NBT BANCORP INC
Form 10-Q
November 09, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016.
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________.

COMMISSION FILE NUMBER 0-14703

NBT BANCORP INC.
(Exact Name of Registrant as Specified in its Charter)

DELAWARE	16-1268674
(State of Incorporation)	(I.R.S. Employer Identification No.)

52 SOUTH BROAD STREET, NORWICH, NEW YORK 13815
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (607) 337-2265

None
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted 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 (Section 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, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of October 31, 2016, there were 43,160,455 shares outstanding of the Registrant's common stock, $0.01 par value per share.

NBT BANCORP INC.
FORM 10-Q--Quarter Ended September 30, 2016

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Item 1 – FINANCIAL STATEMENTS

NBT Bancorp Inc. and Subsidiaries
Consolidated Balance Sheets (unaudited)

	September 30 2016	December 31 2015
(In thousands, except share and per share data)		
Assets		
Cash and due from banks	$ 167,138	$ 130,593
Short-term interest bearing accounts	21,299	9,704
Securities available for sale, at fair value	1,288,899	1,174,544
Securities held to maturity (fair value $495,596 and $473,140, respectively)	485,877	471,031
Trading securities	8,852	8,377
Federal Reserve and Federal Home Loan Bank stock	42,318	36,673
Loans	6,160,185	5,883,133
Less allowance for loan losses	65,668	63,018
Net loans	6,094,517	5,820,115
Premises and equipment, net	84,153	88,826
Goodwill	264,689	265,957
Intangible assets, net	15,899	17,265
Bank owned life insurance	164,464	117,044
Other assets	134,919	122,517
Total assets	$ 8,773,024	$ 8,262,646
Liabilities		
Demand (noninterest bearing)	$ 2,146,229	$ 1,998,165
Savings, NOW and money market	3,921,922	3,697,851
Time	881,087	908,827
Total deposits	6,949,238	6,604,843
Short-term borrowings	585,027	442,481
Long-term debt	114,144	130,447
Junior subordinated debt	101,196	101,196
Other liabilities	114,070	101,675
Total liabilities	7,863,675	7,380,642
Stockholders' equity		
Preferred stock, $0.01 par value. Authorized 2,500,000 shares at September 30, 2016 and December 31, 2015	-	-
Common stock, $0.01 par value. Authorized 100,000,000 shares at September 30, 2016 and December 31, 2015; issued 49,651,494 at September 30, 2016 and December 31, 2015	497	497
Additional paid-in-capital	573,658	576,726
Retained earnings	492,130	462,232
Accumulated other comprehensive loss	(11,980)	(22,418)
Common stock in treasury, at cost, 6,507,270 and 6,220,792 shares at September 30, 2016 and December 31, 2015, respectively	(144,956)	(135,033)
Total stockholders' equity	909,349	882,004
Total liabilities and stockholders' equity	$ 8,773,024	$ 8,262,646

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Income (unaudited)	Three months ended September 30, 2016	 2015	Nine months ended September 30, 2016	 2015
(In thousands, except per share data)				
Interest, fee and dividend income				
Interest and fees on loans	$63,414	$61,656	$187,093	$181,047
Securities available for sale	6,013	5,125	17,976	15,214
Securities held to maturity	2,544	2,318	7,328	6,916
Other	538	401	1,441	1,276
Total interest, fee and dividend income	72,509	69,500	213,838	204,453
Interest expense				
Deposits	3,607	3,554	10,809	10,644
Short-term borrowings	761	296	1,668	561
Long-term debt	819	845	2,425	2,507
Junior subordinated debt	660	560	1,920	1,645
Total interest expense	5,847	5,255	16,822	15,357
Net interest income	66,662	64,245	197,016	189,096
Provision for loan losses	6,388	4,966	17,266	12,506
Net interest income after provision for loan losses	60,274	59,279	179,750	176,590
Noninterest income				
Insurance and other financial services revenue	6,114	5,862	18,685	18,072
Service charges on deposit accounts	4,354	4,349	12,459	12,706
ATM and debit card fees	5,063	4,780	14,580	13,707
Retirement plan administration fees	4,129	3,249	11,937	10,011
Trust	4,535	4,611	13,848	14,257
Bank owned life insurance	1,336	931	3,898	3,418
Net securities gains	-	3	30	43
Gain on the sale of equity investment	-	4,179	-	4,179
Other	4,113	3,297	12,188	9,617
Total noninterest income	29,644	31,261	87,625	86,010
Noninterest expense				
Salaries and employee benefits	32,783	30,227	98,155	91,240
Occupancy	5,035	5,326	15,780	16,804
Data processing and communications	4,183	4,207	12,354	12,598
Professional fees and outside services	3,343	3,137	9,905	10,029
Equipment	3,656	3,352	10,663	9,917
Office supplies and postage	1,438	1,576	4,661	4,822
FDIC expenses	1,287	1,355	3,838	3,833
Advertising	634	421	1,733	1,874
Amortization of intangible assets	952	1,165	2,976	3,636
Loan collection and other real estate owned, net	985	699	2,535	1,593
Other	5,318	8,426	15,683	19,211
Total noninterest expense	59,614	59,891	178,283	175,557
Income before income tax expense	30,304	30,649	89,092	87,043
Income tax expense	10,303	10,798	30,291	29,745
Net income	$20,001	$19,851	$58,801	$57,298
Earnings per share				
Basic	$0.46	$0.45	$1.36	$1.30

Diluted	$0.46	$0.45	$1.35	$1.29

See accompanying notes to unaudited interim consolidated financial statements.

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NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Comprehensive Income (unaudited) (In thousands)	Three months ended September 30, 2016	Three months ended September 30, 2015	Nine months ended September 30, 2016	Nine months ended September 30, 2015
Net income	$20,001	$19,851	58,801	$57,298
Other comprehensive income, net of tax:				
Unrealized net holding (losses) gains arising during the period (pre-tax amounts of ($2,931), $3,801, $14,009 and $3,367)	(1,790)	2,323	8,560	2,057
Reclassification adjustment for net gains related to securities available for sale included in net income (pre-tax amounts of $-, $3, $30 and $43)	-	(2)	(19)	(26)
Unrealized losses on derivatives (cash flow hedges) (pre-tax amounts of $782, $-, $719 and $-)	478	-	439	-
Amortization of unrealized net gains and losses related to the reclassification of available for sale investment securities to held to maturity (pre-tax amounts of $267, $328, $843 and $999)	162	200	515	610
Pension and other benefits:				
Amortization of prior service cost and actuarial gains (pre-tax amounts of $519, $551, $1,544 and $1,673)	317	337	943	1,021
Total other comprehensive (loss) income	(833)	2,858	10,438	3,662
Comprehensive income	$19,168	$22,709	69,239	$60,960

See accompanying notes to unaudited interim consolidated financial statements.

