

CHEMUNG FINANCIAL CORP
Form 10-Q
May 02, 2018

UNITED STATES
SECURITIES AND
EXCHANGE COMMISSION
WASHINGTON D.C. 20549

FORM 10-Q

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

For Quarterly period ended March 31, 2018
Or

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

Commission File No.

000-13888

CHEMUNG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York

16-1237038

(State or other jurisdiction of
incorporation or organization)

I.R.S. Employer Identification No.

One Chemung Canal Plaza,
Elmira, NY

14901

(Address of principal executive
offices)

(Zip Code)

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

(Registrant's telephone number, including area code)

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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: X NO: _____

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

YES: X NO: _____

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

Large

~~accelerated~~ accelerated filer []

filer

Accelerated
 Smaller reporting company []

filer

Emerging growth company []

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

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

YES: NO: X

The number of shares of the registrant's common stock, \$.01 par value, outstanding on May 1, 2018 was 4,764,874.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

INDEX

	PAGES
<u>Glossary of Abbreviations and Terms</u>	<u>3</u>
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1: Financial Statements – Unaudited</u>	
<u>Consolidated Balance Sheets</u>	<u>6</u>
<u>Consolidated Statements of Income</u>	<u>7</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>8</u>
<u>Consolidated Statements of Shareholders’ Equity</u>	<u>9</u>
<u>Consolidated Statements of Cash Flows</u>	<u>10</u>
<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>12</u>
<u>Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>38</u>
<u>Item 3: Quantitative and Qualitative Disclosures About Market Risk</u>	<u>62</u>
<u>Item 4: Controls and Procedures</u>	<u>64</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1: Legal Proceedings</u>	<u>65</u>
<u>Item 1A: Risk Factors</u>	<u>65</u>
<u>Item 2: Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>65</u>
<u>Item 3: Defaults Upon Senior Securities</u>	<u>65</u>
<u>Item 4: Mine Safety Disclosures</u>	<u>65</u>
<u>Item 5: Other Information</u>	<u>65</u>
<u>Item 6: Exhibits</u>	<u>66</u>
<u>SIGNATURES</u>	<u>67</u>
<u>EXHIBIT INDEX</u>	

GLOSSARY OF ABBREVIATIONS AND TERMS

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

Abbreviations

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

Terms

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

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

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

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

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in thousands, except share and per share data)	March 31, 2018	December 31, 2017
ASSETS		
Cash and due from financial institutions	\$25,473	\$ 27,966
Interest-bearing deposits in other financial institutions	5,531	2,763
Total cash and cash equivalents	31,004	30,729
Equity investments, at estimated fair value	2,154	2,337
Securities available for sale, at estimated fair value	278,984	293,091
Securities held to maturity, estimated fair value of \$3,627 at March 31, 2018 and \$3,776 at December 31, 2017	3,640	3,781
FHLBNY and FRBNY Stock, at cost	3,097	5,784
Loans, net of deferred loan fees	1,319,911	1,311,824
Allowance for loan losses	(21,390)	(21,161)
Loans, net	1,298,521	1,290,663
Loans held for sale	190	542
Premises and equipment, net	26,136	26,657
Goodwill	21,824	21,824
Other intangible assets, net	1,891	2,085
Bank-owned life insurance	2,998	2,982
Accrued interest receivable and other assets	29,515	27,145
Total assets	\$ 1,699,954	\$ 1,707,620
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits:		
Non-interest-bearing	\$460,271	\$ 467,610
Interest-bearing	1,057,929	999,836
Total deposits	1,518,200	1,467,446
FHLBNY overnight advances	—	57,700
Securities sold under agreements to repurchase	10,000	10,000
FHLBNY term advances	—	2,000
Long term capital lease obligation	4,464	4,517
Dividends payable	1,238	1,232
Accrued interest payable and other liabilities	15,790	14,912
Total liabilities	1,549,692	1,557,807
Shareholders' equity:		
Common stock, \$0.01 par value per share, 10,000,000 shares authorized; 5,310,076 issued at March 31, 2018 and December 31, 2017	53	53
Additional paid-in capital	46,404	45,967
Retained earnings	131,694	128,453

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Treasury stock, at cost; 548,647 shares at March 31, 2018 and 559,054 shares at December 31, 2017	(14,053)	(14,320)
Accumulated other comprehensive loss	(13,836)	(10,340)
Total shareholders' equity	150,262		149,813	
Total liabilities and shareholders' equity	\$1,699,954		\$1,707,620	

See accompanying notes to unaudited consolidated financial statements.

6

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

(in thousands, except per share data)	Three Months Ended March 31,	
	2018	2017
Interest and dividend income:		
Loans, including fees	\$ 14,050	\$ 12,499
Taxable securities	1,289	1,422
Tax exempt securities	308	238
Interest-bearing deposits	22	155
Total interest and dividend income	15,669	14,314
Interest expense:		
Deposits	501	538
Securities sold under agreements to repurchase	93	193
Borrowed funds	175	89
Total interest expense	769	820
Net interest income	14,900	13,494
Provision for loan losses	709	1,040
Net interest income after provision for loan losses	14,191	12,454
Non-interest income:		
WMG fee income	2,316	2,109
Service charges on deposit accounts	1,164	1,184
Interchange revenue from debit card transactions	1,035	920
Net gains on sales of loans held for sale	46	69
Net gains on sales of other real estate owned	44	17
Income from bank-owned life insurance	16	17
Other	854	531
Total non-interest income	5,475	4,847
Non-interest expenses:		
Salaries and wages	5,714	5,275
Pension and other employee benefits	1,658	1,551
Other components of net periodic pension and postretirement benefits	(408)	(333)
Net occupancy expenses	1,608	1,606
Furniture and equipment expenses	658	682
Data processing expense	1,742	1,604
Professional services	540	300
Amortization of intangible assets	194	226
Marketing and advertising expenses	349	249
Other real estate owned expenses	138	19
FDIC insurance	317	325
Loan expense	169	116
Other	1,487	1,425
Total non-interest expenses	14,166	13,045
Income before income tax expense	5,500	4,256
Income tax expense	1,061	1,277

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Net income	\$4,439	\$2,979
Weighted average shares outstanding	4,822	4,790
Basic and diluted earnings per share	\$0.92	\$0.62

See accompanying notes to unaudited consolidated financial statements.

