

CHEMUNG FINANCIAL CORP
Form 10-K
March 15, 2007

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

FORM 10-K

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

For the fiscal year ended December 31, 2006

OR

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

For the transition period from _____ to _____

Commission File Number 0-13888

CHEMUNG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

NEW YORK

16-123703-8

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

State or other jurisdiction of
incorporation or organization

One Chemung Canal Plaza, P.O. Box 1522
Elmira, New York

14902

(Zip Code)

(Address of principal executive offices)

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

Securities registered pursuant to Section 12(b) of the Act: None

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

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Common Stock, par value \$0.01 a share

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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

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

Indicated by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Based upon the closing price of the registrant's Common Stock as of June 30, 2006, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$57,799,262.

As of February 28, 2007 there were 3,536,140 shares of Common Stock, \$0.01 par value outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on May 9, 2007 are incorporated by reference into Part III, Items 10, 11, 12, 13, and 14 of this Form 10-K.

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CHEMUNG FINANCIAL CORPORATION

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SIGNATURES

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

PART I

ITEM 1. BUSINESS

General Development of Business

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

The Corporation has been a financial holding company since June 22, 2000. This provides the Corporation with the flexibility to offer an array of financial services, such as insurance products, mutual funds, and brokerage services. The Corporation believes that this allows it to better serve the needs of its clients as well as provide an additional

source of fee based income. To that end, the Corporation established a financial services subsidiary, CFS Group, Inc., which commenced operations during September 2001. As such, the Corporation now operates as a financial holding company with two subsidiaries, Chemung Canal Trust Company, a full-service community bank with full trust powers, and CFS Group, Inc., a subsidiary offering non-traditional financial services such as mutual funds, annuities, brokerage services and insurance.

The Securities and Exchange Commission (the "SEC") maintains a web site at www.sec.gov that contains reports, proxy and information statements, and other information regarding the Corporation. In addition, we maintain a corporate web site at www.chemungcanal.com. We make available free of charge through our web site our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports pursuant to Section 13(a) or 15(d) of the Exchange Act and filed with the SEC. These items are available as soon as reasonably practicable after we electronically file or furnish such material with or to the SEC. The contents of our web site are not a part of this report. These materials are also available free of charge by written request to: Jane H. Adamy, Senior Vice President and Secretary, Chemung Canal Trust Company, One Chemung Canal Plaza, Elmira, NY 14901.

Description of Business

Business

The Bank is a New York State chartered, independent commercial bank, which engages in full-service commercial and consumer banking and trust business. The Bank's services include accepting time, demand and savings deposits, including NOW accounts, regular savings accounts, insured money market accounts, investment certificates, fixed-rate certificates of deposit and club accounts. The Bank's services also include making secured and unsecured commercial and consumer loans, financing commercial transactions (either directly or participating with regional industrial development and community lending corporations), and making commercial, residential and home equity mortgage loans, revolving credit loans with overdraft checking protection, small business loans and student loans. Additional services include renting safe deposit facilities and the provision of networked automated teller facilities.

Trust services provided by the Bank include services as executor and trustee under wills and agreements, and guardian, custodian, trustee and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, pension, estate planning and employee benefit administrative services.

CFS Group, Inc., a wholly-owned subsidiary of the Corporation, commenced operations in September 2001 and offers an array of financial services including mutual funds, full and discount brokerage services, and annuity and other insurance products.

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

There have been no material changes in the manner of doing business by the Corporation or its subsidiaries during the fiscal year ended December 31, 2006.

Market Area and Competition

Seven of the Bank's 16 full-service offices, including the main office, are located in Chemung County, New York. The Bank's other nine full-service offices are located in the adjacent counties of Schuyler, Steuben, Tioga and Tompkins, with a representative office located in Broome County. All of the Bank's facilities are located in New York State. The Corporation defines its market areas as those areas within a 25-mile radius of its offices in Broome, Chemung, Steuben, Schuyler, Tioga and Tompkins counties, including the northern tier of Pennsylvania. The Bank's lending policy restricts substantially all lending efforts to these geographical regions.

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

Competition for the Bank's Trust Department investment services comes primarily from brokerage firms and independent investment advisors. These firms devote much of their considerable resources toward gaining larger positions in these markets. The market value of the Bank's trust assets under administration totaled \$1.5 billion at year-end 2006. The Trust and Investment Division is responsible for the largest component of non-interest revenue.

