439

December 31, 2016

Consumer Loans

	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	\$194,764	\$1,476	\$97,183	\$139,339	\$16,967
Non-Performing	4,201	—	1,670	654	45
	\$198,965	\$1,476	\$98,853	\$139,993	\$17,012

At the time of the merger with Fort Orange Financial Corp., the Corporation identified certain loans with evidence of deteriorated credit quality, and the probability that the Corporation would be unable to collect all contractually required payments from the borrower. These loans are classified as PCI loans. The Corporation adjusted its estimates of future expected losses, cash flows, and renewal assumptions on the PCI loans during the current year. These adjustments were made for changes in expected cash flows due to loans refinanced beyond original maturity dates, impairments recognized subsequent to the acquisition, advances made for taxes or insurance to protect collateral held and payments received in excess of amounts originally expected.

The table below summarizes the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the PCI loans from April 1, 2017 to June 30, 2017 and April 1, 2016 to June 30, 2016 (in thousands):

	Balance at March 31, 2017	Income Accretion	All Other Adjustments	Balance at June 30, 2017
Three Months Ended June 30, 2017				
Contractually required principal and interest	\$ 1,877	\$ —	\$ (710)	\$ 1,167
Contractual cash flows not expected to be collected (nonaccretable discount)	(352)	—	319	(33)
Cash flows expected to be collected	1,525	—	(391)	1,134
Interest component of expected cash flows (accretable yield)	(155)	25	2	(128)
Fair value of loans acquired with deteriorating credit quality	\$ 1,370	\$ 25	\$ (389)	\$ 1,006
	Balance at March 31, 2016	Income Accretion	All Other Adjustments	Balance at June 30, 2016
Three Months Ended June 30, 2016				
Contractually required principal and interest	\$ 2,858	\$ —	\$ (366)	\$ 2,492
Contractual cash flows not expected to be collected (nonaccretable discount)	(505)	—	131	(374)
Cash flows expected to be collected	2,353	—	(235)	2,118
Interest component of expected cash flows (accretable yield)	(275)	33	(1)	(243)
Fair value of loans acquired with deteriorating credit quality	\$ 2,078	\$ 33	\$ (236)	\$ 1,875

For those purchased credit impaired loans disclosed above, the Corporation decreased the allowance for loan losses by \$54 thousand and \$15 thousand during the three months ended June 30, 2017 and 2016, respectively. The Corporation reversed \$29 thousand of the allowance for loan losses during the three months ended June 30, 2017. The Corporation did not reverse any allowance for loan losses during the three months ended June 30, 2016.

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

The tables below summarizes the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the PCI loans from January 1, 2017 to June 30, 2017 and January 1, 2016 to June 30, 2016 (in thousands):

	Balance at December 31, 2016	Income Accretion	All Other Adjustments	Balance at June 30, 2017
Six Months Ended June 30, 2017				
Contractually required principal and interest	\$ 1,940	\$ —	\$ (773)	\$ 1,167
Contractual cash flows not expected to be collected (nonaccretable discount)	(352)	—	319	(33)
Cash flows expected to be collected	1,588	—	(454)	1,134
Interest component of expected cash flows (accretable yield)	(170)	40	2	(128)
Fair value of loans acquired with deteriorating credit quality	\$ 1,418	\$ 40	\$ (452)	\$ 1,006
	Balance at December 31, 2015	Income Accretion	All Other Adjustments	Balance at June 30, 2016
Six Months Ended June 30, 2016				
Contractually required principal and interest	\$ 2,912	\$ —	\$ (420)	\$ 2,492
Contractual cash flows not expected to be collected (nonaccretable discount)	(506)	—	132	(374)
Cash flows expected to be collected	2,406	—	(288)	2,118
Interest component of expected cash flows (accretable yield)	(311)	70	(2)	(243)
Fair value of loans acquired with deteriorating credit quality	\$ 2,095	\$ 70	\$ (290)	\$ 1,875

For those purchased credit impaired loans disclosed above, the Corporation decreased the allowance for loan losses by \$54 thousand and \$15 thousand during the six months ended June 30, 2017 and 2016, respectively. The Corporation reversed \$29 thousand of the allowance for losses during the six months ended June 30, 2017. The Corporation did not reverse any allowance for loan losses during the six months ended June 30, 2016.

NOTE 5 FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair value:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods and significant assumptions to estimate fair value on a recurring basis:

Investment Securities: The fair values of securities available for sale are usually determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs), or matrix pricing, which is a mathematical technique widely used to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3 inputs).

Trading Assets: Securities that are held to fund a deferred compensation plan are recorded at fair value with changes in fair value included in earnings. The fair values of trading assets are determined by quoted market prices (Level 1 inputs).

Derivatives: The fair values of interest rate swaps are based on valuation models using observable market data as of the measurement date (Level 2 inputs). Derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, but could include interest rates, prices, and indices to generate continuous yield or pricing curves, prepayment rates, and volatility factors to value the position. The Corporation also incorporates credit valuation adjustments to appropriately reflect both its own nonperformance risk and the respective counter-party's nonperformance risk in the fair value measurements. In adjusting the fair value of its derivative contracts for the effect of nonperformance risk, the Corporation has considered the impact of any applicable credit enhancements, such as collateral postings. Although the Corporation has determined that the majority of the inputs used to value its derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with its derivatives utilize credit default rate assumptions (Level 3 inputs).

The fair values of credit risk participations are based on credit default rate assumptions (Level 3 inputs).

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

Financial Assets:	Fair Value	Fair Value Measurement at June 30, 2017 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$16,360	\$—	\$ 16,360	\$ —
Mortgage-backed securities, residential	246,977	—	246,977	—
Obligations of states and political subdivisions	55,577	—	55,577	—
Corporate bonds and notes	252	—	—	252
SBA loan pools	4,611	—	4,611	—
Corporate stocks	516	184	332	—
Total available for sale securities	\$324,293	\$184	\$ 323,857	\$ 252

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Trading assets	\$877	\$877	\$—	\$ —
Derivative assets	625	—	625	—
Financial Liabilities:				
Derivative liabilities	\$696	\$—	\$ 625	\$ 71

Financial Assets:	Fair Value	Fair Value Measurement at December 31, 2016 Using Quoted Prices in Active Markets for Identical Assets (Level 1)		
		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$17,455	\$—	\$ 17,455	\$ —
Mortgage-backed securities, residential	245,866	—	245,866	—
Obligations of states and political subdivisions	38,740	—	38,740	—
Corporate bonds and notes	250	—	—	250
SBA loan pools	570	—	570	—
Corporate stocks	521	170	351	—
Total available for sale securities	\$303,402	\$ 170	\$ 302,982	\$ 250
Trading assets	\$774	\$774	\$—	\$ —
Derivative assets	693	—	693	—
Financial Liabilities:				
Derivative liabilities	\$761	\$—	\$ 693	\$ 68

There were no transfers between Level 1 and Level 2 during the three and six-month periods ended June 30, 2017. During the year ended December 31, 2016, the Corporation transferred corporate stocks with a fair market value of \$158 thousand at the date of transfer (and \$103 thousand at December 31, 2016) from Level 2 to Level 1 due to the corporation's stock becoming publicly listed.

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three-month periods ended June 30, 2017 and June 30, 2016 (in thousands):

	Assets (Liabilities)			
	Corporate Bonds and Notes		Derivative Liabilities	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Balance of recurring Level 3 assets at April 1	\$251	\$252	\$(65)	\$(84)
Derivative instruments entered into	—	—	—	(23)
Total gains or losses for the period:				
Included in earnings - other non-interest income	—	—	(6)	(13)
Included in other comprehensive income	1	4	—	—
Transfers into Level 3	—	—	—	—

Balance of recurring Level 3 assets at June 30 \$252 \$256 \$(71) \$(120)

30

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six month periods ended June 30, 2017 and June 30, 2016 (in thousands):

	Assets (Liabilities)			
	Corporate Bonds and Notes		Derivative Liabilities	
	June 30, 2017	June 30, 2016	June 30, 2017	June 30, 2016
Balance of recurring Level 3 assets at January 1	\$250	\$248	\$(68)	\$(48)
Derivative instruments entered into	—	—	—	(25)
Total gains or losses for the period:				
Included in earnings - other non-interest income	—	—	(3)	(47)
Included in other comprehensive income	2	8	—	—
Transfers into Level 3	—	—	—	—
Balance of recurring Level 3 assets at June 30	\$252	\$256	\$(71)	\$(120)

The following table presents information related to Level 3 recurring fair value measurements at June 30, 2017 and December 31, 2016 (in thousands):

Description	Fair Value at June 30, 2017	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at June 30, 2017
Corporate bonds and notes	\$ 252	Discounted cash flow	Credit spread	1.73% - 1.73% [1.73%]
Derivative liabilities	\$ 71	Historical trend	Credit default rate	5.07% - 5.07% [5.07%]

Description	Fair Value at December 31, 2016	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at December 31, 2016
Corporate bonds and notes	\$ 250	Discounted cash flow	Credit spread	1.73% - 1.73% [1.73%]
Derivative liabilities	\$ 68	Historical trend	Credit default rate	4.92% - 4.92% [4.92%]

The Corporation used the following methods and significant assumptions to estimate fair value on a non-recurring basis:

Impaired Loans: At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value have been partially charged-off or receive specific allocations as part of the allowance for loan loss accounting. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for

differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, typically resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

OREO: Assets acquired through or instead of loan foreclosures are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Assets in which the Corporation has accepted a purchase offer are classified as Level 2.

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (commercial properties) or certified residential appraisers (residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Once received, appraisals are reviewed for reasonableness of assumptions, approaches utilized, Uniform Standards of Professional Appraisal Practice and other regulatory compliance, as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals are generally completed within the previous 12 month period prior to a property being placed into OREO. On impaired loans, appraisal values are adjusted based on the age of the appraisal, the position of the lien, the type of the property and its condition.

Assets and liabilities measured at fair value on a non-recurring basis are summarized below (in thousands):

	Fair Value Measurement at June 30, 2017 Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:				
Impaired Loans:				
Commercial and agricultural:				
Commercial and industrial	\$84	\$—	—	\$ 84
Commercial mortgages:				
Commercial mortgages, other	2,911	—	—	2,911
Total impaired loans	\$2,995	\$—	—	\$ 2,995
Other real estate owned:				
Residential mortgages	\$138	\$—	—	\$ 138
Consumer loans:				
Home equity lines and loans	8	—	8	—
Total other real estate owned, net	\$146	\$—	8	\$ 138

	Fair Value Measurement at December 31, 2016 Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Financial Assets:				

Markets)
for
Identical
Assets
(Level
1)

Impaired Loans:

Commercial mortgages:

Commercial mortgages, other	\$2,631	\$—	—\$ 2,631
-----------------------------	---------	-----	-----------

Consumer loans:

Home equity lines and loans	219	—	219
-----------------------------	-----	---	-----

Total impaired loans	\$2,850	\$—	—\$ 2,850
----------------------	---------	-----	-----------

Other real estate owned:

Residential mortgages	\$344	\$—	—\$ 344
-----------------------	-------	-----	---------

Total other real estate owned, net	\$344	\$—	—\$ 344
------------------------------------	-------	-----	---------

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

The following tables presents information related to Level 3 non-recurring fair value measurement at June 30, 2017 and December 31, 2016 (in thousands):

Description	Fair Value at June 30, 2017	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at June 30, 2017
Impaired loans:				
Commercial and agricultural:				
Commercial and industrial	\$ 84	Sales comparison	Discount to appraised value	36.07%-36.07% [36.07%]
Commercial mortgages:				
Commercial mortgages, other	316	Sales comparison	Discount to appraised value	13.58% - 42.95% [24.90%]
	2,595	Income approach	Capitalization Rate	9.00% - 10.00% [9.52%]
	\$ 2,995			
OREO:				
Residential mortgages	\$ 138	Sales comparison	Discount to appraised value	17.28% - 36.37% [23.12%]
	\$ 138			

Description	Fair Value at December 31, 2016	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at December 31, 2016
Impaired loans:				
Commercial mortgages:				
Commercial mortgages, other	\$ 2,631	Income approach	Capitalization Rate	9.00% - 10.00% [9.52%]
Consumer loans:				
Home equity lines and loans	219	Sales comparison	Discount to appraised value	22.98% - 22.98% [22.98%]
	\$ 2,850			
OREO:				
Residential mortgages	\$ 344	Sales comparison	Discount to appraised value	20.80% - 48.17% [30.50%]
	\$ 344			

FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments not already discussed:

Cash and Due From Financial Institutions and Interest-Bearing Deposits in Other Financial Institutions

For those short-term instruments that generally mature in 90 days or less, the carrying value approximates fair value of which non-interest-bearing deposits are classified as Level 1 and interest-bearing deposits with the FHLBNY and

FRBNY are classified as Level 1.

Securities Held to Maturity

For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3 inputs).

FHLBNY and FRBNY Stock

It is not practicable to determine the fair value of FHLBNY and FRBNY stock due to restrictions placed on its transferability.