NBT Bancorp Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity (unaudited)

(In thousands, except share and per share data)	Common Stock	Additional Paid-in-Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Common Stock in Treasury	Total
Balance at December 31, 2014	$ 497	$ 576,504	$ 423,956	$ (17,027)	$ (119,749)	$ 864,181
Net income	-	-	57,298	-	-	57,298
Cash dividends - $0.65 per share	-	-	(28,553)	-	-	(28,553)
Purchase of 1,047,152 treasury shares	-	-	-	-	(26,797)	(26,797)
Net issuance of 336,959 shares to employee benefit plans and other stock plans, including tax benefit	-	(3,423)	-	-	6,451	3,028
Stock-based compensation	-	3,397	-	-	-	3,397
Other comprehensive income	-	-	-	3,662	-	3,662
Balance at September 30, 2015	$ 497	$ 576,478	$ 452,701	$ (13,365)	$ (140,095)	$ 876,216
Balance at December 31, 2015	$ 497	$ 576,726	$ 462,232	$ (22,418)	$ (135,033)	$ 882,004
Net income	-	-	58,801	-	-	58,801
Cash dividends - $0.67 per share	-	-	(28,903)	-	-	(28,903)
Purchase of 675,535 treasury shares	-	-	-	-	(17,193)	(17,193)
Net issuance of 389,058 shares to employee benefit plans and other stock plans, including tax benefit	-	(6,164)	-	-	7,270	1,106
Stock-based compensation	-	3,096	-	-	-	3,096
Other comprehensive income	-	-	-	10,438	-	10,438
Balance at September 30, 2016	$ 497	$ 573,658	$ 492,130	$ (11,980)	$ (144,956)	$ 909,349

See accompanying notes to unaudited interim consolidated financial statements.

NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Cash Flows (unaudited) (In thousands)	Nine months ended September 30, 2016	2015
Operating activities		
Net income	$58,801	$57,298
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	17,266	12,506
Depreciation and amortization of premises and equipment	6,765	6,494
Net accretion on securities	3,781	1,851
Amortization of intangible assets	2,976	3,636
Stock-based compensation	3,096	3,397
Bank owned life insurance income	(3,898)	(3,418)
Purchases of trading securities	(34)	(767)
(Gains) losses on trading securities	(441)	660
Proceeds from sales of loans held for sale	71,170	50,998
Originations and purchases of loans held for sale	(73,393)	(49,125)
Net gains on sales of loans held for sale	(459)	(108)
Net security gains	(30)	(43)
Net gain on sales of other real estate owned	(625)	(1,241)
Gain on the sale of equity investment	-	(4,179)
Gain on asset sold	(2,462)	-
Impairment write-down	2,565	-
Net (increase) decrease in other assets	(16,599)	8,846
Net increase in other liabilities	11,395	6,252
Net cash provided by operating activities	79,874	93,057
Investing activities		
Net cash used in acquisitions	(2,000)	-
Securities available for sale:		
Proceeds from maturities, calls and principal paydowns	250,441	229,347
Proceeds from sales	48	-
Purchases	(352,056)	(272,596)
Securities held to maturity:		
Proceeds from maturities, calls and principal paydowns	76,676	61,379
Purchases	(90,476)	(74,951)
Other:		
Net increase in loans	(291,349)	(294,187)
Proceeds from FHLB stock redemption	108,227	39,740
Purchases of Federal Reserve and FHLB stock	(113,872)	(41,115)
Proceeds from settlement of bank owned life insurance	1,478	1,541
Purchase of bank owned life insurance	(45,000)	-
Purchases of premises and equipment	(4,652)	(4,999)
Proceeds from sale of equity investment	-	4,179
Proceeds from the sales of other real estate owned	5,153	3,049
Net cash used in investing activities	(457,382)	(348,613)
Financing activities		
Net increase in deposits	344,395	301,022
Net increase in short-term borrowings	142,546	45,530
Proceeds from issuance of long-term debt	3,880	-

Repayments of long-term debt	(20,183)	(310)
Proceeds from the issuance of shares to employee benefit plans and other stock plans	1,106	3,028
Purchase of treasury stock	(17,193)	(26,797)
Cash dividends	(28,903)	(28,553)
Net cash provided by financing activities	425,648	293,920
Net increase in cash and cash equivalents	48,140	38,364
Cash and cash equivalents at beginning of period	140,297	146,636
Cash and cash equivalents at end of period	$188,437	$185,000

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Supplemental disclosure of cash flow information	Nine months ended September 30,	
Cash paid during the period for:	2016	2015
Interest	$17,269	$16,252
Income taxes paid	29,173	19,027
Noncash investing activities:		
Loans transferred to other real estate owned	$2,363	$2,699
Acquisitions:		
Fair value of assets acquired	$1,703	$-

See accompanying notes to unaudited interim consolidated financial statements.

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NBT BANCORP INC. and Subsidiaries
NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2016

Note 1. Description of Business

NBT Bancorp Inc. (the "Registrant" or the "Company") is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The principal assets of the Registrant consist of all of the outstanding shares of common stock of its subsidiaries, including: NBT Bank, National Association (the "Bank"), NBT Financial Services, Inc. ("NBT Financial"), NBT Holdings, Inc. ("NBT Holdings"), Hathaway Agency, Inc. and CNBF Capital Trust I, NBT Statutory Trust I, NBT Statutory Trust II, Alliance Financial Capital Trust I and Alliance Financial Capital Trust II (collectively, the "Trusts"). The Company's principal sources of revenue are the management fees and dividends it receives from the Bank, NBT Financial and NBT Holdings.

The Company's business, primarily conducted through the Bank but also through its other subsidiaries, consists of providing commercial banking and financial services to customers in its market area, which includes central and upstate New York, northeastern Pennsylvania, northwestern Vermont, western Massachusetts, southern New Hampshire and southern Maine. The Company has been and intends to continue to be, a community-oriented financial institution offering a variety of financial services. The Company's business philosophy is to operate as a community bank with local decision-making, principally in non-metropolitan markets, providing a broad array of banking and financial services to retail, commercial and municipal customers.