Supervision and Regulation

The Corporation, as a financial holding company, is regulated under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and is subject to the supervision of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). As a financial holding company, the Corporation generally may engage in the activities of a bank holding company, which include banking, managing or controlling banks, performing certain servicing activities for subsidiaries, and engaging in other activities that the Federal Reserve Board has determined to be closely related to banking and a proper incident thereto. The Corporation may also engage in activities that are financial in nature or incidental to financial activities, or activities that are complementary to a financial activity and that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The Bank is chartered under the laws of New York State and is supervised by the New York State Banking Department ("NYSBD"). The Bank also is a member bank of the Federal Reserve System and, as such, the Federal Reserve Board serves as its primary federal regulator.

CFS Group, Inc. is subject to supervision by other regulatory authorities as determined by the activities in which it is engaged. Insurance activities are supervised by the New York State Insurance Department, and brokerage activities are subject to supervision by the SEC and the National Association of Securities Dealers, Inc. ("NASD").

The Corporation is subject to capital adequacy guidelines of the Federal Reserve Board. The guidelines apply on a

consolidated basis and require bank holding companies to maintain a minimum ratio of Tier 1 capital to total average assets (or "leverage ratio") of 4%. For the most highly rated bank holding companies, the minimum ratio is 3%. The Federal Reserve Board capital adequacy guidelines also require bank holding companies to maintain a minimum ratio of Tier 1 capital to risk-weighted assets of 4% and a minimum ratio of qualifying total capital to risk-weighted assets of 8%. Any bank holding company whose capital does not meet the minimum capital adequacy guidelines is considered to be undercapitalized, and is required to submit an acceptable plan to the Federal Reserve Board for achieving capital adequacy. In addition, an undercapitalized company's ability to pay dividends to its shareholders and expand its lines of business through the acquisition of new banking or non-banking subsidiaries also could be restricted by the Federal Reserve Board. The Federal Reserve Board may set higher minimum capital requirements for bank holding companies whose circumstances warrant it, such as companies anticipating significant growth or

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facing unusual risks. As of December 31, 2006, the Corporation's leverage ratio was 10.80%, its ratio of Tier 1 capital to risk-weighted assets was 15.12% and its ratio of qualifying total capital to risk-weighted assets was 17.11%. The Federal Reserve Board has not advised the Corporation that it is subject to any special capital requirements.

The Bank is subject to leverage and risk-based capital requirements and minimum capital guidelines of the Federal Reserve Board that are similar to those applicable to the Corporation. As of December 31, 2006, the Bank was in compliance with all minimum capital requirements. The Bank's leverage ratio was 10.35%, its ratio of Tier 1 capital to risk-weighted assets was 14.51%, and its ratio of qualifying total capital to risk-weighted assets was 16.50%.

The Bank also is subject to substantial regulatory restrictions on its ability to pay dividends to the Corporation. Under Federal Reserve Board and NYSBD regulations, the Bank may not pay a dividend without prior approval of the Federal Reserve and the NYSBD if the total amount of all dividends declared during such calendar year, including the proposed dividend, exceeds the sum of its retained net income to date during the calendar year and its retained net income over the preceding two calendar years. As of December 31, 2006, approximately \$5.2 million was available for the payment of dividends by the Bank to the Corporation without prior approval, after giving effect to the payment of dividends in the fourth quarter of 2006. The Bank's ability to pay dividends also is subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements.

The deposits of the Bank are insured up to regulatory limits by the Federal Deposit Insurance Corporation ("FDIC"). The Federal Deposit Insurance Reform Act of 2005, which was signed into law on February 8, 2006, gave the FDIC increased flexibility in assessing premiums on banks and savings associations, including the Bank, to pay for deposit insurance and in managing its deposit insurance reserves. The FDIC has adopted regulations to implement its new authority. Under these regulations, all insured depository institutions are placed into one of four risk categories. Approximately 95% of all insured institutions, including the Bank, are in Risk Category I, the most favorable category. Within this category, all insured institutions pay a base rate assessment of 5 basis points on all insured deposits (which rate may be adjusted annually by the FDIC by up to 3 basis points without public comment) and an additional assessment up to 2 basis points based on the risk of loss to the Depository Insurance Fund ("DIF") posed by the particular institution. For institutions such as the Bank, which do not have a long-term public debt rating, the individual risk assessment is based on its supervisory ratings and certain financial ratios and other measurements of its financial condition. For institutions that have a long-term public debt rating, the individual risk assessment is based on its supervisory ratings and its debt rating. The new law became effective on January 1, 2007, and the first premiums, payable quarterly after the end of each quarter, are payable by June 30, 2007. The reform legislation also provided a credit to all insured depository institutions, based on the amount of their insured deposits at year-end 1996, that may be used as an offset to the premiums that are assessed. The Bank estimates that it will receive a credit of approximately \$599 thousand, which will eliminate its 2007 deposit insurance assessment.

