ARROW FINANCIAL CORP
Form 10-K
March 14, 2017

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, 2016
Commission File Number: 0-12507
ARROW FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

New York	22-2448962
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

250 GLEN STREET, GLENS FALLS, NEW YORK 12801
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (518) 745-1000
SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: NONE
SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
Common Stock, Par Value $1.00
(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 x 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 x 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. x Yes

No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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). x Yes No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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.
x
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes x No
State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $393,513,749
Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Class	Outstanding as of February 28, 2017
Common Stock, par value $1.00 per share	13,510,698

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held May 3, 2017 (Part III)

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*These items are incorporated by reference to the Corporation’s Proxy Statement for the Annual Meeting of Stockholders to be held May 3, 2017.

NOTE ON TERMINOLOGY

In this Annual Report on Form 10-K, the terms “Arrow,” “the registrant,” “the company,” “we,” “us,” and “our” generally refe Arrow Financial Corporation and subsidiaries as a group, except where the context indicates otherwise. At certain points in this Report, our performance is compared with that of our “peer group” of financial institutions. Unless otherwise specifically stated, this peer group is comprised of the group of 325 domestic (U.S.-based) bank holding companies with $1 to $3 billion in total consolidated assets as identified in the Federal Reserve Board’s most recent “Bank Holding Company Performance Report” (which is the Performance Report for the most recently available period ending September 30, 2016), and peer group data has been derived from such Report. This peer group is not, however, identical to either of the peer groups comprising the two bank indices included in the stock performance graphs on pages 19 and 20 of this Report.

THE COMPANY AND ITS SUBSIDIARIES

Arrow is a two-bank holding company headquartered in Glens Falls, New York. Our banking subsidiaries are Glens Falls National Bank and Trust Company (Glens Falls National) whose main office is located in Glens Falls, New York, and Saratoga National Bank and Trust Company (Saratoga National) whose main office is located in Saratoga Springs, New York. Active subsidiaries of Glens Falls National include Capital Financial Group, Inc. (an insurance agency specializing in selling and servicing group health care policies and life insurance), Upstate Agency, LLC (a property and casualty insurance agency), Glens Falls National Insurance Agencies, LLC (a property and casualty insurance agency - currently doing business under the name of McPhillips Insurance Agency), North Country Investment Advisers, Inc. (a registered investment adviser that provides investment advice to our proprietary mutual funds) and Arrow Properties, Inc. (a real estate investment trust, or REIT). Our holding company also owns directly two subsidiary business trusts, organized in 2003 and 2004 to issue trust preferred securities (TRUPs), which are still outstanding.

FORWARD-LOOKING STATEMENTS

The information contained in this Annual Report on Form 10-K contains statements that are not historical in nature but rather are based on our beliefs, assumptions, expectations, estimates and projections about the future. These statements are “forward-looking statements” within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and involve a degree of uncertainty and attendant risk. Words such as “expects,” “believes,” “anticipates,” “estimates” and variations of such words and similar expressions often identify such forward-looking statements. Some of these statements, such as those included in the interest rate sensitivity analysis in Item 7A of this Report, entitled “Quantitative and Qualitative Disclosures About Market Risk,” are merely presentations of what future performance or changes in future performance would look like based on hypothetical assumptions and on simulation models. Other forward-looking statements are based on our general perceptions of market conditions and trends in activity, both locally and nationally, as well as current management strategies for future operations and development.

Forward-looking statements in this Report include the following:

Topic	Section	Page	Location
Dividend Capacity	Part I, Item 1.C.	8	First paragraph under "Dividend Restrictions; Other Regulatory Sanctions"
	Part II, Item 7.E.	48	First paragraph under "Dividends"
Impact of Legislative Developments	Part I, Item 1.D.	10	Last paragraph in Section D
	Part II, Item 7.A.	11	Paragraph in "Health Care Reform"
Visa Stock		28	Paragraph under "Visa Class B Common Stock"

	Part II, Item 7.A.		
Impact of Changing Interest Rates on Earnings	Part II, Item 7.C.II.a.	41	Last paragraph under "Automobile Loans"
	Part II, Item 7.C.II.a.	40	Last two paragraphs
	Part II, Item 7A.	52	Last four paragraphs
Adequacy of the Allowance for Loan Losses	Part II, Item 7.B.II.	33	First paragraph under "II. Provision For Loan Losses and Allowance For Loan Losses"
Noninterest Income	Part II, Item 7.C.III	34	Paragraphs four and five under "2016 Compared to 2015"
Expected Level of Real Estate Loans	Part II, Item 7.C.II.a.	40	Paragraphs under "Residential Real Estate Loans"
Expected Level of Commercial Loans	Part II, Item 7.C.II.a.	41	Paragraphs under "Commercial, Commercial Real Estate and Construction and Land Development Loans"
Expected Level of Nonperforming Assets	Part II, Item 7.C.II.c.	43	Last two paragraphs under "Potential Problem Loans"
Liquidity	Part II, Item 7.D.	47	Last two paragraphs under "Liquidity"
Commitments to Extend Credit	Part II, Item 8	81	Last two paragraphs in Note 8
Pension plan return on assets	Part II, Item 8	96	Second to last paragraph in Note 13
Realization of recognized net deferred tax assets	Part II, Item 8	97	Second to last paragraph in Note 15

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These forward-looking statements may not be exhaustive, are not guarantees of future performance and involve certain risks and uncertainties that are difficult to quantify or, in some cases, to identify. You should not place undue reliance on any such forward-looking statements. In the case of all forward-looking statements, actual outcomes and results may differ materially from what the statements predict or forecast. Factors that could cause or contribute to such differences include, but are not limited to:

a. rapid and dramatic changes in economic and market conditions, such as the U.S. economy experienced during the financial crisis of 2008-2010;
b. sharp fluctuations in interest rates, economic activity, or consumer spending patterns;
c. sudden changes in the market for products we provide, such as real estate loans;
d. significant changes in banking or other laws and regulations, including both enactment of new legal or regulatory measures (e.g., the Dodd-Frank Act) or the modification or elimination of pre-existing measures
e. significant changes in U.S. monetary or fiscal policy, including new or revised monetary programs or targets adopted or announced by the Federal Reserve ("monetary tightening or easing") or significant new federal legislation materially affecting the federal budget ("fiscal tightening or expansion");
f. enhanced competition from unforeseen sources (e.g., so-called Fintech enterprises); and
g. similar uncertainties inherent in banking operations or business generally, including technological developments and changes.

We are under no duty to update any of the forward-looking statements after the date of this Annual Report on Form 10-K to conform such statements to actual results. All forward-looking statements, express or implied, included in this report and the documents we incorporate by reference and that are attributable to the Company are expressly qualified in their entirety by this cautionary statement. This cautionary statement should also be considered in connection with any subsequent written or oral forward-looking statements that the Company or any persons acting on our behalf may issue.

USE OF NON-GAAP FINANCIAL MEASURES

The Securities and Exchange Commission (SEC) has adopted Regulation G, which applies to all public disclosures, including earnings releases, made by registered companies that contain “non-GAAP financial measures.” GAAP is generally accepted accounting principles in the United States of America. Under Regulation G, companies making public disclosures containing non-GAAP financial measures must also disclose, along with each non-GAAP financial measure, certain additional information, including a reconciliation of the non-GAAP financial measure to the closest comparable GAAP financial measure and a statement of the Company’s reasons for utilizing the non-GAAP financial measure as part of its financial disclosures. The SEC has exempted from the definition of “non-GAAP financial measures” certain commonly used financial measures that are not based on GAAP. When these exempted measures are included in public disclosures, supplemental information is not required. The following measures used in this Report, which are commonly utilized by financial institutions, have not been specifically exempted by the SEC and may constitute "non-GAAP financial measures" within the meaning of the SEC's new rules, although we are unable to state with certainty that the SEC would so regard them.

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

The Efficiency Ratio: Financial institutions often use an "efficiency ratio" as a measure of expense control. The efficiency ratio typically is defined as the ratio of noninterest expense to net interest income and noninterest income. Net interest income as utilized in calculating the efficiency ratio is typically the same as the net interest income presented in Selected Financial Information table discussed in the preceding paragraph, i.e., it is expressed on a tax-equivalent basis. Moreover, many financial institutions, in calculating the efficiency ratio, also adjust both noninterest expense and noninterest income to exclude from these items (as calculated under GAAP) certain recurring component elements of income and expense, such as intangible asset amortization (which is included in noninterest expense under GAAP but may not be included therein for purposes of calculating the efficiency ratio) and securities gains or losses (which are reflected in the calculation of noninterest income under GAAP but may be ignored for purposes of calculating the efficiency ratio). We make these adjustments.

Tangible Book Value per Share: Tangible equity is total stockholders' equity less intangible assets. Tangible book value per share is tangible equity divided by total shares issued and outstanding. Tangible book value per share is often regarded as a more meaningful comparative ratio than book value per share as calculated under GAAP, that is, total stockholders' equity including intangible assets divided by total shares issued and outstanding. Intangible assets includes many items, but in our case, essentially represents goodwill.

Adjustments for Certain Items of Income or Expense: In addition to our regular utilization in our public filings and disclosures of the various non-GAAP measures commonly utilized by financial institutions discussed above, we also may elect from time to time, in connection with our presentation of various financial measures prepared in accordance with GAAP, such as net income, earnings per share (i.e. EPS), return on average assets (i.e. ROA), and return on average equity (i.e. ROE), to provide as well certain comparative disclosures that adjust these GAAP financial measures, typically by removing therefrom the impact of certain transactions or other material items of income or expense that are unusual or unlikely to be repeated. We do so only if we believe that inclusion of the resulting non-GAAP financial measures may improve the average investor's understanding of our results of operations by separating out items that have a disproportional positive or negative impact on the particular period in question or by otherwise permitting a better comparison from period-to-period in our results of operations with respect to our fundamental lines of business, including the commercial banking business.

We believe that the non-GAAP financial measures disclosed by us from time-to-time are useful in evaluating our performance and that such information should be considered as supplemental in nature, and not as a substitute for or superior to, the related financial information prepared in accordance with GAAP. Our non-GAAP financial measures may differ from similar measures presented by other companies.

PART I

Item 1. Business

A. GENERAL

Our holding company, Arrow Financial Corporation, a New York corporation, was incorporated on March 21, 1983 and is registered as a bank holding company within the meaning of the Bank Holding Company Act of 1956. Arrow owns two nationally- chartered banks in New York (Glens Falls National and Saratoga National), and through such banks indirectly owns various non-bank subsidiaries, including three insurance agencies, a registered investment adviser and a REIT. See "The Company and Its Subsidiaries," above.

Subsidiary Banks (dollars in thousands)

	Glens Falls National	Saratoga National
Total Assets at Year-End	$ 2,158,385	$ 443,258
Trust Assets Under Administration and Investment Management at Year-End (Not Included in Total Assets)	$ 1,217,312	$ 84,096
Date Organized	1851	1988
Employees (full-time equivalent)	473	51
Offices	30	9
Counties of Operation	Warren, Washington, Saratoga, Essex & Clinton	Saratoga, Albany & Rensselaer
Main Office	250 Glen Street Glens Falls, NY	171 So. Broadway Saratoga Springs, NY

The holding company’s business consists primarily of the ownership, supervision and control of our two banks, including the banks' subsidiaries. The holding company provides various advisory and administrative services and coordinates the general policies and operation of the banks. There were 524 full-time equivalent employees, including

62 employees within our insurance agency affiliates, at December 31, 2016.
We offer a broad range of commercial and consumer banking and financial products. Our deposit base consists of deposits derived principally from the communities we serve. We target our lending activities to consumers and small and mid-sized companies in our immediate geographic areas. Through our banks' trust operations, we provide retirement planning, trust and estate administration services for individuals, and pension, profit-sharing and employee benefit plan administration for corporations.

B. LENDING ACTIVITIES
Arrow engages in a wide range of lending activities, including commercial and industrial lending primarily to small and mid-sized companies; mortgage lending for residential and commercial properties; and consumer installment and home equity financing. We also maintain an active indirect lending program through our sponsorship of automobile dealer programs under which we purchase dealer paper, primarily from dealers that meet pre-established specifications. From time to time, we sell a portion of our residential real estate loan originations into the secondary market, primarily to the Federal Home Loan Mortgage Corporation ("Freddie Mac") and governmental agencies. Normally, we retain the servicing rights on mortgage loans originated and sold by us into the secondary markets, subject to our periodic determinations on the continuing profitability of such activity.
Generally, we continue to implement lending strategies and policies that are intended to protect the quality of the loan portfolio, including strong underwriting and collateral control procedures and credit review systems. Loans are placed on nonaccrual status either due to the delinquency status of principal and/or interest or a judgment by management that the full repayment of principal and interest is unlikely. Home equity lines of credit, secured by real property, are systematically placed on nonaccrual status when 120 days past due, and residential real estate loans when 150 days past due. Commercial and commercial real estate loans are evaluated on a loan-by-loan basis and are placed on nonaccrual status when 90 days past due if the full collection of principal and interest is uncertain. (See Part II, Item 7.C.II.c. "Risk Elements.") Subsequent cash payments on loans classified as nonaccrual may be applied all to principal, although income in some cases may be recognized on a cash basis.
We lend almost exclusively to borrowers within our normal retail service area in northeastern New York State, with the exception of our indirect consumer lending line of business, where we acquire retail paper from an extensive network of automobile dealers

that operate in a larger area of upstate New York, and in central and southern Vermont. The loan portfolio does not include any foreign loans or any other significant risk concentrations. We do not generally participate in loan syndications, either as originator or as a participant. However, from time to time, we buy participations in individual loans, typically commercial loans, originated by other financial institutions in New York and adjacent states. In recent periods, the total dollar amount of such participations has fluctuated, but generally represents less than 20% of commercial loans outstanding. Most of the portfolio is fully collateralized, and many commercial loans are further supported by personal guarantees.
We do not engage in subprime mortgage lending as a business line and we do not extend or purchase so-called "Alt A," "negative amortization," "option ARM's" or "negative equity" mortgage loans.

C. SUPERVISION AND REGULATION
The following generally describes the laws and regulations to which we are subject. Bank holding companies, banks and their affiliates are extensively regulated under both federal and state law. To the extent that the following information summarizes statutory or regulatory law, it is qualified in its entirety by reference to the particular provisions of the various statutes and regulations. Any change in applicable law may have a material effect on our business operations, customers, prospects and investors.