Loans, Net

For variable-rate loans that reprice frequently, fair values approximate carrying values. The fair values for other loans are estimated through discounted cash flow analysis using interest rates currently being offered for loans with similar terms and credit quality. Loans are classified as Level 3. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

Loans Held for Sale

Certain mortgage loans are originated with the intent to sell. Loans held for sale are recorded at the lower of cost or market and are classified as Level 2.

Deposits

The fair values disclosed for demand deposits, savings accounts and money market accounts are, by definition, equal to the amounts payable on demand at the reporting date (i.e., their carrying values) and classified as Level 1.

The fair value of certificates of deposits is estimated using a discounted cash flow approach that applies interest rates currently being offered on certificates to a schedule of the weighted-average expected monthly maturities and classified as Level 2.

Securities Sold Under Agreements to Repurchase

These instruments bear both variable and fixed rates of interest. Therefore, the carrying value approximates fair value for the variable rate instruments and the fair value of fixed rate instruments is based on discounted cash flows to maturity. These are classified as Level 2.

FHLBNY Overnight Advances and FHLBNY Term Advances

These instruments bear a stated rate of interest to maturity and, therefore, the fair value is based on discounted cash flows to maturity and classified as Level 2.

Accrued Interest Receivable and Payable

For these short-term instruments, the carrying value approximates fair value resulting in a classification of Level 1, Level 2 or Level 3 depending upon the classification of the asset/liability they are associated with.

The carrying amounts and estimated fair values of other financial instruments, at June 30, 2017 and December 31, 2016, are as follows (in thousands):

Financial assets:	June 30, 2017				
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Estimated Fair Value (1)
Cash and due from financial institutions	\$26,684	\$26,684	\$	—\$	—\$26,684
Interest-bearing deposits in other financial institutions	37,862	37,862	—	—	37,862
Trading assets	877	877	—	—	877
Securities available for sale	324,293	184	323,857	252	324,293
Securities held to maturity	4,928	—	1,876	3,241	5,117
FHLB NY and FRBNY stock	3,764	—	—	—	N/A
Loans, net	1,237,543	—	—	1,242,298	1,242,298
Loans held for sale	386	—	386	—	386
Accrued interest receivable	3,998	8	825	3,165	3,998
Derivative assets	625	—	625	—	625
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	\$1,392,234	\$1,392,234	\$	—\$	—\$1,392,234
Time deposits	132,803	—	133,091	—	133,091
Securities sold under agreements to repurchase	11,937	—	12,092	—	12,092
FHLB NY term advances	9,038	—	9,088	—	9,088
Accrued interest payable	163	19	144	—	163
Derivative liabilities	696	—	625	71	696

(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Financial assets:	December 31, 2016				
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Estimated Fair Value (1)
Cash and due from financial institutions	\$28,205	\$28,205	\$	—\$	—\$28,205
Interest-bearing deposits in other financial institutions	45,957	45,957	—	—	45,957
Trading assets	774	774	—	—	774
Securities available for sale	303,402	170	302,982	250	303,402
Securities held to maturity	4,705	—	981	3,931	4,912
FHLBNY and FRBNY stock	4,041	—	—	—	N/A
Loans, net	1,186,037	—	—	1,205,814	1,205,814
Loans held for sale	412	—	412	—	412
Accrued interest receivable	4,000	9	784	3,207	4,000
Derivative assets	693	—	693	—	693

Financial liabilities:

Deposits:

Demand, savings, and insured money market accounts	\$1,312,237	\$1,312,237	\$	—\$	—\$1,312,237
Time deposits	144,106	—	144,460	—	144,460
Securities sold under agreements to repurchase	27,606	—	27,880	—	27,880
FHLBNY term advances	9,093	—	9,189	—	9,189
Accrued interest payable	210	25	185	—	210
Derivative liabilities	761	—	693	68	761

(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

NOTE 6 GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill included in the core banking segment during the periods ended June 30, 2017 and 2016 were as follows (in thousands):

	2017	2016
Beginning of year	\$21,824	\$21,824
Acquired goodwill	—	—
Ending balance June 30,	\$21,824	\$21,824

Acquired intangible assets were as follows at June 30, 2017 and December 31, 2016 (in thousands):

	At June 30, 2017		At December 31, 2016	
	Balance	Accumulated Amortization	Balance	Accumulated Amortization
Core deposit intangibles	\$5,975	\$ 4,952	\$5,975	\$ 4,689

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Other customer relationship intangibles	5,633	4,150	5,633	3,974
Total	\$11,608	\$ 9,102	\$11,608	\$ 8,663

Aggregate amortization expense was \$0.2 million for both of the three month periods ended June 30, 2017 and 2016. Aggregate amortization expense was \$0.4 million and \$0.5 million for the six month periods ended June 30, 2017 and 2016, respectively.

The remaining estimated aggregate amortization expense at June 30, 2017 is listed below (in thousands):

Year	Estimated Expense
2017	\$ 421
2018	734
2019	609
2020	484
2021	258
Total	\$ 2,506

NOTE 7 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

A summary of securities sold under agreements to repurchase as of June 30, 2017 and December 31, 2016 is as follows (in thousands):

	June 30, 2017				Total
	Overnight and Continuous	Up to 1 Year	1 - 3 Years	3+ Years	
Mortgage-backed securities, residential	\$7,862	\$13,089	\$ —	—	—\$20,951
Excess collateral held	(5,925)	(3,089)	—	—	(9,014)
Gross amount of recognized liabilities for repurchase agreements	\$1,937	\$10,000	\$ —	—	—\$11,937

	December 31, 2016				Total
	Overnight and Continuous	Up to 1 Year	1 - 3 Years	3+ Years	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$—	\$1,276	\$—	\$ —	—\$1,276
Mortgage-backed securities, residential	13,092	9,664	14,244	—	37,000
Total	13,092	10,940	14,244	—	38,276
Excess collateral held	(5,486)	(940)	(4,244)	—	(10,670)
Gross amount of recognized liabilities for repurchase agreements	\$7,606	\$10,000	\$10,000	\$ —	—\$27,606

The Corporation enters into sales of securities under agreements to repurchase and the amounts received under these agreements represent borrowings and are reflected as a liability in the consolidated balance sheets. The securities underlying these agreements are included in investment securities in the consolidated balance sheets.

The Corporation has no control over the market value of the securities which fluctuate due to market conditions, however, the Corporation is obligated to promptly transfer additional securities if the market value of the securities falls below the repurchase agreement price. The Corporation manages this risk by utilizing highly marketable and easily priced securities, monitoring these securities for significant changes in market valuation routinely, and maintaining an unpledged securities portfolio believed to be sufficient to cover a decline in the market value of the securities sold under agreements to repurchase.

NOTE 8 ACCUMULATED OTHER COMPREHENSIVE LOSS

Accumulated other comprehensive loss represents the net unrealized holding gains or losses on securities available for sale and the funded status of the Corporation's defined benefit pension plan and other benefit plans, as of the consolidated balance sheet dates, net of the related tax effect.

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

The following is a summary of the changes in accumulated other comprehensive loss by component, net of tax, for the periods indicated (in thousands):

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at April 1, 2017	\$ (2,379)	\$(6,377)	\$(8,756)
Other comprehensive income before reclassification	1,772	—	1,772
Amounts reclassified from accumulated other comprehensive income	(8)	20	12
Net current period other comprehensive income	1,764	20	1,784
Balance at June 30, 2017	\$ (615)	\$(6,357)	\$(6,972)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at April 1, 2016	\$ 1,581	\$(10,919)	\$(9,338)
Other comprehensive loss before reclassification	1,571	—	1,571
Amounts reclassified from accumulated other comprehensive income	—	232	232
Net current period other comprehensive income	1,571	232	1,803
Balance at June 30, 2016	\$ 3,152	\$(10,687)	\$(7,535)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at January 1, 2017	\$ (4,356)	\$(6,398)	\$(10,754)
Other comprehensive income before reclassification	3,749	—	3,749
Amounts reclassified from accumulated other comprehensive income	(8)	41	33
Net current period other comprehensive gain	3,741	41	3,782
Balance at June 30, 2017	\$ (615)	\$(6,357)	\$(6,972)

	Unrealized Gains and Losses on Securities Available for Sale	Defined Benefit and Other Benefit Plans	Total
Balance at January 1, 2016	\$ 210	\$(11,152)	\$(10,942)
Other comprehensive income before reclassification	3,507	—	3,507
Amounts reclassified from accumulated other comprehensive income	(565)	465	(100)
Net current period other comprehensive gain (loss)	2,942	465	3,407
Balance at June 30, 2016	\$ 3,152	\$(10,687)	\$(7,535)

The following is the reclassification out of accumulated other comprehensive income for the periods indicated (in thousands):

Details about Accumulated Other Comprehensive Income Components	Three Months Ended June 30, 2017	2016	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on securities available for sale:			
Realized gains on securities available for sale	\$(12)	\$—	Net gains (losses) on securities transactions
Tax effect	4	—	Income tax expense
Net of tax	(8) —	
Amortization of defined pension plan and other benefit plan items:			
Prior service costs (a)	(55	) (23	Pension and other employee benefits
Actuarial losses (a)	88	396	Pension and other employee benefits
Tax effect	(13	) (141	Income tax expense
Net of tax	20	232	
Total reclassification for the period, net of tax	\$12	\$232	

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and other benefit plan costs (see Note 10 for additional information).

Details about Accumulated Other Comprehensive Income Components	Six Months Ended June 30, 2017	2016	Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains and losses on securities available for sale:			
Realized gains on securities available for sale	\$(12)	\$(908)	Net gains (losses) on securities transactions
Tax effect	4	343	Income tax expense
Net of tax	(8	) (565)
Amortization of defined pension plan and other benefit plan items:			
Prior service costs (a)	(110)	(45	) Pension and other employee benefits
Actuarial losses (a)	176	792	Pension and other employee benefits
Tax effect	(25	) (282	) Income tax expense
Net of tax	41	465	
Total reclassification for the period, net of tax	\$33	\$(100)	

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and other benefit plan costs (see Note 10 for additional information).

NOTE 9 COMMITMENTS AND CONTINGENCIES

The Corporation is a party to certain financial instruments with off-balance sheet risk such as commitments under standby letters of credit, unused portions of lines of credit, overdraft protection and commitments to fund new loans. In accordance with GAAP, these financial instruments are not recorded in the financial statements. The Corporation's policy is to record such instruments when funded. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are generally used by the Corporation to manage clients' requests for

funding and other client needs.

39

The following table lists the contractual amounts of financial instruments with off-balance sheet risk at June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017		December 31, 2016	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Commitments to make loans	\$32,569	\$29,701	\$38,246	\$33,189
Unused lines of credit	1,233	202,917	610	208,124
Standby letters of credit	—	14,574	—	14,241

On March 23, 2016, the Bank received a summons and complaint for an action brought in the State of New York Supreme Court for the County of Tompkins, regarding its lease of 202 East State Street, Ithaca, NY. The owner of the leased premises has alleged that the Bank has breached its contract and is requesting a judgment declaring that the term of the lease runs through December 31, 2025 or a judgment in his favor in the amount of \$4.0 million. On July 25, 2016, the Corporation received Notice of Entry of the decision and order of the New York Supreme Court for the County of Tompkins, against the Bank. The Court granted, in part, partial summary judgment in favor of the plaintiff - on the issue of liability only- for anticipatory breach and breach of contract. The fraud claims were dismissed, and summary judgment was denied on the plaintiff's trespass claims. The Court set the matter down for an inquest on damages at a later date, with the original claim by the plaintiff seeking \$4.0 million in damages. The Corporation established a legal reserve of \$1.2 million in connection with this case during the second quarter of 2016.

Subsequent to an appeal to the court determination, which was perfected in the Appellate Division, Third Department of State Supreme Court, on June 29, 2017, the Bank received Notice of Entry of the decision and Order of the New York Appellate Division, Third Department, in the matter. The Court affirmed the lower court's decision in favor of the plaintiff with damages to be determined at a later proceeding. The Bank established an additional legal reserve in the amount of \$850 thousand, in connection with this case, during the second quarter of 2017. The Bank's total reserve with respect to this matter now stands at \$2.3 million, including \$0.2 million accrued for related expenses not yet paid.

In the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. Except for the above matter, we believe that we are not a party to any pending legal, arbitration, or regulatory proceedings that could have a material adverse impact on our financial results or liquidity.