7

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

(in thousands)	Three Months Ended	
	March 31, 2018	2017
Net income	\$4,439	\$2,979
Other comprehensive income (loss):		
Unrealized holding gains (losses) on securities available for sale	(4,439)	3,166
Tax effect	(1,132)	1,189
Net of tax amount	(3,307)	1,977
Change in funded status of defined benefit pension plan and other benefit plans:		
Reclassification adjustment for amortization of prior service costs	(55)	(55)
Reclassification adjustment for amortization of net actuarial loss	73	88
Total before tax effect	18	33
Tax effect	5	12
Net of tax amount	13	21
Total other comprehensive income (loss)	(3,294)	1,998
Comprehensive income	\$1,145	\$4,977

See accompanying notes to unaudited consolidated financial statements.

8

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

(in thousands, except share and per share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total
Balances at January 1, 2017	\$ 53	\$ 45,603	\$ 124,111	\$(15,265)	\$ (10,754)	\$ 143,748
Net income	—	—	2,979	—	—	2,979
Other comprehensive income	—	—	—	—	1,998	1,998
Restricted stock awards	—	52	—	—	—	52
Restricted stock units for directors' deferred compensation plan	—	24	—	—	—	24
Cash dividends declared (\$0.26 per share)	—	—	(1,230)	—	—	(1,230)
Distribution of 7,880 shares of treasury stock for directors' compensation	—	68	—	201	—	269
Distribution of 5,861 shares of treasury stock for employee compensation	—	50	—	150	—	200
Sale of 6,101 shares of treasury stock (a)	—	61	—	156	—	217
Forfeiture of 1,139 shares of restricted stock awards	—	43	—	(43)	—	—
Balances at March 31, 2017	\$ 53	\$ 45,901	\$ 125,860	\$(14,801)	\$ (8,756)	\$ 148,257
Balances at December 31, 2017, as reported	\$ 53	\$ 45,967	\$ 128,453	\$(14,320)	\$ (10,340)	\$ 149,813
Cumulative effect of accounting change (b)	—	—	40	—	(202)	(162)
Balances at January 1, 2018, as adjusted	53	45,967	128,493	(14,320)	(10,542)	149,651
Net income	—	—	4,439	—	—	4,439
Other comprehensive loss	—	—	—	—	(3,294)	(3,294)
Restricted stock awards	—	163	—	—	—	163
Restricted stock units for directors' deferred compensation plan	—	25	—	—	—	25
Cash dividends declared (\$0.26 per share)	—	—	(1,238)	—	—	(1,238)
Distribution of 6,015 shares of treasury stock for directors' compensation	—	147	—	154	—	301
Distribution of 1,784 shares of treasury stock for employee compensation	—	44	—	45	—	89
Sale of 2,648 shares of treasury stock (a)	—	58	—	68	—	126
Balances at March 31, 2018	\$ 53	\$ 46,404	\$ 131,694	\$(14,053)	\$ (13,836)	\$ 150,262

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

(b) Due to implementation of ASC 2016-01. See "Adoption of New Accounting Standards" discussion in Note 1.

See accompanying notes to unaudited consolidated financial statements.

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

(in thousands)	Three Months Ended March 31,	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$4,439	\$2,979
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of intangible assets	194	226
Provision for loan losses	709	1,040
Net losses on disposal of fixed assets	7	—
Depreciation and amortization of fixed assets	889	960
Amortization of premiums on securities, net	305	357
Gains on sales of loans held for sale, net	(46)	(69)
Proceeds from sales of loans held for sale	3,611	3,634
Loans originated and held for sale	(3,213)	(3,173)
Net gains on equity investments	(6)	(32)
Net gains on sales of other real estate owned	(44)	(17)
Purchase of equity investments	(28)	(20)
Expense related to restricted stock units for directors' deferred compensation plan	25	24
Expense related to employee stock compensation	89	200
Expense related to employee restricted stock awards	163	52
Income from bank-owned life insurance	(16)	(17)
(Increase) decrease in other assets and accrued interest receivable	(2,478)	2,290
Decrease in accrued interest payable	(29)	(38)
Increase (decrease) in other liabilities	2,409	(1,892)
Net cash provided by operating activities	6,980	6,504
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and calls of securities available for sale	285	—
Proceeds from maturities and principal collected on securities available for sale	9,078	9,289
Proceeds from maturities and principal collected on securities held to maturity	261	1,164
Purchases of securities available for sale	—	(5,659)
Purchases of securities held to maturity	(120)	(180)
Purchase of FHLB NY and FRB NY stock	(6,437)	(6)
Redemption of FHLB NY and FRB NY stock	9,124	450
Purchases of premises and equipment	(375)	(243)
Proceeds from sales of other real estate owned	157	101
Net increase in loans	(8,572)	(34,327)
Net cash (used in) provided by investing activities	3,401	(29,411)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net increase in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts	52,670	91,400
Net decrease in time deposits	(1,916)	(3,492)
Net decrease in securities sold under agreements to repurchase	—	(12,391)
Net decrease in FHLB NY overnight advances, net	(57,700)	—
Repayments of FHLB NY long term advances	(2,000)	(28)

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Payments made on capital leases	(53)	(51)
Sale of treasury stock	126	217
Cash dividends paid	(1,233)	(1,225)
Net cash (used in) provided by financing activities	(10,106)	74,430
Net increase in cash and cash equivalents	275	51,523
Cash and cash equivalents, beginning of period	30,729	74,162
Cash and cash equivalents, end of period	\$31,004	\$125,685

(continued)

See accompanying notes to unaudited consolidated financial statements.