Bank Regulatory Authorities with Jurisdiction over Arrow and its Subsidiary Banks

Arrow is a registered bank holding company within the meaning of the Bank Holding Company Act of 1956 ("BHC Act") and as such is subject to regulation by the Board of Governors of the Federal Reserve System ("FRB"). As a "bank holding company" under New York State law, Arrow is also subject to regulation by the New York State Department of Financial Services. Our two subsidiary banks are both national banks and are subject to supervision and examination by the Office of the Comptroller of the Currency ("OCC"). The banks are members of the Federal Reserve System and the deposits of each bank are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation ("FDIC"). The BHC Act generally prohibits Arrow from engaging, directly or indirectly, in activities other than banking, activities closely related to banking, and certain other financial activities. Under the BHC Act, a bank holding company generally must obtain FRB approval before acquiring, directly or indirectly, voting shares of another bank or bank holding company, if after the acquisition the acquiror would own 5 percent or more of a class of the voting shares of that other bank or bank holding company. Bank holding companies are able to acquire banks or other bank holding companies located in all 50 states, subject to certain limitations. Bank holding companies that meet certain qualifications may choose to apply to the Federal Reserve Board for designation as "financial holding companies." If they obtain such designation, they will thereafter be eligible to acquire or otherwise affiliate with a much broader array of other financial institutions than "bank holding companies" are eligible to acquire or affiliate with, including insurance companies, investment banks and merchant banks. Arrow has not attempted to become, and has not been designated as, a financial holding company. See Item 1.D., "Recent Legislative Developments."

The FRB and the OCC have broad regulatory, examination and enforcement authority. The FRB and the OCC conduct regular examinations of the entities they regulate. In addition, banking organizations are subject to periodic reporting requirements to the regulatory authorities. The FRB and OCC have the authority to implement various remedies if they determine that the financial condition, capital, asset quality, management, earnings, liquidity or other aspects of a banking organization's operations are unsatisfactory or if they determine the banking organization is violating or has violated any law or regulation. The authority of the FRB and the OCC over banking organizations includes, but is not limited to, prohibiting unsafe or unsound practices; requiring affirmative action to correct a violation or unsafe or unsound practice; issuing administrative orders; requiring the organization to increase capital; requiring the organization to sell subsidiaries or other assets; restricting dividends, distributions and repurchases of the organization's stock; restricting the growth of the organization; assessing civil money penalties; removing officers and directors; and terminating deposit insurance. The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices for certain other reasons.

Regulatory Supervision of Other Arrow Subsidiaries

The insurance agency subsidiaries of Glens Falls National are subject to the licensing and other provisions of New York State Insurance Law and are regulated by the New York State Department of Financial Services. Arrow's investment adviser subsidiary is subject to the licensing and other provisions of the federal Investment Advisers Act of 1940 and is regulated by the Securities and Exchange Commission (SEC).

Regulation of Transactions between Banks and their Affiliates

Transactions between banks and their "affiliates" are regulated by Sections 23A and 23B of the Federal Reserve Act (FRA). Each of our organization's non-bank subsidiaries (other than the business trusts we formed to issue our TRUPs) is a subsidiary of one of our banks, and also is an "operating subsidiary" under Sections 23A and 23B. This means the non-bank subsidiary is considered to be part of the bank that owns it and thus is not an affiliate of the bank for purposes of Section 23A and 23B. However, each of our two banks is an affiliate of the other bank, and our holding company (Arrow) is also an affiliate of each bank. Extensions of credit that a bank may make to affiliates, or to third parties secured by securities or obligations of the affiliates, are substantially limited by the FRA and the Federal Deposit Insurance Act (FDIA). Such acts further restrict the range of permissible transactions between a bank and any affiliate, including a bank affiliate. Furthermore, under the FRA, a bank may engage in certain transactions, including loans and purchases of assets, with a non-bank affiliate, only if certain special conditions, including collateral requirements for loans, are met and if the other terms and conditions of the transaction, including interest rates and credit standards, are substantially the same as, or at least as favorable to the bank as, those prevailing at the time for comparable transactions by the bank with non-affiliated companies or, in the absence of comparable transactions, on terms and conditions that would be offered by the bank to non-affiliated companies.

Regulatory Capital Standards

An important area of banking regulation is the federal banking system's promulgation and enforcement of minimum capitalization standards for banks and bank holding companies.

Bank Capital Rules. The Dodd-Frank Act, among other things, directed U.S. bank regulators to promulgate revised capital standards for U.S. banking organizations, which needed be at least as strict (i.e., must establish minimum capital levels that are at least as high) as the regulatory capital standards that were in effect for U.S. insured depository financial institutions at the time Dodd-Frank was enacted in 2010.

In July 2013, federal bank regulators, including the FRB and the OCC, approved their revised bank capital rules aimed at implementing these Dodd-Frank capital requirements. These rules were also intended to coordinate U.S. bank capital standards with the current drafts of the Basel III proposed bank capital standards for all of the developed world's banking organizations. The federal regulators' revised capital rules (the "Capital Rules"), which impose significantly higher minimum capital ratios on U.S. financial institutions than the rules they replaced, became effective for our holding company and banks on January 1, 2015, and will be fully phased in by 2019.

The revised Capital Rules, like the rules they replaced, consist of two basic types of capital measures, a leverage ratio and set of risk-based capital measures. Within these two broad types of rules, however, significant changes were made in the revised Capital Rules, as discussed below.

Leverage Rule. The revised Capital Rules did not fundamentally alter the structure of the leverage rule that previously applied to banks and bank holding companies, except to increase the minimum required leverage ratio from 3.0% to 4.0%. The leverage ratio continues to be defined as the ratio of the institution's "Tier 1" capital (as defined under the new leverage rule) to total tangible assets (again, as defined under the revised leverage rule).

Risk-Based Capital Measures. The principal changes under the revised Capital Rules involve the other basic type of regulatory capital measures, the so-called risk-based capital measures. As a general matter, risk-based capital measures assign various risk weightings to all of the institution's assets, by asset type, and to certain off-balance sheet items, and then establish minimum levels of capital to the aggregate dollar amount of such risk-weighted assets. The general effect of the revised risk-based Capital Rules was to increase most of the pre-existing risk-based minimum capital ratios and to introduce several new minimum capital ratios and capital definitions. The basic result was to increase required capital for banks and their holding companies.

Under the revised risk-based Capital Rules, there are 8 major risk-weighted categories of assets (although there are several additional super-weighted categories for high-risk assets that are generally not held by community banking organizations like ours). The revised rules also are more restrictive in their definitions of what qualify as capital components. Most importantly, the revised rules, as required under Dodd-Frank, added several risk-based capital measures that also must be met. One such measure is the "common equity tier 1 capital ratio" (CET1). For this ratio, only common equity (basically, common stock plus surplus plus retained earnings) qualifies as capital (i.e., CET1). Preferred stock and trust preferred securities, which qualified as Tier 1 capital under the old Tier 1 risk-based capital measure (and continue to qualify as capital under the revised Tier 1 risk-based capital measure), are not included in CET1 capital. Technically, under the revised rules, CET1 capital also includes most elements of accumulated other comprehensive income (AOCI), including unrealized securities gains and losses, as part of both total regulatory capital (numerator) and total assets (denominator). However, smaller banking organizations like ours were given the opportunity to make a one-time irrevocable election to include or not to include certain elements of AOCI, most notably unrealized securities gains or losses. We made such an election, i.e., not to include unrealized securities gains and losses in calculating our CET1 ratio under the revised Capital Rules. The minimum CET1 ratio under the revised rules, effective January 1, 2015, is 4.50%, which will remain constant throughout the phase-in period.

Consistent with the general theme of higher capital levels, the revised Capital Rules also increased the minimum ratio for Tier 1 risk-based capital, which was 4.0%, to 6.0%, effective January 1, 2015. The minimum level for total risk-based capital under the revised Capital Rules remained at 8.0%, the same level as under the old rules.

The revised Capital Rules incorporate a capital concept, the so-called "capital conservation buffer" (set at 2.5%, after full phase-in), which must be added to each of the minimum required risk-based capital ratios (i.e., the minimum CET1 ratio, the minimum Tier 1 risk-based capital ratio and the minimum total risk-based capital ratio). The capital conservation buffer is being phased-in over four years beginning January 1, 2016 (see the table below). When, during economic downturns, an institution's capital begins to erode, the first deductions from a regulatory perspective would be taken against the conservation buffer. To the extent that such deductions should erode the buffer below the required level (2.5% of total risk-based assets), the institution will not necessarily be required to replace the buffer deficit immediately, but will face restrictions on paying dividends and other negative consequences until the buffer is fully replenished.

Also under the revised Capital Rules, and as required under Dodd-Frank, TRUPs issued by small- to medium-sized banking organizations (such as ours) that were outstanding on the Dodd-Frank grandfathering date for TRUPS (May 19, 2010) will continue to qualify as tier 1 capital, up to a limit of 25% of tier 1 capital, until the TRUPs mature or are redeemed. See the discussion of grandfathered TRUPs in section D of this item under "The Dodd-Frank Act."

The following is a summary of the revised definitions of capital under the various new risk-based measures in the revised Capital Rules:

Common Equity Tier 1 Capital (CET1): Equals the sum of common stock instruments and related surplus (net of treasury stock), retained earnings, accumulated other comprehensive income (AOCI), and qualifying minority interests, minus applicable regulatory adjustments and deductions. Such deductions will include AOCI, if the organization has exercised its irrevocable option not to include AOCI in capital (we made such an election). Mortgage-servicing assets, deferred tax assets, and investments in financial institutions are limited to 15 percent of CET1 in the aggregate and 10 percent of CET1 for each such item individually.
Additional Tier 1 Capital: Equals the sum of noncumulative perpetual preferred stock, tier 1 minority interests, grandfathered TRUPs, and Troubled Asset Relief Program instruments, minus applicable regulatory adjustments and deductions.
Tier 2 Capital: Equals the sum of subordinated debt and preferred stock, total capital minority interests not included in Tier 1, and allowance for loan and lease losses (not exceeding 1.25 percent of risk-weighted assets) minus applicable regulatory adjustments and deductions.

The following table presents the transition schedule applicable to our holding company and banks under the revised Capital Rules:

Year, as of January 1	2016	2017	2018	2019
Minimum CET1 Ratio	4.500%	4.500%	4.500%	4.500%
Capital Conservation Buffer ("Buffer")	0.625%	1.250%	1.875%	2.500%
Minimum CET1 Ratio Plus Buffer	5.125%	5.750%	6.375%	7.000%
Minimum Tier 1 Risk-Based Capital Ratio	6.000%	6.000%	6.000%	6.000%
Minimum Tier 1 Risk-Based Capital Ratio Plus Buffer	6.625%	7.250%	7.875%	8.500%
Minimum Total Risk-Based Capital Ratio	8.000%	8.000%	8.000%	8.000%
Minimum Total Risk-Based Capital Ratio Plus Buffer	8.625%	9.250%	9.875%	10.500%
Minimum Leverage Ratio	4.000%	4.000%	4.000%	4.000%

These minimum capital ratios, especially the CET1 ratio (4.5%) and the enhanced Tier 1 risk-based capital ratio (6.0%), which began to apply to our organization on January 1, 2015, represent a heightened and more restrictive capital regime than institutions like ours previously had to meet, and the four year phase-in of the regulatory capital buffer, which began January 1, 2016, will add to the stress on banks' profitability.
At December 31, 2016, our holding company and both of our banks exceeded by a substantial amount each of the applicable minimum capital ratios established under the revised Capital Rules, including the minimum CET1 Ratio, the minimum Tier 1 Risk-Based Capital Ratio, the minimum Total Risk-Based Capital Ratio, and the minimum Leverage Ratio, including in the case of each risk-based ratio, the phased-in portion of the capital buffer. See Note 19 to our audited financial statements, beginning on page 102, for a presentation of our period-end ratios for 2016 and 2015.

Regulatory Capital Classifications. Under applicable banking law, federal banking regulators are required to take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. The regulators have established five capital classifications for banking institutions, ranging from the highest category of "well-capitalized" to the lowest category of "critically under-capitalized". As a result of the regulators' adoption of the revised Capital Rules, the definitions for determining which of the five capital classifications a particular banking organization will fall into were changed, effective as of January 1, 2015. Under the revised capital classifications, a banking institution is considered "well-capitalized" if it meets the following capitalization standards on the date of measurement: a CET1 risk-based capital ratio of 6.50% or greater, a Tier 1 risk-based capital ratio of 8.00% or greater, and a total risk-based capital ratio of 10.00% or greater, provided the institution is not subject to any

regulatory order or written directive regarding capital maintenance.
As of December 31, 2016, our holding company and both of our banks qualified as "well-capitalized" under the revised capital classification scheme.

Dividend Restrictions; Other Regulatory Sanctions

A holding company's ability to pay dividends or repurchase its outstanding stock, as well as its ability to expand its business through acquisitions of additional banking organizations or permitted non-bank companies, may be restricted if its capital falls below minimum regulatory capital ratios or fails to meet other informal capital guidelines that the regulators may apply from time to time to specific banking organizations. In addition to these potential regulatory limitations on payment of dividends, our holding company's ability to pay dividends to our shareholders, and our subsidiary banks' ability to pay dividends to our holding company are also subject to various restrictions under applicable corporate laws, including banking laws (which affect our subsidiary banks) and the New York Business Corporation Law (which affects our holding company). The ability of our holding company and banks to pay dividends or repurchase shares in the future is, and is expected to continue to be, influenced by regulatory policies, the phase-in of the revised, more stringent bank capital guidelines and applicable law.

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In cases where banking regulators have significant concerns regarding the financial condition, assets or operations of a bank holding company or one of its banks, the regulators may take enforcement action or impose enforcement orders, formal or informal, against the holding company or the particular bank. If the ratio of tangible equity to total assets of a bank falls to 2% or below, the bank will likely be closed and placed in receivership, with the FDIC as receiver.

Cybersecurity

In additional to the provisions in the Gramm-Leach-Bliley Act relating to data security, Arrow and its subsidiaries are subject to many federal and state laws, regulations and regulatory interpretations which impose standards and requirements related to cybersecurity. For example, in March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution’s management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution’s operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. Financial institutions that fail to observe this regulatory guidance on cybersecurity may be subject to various regulatory sanctions, including financial penalties.