The Federal Deposit Insurance Act provides for additional assessments to be imposed on insured depository institutions to pay for the cost of Financing Corporation ("FICO") funding. The FICO assessments are adjusted quarterly to reflect changes in the assessment bases of the FDIC insurance funds and do not vary depending upon a depository institution's capitalization or supervisory evaluation. During 2006, FDIC assessments for purposes of funding FICO bond obligations ranged from an annualized \$0.0132 per \$100 of deposits for the first quarter of 2006 to \$0.0124 per \$100 of deposits for the fourth quarter of 2006. The Bank paid \$69 thousand of FICO assessments in 2006. For the first quarter of 2007, the FICO assessment rate is \$0.0122 per \$100 of deposits.

Transactions between the Bank, and either the Corporation or CFS Group, Inc., are governed by sections 23A and 23B of the Federal Reserve Act and Federal Reserve Board regulations thereunder. Generally, sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by limiting the extent to which a bank or its subsidiaries may engage in covered transactions with any one affiliate and with all affiliates of the bank in the aggregate, and requiring that such transactions be on terms that are consistent with safe and sound banking practices.

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On October 13, 2006, the Financial Services Regulatory Relief Act of 2006 was signed into law. This Act permits a financial holding company, such as the Corporation, to increase cross-marketing between its banking subsidiaries, such as the Bank, and any commercial companies in which it may invest pursuant to its merchant banking authority under the Gramm-Leach-Bliley Act ("GLB Act"). The Act also directs the Federal Reserve Board and the SEC to engage in joint rulemaking to clarify that traditional banking activities involving some elements of securities brokerage activities may be performed by banks without SEC supervision. A proposed rule was issued for public comment on December 18, 2006. Other provisions of this Act increase parity between banks and thrifts with regard to certain powers, accounting practices, and lending limits, and may increase competition between them.

Under the GLB Act, all financial institutions, including the Corporation, the Bank and CFS Group, Inc. are required to establish policies and procedures to restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request and to protect customer data from unauthorized access. In addition, the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act") includes many provisions concerning national credit reporting standards and permits customers, including customers of the Bank, to opt out of information-sharing for marketing purposes among affiliated companies. The FACT Act also requires banks and other financial institutions to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The Federal Reserve Board and the Federal Trade Commission have extensive rule making authority under the FACT Act, and the Corporation and the Bank are subject to these provisions. The Corporation has developed policies and procedures for itself and its subsidiaries to maintain compliance and believes it is in compliance with all privacy, information sharing and notification provisions of the GLB Act and the FACT Act.

Periodic disclosures by companies in various industries of the loss or theft of computer-based nonpublic customer information have led several members of Congress to call for the adoption of national standards for the safeguarding of such information and the disclosure of security breaches. Several committees of both houses of Congress have discussed plans to conduct hearings on data security and related issues.

Under Title III of the USA PATRIOT Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions are required in general to identify their customers,

adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Additional information-sharing among financial Institution, regulators, and law enforcement authorities is encouraged by the presence of an exemption from the privacy provisions of the GLB Act for financial institutions that comply with this provision and the authorization of the Secretary of the Treasury to adopt rules to further encourage cooperation and information-sharing. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank, or the BHC Act, which applies to the Corporation.

Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences for the institution. As of December 31, 2006, the Corporation and the Bank believe they are in compliance with the USA Patriot Act and regulations thereunder.

The Sarbanes-Oxley Act of 2002 implemented a broad range of measures to increase corporate responsibility, enhance penalties for accounting and auditing improprieties at publicly traded companies, and protect investors by improving the accuracy and reliability of corporate disclosures for companies that have securities registered under the Exchange Act, including publicly-held financial holding companies such as the Corporation. It includes very specific additional disclosure requirements and new corporate governance rules, requires the SEC and securities exchanges to adopt extensive additional disclosures, corporate governance and other related rules, and mandates further studies of certain issues by the SEC and the Comptroller General. The Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees. In addition, the federal regulators have adopted generally similar requirements concerning the certification of financial statements by bank officials.

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Home mortgage lenders, including banks, are required under the Home Mortgage Disclosure Act to make available to the public expanded information regarding the pricing of home mortgage loans, including the "rate spread" between the interest rate on loans and certain Treasury securities and other benchmarks. The availability of this information has led to increased scrutiny of higher-priced loans at all financial institutions to detect illegal discriminatory practices and to the initiation of a limited number of investigations by federal banking agencies and the U.S. Department of Justice. The Corporation has no information that it or its affiliates is the subject of any investigation.

Employees

As of December 31, 2006, the Corporation and its subsidiaries employed 293 persons on a full-time equivalent basis. None of the Corporation's employees are covered by collective bargaining agreements, and the Corporation believes that its relationship with its employees is good.