Note 2. Basis of Presentation

The accompanying unaudited interim consolidated financial statements include the accounts of the Registrant and its wholly owned subsidiaries, the Bank, NBT Financial and NBT Holdings. Collectively, the Registrant and its subsidiaries are referred to herein as "the Company." The interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in accordance with generally accepted accounting principles in the United States of America ("GAAP"). These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2015 Annual Report on Form 10-K. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. All intercompany transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

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Note 3. Securities

The amortized cost, estimated fair value and unrealized gains and losses of securities available for sale are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
September 30, 2016				
Federal Agency	$255,115	$ 1,006	$ (28)	$256,093
State & municipal	38,327	357	(30)	38,654
Mortgage-backed:				
Government-sponsored enterprises	356,484	8,969	-	365,453
U.S. government agency securities	6,418	506	(13)	6,911
Collateralized mortgage obligations:				
Government-sponsored enterprises	536,694	4,580	(189)	541,085
U.S. government agency securities	59,931	478	(24)	60,385
Other securities	16,744	4,720	(1,146)	20,318
Total securities available for sale	$1,269,713	$ 20,616	$ (1,430)	$1,288,899
December 31, 2015				
Federal Agency	$312,580	$ 203	$ (1,511)	$311,272
State & municipal	31,208	446	(17)	31,637
Mortgage-backed:				
Government-sponsored enterprises	398,086	4,141	(1,068)	401,159
U.S. government agency securities	8,191	560	(14)	8,737
Collateralized mortgage obligations:				
Government-sponsored enterprises	364,936	931	(1,828)	364,039
U.S. government agency securities	40,699	348	(115)	40,932
Other securities	13,637	3,249	(118)	16,768
Total securities available for sale	$1,169,337	$ 9,878	$ (4,671)	$1,174,544

Other securities primarily represent marketable equity securities.

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The amortized cost, estimated fair value and unrealized gains and losses of securities held to maturity are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
September 30, 2016				
Mortgage-backed:				
Government-sponsored enterprises	$ 49,229	$ 617	$ -	$ 49,846
U.S. government agency securities	549	101	-	650
Collateralized mortgage obligations:				
Government-sponsored enterprises	237,819	5,314	(386)	242,747
State & municipal	198,280	4,130	(57)	202,353
Total securities held to maturity	$ 485,877	$ 10,162	$ (443)	$ 495,596
December 31, 2015				
Mortgage-backed:				
Government-sponsored enterprises	$ 9,432	$ -	$ (107)	$ 9,325
U.S. government agency securities	611	95	-	706
Collateralized mortgage obligations:				
Government-sponsored enterprises	272,550	1,411	(1,560)	272,401
State & municipal	188,438	2,288	(18)	190,708
Total securities held to maturity	$ 471,031	$ 3,794	$ (1,685)	$ 473,140

Securities with amortized costs totaling $1.6 billion at September 30, 2016 and $1.4 billion at December 31, 2015 were pledged to secure public deposits and for other purposes required or permitted by law. At September 30, 2016 and December 31, 2015, securities with an amortized cost of $223.8 million and $205.9 million, respectively, were pledged as collateral for securities sold under repurchase agreements.

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The following table sets forth information with regard to investment securities with unrealized losses for the periods presented (dollars in thousands):

	Less than 12 months			12 months or longer			Total		
Security Type:	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions
September 30, 2016									
Investment securities available for sale:									
Federal agency	$9,955	$(28)	1	$-	$-	-	$9,955	$(28)	1
State & municipal	7,659	(28)	12	488	(2)	1	8,147	(30)	13
Mortgage-backed	-	-	-	996	(13)	4	996	(13)	4
Collateralized mortgage obligations	56,083	(213)	8	-	-	-	56,083	(213)	8
Other securities	174	(26)	1	4,746	(1,120)	2	4,920	(1,146)	3
Total securities with unrealized losses	$73,871	$(295)	22	$6,230	$(1,135)	7	$80,101	$(1,430)	29
Investment securities held to maturity:									
Collateralized mortgage obligations	$-	$-	-	$37,888	$(386)	4	$37,888	$(386)	4
State & municipal	5,501	(57)	9	-	-	-	5,501	(57)	9
Total securities with unrealized losses	$5,501	$(57)	9	$37,888	$(386)	4	$43,389	$(443)	13
December 31, 2015									
Investment securities available for sale:									
Federal agency	$186,685	$(1,312)	15	$19,801	$(199)	2	$206,486	$(1,511)	17
State & municipal	4,599	(14)	7	502	(3)	1	5,101	(17)	8
Mortgage-backed	177,270	(1,068)	33	1,066	(14)	5	178,336	(1,082)	38
Collateralized mortgage obligations	256,265	(1,889)	24	5,218	(54)	2	261,483	(1,943)	26
Other securities	-	-	-	3,235	(118)	2	3,235	(118)	2
Total securities with unrealized losses	$624,819	$(4,283)	79	$29,822	$(388)	12	$654,641	$(4,671)	91
Investment securities held to maturity:									
Mortgage-backed	$9,325	$(107)	1	$-	$-	-	$9,325	$(107)	1
Collateralized mortgage obligations	105,604	(281)	12	41,523	(1,279)	4	147,127	(1,560)	16
State & municipal	2,200	(18)	3	-	-	-	2,200	(18)	3
	$117,129	$(406)	16	$41,523	$(1,279)	4	$158,652	$(1,685)	20

Total securities with unrealized losses

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Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses or in other comprehensive income, depending on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into (a) the amount representing the credit loss and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes. As of September 30, 2016 and December 31, 2015, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment losses have been realized in the Company's consolidated statements of income.

In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer and (iii) the historical and implied volatility of the fair value of the security.

Management has the intent to hold the securities classified as held to maturity until they mature, at which time it is believed the Company will receive full value for the securities. Furthermore, as of September 30, 2016, management also has the intent to hold and will not be required to sell, the securities classified as available for sale for a period of time sufficient for a recovery of cost, which may be until maturity. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether or not it will receive the contractual principal and interest on certain securities. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. As of September 30, 2016 and December 31, 2015, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment losses have been realized in the Company's consolidated statements of income.

The following tables set forth information with regard to contractual maturities of debt securities at September 30, 2016:

(In thousands)	Amortized cost	Estimated fair value
Debt securities classified as available for sale		
Within one year	$39,403	$39,495
From one to five years	245,571	247,544
From five to ten years	153,633	156,600
After ten years	814,362	824,942
	$1,252,969	$1,268,581
Debt securities classified as held to maturity		
Within one year	$34,787	$34,790
From one to five years	25,392	25,639
From five to ten years	123,615	126,865
After ten years	302,083	308,302
	$485,877	$495,596

Maturities of mortgage-backed and collateralized mortgage obligations are stated based on their estimated average lives. Actual maturities may differ from estimated average lives or contractual maturities because, in certain cases, borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

Except for U.S. Government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of consolidated stockholders’ equity at September 30, 2016 and December 31, 2015.

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Note 4. Allowance for Loan Losses and Credit Quality of Loans

Allowance for Loan Losses

The allowance for loan losses is maintained at a level estimated by management to provide adequately for probable incurred losses inherent in the current loan portfolio. The adequacy of the allowance for loan losses is continuously monitored. It is assessed for adequacy using a methodology designed to ensure the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan portfolio.