Anti-Money Laundering and OFAC

Under federal law, financial institutions must maintain anti-money laundering programs that include established internal policies, procedures, and controls. Financial institutions are also prohibited from entering into specified financial transactions and account relationships and must meet enhanced standards for due diligence and customer identification. Financial institutions must take reasonable steps to conduct enhanced scrutiny of account relationships to guard against money laundering and to report any suspicious transactions. Law enforcement authorities have been granted increased access to financial information maintained by financial institutions. Bank regulators routinely examine institutions for compliance with these obligations and they must consider an institution's compliance in connection with the regulatory review of applications, including applications for banking mergers and acquisitions. The U.S. Department of the Treasury's Office of Foreign Assets Control, or "OFAC," is responsible for helping to insure that U.S. entities do not engage in transactions with certain prohibited parties, as defined by various Executive Orders and Acts of Congress. OFAC publishes lists of persons, organizations, and countries suspected of aiding, harboring or engaging in terrorist acts, known as Specially Designated Nationals and Blocked Persons. If Arrow finds a name on any transaction, account or wire transfer that is on an OFAC list, Arrow must freeze or block such account or transaction, file a suspicious activity report and notify the appropriate authorities. The U.S. Treasury Department's Financial Crises Enforcement Network ("FinCEN") issued a final rule in 2016 increasing customer due diligence requirements for banks, including adding a requirement to identify and verify the identity of beneficial owners of customers that are legal entities, subject to certain exclusions and exemptions. Compliance with this rule is required in May 2018.

Reserve Requirements

Pursuant to regulations of the FRB, all banking organizations are required to maintain average daily reserves at mandated ratios against their transaction accounts and certain other types of deposit accounts. These reserves must be maintained in the form of vault cash or in an account at a Federal Reserve Bank.

Community Reinvestment Act

Each of Arrow's subsidiary banks is subject to the Community Reinvestment Act ("CRA") and implementing regulations. CRA regulations establish the framework and criteria by which the bank regulatory agencies assess an institution's record of helping to meet the credit needs of its community, including low and moderate-income neighborhoods. CRA ratings are taken into account by regulators in reviewing certain applications made by Arrow and its bank subsidiaries.

Privacy and Confidentiality Laws

Arrow and its subsidiaries are subject to a variety of laws that regulate customer privacy and confidentiality. The Gramm-Leach-Bliley Act requires financial institutions to adopt privacy policies, to restrict the sharing of nonpublic customer information with nonaffiliated parties upon the request of the customer, and to implement data security measures to protect customer information. The Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act of 2003, regulates use of credit reports, providing of information to credit reporting agencies and sharing of customer information with affiliates, and sets identity theft prevention standards.

The Dodd-Frank Act

As a result of the 2008-2009 financial crisis, the U.S. Congress passed and the President signed Dodd-Frank on July 21, 2010. While some of the Act's provisions have not had, and likely will not have, any direct impact on Arrow, other provisions have impacted or likely will impact our business operations and financial results in a significant way. These include the establishment of a new regulatory body known as the Consumer Financial Protection Bureau (CFPB), which operates as an independent entity within the Federal Reserve System and is authorized to issue rules for consumer protection, some of which have increased, and likely will continue to increase banks' compliance expenses, thereby negatively impacting profitability. For depository institutions with $10 billion or less in assets (such as Arrow's banks), the banks' traditional regulatory agencies (for our banks, the OCC), and not the CFPB, will have primary examination and enforcement authority over the banks' compliance with new CFPB rules as well as all other consumer protection rules and regulations. However, the CFPB has the right to include its examiners on a "sampling" basis in examinations conducted by the traditional regulators and is authorized to give those agencies input and recommendations with respect to consumer protection laws and to require reports and other examination documents. The CFPB has broad authority to curb practices it finds to be unfair, deceptive and abusive. What constitutes "abusive" behavior has been broadly defined and is very likely to create an environment conducive to increased litigation. This is likely to be exacerbated by the fact that, in addition to the federal authorities charged with enforcing the CFPB's rules, state attorneys general are also authorized to enforce certain of the Federal consumer laws transferred to the jurisdiction of the CFPB and the rules issued by the CFPB thereunder.
Dodd-Frank also directed the federal banking authorities to issue new capital requirements for banks and holding companies. See the discussion under “Regulatory Capital Standards” on pages 7 and 8 of this Report. Dodd-Frank also provided that any new issuances of trust preferred securities (TRUPs) by bank holding companies having between $500 million and $15 billion in assets (such as Arrow) will no longer be able to qualify as Tier 1 capital, although previously issued TRUPs of such bank holding companies that were outstanding on the Dodd-Frank grandfathering date (May 19, 2010), including the $20 million of TRUPs issued by Arrow before that date, will continue to qualify as Tier 1 capital until maturity or earlier redemption, subject to certain limitations. The new bank Capital Rules, in their final form, preserve this "grandfathered" status of TRUPs previously issued by small- to mid-sized financial institutions like Arrow before the grandfathering date. Generally, however, TRUPs, which were an important financing tool for community banks such as ours, can no longer be counted on as a viable source of new capital for banks, unless the U.S. Congress passes legislation that specifically accords regulatory capital status to newly-issued TRUPs.
Bank regulators have not finished promulgating all the rules required to be issued by them under Dodd-Frank. To date, implementation of Dodd-Frank provisions has resulted in many new mandatory and discretionary rule-makings by regulatory authorities, a process that is still not completed, almost seven years after Dodd-Frank's enactment. As a result, bank holding companies and their bank and non-bank operating subsidiaries have faced thousands of new pages of regulations and associated regulatory burdens still being formulated, several of which are highly controversial and the implementation of which has proven to be costly and time consuming.
Various legislative proposals have been advanced for consideration or possible consideration by the U.S. Congress that would rescind or substantially modify various provisions of Dodd-Frank. At present, we are not able to estimate the likelihood of adoption of any such provisions or the potential impact thereof if adopted.

Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 implemented a broad range of corporate governance, accounting and reporting requirements for companies that have securities registered under the Exchange Act. These requirements include: (1) requirements for audit committees, including independence and financial expertise; (2) certification of financial statements by the chief executive officer and chief financial officer of the reporting company; (3) standards for auditors and regulation of audits; (4) disclosure and reporting requirements for the reporting company and directors and executive officers; and (5) a range of civil and criminal penalties for fraud and other violations of securities laws.

The USA Patriot Act

The USA Patriot Act initially adopted in 2001 and re-adopted by the U.S. Congress in 2006 with certain changes (the "Patriot Act"), imposes substantial record-keeping and due diligence obligations on banks and other financial institutions, with a particular focus on detecting and reporting money-laundering transactions involving domestic or international customers. The U.S. Treasury Department has issued and will continue to issue regulations clarifying the Patriot Act's requirements. The Patriot Act requires all financial institutions, including banks, to maintain certain anti-money laundering compliance and due diligence programs. The provisions of the Patriot Act impose substantial costs on all financial institutions, including ours.

Incentive Compensation

The Dodd-Frank Act required the federal bank regulatory agencies and the SEC to establish joint regulations or guidelines prohibiting incentive-based payment arrangements at specified regulated entities, such as the Company, having at least $1 billion in total assets that encourage inappropriate risks by providing an executive officer, employee, director or principal shareholder with excessive compensation, fees, or benefits or that could lead to material financial loss to the entity. In addition, these regulators must establish regulations or guidelines requiring enhanced disclosure to regulators of incentive-based compensation arrangements. Final regulations and/or guidelines have not yet been issued by the agencies under this provision of Dodd-Frank.

However, in 2010, the FRB, OCC and FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. The guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization’s incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization’s ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization’s board of directors. Management believes the current and past compensation practices of the Company do not encourage excessive risk taking or undermine the safety and soundness of the organization.
The FRB will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Company, that are not “large, complex banking organizations.” These reviews will be tailored to each organization based on the scope and complexity of the organization’s activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization’s supervisory ratings, which can affect the organization’s ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization’s safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Deposit Insurance Laws and Regulations

In February of 2011, the FDIC finalized a new assessment system that took effect in the second quarter of 2011. The final rule changed the assessment base from domestic deposits to average assets minus average tangible equity, adopted a new large-bank pricing assessment scheme, and set a target size for the Deposit Insurance Fund. The changes went into effect in the second quarter of 2011. The rule (as mandated by Dodd-Frank) finalizes a target size for the Deposit Insurance Fund Reserve Ratio at 2% of insured deposits. It also implements a lower assessment rate schedule when the ratio reaches 1.15% (so that the average rate over time should be about 8.5 basis points) and, in lieu of dividends, provides for a lower rate schedule when the reserve ratio reaches 2% and 2.5%. Also as mandated by Dodd-Frank, the rule changes the assessment base from adjusted domestic deposits to a bank's average consolidated total assets minus average tangible equity.
In August of 2016, the FDIC announced that the reserve ratio reached 1.17% at the end of June, 2016. This represents the highest level the ratio has reached in more than eight years. The reduction in assessment rates went into effect in the third quarter of 2016. We are unable to predict whether or to what extent the FDIC may elect to impose additional special assessments on insured institutions in upcoming years, if bank failures should once again become a significant problem.

D. RECENT LEGISLATIVE DEVELOPMENTS

Health Care Reform
Various proposals have been discussed for consideration that would substantially modify various health care laws. At present, we are not able to estimate the likelihood of adoption of any such provisions or the potential impact thereof if adopted.

Other Legislative Initiatives
From time to time, various legislative and regulatory initiatives are introduced in Congress and state legislatures, as well as by regulatory authorities. These initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to change the financial institution regulatory environment.

Such legislation could change banking laws and the operating environment of our company in substantial, but unpredictable ways. We cannot predict whether any such legislation will be enacted, and, if enacted, the effect that it, or any implementing regulations would have on our financial condition or results of operations.

E. STATISTICAL DISCLOSURE – (GUIDE 3)

Set forth below is an index identifying the location in this Report of various items of statistical information required to be included in this Report by the SEC's industry guide for Bank Holding Companies.

Required Information	Location in Report
Distribution of Assets, Liabilities and Stockholders' Equity; Interest Rates and Interest Differential	Part II, Item 7.B.I.
Investment Portfolio	Part II, Item 7.C.I.
Loan Portfolio	Part II, Item 7.C.II.
Summary of Loan Loss Experience	Part II, Item 7.C.III.
Deposits	Part II, Item 7.C.IV.
Return on Equity and Assets	Part II, Item 6.
Short-Term Borrowings	Part II, Item 7.C.V.

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F. COMPETITION

We face intense competition in all markets we serve. Competitors include traditional local commercial banks, savings banks and credit unions, non-traditional internet-based lending alternatives, as well as local offices of major regional and money center banks. Like all banks, we encounter strong competition in the mortgage lending space from a wide variety of other mortgage originators, all of whom are principally affected in this business by the rate and terms set, and the lending practices established from time-to-time by the very large government sponsored enterprises ("GSEs") engaged in residential mortgage lending, most importantly, “Fannie Mae” and “Freddie Mac.” For many years, these GSEs have purchased and/or guaranteed a very substantial percentage of all newly-originated mortgage loans in the U.S., and in recent years, a large majority of such originations. Additionally, non-banking financial organizations, such as consumer finance companies, insurance companies, securities firms, money market funds, mutual funds, credit card companies, wealth management enterprises, and Fintech companies offer substantive equivalents of the various other types of loan and financial products and services and transactional accounts that we offer, even though these non-banking organizations are not subject to the same regulatory restrictions and capital requirements that apply to us. Under federal banking laws, such non-banking financial organizations not only may offer products and services comparable to those offered by commercial banks, but also may establish or acquire their own commercial banks.

G. EXECUTIVE OFFICERS OF THE REGISTRANT

The names and ages of the executive officers of Arrow and positions held by each are presented in the following table. Officers are elected annually by the Board of Directors.

Name	Age	Positions Held and Years from Which Held
Thomas J. Murphy, CPA	58	President and Chief Executive Officer of Arrow since January 1, 2013. He has been a director of Arrow since July 2012. Mr. Murphy served as a Vice President of Arrow from 2009 to 2012, and as Corporate Secretary from 2009 to 2012. Mr. Murphy also has been the President and Chief Executive Officer of GFNB since January 1, 2013. Prior to that date he served as Senior Executive Vice President of Arrow and President of GFNB commencing July 1, 2011. Prior to July 1, 2011, Mr. Murphy served as Senior Trust Officer of GFNB (since 2010) and Cashier of GFNB (since 2009). Mr. Murphy previously served as Assistant Corporate Secretary of Arrow (2008-2009), Senior Vice President of GFNB (2008-2011) and Manager of the Personal Trust Department of GFNB (2004-2011). Mr. Murphy started with the Company in 2004.
Terry R. Goodemote, CPA	53	Chief Financial Officer of Arrow since January 1, 2007. He also has been Executive Vice President of Arrow (since January 1, 2013); prior to that, he was Senior Vice President of Arrow (since 2008). Mr. Goodemote also serves as Chief Financial Officer of GFNB (since January 1, 2007) and as Senior Executive Vice President of GFNB (since July 1, 2011). Before that he was Executive Vice President of GFNB (since 2008). Prior to becoming Chief Financial Officer, Mr. Goodemote served as Senior Vice President and Head of the Accounting Division of GFNB. Mr. Goodemote started with the Company in 1992. On February 7, 2017, the company announced Mr. Goodemote's intention is to retire from the company. He intends to continue in his current role until his successor is chosen.
David S. DeMarco	55	Senior Vice President of Arrow since May 1, 2009. Mr. DeMarco has been the President and Chief Executive Officer of SNB since January 1, 2013. Prior to that date, Mr. DeMarco served as Executive Vice President and Head of the Branch, Corporate Development, Financial Services & Marketing Division of GFNB since January 1, 2003. Mr. DeMarco started with the Company in 1987.
David D. Kaiser	56	Senior Vice President of Arrow since February 1, 2015. Mr. Kaiser has also served as Executive Vice President of GFNB since 2012 and as Chief Credit Officer of GFNB and SNB since 2011. Previously, he served as the Corporate Banking Manager for GFNB from 2005 to 2011. Mr. Kaiser started with the Company in 2000.

H. AVAILABLE INFORMATION

Our Internet address is www.arrowfinancial.com. We make available, free of charge on or through our internet website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports as soon as practicable after we file or furnish them with the SEC pursuant to the Exchange Act. We also make available on the internet website various other documents related to corporate operations, including our Corporate Governance Guidelines, the charters of our principal board committees, and our codes of ethics. We have adopted a financial code of ethics that applies to Arrow's chief executive officer, chief financial officer and principal accounting officer and a business code of ethics that applies to all directors, officers and employees of our holding company and its subsidiaries.