Financial Information About Foreign and Domestic Operations and Export Sales

Neither the Corporation nor its subsidiaries relies on foreign sources of funds or income.

Statistical Disclosure by Bank Holding Companies

The following disclosures present certain summarized statistical data covering the Corporation and its subsidiaries. See also Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7, of this report for other required statistical data.

Investment Portfolio

The following table sets forth the carrying amount of investment securities at the dates indicated (in thousands of dollars):

	December 31,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Obligations of U.S. Government and U.S Government sponsored enterprises	\$ 80,134	\$104,699	\$121,391
Mortgage-backed securities	69,206	87,104	87,260
Obligations of states and political subdivisions	23,950	27,801	28,768
Corporate bonds and notes	9,275	13,026	9,469
Corporate stocks	<u>9,131</u>	<u>8,935</u>	<u>8,636</u>
Total	<u>\$191,696</u>	<u>\$241,565</u>	<u>\$255,524</u>

Included in the above table are \$184,830, \$232,979 and \$243,386 (in thousands of dollars) of securities available for sale at December 31, 2006, 2005 and 2004, respectively. Also included in the above table are \$6,866, \$8,586 and \$12,138 of securities held to maturity at December 31, 2006, 2005 and 2004, respectively.

The following table sets forth the carrying amounts and maturities of debt securities at December 31, 2006 and the weighted average yields of such securities (all yields are calculated on the basis of the amortized cost and weighted for the scheduled maturity of each security, except mortgage-backed securities which are based on the average life at the projected prepayment speed of each security). Federal tax equivalent adjustments have not been made in calculating yields on municipal obligations (in thousands of dollars):

	Maturing
	After One, But Within Five Years
Within One Year	

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	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>
Obligations of U.S. Government and U.S Government sponsored enterprises	\$ 9,906	3.17%	\$ 55,696	4.13%
Mortgage-backed securities	723	5.78%	61,356	4.04%
Obligations of states and political subdivisions	7,437	3.94%	10,341	4.04%
Corporate bonds and notes	<u>6,870</u>	<u>6.11%</u>	-	-
Total	<u>\$ 24,936</u>	<u>4.26%</u>	<u>\$127,393</u>	<u>4.08%</u>

Maturing

	After Five, But Within Ten Years		After Ten Years	
	<u>Amount</u>	<u>Yield</u>	<u>Amount</u>	<u>Yield</u>
Obligations of U.S. Government and U.S Government sponsored enterprises	\$ 14,532	4.59%	\$ -	-
Mortgage-backed securities	7,127	4.18%	-	-
Obligations of states and political subdivisions	5,932	3.70%	240	5.90%
Corporate bonds and notes	<u>2,405</u>	<u>4.77%</u>	-	-
Total	<u>\$ 29,996</u>	<u>4.33%</u>	<u>\$ 240</u>	<u>5.90%</u>

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Loan Portfolio

The following table shows the Corporation's loan distribution at the end of each of the last five years, excluding net deferred origination fees and costs, and unearned income (in thousands of dollars):

	December 31,				
	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Commercial, financial and agricultural	\$193,004	\$182,352	\$163,152	\$175,501	\$197,485

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Residential mortgages	133,286	97,199	88,042	87,503	101,036
Consumer loans	<u>149,586</u>	<u>138,198</u>	<u>130,011</u>	<u>127,531</u>	<u>134,204</u>
Total	<u>\$475,876</u>	<u>\$417,749</u>	<u>\$381,205</u>	<u>\$390,535</u>	<u>\$432,725</u>

The following table shows the maturity of loans (excluding residential mortgages and consumer loans) outstanding as of December 31, 2006. Also provided are the amounts due after one year, classified according to the sensitivity to changes in interest rates (in thousands of dollars):

	<u>Within One Year</u>	<u>After One But Within Five Years</u>	<u>After Five Years</u>	<u>Total</u>
Commercial, financial and agricultural	\$ 60,277	\$ 33,179	\$ 99,548	\$ 193,004
Loans maturing after one year with:				
Fixed interest rates	N/A	\$ 24,922	\$ 7,530	\$ 32,452
Variable interest rates	N/A	<u>8,257</u>	<u>92,018</u>	<u>100,275</u>
Total	N/A	<u>\$ 33,179</u>	<u>\$ 99,548</u>	<u>\$ 132,727</u>

Loan Concentrations

At December 31, 2006, the Corporation had no loan concentrations to borrowers engaged in the same or similar industries that exceed 10% of total loans.