10

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

(in thousands)	Three Months Ended March 31,	
	2018	2017
Supplemental disclosure of cash flow information:		
Cash paid (received) for:		
Interest	\$798	\$858
Income taxes	\$(175)	\$—
Supplemental disclosure of non-cash activity:		
Transfer of loans to other real estate owned	\$5	\$33
Dividends declared, not yet paid	\$1,238	\$1,230
Distribution of treasury stock for directors' compensation	\$301	\$269

See accompanying notes to unaudited consolidated financial statements.

11

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

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

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

Basis of Presentation

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

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. In the opinion of management, all adjustments (consisting of normal recurring adjustments) and disclosures necessary for the fair presentation of the accompanying consolidated financial statements have been included. The unconsolidated financial statements should be read in conjunction with the Corporation's 2017 Annual Report on Form 10-K for the year ended December 31, 2017. The results of operations for any interim periods are not necessarily indicative of the results which may be expected for the entire year.

Reclassifications

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or shareholders' equity.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). ASU 2016-02 requires companies that lease valuable assets to recognize on their balance sheets the assets and liabilities generated by contracts longer than a year. The amendments in this update are effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2018, though early adoption is permitted. The Corporation intends to adopt the new lease guidance as of January 1, 2019 and is currently evaluating the impact that adoption of these updates will have on

its consolidated financial statements. Currently, the Corporation believes the implementation of this ASU will create a right of use asset of less than \$10.0 million for the Corporation's 15 leased facilities and a related capital obligation of the same amount as of January 1, 2019.

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

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

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

Adoption of New Accounting Standards

On December 31, 2017, the Corporation elected for early adoption of ASU 2018-02, Income Statement - Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("ASC 220"). The objective of ASC 220 was to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act passed in December 2017. Adoption of ASC 220 eliminated the stranded tax effects within accumulated other comprehensive income resulting from the revaluation of the net deferred tax asset. Results for the three and twelve months ended December 31, 2017 were presented in accordance with ASC 220, with a reclassification of \$1.8 million from accumulated other comprehensive income to retained earnings. The adoption of ASC 220 did not result in any adjustments during the first quarter of 2018 and the Corporation does not expect any adjustments going forward.

On January 1, 2018, the Corporation adopted ASU 2014-09 Revenue from Contracts with Customers and all subsequent amendments to the ASU (collectively, "ASC 606"), which (1) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (2) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as other real estate owned. The majority of the Corporation's

revenues come from interest income and other sources, including loans, leases, securities, and derivatives, that are outside the scope of ASC 606. The Corporation's services that fall within the scope of ASC 606 are presented within Non-interest income and are recognized as revenue as the Corporation satisfies its obligation to the customer. Services within the scope of ASC 606 include deposit service charges on deposits, interchange income, wealth management fees, investment brokerage fees, and the sale of other real estate owned. Refer to Note 10 Revenue from Contracts with Customers for further discussion on the Corporation's accounting policies for revenue sources within the scope of ASC 606.

The Corporation adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606, while prior period amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; as such, no cumulative effect adjustment was recorded.

On January 1, 2018, the Corporation adopted ASU 2016-01, an amendment to Recognition and Measurement of Financial Assets and Financial Liabilities ("ASC 825"). The objectives of the ASC 825 were (1) require equity investments to be measured at fair value, with changes in fair value recognized in net income, (2) simplify the impairment assessment of equity investments without readily determinable fair values, (3) eliminate the requirement to disclose methods and significant assumptions used to estimate fair value for financial instruments measured at amortized cost on the balance sheet, (4) require the use of the exit price notion when measuring the fair value of financial instruments, and (5) clarify the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

The Corporation adopted ASC 825 using the modified retrospective method applied to equity investments as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 825, with comparable consolidated balance sheets also reported. The adjustments to opening retained earnings and accumulated other comprehensive loss related to the adoption of ASC 825 and are immaterial to the financial statements.

On January 1, 2018, the Corporation adopted ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments ("ASC 230"). The objective of ASC 230 was to reduce the existing diversity in practice relating to eight specific cash flow issues: (1) debt prepayment or debt extinguishment costs, (2) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing, (3) contingent consideration payments made after a business combination, (4) proceeds from the settlement of insurance claims, (5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, (6) distributions received from equity method investees, (7) beneficial interests in securitization transactions, and (8) separately identifiable cash flows and application of the predominance principal. Results for reporting periods beginning after January 1, 2018 are presented under ASC 230, while prior periods amounts continue to be reported in accordance with legacy GAAP. The adoption of ASC 230 did not result in a change to how the Corporation accounts for its cash flows.

On January 1, 2018, the Corporation adopted ASU 2017-07, Compensation - Retirement Benefits - Improving the Presentation of Net Periodic Cost and Net Periodic Postretirement Benefit Cost ("ASC 715"). The objective of ASC 715 was to improve guidance related to the presentation of defined benefit costs in the income statement. Specifically, ASC 715 required that an employer report the service cost component in the same line item(s) as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. Additionally, ASC 715 allows only the service cost component to be eligible for capitalization, when applicable. Results for reporting periods beginning after January 1, 2018 are presented under ASC 715, while prior period amounts continue to be reported in accordance with legacy GAAP, with comparable periods presented retrospectively for the presentation of the service cost and net periodic postretirement benefit cost in the income statement. The Corporation elected the practical expedient, which permits employers to use the amounts disclosed in its pension and other postretirement benefit plan note for the prior comparative periods as the estimation for applying retrospective presentation requirements.

NOTE 2 EARNING PER COMMON SHARE (shares in thousands)

Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities and are considered outstanding at grant date. Earnings per share information is adjusted to present comparative results for

stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,822 and 4,790 weighted average shares outstanding for the three-month periods ended March 31, 2018 and 2017, respectively. There were no common stock equivalents during the three-month periods ended March 31, 2018 or 2017.