Item 1A. Risk Factors
Our financial results and the market price of our stock are subject to risks arising from many factors, including the risks listed below, as well as other risks and uncertainties. Any of these risks could materially and adversely affect our business, financial condition or results of operations. (Please note that the discussion below regarding the potential impact on Arrow of certain of these factors that may develop in the future is not meant to provide predictions by Arrow's management that such factors will develop, but to acknowledge the possible negative consequences to our company and business if certain conditions develop.)
Difficult market conditions continue to present significant challenges to the profitability of the U.S. commercial banking industry and its core business of making and servicing loans and any substantial downturn in the U.S. economy generally could adversely affect our ability to maintain steady growth in our loan portfolio and our earnings. Many existing or potential loan customers of commercial banks, especially individuals and small businesses, continue to experience financial and budgetary pressures that both challenge their ability to service their existing indebtedness and sharply restrict their ability or willingness to incur additional indebtedness. The demand for loans has generally increased in recent years, and very low prevailing rates of interest for all types of credit still exist, which makes borrowing more affordable and attractive to customers of all types. However, while the U.S. economy and our regional economy have shown signs of improvement in recent years, consumers and small businesses are still struggling under heavy debt loads, which will continue to weigh against any surge in growth or profitability in the banking sector. This cautionary scenario confronts us as it confronts all commercial banks, large and small, and could adversely affect our ability to originate loans.
We face continuing and growing security risks to our information base including the information we maintain relating to our customers, and any breaches in the security systems we have implemented to protect this information could have a material negative effect on our business operations and financial condition. In the ordinary course of business, Arrow relies on electronic communications and information systems to conduct our operations and to store sensitive data. Arrow employs an in-depth, layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. Arrow employs a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. We have implemented and regularly review and update extensive systems of internal controls and procedures as well as corporate governance policies and procedures intended to protect our business operations, including the security and privacy of all confidential customer information. In addition, we rely on the services of a variety of vendors to meet our data processing and communication needs. No matter how well designed or implemented our controls are, we cannot provide an absolute guarantee to protect our business operations from every type of cybersecurity or other security problem in every situation. A failure or circumvention of these controls could have a material adverse effect on our business operations and financial condition. Notwithstanding the strength of our defensive measures, the threat from cyber attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date, Arrow has not experienced a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers.
The computer systems and network infrastructure that we use are always vulnerable to unforeseen disruptions, including theft of confidential customer information (“identity theft”) and interruption of service as a result of fire, natural disasters, explosion, general infrastructure failure or cyber attacks. These disruptions may arise in our internally developed systems, or the systems of our third-party service providers or may originate from the actions of our consumer and business customers who access our systems from their own networks or digital devices to process transactions. Information security and cyber security risks have increased significantly in recent years because of consumer demand to use the Internet and other electronic delivery channels to conduct financial transactions. Cybersecurity risk is a major concern to financial services regulators and all financial service providers, including our company. These risks are further exacerbated due to the increased sophistication and activities of organized crime,

hackers, terrorists and other disreputable parties. We regularly assess and test our security systems and disaster preparedness, including back-up systems, but the risks are substantially escalating. As a result, cybersecurity and the continued enhancement of our controls and processes to protect our systems, data and networks from attacks or unauthorized access remain a priority. Accordingly, we may be required to expend additional resources to enhance our protective measures or to investigate and remediate any information security vulnerabilities or exposures. Any breach of our system security could result in disruption of our operations, unauthorized access to confidential customer information, significant regulatory costs, litigation exposure and other possible damages, loss or liability. Such costs or losses could exceed the amount of available insurance coverage, if any, and would adversely affect our earnings. Also, any failure to prevent a security breach or to quickly and effectively deal with such a breach could negatively impact customer confidence, damaging our reputation and undermining our ability to attract and keep customers. In addition, if we fail to observe any of the cybersecurity requirements in federal or state laws, regulations or regulatory guidance, we could be subject to various sanctions, including financial penalties.

The quality of our bank loan portfolio remains strong but could erode somewhat if the U.S. economy or our regional economy experiences even a modest downturn; any such erosion could have an adverse impact on our financial condition. Home prices in all regions of the U.S., including our market area in northeastern New York, have stabilized or even strengthened somewhat in recent periods. Delinquency and charge-off rates in our loan portfolio remain very low. However, we like most banks continue to have substantial exposure in our portfolio to borrowers, particularly individual and small business borrowers, who if confronted by an economic downturn of any consequence, including one that results in their loss of their job or the failure of their business, may quickly fall in arrears on their borrowings including on our loans to them. We believe not only that the quality of our loan portfolio is strong but also that our allowance is entirely adequate to cover all embedded risk. However, any downturn of consequence in the economy, nationwide or in our region, would likely require increased provisions to our allowance, potentially damaging our financial condition and results.

Persistent volatility in the U.S. equity markets, coupled with economic instability and uncertainty, has an adverse effect on the core business of the U.S. commercial banking sector which could adversely impact our financial results. The U.S. financial sector, particularly that portion that is focused on the equity markets (i.e., “Wall Street”), has largely recovered from the 2008-2009 financial crisis, although periods of enhanced volatility continue to surface-. At the same time, the wider U.S. economy, especially the business sector that underlies the day-to-day health of U.S. commercial banks (“Main Street”), continues to experience only very modest growth. In some areas of the U.S. and some sectors of the U.S. economy. companies, workers and municipalities have not returned to the levels of financial health they enjoyed before the 2008-2009 crisis. Commercial banks like ours are much more closely tied, in terms of growth and profits, to the Main Street sector than the Wall Street sector. Accordingly, our financial results and condition may continue to be pressured by the modest and uneven growth that continues to characterize the U.S. economy generally and our regional economy as well.

Any future economic or financial downturn, including any significant correction in the equity markets, may negatively affect the volume of income attributable to, and demand for, fee-based services of banks such as ours, including our fiduciary business, which could negatively impact our financial condition and results of operation. Revenues from our trust and wealth management business are dependent on the level of assets under management. Any significant downturn in the equity markets may lead our trust and wealth management customers to liquidate their investments, or may diminish account values for those customers who elect to leave their portfolios with us, in either case reducing our assets under management and thereby decreasing our revenues from this important sector of our business. Our other fee-based businesses are also susceptible to a sudden economic or financial downturn.

Rulemaking under Dodd-Frank continues to unfold; these and other regulations being promulgated may adversely affect our Company and certain players in the financial industry as a whole. Even before the financial crisis and the resulting new banking laws and regulations, including Dodd-Frank, we were subject to extensive Federal and state banking regulations and supervision. Banking laws and regulations are intended primarily to protect bank depositors’ funds (and indirectly the Federal deposit insurance funds) as well as bank retail customers, who may lack the sophistication to understand or appreciate bank products and services. These laws and regulations generally are not, however, aimed at protecting or enhancing the returns on investment enjoyed by bank shareholders.

Our depositor/customer awareness of the changing regulatory environment is particularly true of the set of laws and regulations under Dodd-Frank, which were passed in the aftermath of the 2008-2009 financial crisis and in large part were intended to better protect bank customers (and to some degree, banks) against a wide variety of lending products and aggressive lending practices that pre-dated the crisis and are seen as having contributed to its severity. Although not all banks offered such products or engaged in such practices, all banks are affected by the new laws and regulations to some degree.

Dodd-Frank restricts our lending practices, requires us to expend substantial additional resources to safeguard customers, significantly increases our regulatory burden, and subjects us to significantly higher minimum capital requirements which, in the long run, may serve as a drag on our earnings, growth and ultimately on our dividends and stock price (the new capital standards are separately addressed in the following risk factor).

While it is difficult to predict the full extent to which Dodd-Frank and the resulting new regulations and rules may adversely impact our business or financial results, or the extent to which regulations previously adopted under Dodd-Frank or the provisions of Dodd-Frank itself may be rescinded or modified in upcoming periods, as a result of recent political developments,we believe the changes flowing from Dodd-Frank will continue to increase our costs. Furthermore, we also believe that any potential changes to Dodd-Frank will require us to continue to modify certain strategies, business operations and capital and liquidity structures which, individually or collectively, may very well have a material adverse impact on our financial condition.

Revised capital and liquidity standards adopted by the U.S. banking regulators require banks and bank holding companies to maintain more and higher quality capital and greater liquidity than has historically been the case. Capital standards, particularly those adopted as a result of Dodd-Frank, continue to have a significant effect on banks and bank holding companies, including Arrow. Although many of the remedial measures contained in Dodd-Frank and the regulations promulgated thereunder may be reconsidered at the federal legislative and regulatory levels as a result of the recent U.S. elections and political developments, the revised and enhanced regulatory capital standards adopted by bank regulators in response to the mandates in Dodd-Frank are generally perceived as less likely to be rescinded or relaxed than some of the other restrictive or burdensome changes mandated by Dodd-Frank. Thus, many if perhaps not all of the enhanced bank capital standards promulgated under Dodd-Frank are widely expected to remain in effect, including the capital buffers yet to be fully phased in, forcing bank holding companies and their bank subsidiaries to maintain substantially higher levels of capital as a percentage of their assets, with a greater emphasis on common equity as opposed to other components of capital. The need to maintain more and higher quality capital, as well as greater liquidity, and generally increased regulatory scrutiny with respect to capital levels, may at some point limit our business activities, including lending, and our ability to expand. It could also result in our being required to take steps to increase our regulatory capital and may dilute shareholder value or limit our ability to pay dividends or otherwise return capital to our investors through stock repurchases.

If economic conditions should worsen and the U.S. experiences a recession or prolonged economic stagnation, the quality of our loan portfolio may weaken so significantly that our allowance for loan losses may not be adequate to cover actual or expected loan losses. Like all financial institutions, we maintain an allowance for loan losses to provide for probable loan losses at the balance sheet date. Our allowance for loan losses is based on our historical loss experience as well as an evaluation of the risks associated with our loan portfolio, including the size and composition of the portfolio, current economic conditions and geographic concentrations within the portfolio and other factors. While we have continued to enjoy a very high level of quality in our loan portfolio generally and very low levels of loan charge-offs and non-performing loans, if the economy in our geographic market area should deteriorate to the point that recessionary conditions return, or if the regional or national economy experiences a protracted period of stagnation, the quality of our loan portfolio may weaken so significantly that our allowance for loan losses may not be adequate to cover actual or expected loan losses. If so, future increases in provisions for loan losses could materially and adversely affect financial results. Moreover, weak or worsening economic conditions often lead to difficulties in other areas of our business, including growth of our business generally, thereby compounding the negative effects on earnings.

Although rates have begun to rise somewhat, the current interest rate environment, still is not particularly favorable for commercial banks or their core businesses, and any future significant increases in prevailing rates may ultimately have a negative impact on our prospects and performance. Prevailing market interest rates, and changes in those rates, have a direct and material impact on the financial performance and condition of commercial banks. A bank’s net interest income generally comprises the majority of its total income, and changes in prevailing rates for bank assets and bank liabilities significantly affect its net interest income. Currently, market interest rates in the U.S., across all maturities and for all types of loans, although beginning to rise, still remain low. Lending institutions such as commercial banks remain in a very challenging position.

After raising the Fed funds rate by 25 basis points in December 2016, the Fed elected to raise the Fed funds rate again in December 2016, again by 25 basis points. Presumably, short-term interest rates will rise again accordingly. Moreover, the general expectation is that the Fed will proceed with additional rate rises this year and perhaps next year. These increases in market rates, although possibly helpful to banks at least initially as loans reprice upward, may nevertheless be expected ultimately to adversely impact the commercial banking sector in certain respects. If rate rises persist, it may be expected that bank liabilities (deposits) also will reprice upward, pressuring margins once again. Additionally, if rates rise substantially, especially long-term rates, economic growth is likely to be negatively impacted at some point, and the housing sector particularly may suffer significant damage. It was out of concern for the long-run health of the U.S. economy at large that led the Fed to pursue the imposition of a long-term, low-rate environment, and it is to be expected that the Fed will approach further rate increases with great caution and abandon or defer future increases if any weakness in the economy should surface. Whatever the Fed and the other central banks in the developed world elect to do from the standpoint of monetary policy, their decisions will affect the activities, results of operations and profitability of banks and bank holding companies such as Arrow. We cannot predict the nature or timing of future changes in monetary and other policies or the effect that they may have on our operations or financial condition.

We operate in a highly competitive industry and market areas that could negatively affect our growth and profitability. Competition for commercial banking and other financial services is fierce in our market areas. In one or more aspects of business, our subsidiaries compete with other commercial banks, savings and loan associations, credit unions, finance companies, Internet-based financial services companies, mutual funds, insurance companies, brokerage and investment banking companies, and other financial intermediaries. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services, as well as better pricing for those products and services, than we can. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. In addition, many of our competitors are not subject to the same extensive Federal regulations that govern bank holding companies and Federally insured banks. Failure to offer competitive services in our market areas could significantly weaken our market position, adversely affecting our growth, which, in turn, could have a material adverse effect on our financial condition and results of operations.

The Company relies on the operations of our banking subsidiaries to provide liquidity which, if limited, could impact our ability to pay dividends to our shareholders or to repurchase our common stock. We are a bank holding company, a separate legal entity from our subsidiaries. Our bank holding company does not have significant operations of its own. The ability of our subsidiaries, including our bank and insurance subsidiaries, to pay dividends is limited by various statutes and regulations. It is possible, depending upon the financial condition of our subsidiaries and other factors, that our subsidiaries might be restricted at some point in their ability to pay dividends to the holding company, including by a bank regulator asserting that the payment of such dividends or other payments would constitute an unsafe or unsound practice. In addition, under Dodd-Frank, we are subjected to consolidated capital requirements at the holding company level. If our holding company or its bank subsidiaries are required to retain or increase capital, we may not be able to maintain our cash dividends or pay dividends at all, or to repurchase shares of our common stock.

If economic conditions worsen and the U.S. financial markets should suffer a downturn, we may experience limited access to credit markets. As discussed under Part I, Item 7.D. "Liquidity," we maintain borrowing relationships with various third parties that enable us to obtain from them, on relatively short notice, overnight and longer-term funds sufficient to enable us to fulfill our obligations to customers, including deposit withdrawals. If, in the context of a downturn in the U.S. economy or financial markets, these third parties should encounter difficulty in accessing their own credit markets, we may, in turn, experience a decrease in our capacity to borrow funds from them or other third parties traditionally relied upon by banks for liquidity.

We are subject to the local economies where we operate, and unfavorable economic conditions in these areas could have a material adverse effect on our financial condition and results of operations. Much of our success depends upon the growth in business activity, income levels and deposits in our geographic market area. Although our market area has experienced a stabilizing of economic conditions in recent years and even periods of modest growth, if unpredictable or unfavorable economic conditions unique to our market area should occur in upcoming periods, such will likely have an adverse effect on the quality of our loan portfolio and financial performance. As a community bank, we are less able than our larger regional competitors to spread the risk of unfavorable local economic conditions over a larger market area. Moreover, we cannot give any assurances that we, as a single enterprise, will benefit from any unique and favorable economic conditions in our market area, even if they do occur.