NOTE 10 COMPONENTS OF QUARTERLY AND YEAR TO DATE NET PERIODIC BENEFIT COSTS

The components of net periodic expense for the Corporation's pension and other benefit plans for the periods indicated are as follows (in thousands):

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
Qualified Pension Plan				
Service cost, benefits earned during the period	\$—	\$298	\$—	\$594
Interest cost on projected benefit obligation	403	470	806	940
Expected return on plan assets	(785)	(756)	(1,570)	(1,511)
Amortization of unrecognized transition obligation	—	—	—	—
Amortization of unrecognized prior service cost	—	2	—	4
Amortization of unrecognized net loss	58	383	116	767
Net periodic pension cost (benefit)	\$(324)	\$397	\$(648)	\$794
Supplemental Pension Plan				
Service cost, benefits earned during the period	\$—	\$10	\$—	\$21
Interest cost on projected benefit obligation	12	13	24	26
Expected return on plan assets	—	—	—	—
Amortization of unrecognized prior service cost	—	—	—	—
Amortization of unrecognized net loss	1	7	2	13
Net periodic supplemental pension cost	\$13	\$30	\$26	\$60
Postretirement Plan, Medical and Life				
Service cost, benefits earned during the period	\$—	\$12	\$—	\$24
Interest cost on projected benefit obligation	4	18	8	35
Expected return on plan assets	—	—	—	—
Amortization of unrecognized prior service cost	(55)	(25)	(110)	(49)
Amortization of unrecognized net loss	29	6	58	12
Net periodic postretirement, medical and life cost (benefit)	\$(22)	\$11	\$(44)	\$22

NOTE 11 SEGMENT REPORTING

The Corporation manages its operations through two primary business segments: core banking and WMG. The core banking segment provides revenues by attracting deposits from the general public and using such funds to originate consumer, commercial, commercial real estate, and residential mortgage loans, primarily in the Corporation's local markets and to invest in securities. The WMG services segment provides revenues by providing trust and investment advisory services to clients.

Accounting policies for the segments are the same as those described in Note 1 of the Corporation's 2016 Annual Report on Form 10-K, which was filed with the SEC on March 8, 2017. Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results are shown in the following table. Income taxes are allocated based on the separate taxable income of each entity and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. CFS amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the Holding Company, CFS, and CRM column below, along with amounts to eliminate transactions between those

segments (in thousands).

41

	Three months ended June 30, 2017			
	Core	WMG	Holding Company, CFS, and CRM	Consolidated Totals
	Banking			
Interest and dividend income	\$14,680	\$ —	\$ 4	\$ 14,684
Interest expense	734	—	—	734
Net interest income	13,946	—	4	13,950
Provision for loan losses	421	—	—	421
Net interest income after provision for loan losses	13,525	—	4	13,529
Other non-interest income	2,634	2,269	119	5,022
Legal accruals and settlements	850	—	—	850
Other non-interest expenses	11,700	1,467	315	13,482
Income (loss) before income tax expense (benefit)	3,609	802	(192)	4,219
Income tax expense (benefit)	1,018	304	(59)	1,263
Segment net income (loss)	\$2,591	\$ 498	\$ (133)	\$ 2,956

	Three months ended June 30, 2016			
	Core	WMG	Holding Company, CFS, and CRM	Consolidated Totals
	Banking			
Interest and dividend income	\$13,922	\$ —	\$ 3	\$ 13,925
Interest expense	957	—	—	957
Net interest income	12,965	—	3	12,968
Provision for loan losses	388	—	—	388
Net interest income after provision for loan losses	12,577	—	3	12,580
Other non-interest income	2,860	2,201	155	5,216
Legal accruals and settlements	1,200	—	—	1,200
Other non-interest expenses	12,465	1,569	336	14,370
Income (loss) before income tax expense (benefit)	1,772	632	(178)	2,226
Income tax expense (benefit)	447	239	(81)	605
Segment net income (loss)	\$1,325	\$ 393	\$ (97)	\$ 1,621

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Six months ended June 30, 2017

	Core Banking	WMG	Holding Company, CFS, and CRM	Consolidated Totals
Interest and dividend income	\$28,991	\$—	\$ 7	\$ 28,998
Interest expense	1,554	—	—	1,554
Net interest income	27,437	—	7	27,444
Provision for loan losses	1,461	—	—	1,461
Net interest income after provision for loan losses	25,976	—	7	25,983
Other non-interest income	5,239	4,378	252	9,869
Legal settlements	850	—	—	850
Other non-interest expenses	23,144	2,772	611	26,527
Income (loss) before income tax expense (benefit)	7,221	1,606	(352)	8,475
Income tax expense (benefit)	2,066	609	(135)	2,540
Segment net income (loss)	\$5,155	\$997	\$ (217)	\$5,935
Segment assets	\$1,706,266	\$4,863	\$ 7,443	\$ 1,718,572

Six months ended June 30, 2016

	Core Banking	WMG	Holding Company, CFS, and CRM	Consolidated Totals
Interest and dividend income	\$27,871	\$—	\$ 3	\$ 27,874
Interest expense	1,881	—	—	1,881
Net interest income	25,990	—	3	25,993
Provision for loan losses	983	—	—	983
Net interest income after provision for loan losses	25,007	—	3	25,010
Other non-interest income	6,276	4,213	328	10,817
Legal accruals and settlements	1,200	—	—	1,200
Other non-interest expenses	24,717	2,958	703	28,378
Income (loss) before income tax expense (benefit)	5,366	1,255	(372)	6,249
Income tax expense (benefit)	1,617	474	(170)	1,921
Segment net income	\$3,749	\$781	\$ (202)	\$4,328
Segment assets	\$1,676,475	\$4,539	\$ 2,918	\$ 1,683,932

NOTE 12 STOCK COMPENSATION

Board of Director's Stock Compensation

Members of the Board of Directors receive common shares of the Corporation equal in value to the amount of fees individually earned during the previous year for service as a director. The common shares are distributed to the Corporation's individual board members from treasury shares of the Corporation on or about January 15 following the calendar year of service.

Additionally, the Chief Executive Officer of the Corporation, who does not receive cash compensation as a member of the Board of Directors, is awarded common shares equal in value to the average of those awarded to board members not employed by the Corporation who have served for 12 months during the prior year.

During January 2017 and 2016, 7,880 and 9,532 shares, respectively, were re-issued from treasury to fund the stock component of directors' compensation. An expense of \$75 thousand and \$65 thousand related to this compensation was recognized during

the three-month periods ended June 30, 2017 and 2016, respectively. An expense of \$154 thousand and \$135 thousand related to this compensation was recognized during the six month periods ended June 30, 2017 and 2016, respectively. This expense is accrued as shares are earned.

Restricted Stock Plan

Pursuant to the Corporation's Restricted Stock Plan, the Corporation may make discretionary grants of restricted stock to officers other than the Corporation's Chief Executive Officer. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date.

A summary of restricted stock activity for the three month period ended June 30, 2017 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at April 1, 2017	22,240	\$ 29.96
Granted	—	—
Vested	—	—
Forfeited or cancelled	—	—
Nonvested at June 30, 2017	22,240	\$ 29.96

A summary of restricted stock activity for the six month period ended June 30, 2017 is presented below:

	Shares	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2017	23,794	\$ 29.90
Granted	—	—
Vested	(415)	26.59
Forfeited or cancelled	(1,139)	29.97
Nonvested at June 30, 2017	22,240	\$ 29.96

As of June 30, 2017, there was \$555 thousand of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.39 years. The total fair value of shares vested was \$16 thousand and \$11 thousand for the six month periods ended June 30, 2017 and 2016, respectively.

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

Introduction

The following is the MD&A of the Corporation in this Form 10-Q for the six months ended June 30, 2017 and 2016. Reference should be made to the accompanying unaudited consolidated financial statements and footnotes, and the Corporation's 2016 Annual Report on Form 10-K, which was filed with the SEC on March 8, 2017, for an understanding of the following discussion and analysis. See the list of commonly used abbreviations and terms on pages 3–5.

The MD&A included in this Form 10-Q contains statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are based on the current beliefs and expectations of the Corporation's management and are subject to significant risks and uncertainties. Actual results may differ from

those set forth in the forward-looking statements. For a discussion of those risks and uncertainties and the factors that could cause the Corporation's actual results to differ materially from those risks and uncertainties, see Forward-looking Statements below and Part I, Item 1A, Risk Factors, on pages 17–22 of the Corporation's 2016 Annual Report. For a discussion of use of non-GAAP financial measures, see pages 60–63 of the Corporation's 2016 Annual Report or pages 68-71 in this Form 10-Q.

The Corporation has been a financial holding company since 2000, the Bank was established in 1833, CFS in 2001, and CRM in 2016. Through the Bank and CFS, the Corporation provides a wide range of financial services, including demand, savings and

time deposits, commercial, residential and consumer loans, interest rate swaps, letters of credit, wealth management services, employee benefit plans, insurance products, mutual funds and brokerage services. The Bank relies substantially on a foundation of locally generated deposits. The Corporation, on a stand-alone basis, has minimal results of operations. The Bank derives its income primarily from interest and fees on loans, interest income on investment securities, WMG fee income, and fees received in connection with deposit and other services. The Bank's operating expenses are interest expense paid on deposits and borrowings, salaries and employee benefit plans, and general operating expenses. CRM is a Nevada-based captive insurance company which insures against certain risks unique to the operations of the Corporation and its subsidiaries and for which insurance may not be currently available or economically feasible in today's insurance marketplace. CRM pools resources with several other similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves.

Forward-looking Statements

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. 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 web site at <http://www.sec.gov>, on the Corporation's web site at <http://www.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.

Consolidated Financial Highlights

	As of or for the Three Months Ended				As of or for the Six Months Ended			
	June 30,	March 31,	Dec. 31,	Sept. 30,	June 30,	June 30,	June 30,	
(in thousands, except per share data)	2017	2017	2016	2016	2016	2017	2016	
RESULTS OF OPERATIONS								
Interest income	\$14,684	\$14,314	\$14,269	\$14,025	\$13,925	\$28,998	\$27,874	
Interest expense	734	820	973	985	957	1,554	1,881	
Net interest income	13,950	13,494	13,296	13,040	12,968	27,444	25,993	
Provision for loan losses	421	1,040	404	1,050	388	1,461	983	
Net interest income after provision for loan losses	13,529	12,454	12,892	11,990	12,580	25,983	25,010	
Non-interest income	5,022	4,847	4,897	5,435	5,216	9,869	10,817	
Non-interest expense	14,332	13,045	13,561	13,471	15,570	27,377	29,578	
Income before income tax expense	4,219	4,256	4,228	3,954	2,226	8,475	6,249	
Income tax expense	1,263	1,277	1,274	1,209	605	2,540	1,921	
Net income	\$2,956	\$2,979	\$2,954	\$2,745	\$1,621	\$5,935	\$4,328	
Basic and diluted earnings per share	\$0.62	\$0.62	\$0.62	\$0.58	\$0.34	\$1.24	\$0.91	
Average basic and diluted shares outstanding	4,797	4,790	4,773	4,765	4,760	4,793	4,754	
PERFORMANCE RATIOS								
Return on average assets	0.69	% 0.71	% 0.69	% 0.65	% 0.39	% 0.70	% 0.53	%
Return on average equity	7.90	% 8.24	% 8.20	% 7.55	% 4.57	% 8.06	% 6.14	%
Return on average tangible equity (a)	9.43	% 9.90	% 9.92	% 9.14	% 5.55	% 9.66	% 7.48	%
Efficiency ratio (a) (b)	69.28	% 69.25	% 72.63	% 71.28	% 77.00	% 69.27	% 76.95	%
	3.34	% 3.12	% 3.18	% 3.20	% 3.75	% 3.23	% 3.61	%

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Non-interest expense to average assets								
Loans to deposits	82.14	% 79.93	% 82.42	% 80.62	% 81.83	% 82.14	% 81.83	%
YIELDS / RATES - Fully Taxable Equivalent								
Yield on loans	4.18	% 4.19	% 4.16	% 4.16	% 4.17	% 4.18	% 4.19	%
Yield on investments	2.01	% 2.00	% 1.75	% 1.73	% 1.81	% 2.01	% 1.94	%
Yield on interest-earning assets	3.65	% 3.66	% 3.57	% 3.58	% 3.60	% 3.65	% 3.66	%
Cost of interest-bearing deposits	0.20	% 0.20	% 0.21	% 0.21	% 0.21	% 0.20	% 0.20	%
Cost of borrowings	2.82	% 3.04	% 3.13	% 3.15	% 3.16	% 2.94	% 2.89	%
Cost of interest-bearing liabilities	0.26	% 0.30	% 0.35	% 0.36	% 0.35	% 0.28	% 0.35	%
Interest rate spread	3.39	% 3.36	% 3.22	% 3.22	% 3.25	% 3.37	% 3.31	%
Net interest margin, fully taxable equivalent	3.47	% 3.45	% 3.33	% 3.33	% 3.36	% 3.46	% 3.41	%
CAPITAL								
Total equity to total assets at end of period	8.84	% 8.54	% 8.67	% 8.38	% 8.52	% 8.84	% 8.52	%
Tangible equity to tangible assets at end of period (a)	7.53	% 7.23	% 7.29	% 7.03	% 7.12	% 7.53	% 7.12	%
Book value per share	\$31.67	\$30.93	\$30.07	\$30.37	\$30.12	\$31.67	\$30.12	
Tangible book value per share	26.60	25.81	24.89	25.13	24.81	26.60	24.81	
Period-end market value per share	40.88	39.50	36.35	28.99	29.35	40.88	29.35	
Dividends declared per share	0.26	0.26	0.26	0.26	0.26	0.52	0.52	
AVERAGE BALANCES								
Loans and loans held for sale (c)	\$1,237,189	\$1,215,445	\$1,210,922	\$1,199,367	\$1,192,786	\$1,226,377	\$1,183,919	

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Earning assets	1,634,955	1,605,460	1,607,287	1,577,348	1,573,306	1,620,290	1,550,481
Total assets	1,723,664	1,694,199	1,699,059	1,674,492	1,669,654	1,709,014	1,647,121
Deposits	1,532,819	1,495,724	1,483,348	1,456,622	1,457,173	1,514,374	1,430,840
Total equity	150,155	146,642	143,388	144,631	142,746	148,408	141,795
Tangible equity (a)	125,720	121,988	118,502	119,504	117,374	123,864	116,297

ASSET QUALITY

Net charge-offs	\$277	\$333	\$1,476	\$393	\$247	\$610	\$575
Non-performing loans (d)	15,208	12,914	12,043	12,903	12,429	15,208	12,429

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Non-performing assets (e)	15,545	13,251	12,431	13,270	12,822	15,545	12,822
Allowance for loan losses	15,104	14,960	14,253	15,325	14,668	15,104	14,668
Annualized net charge-offs to average loans	0.09	0.11	0.48	0.13	0.08	0.10	0.10
Non-performing loans to total loans	2.21	0.05	0.00	0.06	0.03	2.21	0.03
Non-performing assets to total assets	0.90	0.76	0.75	0.77	0.76	0.90	0.76
Allowance for loan losses to total loans	2.21	2.21	1.19	2.26	2.22	2.21	2.22
Allowance for loan losses to non-performing loans	90.32	15.84	18.35	18.77	18.01	90.32	18.01

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

(b) Efficiency ratio is non-interest expense less merger and acquisition expenses less amortization of intangible assets less legal reserve divided by the total of fully taxable equivalent net interest income plus non-interest income less net gains on securities transactions.