NOTE 3 SECURITIES

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

	March 31, 2018			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$15,490	\$ 15	\$ 54	\$15,451
Mortgage-backed securities, residential	216,489	87	8,757	207,819
Obligations of states and political subdivisions	52,177	44	604	51,617
Corporate bonds and notes	249	—	—	249
SBA loan pools	3,874	1	27	3,848
Total	\$288,279	\$ 147	\$ 9,442	\$278,984

	December 31, 2017			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$15,492	\$ 20	\$ 21	\$15,491
Mortgage-backed securities, residential	224,939	136	5,166	219,909
Obligations of states and political subdivisions	52,928	355	151	53,132
Corporate bonds and notes	249	2	—	251
SBA loan pools	4,339	1	32	4,308
Total	\$297,947	\$ 514	\$ 5,370	\$293,091

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

	March 31, 2018			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of states and political subdivisions	\$1,805	\$ —	\$ —	\$ 1,805
Time deposits with other financial institutions	1,835	—	13	1,822
Total	\$3,640	\$ —	\$ 13	\$ 3,627

	December 31, 2017			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Obligations of states and political subdivisions	\$1,946	\$ —	\$ —	\$ 1,946
Time deposits with other financial institutions	1,835	—	5	1,830
Total	\$3,781	\$ —	\$ 5	\$ 3,776

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The amortized cost and estimated fair value of debt securities are shown below by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately (in thousands):

	March 31, 2018			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Within one year	\$18,365	\$18,350	\$900	\$899
After one, but within five years	19,992	19,911	2,507	2,495
After five, but within ten years	28,720	28,245	233	233
After ten years	839	811	—	—
	67,916	67,317	3,640	3,627
Mortgage-backed securities, residential	216,489	207,819	—	—
SBA loan pools	3,874	3,848	—	—
Total	\$288,279	\$278,984	\$3,640	\$3,627

There were no proceeds from sales and calls of securities resulting in gains or losses for the three months ended March 31, 2018 and 2017.

The following tables summarize the investment securities available for sale with unrealized losses at March 31, 2018 and December 31, 2017 by aggregated major security type and length of time in a continuous unrealized loss position (in thousands):

March 31, 2018	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$14,947	\$ 54	\$—	\$ —	\$14,947	\$ 54
Mortgage-backed securities, residential	73,034	2,093	132,122	6,664	205,156	8,757
Obligations of states and political subdivisions	42,728	574	260	30	42,988	604
SBA loan pools	1,833	25	1,756	2	3,589	27
Total temporarily impaired securities	\$132,542	\$ 2,746	\$134,138	\$ 6,696	\$266,680	\$ 9,442

December 31, 2017	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$14,982	\$ 21	\$—	\$ —	\$14,982	\$ 21
Mortgage-backed securities, residential	83,562	1,013	131,165	4,153	214,727	5,166
Obligations of states and political subdivisions	20,526	133	271	18	20,797	151
SBA loan pools	3,937	32	—	—	3,937	32
Total temporarily impaired securities	\$123,007	\$ 1,199	\$131,436	\$ 4,171	\$254,443	\$ 5,370

Other-Than-Temporary Impairment

As of March 31, 2018, the majority of the Corporation's unrealized losses in the investment securities portfolio related to mortgage-backed securities. At March 31, 2018, all of the unrealized losses related to mortgage-backed securities were issued by U.S. government sponsored entities, Fannie Mae and Freddie Mac. Because the decline in fair value is

attributable to changes in interest rates and not credit quality, and because it is not likely that the Corporation will be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at March 31, 2018.

NOTE 4 LOANS AND ALLOWANCE FOR LOAN LOSSES

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

	March 31, 2018	December 31, 2017
Commercial and agricultural:		
Commercial and industrial	\$ 199,947	\$ 198,463
Agricultural	529	544
Commercial mortgages:		
Construction	55,404	45,558
Commercial mortgages, other	592,195	598,772
Residential mortgages	194,600	194,440
Consumer loans:		
Credit cards	1,418	1,517
Home equity lines and loans	100,611	100,591
Indirect consumer loans	156,958	153,060
Direct consumer loans	18,249	18,879
Total loans, net of deferred origination fees and costs	\$ 1,319,911	\$ 1,311,824
Interest receivable on loans	3,618	3,758
Total recorded investment in loans	\$ 1,323,529	\$ 1,315,582

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

The following tables present the activity in the allowance for loan losses by portfolio segment for the three-month periods ended March 31, 2018 and 2017 (in thousands):

Allowance for loan losses	Three Months Ended March 31, 2018				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Beginning balance	\$ 6,976	\$ 8,514	\$ 1,316	\$ 4,355	\$ 21,161
Charge-offs	(19)	—	(94)	(458)	(571)
Recoveries	9	1	5	76	91
Net recoveries (charge-offs)	(10)	1	(89)	(382)	(480)
Provision	37	125	180	367	709
Ending balance	\$ 7,003	\$ 8,640	\$ 1,407	\$ 4,340	\$ 21,390
Allowance for loan losses	Three Months Ended March 31, 2017				Total
	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	
Beginning balance	\$ 1,589	\$ 7,270	\$ 1,523	\$ 3,871	\$ 14,253
Charge-offs	(5)	—	(12)	(427)	(444)
Recoveries	24	1	17	69	111
Net recoveries (charge-offs)	19	1	5	(358)	(333)
Provision	42	478	(16)	536	1,040
Ending balance	\$ 1,650	\$ 7,749	\$ 1,512	\$ 4,049	\$ 14,960

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018				
Allowance for loan losses:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$4,910	\$ 771	\$ —	\$ —	\$5,681
Collectively evaluated for impairment	2,093	7,869	1,407	4,340	15,709
Total ending allowance balance	\$7,003	\$ 8,640	\$ 1,407	\$ 4,340	\$21,390