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into three segments, each with different risk characteristics and methodologies for assessing risk. Those segments are further segregated between our loans accounted for under the amortized cost method (referred to as "originated" loans) and loans acquired in a business combination (referred to as "acquired" loans). Each portfolio segment is broken down into class segments where appropriate. Class segments contain unique measurement attributes, risk characteristics and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type and risk characteristics define each class segment. The following table illustrates the portfolio and class segments for the Company's loan portfolio:

Portfolio	Class
Commercial Loans	Commercial
	Commercial Real Estate
	Agricultural
	Agricultural Real Estate
	Business Banking
Consumer Loans	Indirect
	Home Equity
	Direct
Residential Real Estate Mortgages	

Commercial Loans

The Company offers a variety of commercial loan products including commercial (non-real estate), commercial real estate, agricultural, agricultural real estate, and business banking loans. The Company's underwriting analysis for commercial loans typically includes credit verification, independent appraisals, a review of the borrower's financial condition and a detailed analysis of the borrower's underlying cash flows.

Commercial – The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure real estate as collateral and obtain personal guarantees of the borrowers.

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Commercial Real Estate – The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real estate, generally with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and other non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings and are generally originated in amounts of no more than 80% of the appraised value of the property.

Agricultural – The Company offers a variety of agricultural loans to meet the needs of our agricultural customers including term loans, time notes and lines of credit. These loans are made to purchase livestock, purchase and modernize equipment and finance seasonal crop expenses. Generally, a collateral lien is placed on the livestock, equipment, produce inventories and/or receivables owned by the borrower. These loans may carry a higher risk than commercial and agricultural real estate loans due to the industry price volatility and in some cases, the perishable nature of the underlying collateral. To reduce these risks, management may attempt to secure these loans with additional real estate collateral, obtain personal guarantees of the borrowers or obtain government loan guarantees to provide further support.

Agricultural Real Estate – The Company offers real estate loans to our agricultural customers to finance farm related real estate purchases, refinancings, expansions and improvements to agricultural properties such as barns, production facilities and land. The agricultural real estate loans are secured by first liens on the farm real estate. Because they are secured by land and buildings, these loans may be less risky than agricultural loans. These loans are typically originated in amounts of no more than 75% of the appraised value of the property. Government loan guarantees may be obtained to provide further support.

Business Banking – The Company offers a variety of loan options to meet the specific needs of our business banking customers including term loans, business banking mortgages and lines of credit. Such loans are generally less than $0.8 million and are made available to businesses for working capital such as inventory and receivables, business expansion, equipment purchases and agricultural needs. Generally, a collateral lien is placed on equipment or other assets owned by the borrower such as inventory and/or receivables. These loans carry a higher risk than commercial loans due to the smaller size of the borrower and lower levels of capital. To reduce these risks, the Company obtains personal guarantees of the owners for a majority of the loans.

Consumer Loans

The Company offers a variety of consumer loan products including indirect, home equity and direct loans.

Indirect – The Company maintains relationships with many dealers primarily in the communities that we serve. Through these relationships, the Company primarily finances the purchases of automobiles and recreational vehicles (such as campers, boats, etc.) indirectly through dealer relationships. Approximately 75% of the indirect relationships represent automobile financing. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to six years, based upon the nature of the collateral and the size of the loan. The majority of indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Home Equity – The Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Consumers are able to borrow up to 85% of the equity in their homes. The Company originates home equity lines of credit and second mortgage loans (loans secured by a second junior lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position with respect to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

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Direct – The Company offers a variety of consumer installment loans to finance vehicle purchases, mobile home purchases and personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed or a customer's deposit account. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. A minimal amount of loans are unsecured, which carry a higher risk of loss.

Residential Real Estate Mortgages

Residential real estate loans consist primarily of loans secured by first or second deeds of trust on primary residences. We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower) or have private mortgage insurance. The Company's underwriting analysis for residential mortgage loans typically includes credit verification, independent appraisals and a review of the borrower's financial condition. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period.

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectability of the portfolio. For individually analyzed loans, these include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectability. These factors include: past loss experience, loss emergence period, size, trend, composition and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make loan grade changes as well as recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These charges or credits are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions and reductions of the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above.

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The following tables illustrate the changes in the allowance for loan losses by our portfolio segments for the three and nine months ended September 30, 2016 and 2015 (in thousands):

Three months ended September 30,	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
Balance as of June 30, 2016	$ 25,222	$ 31,471	$ 7,875	$ -	$ 64,568
Charge-offs	(637)	(6,046)	(142)	-	(6,825)
Recoveries	512	898	127	-	1,537
Provision	1,514	6,078	(1,481)	277	6,388
Ending Balance as of September 30, 2016	$ 26,611	$ 32,401	$ 6,379	$ 277	$ 65,668
Balance as of June 30, 2015	$ 28,326	$ 28,314	$ 8,281	$ 38	$ 64,959
Charge-offs	(1,333)	(4,530)	(511)	-	(6,374)
Recoveries	258	889	161	-	1,308
Provision	(2,800)	7,333	51	382	4,966
Ending Balance as of September 30, 2015	$ 24,451	$ 32,006	$ 7,982	$ 420	$ 64,859

Nine months ended September 30,	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
Balance as of December 31, 2015	$ 25,545	$ 29,253	$ 7,960	$ 260	$ 63,018
Charge-offs	(1,723)	(16,409)	(1,119)	-	(19,251)
Recoveries	1,616	2,779	240	-	4,635
Provision	1,173	16,778	(702)	17	17,266
Ending Balance as of September 30, 2016	$ 26,611	$ 32,401	$ 6,379	$ 277	$ 65,668
Balance as of December 31, 2014	$ 32,433	$ 26,720	$ 7,130	$ 76	$ 66,359
Charge-offs	(2,715)	(13,183)	(1,524)	-	(17,422)
Recoveries	772	2,334	310	-	3,416
Provision	(6,039)	16,135	2,066	344	12,506
Ending Balance as of September 30, 2015	$ 24,451	$ 32,006	$ 7,982	$ 420	$ 64,859

Included in the above table there was $0.7 million and $1.9 million in the allowance for loan losses related to acquired commercial loans as of September 30, 2016 and September 30, 2015, respectively. Net charge-offs related to acquired loans totaled approximately $0.1 million and $0.5 million during the three months ended September 30, 2016 and 2015, respectively and approximately $0.4 million and $1.2 million during the nine months ended September 30, 2016 and 2015, respectively and are included in the table above.