(c) Loans and loans held for sale do not reflect the allowance for loan losses.

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

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

In addition to analyzing the Corporation's results on a reported basis, management uses certain non-GAAP financial measures, because it believes these non-GAAP financial measures provide information to investors about the underlying operational performance and trends of the Corporation and, therefore, facilitate a comparison of the Corporation with the performance of its competitors. Non-GAAP financial measures used by the Corporation may not be comparable to similarly named non-GAAP financial measures used by other companies. Refer to pages 68-71 for further explanation and reconciliation of the Corporation's use of non-GAAP measures.

Executive Summary

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

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

	Three Months Ended			
	June 30,			
	2017	2016	Change	Percentage Change
Net interest income	\$ 13,950	\$ 12,968	\$ 982	7.6 %
Non-interest income	5,022	5,216	(194)	(3.7)%
Non-interest expenses	14,332	15,570	(1,238)	(8.0)%
Pre-provision income	4,640	2,614	2,026	77.5 %
Provision for loan losses	421	388	33	8.5 %
Income tax expense	1,263	605	658	108.8 %
Net income	\$ 2,956	\$ 1,621	\$ 1,335	82.4 %
Basic and diluted earnings per share	\$ 0.62	\$ 0.34	\$ 0.28	82.4 %

Selected financial ratios:

Return on average assets	0.69	%	0.39	%
Return on average equity	7.90	%	4.57	%

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Net interest margin, fully taxable equivalent	3.47	%	3.36	%
Efficiency ratio	69.28	%	77.00	%
Non-interest expenses to average assets	3.34	%	3.75	%

Net income for the second quarter of 2017 was \$3.0 million, or \$0.62 per share, compared with a net income of \$1.6 million, or \$0.34 per share, for the same period in the prior year. Return on equity for the quarter was 7.90%, compared with 4.57% for the prior year quarter. The increase in net income was driven by an increase in net interest income and a reduction in non-interest expenses, offset by a decrease in non-interest income and increases in the provision for loan losses and income tax expense.

Net interest income

Net interest income increased \$1.0 million, or 7.6%, compared with the same period in the prior year. The increase was due primarily to interest income from the commercial loan portfolio, taxable securities, and interest-bearing deposits and decreases in interest expense on securities sold under agreements to repurchase and borrowed funds.

Non-interest income

Non-interest income decreased \$0.2 million, or 3.7%, compared to the same period in the prior year. The decrease was due primarily to a decrease in other non-interest income.

Non-interest expenses

Non-interest expenses decreased \$1.2 million, or 8.0%, compared to the prior year quarter. The decrease was due primarily to decreases in pension and other employee benefits, net occupancy expenses, data processing expenses, professional services, legal accruals and settlements, and marketing and advertising expenses, offset by increases in salaries and wages and other non-interest expenses. For the three months ended June 30, 2017, non-interest expenses to average assets was 3.34%, compared with 3.75% for the same period in the prior year.

Provision for loan losses

The provision for loan losses slightly increased, compared to the same period in the prior year. Net charge-offs also were also slightly higher, compared with the same period in the prior year.

Income tax expense

Income tax expensed increased \$0.7 million, or 108.8%, compared to the prior year quarter. The increase was due primarily to higher income before income tax expense, offset by an increase in the income generated by CCTC Funding Corp., a real estate investment trust subsidiary of the Bank, and a tax exclusion for insurance premiums within CRM.

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

	Six Months Ended		Change	Percentage	
	June 30,			Change	
	2017	2016			
Net interest income	\$27,444	\$25,993	\$1,451	5.6	%
Non-interest income	9,869	10,817	(948)	(8.8)	%
Non-interest expense	27,377	29,578	(2,201)	(7.4)	%
Pre-provision income	9,936	7,232	2,704	37.4	%
Provision for loan losses	1,461	983	478	48.6	%
Income tax expense	2,540	1,921	619	32.2	%
Net income	\$5,935	\$4,328	\$1,607	37.1	%
Basic and diluted earnings per share	\$1.24	\$0.91	\$0.33	36.3	%

Selected financial ratios:

Return on average assets	0.70	%	0.53	%
Return on average equity	8.06	%	6.14	%
Net interest margin, fully taxable equivalent	3.46	%	3.41	%
Efficiency ratio	69.27	%	76.95	%
Non-interest expense to average assets	3.23	%	3.61	%

Net income for the six months ended June 30, 2017 was \$5.9 million, or \$1.24 per share, compared with a net income of \$4.3 million, or \$0.91 per share, for the same period in the prior year. Return on equity for the six months ended June 30, 2017 was 8.06%, compared with 6.14% for the same period in the prior year. The increase in net income from the prior year was driven by an increase in net interest income and a decrease in non-interest expense, offset by a decrease in non-interest income and increases in the provision for loan losses and income tax expense.

Net interest income

Net interest income increased \$1.5 million, or 5.6%, compared with the same period in the prior year. The increase was due primarily to interest income from the commercial loan portfolio and interest-bearing deposits and decreases in interest expense on securities sold under agreements to repurchase and borrowed funds.

Non-interest income

Non-interest income decreased \$0.9 million, or 8.8%, compared to the same period in the prior year. The decrease was due primarily to net gains on securities transactions during the first quarter of 2016 and other non-interest income, offset by an increase in WMG fee income.

Non-interest expenses

Non-interest expenses decreased \$2.2 million, or 7.4%, compared to the same period in the prior year. The decrease was due primarily to decreases in pension and other employee benefits, net occupancy expense, furniture and equipment, data processing expense, legal accruals and settlements, and marketing and advertising, offset by an increase in salaries and wages. For the six months ended June 30, 2017, non-interest expenses to average assets was 3.23%, compared with 3.61% for the same period in the prior year.

Provision for loan losses

The provision for loan losses increased \$0.5 million, or 48.6%, compared to the same period in the prior year. The increase was due primarily to growth in the commercial mortgages portfolio and additional reserves on problem assets previously identified during the six months ended June 30, 2017. Net charge-offs had a slight increase, compared with the same period in the prior year.

Income tax expense

Income tax expense increased \$0.6 million, or 32.2%, compared to the same period in the prior year. The increase was due primarily to higher income before income tax expense, offset by an increase in the income generated by CCTC Funding Corp., a real estate investment trust subsidiary of the Bank, and a tax exclusion for insurance premiums within CRM.

Consolidated Results of Operations

The following section of the MD&A provides a comparative discussion of the Corporation's Consolidated Results of Operations on a reported basis for the three and six months ended June 30, 2017 and 2016. For a discussion of the Critical Accounting Policies, Estimates and Risks and Uncertainties that affect the Consolidated Results of Operations, see page 58 of this Form 10-Q and pages 60 of the Corporation's 2016 Annual Report.

Net Interest Income

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

	Three Months Ended June 30,		Change	Percentage Change	
	2017	2016			
Interest and dividend income	\$14,684	\$13,925	\$759	5.5	%
Interest expense	734	957	(223)	(23.3)	%
Net interest income	\$13,950	\$12,968	\$982	7.6	%

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

Net interest income for the three months ended June 30, 2017 totaled \$14.0 million compared with \$13.0 million for the same period in the prior year, an increase of \$1.0 million, or 7.6%. Fully taxable equivalent net interest margin was 3.47% for the three months ended June 30, 2017 compared with 3.36% for the same period in the prior year. The increase in net interest income was due primarily to an increase of \$61.6 million in interest-earning assets. The yield on interest-earning assets increased five basis points, while the cost of interest-bearing liabilities decreased nine basis points compared to the same period in the prior year. The increase in the yield on interest-earning assets can be mostly attributed to a 20 basis point increase in the yield on investments due

to the reinvestment of maturing securities into higher yielding mortgage-backed and municipal securities. The decline in the cost of interest-bearing liabilities can be attributed to a 34 basis point decline in the cost of borrowings due to the maturity of one \$10.0 million FHLB term advance (4.60% rate) in December 2016 and one \$10.0 million repurchase agreement (4.54% rate) in March 2017.

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

	Six Months Ended June 30,		Change	Percentage Change
	2017	2016		
Interest and dividend income	\$28,998	\$27,874	\$1,124	4.0 %
Interest expense	1,554	1,881	(327)	(17.4)%
Net interest income	\$27,444	\$25,993	\$1,451	5.6 %

Net interest income for the six months ended June 30, 2017 totaled \$27.4 million compared with \$26.0 million for the same period in the prior year, an increase of \$1.5 million, or 5.6%. Fully taxable equivalent net interest margin was 3.46% for the six months ended June 30, 2017 compared with 3.41% for the same period in the prior year. The increase in net interest income was due primarily to an increase of \$69.8 million in average interest-earning assets. The yield on interest-earning assets decreased one basis point, while the cost of interest-bearing liabilities decreased seven basis points compared to the same period in the prior year. The decline in the yield on interest-earning assets can be mostly attributed to a one basis point decline in the yield on loans. The decline in the cost of interest-bearing liabilities can be attributed to a change in the mix of deposits to lower cost deposits and the maturity of one \$10.0 million FHLB term advance (4.60% rate) in December 2016 and one \$10.0 million repurchase agreement (4.54% rate) in March 2017.

Average Consolidated Balance Sheet and Interest Analysis

The following tables present certain information related to the Corporation's average consolidated balance sheets and its consolidated statements of income for the three and six months ended June 30, 2017 and 2016. For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding. Daily balances were used for average balance computations. Investment securities are stated at amortized cost. Tax equivalent adjustments have been made in calculating yields on obligations of states and political subdivisions, tax-free commercial loans and dividends on equity investments.

AVERAGE CONSOLIDATED BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS

(in thousands)	Three Months Ended June 30, 2017				Three Months Ended June 30, 2016			
	Average Balance	Interest	Yield/Rate		Average Balance	Interest	Yield/Rate	
Interest-earning assets:								
Commercial loans	\$779,218	\$8,357	4.30	%	\$732,265	\$7,893	4.34	%
Mortgage loans	201,093	1,867	3.72	%	196,502	1,916	3.92	%
Consumer loans	256,878	2,658	4.15	%	264,019	2,562	3.90	%
Taxable securities	275,275	1,400	2.04	%	269,434	1,283	1.92	%
Tax-exempt securities	51,027	401	3.15	%	45,665	347	3.06	%
Interest-bearing deposits	71,464	193	1.08	%	65,421	83	0.51	%
Total interest-earning assets	1,634,955	14,876	3.65	%	1,573,306	14,084	3.60	%
Non-earning assets:								
Cash and due from banks	24,446				26,500			
Premises and equipment, net	28,205				30,316			
Other assets	54,033				51,414			
Allowance for loan losses	(15,060	)			(14,647)		
AFS valuation allowance	(2,915	)			2,765			
Total assets	\$1,723,664				\$1,669,654			
Interest-bearing liabilities:								
Interest-bearing demand deposits	\$142,892	\$33	0.09	%	\$134,938	\$37	0.11	%
Savings and insured money market deposits	822,989	394	0.19	%	756,674	353	0.19	%
Time deposits	137,502	122	0.36	%	161,921	149	0.37	%
FHLB NY advances, securities sold under agreements to repurchase, and other debt	26,341	185	2.82	%	53,137	418	3.16	%
Total interest-bearing liabilities	1,129,724	734	0.26	%	1,106,670	957	0.35	%
Non-interest-bearing liabilities:								
Demand deposits	429,436				403,640			
Other liabilities	14,349				16,598			
Total liabilities	1,573,509				1,526,908			
Shareholders' equity	150,155				142,746			
Total liabilities and shareholders' equity	\$1,723,664				\$1,669,654			
Fully taxable equivalent net interest income		14,142				13,127		
Net interest rate spread (1)			3.39	%			3.25	%
Net interest margin, fully taxable equivalent (2)			3.47	%			3.36	%
Taxable equivalent adjustment		(192	)			(159)	
Net interest income		\$13,950				\$12,968		

- (1) Net interest rate spread is the difference in the average yield on interest-earning assets less the average rate on interest-bearing liabilities.
- (2) Net interest margin is the ratio of fully taxable equivalent net interest income divided by average interest-earning assets.