	December 31, 2017				
Allowance for loan losses:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Ending allowance balance attributable to loans:					
Individually evaluated for impairment	\$5,135	\$ 802	\$ —	\$ —	\$5,937
Collectively evaluated for impairment	1,841	7,683	1,316	4,355	15,195
Loans acquired with deteriorated credit quality	—	29	—	—	29
Total ending allowance balance	\$6,976	\$ 8,514	\$ 1,316	\$ 4,355	\$21,161

	March 31, 2018				
Loans:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	\$5,795	\$ 7,359	\$ 425	\$ 61	\$13,640
Loans collectively evaluated for impairment	195,242	642,054	194,671	277,922	1,309,889
Total ending loans balance	\$201,037	\$ 649,413	\$ 195,096	\$ 277,983	\$1,323,529

	December 31, 2017				
Loans:	Commercial and Agricultural	Commercial Mortgages	Residential Mortgages	Consumer Loans	Total
Loans individually evaluated for impairment	\$6,133	\$ 7,302	\$ 427	\$ 64	\$13,926
Loans collectively evaluated for impairment	193,443	638,080	194,510	274,831	1,300,864
Loans acquired with deteriorated credit quality	—	792	—	—	792
Total ending loans balance	\$199,576	\$ 646,174	\$ 194,937	\$ 274,895	\$1,315,582

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The following table presents loans individually evaluated for impairment recognized by class of loans as of March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018			December 31, 2017		
	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated
With no related allowance recorded:						
Commercial and agricultural:						
Commercial and industrial	\$ 770	\$ 773	\$ —	\$ 861	\$ 867	\$ —
Commercial mortgages:						
Construction	351	352	—	364	365	—
Commercial mortgages, other	4,210	4,212	—	4,135	4,138	—
Residential mortgages	447	425	—	450	427	—
Consumer loans:						
Home equity lines and loans	61	61	—	64	64	—
With an allowance recorded:						
Commercial and agricultural:						
Commercial and industrial	5,019	5,022	4,910	5,231	5,266	5,135
Commercial mortgages:						
Commercial mortgages, other	2,984	2,795	771	2,989	2,799	802
Total	\$ 13,842	\$ 13,640	\$ 5,681	\$ 14,094	\$ 13,926	\$ 5,937

The following table presents the average recorded investment and interest income of loans individually evaluated for impairment recognized by class of loans as of the three-month periods ended March 31, 2018 and 2017 (in thousands):

	Three Months Ended March 31, 2018		Three Months Ended March 31, 2017	
	Average Recorded Investment	Interest Income Recognized (1)	Average Recorded Investment	Interest Income Recognized (1)
With no related allowance recorded:				
Commercial and agricultural:				
Commercial and industrial	\$ 820	\$ 9	\$ 671	\$ 9
Commercial mortgages:				
Construction	359	3	919	3
Commercial mortgages, other	4,175	5	7,000	59
Residential mortgages	426	2	393	2
Consumer loans:				
Home equity lines & loans	63	1	84	1
With an allowance recorded:				
Commercial and agricultural:				
Commercial and industrial	5,144	—	—	—
Commercial mortgages:				
Commercial mortgages, other	2,797	1	3,257	1
Consumer loans:				
Home equity lines and loans	—	—	360	—
Total	\$ 13,784	\$ 21	\$ 12,684	\$ 75

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

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The following table present the recorded investment in non-accrual and loans past due 90 days or more and still accruing by class of loans as of March 31, 2018 and December 31, 2017 (in thousands):

	Non-accrual		Loans Past Due 90 Days or More and Still Accruing	
	March 31, 2018	December 31, 2017	March 31, 2018	December 31, 2017
	Commercial and agricultural:			
Commercial and industrial	\$5,164	\$ 5,250	\$ 2	\$ 5
Commercial mortgages:				
Construction	130	135	—	—
Commercial mortgages, other	6,597	6,520	—	—
Residential mortgages	3,155	3,160	—	—
Consumer loans:				
Credit cards	—	—	26	24
Home equity lines and loans	1,302	1,310	—	—
Indirect consumer loans	886	935	—	—
Direct consumer loans	46	14	—	—
Total	\$17,280	\$ 17,324	\$ 28	\$ 29

The following tables present the aging of the recorded investment in loans as of March 31, 2018 and December 31, 2017 (in thousands):

	March 31, 2018				Loans Acquired with Deteriorated Credit Quality	Loans Not Past Due	Total
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due			
Commercial and agricultural:							
Commercial and industrial	\$ 1,397	\$ —	\$ 3,642	\$ 5,039	\$ —	\$ 195,468	\$ 200,507
Agricultural	—	—	—	—	—	530	530
Commercial mortgages:							
Construction	—	—	—	—	—	55,560	55,560
Commercial mortgages, other	442	—	928	1,370	—	592,483	593,853
Residential mortgages	1,719	308	1,263	3,290	—	191,806	195,096
Consumer loans:							
Credit cards	3	9	26	38	—	1,380	1,418
Home equity lines and loans	283	231	856	1,370	—	99,532	100,902
Indirect consumer loans	1,332	216	489	2,037	—	155,303	157,340
Direct consumer loans	38	4	35	77	—	18,246	18,323
Total	\$5,214	\$ 768	\$ 7,239	\$ 13,221	\$ —	\$ 1,310,308	\$ 1,323,529

	December 31, 2017			Total Past Due	Loans Acquired with Deteriorated Credit Quality	Loans Not Past Due	Total
	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due				
Commercial and agricultural:							
Commercial and industrial	\$ 1,689	\$ 999	\$ 20	\$ 2,708	\$ —	\$ 196,322	\$ 199,030
Agricultural	—	—	—	—	—	546	546
Commercial mortgages:							
Construction	—	—	—	—	—	45,688	45,688
Commercial mortgages, other	2,399	115	748	3,262	792	596,432	600,486
Residential mortgages	1,399	939	1,474	3,812	—	191,125	194,937
Consumer loans:							
Credit cards	17	9	24	50	—	1,466	1,516
Home equity lines and loans	265	31	983	1,279	—	99,599	100,878
Indirect consumer loans	1,822	484	581	2,887	—	150,645	153,532
Direct consumer loans	48	28	2	78	—	18,891	18,969
Total	\$ 7,639	\$ 2,605	\$ 3,832	\$ 14,076	\$ 792	\$ 1,300,714	\$ 1,315,582