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The following tables illustrate the allowance for loan losses and the recorded investment by portfolio segments as of September 30, 2016 and December 31, 2015:

Allowance for Loan Losses and Recorded Investment in Loans
(In thousands)

	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
As of September 30, 2016					
Allowance for loan losses	$26,611	$32,401	$6,379	$ 277	$65,668
Allowance for loans individually evaluated for impairment	3,372	-	-	-	3,372
Allowance for loans collectively evaluated for impairment	$23,239	$32,401	$6,379	$ 277	$62,296
Ending balance of loans	$2,781,143	$2,138,705	$1,240,337		$6,160,185
Ending balance of originated loans individually evaluated for impairment	21,594	8,502	6,088		36,184
Ending balance of acquired loans individually evaluated for impairment	1,205	-	-		1,205
Ending balance of acquired loans collectively evaluated for impairment	252,414	69,173	207,289		528,876
Ending balance of originated loans collectively evaluated for impairment	$2,505,930	$2,061,030	$1,026,960		$5,593,920
As of December 31, 2015					
Allowance for loan losses	$25,545	$29,253	$7,960	$ 260	$63,018
Allowance for loans individually evaluated for impairment	2,005	-	-	-	2,005
Allowance for loans collectively evaluated for impairment	$23,540	$29,253	$7,960	$ 260	$61,013
Ending balance of loans	$2,589,707	$2,096,646	$1,196,780		$5,883,133
Ending balance of originated loans individually evaluated for impairment	12,253	7,693	6,017		25,963
Ending balance of acquired loans individually evaluated for impairment	1,205	-	-		1,205
Ending balance of acquired loans collectively evaluated for impairment	284,524	95,427	230,358		610,309
Ending balance of originated loans collectively evaluated for impairment	$2,291,725	$1,993,526	$960,405		$5,245,656

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Credit Quality of Loans

Loans are placed on nonaccrual status when timely collection of principal and interest in accordance with contractual terms is doubtful. Loans are transferred to nonaccrual status generally when principal or interest payments become 90 days delinquent, unless the loan is well secured and in the process of collection or sooner when management concludes or circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan losses. The Company's nonaccrual policies are the same for all classes of financing receivable.

If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. Nonaccrual loans are returned to accrual status when they become current as to principal and interest and demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. When in the opinion of management the collection of principal appears unlikely, the loan balance is charged-off in total or in part. For loans in all portfolios, the principal amount is charged off in full or in part as soon as management determines, based on available facts, that the collection of principal in full is improbable. For commercial loans, management considers specific facts and circumstances relative to individual credits in making such a determination. For consumer and residential loan classes, management uses specific guidance and thresholds from the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy.

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The following tables set forth information with regard to past due and nonperforming loans by loan class as of September 30, 2016 and December 31, 2015:

Age Analysis of Past Due Financing Receivables
As of September 30, 2016
(In thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Nonaccrual	Current	Recorded Total Loans
ORIGINATED							
Commercial Loans							
Commercial	$ 416	$ 6	$ -	$ 422	$ 3,188	$ 676,143	$ 679,753
Commercial Real Estate	-	152	-	152	13,748	1,301,079	1,314,979
Agricultural	-	-	-	-	1,069	36,236	37,305
Agricultural Real Estate	-	-	-	-	1,686	30,710	32,396
Business Banking	1,622	598	-	2,220	3,969	456,902	463,091
	2,038	756	-	2,794	23,660	2,501,070	2,527,524
Consumer Loans							
Indirect	14,618	3,559	2,412	20,589	1,830	1,523,881	1,546,300
Home Equity	3,420	864	383	4,667	3,083	452,056	459,806
Direct	413	171	38	622	82	62,722	63,426
	18,451	4,594	2,833	25,878	4,995	2,038,659	2,069,532
Residential Real Estate							
Mortgages	2,400	151	489	3,040	6,579	1,023,429	1,033,048
	$ 22,889	$ 5,501	$ 3,322	$ 31,712	$ 35,234	$ 5,563,158	$ 5,630,104
ACQUIRED							
Commercial Loans							
Commercial	$ -	$ -	$ -	$ -	$ -	$ 59,215	$ 59,215
Commercial Real Estate	-	-	834	834	1,898	140,390	143,122
Business Banking	887	64	-	951	403	49,928	51,282
	887	64	834	1,785	2,301	249,533	253,619
Consumer Loans							
Indirect	64	29	6	99	53	12,157	12,309
Home Equity	239	9	34	282	321	53,003	53,606
Direct	11	-	-	11	42	3,205	3,258
	314	38	40	392	416	68,365	69,173
Residential Real Estate							
Mortgages	822	127	248	1,197	2,765	203,327	207,289
	$ 2,023	$ 229	$ 1,122	$ 3,374	$ 5,482	$ 521,225	$ 530,081
Total Loans	$ 24,912	$ 5,730	$ 4,444	$ 35,086	$ 40,716	$ 6,084,383	$ 6,160,185

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Age Analysis of Past Due Financing Receivables
As of December 31, 2015
(In thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Nonaccrual	Current	Recorded Total Loans
ORIGINATED							
Commercial Loans							
Commercial	$ 782	$ 23	$ -	$ 805	$ 2,817	$640,696	$644,318
Commercial Real Estate	39	32	-	71	5,546	1,189,280	1,194,897
Agricultural	94	-	-	94	897	33,633	34,624
Agricultural Real Estate	-	-	-	-	1,046	28,172	29,218
Business Banking	912	394	-	1,306	4,247	395,368	400,921
	1,827	449	-	2,276	14,553	2,287,149	2,303,978
Consumer Loans							
Indirect	15,731	2,963	2,271	20,965	1,786	1,454,499	1,477,250
Home Equity	3,396	1,671	340	5,407	4,835	454,473	464,715
Direct	425	201	28	654	49	58,551	59,254
	19,552	4,835	2,639	27,026	6,670	1,967,523	2,001,219
Residential Real Estate Mortgages	3,301	365	696	4,362	7,713	954,347	966,422
	$ 24,680	$ 5,649	$ 3,335	$ 33,664	$ 28,936	$5,209,019	$5,271,619
ACQUIRED							
Commercial Loans							
Commercial	$ -	$ -	$ -	$ -	$ -	$68,991	$68,991
Commercial Real Estate	-	-	-	-	1,313	165,630	166,943
Business Banking	288	-	-	288	307	49,200	49,795
	288	-	-	288	1,620	283,821	285,729
Consumer Loans							
Indirect	143	11	1	155	104	27,516	27,775
Home Equity	327	132	-	459	457	62,811	63,727
Direct	76	20	-	96	43	3,786	3,925
	546	163	1	710	604	94,113	95,427
Residential Real Estate Mortgages	1,443	293	326	2,062	2,584	225,712	230,358
	$ 2,277	$ 456	$ 327	$ 3,060	$ 4,808	$603,646	$611,514
Total Loans	$ 26,957	$ 6,105	$ 3,662	$ 36,724	$ 33,744	$5,812,665	$5,883,133

There were no material commitments to extend further credit to borrowers with nonperforming loans.