Changes in accounting standards may materially and negatively impact our financial statements. From time-to-time, the Financial Accounting Standards Board ("FASB") changes the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can be hard to predict and can materially impact how we record and report our financial condition and results of operations. In some cases, we may be required to apply a new or revised standard retroactively, resulting in changes to previously reported financial statements. Specifically, changes in the fair value of our financial assets could have a significant negative impact on our asset portfolios and indirectly on our capital levels.

Our business could suffer if we lose key personnel unexpectedly or if employee wages increase significantly. Our success depends, in large part, on our ability to retain our key personnel for the duration of their expected terms of service. On an ongoing basis, we prepare and review back-up plans, in the event key personnel are unexpectedly rendered incapable of performing or depart or resign from their positions. However, any sudden unexpected change at the senior management level may adversely affect our business. In addition, should our industry begin to experience a shortage of qualified employees, we like other financial institutions may have difficulty attracting and retaining entry level or higher bracket personnel and also may experience, as a result of such shortages or the enactment of higher minimum wage laws locally or nationwide, increased salary expense, which would likely negatively impact our results of operations.

We rely on other companies to provide key components of our business infrastructure. Third-party vendors provide key components of our business infrastructure such as Internet connections, network access and mutual fund distribution. The financial health and operational capabilities of these third parties are for the most part beyond our control, and any problems experienced by these third parties, such that they may not be able to continue to provide services to us or to perform such services consistent with our expectations, could adversely affect our ability to deliver products and services to our customers and to conduct our business.

Problems encountered by other financial institutions could adversely affect us. Our ability to engage in routine funding transactions could be adversely affected by financial or commercial problems confronting other financial institutions. Financial services institutions are interrelated as a result of trading, clearing, counterparty and other relationships. We have exposure to many different counterparties in the normal course of business, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, other commercial banks, investment banks, mutual and hedge funds, and other financial institutions. As a result, defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, could lead to market-wide liquidity problems and losses or defaults by us or by other financial institutions on whom we rely or with whom we interact. Some of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated when the collateral held by us cannot be liquidated or only may be liquidated at prices not sufficient to recover the full amount due us under the underlying financial instrument held by us. There is no assurance that any such losses would not materially and adversely affect our results of operations.

Our industry is faced with technological advances and changes on a continuing basis, and failure to adapt to these advances and changes could have a material adverse impact on our business. Technological advances and changes in the financial services industry are pervasive and constant factors. The retail financial services sector, like many other retail goods and services sectors, is currently in the throes of revolutionary change, involving new delivery and communications systems and technologies that are extraordinarily far-reaching and impactful. For us to remain competitive, we must comprehend and adapt to these systems and technologies . Proper implementation of new technologies can increase efficiency, decrease costs and help to meet customer demand. However, many of our competitors have greater resources to invest in technological advances and changes. We may not always be successful in utilizing the latest technological advances in offering our products and services or in otherwise conducting our business. Failure to identify, consider, adapt to and implement technological advances and changes could have a material adverse effect on our business.

Item 1B. Unresolved Staff Comments - None

Item 2. Properties

Our main office is at 250 Glen Street, Glens Falls, New York. The building is owned by us and serves as the main office for Arrow and Glens Falls National, our principal subsidiary bank. The main office of our other banking subsidiary, Saratoga National, is in Saratoga Springs, New York. We own twenty-nine branch banking offices, lease ten branch banking offices and lease two residential loan origination offices, all at market rates. Our insurance agencies are co-located in four bank-owned branches, as well

as four leased bank branches and 1 owned stand-alone building. We also lease office space in buildings and parking lots near our main office in Glens Falls as well as a back-up site for business continuity purposes.
In the opinion of management, the physical properties of our holding company and our various subsidiaries are suitable and adequate. For more information on our properties, see Notes 2, 6 and 18 to the Consolidated Financial Statements contained in Part II, Item 8 of this Report.

Item 3. Legal Proceedings

We are not the subject of any material pending legal proceedings, other than ordinary routine litigation occurring in the normal course of our business. On an ongoing basis, we typically are the subject of or a party to various legal claims, which arise in the normal course of our business. The various legal claims currently pending against us will not, in the opinion of management based upon consultation with counsel, result in any material liability.

Item 4. Mine Safety Disclosures - None

PART II

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The common stock of Arrow Financial Corporation is traded on the Global Select Market of the National Association of Securities Dealers, Inc. ("NASDAQ®")Stock Market under the symbol AROW.
The high and low prices listed below represent actual sales transactions, as reported by NASDAQ®. All stock prices and cash dividends per share have been restated to reflect subsequent stock dividends. On September 29, 2016, we distributed a 3% stock dividend on our outstanding shares of common stock.

	2016			2015		
	Market Price		Cash	Market Price		Cash
	Low	High	Dividends Declared	Low	High	Dividends Declared
First Quarter	$23.83	$26.74	$ 0.243	$24.32	$26.20	$ 0.238
Second Quarter	25.16	29.51	0.243	24.06	26.65	0.238
Third Quarter	28.62	34.08	0.243	25.30	27.18	0.238
Fourth Quarter	30.56	41.70	0.250	25.07	28.39	0.243

The payment of cash dividends by Arrow is determined at the discretion of its Board of Directors and is dependent upon, among other things, our earnings, financial condition and other factors, including applicable legal and regulatory restrictions. See "Capital Resources and Dividends" in Part II, Item 7.E. of this Report.
Based on information received from our transfer agent and various brokers, custodians and agents, we estimate there were approximately 7,000 beneficial owners of Arrow's common stock at December 31, 2016. Arrow has no other class of stock outstanding.

Equity Compensation Plan Information
The following table sets forth certain information regarding Arrow's equity compensation plans as of December 31, 2016. These equity compensation plans were (i) our 2013 Long-Term Incentive Plan ("LTIP"), and its predecessors, our 2008 Long-Term Incentive Plan and our 1998 Long-Term Incentive Plan; (ii) our 2014 Employee Stock Purchase Plan ("ESPP"); and (iii) our 2013 Directors' Stock Plan ("DSP"). All of these plans have been approved by Arrow's shareholders.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in

			Column (a)
Equity Compensation Plans Approved by Security Holders (1)(2)	355,651	$ 22.52	511,293
Equity Compensation Plans Not Approved by Security Holders	—		—
Total	355,651		511,293

(1) All 355,651 shares of common stock listed in column (a) are issuable pursuant to outstanding stock options granted under the LTIP or its predecessor plans.

(2) The total of 511,293 shares listed in column (c) includes (i) 367,775 shares of common stock available for future award grants under the LTIP, (ii) 115,554 shares of common stock available for future issuance under the ESPP, and (iii) 27,964 shares of common stock available for future issuance under the DSP.

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STOCK PERFORMANCE GRAPHS

The following two graphs provide a comparison of the total cumulative return (assuming reinvestment of dividends) for the common stock of Arrow as compared to the Russell 2000 Index, the NASDAQ Banks Index and the Zacks $1B-$5B Bank Assets Index.
The first graph presents comparative stock performance for the five-year period from December 31, 2011 to December 31, 2016 and the second graph presents comparative stock performance for the fifteen-year period from December 31, 2001 to December 31, 2016.
The historical information in the graphs and accompanying tables may not be indicative of future performance of Arrow stock on the various stock indices.

	TOTAL RETURN PERFORMANCE					
	Period Ending					
Index	2011	2012	2013	2014	2015	2016
Arrow Financial Corporation	100.00	113.12	127.72	140.05	146.51	232.25
Russell 2000 Index	100.00	116.35	161.52	169.42	161.95	196.45
NASDAQ Banks Index	100.00	119.64	171.23	179.93	195.98	265.31
Zacks $1B - $5B Bank Assets Index	100.00	118.73	161.37	169.29	185.89	267.98

Source: Prepared by Zacks Investment Research, Inc. Used with permission.

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TOTAL RETURN PERFORMANCE

	Period Ending							
Index	2001	2002	2003	2004	2005	2006	2007	2008
Arrow Financial Corporation	100.00	114.37	133.42	158.20	142.19	144.44	135.32	165.76
Russell 2000 Index	100.00	79.52	117.09	138.68	144.93	171.55	168.87	111.81
NASDAQ Banks Index	100.00	102.37	131.69	150.81	147.31	165.41	130.91	95.44
Zacks $1B - $5B Bank Assets Index	100.00	118.21	164.17	195.13	190.45	220.30	173.64	160.60

TOTAL RETURN PERFORMANCE (Cont'd.)

	Period Ending							
Index	2009	2010	2011	2012	2013	2014	2015	2016
Arrow Financial Corporation	177.11	209.52	192.14	217.34	245.41	269.08	281.50	446.24
Russell 2000 Index	142.19	180.38	172.85	201.11	279.18	292.85	279.92	339.57
NASDAQ Banks Index	79.42	94.44	84.46	101.05	144.63	151.98	165.53	224.09
Zacks $1B - $5B Bank Assets Index	125.68	145.68	139.24	165.32	224.69	235.72	258.83	373.14

Source: Prepared by Zacks Investment Research, Inc. Used with permission.

The preceding stock performance graphs and tables shall not be deemed incorporated by reference, by virtue of any general statement contained herein or in any other filing incorporated by reference herein, into any other SEC filing by the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent the company specifically incorporates this information by reference into such filing, and shall not otherwise be deemed filed as part of any such other filing.

Unregistered Sales of Equity Securities
None.

Issuer Purchases of Equity Securities
The following table presents information about repurchases by Arrow during the three months ended December 31, 2016 of our common stock (our only class of equity securities registered pursuant to Section 12 of the Securities Exchange Act of 1934):

Fourth Quarter 2016 Calendar Month	(a) Total Number of Shares Purchased[1]	(b) Average Price Paid Per Share[1]	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[2]	(d) Maximum Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs[2]
October	3,979	$ 32.40	—	$ 4,505,130
November	7,035	35.82	—	4,505,130
December	14,603	40.10	—	4,505,130
Total	25,617	37.73	—	

[1]The total number of shares purchased and the average price paid per share listed in columns (a) and (b) consist of (i) any shares purchased in such periods in open market or private transactions under the Arrow Financial Corporation Automatic Dividend Reinvestment Plan (the "DRIP") by the administrator of the DRIP, and (ii) shares surrendered or deemed surrendered to Arrow in such periods by holders of options to acquire Arrow common stock received by them under Arrow's long-term incentive plans ("LTIPs") in connection with their stock-for-stock exercise of such options. In the months indicated, the listed number of shares purchased included the following numbers of shares purchased by Arrow through such methods: October - DRIP purchases (2,789 shares), stock-for-stock option exercises (1,190 shares); November - DRIP purchases (1,891 shares), stock-for-stock option exercises (5,144 shares); December - DRIP purchases (12,360 shares), stock-for-stock option exercises (2,243 shares).
[2]Includes only those shares acquired by Arrow pursuant to its publicly-announced stock repurchase programs. Our only publicly-announced stock repurchase program in effect for the fourth quarter of 2016 was the program approved by the Board of Directors and announced in November 2015, under which the Board authorized management, in its discretion, to repurchase from time to time during 2016, in the open market or in privately negotiated transactions, up to $5 million of Arrow common stock subject to certain exceptions (the "2016 Program"). Arrow did not repurchase any of its shares in the fourth quarter of 2016 under the 2016 Program. In October 2016, the Board authorized a repurchase program for 2017 similar to its 2016 program, which also authorizes management to repurchase up to $5 million of stock in the ensuing year (2017).

Item 6. Selected Financial Data

FIVE YEAR SUMMARY OF SELECTED DATA
Arrow Financial Corporation and Subsidiaries
(Dollars In Thousands, Except Per Share Data)

Consolidated Statements of Income Data:	2016	2015	2014	2013	2012
Interest and Dividend Income	$76,915	$70,738	$66,861	$64,138	$69,379
Interest Expense	5,356	4,813	5,767	7,922	11,957
Net Interest Income	71,559	65,925	61,094	56,216	57,422
Provision for Loan Losses	2,033	1,347	1,848	200	845
Net Interest Income After Provision for Loan Losses	69,526	64,578	59,246	56,016	56,577
Noninterest Income	27,854	27,995	28,206	27,521	26,234
Net (Losses) Gains on Securities Transactions	(22)	129	110	540	865
Noninterest Expense	(59,609)	(57,430)	(54,028)	(53,203)	(51,836)
Income Before Provision for Income Taxes	37,749	35,272	33,534	30,874	31,840
Provision for Income Taxes	11,215	10,610	10,174	9,079	9,661
Net Income	$26,534	$24,662	$23,360	$21,795	$22,179
Per Common Share: [1]					
Basic Earnings	$1.98	$1.86	$1.76	$1.65	$1.69
Diluted Earnings	1.97	1.85	1.76	1.65	1.69
Per Common Share: [1]					
Cash Dividends	$0.98	$0.96	$0.94	$0.92	$0.90
Book Value	17.27	16.05	15.16	14.50	13.38
Tangible Book Value [2]	15.45	14.18	13.22	12.53	11.36
Consolidated Year-End Balance Sheet Data:					
Total Assets	$2,605,242	$2,446,188	$2,217,420	$2,163,698	$2,022,796
Securities Available-for-Sale	346,996	402,309	366,139	457,606	478,698
Securities Held-to-Maturity	345,427	320,611	302,024	299,261	239,803
Loans	1,753,268	1,573,952	1,413,268	1,266,472	1,172,641
Nonperforming Assets [3]	7,186	8,924	8,162	7,916	9,070
Deposits	2,116,546	2,030,423	1,902,948	1,842,330	1,731,155
Federal Home Loan Bank Advances	178,000	137,000	51,000	73,000	59,000
Other Borrowed Funds	55,836	43,173	39,421	31,777	32,678
Stockholders' Equity	232,852	213,971	200,926	192,154	175,825
Selected Key Ratios:					
Return on Average Assets	1.06 %	1.05 %	1.07 %	1.04 %	1.11 %
Return on Average Equity	11.79	11.86	11.79	12.11	12.88
Dividend Payout [4]	49.75	51.89	53.41	55.76	53.25
Average Equity to Average Assets	8.95	8.88	9.05	8.56	8.62