AVERAGE CONSOLIDATED BALANCE SHEETS AND NET INTEREST INCOME ANALYSIS

(in thousands)	Six Months Ended June 30, 2017			Six Months Ended June 30, 2016		
	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Interest-earning assets:						
Commercial loans	\$770,267	\$16,387	4.29%	\$720,903	\$15,650	4.37%
Mortgage loans	199,740	3,754	3.79%	196,551	3,856	3.95%
Consumer loans	256,370	5,300	4.17%	266,465	5,161	3.89%
Taxable securities	273,935	2,823	2.08%	281,876	2,722	1.94%
Tax-exempt securities	47,910	747	3.14%	46,902	713	3.06%
Interest-bearing deposits	72,068	348	0.97%	37,784	95	0.51%
Total interest-earning assets	1,620,290	29,359	3.65%	1,550,481	28,197	3.66%
Non-earning assets:						
Cash and due from banks	25,161			26,588		
Premises and equipment, net	28,429			29,758		
Other assets	54,994			52,266		
Allowance for loan losses	(14,706)			(14,496)		
AFS valuation allowance	(4,154)			2,524		
Total assets	\$1,710,014			\$1,647,121		
Interest-bearing liabilities:						
Interest-bearing demand deposits	\$147,895	\$67	0.09%	\$138,528	\$75	0.11%
Savings and insured money market deposits	803,269	771	0.19%	730,641	672	0.18%
Time deposits	139,366	250	0.36%	163,250	299	0.37%
FHLB NY advances, securities sold under agreements to repurchase, and other debt	31,973	466	2.94%	58,114	835	2.89%
Total interest-bearing liabilities	1,122,503	1,554	0.28%	1,090,533	1,881	0.35%
Non-interest-bearing liabilities:						
Demand deposits	423,844			398,421		
Other liabilities	14,259			16,372		
Total liabilities	1,560,606			1,505,326		
Shareholders' equity	148,408			141,795		
Total liabilities and shareholders' equity	\$1,709,014			\$1,647,121		
Fully taxable equivalent net interest income		27,805			26,316	
Net interest rate spread (1)			3.37%			3.31%
Net interest margin, fully taxable equivalent (2)			3.46%			3.41%
Taxable equivalent adjustment		(361)			(323)	
Net interest income		\$27,444			\$25,993	

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

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

Changes Due to Rate and Volume

Net interest income can be analyzed in terms of the impact of changes in rates and volumes. The tables below illustrate the extent to which changes in interest rates and the volume of average interest-earning assets and interest-bearing liabilities have affected the Corporation's interest income and interest expense during the three and six months ended June 30, 2017 and 2016. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rates (changes in rates multiplied by prior volume); and (iii) the net changes. For purposes of this table, changes that are not due solely to volume or rate changes have been allocated to these categories based on the respective percentage changes in average volume and rate. Due to the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes between volume and rates. In addition, average interest-earning assets include non-accrual loans and taxable equivalent adjustments were made.

RATE/VOLUME ANALYSIS OF NET INTEREST INCOME

(in thousands)	Three Months Ended June 30, 2017 vs. 2016 Increase/(Decrease)		
	Total Change	Due to Volume	Due to Rate
Interest and dividend income on:			
Commercial loans	\$464	\$ 533	\$(69)
Mortgage loans	(49)	46	(95)
Consumer loans	96	(69)	165
Taxable investment securities	117	30	87
Tax-exempt investment securities	54	43	11
Interest-earning deposits	110	8	102
Total interest and dividend income, fully taxable equivalent	792	591	201
Interest expense on:			
Interest-bearing demand deposits	(4)	2	(6)
Savings and insured money market deposits	41	41	—
Time deposits	(27)	(23)	(4)
FHLBNY advances, securities sold under agreements to repurchase and other debt	(233)	(192)	(41)
Total interest expense	(223)	(172)	(51)
Net interest income, fully taxable equivalent	\$1,015	\$ 763	\$252

	Six Months Ended		
	June 30, 2017 vs. 2016		
	Increase/(Decrease)		
	Total	Due to	Due to
	Change	Volume	Rate
(in thousands)			
Interest and dividend income on:			
Commercial loans	\$737	\$1,033	\$(296)
Mortgage loans	(102)	60	(162)
Consumer loans	139	(207)	346
Taxable investment securities	101	(81)	182
Tax-exempt investment securities	34	15	19
Interest-earning deposits	253	127	126
Total interest and dividend income	1,162	947	215
Interest expense on:			
Interest-bearing demand deposits	(8)	5	(13)
Savings and insured money market deposits	99	64	35
Time deposits	(49)	(41)	(8)
FHLBNY advances, securities sold under agreements to repurchase and other debt	(369)	(383)	14
Total interest expense	(327)	(355)	28
Net interest income, fully taxable equivalent	\$1,489	\$1,302	\$187

Provision for loan losses

Management performs an ongoing assessment of the adequacy of the allowance for loan losses based upon a number of factors including an analysis of historical loss factors, collateral evaluations, recent charge-off experience, credit quality of the loan portfolio, current economic conditions and loan growth. Based on this analysis, the provision for loan losses for both the second quarter of 2017 and 2016 were \$0.4 million, respectively. The provision for loan losses for the six months ended June 30, 2017 and 2016 were \$1.5 million and \$1.0 million, respectively. Net charge-offs for the second quarter of 2017 were \$0.3 million compared with \$0.2 million for the same period in the prior year. Net charge-offs for both six months ended June 30, 2017 and 2016 were \$0.6 million, respectively. The increase in the provision for loan losses for the six months ended June 30, 2017, compared to the same period in the prior year, was due to increases in the commercial mortgage portfolio, an increase in loss factors in the indirect loan portfolio, and additional reserves on problem assets previously identified.

Non-interest income

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

	Three Months		Change	Percentage
	Ended			
	June 30,		Change	Change
	2017	2016		
WMG fee income	\$2,269	\$2,201	\$68	3.1 %
Service charges on deposit accounts	1,225	1,285	(60)	(4.7)%
Interchange revenue from debit card transactions	964	939	25	2.7 %
Net gains on securities transactions	12	—	12	N/M
Net gains on sales of loans held for sale	53	97	(44)	(45.4)%

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Net gains (losses) on sales of other real estate owned	(9)	(11)	2	N/M
Income from bank owned life insurance	18	18	—	— %
CFS fee and commission income	174	163	11	6.7 %
Other	316	524	(208)	(39.7)%
Total non-interest income	\$5,022	\$5,216	\$(194)	(3.7)%

54

Total non-interest income for the second quarter of 2017 decreased \$0.2 million compared with the same period in the prior year. The decrease was mostly due to a decrease in other non-interest income.

Other

Other non-interest income decreased due to decreases in rental income from other real estate owned and interest rate swap fees.

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

	Six Months Ended June 30,		Change	Percentage Change	
	2017	2016			
WMG fee income	\$4,378	\$4,213	\$ 165	3.9	%
Service charges on deposit accounts	2,409	2,420	(11)	(0.5)%
Interchange revenue from debit card transactions	1,884	1,832	52	2.8	%
Net gains on securities transactions	12	908	(896)	(98.7)%
Net gains on sales of loans held for sale	122	158	(36)	(22.8)%
Net gains (losses) on sales of other real estate owned	8	(16)	24	N/M	
Income from bank owned life insurance	35	36	(1)	(2.8)%
CFS fee and commission income	313	337	(24)	(7.1)%
Other	708	929	(221)	(23.8)%
Total non-interest income	\$9,869	\$10,817	\$(948)	(8.8)%

Total non-interest income for the six months ended June 30, 2017 decreased \$0.9 million compared with the same period in the prior year. The decrease was mostly due to decreases in net gains on securities transactions and other non-interest income, offset by an increase in WMG fee income.

WMG fee income

WMG fee income increased compared to the same period in the prior year due to an increase in assets under management or administration.

Net gains on securities transactions

Net gains on securities transactions decreased compared to the same period in the prior year due to a \$0.9 million net gain on the sale of \$14.5 million of U.S. Treasuries.

Other

Other non-interest income decreased due to a decrease in rental income from other real estate owned and interest rate swap fees.

Non-interest expense

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

	Three Months Ended June 30,		Change	Percentage Change	
	2017	2016			
Compensation expense:					
Salaries and wages	\$5,422	\$5,182	\$240	4.6	%
Pension and other employee benefits	1,207	1,646	(439)	(26.7)	%
Total compensation expense	6,629	6,828	(199)	(2.9)	%
Non-compensation expenses:					
Net occupancy expenses	1,702	1,878	(176)	(9.4)	%
Furniture and equipment expenses	781	829	(48)	(5.8)	%
Data processing expenses	1,587	1,720	(133)	(7.7)	%
Professional services	417	575	(158)	(27.5)	%
Legal accruals and settlements	850	1,200	(350)	(29.2)	%
Amortization of intangible assets	213	245	(32)	(13.1)	%
Marketing and advertising expenses	118	325	(207)	(63.7)	%
Other real estate owned expenses	11	57	(46)	(80.7)	%
FDIC insurance	309	277	32	11.6	%
Loan expense	166	188	(22)	(11.7)	%
Other	1,549	1,448	101	7.0	%
Total non-compensation expenses	7,703	8,742	(1,039)	(11.9)	%
Total non-interest expenses	\$14,332	\$15,570	\$(1,238)	(8.0)	%

Total non-interest expenses for the second quarter of 2017 decreased \$1.2 million compared with the same period in the prior year. The decrease was due to decreases in compensation and non-compensation expenses.

Compensation expense

Compensation expense decreased compared to the same period in the prior year due to a decrease in pension and other employee benefits, offset by an increase in salaries and wages. The decrease in pension and other employee benefits can be mostly attributed to a \$0.7 million decrease due to the freezing of accruals for the pension and post-retirement health care plans during the fourth quarter of 2016, offset by increases of \$0.3 million in health care costs and \$0.1 million in 401(k) contributions. The increase in salaries and wages can be attributed to annual merit increases that occur throughout the year, offset by a decline in average full-time equivalent employees.

Non-compensation expenses

Non-compensation expenses decreased compared to the same period in the prior year due primarily to decreases in net occupancy expenses, furniture and equipment expenses, data processing expenses, professional services, legal accruals and settlements expense, and marketing and advertising expenses, offset by an increase in other non-interest expenses. The decrease in net occupancy expenses and furniture and equipment expenses can be attributed to the closure of the branch office at 202 East State Street in Ithaca, NY at the end of May 2016, along with a net decrease in exit costs when comparing exit costs for the 120 Genesee Street branch in Auburn, NY in 2017 and exit costs associated with the closure of the 202 East State Street branch in 2016. The decrease in data processing expenses can be attributed to the renegotiation of contracts and changing of vendors for certain data processing communication lines. The decrease

in professional services can be mostly attributed to start-up costs associated with the establishment of CRM, which was completed in May 2016. The decrease in legal accruals and settlements expense can attributed to a decline in legal accruals and settlements expense for the Fane v. Chemung Canal Trust Company case from \$1.2 million in 2016 to \$0.9 million in 2017. Please refer to Note 9 for further discussion of the case. The decrease in marketing and advertising expenses can be mostly attributed to timing.

56

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

	Six Months Ended June 30,		Change	Percentage Change	
	2017	2016			
Compensation expense:					
Salaries and wages	\$10,697	\$10,365	\$332	3.2	%
Pension and other employee benefits	2,425	3,321	(896)	(27.0)	%
Total compensation expense	13,122	13,686	(564)	(4.1)	%
Non-compensation expenses:					
Net occupancy expenses	3,308	3,784	(476)	(12.6)	%
Furniture and equipment expenses	1,462	1,601	(139)	(8.7)	%
Data processing expenses	3,191	3,434	(243)	(7.1)	%
Professional services	717	916	(199)	(21.7)	%
Legal accruals and settlements	850	1,200	(350)	(29.2)	%
Amortization of intangible assets	439	503	(64)	(12.7)	%
Marketing and advertising expenses	367	547	(180)	(32.9)	%
Other real estate owned expenses	31	109	(78)	(71.6)	%
FDIC insurance	634	571	63	11.0	%
Loan expense	282	300	(18)	(6.0)	%
Other	2,974	2,927	47	1.6	%
Total non-compensation expenses	14,255	15,892	(1,637)	(10.3)	%
Total non-interest expenses	\$27,377	\$29,578	\$(2,201)	(7.4)	%

Total non-interest expenses for the six months ended June 30, 2017 decreased \$2.2 million compared with the same period in the prior year. The decrease was due to decreases in compensation expense and non-compensation expenses.