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Impaired Loans

The methodology used to establish the allowance for loan losses on impaired loans incorporates specific allocations on loans analyzed individually. Classified and nonperforming loans with outstanding balances of $0.8 million or more and all troubled debt restructured loans ("TDRs") are evaluated for impairment through the Company's quarterly status review process. In determining that we will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated. For loans that are impaired as defined by accounting standards, impairment is measured by one of three methods: 1) the fair value of collateral less cost to sell, 2) present value of expected future cash flows discounted at the loan's original effective interest rate or 3) the loan's observable market price. All impaired loans are reviewed on a quarterly basis for changes in the level of impairment. Any change to the previously recognized impairment loss is recognized as a change to the allowance account and recorded in the unaudited interim consolidated statements of income as a component of the provision for loan losses.

The following table provides information on loans specifically evaluated for impairment as of September 30, 2016 and December 31, 2015:

	September 30, 2016			December 31, 2015		
(In thousands)	Recorded Investment Balance (Book)	Unpaid Principal Balance (Legal)	Related Allowance	Recorded Investment Balance (Book)	Unpaid Principal Balance (Legal)	Related Allowance
ORIGINATED						
With no related allowance recorded:						
Commercial Loans						
Commercial	$2,174	$2,441		$2,244	$2,490	
Commercial Real Estate	8,469	8,602		3,165	3,175	
Agricultural	133	139		576	1,164	
Agricultural Real Estate	1,457	1,583		618	744	
Business Banking	665	732		983	1,033	
Total Commercial Loans	12,898	13,497		7,586	8,606	
Consumer Loans						
Indirect	7	17		12	21	
Home Equity	8,495	9,463		7,681	8,574	
Direct	-	-		-	-	
Total Consumer Loans	8,502	9,480		7,693	8,595	
Residential Real Estate Mortgages	6,088	6,910		6,017	6,627	
Total	27,488	29,887		21,296	23,828	
With an allowance recorded:						
Commercial Loans						
Commercial	1,014	1,022	$ 555	457	457	$ 300
Commercial Real Estate	7,476	9,324	2,035	4,210	6,059	970
Agricultural	50	50	37	-	-	-
Agricultural Real Estate	156	156	54	-	-	-

Total Commercial Loans	8,696	10,552	2,681	4,667	6,516	1,270
ACQUIRED						
With an allowance recorded:						
Commercial Loans						
Commercial Real Estate	1,205	1,321	691	1,205	1,321	735
Total Commercial Loans	1,205	1,321	691	1,205	1,321	735
Total:	$37,389	$41,760	$ 3,372	$27,168	$31,665	$ 2,005

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The following tables summarize the average recorded investments on impaired loans specifically evaluated for impairment and the interest income recognized for the three and nine months ended September 30, 2016 and 2015:

	For the three months ended			
	September 30, 2016		September 30, 2015	
(In thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
ORIGINATED				
Commercial Loans				
Commercial	$3,204	$ -	$2,469	$ 42
Commercial Real Estate	15,799	48	8,560	42
Agricultural	85	-	19	-
Agricultural Real Estate	935	11	626	11
Business Banking	743	-	1,003	3
Consumer Loans				
Indirect	8	-	20	-
Home Equity	8,401	116	7,432	134
Direct	-	-	-	-
Residential Real Estate Mortgage	6,141	76	5,564	37
Total Originated	$35,316	$ 251	$25,693	$ 269
ACQUIRED				
Commercial Loans				
Commercial	-	-	2,531	-
Commercial Real Estate	1,205	-	6,918	-
Total Acquired	$1,205	$ -	$9,449	$ -
Total Loans	$36,521	$ 251	$35,142	$ 269

	For the nine months ended			
	September 30, 2016		September 30, 2015	
(In thousands)	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
ORIGINATED				
Commercial Loans				
Commercial	$3,041	$ -	$2,026	$ 128
Commercial Real Estate	14,782	122	8,884	124
Agricultural	101	1	19	1
Agricultural Real Estate	742	33	630	34
Business Banking	882	7	952	9
Consumer Loans				
Indirect	9	-	14	-
Home Equity	8,207	357	6,869	298
Direct	-	-	1	-
Residential Real Estate Mortgage	6,147	211	4,857	100
Total Originated	$33,911	$ 731	$24,252	$ 694
ACQUIRED				

Commercial Loans				
Commercial	-	-	2,658	-
Commercial Real Estate	1,205	-	7,070	-
Total Acquired	$1,205	$ -	$9,728	$ -
Total Loans	$35,116	$ 731	$33,980	$ 694

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Credit Quality Indicators

The Company has developed an internal loan grading system to evaluate and quantify the Company's loan portfolio with respect to quality and risk. The system focuses on, among other things, financial strength of borrowers, experience and depth of borrower's management, primary and secondary sources of repayment, payment history, nature of the business and outlook on particular industries. The internal grading system enables the Company to monitor the quality of the entire loan portfolio on a consistent basis and provide management with an early warning system, enabling recognition and response to problem loans and potential problem loans.

Commercial Grading System

For commercial and agricultural loans, the Company uses a grading system that relies on quantifiable and measurable characteristics when available. This would include comparison of financial strength to available industry averages, comparison of transaction factors (loan terms and conditions) to loan policy and comparison of credit history to stated repayment terms and industry averages. Some grading factors are necessarily more subjective such as economic and industry factors, regulatory environment, and management. Classified commercial loans consist of loans graded substandard and below. The grading system for commercial and agricultural loans is as follows:

Doubtful
A doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as a loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Nonaccrual treatment is required for doubtful assets because of the high probability of loss.

Substandard
Substandard loans have a high probability of payment default or they have other well-defined weaknesses. They require more intensive supervision by bank management. Substandard loans are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. For some Substandard loans, the likelihood of full collection of interest and principal may be in doubt and those loans should be placed on nonaccrual. Although Substandard assets in the aggregate will have a distinct potential for loss, an individual asset's loss potential does not have to be distinct for the asset to be rated Substandard.

Special Mention
Special Mention loans have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the Company's position at some future date. These loans pose elevated risk, but their weakness does not yet justify a Substandard classification. Borrowers may be experiencing adverse operating trends (declining revenues or margins) or may be struggling with an ill-proportioned balance sheet (e.g., increasing inventory without an increase in sales, high leverage, tight liquidity). Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a Special Mention rating. Although a Special Mention loan has a higher probability of default than a pass asset, its default is not imminent.

Pass
Loans graded as Pass encompass all loans not graded as Doubtful, Substandard or Special Mention. Pass loans are in compliance with loan covenants and payments are generally made as agreed. Pass loans range from superior quality to fair quality.

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Business Banking Grading System

Business banking loans are graded as either Classified or Non-classified:

Classified

Classified loans are inadequately protected by the current worth and paying capacity of the obligor or, if applicable, the collateral pledged. These loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt, or in some cases make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Classified loans have a high probability of payment default or a high probability of total or substantial loss. These loans require more intensive supervision by management and are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. When the likelihood of full collection of interest and principal may be in doubt; classified loans are considered to have a nonaccrual status. In some cases, Classified loans are considered uncollectible and of such little value that their continuance as assets is not warranted.