Allocation of the Allowance for Loan Losses

The allocated portions of the allowance reflect management's estimates of specific known risk elements in the respective portfolios. In 2006, management refined the methodology followed in evaluating the allowance for loan losses to include a more detailed analysis of historical loss factors for pools of similarly graded loans, as well as implementing a specific collateral review of relationships graded special mention, substandard or doubtful with outstanding balances of \$1.0 million or greater. Among the factors considered in allocating portions of the allowance by loan type are the current levels of past due, non-accrual and impaired loans, as well as historical loss experience and the evaluation of collateral. The unallocated portion of the allowance represents risk elements and probable losses in the loan portfolio that have not been specifically identified. In addition, management has more formally documented factors considered in determining the appropriate level of unallocated allowance, including current economic conditions, forecasted trends in the credit quality cycle, loan growth, entry into new markets, and industry and peer group trends. The following table summarizes the Corporation's allocation of the loan loss allowance for

each year in the five-year period ended December 31, 2006:

Amount of loan loss allowance (in thousands) and Percent of Loans
by Category to Total Loans (%)

Balance at end of period applicable to:	<u>2006</u>	<u>%</u>	<u>2005</u>	<u>%</u>	<u>2004</u>	<u>%</u>	<u>2003</u>	<u>%</u>	<u>2002</u>
Commercial, financial and agricultural	\$4,122	29.0	\$2,990	33.7	\$1,883	31.7	\$3,198	33.7	\$4,743
Commercial mortgages	2,473	11.4	3,530	10.0	5,206	11.6	4,579	11.2	879
Residential mortgages	214	28.0	342	23.3	321	22.9	322	22.4	295
Consumer loans	<u>574</u>	<u>31.6</u>	<u>846</u>	<u>33.0</u>	<u>908</u>	<u>33.8</u>	<u>951</u>	<u>32.7</u>	<u>1,077</u>
		100.0		100.0		100.0	9,050	100.0	6,994
Unallocated	<u>600</u>	<u>N/A</u>	<u>2,070</u>	<u>N/A</u>	<u>1,665</u>	<u>N/A</u>	<u>798</u>	<u>N/A</u>	<u>680</u>
Total	<u>\$7,983</u>	<u>100.0</u>	<u>\$9,778</u>	<u>100.0</u>	<u>\$9,983</u>	<u>100.0</u>	<u>\$9,848</u>	<u>100.0</u>	<u>\$7,674</u>

The above allocation is neither indicative of the specific loan amounts or the loan categories in which future charge-offs may occur, nor is it an indicator of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

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Deposits

The average daily amounts of deposits and rates paid on such deposits is summarized for the periods indicated in the following table (in thousands of dollars):

Year Ended December 31,

2006

2005

2004

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	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>	<u>Amount</u>	<u>Rate</u>
Non-interest-bearing demand deposits	\$139,626	- %	\$132,618	- %	\$124,521	- %
Interest-bearing demand deposits	38,249	0.46	43,301	0.40	41,959	0.36
Savings and insured money market deposits	165,258	1.57	166,814	0.99	180,934	0.71
Time deposits	<u>225,165</u>	4.12	<u>187,316</u>	2.99	<u>194,395</u>	2.61
	<u>\$568,298</u>		<u>\$530,049</u>		<u>\$541,809</u>	

Scheduled maturities of time deposits at December 31, 2006 are summarized as follows (in thousands of dollars):

2007	\$ 178,876
2008	29,072
2009	9,375
2010	7,042
2011	6,168
Thereafter	<u>80</u>
	\$ 230,613
	=====

Maturities of time deposits in denominations of \$100,000 or more outstanding at December 31, 2006 are summarized as follows (in thousands of dollars):

3 months or less	\$ 32,769
Over 3 through 6 months	3,394
Over 6 through 12 months	12,212
Over 12 months	<u>24,705</u>
	\$ 73,080
	=====

Return on Equity and Assets

The following table shows consolidated operating and capital ratios of the Corporation for each of the last three years:

<u>Year Ended December 31,</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Return on average assets	0.91%	0.92%	1.17%
Return on average equity	8.11%	8.08%	10.79%
Dividend payout ratio	51.94%	52.68%	39.31%
Average equity to average assets ratio	11.25%	11.40%	10.85%
Year-end equity to year-end assets ratio	11.08%	11.31%	11.38%

Short-Term Borrowings

For each of the three years in the period ended December 31, 2006, the average outstanding balance of short-term borrowings did not exceed 30% of shareholders' equity.

Securities Sold Under Agreements to Repurchase and Federal Home Loan Bank ("FHLB") Advances

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

ITEM 1A RISK FACTORS

The Corporation's business is subject to many risks and uncertainties. Although the Corporation seeks ways to manage these risks and develop programs to control those that management can, the Corporation ultimately cannot predict the extent to which these risks and uncertainties could affect results. Actual results may differ materially from management's expectations. Some of the significant risks and uncertainties are discussed below.