[1]Share and per share amounts have been adjusted for subsequent stock splits and dividends, including the most recent September 29, 2016 3% stock dividend.
[2]Tangible book value excludes goodwill and other intangible assets from total equity.
[3]Nonperforming assets consist of nonaccrual loans, loans past due 90 or more days but still accruing interest, repossessed assets, restructured loans, other real estate owned and nonaccrual investments.
[4]Dividend Payout Ratio – cash dividends per share to fully diluted earnings per share.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations
Selected Quarterly Information
Dollars in thousands, except per share amounts
Share and per share amounts have been restated for the September 2016 3% stock dividend

Quarter Ended	12/31/2016	9/30/2016	6/30/2016	3/31/2016	12/31/2015
Net Income	$6,600	$6,738	$6,647	$6,549	$6,569
Transactions Recorded in Net Income (Net of Tax):					
Net (Loss) Gain on Securities Transactions	(101)	—	88	—	14
Period End Shares Outstanding	13,483	13,426	13,388	13,361	13,328
Basic Average Shares Outstanding	13,441	13,407	13,372	13,343	13,306
Diluted Average Shares Outstanding	13,565	13,497	13,429	13,379	13,368
Basic Earnings Per Share	$0.49	$0.50	$0.50	$0.49	$0.49
Diluted Earnings Per Share	0.49	0.50	0.49	0.49	0.49
Cash Dividend Per Share	0.250	0.243	0.243	0.243	0.243
Selected Quarterly Average Balances:					
Interest-Bearing Deposits at Banks	$34,731	$21,635	$22,195	$21,166	$44,603
Investment Securities	684,906	696,712	701,526	716,523	716,947
Loans	1,726,738	1,680,850	1,649,401	1,595,018	1,556,234
Deposits	2,160,156	2,063,832	2,082,449	2,069,964	2,075,825
Other Borrowed Funds	157,044	209,946	165,853	143,274	127,471
Shareholders' Equity	230,198	228,048	223,234	218,307	213,219
Total Assets	2,572,425	2,528,124	2,496,795	2,456,431	2,442,964
Return on Average Assets	1.02 %	1.06 %	1.07 %	1.07 %	1.07 %
Return on Average Equity	11.41 %	11.75 %	11.98 %	12.07 %	12.22 %
Return on Tangible Equity[2]	12.77 %	13.18 %	13.47 %	13.62 %	13.86 %
Average Earning Assets	$2,446,375	$2,399,197	$2,373,122	$2,332,707	$2,317,784
Average Paying Liabilities	1,933,974	1,892,583	1,891,017	1,867,455	1,854,549
Interest Income, Tax-Equivalent	20,709	20,222	20,154	19,549	19,422
Interest Expense	1,404	1,405	1,284	1,263	1,231
Net Interest Income, Tax-Equivalent	19,305	18,817	18,870	18,286	18,191
Tax-Equivalent Adjustment	939	940	917	923	912
Net Interest Margin [3]	3.14 %	3.12 %	3.20 %	3.15 %	3.11 %
Efficiency Ratio Calculation:					
Noninterest Expense	$15,272	$15,082	$14,884	$14,370	$14,242
Less: Intangible Asset Amortization	73	74	74	75	78
Net Noninterest Expense	$15,199	$15,008	$14,810	$14,295	$14,164
Net Interest Income, Tax-Equivalent	$19,305	$18,817	$18,870	$18,286	$18,191
Noninterest Income	6,648	7,114	7,194	6,875	6,687
Less: Net Securities (Losses) Gains	(166)	—	144	—	23
Net Gross Income	$26,119	$25,931	$25,920	$25,161	$24,855
Efficiency Ratio	58.19 %	57.88 %	57.14 %	56.81 %	56.99 %
Period-End Capital Information:					
Total Stockholders' Equity (i.e. Book Value)	$232,852	$229,208	$225,373	$220,703	$213,971
Book Value per Share	17.27	17.07	16.83	16.52	16.05

Intangible Assets	24,569		24,675		24,758		24,872		24,980	
Tangible Book Value per Share [2]	15.45		15.23		14.98		14.66		14.18	
Capital Ratios:										
Tier 1 Leverage Ratio	9.47	%	9.44	%	9.37	%	9.36	%	9.25	%
Common Equity Tier 1 Capital Ratio	12.97	%	12.80	%	12.74	%	12.84	%	12.82	%
Tier 1 Risk-Based Capital Ratio	14.14	%	13.98	%	13.95	%	14.08	%	14.08	%
Total Risk-Based Capital Ratio	15.15	%	14.99	%	14.96	%	15.09	%	15.09	%
Assets Under Trust Administration and Investment Management	$1,301,408		$1,284,051		$1,250,770		$1,231,237		$1,232,890	

[1] See "Use of Non-GAAP Financial Measures" on page 4.

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Selected Twelve-Month Information
Dollars in thousands, except per share amounts
Share and per share amounts have been restated for the September 2016 3% stock dividend

	2016		2015		2014	
Net Income	$26,534		$24,662		$23,360	
Transactions Recorded in Net Income (Net of Tax):						
Net Securities (Losses) Gains	$(13	)	$78		$67	
Period End Shares Outstanding	13,483		13,328		13,260	
Basic Average Shares Outstanding	13,391		13,281		13,242	
Diluted Average Shares Outstanding	13,476		13,330		13,272	
Basic Earnings Per Share	$1.98		$1.86		$1.76	
Diluted Earnings Per Share	1.97		1.85		1.76	
Cash Dividends Per Share	0.98		0.96		0.94	
Average Assets	$2,513,645		$2,341,467		$2,190,480	
Average Equity	224,969		208,017		198,208	
Return on Average Assets	1.06	%	1.05	%	1.07	%
Return on Average Equity	11.79		11.86		11.79	
Average Earning Assets	$2,388,042		$2,218,440		$2,068,611	
Average Interest-Bearing Liabilities	1,896,351		1,777,867		1,675,285	
Interest Income, Tax-Equivalent [1]	80,636		74,227		70,188	
Interest Expense	5,356		4,813		5,767	
Net Interest Income, Tax-Equivalent [1]	75,280		69,414		64,421	
Tax-Equivalent Adjustment	3,721		3,489		3,327	
Net Interest Margin [1]	3.15	%	3.13	%	3.11	%
Efficiency Ratio Calculation [1]						
Noninterest Expense	$59,609		$57,430		$54,028	
Less: Intangible Asset Amortization	297		327		387	
Net Noninterest Expense	$59,312		$57,103		$53,641	
Net Interest Income, Tax-Equivalent [1]	$75,280		$69,414		$64,421	
Noninterest Income	27,832		28,124		28,316	
Less: Net Securities (Losses) Gains	(22	)	129		110	
Net Gross Income, Adjusted	$103,134		$97,409		$92,627	
Efficiency Ratio [1]	57.51	%	58.62	%	57.91	%
Period-End Capital Information:						
Tier 1 Leverage Ratio	9.47	%	9.25	%	9.44	%
Total Stockholders' Equity (i.e. Book Value)	$232,852		$213,971		$200,926	
Book Value per Share	17.27		16.05		15.15	
Intangible Assets	24,569		24,980		25,628	
Tangible Book Value per Share [1]	15.45		14.18		13.22	
Asset Quality Information:						
Net Loans Charged-off as a Percentage of Average Loans	0.06	%	0.06	%	0.05	%
Provision for Loan Losses as a Percentage of Average Loans	0.12	%	0.09	%	0.14	%
Allowance for Loan Losses as a Percentage of Period-End Loans	0.97	%	1.02	%	1.10	%
Allowance for Loan Losses as a Percentage of Nonperforming Loans	309.31	%	232.24	%	200.41	%
Nonperforming Loans as a Percentage of Period-End Loans	0.31	%	0.44	%	0.55	%
Nonperforming Assets as a Percentage of Total Assets	0.28	%	0.36	%	0.37	%

[1] See "Use of Non-GAAP Financial Measures" on page 4.

Arrow Financial Corporation
Reconciliation of Non-GAAP Financial Information
(Dollars In Thousands, Except Per Share Amounts)

Footnotes:

1. Share and Per Share Data have been restated for the September 29, 2016 3% stock dividend.

2. Tangible Book Value, Tangible Equity, and Return on Tangible Equity exclude goodwill and other intangible assets, net from total equity. These are non-GAAP financial measures which we believe provide investors with information that is useful in understanding our financial performance.

	12/31/2016	9/30/2016	6/30/2016	3/31/2016	12/31/2015
Total Stockholders' Equity (GAAP)	$232,852	$229,208	$225,373	$220,703	$213,971
Less: Goodwill and Other Intangible assets, net	24,569	24,675	24,758	24,872	24,980
Tangible Equity (Non-GAAP)	$208,283	$204,533	$200,615	$195,831	$188,991
Period End Shares Outstanding	13,483	13,426	13,388	13,361	13,328
Tangible Book Value per Share (Non-GAAP)	$15.45	$15.23	$14.98	$14.66	$14.18
Net Income	6,600	6,738	6,647	6,549	6,569
Return on Tangible Equity (Net Income/Tangible Equity - Annualized)	12.77 %	13.18 %	13.47 %	13.62 %	13.86 %

3. Net Interest Margin is the ratio of our annualized tax-equivalent net interest income to average earning assets. This is also a non-GAAP financial measure which we believe provides investors with information that is useful in understanding our financial performance.

	12/31/2016	9/30/2016	6/30/2016	3/31/2016	12/31/2015
Interest Income (GAAP)	$19,770	$19,282	$19,237	$18,626	$18,510
Add: Tax Equivalent Adjustment (Non-GAAP)	939	940	917	923	912
Interest Income - Tax Equivalent (Non-GAAP)	$20,709	$20,222	$20,154	$19,549	$19,422
Net Interest Income (GAAP)	$18,366	$17,877	$17,953	$17,363	$17,279
Add: Tax-Equivalent adjustment (Non-GAAP)	939	940	917	923	912
Net Interest Income - Tax Equivalent (Non-GAAP)	$19,305	$18,817	$18,870	$18,286	$18,191
Average Earning Assets	2,446,375	2,399,197	2,373,122	2,332,707	2,317,784
Net Interest Margin (Non-GAAP)	3.14 %	3.12 %	3.20 %	3.15 %	3.11 %

4. Financial Institutions often use the "efficiency ratio", a non-GAAP ratio, as a measure of expense control. We believe the efficiency ratio provides investors with information that is useful in understanding our financial performance. We define our efficiency ratio as the ratio of our noninterest expense to our net gross income (which equals our tax-equivalent net interest income plus noninterest income, as adjusted).

5. For the current quarter, all of the regulatory capital ratios in the table above, as well as the Total Risk-Weighted Assets and Common Equity Tier 1 Capital amounts listed in the table below, are estimates based on, and calculated in accordance with bank regulatory capital rules. All prior quarters reflect actual results. The December 31, 2016 CET1 ratio listed in the tables (i.e., 12.92%) exceeds the sum of the required minimum CET1 ratio plus the fully phased-in Capital Conservation Buffer (i.e., 7.00%).

	12/31/2016	9/30/2016	6/30/2016	3/31/2016	12/31/2015
Total Risk Weighted Assets	1,707,829	1,690,646	1,662,381	1,617,957	1,590,129
Common Equity Tier 1 Capital	221,472	216,382	211,801	207,777	203,848

Common Equity Tier 1 Ratio	12.97 %	12.80 %	12.74 %	12.84 %	12.82 %

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CRITICAL ACCOUNTING ESTIMATES

Our significant accounting principles, as described in Note 2 - Summary of Significant Accounting Policies to the Consolidated Financial Statements are essential in understanding the MD&A. Many of our significant accounting policies require complex judgments to estimate the values of assets and liabilities. We have procedures and processes in place to facilitate making these judgments. The more judgmental estimates are summarized in the following discussion. In many cases, there are numerous alternative judgments that could be used in the process of determining the inputs to the models. Where alternatives exist, we have used the factors that we believe represent the most reasonable value in developing the inputs. Actual performance that differs from
our estimates of the key variables could impact our results of operations.

Allowance for loan losses: The allowance for loan losses represents management’s estimate of probable losses inherent in the Company’s loan portfolio. Our process for determining the allowance for loan losses is discussed in Note 2 - Summary of Significant Accounting Policies and Note 5 - Loans to the Consolidated Financial Statements. We evaluate our allowance at the portfolio segment level and our portfolio segments are commercial, commercial real estate, residential real estate, and consumer loans. Due to the variability in the drivers of the assumptions used in this process, estimates of the portfolio’s inherent risks and overall collectability change with changes in the economy, individual industries, and borrowers’ ability and willingness to repay their obligations. The degree to which any particular assumption affects the allowance for loan losses depends on the severity of the change and its relationship to the other assumptions. Key judgments used in determining the allowance for loan losses for individual commercial loans include credit quality indicators, collateral values and estimated cash flows for impaired loans. For pools of loans we consider our historical net loss experience, and as necessary, adjustments to address current events and conditions, considerations regarding economic uncertainty, and overall credit conditions. The historical loss factors incorporate a rolling twelve quarter look-back period for each loan segment in order to reduce the volatility associated with improperly weighting short-term fluctuations. The process of determining the level of the allowance for loan losses requires a high degree of judgment. Any downward trend in the economy, regional or national, may require us to increase the allowance for loan losses resulting in a negative impact on our results of operations and financial condition.

Pension and retirement plans: Management is required to make various assumptions in valuing its pension and postretirement plan assets, expenses and liabilities. The most significant assumptions include the expected rate of return on plan assets, the discount rate, and the rate of increase in future compensation levels. Changes to these assumptions could impact earnings in future periods. The Company utilizes an actuarial firm to assist in determining the various rates used to estimate pension obligations and expense, including the evaluation of market interest rates and discounted cash flows in setting the appropriate discount rate. In addition, the Company reviews expected inflationary and merit increases to compensation in determining the rate of increase in future compensation levels. Changes in these assumptions due to market conditions and governing laws and regulations may result in material changes to the Company’s pension and other postretirement plan assets, expenses and liabilities.

Other than temporary decline in the value of debt and equity securities: Management systematically evaluates individual securities classified as either available-for-sale or held-to-maturity to determine whether a decline in fair value below the amortized cost basis is other than temporary. Management considers historical values and current market conditions as a part of the assessment. The amount of the total other-than-temporary impairment related to the credit loss, if any, is recognized in earnings and the amount of the total other-than-temporary impairment related to other factors is generally recognized in other comprehensive income, net of applicable taxes unless the Company intends to sell the security prior to the recovery of the unrealized loss or it is more likely than not that the Company would be forced to sell the security, in which case the entire impairment is recognized in earnings. Any significant economic downturn might result, and historically have on occasion resulted, in an other-than-temporary impairment in securities held in our investment portfolio.