Compensation expense

Compensation expense decreased compared to the same period in the prior year due to a decrease in pension and other employee benefits, offset by an increase in salaries and wages. The decrease in pension and other employee benefits can be mostly attributed to a \$1.4 million decrease due to the freezing of accruals for the pension and post-retirement health care plans during the fourth quarter of 2016, offset by increases of \$0.5 million in health care costs and \$0.2 million in 401(k) contributions. The increase in salaries and wages can be attributed to annual merit increases that occur throughout the year, offset by a decline in average full-time equivalent employees.

Non-compensation expenses

Non-compensation expenses decreased compared to the same period in the prior year due primarily to decreases in net occupancy expenses, furniture and equipment expenses, data processing expenses, professional services, legal accruals and settlements expense, and marketing and advertising expenses. The decrease in net occupancy expenses and furniture and equipment expenses can be attributed to the closure of the branch office at 202 East State Street in Ithaca, NY at the end of May 2016, along with a net decrease in exit costs when comparing exit costs for the 120 Genesee Street branch in Auburn, NY in 2017 and exit costs associated with the closure of the 202 East State Street branch in 2016. The decrease in data processing expenses can be attributed to the renegotiation of contracts and changing of vendors for certain data processing communication lines. The decrease in professional services can be mostly attributed to start-up costs associated with the establishment of CRM, which was completed in May 2016. The

decrease in legal accruals and settlements expense can attributed to a decline in legal accruals and settlements expense for the Fane v. Chemung Canal Trust Company case from \$1.2 million in 2016 to \$0.9 million in 2017. Please refer to Note 9 for further discussion of the case. The decrease in marketing and advertising expenses can be mostly attributed to timing.

57

Income tax expense

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

	Three Months Ended June 30,		Change	Percentage Change	
	2017	2016			
Income before income tax expense	\$4,219	\$2,226	\$1,993	89.5	%
Income tax expense	1,263	605	658	108.8	%
Effective tax rate	29.9	% 27.2	%		

The increase in the effective tax rate can be attributed to an improvement in income before income tax expense, offset by changes in the mix of income and expense subject to U.S. federal, state, and local income taxes. These changes include an increase in the income generated by CCTC Funding Corp., a real estate investment trust subsidiary of the Bank, and a tax exclusion for insurance premiums within CRM.

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

	Six Months Ended June 30,		Change	Percentage Change	
	2017	2016			
Income before income tax expense	\$8,475	\$6,249	\$2,226	35.6	%
Income tax expense	2,540	1,921	619	32.2	%
Effective tax rate	30.0	% 30.7	%		

The decrease in the effective tax rate can be attributed to changes in the mix of income and expense subject to U.S. federal, state, and local income taxes, offset by an improvement in income before income taxes. These changes include an increase in the income generated by CCTC Funding Corp., a real estate investment trust subsidiary of the Bank, and a tax exclusion for insurance premiums within CRM.

Financial Condition

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

	June 30, 2017	December 31, 2016	Change	Percentage Change	
ASSETS					
Total cash and cash equivalents	\$64,546	\$74,162	\$(9,616)	(13.0)	%
Total investment securities	332,985	312,148	20,837	6.7	%
Loans, net of deferred loan fees	1,252,647	1,200,290	52,357	4.4	%
Allowance for loan losses	(15,104)	(14,253)	(851)	6.0	%
Loans, net	1,237,543	1,186,037	51,506	4.3	%
Goodwill and other intangible assets, net	24,330	24,769	(439)	(1.8)	%
Other assets	59,168	60,063	(895)	(1.5)	%
Total assets	\$1,718,572	\$1,657,179	\$61,393	3.7	%
LIABILITIES AND SHAREHOLDERS' EQUITY					
Total deposits	\$1,525,037	\$1,456,343	\$68,694	4.7	%
FHLBNY advances and other debt	25,595	41,421	(15,826)	(38.2)	%
Other liabilities	15,978	15,667	311	2.0	%
Total liabilities	1,566,610	1,513,431	53,179	3.5	%
Total shareholders' equity	151,962	143,748	8,214	5.7	%
Total liabilities and shareholders' equity	\$1,718,572	\$1,657,179	\$61,393	3.7	%

Cash and cash equivalents

The decrease in cash and cash equivalents can be mostly attributed to increases in investment securities and loans, along with the maturity of one \$10.0 million repurchase agreement during the first quarter of 2017, offset by an increase in deposits.

Investment securities

The increase in investment securities can be mostly attributed to additional purchases and a decline in the unrealized losses in the securities available for sale portfolio, offset by maturities and calls.

Loans, net

The increase in total loans can be attributed to increases of \$36.1 million in commercial mortgages, \$12.9 million in commercial and agriculture loans, \$2.1 million in residential mortgages, and \$3.2 million in indirect consumer loans, offset by a decrease of \$2.0 million in other consumer loans. The increase in the allowance for loan losses can be mostly attributed to an increase in the commercial loan portfolio and additional reserves on problem assets previously identified.

Goodwill and other intangible assets, net

The decrease in goodwill and other intangible assets, net can be attributed to the amortization of intangible assets.

Other assets

The decrease in other assets can be mostly attributed to a decline in premises and equipment, net.

Deposits

The increase in deposits can be attributed to increases of \$18.2 million in non-interest bearing demand deposits, \$7.4 million in interest-bearing demand deposits, \$42.8 million in money market accounts, and \$11.6 million in savings deposits. Partially offsetting the increases noted above was a decrease of \$11.3 million in time deposits. The changes in money market accounts and demand deposits can be mostly attributed to new municipal clients, along with the seasonal inflow of deposits from existing municipal clients.

FHLBNY advances and other debt

The decrease in FHLBNY advances and other debt can be mostly attributed to the maturity of one \$10.0 million repurchase agreement during the first quarter of 2017.

Other liabilities

The increase in other liabilities can be mostly attributed to the legal reserve for the Fane v. Chemung Canal Trust Company suit. Please refer to Note 9 for further discussion of the case.

Shareholders' equity

The increase in shareholders' equity was primarily due to earnings of \$5.9 million, a reduction of \$0.6 million in treasury stock, and a decrease of \$3.8 million in accumulated other comprehensive loss, mostly attributable to the increase in the fair market value of the securities portfolio, offset by \$2.4 million in dividends declared during the year.

Assets under management or administration

The market value of total assets under management or administration in our WMG was \$1.826 billion at June 30, 2017, including \$323.9 million of assets held under management or administration for the Corporation, compared with \$1.721 billion at December 31, 2016, including \$294.9 million of assets held under management or administration for the Corporation, an increase of \$104.6 million, or 6.1%.

Securities

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

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

SECURITIES AVAILABLE FOR SALE

	June 30, 2017				December 31, 2016			
	Amortized Cost	Estimated Fair Value	Percent of Total Estimated Fair Value		Amortized Cost	Estimated Fair Value	Percent of Total Estimated Fair Value	
Obligations of U.S. Government sponsored enterprises	\$16,245	\$16,360	5.0	%	\$17,300	\$17,455	5.8	%
Mortgage-backed securities, residential and collateralized mortgage obligations	249,163	246,977	76.2	%	253,156	245,866	81.0	%
Obligations of states and political subdivisions	54,751	55,577	17.1	%	38,843	38,740	12.8	%
Other securities	5,125	5,379	1.7	%	1,102	1,341	0.4	%
Total	\$325,284	\$324,293	100.0	%	\$310,401	\$303,402	100.0	%

The available for sale segment of the securities portfolio totaled \$324.3 million at June 30, 2017, an increase of \$20.9 million, or 6.9%, from \$303.4 million at December 31, 2016. The increase can be mostly attributed to additional purchases of obligations of states and political subdivisions and a decline in unrealized losses, offset by maturities and calls.

The held to maturity segment of the securities portfolio consists of obligations of political subdivisions in the Corporation's market areas. These securities totaled \$4.9 million at June 30, 2017, an increase of \$0.2 million, or 4.7%, from \$4.7 million at December 31, 2016.

Loans

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

The table below presents the Corporation's loan composition by segment for the periods indicated, and the dollar and percent change from December 31, 2016 to June 30, 2017 (in thousands):

LOANS

	June 30, 2017	December 31, 2016	Dollar Change	Percentage Change
Commercial and agricultural	\$ 189,461	\$ 176,561	\$ 12,900	7.3 %
Commercial mortgages	604,714	568,656	36,058	6.3 %
Residential mortgages	200,629	198,493	2,136	1.1 %
Indirect consumer loans	142,791	139,572	3,219	2.3 %
Other consumer loans	115,052	117,008	(1,956)	(1.7)%
Total loans, net of deferred loan fees	\$ 1,252,647	\$ 1,200,290	\$ 52,357	4.4 %

Portfolio loans totaled \$1.253 billion at June 30, 2017, an increase of \$52.4 million, or 4.4%, from \$1.200 billion at December 31, 2016. The increase in loans can be attributed to increases of \$12.9 million in commercial and agricultural loans, \$36.1 million in commercial mortgages, \$2.1 million in residential mortgages, and \$3.2 million in indirect consumer loans, offset by a decrease of \$2.0 million in other consumer loans. The growth in commercial and agriculture and commercial mortgages was due primarily to an increase in the Capital Bank division in the Albany, New York region.

Residential mortgage loans totaled \$200.6 million at June 30, 2017, an increase of \$2.1 million, or 1.1%, from December 31, 2016. In addition, during the six months ended June 30, 2017, \$5.9 million of newly originated residential mortgages were sold in the secondary market to Freddie Mac and \$0.2 million of residential mortgages were sold to the State of New York Mortgage Agency.

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

LOANS BY DIVISION

	June 30, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Chemung Canal Trust Company*	\$ 631,402	\$ 636,836	\$ 683,137	\$ 724,099	\$ 687,256
Capital Bank Division	621,245	563,454	485,496	397,475	308,610
Total loans	\$ 1,252,647	\$ 1,200,290	\$ 1,168,633	\$ 1,121,574	\$ 995,866

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

Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by economic or other conditions. Specific industries are identified using NAICS codes. The Corporation monitors specific NAICS industry classifications of commercial loans to identify concentrations greater than 10.0% of total loans. At June 30, 2017 and December 31, 2016, commercial loans to borrowers involved in the real estate, and real estate rental and lending businesses were 44.7% and 43.9% of total loans, respectively. No other concentration of loans existed in the commercial loan portfolio in excess of 10.0% of total loans as of June 30, 2017 and December 31, 2016.

Non-Performing Assets

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

Past due status on all loans is based on the contractual terms of the loan. It is generally the Corporation's policy that a loan 90 days past due be placed in non-accrual status unless factors exist that would eliminate the need to place a loan in this status. A

61

loan may also be designated as non-accrual at any time if payment of principal or interest in full is not expected due to deterioration in the financial condition of the borrower. At the time loans are placed in non-accrual status, the accrual of interest is discontinued and previously accrued interest is reversed. All payments received on non-accrual loans are applied to principal. Loans are considered for return to accrual status when they become current as to principal and interest and remain current for a period of six consecutive months or when, in the opinion of management, the Corporation expects to receive all of its original principal and interest. In the case of non-accrual loans where a portion of the loan has been charged off, the remaining balance is kept in non-accrual status until the entire principal balance has been recovered.

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

NON-PERFORMING ASSETS	June 30, 2017	December 31, 2016
Non-accrual loans	\$7,986	\$7,649
Non-accrual troubled debt restructurings	7,222	4,394
Total non-performing loans	15,208	12,043
Other real estate owned	337	388
Total non-performing assets	\$15,545	\$12,431
Ratio of non-performing loans to total loans	1.21	% 1.00
Ratio of non-performing assets to total assets	0.90	% 0.75
Ratio of allowance for loan losses to non-performing loans	99.32	% 118.35
Accruing loans past due 90 days or more (1)	\$36	\$13
Accruing troubled debt restructurings (1)	2,752	5,839

(1) These loans are not included in non-performing assets above.

Non-Performing Loans

Non-performing loans totaled \$15.2 million at June 30, 2017, or 1.21% of total loans, compared with \$12.0 million at December 31, 2016, or 1.00% of total loans. The increase in non-performing loans at June 30, 2017 was primarily in commercial mortgage and related to one large commercial loan, offset by decreases in the residential mortgage and consumer segments. Non-performing assets, which are comprised of non-performing loans and other real estate owned, was \$15.5 million, or 0.90% of total assets, at June 30, 2017, compared with \$12.4 million, or 0.75% of total assets, at December 31, 2016. As noted above, the increase in non-performing assets was primarily due to the commercial mortgage segment of the loan portfolio.

Not included in non-performing loan totals are \$1.0 million of acquired loans which the Corporation has identified as PCI loans. The PCI loans are accounted for under separate accounting guidance, Accounting Standards Codification ("ASC") Subtopic 310-30, "Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality" as disclosed in Note 4 of the financial statements.

Accruing Loans Past due 90 Days or More

The recorded investment in accruing loans past due 90 days or more totaled \$36.0 thousand at June 30, 2017, an increase of \$23.0 thousand from December 31, 2016.