Troubled Debt Restructurings:

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

As of March 31, 2018 and December 31, 2017, the Corporation has a recorded investment in TDRs of \$7.3 million and \$7.7 million, respectively. There were specific reserves of \$0.5 million and \$0.7 million allocated for TDRs at March 31, 2018 and December 31, 2017, respectively. As of March 31, 2018, TDRs totaling \$1.5 million were accruing interest under the modified terms and \$5.8 million were on non-accrual status. As of December 31, 2017, TDRs totaling \$1.7 million were accruing interest under the modified terms and \$6.0 million were on non-accrual status. The Corporation had committed no additional amounts as of both March 31, 2018 and December 31, 2017, to customers with outstanding loans that are classified as TDRs.

During the three-month periods ended March 31, 2018 and 2017, the terms of certain loans were modified as TDRs. The modification of the terms of one commercial & industrial term loan during the three months ended March 31, 2018 included an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk. The modification of the terms of one commercial mortgage loan during the three months ended March 31, 2017 included a reduction of the scheduled amortized payments of the loan for greater than a three month period.

The following table presents loans by class modified as TDRs that occurred during the three month periods ended March 31, 2018 and 2017 (dollars in thousands):

March 31, 2018	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial and agricultural:			
Commercial and industrial	1	\$ 100	\$ 100
Total	1	\$ 100	\$ 100

March 31, 2017	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled debt restructurings:			
Commercial mortgages:			
Commercial mortgages	1	\$ 166	\$ 166
Total	1	\$ 166	\$ 166

The TDRs described above did not increase the allowance for loan losses and resulted in no charge-offs during the three month periods ended March 31, 2018 and 2017.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. There were no payment defaults on any loans previously modified as TDRs within twelve months following the modification during the three month periods ended March 31, 2018 and 2017.

Credit Quality Indicators

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

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

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

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

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

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

Commercial loans not meeting the criteria above to be considered criticized or classified are considered to be pass rated loans. Loans listed as not rated are included in groups of homogeneous loans performing under terms of the loan notes. Based on the analyses performed as of March 31, 2018 and December 31, 2017, the risk category of the recorded investment of loans by class of loans is as follows (in thousands):

March 31, 2018

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loans acquired with deteriorated credit quality	Total
Commercial and agricultural:							
Commercial and industrial	\$—	\$183,869	\$8,719	\$2,911	\$5,008	\$—	—\$200,507
Agricultural	—	530	—	—	—	—	530
Commercial mortgages:							
Construction	—	55,430	—	130	—	—	55,560
Commercial mortgages	—	567,624	11,570	13,307	1,352	—	593,853
Residential mortgages	191,941	—	—	3,155	—	—	195,096
Consumer loans:							
Credit cards	1,418	—	—	—	—	—	1,418
Home equity lines and loans	99,600	—	—	1,302	—	—	100,902
Indirect consumer loans	156,454	—	—	886	—	—	157,340
Direct consumer loans	18,277	—	—	46	—	—	18,323
Total	\$467,690	\$807,453	\$20,289	\$21,737	\$6,360	\$—	—\$1,323,529

December 31, 2017

	Not Rated	Pass	Special Mention	Substandard	Doubtful	Loans acquired with deteriorated credit quality	Total
Commercial and agricultural:							
Commercial and industrial	\$—	\$186,556	\$4,447	\$6,605	\$1,422	\$—	\$199,030
Agricultural	—	546	—	—	—	—	546
Commercial mortgages:							
Construction	—	45,553	—	135	—	—	45,688
Commercial mortgages	—	575,321	9,665	13,331	1,377	792	600,486
Residential mortgages	191,777	—	—	3,160	—	—	194,937
Consumer loans:							
Credit cards	1,516	—	—	—	—	—	1,516
Home equity lines and loans	99,568	—	—	1,310	—	—	100,878
Indirect consumer loans	152,598	—	—	934	—	—	153,532
Direct consumer loans	18,955	—	—	14	—	—	18,969
Total	\$464,414	\$807,976	\$14,112	\$25,489	\$2,799	\$792	\$1,315,582

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of March 31, 2018 and December 31, 2017 (in thousands):

March 31, 2018					
Consumer Loans					
	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	\$191,941	\$1,418	\$99,600	\$156,454	\$18,277
Non-Performing	3,155	—	1,302	886	46
	\$195,096	\$1,418	\$100,902	\$157,340	\$18,323
December 31, 2017					
Consumer Loans					
	Residential Mortgages	Credit Card	Home Equity Lines and Loans	Indirect Consumer Loans	Other Direct Consumer Loans
Performing	\$191,777	\$1,516	\$99,568	\$152,598	\$18,955
Non-Performing	3,160	—	1,310	934	14
	\$194,937	\$1,516	\$100,878	\$153,532	\$18,969

At the time of the merger with Fort Orange Financial Corp., the Corporation identified certain loans with evidence of deteriorated credit quality, and the probability that the Corporation would be unable to collect all contractually required payments from the borrower. These loans were classified as PCI loans. The Corporation previously adjusted its estimates of future expected losses, cash flows, and renewal assumptions on the PCI loans. These adjustments were made for changes in expected cash flows due to loans refinanced beyond original maturity dates, impairments recognized subsequent to the acquisition, advances made for taxes or insurance to protect collateral held and payments received in excess of amounts originally expected. During the first quarter of 2018, management determined that the disclosure of PCI loans was no longer material and will analyze these loans as part of the overall impairment process going forward.

NOTE 5 FAIR VALUE

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

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

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

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

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

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

Equity Investments: Securities that are held to fund a deferred compensation plan and securities that have a readily determinable fair market value, are recorded at fair value with changes in fair value included in earnings. The fair values of equity investments are determined by quoted market prices (Level 1 inputs).