A. OVERVIEW

The following discussion and analysis focuses on and reviews our results of operations for each of the years in the three-year period ended December 31, 2016 and our financial condition as of December 31, 2016 and 2015. The discussion below should be read in conjunction with the selected quarterly and annual information set forth above and the consolidated financial statements and other financial data presented elsewhere in this Report. When necessary, prior-year financial information has been reclassified to conform to the current-year presentation.

Summary of 2016 Financial Results: We reported net income for 2016 of $26.5 million, an increase of $1.9 million or 7.6% over the 2015 total. Diluted earnings per share ("EPS") for 2016 was $1.97, an increase of $0.12, or 6.5% from our 2015 EPS. Return on average equity ("ROE") for the 2016 year continued to be strong at 11.79%, down from our ROE of 11.86% for the 2015 year. Return on average assets ("ROA") for 2016 also continued to be strong at 1.06%, an increase from an ROA of 1.05% for 2015.

The driving factor behind our increase in net income was a significant increase year-over-year in our net interest income, which increased to $71.6 million in 2016 from $65.9 million in 2015, an 8.5% increase. Tax-equivalent net interest income (a non-GAAP measure, see p. 4) was $75.3 million for 2016, an increase of $5.9 million or 8.5% over the $69.4 million total for 2015. This increase in net interest income was primarily attributable to the significant amount of loan growth we experienced during the year. See our analysis of changes in the loan portfolio beginning on page 40. Our noninterest income, including net gains (losses) on securities transactions, decreased in 2016 by $292 thousand, or 1.0%, while our noninterest expense increased by $2.2 million, or 3.8%. The

increased provision for loan losses in 2016 over 2015 of $686 thousand was primarily due to the significant growth in our loan portfolio. Asset quality measures remained strong throughout the year.
Total assets were $2.6 billion at December 31, 2016, which represented an increase of $159.1 million, or 6.5%, above the $2.4 billion level at December 31, 2015. Virtually all asset growth was the result of organic internal growth from our existing branch network, as opposed to acquisitions.
Total Stockholders' equity was $232.9 million at December 31, 2016, an increase of $18.9 million, or 8.8%, from the year earlier level. The components of the change in stockholders' equity since year-end 2015 are presented in the Consolidated Statement of Changes in Stockholders' Equity on page 59. Total book value per share increased by 7.6% over the prior year level. At December 31, 2016, our tangible book value per share, a non-GAAP financial measure calculated based on tangible book value (total stockholders' equity minus intangible assets including goodwill) was $15.45, an increase of $1.27, or 9.0%, over the December 31, 2015 amount. This increase in total stockholders' equity during 2016 principally reflected the following factors: (i) $26.5 million net income for the period, plus (ii) $3.1 million of equity received from our various stock-based compensation plans, plus (iii) a $1.1 million increase in accumulated other comprehensive income, reduced by (iv) cash dividends of $13.1 million; and (v) repurchases of our own common stock of $2.1 million. As of December 31, 2016, our closing stock price was $40.50, resulting in a trading multiple of 2.62 to our tangible book value. The Board of Directors declared and the Company paid a cash dividend of $0.243 per share for each of the first three quarters of 2016, as adjusted for a 3% stock dividend distributed September 29, 2016, a cash dividend of $0.25 per share for the fourth quarter of 2016, and has declared a $0.25 per share cash dividend for the first quarter of 2017.

Regulatory capital: As of December 31, 2016, we continued to exceed all regulatory minimum capital requirements at both the holding company and bank levels, by a substantial amount. As of January 1, 2015, we became subject to revised bank regulatory capital standards adopted in 2013 by federal bank regulatory agencies pursuant to the Dodd-Frank Act. These revised regulatory standards generally require financial institutions to meet higher minimum capital levels, measured in new ways. The standards are being phased in over a 5-year time period ending in 2019. See "Regulatory Capital Standards" on pages 7 and 8.

Economic trends and loan quality: During the past three years, economic activity in our market area has been generally positive, but employment growth and average hourly wages have been less than the national average. Single family home values in upstate New York have generally increased at a higher rate than the national average over the same period. Our nonperforming loans were $5.5 million at December 31, 2016, a decrease of $1.4 million, or 20.4%, from year-end 2015, even with substantial portfolio growth. The ratio of nonperforming loans to period-end loans at December 31, 2016 was 0.31%, a decrease from 0.44% at December 31, 2015. By way of comparison, this ratio for our peer group was 0.83% at September 30, 2016 which itself was a significant improvement for the peer group from its ratio of 3.60% at year-end 2010, and is now below the group's ratio of 1.09% at December 31, 2007 (i.e., before the financial crisis). Loans charged-off (net of recoveries) against our allowance for loan losses amounted to $1.1 million for 2016, an increase of $180 thousand from 2015. Our ratio of net charge-offs to average loans was 0.06% for 2016, compared to our peer group ratio of 0.07% for the period ended September 30, 2016. At December 31, 2016, our allowance for loan losses was $17.0 million, representing 0.97% of total loans, a decrease of 5 basis points from the December 31, 2015 ratio.

Our major loan segments are:
Commercial Loans: These loans comprise approximately 6% of our loan portfolio. The business sector in our service area, including small- and mid-sized businesses with headquarters in the area, continued to be in reasonably good financial condition at period-end, and some lines of business appear to be experiencing modest improvement during the year.
Commercial Real Estate Loans: These loans comprise approximately 25% of our loan portfolio. Commercial property values in our region have remained stable in recent periods, although it should be noted such values did not show

significant deterioration even in the worst phases of the financial crisis. We update the appraisals on our nonperforming and watched commercial properties as deemed necessary, usually when the loan is downgraded or when we perceive significant market deterioration since our last appraisal.

Residential Real Estate Loans: These loans, including home equity loans, make up approximately 39% of our portfolio. We have not experienced any significant increase in our delinquency and foreclosure rates, primarily due to the fact that we not have originated or participated in underwriting high-risk mortgage loans, such as so called "Alt A," "negative amortization," "option ARM's" or "negative equity" loans. We originate all of the residential real estate loans held in our portfolio and apply conservative underwriting standards to all of our originations. The residential real estate market in our service area has been stable in recent periods. If long-term interest rates, which decreased during the second quarter of 2016 before rebounding modestly during the third quarter, do not increase significantly above their period-end levels, we may continue to experience a modest volume of mortgage refinancings. We typically sell a portion, sometimes a significant portion, of our residential real estate mortgage originations to the secondary market, although our sales of originations as a portion of our total originations have diminished somewhat in recent periods.

Consumer Loans (Primarily Indirect Automobile Loans): These loans comprise approximately 31% of our loan portfolio. Throughout the past three years we did not experience any significant change in our level of charge-offs on these loans or in our overall average delinquency rate for automobile loans. Employment in our service area continues to expand modestly, and unemployment rates remain low, well off their post-crisis levels.

Liquidity and access to credit markets: We did not experience any liquidity problems or special concerns during 2016, nor during the prior two years. The terms of our lines of credit with our correspondent banks, the FHLBNY and the Federal Reserve Bank have not changed (see our general liquidity discussion on page 47). In general, we principally rely on asset-based liquidity (i.e., funds in overnight investments and cash flow from maturing investments and loans) with liability-based liquidity as a secondary source. Our main liability-based sources are overnight borrowing arrangements with our correspondent banks, an arrangement for overnight borrowing and term credit advances from the FHLBNY, and an additional arrangement for short-term advances at the Federal Reserve Bank discount window). We regularly perform a liquidity stress test and periodically test our contingent liquidity plan to ensure that we can generate an adequate amount of available funds to meet a wide variety of potential liquidity crises, including a severe crisis.

Visa Class B Common Stock: We, like other former Visa member banks, bear some indirect contingent liability for Visa's future liability on such claims to the extent that Visa's liability might exceed the remaining escrow amount. In light of the current state of covered litigation at Visa, which is winding down, as well as the substantial remaining dollar amounts in Visa's escrow fund, we determined that the balance that Visa maintains in its escrow fund is substantially sufficient to satisfy Visa's remaining direct liability to such claims without further resort to the contingent liability of the former Visa member banks such as ours. At December 31, 2016, the Company held 45,686 shares of Visa Class B common stock. There continue to be restrictions remaining on Visa Class B shares held by us. We continue not to recognize any economic value for these shares.

B. RESULTS OF OPERATIONS

The following analysis of net interest income, the provision for loan losses, noninterest income, noninterest expense and income taxes, highlights the factors that had the greatest impact on our results of operations for December 31, 2016 and the prior two years.

I. NET INTEREST INCOME (Tax-equivalent Basis)
Net interest income represents the difference between interest, dividends and fees earned on loans, securities and other earning assets and interest paid on deposits and other sources of funds. Changes in net interest income result from changes in the level and mix of earning assets and sources of funds (volume) and changes in the yields earned and interest rates paid (rate). Net interest margin is the ratio of net interest income to average earning assets. Net interest income may also be described as the product of average earning assets and the net interest margin. As described in the section entitled “Use of Non-GAAP Financial Measures” on page 4 of this Report, for purposes of our presentation of Selected Financial Information in this Report, including in this Item 7, "Management's Discussion and Analysis of Financial Conditions and Results of Operations," we calculate net interest income on a tax-equivalent basis, producing a non-GAAP financial measure. For our 2016 adjustment, we used a marginal tax rate of 35%. See the discussion and calculation of our 2016 tax equivalent net interest income and net interest margin on page 4 of this Report.

CHANGE IN NET INTEREST INCOME
(Dollars In Thousands) (Tax-equivalent Basis)

	Years Ended December 31,			Change From Prior Year					
				2015 to 2016			2014 to 2015		
	2016	2015	2014	Amount	%		Amount	%	
Interest and Dividend Income	$80,636	$74,227	$70,188	$6,409	8.6	%	$4,039	5.8	%
Interest Expense	5,356	4,813	5,767	543	11.3		(954)	(16.5)	
Net Interest Income	$75,280	$69,414	$64,421	$5,866	8.5		$4,993	7.8	

On a tax-equivalent basis, net interest income was $75.3 million in 2016, an increase of $5.9 million, or 8.5%, from $69.4 million in 2015. This compared to an increase of $5.0 million, or 7.8%, from 2014 to 2015. Factors contributing to the year-to-year changes in net interest income over the three-year period are discussed in the following portions of this Section B.I.

In the following table, net interest income components are presented on a tax-equivalent basis. Changes between periods are attributed to movement in either the average daily balances or average rates for both earning assets and interest-bearing liabilities. Changes attributable to both volume and rate have been allocated proportionately between the categories.

	2016 Compared to 2015 Change in Net Interest Income Due to:			2015 Compared to 2014 Change in Net Interest Income Due to:		
Interest and Dividend Income:	Volume	Rate	Total	Volume	Rate	Total
Interest-Bearing Bank Balances	$(26)	$85	$59	$12	$2	$14
Investment Securities:						
Fully Taxable	(199)	88	(111)	428	(337)	91
Exempt from Federal Taxes	306	91	397	(536)	731	195
Loans	6,808	(744)	6,064	5,455	(1,716)	3,739
Total Interest and Dividend Income	6,889	(480)	6,409	5,359	(1,320)	4,039
Interest Expense:						
Deposits:						
Interest-Bearing Checking Accounts	3	—	3	103	(549)	(446)
Savings Deposits	86	104	190	50	(148)	(98)
Time Deposits of $100,000 or More	60	37	97	(102)	(312)	(414)
Other Time Deposits	(38)	(46)	(84)	(170)	(442)	(612)
Total Deposits	111	95	206	(119)	(1,451)	(1,570)
Short-Term Borrowings	182	83	265	44	17	61
Long-Term Debt	203	(131)	72	797	(242)	555
Total Interest Expense	496	47	543	722	(1,676)	(954)
Net Interest Income	$6,393	$(527)	$5,866	$4,637	$356	$4,993

The following table reflects the components of our net interest income, setting forth, for years ended December 31, 2016, 2015 and 2014: (i) average balances of assets, liabilities and stockholders' equity, (ii) interest and dividend income earned on earning assets and interest expense incurred on interest-bearing liabilities, (iii) average yields earned on earning assets and average rates paid on interest-bearing liabilities, (iv) the net interest spread (average yield less average cost) and (v) the net interest margin (yield) on earning assets. Interest income, net interest income and interest rate information is presented on a tax-equivalent basis, using a marginal tax rate of 35% (see the discussion under "Use of Non-GAAP Financial Measures" on page 4 of this Report). The yield on securities available-for-sale is based on the amortized cost of the securities. Nonaccrual loans are included in average loans.