Troubled Debt Restructurings

The Corporation works closely with borrowers that have financial difficulties to identify viable solutions that minimize the potential for loss. In that regard, the Corporation modified the terms of select loans to maximize their collectability. The modified loans are considered TDRs under current accounting guidance. Modifications generally involve short-term deferrals of principal and/or interest payments, reductions of scheduled payment amounts, interest rates or principal of the loan, and forgiveness of accrued interest. As of June 30, 2017, the Corporation had \$7.2 million of non-accrual TDRs compared with \$4.4 million as of December 31, 2016. As of June 30, 2017, the Corporation had \$2.8 million of accruing TDRs compared with \$5.8 million as of December 31, 2016.

Impaired Loans

A loan is classified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect both the principal and interest due under the contractual terms of the loan agreement. Impaired loans at June 30, 2017 totaled \$14.1 million, including TDRs of \$10.0 million, compared to \$12.9 million at December 31, 2016, including TDRs of \$10.2 million. Not included in the impaired loan totals are acquired loans which the Corporation has identified as PCI loans, as these loans are accounted for under ASC Subtopic 310-30 as noted under the above discussion of non-performing loans. The increase in impaired loans was due primarily to an increase in commercial mortgage loans. Included in the recorded investment of impaired loans at June 30, 2017, are loans totaling \$4.8 million for which impairment allowances of \$1.0 million have been specifically allocated to the allowance for loan losses. As of December 31, 2016, the impaired loan total included \$2.6 million of loans for which specific impairment allowances of \$0.9 million were allocated to the allowance for loan losses.

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

Allowance for Loan Losses

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

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

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

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

The allowance for loan losses was \$15.1 million at June 30, 2017, up from \$14.3 million at December 31, 2016. The ratio of allowance for loan losses to total loans was 1.21% at June 30, 2017, up from 1.19% at December 31, 2016, respectively. Net charge-offs for both the six months ended June 30, 2017 and 2016 were \$0.6 million, respectively.

The table below summarizes the Corporation's loan loss experience for the six months ended June 30, 2017 and 2016 (in thousands, except ratio data):

SUMMARY OF LOAN LOSS EXPERIENCE

	Six Months Ended		
	June 30,		
	2017	2016	
Balance at beginning of period	\$14,253	\$14,260	
Charge-offs:			
Commercial and agricultural	7	17	
Commercial mortgages	—	—	
Residential mortgages	60	58	
Consumer loans	825	715	
Total charge-offs	892	790	
Recoveries:			
Commercial and agricultural	61	50	
Commercial mortgages	3	9	
Residential mortgages	30	—	
Consumer loans	188	156	
Total recoveries	282	215	
Net charge-offs	610	575	
Provision for loan losses	1,461	983	
Balance at end of period	\$15,104	\$14,668	
Ratio of net charge-offs to average loans outstanding	0.10	% 0.10	%
Ratio of allowance for loan losses to total loans outstanding	1.21	% 1.22	%

Deposits

The table below summarizes the Corporation's deposit composition by segment for the periods indicated, and the dollar and percent change from December 31, 2016 to June 30, 2017 (in thousands):

DEPOSITS

	June 30, 2017	December 31, 2016	Dollar Change	Percentage Change	
Non-interest-bearing demand deposits	\$436,017	\$417,812	\$18,205	4.4	%
Interest-bearing demand deposits	144,239	136,826	7,413	5.4	%
Insured money market accounts	591,751	548,963	42,788	7.8	%
Savings deposits	220,227	208,636	11,591	5.6	%
Time deposits	132,803	144,106	(11,303)	(7.8)	%
Total	\$1,525,037	\$1,456,343	\$68,694	4.7	%

Deposits totaled \$1.525 billion at June 30, 2017 compared with \$1.456 billion at December 31, 2016, an increase of \$68.7 million, or 4.7%. The increase was attributable to increases of \$18.2 million in non-interest bearing demand deposits, \$7.4 million in interest-bearing demand deposits, \$42.8 million in money market accounts, and \$11.6 million in savings deposits. These items were offset by a decrease of \$11.3 million in time deposits. The changes in money market accounts can be attributed to new municipal clients, along with the seasonal inflow of deposits from current municipal clients. At June 30, 2017, demand deposit and money market accounts comprised 76.9% of total deposits compared with 75.8% at December 31, 2016.

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

DEPOSITS BY DIVISION

	June 30, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Chemung Canal Trust Company*	\$1,317,570	\$1,249,870	\$1,219,282	\$1,119,377	\$1,097,920
Capital Bank Division	207,467	206,473	181,013	160,637	168,336
Total loans	\$1,525,037	\$1,456,343	\$1,400,295	\$1,280,014	\$1,266,256

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

In addition to consumer, commercial and public deposits, other sources of funds include brokered deposits. Brokered deposits include funds obtained through brokers, and the Bank's participation in the CDARS and ICS programs. There were no deposits obtained through brokers as of June 30, 2017 and December 31, 2016. Deposits obtained through the CDARS and ICS programs were \$255.0 million and \$203.7 million as of June 30, 2017 and December 31, 2016, respectively. The increase in CDARS and ICS deposits was due to the Corporation offering the programs to new municipal clients, in addition to the seasonal inflow of current municipal client balances.

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

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

Borrowings

Securities sold under agreements to repurchase decreased \$15.7 million from \$27.6 million at December 31, 2016 to \$11.9 million at June 30, 2017. The decrease in securities sold under agreements to repurchase was related to the maturity of one \$10.0 million

repurchase agreement and normal fluctuations in client accounts and discontinuation of the Bank's customer repurchase agreement product during 2017.

Shareholders' Equity

Shareholders' equity was \$152.0 million at June 30, 2017 compared with \$143.7 million at December 31, 2016. The increase was primarily due to earnings of \$5.9 million and a reduction of \$0.6 million in treasury stock and a decrease of \$3.8 million in accumulated other comprehensive loss, offset by \$2.4 million in dividends declared during the six months ended June 30, 2017. The total shareholders' equity to total assets ratio was 8.84% at June 30, 2017 compared with 8.67% at December 31, 2016. The tangible equity to tangible assets ratio was 7.53% at June 30, 2017 compared with 7.29% at December 31, 2016. Book value per share increased to \$31.67 at June 30, 2017 from \$30.07 at December 31, 2016.

The Corporation and the Bank are subject to capital adequacy guidelines of the Federal Reserve which establish a framework for the classification of financial holding companies and financial institutions into five categories: well-capitalized, adequately capitalized, under-capitalized, significantly under-capitalized and critically under-capitalized. As of June 30, 2017, the Bank's capital ratios were in excess of those required to be considered well-capitalized under regulatory capital guidelines and the Corporation met capital requirements under regulatory guidelines.

Off-balance Sheet Arrangements

See Note 9 – Commitments and Contingencies in the Notes to Unaudited Consolidated Financial Statements for a discussion of off-balance sheet arrangements.

Liquidity

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

The Corporation is a member of the FHLBNY which allows it to access borrowings which enhance management's ability to satisfy future liquidity needs. Based on available collateral and current advances outstanding, the Corporation was eligible to borrow up to a total of \$127.9 million and \$131.6 million at June 30, 2017 and December 31, 2016, respectively. The Corporation also had a total of \$28.0 million of unsecured lines of credit with four different financial institutions, all of which was available at June 30, 2017 and December 31, 2016.

Consolidated Cash Flows Analysis

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

CONSOLIDATED SUMMARY OF CASH FLOWS

(in thousands)	Six Months Ended	
	June 30,	
	2017	2016
Net cash provided by operating activities	\$8,999	\$11,446
Net cash (used in) provided by investing activities	(69,350)	17,993
Net cash provided by financing activities	50,735	51,730

Net increase (decrease) in cash and cash equivalents \$(9,616) \$81,169

Operating activities

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

Cash provided by operating activities in the first six months of 2017 and 2016 predominantly resulted from net income after non-cash operating adjustments.

Investing activities

Cash used by investing activities during the first six months of 2017 predominantly resulted from a net increase in loans and purchases of securities, offset by sales, calls, maturities, and principal collected in securities available for sale. Cash provided by investing activities during the first six months of 2016 predominantly resulted from sales, calls, maturities, and principal collected on securities available for sale, offset by a net increase in loans.

Financing activities

Cash provided by financing activities during the first six months of 2017 and 2016 predominantly resulted from an increase in deposits, offset by the maturity of one \$10.0 million repurchase agreement in 2017 and the redemption of FHLB NY overnight advances that were no longer needed with the inflow of municipal deposits in 2016.

Capital Resources

The Corporation and the Bank are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel III rules became effective for the Corporation on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under Basel III rules, the Corporation must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2017 is 1.25%. The net unrealized gain or loss on available for sale securities and changes in the funded status of the defined benefit pension plan and other benefit plans are not included in computing regulatory capital. Management believes as of June 30, 2017, the Corporation and the Bank meet all capital adequacy requirements to which they are subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. Management believes that, as of June 30, 2017 and December 31, 2016, the Corporation and the Bank met all capital adequacy requirements to which they were subject.

As of June 30, 2017, the most recent notification from the Federal Reserve Bank of New York categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There have been no conditions or events since that notification that management believes have changed the Bank's or the Corporation's capital category.

The regulatory capital ratios as of June 30, 2017 and December 31, 2016 were calculated under Basel III rules. There is no threshold for well-capitalized status for bank holding companies.

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

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

	Actual		Minimum Capital Adequacy		Minimum Capital Adequacy with Capital Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of June 30, 2017								
Total Capital (to Risk Weighted Assets):								
Consolidated	\$150,323	12.06%	\$99,676	8.00%	\$115,250	9.250%	N/A	N/A
Bank	\$143,882	11.56%	\$99,565	8.00%	\$115,122	9.250%	\$124,457	10.00%
Tier 1 Capital (to Risk Weighted Assets):								
Consolidated	\$135,105	10.84%	\$74,757	6.00%	\$90,331	7.250%	N/A	N/A
Bank	\$128,746	10.34%	\$74,674	6.00%	\$90,231	7.250%	\$99,565	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets):								
Consolidated	\$135,105	10.84%	\$56,068	4.50%	\$71,642	5.750%	N/A	N/A
Bank	\$128,746	10.34%	\$56,005	4.50%	\$71,563	5.750%	\$80,897	6.50%
Tier 1 Capital (to Average Assets):								
Consolidated	\$135,105	7.94%	\$68,064	4.00%	N/A	N/A	N/A	N/A
Bank	\$128,746	7.58%	\$67,939	4.00%	N/A	N/A	\$84,924	5.00%
As of December 31, 2016								
Total Capital (to Risk Weighted Assets):								
Consolidated	\$145,269	12.14%	\$95,748	8.00%	\$103,229	8.625%	N/A	N/A
Bank	\$140,020	11.71%	\$95,640	8.00%	\$103,112	8.625%	\$119,550	10.00%
Tier 1 Capital (to Risk Weighted Assets):								
Consolidated	\$130,911	10.94%	\$71,811	6.00%	\$79,292	6.625%	N/A	N/A
Bank	\$125,736	10.52%	\$71,730	6.00%	\$79,202	6.625%	\$95,640	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets):								
Consolidated	\$130,911	10.94%	\$53,858	4.50%	\$61,339	5.125%	N/A	N/A
Bank	\$125,736	10.52%	\$53,798	4.50%	\$61,270	5.125%	\$77,708	6.50%
Tier 1 Capital (to Average Assets):								
Consolidated	\$130,911	7.81%	\$67,031	4.00%	N/A	N/A	N/A	N/A
Bank	\$125,736	7.52%	\$66,919	4.00%	N/A	N/A	\$83,649	5.00%

Dividend Restrictions

The Corporation's principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to current year's net income, combined with the retained net income of the preceding two years, subject to the capital requirements in the table below. At June 30, 2017, the Bank could, without prior approval, declare dividends of approximately \$15.0 million.

Adoption of New Accounting Standards

Please refer to Note 1, Summary of Significant Accounting Policies - Recent Accounting Pronouncements for a discussion of new accounting standards.

Critical Accounting Policies, Estimates and Risks and Uncertainties

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

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

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

The Corporation prepares its Consolidated Financial Statements in accordance with GAAP; these financial statements appear on pages 6–11. That presentation provides the reader with an understanding of the Corporation's results that can be tracked consistently from year-to-year and enables a comparison of the Corporation's performance with other companies' GAAP financial statements.

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

The SEC has adopted Regulation G, which applies to all public disclosures, including earnings releases, made by registered companies that contain "non-GAAP financial measures." Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure and a statement of the Corporation's reasons for utilizing the non-GAAP

financial measure as part of its financial disclosures. The SEC has exempted from the definition of “non-GAAP financial measures” certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. The following measures used in this Report, which are commonly utilized by financial institutions, have not been specifically exempted by the SEC and may constitute "non-GAAP financial measures" within the meaning of the SEC's new rules, although we are unable to state with certainty that the SEC would so regard them.