Impaired Loans: At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value have been partially charged-off or receive specific allocations as part of the allowance for loan loss accounting. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, typically resulting in a Level 3 fair value

classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

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

Appraisals for both collateral-dependent impaired loans and OREO are performed by certified general appraisers (commercial properties) or certified residential appraisers (residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Once received, appraisals are reviewed for reasonableness of assumptions, approaches utilized, Uniform Standards of Professional Appraisal Practice and other regulatory compliance, as well as the overall resulting fair value

in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals are generally completed within the previous 12 month period prior to a property being placed into OREO. On impaired loans, appraisal values are adjusted based on the age of the appraisal, the position of the lien, the type of the property and its condition.

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

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

Financial Assets:	Fair Value	Fair Value Measurement at March 31, 2018 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$ 15,451	\$—	\$ 15,451	\$ —
Mortgage-backed securities, residential	207,819	—	207,819	—
Obligations of states and political subdivisions	51,617	—	51,617	—
Corporate bonds and notes	249	—	249	—
SBA loan pools	3,848	—	3,848	—
Total available for sale securities	\$278,984	\$—	\$ 278,984	\$ —
Equity investments	\$ 1,225	\$ 1,225	\$ —	\$ —
Derivative assets	1,820	—	1,820	—
Financial Liabilities:				
Derivative liabilities	\$ 1,870	\$—	\$ 1,820	\$ 50

There were no transfers between Level 1 and Level 2 during the three-month period ended March 31, 2018.

Financial Assets:	Fair Value	Fair Value Measurement at December 31, 2017 Using Quoted Prices in Active Markets for Identical Assets (Level 1)		
		Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Obligations of U.S. Government and U.S. Government sponsored enterprises	\$15,491	\$—	\$15,491	\$—
Mortgage-backed securities, residential	219,909	—	219,909	—
Obligations of states and political subdivisions	53,132	—	53,132	—
Corporate bonds and notes	251	—	251	—
SBA loan pools	4,308	—	4,308	—
Total available for sale securities	\$293,091	\$—	\$293,091	\$—
Equity investments	\$1,192	\$1,192	\$—	\$—
Derivative assets	974	—	974	—
Financial Liabilities:				
Derivative liabilities	\$1,049	\$—	\$974	\$75

There were no transfers between Level 1 and Level 2 during the twelve month period ended December 31, 2017.

The table below presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three-month periods ended March 31, 2018 and March 31, 2017 (in thousands):

	Assets (Liabilities)		
	Corporate Bonds and Notes	Derivative Liabilities	
	March 31, 2017	March 31, 2018	March 31, 2017
Balance of recurring Level 3 assets at January 1	\$—	250	250
Total gains or losses for the period:			
Included in earnings - other non-interest income	—	25	3
Included in other comprehensive income	—	1	—
Balance of recurring Level 3 assets at March 31,	\$—	251	250

The following table presents information related to Level 3 recurring fair value measurements at March 31, 2018 and December 31, 2017 (in thousands):

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Description	Fair Value at March 31, 2018	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at March 31, 2018
Derivative liabilities	\$ 50	Historical trend	Credit default rate	5.52% - 5.52% [5.52%]

Description	Fair Value at December 31, 2017	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at December 31, 2017
Derivative liabilities	\$ 75	Historical trend	Credit default rate	5.67% - 5.67% [5.67%]

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

Financial Assets:	Fair Value	Fair Value Measurement at March 31, 2018 Using			Total Gains (Losses)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Impaired Loans:					
Commercial and agricultural:					
Commercial and industrial	\$12	\$—	—\$ 12	\$ —	
Commercial mortgages:					
Commercial mortgages	338	—	338	(59)	
Total impaired loans	\$350	\$—	—\$ 350	\$ (59)	
Other real estate owned:					
Commercial mortgages:					
Commercial mortgages	\$1,474	\$—	—\$ 1,474	\$ —	
Residential mortgages	283	—	283	—	
Consumer loans:					
Home equity lines and loans	75	—	75	—	
Total other real estate owned, net	\$1,832	\$—	—\$ 1,832	\$ —	

Financial Assets:	Fair Value	Fair Value Measurement at December 31, 2017 Using			Total Gains (Losses)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Impaired Loans:					
Commercial and agricultural:					
Commercial and industrial	\$96	\$—	—\$ 96	\$ (70)	
Commercial mortgages:					
Commercial mortgages	411	—	411	(105)	
Total impaired loans	\$507	\$—	—\$ 507	\$ (175)	
Other real estate owned:					
Commercial mortgages:					
Commercial mortgages	\$1,483	\$—	—\$ 1,483	\$ (43)	

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Residential mortgages	382	—	382	—
Consumer loans:				
Home equity lines and loans	75	—	75	—
Total other real estate owned, net	\$1,940	\$	— \$ 1,940	\$ (43)

28

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The following tables presents information related to Level 3 non-recurring fair value measurement at March 31, 2018 and December 31, 2017 (in thousands):