Changes in economic conditions or interest rates.

The results of operations for financial institutions, including the Corporation, may be materially and adversely affected by changes in prevailing local and national economic conditions, including declines in real estate market values, rapid increases or decreases in interest rates and changes in the monetary and fiscal policies of the federal government. The Corporation's profitability is heavily influenced by the spread between the interest

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rates earned on investments and loans and the interest rates paid on deposits and other interest-bearing liabilities. Substantially all of the Bank's loans are to businesses and individuals in the southern tier of New York and northern tier of Pennsylvania, and any decline in the economy of this area could adversely affect results. Like most financial

institutions, the Corporation's net interest spread and margin will be affected by general economic conditions and other factors that influence market interest rates and the ability to respond to changes in such rates. At any given time, assets and liabilities may be such that they are affected differently by a given change in interest rates. For additional information, see Part II, Item 7, "Interest Rate Risk."

Credit Risk. A significant source of risk for the Bank arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loan agreements. Loans originated by the Bank can be either secured or unsecured depending on the nature of the loan. With respect to secured loans, the collateral securing the repayment of these loans includes a wide variety of real and personal property that may be insufficient to cover the obligations owed under such loans. Collateral values may be adversely affected by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, wide-spread disease, terrorist activity, environmental contamination and other external events. In addition, collateral appraisals that are out of date or that do not meet industry recognized standards may create the impression that a loan is adequately collateralized when in fact it is not. The Bank has adopted underwriting and credit monitoring procedures and policies, including the establishment and review of the allowance for loan losses and regular review of appraisals and borrower financial statements, that management believes are appropriate to mitigate the risk of loss by assessing the likelihood of nonperformance and the value of available collateral, monitoring loan performance and diversifying the Bank's credit portfolio. Such policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on the Bank's business, financial condition, results of operations or liquidity. For further information regarding asset quality, see Part II, Item 7, "Management of Credit Risk-Loan Portfolio" and "Asset Quality."

Litigation risk.

Neither the Corporation nor its subsidiaries are a party to any material pending legal proceedings. If in the future any legal action is determined adversely to the Corporation, or if any legal action resulted in the Corporation paying a substantial settlement, then such adverse determination or settlement may have a material adverse effect on the Corporation's financial condition.

Difficulties in managing our growth.

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

In addition, the Corporation may acquire banks and related businesses that it believes provide a strategic fit with its business. To the extent that the Corporation grows through acquisitions, it cannot provide assurance that such strategic decisions will be initially accretive to earnings. These are risks commonly associated with strategic acquisitions.

Competition.

The Corporation faces substantial competition in all phases of its operations from a variety of different competitors. Future growth and success will depend on the ability to compete effectively in this highly competitive environment. The Corporation competes for deposits, loans and other financial services with a variety of banks, thrifts, credit unions

and other financial institutions as well as other entities which provide financial services. Some of the financial institutions and financial services organizations with which we compete are not subject to the same degree of regulation as the Corporation. Many competitors have been in business for many years, have established customer bases, are larger, and have substantially higher lending limits. The financial services industry is also likely to become more competitive as further technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties. For further information, see Part II, Item 7, "Competition."

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Government regulation.

The financial services industry is heavily regulated under both federal and state law. These regulations are primarily intended to protect customers, not creditors or shareholders. As a financial holding company, the Corporation is also subject to extensive regulation by the Federal Reserve, in addition to other regulatory organizations. The ability to establish new facilities or make acquisitions is conditioned upon the receipt of the required regulatory approvals from these organizations. Regulations affecting banks and financial services companies undergo continuous change, and the Corporation cannot predict the ultimate effect of such changes, which could have a material adverse effect on profitability or financial condition. For further information, see Part I, Item 1, "Supervision and Regulation."

Technological change and breach of information security.

The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables financial institutions to manage costs. The Corporation's future success will depend, in part, on the ability to address the needs of customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in operations. Many competitors have substantially greater resources to invest in technological improvements. There can be no assurance that the Corporation will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to customers.