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

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

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

(in thousands, except ratio data)	As of the Three Months Ended				As of the Six Months Ended		
	June 30, 2017	March 31, 2017	Dec. 31, 2016	Sept. 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016
NET INTEREST MARGIN - FULLY TAXABLE EQUIVALENT AND EFFICIENCY RATIO							
Net interest income (GAAP)	\$13,950	\$13,494	\$13,296	\$13,040	\$12,968	\$27,444	\$25,993
Fully taxable equivalent adjustment	192	169	154	154	159	361	323
Fully taxable equivalent net interest income (non-GAAP)	\$14,142	\$13,663	\$13,450	\$13,194	\$13,127	\$27,805	\$26,316
Non-interest income (GAAP)	\$5,022	\$4,847	\$4,897	\$5,435	\$5,216	\$9,869	\$10,817

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

Less: net (gains) losses on security transactions	(12	) —	(4	) (75	) —	(12	) (908)
Adjusted non-interest income (non-GAAP)	\$5,010	\$4,847	\$4,893	\$5,360	\$5,216	\$9,857	\$9,909	
Non-interest expense (GAAP)	\$14,332	\$13,045	\$13,561	\$13,471	\$15,570	\$27,377	\$29,578	
Less: amortization of intangible assets	(213	) (226	) (238	) (245	) (245	) (439	) (503)
Less: legal reserve	(850	) —	—	—	(1,200	) (850	) (1,200)
Adjusted non-interest expense (non-GAAP)	\$13,269	\$12,819	\$13,323	\$13,226	\$14,125	\$26,088	\$27,875	
Average interest-earning assets (GAAP)	\$1,634,955	\$1,605,460	\$1,607,287	\$1,577,348	\$1,573,306	\$1,620,290	\$1,550,481	
Net interest margin - fully taxable equivalent (non-GAAP)	3.47	% 3.45	% 3.33	% 3.33	% 3.36	% 3.46	% 3.41	%
Efficiency ratio (non-GAAP)	69.28	% 69.25	% 72.63	% 71.28	% 77.00	% 69.27	% 76.95	%

Tangible Equity and Tangible Assets (Period-End)

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

(in thousands, except per share and ratio data)	As of or for the Three Months Ended					As of or for the Six Months Ended	
	June 30, 2017	March 31, 2017	Dec. 31, 2016	Sept. 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016
TANGIBLE EQUITY AND TANGIBLE ASSETS (PERIOD END)							
Total shareholders' equity (GAAP)	\$151,962	\$148,257	\$143,748	\$144,812	\$143,409	\$151,962	\$143,409
Less: intangible assets	(24,330)	(24,543)	(24,769)	(25,007)	(25,252)	(24,330)	(25,252)
Tangible equity (non-GAAP)	\$127,632	\$123,714	\$118,979	\$119,805	\$118,157	\$127,632	\$118,157
Total assets (GAAP)	\$1,718,572	\$1,736,100	\$1,657,179	\$1,728,865	\$1,683,932	\$1,718,572	\$1,683,932
Less: intangible assets	(24,330)	(24,543)	(24,769)	(25,007)	(25,252)	(24,330)	(25,252)
Tangible assets (non-GAAP)	\$1,694,242	\$1,711,557	\$1,632,410	\$1,703,858	\$1,658,680	\$1,694,242	\$1,658,680
Total equity to total assets at end of period (GAAP)	8.84	% 8.54	% 8.67	% 8.38	% 8.52	% 8.84	% 8.52
Book value per share (GAAP)	\$31.67	\$30.93	\$30.07	\$30.37	\$30.12	\$31.67	\$30.12
Tangible equity to tangible assets at end of period (non-GAAP)	7.53	% 7.23	% 7.29	% 7.03	% 7.12	% 7.53	% 7.12
Tangible book value per share	\$26.60	\$25.81	\$24.89	\$25.13	\$24.81	\$26.60	\$24.81

(non-GAAP)

Tangible Equity (Average)

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

(in thousands, except ratio data)	As of or for the Three Months Ended					As of or for the Six Months Ended		
	June 30, 2017	March 31, 2017	Dec. 31, 2016	Sept. 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016	
TANGIBLE EQUITY (AVERAGE)								
Total average shareholders' equity (GAAP)	\$150,155	\$146,642	\$143,388	\$144,631	\$142,746	\$148,408	\$141,795	
Less: average intangible assets	(24,435)	(24,654)	(24,886)	(25,127)	(25,372)	(24,544)	(25,498)	
Average tangible equity (non-GAAP)	\$125,720	\$121,988	\$118,502	\$119,504	\$117,374	\$123,864	\$116,297	
Return on average equity (GAAP)	7.90	% 8.24	% 8.20	% 7.55	% 4.57	% 8.06	% 6.14	%
Return on average tangible equity (non-GAAP)	9.43	% 9.90	% 9.92	% 9.14	% 5.55	% 9.66	% 7.48	%

Adjustments for Certain Items of Income or Expense

In addition to disclosures of certain GAAP financial measures, including net income, EPS, ROA, and ROE, we may also provide comparative disclosures that adjust these GAAP financial measures for a particular period by removing from the calculation thereof the impact of certain transactions or other material items of income or expense occurring during the period, including certain nonrecurring items. The Corporation believes that the resulting non-GAAP financial measures may improve an understanding of its results of operations by separating out any such transactions or items that may have had a disproportionate positive or negative impact on the Corporation's financial results during the particular period in question. In the Corporation's presentation of any such non-GAAP (adjusted) financial measures not specifically discussed in the preceding paragraphs, the Corporation supplies the supplemental financial information and explanations required under Regulation G.

(in thousands, except per share and ratio data)	As of or for the Three Months Ended					As of or for the Six Months Ended	
	June 30, 2017	March 31, 2017	Dec. 31, 2016	Sept. 30, 2016	June 30, 2016	June 30, 2017	June 30, 2016
NON-GAAP NET INCOME							
Reported net income (GAAP)	\$2,956	\$2,979	\$2,954	\$2,745	\$1,621	\$5,935	\$4,328
Net (gains) losses on security transactions (net of tax)	(8)	—	(2)	(47)	—	(8)	(565)
Legal reserve (net of tax)	528	—	—	—	747	528	747
Non- GAAP net income	\$3,476	\$2,979	\$2,952	\$2,698	\$2,368	\$6,455	\$4,510
Average basic and diluted shares outstanding	4,797	4,790	4,773	4,765	4,760	4,793	4,754
Reported basic and diluted earnings per share (GAAP)	\$0.62	\$0.62	\$0.62	\$0.58	\$0.34	\$1.24	\$0.91
Reported return on average assets (GAAP)	0.69 %	0.71 %	0.69 %	0.65 %	0.39 %	0.70 %	0.53 %
Reported return on average equity (GAAP)	7.90 %	8.24 %	8.20 %	7.55 %	4.57 %	8.06 %	6.14 %
Non-GAAP basic and diluted earnings per share	\$0.72	\$0.62	\$0.62	\$0.57	\$0.50	\$1.35	\$0.95
Non-GAAP return on average assets	0.81 %	0.71 %	0.69 %	0.64 %	0.57 %	0.76 %	0.55 %
Non-GAAP return on average equity	9.29 %	8.24 %	8.19 %	7.42 %	6.67 %	8.77 %	6.40 %

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

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

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

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

Interest rate risk is the risk that net interest income will fluctuate as a result of a change in interest rates. It is the assumption of interest rate risk, along with credit risk, that drives the net interest margin of a financial institution. For that reason, the ALCO has established tolerance limits based upon a 200-basis point change in interest rates, with appropriate floors set for interest-bearing liabilities. At June 30, 2017, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the next 12 months net interest income by 10.62% and an immediate 200-basis point increase would negatively impact the next 12 months net interest income by 9.38%. Both are within the Corporation's policy guideline of 15%. Given the overall low level of current interest rates and the unlikely event of a 200-basis point decline from this point, management additionally modeled an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates. When applied, it is estimated these scenarios would result in negative impacts to net interest income of 5.70% and 14.24%, respectively.

A related component of interest rate risk is the expectation that the market value of the Corporation's capital account will fluctuate with changes in interest rates. This component is a direct corollary to the earnings-impact component: an institution exposed to earnings erosion is also exposed to shrinkage in market value. At June 30, 2017, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the market value of the Corporation's capital account by 12.82% and an immediate 200-basis point increase in interest rates would negatively impact the market value by 5.28%. Both are within the Corporation's policy guideline of 15%. Management also modeled the impact to the market value of the Corporation's capital with an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates, based on the current interest rate environment. When applied, it is estimated these scenarios would result in negative impacts to the market value of the Corporation's capital of 5.80% and 8.02%, respectively.

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

Credit Risk

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

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

ITEM 4: CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Corporation's management, with the participation of its Chief Executive Officer, who is the Corporation's principal executive officer, and its Chief Financial Officer and Treasurer, who is the Corporation's principal financial officer, have evaluated the effectiveness of the Corporation's disclosure controls and procedures as of June 30, 2017 pursuant to Rule 13a-15 of the Exchange, as amended. Based upon that evaluation, the principal executive officer and principal financial officer have concluded that the Corporation's disclosure controls and procedures are effective as of June 30, 2017. In addition, there have been no changes in the Corporation's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Disclosure controls and procedures are designed with the objective of ensuring that information required to be disclosed in reports filed by the Corporation under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. Disclosure controls and procedures are also designed with the objective of ensuring that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

For information related to this item, please see Note 9 to the Corporation's financial statements included herein.

ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors set forth in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the Securities and Exchange Commission on March 8, 2017.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Issuer Purchases of Equity Securities (1)

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
4/1/17-4/30/17	—	\$	—	121,906
5/1/17-5/31/17	—	—	—	121,906
6/1/17-6/30/17	—	—	—	121,906
Quarter ended 6/30/17	—	\$	—	121,906

(1) On December 19, 2012, the Corporation's Board of Directors approved a stock repurchase plan authorizing the purchase of up to 125,000 shares of the Corporation's outstanding common stock. Purchases may be made from time to time on the open market or in private negotiated transactions and will be at the discretion of management. For the three months ended June 30, 2017, no shares had been purchased under this plan. Since inception of the plan, a total of 3,094 shares have been purchased under the plan.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

The following exhibits are either filed with this Form 10-Q or are incorporated herein by reference. The Corporation's Securities Exchange Act File number is 000-13888.

- 3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984 (as incorporated by reference to Exhibit 3.1 to Registrant's Form 10-K for the year ended December 31, 2007 filed with the Commission on March 13, 2008).
- 3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988 (as incorporated by reference to Exhibit 3.2 to Registrant's Form 10-K for the year ended December 31, 2007 filed with the Commission on March 13, 2008).
- 3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998 (as incorporated by reference to Exhibit 3.4 to Registrant's Form 10-K for the year ended December 31, 2005 and filed with the Commission on March 15, 2006).
- 3.4 Amended and Restated Bylaws of Chemung Financial Corporation, as amended to December 21, 2016 (as incorporated by reference to Exhibit 3.1 to Registrant's Form 8-K filed with the Commission on December 23, 2016).
- 31.1 Certification of Principal Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.*
- 31.2 Certification of Principal Financial Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.*
- 32.1 Certification of Principal Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.*
- 32.2 Certification of Principal Financial Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.*
- 101.INS Instance Document*
- 101.SCHXBRL Taxonomy Schema*
- 101.CALXBRL Taxonomy Calculation Linkbase*
- 101.DEF XBRL Taxonomy Definition Linkbase*
- 101.LABXBRL Taxonomy Label Linkbase*
- 101.PRE XBRL Taxonomy Presentation Linkbase*

* Filed herewith.

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.

CHEMUNG FINANCIAL CORPORATION

DATED: August 2, 2017 By: /s/ Anders M. Tomson
Anders M. Tomson
Chief Executive Officer
(Principal Executive Officer)

DATED: August 2, 2017 By: /s/ Karl F. Krebs
Karl F. Krebs
Chief Financial Officer and Treasurer
(Principal Financial Officer)

EXHIBIT INDEX

The following exhibits are either filed with this Form 10-Q or are incorporated herein by reference. The Corporation's Securities Exchange Act File number is 000-13888

- 3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984 (as incorporated by reference to Exhibit 3.1 to Registrant's Form 10-K for the year ended December 31, 2007 filed with the Commission on March 13, 2008).
- 3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988 (as incorporated by reference to Exhibit 3.2 to Registrant's Form 10-K for the year ended December 31, 2007 filed with the Commission on March 13, 2008).
- 3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998 (as incorporated by reference to Exhibit 3.4 to Registrant's Form 10-K for the year ended December 31, 2005 and filed with the Commission on March 15, 2006).
- 3.4 Amended and Restated Bylaws of Chemung Financial Corporation, as amended to December 21, 2016 (as incorporated by reference to Exhibit 3.1 to Registrant's Form 8-K filed with the Commission on December 23, 2016).
- 31.1 Certification of Principal Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.*
- 31.2 Certification of Principal Financial Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.*
- 32.1 Certification of Principal Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.*
- 32.2 Certification of Principal Financial Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.*
- 101.INS Instance Document*
- 101.SCHXBRL Taxonomy Schema*
- 101.CALXBRL Taxonomy Calculation Linkbase*
- 101.DEF XBRL Taxonomy Definition Linkbase*
- 101.LABXBRL Taxonomy Label Linkbase*
- 101.PRE XBRL Taxonomy Presentation Linkbase*

* Filed herewith.