Non-classified

Loans graded as Non-classified encompass all loans not graded as Classified. Non-classified loans are in compliance with loan covenants and payments are generally made as agreed and it is expected that such timely payments of principal and interest will continue.

Consumer and Residential Mortgage Grading System

Consumer and Residential Mortgage loans are graded as either Performing or Nonperforming. Nonperforming loans are loans that are 1) over 90 days past due and interest is still accruing, 2) on nonaccrual status or 3) restructured. All loans not meeting any of these three criteria are considered Performing.

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The following tables illustrate the Company’s credit quality by loan class as of September 30, 2016 and December 31, 2015:

Credit Quality Indicators
As of September 30, 2016
(In thousands)

ORIGINATED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Pass	$631,244	$1,262,056	$36,493	$29,254	$1,959,047
Special Mention	9,307	13,110	1	1,480	23,898
Substandard	39,202	39,813	806	1,662	81,483
Doubtful	-	-	5	-	5
Total	$679,753	$1,314,979	$37,305	$32,396	$2,064,433

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$449,947	$449,947
Classified	13,144	13,144
Total	$463,091	$463,091

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$1,542,058	$456,340	$63,306	$2,061,704
Nonperforming	4,242	3,466	120	7,828
Total	$1,546,300	$459,806	$63,426	$2,069,532

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$1,025,980	$1,025,980
Nonperforming	7,068	7,068
Total	$1,033,048	$1,033,048

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Credit Quality Indicators
As of September 30, 2016
(In thousands)

ACQUIRED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Total
Pass	$ 57,040	$ 131,985	$189,025
Special Mention	171	1,248	1,419
Substandard	2,004	9,889	11,893
Total	$ 59,215	$ 143,122	$202,337

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 47,983	$47,983
Classified	3,299	3,299
Total	$ 51,282	$51,282

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 12,250	$ 53,251	$3,216	$68,717
Nonperforming	59	355	42	456
Total	$ 12,309	$ 53,606	$3,258	$69,173

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 204,276	$204,276
Nonperforming	3,013	3,013
Total	$ 207,289	$207,289

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Credit Quality Indicators
As of December 31, 2015
(In thousands)

ORIGINATED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Agricultural	Agricultural Real Estate	Total
Pass	$604,405	$1,144,832	$ 33,565	$ 27,320	$1,810,122
Special Mention	9,726	21,587	311	429	32,053
Substandard	30,187	28,478	740	1,469	60,874
Doubtful	-	-	8	-	8
Total	$644,318	$1,194,897	$ 34,624	$ 29,218	$1,903,057

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$386,397	$386,397
Classified	14,524	14,524
Total	$400,921	$400,921
Total		

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$1,473,193	$459,540	$ 59,177	$1,991,910
Nonperforming	4,057	5,175	77	9,309
Total	$1,477,250	$464,715	$ 59,254	$2,001,219

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$958,013	$958,013
Nonperforming	8,409	8,409
Total	$966,422	$966,422

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Credit Quality Indicators
As of December 31, 2015
(In thousands)

ACQUIRED

Commercial Credit Exposure By Internally Assigned Grade:	Commercial	Commercial Real Estate	Total
Pass	$ 67,241	$ 154,871	$222,112
Special Mention	802	2,174	2,976
Substandard	948	9,898	10,846
Total	$ 68,991	$ 166,943	$235,934

Business Banking Credit Exposure By Internally Assigned Grade:	Business Banking	Total
Non-classified	$ 46,032	$46,032
Classified	3,763	3,763
Total	$ 49,795	$49,795

Consumer Credit Exposure By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	$ 27,670	$ 63,270	$3,882	$94,822
Nonperforming	105	457	43	605
Total	$ 27,775	$ 63,727	$3,925	$95,427

Residential Mortgage Credit Exposure By Payment Activity:	Residential Mortgage	Total
Performing	$ 227,448	$227,448
Nonperforming	2,910	2,910
Total	$ 230,358	$230,358

Troubled Debt Restructured Loans

The Company's loan portfolio includes certain loans that have been modified where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. Substantially all of these modifications included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; temporary reduction in the interest rate; or change in scheduled payment amount.

When the Company modifies a loan, management evaluates any possible impairment based on the present value of the expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If management determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized through an allowance estimate or a charge-off to the allowance.

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The following tables illustrate the recorded investment and number of modifications for modified loans, including the recorded investment in the loans prior to a modification and the recorded investment in the loans after restructuring for the three and nine months ended September 30, 2016 and 2015 (dollars in thousands):

	Three months ended September 30, 2016		
	Number of contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Consumer			
Home Equity	10	$ 580	$ 556
Total Consumer	10	580	556
Residential Real Estate	4	230	126
Total Troubled Debt Restructurings	14	$ 810	$ 682

	Three months ended September 30, 2015		
	Number of contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Consumer			
Home Equity	12	$ 863	$ 802
Total Consumer	12	863	802
Residential Real Estate	16	1,293	1,191
Total Troubled Debt Restructurings	28	$ 2,156	$ 1,993

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	Nine months ended September 30, 2016		
	Number of contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Consumer			
Home Equity	24	$ 1,690	$ 1,567
Total Consumer	24	1,690	1,567
Residential Real Estate	10	914	692
Total Troubled Debt Restructurings	34	$ 2,604	$ 2,259

	Nine months ended September 30, 2015		
	Number of contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Commercial			
Commercial	1	$ 1,250	$ 186
Business Banking	1	220	173
Total Commercial	2	1,470	359
Consumer			
Home Equity	43	3,321	3,017
Total Consumer	43	3,321	3,017
Residential Real Estate	32	3,066	2,854
Total Troubled Debt Restructurings	77	$ 7,857	$ 6,230

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The following table illustrates the recorded investment and number of modifications for TDRs within the three and nine months ended September 30, 2016 and 2015 where a concession has been made and subsequently defaulted during the period (dollars in thousands):

	Three months ended September 30, 2016			Three months ended September 30, 2015		
(Dollars in thousands)	Number of contracts		Recorded Investment	Number of contracts		Recorded Investment
Consumer						
Home Equity	2	$	121	-	$	-
Residential Real Estate	1		121	2		174
Total Troubled Debt Restructurings	3	$	242	2	$	174

	Nine months ended September 30, 2016			Nine months ended September 30, 2015		
	Number of contracts		Recorded Investment	Number of contracts		Recorded Investment
Consumer						
Home Equity	2	$	121	4	$	343
Residential Real Estate	2		296	2		174
Total Troubled Debt Restructurings	4	$	417	6	$	517

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Note 5. Defined Benefit Postretirement Plans

The Company has a qualified, noncontributory, defined benefit pension plan ("the Plan") covering substantially all of its employees at September 30, 2016. Benefits paid from the plan are based on age, years of service, compensation and social security benefits and are determined in accordance with defined formulas. The Company's policy is to fund the pension plan in accordance with Employee Retirement Income Security Act of 1974 ("ERISA") standards. Assets of the plan are invested in publicly traded stocks and bonds. The Company is not required to make contributions to the Plan in 2016. However, the Company made contributions to the plan totaling $5.6 million during the nine months ended September 30, 2016.