Description	Fair Value at March 31, 2018	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at March 31, 2018
Impaired loans:				
Commercial and agricultural:				
Commercial and industrial	\$ 12	Sales comparison	Discount to appraised value	0.00% - 0.00% [0.00%]
Commercial mortgages:				
Commercial mortgages	338	Sales comparison	Discount to appraised value	21.98% - 69.81% [55.51%]
	\$ 350			
OREO:				
Commercial mortgages:				
Commercial mortgages	\$ 1,474	Sales comparison	Discount to appraised value	10.00% - 22.95% [19.79%]
Residential mortgages	283	Sales comparison	Discount to appraised value	17.28% - 39.78% [20.39%]
Consumer loans:				
Home equity lines and loans	75	Sales comparison	Discount to appraised value	20.80% - 20.80% [20.80%]
	\$ 1,832			
Description	Fair Value at December 31, 2017	Valuation Technique	Unobservable Inputs	Range [Weighted Average] at December 31, 2017
Impaired loans:				
Commercial and agricultural:				
Commercial and industrial	\$ 96	Sales comparison	Discount to appraised value	0.00% - 36.07% [33.02%]
Commercial mortgages:				
Commercial mortgages	411	Sales comparison	Discount to appraised value	10.00% - 89.98% [51.35%]
	\$ 507			
OREO:				
Commercial mortgages:				
Commercial mortgages	\$ 1,483	Sales comparison	Discount to appraised value	10.00% - 22.95% [19.75%]
Residential mortgages	382	Sales comparison	Discount to appraised value	17.28% - 27.97% [20.77%]
Consumer loans:				
Home equity lines and loans	75	Sales comparison	Discount to appraised value	20.80% - 20.80% [20.80%]
	\$ 1,940			

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of other financial instruments, at March 31, 2018 and December 31, 2017, are as follows (in thousands):

Financial assets:	March 31, 2018				
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Estimated Fair Value (1)
Cash and due from financial institutions	\$25,473	\$25,473	\$	—\$	—\$25,473
Interest-bearing deposits in other financial institutions	5,531	5,531	—	—	5,531
Equity investments	1,225	1,225	—	—	1,225
Securities available for sale	278,984	—	278,984	—	278,984
Securities held to maturity	3,640	—	1,822	1,085	2,907
FHLBNY and FRBNY stock	3,097	—	—	—	N/A
Loans, net and loans held for sale	1,298,711	—	—	1,272,169	1,272,169
Accrued interest receivable	4,624	—	1,006	3,618	4,624
Derivative assets	1,820	—	1,820	—	1,820
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	\$1,401,753	\$1,401,753	\$	—\$	—\$1,401,753
Time deposits	116,447	—	116,677	—	116,677
Securities sold under agreements to repurchase	10,000	—	10,019	—	10,019
Accrued interest payable	119	24	95	—	119
Derivative liabilities	1,870	—	1,820	50	1,870

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

Financial assets:	December 31, 2017				
	Carrying Amount	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Estimated Fair Value (1)
Cash and due from financial institutions	\$27,966	\$27,966	\$	—\$	—\$27,966
Interest-bearing deposits in other financial institutions	2,763	2,763	—	—	2,763
Equity investments	1,192	1,192	—	—	1,192
Securities available for sale	293,091	—	293,091	—	293,091
Securities held to maturity	3,781	—	1,830	1,946	3,776
FHLB NY and FRB NY stock	5,784	—	—	—	N/A
Loans, net	1,291,205	—	—	1,289,584	1,289,584
Loans held for sale	542	—	542	—	542
Accrued interest receivable	4,642	1	867	3,774	4,642
Derivative assets	974	—	974	—	974
Financial liabilities:					
Deposits:					
Demand, savings, and insured money market accounts	\$1,349,084	\$1,349,084	\$	—\$	—\$1,349,084
Time deposits	118,362	—	118,598	—	118,598
Securities sold under agreements to repurchase	10,000	—	10,058	—	10,058
FHLB NY overnight advances	57,700	—	57,700	—	57,700
FHLB NY term advances	2,000	—	2,001	—	2,001
Accrued interest payable	148	24	124	—	148
Derivative liabilities	1,049	—	974	75	1,049

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

NOTE 6 GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill included in the core banking segment during the periods ended March 31, 2018 and 2017 were as follows (in thousands):

	2018	2017
Beginning of year	\$21,824	\$21,824
Acquired goodwill	—	—
Ending balance March 31,	\$21,824	\$21,824

Acquired intangible assets were as follows at March 31, 2018 and December 31, 2017 (in thousands):

At March 31, 2018		At December 31, 2017	
Balance	Accumulated	Balance	Accumulated
Acquired	Amortization	Acquired	Amortization

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Core deposit intangibles	\$5,975	\$ 5,301	\$5,975	\$ 5,196
Other customer relationship intangibles	5,633	4,416	5,633	4,327
Total	\$11,608	\$ 9,717	\$11,608	\$ 9,523

Aggregate amortization expense was \$0.2 million for both of the three month periods ended March 31, 2018 and 2017.

The remaining estimated aggregate amortization expense at March 31, 2018 is listed below (in thousands):

Year	Estimated Expense
2018	\$ 540
2019	609
2020	484
2021	258
2022	—
Total	\$ 1,891

NOTE 7 SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

A summary of securities sold under agreements to repurchase as of March 31, 2018 and December 31, 2017 is as follows (in thousands):

	March 31, 2018			
	Overnight and Up to 1 Year Continuous	1 - 3 Years	3+ Years	Total
Mortgage-backed securities, residential	\$-\$12,000	\$ —	—	-\$12,000
Excess collateral held	—(2,000)	—	—	(2,000)
Gross amount of recognized liabilities for repurchase agreements	\$-\$10,000	\$ —	—	-\$10,000

	December 31, 2017			
	Overnight and Up to 1 Year Continuous	1 - 3 Years	3+ Years	Total
Mortgage-backed securities, residential	\$-\$11,798	\$ —	—	-\$11,798
Excess collateral held	—(1,798)	—	—	(1,798)
Gross amount of recognized liabilities for repurchase agreements	\$-\$10,000	\$ —	—	-\$10,000

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

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

NOTE 8 COMMITMENTS AND CONTINGENCIES

The Corporation is a party to certain financial instruments with off-balance sheet risk such as commitments under standby letters of credit, unused portions of lines of credit, overdraft protection and commitments to fund new loans. In accordance with GAAP, these financial instruments are not recorded in the financial statements. The Corporation's

policy is to record such instruments when funded. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are generally used by the Corporation to manage clients' requests for funding and other client needs.

The following table lists the contractual amounts of financial instruments with off-balance sheet risk at March 31, 2018 and December 31, 2017 (in thousands):

March 31, 2018	December 31, 2017
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