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

ITEM 2. PROPERTIES

The Corporation and the Bank currently conduct all their business activities from the Bank's main office in Elmira, NY, 15 full-service locations and one representative office situated in a six-county area, owned office space adjacent to the Bank's main office in Elmira, NY, and twelve off-site automated teller facilities (ATMs), eight of which are located on leased property. The main office is a six-story structure located at One Chemung Canal Plaza, Elmira, New York, in the downtown business district. The main office consists of approximately 59,342 square feet of space, of which 745 square feet is occupied by the Corporation's subsidiary CFS Group, with the remaining 58,597 square feet

entirely occupied by the Bank. The combined square footage of the 15 branch banking facilities totals approximately 72,152 square feet. The office building adjacent to the main office was acquired during 1995 and consists of approximately 33,186 square feet of which 30,766 square feet are occupied by operating departments of the Bank and 2,420 square feet are leased. The leased automated teller facility spaces total approximately 384 square feet.

The Bank operates three of its facilities (Bath, Community Corners & Vestal Offices) and eight automated teller facilities (two Byrne Dairy Food Stores, Convenient Food Mart, Elmira College, Elmira/Corning Regional Airport, General Revenue Corp., Island Health and Fitness, and Wal-Mart Store) under lease arrangements. Additionally, in October 2004, the Bank leased approximately 7,800 square feet of space in the Eastowne Mall, which is located in close proximity to the main office. This is temporary space until renovations in the main office have been completed. The rest of its offices, including the main office and the adjacent office building, are owned. All properties owned or leased by the Bank are considered to be in good condition.

The Corporation holds no real estate in its own name.

ITEM 3. LEGAL PROCEEDINGS

Neither the Corporation nor its subsidiaries are a party to any material pending legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of shareholders during the fourth quarter of 2006.

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PART II

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

The Corporation's stock is traded in the over-the-counter market under the symbol CHMG.OB.

STOCK PERFORMANCE GRAPH

The following graph compares the yearly change in the cumulative total shareholder return on the Corporation's common stock against the cumulative total return of the NASDAQ Stock Market (U.S. Companies), NASDAQ Bank Stocks Index and SNL \$500M - \$1B Bank Index for the period of five years commencing December 31, 2001.

[performgraph2006.gif](#)

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<u>Index as of December 31,</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Chemung Financial Corporation	100.00	95.41	134.35	122.83	119.47	127.80
NASDAQ Composite	100.00	68.76	103.67	113.16	115.57	127.58
NASDAQ Bank	100.00	106.95	142.29	161.73	158.61	180.53
SNL \$500M - \$1B Bank Index	100.00	127.67	184.09	208.62	217.57	247.44

The cumulative total return includes (1) dividends paid and (2) changes in the share price of the Corporation's common stock and assumes that all dividends were reinvested. The above graph assumes that the value of the investment in Chemung Financial Corporation and each index was \$100 on December 31, 2001.

The Total Returns Index for NASDAQ Stock Market (U.S. Companies) and Bank Stocks indices were obtained from SNL Financial LC, Charlottesville, VA.

Below are the quarterly market price ranges for the Corporation's stock for the past two years, based upon actual transactions as reported by securities brokerage firms which maintain a market or conduct trades in the Corporation's stock and other transactions known by the Corporation's management.

Market Prices During Past Two Years (dollars)

	<u>2006</u>	<u>2005</u>
1st Quarter	29.50 - 30.90	31.00 - 34.00
2nd Quarter	29.05 - 31.75	31.50 - 34.00
3rd Quarter	29.40 - 32.00	30.50 - 32.50
4th Quarter	31.00 - 33.75	29.65 - 31.50

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Below are the dividends paid quarterly by the Corporation for each share of the Corporation's common stock over the last three years:

Dividends Paid Per Share During Past Three Years

	<u>2006</u>	<u>2005</u>	<u>2004</u>
January	\$0.24	\$0.24	\$0.23
April	0.24	0.24	0.23
July	0.24	0.24	0.23
October	<u>0.24</u>	<u>0.24</u>	<u>0.23</u>
	\$0.96	\$0.96	\$0.92
	=====	=====	=====

The Bank is also subject to legal limitations on the amount of dividends that can be paid to the Corporation without prior regulatory approval. Dividends are limited to retained net profits, as defined by regulations, for the current year and the two preceding years. At December 31, 2006, approximately \$5.2 million was available for the declaration of dividends from the Bank to the Corporation.

As of February 28, 2007 there were 601 registered holders of record of the Corporation's stock.