Market conditions can result in an unusually high degree of volatility and increase the risks and short-term liquidity associated with certain investments held by the Plan which could impact the value of these investments.

In addition to the Plan, the Company also provides supplemental employee retirement plans to certain current and former executives. These supplemental employee retirement plans and the Plan are collectively referred to herein as "Pension Benefits."

Also, the Company provides certain health care benefits for retired employees. Benefits are accrued over the employees' active service period. Only employees that were employed by the Company on or before January 1, 2000 are eligible to receive postretirement health care benefits. In addition, the Company assumed post-retirement medical life insurance benefits for certain Alliance employees, retirees and their spouses, if applicable, in the Alliance acquisition. These postretirement benefits are referred to herein as "Other Benefits." The components of expense for Pension Benefits and Other Benefits are set forth below (in thousands):

	Pension Benefits Three months ended September 30,		Other Benefits Three months ended September 30,	
Components of net periodic (benefit) cost:	2016	2015	2016	2015
Service cost	$534	$669	$ 3	$ 4
Interest cost	1,050	996	89	101
Expected return on plan assets	(1,857)	(2,147)	-	-
Net amortization	504	550	15	1
Total cost	$231	$68	$ 107	$ 106

	Pension Benefits Nine months ended September 30,		Other Benefits Nine months ended September 30,	
Components of net periodic (benefit) cost:	2016	2015	2016	2015
Service cost	$1,654	$1,979	$ 10	$ 12
Interest cost	3,151	2,992	277	283
Expected return on plan assets	(5,527)	(6,447)	-	-
Net amortization	1,471	1,642	73	31
Total cost	$749	$166	$ 360	$ 326

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Note 6. Earnings Per Share

Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as the Company's dilutive stock options and restricted stock units).

The following is a reconciliation of basic and diluted earnings per share for the periods presented in the unaudited interim consolidated statements of income.

Three months ended September 30,	2016	2015
(In thousands, except per share data)		
Basic EPS:		
Weighted average common shares outstanding	43,200	43,692
Net income	$20,001	$19,851
Basic EPS	$0.46	$0.45
Diluted EPS:		
Weighted average common shares outstanding	43,200	43,692
Dilutive effect of common stock options and restricted stock	362	570
Weighted average common shares and common share equivalents	43,562	44,262
Net income	$20,001	$19,851
Diluted EPS	$0.46	$0.45

Nine months ended September 30,	2016	2015
(In thousands, except per share data)		
Basic EPS:		
Weighted average common shares outstanding	43,214	43,949
Net income	$58,801	$57,298
Basic EPS	$1.36	$1.30
Diluted EPS:		
Weighted average common shares outstanding	43,214	43,949
Dilutive effect of common stock options and restricted stock	366	519
Weighted average common shares and common share equivalents	43,580	44,468
Net income	$58,801	$57,298
Diluted EPS	$1.35	$1.29

There were no stock options for the quarter ended September 30, 2016 and 36,360 stock options for the quarter ended September 30, 2015 that were not considered in the calculation of diluted earnings per share since the stock options' exercise price was greater than the average market price during these periods.

There were 36,865 and 334,759 stock options for the nine months ended September 30, 2016 and September 30, 2015 respectively, that were not considered in the calculation of diluted earnings per share since the stock options' exercise price was greater than the average market price during these periods.

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Note 7. Reclassification Adjustments Out of Other Comprehensive Income (Loss)

The following table summarizes the reclassification adjustments out of accumulated other comprehensive income (loss) (in thousands):

Detail About Accumulated Other Comprehensive Income (Loss) Components	Amount reclassified from accumulated other comprehensive income (loss) Three months ended September 30, 2016	September 30, 2015	Affected line item in the consolidated statement of comprehensive income (loss)
Securities:			
Gains on available for sale securities	$ -	$ (3)	Net securities gains
Amortization of unrealized gains and losses related to securities transfer	267	328	Interest income
Tax benefit	(105)	(127)	Income tax expense
Net of tax	$ 162	$ 198	
Pension and other benefits:			
Amortization of net losses	$ 565	$ 566	Salaries and employee benefits
Amortization of prior service costs	(46)	(15)	Salaries and employee benefits
Tax benefit	(202)	(214)	Income tax expense
Net of tax	$ 317	$ 337	
Total reclassifications during the period, net of tax	$ 479	$ 535	

Detail About Accumulated Other Comprehensive Income (Loss) Components	Amount reclassified from accumulated other comprehensive income (loss) Nine months ended September 30, 2016	September 30, 2015	Affected line item in the consolidated statement of comprehensive income (loss)
Securities:			
Gains on available for sale securities	$ (30)	(43)	Net securities gains
Amortization of unrealized gains and losses related to securities transfer	843	999	Interest income
Tax benefit	(317)	(372)	Income tax expense
Net of tax	$ 496	$ 584	
Pension and other benefits:			
Amortization of net losses	$ 1,595	$ 1,697	Salaries and employee benefits
Amortization of prior service costs	(51)	(24)	Salaries and employee benefits
Tax benefit	(601)	(652)	Income tax expense

Net of tax	$943	$ 1,021
Total reclassifications during the period, net of tax	$1,439	$ 1,605

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Note 8. Fair Value Measurements and Fair Value of Financial Instruments

GAAP states that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value measurements are not adjusted for transaction costs. A fair value hierarchy exists within GAAP that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The types of instruments valued based on quoted market prices in active markets include most U.S. government and agency securities, many other sovereign government obligations, liquid mortgage products, active listed equities and most money market securities. Such instruments are generally classified within Level 1 or Level 2 of the fair value hierarchy. The Company does not adjust the quoted prices for such instruments.

The types of instruments valued based on quoted prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most investment-grade and high-yield corporate bonds, less liquid mortgage products, less liquid agency securities, less liquid listed equities, state, municipal and provincial obligations and certain physical commodities. Such instruments are generally classified within Level 2 of the fair value hierarchy.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate will be used. Management's best estimate consists of both internal and external support on certain Level 3 investments. Subsequent to inception, management only changes Level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt markets and changes in financial ratios or cash flows.

For the nine month period ending September 30, 2016, the Company has made no transfers of assets between Level 1 and Level 2 and has had no Level 3 activity.

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The following tables set forth the Company's financial assets and liabilities measured on a recurring basis that were accounted for at fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands):

September 30, 2016:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2016
Assets:				
Securities Available for Sale:				
Federal Agency	$ -	$ 256,093		