The table below sets forth the information with respect to purchases made by the Corporation of our common stock during each quarter of our fiscal year ended December 31, 2006:

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
1/1/06-1/31/06	595	\$30.10	595	99,540
2/1/06-2/29/06	12,891	\$30.11	12,891	86,649
3/1/06-3/31/06	<u>2,650</u>	<u>\$30.21</u>	<u>2,650</u>	83,999
Quarter ended 3/31/06	<u>16,136</u>	<u>\$30.13</u>	<u>16,136</u>	
4/1/06-4/30/06	100	\$29.30	100	83,899
5/1/06-5/31/06	14,628	\$29.52	14,628	69,261
6/1/06-6/30/06	<u>7,284</u>	<u>\$29.48</u>	<u>7,284</u>	61,987
Quarter ended 6/30/06	<u>22,012</u>	<u>\$29.51</u>	<u>22,012</u>	
7/1/06-7/31/06	3,275	\$29.35	3,275	58,712
8/1/06-8/31/06	6,750	\$30.09	6,750	51,962
9/1/06-9/30/06	<u>770</u>	<u>\$30.05</u>	<u>770</u>	51,192
Quarter ended 9/30/06	<u>10,795</u>	<u>\$29.86</u>	<u>10,795</u>	

10/1/06-10/31/06	12,753	\$32.70	12,753	38,439
11/1/06-11/30/06 (1)	5,075	\$33.00	5,075	174,925
12/1/06-12/31/06	<u>6,725</u>	<u>\$33.14</u>	<u>6,725</u>	<u>168,200</u>
Quarter ended 12/31/06	<u>24,553</u>	<u>\$32.88</u>	<u>24,553</u>	<u>168,200</u>
Period ended 12/31/06	<u>73,496</u> =====	<u>\$30.82</u> =====	<u>73,496</u> =====	<u>168,200</u> =====

(1)

On November 16, 2006, the Corporation announced that its Board of Directors had authorized the repurchase of up to 180,000 shares, or approximately 5% of the Corporation's then outstanding common stock over a two-year period, expiring November 15, 2008. This program replaced the share repurchase program that had been approved on November 17, 2004 and expired in November 2006. Purchases will be made from time to time on the open-market or in private negotiated transactions, and will be at the discretion of management. Of the above 73,496 total shares repurchased by the Corporation, 20,500 shares were repurchased through open-market transactions and the remaining 52,996 shares were repurchased in direct transactions.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected financial data as of and for the years ended December 31, 2002, 2003, 2004, 2005 and 2006. The selected financial data is derived from our audited consolidated financial statements appearing elsewhere in this report.

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The selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes thereto appearing elsewhere in this report.

SUMMARIZED BALANCE
SHEET DATA AT
DECEMBER 31,

2006 2005 2004 2003 2002

(in thousands)

Total assets \$738,170 \$718,039 \$722,544 \$747,209 \$751,171

Loans, net of deferred fees and

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costs, and unearned income	477,664	418,685	381,508	390,353	432,294
Investment Securities	191,696	241,566	255,525	290,537	258,787
Federal Home Loan Bank and Federal Reserve Bank stock	3,605	5,356	5,944	5,468	6,202
Deposits	585,092	524,937	519,560	551,051	541,765
Securities sold under agreements to repurchase	35,024	60,856	88,505	79,035	78,661
Federal Home Loan Bank Advances	27,900	40,800	25,000	25,000	40,750
Shareholders' equity	81,761	81,178	82,196	79,993	79,427

SUMMARIZED EARNINGS
DATA FOR THE YEARS
ENDED DECEMBER 31,

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
(in thousands)					
Net interest income	\$24,546	\$24,737	\$25,257	\$25,864	\$27,069
Provision for loan losses	125	1,300	1,500	4,700	3,283
Net interest income after provision for loan losses	24,421	23,437	23,757	21,164	23,786
Other operating income:					
Trust and investment services income	4,901	5,095	4,725	4,501	4,513
Securities gains (losses), net	27	6	602	1,185	(459)
Net gains on sales of loans held for sale	103	107	983	245	9
Other income	9,281	7,806	7,958	7,415	6,318
Total other operating income	14,312	13,014	14,268	13,346	10,381
Other operating expenses	29,523	27,315	25,481	25,020	25,405
Income before income tax expense	9,210	9,136	12,544	9,490	8,762

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Income tax expense	2,621	2,546	3,811	2,537	2,222
Net income	<u>\$ 6,589</u>	<u>\$ 6,590</u>	<u>\$ 8,733</u>	<u>\$ 6,953</u>	<u>\$ 6,540</u>

SELECTED PER SHARE DATA ON SHARES OF COMMON STOCK AT OR FOR THE YEARS ENDED DECEMBER 31,	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>%</u>	<u>Compounded</u>
							<u>Change</u>	<u>Annual</u>
							<u>2005</u>	<u>Growth 5</u>
							<u>To</u>	<u>Years</u>
							<u>2006</u>	
Net income per share	\$1.81	\$1.79	\$2.32	\$1.82	\$1.66	\$ 2.10	1.1%	-2.9%
Dividends declared	0.96	0.96	0.93	0.92	0.92	0.90	0.0%	1.3%
Tangible book value	21.99	21.35	21.14					