Average Consolidated Balance Sheets and Net Interest Income Analysis
(Tax-equivalent basis using a marginal tax rate of 35%)
(Dollars in Thousands)

Years Ended:	2016			2015			2014		
	Average Balance	Interest Income/ Expense	Rate Earned/ Paid	Average Balance	Interest Income/ Expense	Rate Earned/ Paid	Average Balance	Interest Income/ Expense	Rate Earned/ Paid
Interest-Bearing Deposits at Banks	$24,950	$153	0.61 %	$32,562	$94	0.29 %	$28,266	$80	0.28 %
Investment Securities:									
Fully Taxable	420,885	7,950	1.89 %	431,445	8,061	1.87 %	408,989	7,970	1.95 %
Exempt from Federal Taxes	278,982	9,187	3.29 %	269,667	8,790	3.26 %	286,929	8,595	3.00 %
Loans	1,663,225	63,346	3.81 %	1,484,766	57,282	3.86 %	1,344,427	53,543	3.98 %
Total Earning Assets	2,388,042	80,636	3.38 %	2,218,440	74,227	3.35 %	2,068,611	70,188	3.39 %
Allowance for Loan Losses	(16,449)			(15,595)			(14,801)		
Cash and Due From Banks	33,207			31,007			30,383		
Other Assets	108,845			107,615			106,287		
Total Assets	$2,513,645			$2,341,467			$2,190,480		
Deposits:									
Interest-Bearing Checking Accounts	$912,461	1,279	0.14 %	$915,565	1,276	0.14 %	$861,457	1,722	0.20 %
Savings Deposits	616,208	931	0.15 %	554,330	741	0.13 %	521,595	839	0.16 %
Time Deposits of $100,000 Or More	69,489	453	0.65 %	59,967	356	0.59 %	70,475	770	1.09 %
Other Time Deposits	129,084	658	0.51 %	136,396	742	0.54 %	158,592	1,354	0.85 %
Total Interest-Bearing Deposits	1,727,242	3,321	0.19 %	1,666,258	3,115	0.19 %	1,612,119	4,685	0.29 %
Short-Term Borrowings	94,109	393	0.42 %	45,595	128	0.28 %	29,166	67	0.23 %
FHLBNY Term Advances and	75,000	1,642	2.19 %	66,014	1,570	2.38 %	34,000	1,015	2.99 %

Other Long-Term Debt									
Total Interest-Bearing Liabilities	1,896,351	5,356	0.28 %	1,777,867	4,813	0.27 %	1,675,285	5,767	0.34 %
Demand Deposits	366,956			329,017			290,922		
Other Liabilities	25,369			26,566			26,065		
Total Liabilities	2,288,676			2,133,450			1,992,272		
Stockholders’ Equity	224,969			208,017			198,208		
Total Liabilities and Stockholders’ Equity	$2,513,645			$2,341,467			$2,190,480		
Net Interest Income (Tax-equivalent Basis)		75,280			69,414			64,421	
Reversal of Tax Equivalent Adjustment		(3,721)	0.16 %		(3,489)	0.16 %		(3,327)	0.16 %
Net Interest Income		$71,559			$65,925			$61,094	
Net Interest Spread			3.10 %			3.08 %			3.05 %
Net Interest Margin			3.15 %			3.13 %			3.11 %

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CHANGES IN NET INTEREST INCOME DUE TO RATE

YIELD ANALYSIS (Tax-equivalent basis)	December 31,		
	2016	2015	2014
Yield on Earning Assets	3.38%	3.35%	3.39%
Cost of Interest-Bearing Liabilities	0.28	0.27	0.34
Net Interest Spread	3.10%	3.08%	3.05%
Net Interest Margin	3.15%	3.13%	3.11%

Our increase in net interest income on a tax-equivalent basis (a non-GAAP measure, see discussion on p. 4) from 2015 to 2016 was $5.9 million, or 8.5%, which continued the trend of increasing net interest income experienced by us in 2015 and 2014. These increases were similar to increases in our average earning assets during the respective year aided in 2016 by a continued slight increase in our net interest margin.

During 2016, our net interest margin (NIM) increased two basis points, as our yield on earning assets increased more than our cost of interest bearing liabilities. Our NIM has continued to increase as we have repositioned our asset portfolio in favor of loans versus investment securities. While our continued loan growth has been the primary driver for maintaining a stable NIM for the past three years, our increased ratio of non-interest-bearing demand deposits to total deposits has helped limit the increase in our cost of funds. We can give no assurances regarding our NIM in 2017 or following periods, even though the Fed has raised short term rates in December of each of the last two years and has signaled the markets that additional rate increases are likely in 2017. We continue to believe that the Fed will be extremely cautious in following through on additional rate increases in future periods.

Our existing, higher-rate assets continue to mature and pay off at a faster pace than we originate new loans (at slightly higher rates) and purchase new investment securities (at slightly higher rates). As a result, we may continue to experience margin compression in upcoming periods, even if prevailing rates ascend slowly. In this light, no assurances can be given that our net interest income will increase in 2017 and subsequent periods, even if asset growth continues or increases, or that net earnings will continue to grow.

A discussion of the models we use in projecting the impact on net interest income resulting from possible changes in interest rates vis-à-vis the repricing patterns of our earning assets and interest-bearing liabilities is included later in this report under Item 7.A., "Quantitative and Qualitative Disclosures About Market Risk."

CHANGES IN NET INTEREST INCOME DUE TO VOLUME
AVERAGE BALANCES
(Dollars In Thousands)

	Years Ended December 31,			Change From Prior Year			
				2015 to 2016		2014 to 2015	
	2016	2015	2014	Amount	%	Amount	%
Earning Assets	$2,388,042	$2,218,440	$2,068,611	$169,602	7.6 %	$149,829	7.2 %
Interest-Bearing Liabilities	1,896,351	1,777,867	1,675,285	118,484	6.7	102,582	6.1
Demand Deposits	366,956	329,017	290,922	37,939	11.5	38,095	13.1
Total Assets	2,513,645	2,341,467	2,190,480	172,178	7.4	150,987	6.9
Earning Assets to Total Assets	95.00 %	94.75 %	94.44 %				

2016 Compared to 2015: In general, an increase in average earning assets has a positive impact on net interest income. For 2016, average earning assets increased $169.6 million or 7.6% over 2015, while average interest-bearing liabilities increased $118.5 million, or 6.7%, and non-interest bearing demand deposits increased $37.9 million or 11.5%. The growth in our net earning assets and demand deposits were the primary factors in the $5.9 million, or 7.8%, increase in our net interest income in 2016 (on a tax-equivalent basis).

An underlying factor in our net asset growth in 2016, and the resulting increase in our net interest income, was a positive change in the mix of our earning assets. The $169.6 million increase in average earning assets from 2015 to 2016 resulted from the average balance of our securities portfolio remaining virtually unchanged, while the average balance of our total loans increased substantially. Within the loan portfolio, our three principal segments are residential real estate loans, automobile loans (primarily through our indirect lending program) and commercial loans. We continued to sell a portion of our residential real estate loan originations into the secondary market in 2016, approximately 16% of our originations. Additionally, we originated a higher volume of residential mortgages in 2016 than in the prior two years and as a result, we experienced a significant increase in the average balance of this segment of the portfolio in 2016. The average balance of our automobile loan portfolio also increased in 2016, reflecting continuing strong demand in automobile sales and our determination to remain competitive on our pricing of these loans with respect to other commercial banks (although we remained at a disadvantage compared to the subsidized, below-market loan rates offered by the financing affiliates of the automobile manufacturers). Our commercial and commercial real estate loan portfolio also experienced growth during 2016.

The $118.5 million increase in average interest-bearing liabilities during 2016 was primarily attributable to an increase in deposits from our existing branch network and secondarily to a $41 million increase in our FHLBNY advances.

2015 Compared to 2014: For 2015, average earning assets increased $149.8 million or 7.2% over 2014, while average interest-bearing liabilities increased $102.6 million, or 6.1%. The growth in our net earning assets was the primary factor in the $4.7 million, or 7.2%, increase in our net interest income in 2015 (on a tax-equivalent basis).

An underlying factor in our net asset growth in 2015, and the resulting increase in our net interest income, was a positive change in the mix of our earning assets. The $149.8 million increase in average earning assets from 2014 to 2015 resulted from a slight increase in the average balance of our securities portfolio, while the average balance of our total loans increased substantially. Within the loan portfolio, our three principal segments are residential real estate loans, automobile loans (primarily through our indirect lending program) and commercial loans. We sold a portion of our residential real estate loan originations into the secondary market in 2015, but such sales were a significantly smaller percentage of our originations than in either of the prior two years. Additionally, we originated a higher volume of residential mortgages in 2015 than in the prior two years. As a result, we experienced a significant increase in the average balance of this segment of the portfolio in 2015. The average balance of our automobile loan portfolio also increased in 2015, reflecting continuing strong demand in automobile sales and our determination to remain competitive on our pricing of these loans with respect to other commercial banks (although we remained at a disadvantage compared to the subsidized, below-market loan rates offered by the financing affiliates of the automobile manufacturers). Our commercial and commercial real estate loan portfolio also experienced growth during 2015.

The $102.6 million increase in average interest-bearing liabilities during 2015 was primarily attributable to an increase in deposits from our existing branch network and secondarily to a $49 million increase in our FHLBNY advances.

II. PROVISION FOR LOAN LOSSES AND ALLOWANCE FOR LOAN LOSSES

We consider our accounting policy relating to the allowance for loan losses to be a critical accounting policy, given the uncertainty involved in evaluating the level of the allowance required to cover credit losses inherent in the loan portfolio, and the material effect that such judgments may have on our results of operations. We recorded a $2.0 million provision for loan losses for 2016, compared to the $1.3 million provision for 2015. The level of the 2016 provision was impacted primarily by the significant growth in loan balances during 2016. Our analysis of the method we employ for determining the amount of the loan loss provision is explained in detail in Notes 2 and 5 to the audited financial statements.

SUMMARY OF THE ALLOWANCE AND PROVISION FOR LOAN LOSSES
(Dollars In Thousands) (Loans, Net of Unearned Income)

Years-Ended December 31,	2016	2015	2014	2013	2012
Period-End Loans	$1,753,268	$1,573,952	$1,413,268	$1,266,472	$1,172,341
Average Loans	1,663,225	1,484,766	1,344,427	1,208,954	1,147,286
Period-End Assets	2,605,242	2,446,188	2,217,420	2,163,698	2,022,796
Nonperforming Assets, at Period-End:					
Nonaccrual Loans:					
Commercial Real Estate	875	2,402	2,071	2,048	2,026
Commercial Loans	155	387	473	352	1,787
Residential Real Estate Loans	2,574	3,195	3,940	3,860	2,400
Consumer Loans	589	449	415	219	420
Total Nonaccrual Loans	4,193	6,433	6,899	6,479	6,633
Loans Past Due 90 or More Days and Still Accruing Interest	1,201	187	537	652	920
Restructured	106	286	333	641	483
Total Nonperforming Loans	5,500	6,906	7,769	7,772	8,036
Repossessed Assets	101	140	81	63	64
Other Real Estate Owned	1,585	1,878	312	81	970
Total Nonperforming Assets	$7,186	$8,924	$8,162	$7,916	$9,070
Allowance for Loan Losses:					
Balance at Beginning of Period	$16,038	$15,570	$14,434	$15,298	$15,003
Loans Charged-off:					
Commercial Loans	(97)	(62)	(212)	(926)	(90)
Real Estate - Commercial	(195)	(7)	—	(11)	(206)
Real Estate - Residential	(107)	(326)	(91)	(15)	(33)
Consumer Loans	(871)	(711)	(718)	(459)	(453)
Total Loans Charged-off	(1,270)	(1,106)	(1,021)	(1,411)	(782)
Recoveries of Loans Previously Charged-off:					
Commercial Loans	23	33	86	88	23
Real Estate – Commercial	—	—	—	—	—
Real Estate – Residential	6	—	—	—	—
Consumer Loans	182	194	223	259	209
Total Recoveries of Loans Previously Charged-off	211	227	309	347	232
Net Loans Charged-off	(1,059)	(879)	(712)	(1,064)	(550)

Provision for Loan Losses					
Charged to Expense	2,033	1,347	1,848	200	845
Balance at End of Period	$17,012	$16,038	$15,570	$14,434	$15,298
Asset Quality Ratios:					
Net Charge-offs to Average Loans	0.06 %	0.06 %	0.05 %	0.09 %	0.05 %
Provision for Loan Losses to Average Loans	0.12 %	0.09 %	0.14 %	0.02 %	0.07 %
Allowance for Loan Losses to Period-end Loans	0.97 %	1.02 %	1.10 %	1.14 %	1.30 %
Allowance for Loan Losses to Nonperforming Loans	309.31 %	232.24 %	200.41 %	185.71 %	190.37 %
Nonperforming Loans to Period-end Loans	0.31 %	0.44 %	0.55 %	0.61 %	0.69 %
Nonperforming Assets to Period-end Assets	0.28 %	0.36 %	0.37 %	0.37 %	0.45 %

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ALLOCATION OF THE ALLOWANCE FOR LOAN LOSSES
(Dollars in Thousands)

	2016	2015	2014	2013	2012
Commercial Loans	$1,017	$1,827	$2,382	$2,303	$2,945
Real Estate-Commercial	5,677	4,520	3,846	3,545	3,050
Real Estate-Residential	4,198	3,790	3,369	3,026	3,405
Consumer Loans	6,120	5,554	5,210	4,478	4,840
Unallocated	—	347	763	1,082	1,058
Total	$17,012	$16,038	$15,570	$14,434	$15,298

The allowance for loan losses increased to $17.0 million at year-end 2016 from $16.0 million at year-end 2015, an increase of 6.1%. However, the loan portfolio increased at an even faster rate during 2016 (the portfolio at year-end 2016 was up by 11.4% compared to year-end 2015), with the result that the allowance for loan losses as a percentage of period-end total loans declined to 0.97% at year-end 2016 from 1.02% at year-end 2015, a decrease of 4.90%.
A variety of factors were considered in evaluating the adequacy of the allowance for loan losses at December 31, 2016 and the provision for loan losses for the year, including:

Factors leading to an increase in the provision for loan losses:
- Loan growth in all three major portfolio segments (commercial, automobile and residential real estate)
- A small increase in classified construction and commercial real estate loans
- A slight increase in the historical loss factor for commercial real estate and automobile loans
- Modest increases in the qualitative factors for automobile and other consumer loans

Factors leading to a decrease in the provision for loan losses:
- A decrease in the historical loss factor for commercial loans
- A general decrease in most qualitative factors for certain loan segments, primarily for the commercial loan segment (related to the nature and volume of the portfolio and loan terms), but also for the residential real estate loan segment (related to a general improvement in collateral values).

See Note 5 to our audited financial statements for a complete list of all the factors used to calculate the provision for loan losses, including the factors that did not change during the year.
Most of our adversely classified loans (special mention and substandard - see our definition for these classifications in Note 5 to our audited financial statements) continued to perform under their contractual terms. The decrease in nonaccrual and impaired loans from 2015 to 2016 was primarily due to just two loans: one transferred to other real estate owned, and one that paid-off during 2016.

III. NONINTEREST INCOME
The majority of our noninterest income constitutes fee income from services, principally fees and commissions from fiduciary services, deposit account service charges, insurance commissions, net gains (losses) on securities transactions and other recurring fee income.

ANALYSIS OF NONINTEREST INCOME
(Dollars In Thousands)

	Years Ended December 31,			Change From Prior Year			
				2015 to 2016		2014 to 2015	
	2016	2015	2014	Amount	%	Amount	%
Income from Fiduciary Activities	$7,783	$7,762	$7,468	$21	0.3 %	$294	3.9 %
Fees for Other Services to Customers	9,469	9,220	9,261	249	2.7	(41)	(0.4)
Insurance Commissions	8,668	8,967	9,455	(299)	(3.3)	(488)	(5.2)

Net (Loss) Gain on Securities Transactions	(22)	129	110	(151)	(117.1)	19	17.3
Net Gain on Sales of Loans	821	692	784	129	18.6	(92)	(11.7)
Other Operating Income	1,113	1,354	1,238	(241)	(17.8)	116	9.4
Total Noninterest Income	$27,832	$28,124	$28,316	$(292)	(1.0)	$(192)	(0.7)

2016 Compared to 2015: Total noninterest income in 2016 was $27.8 million, a decrease of $292 thousand, or 1.0%, from total noninterest income of $28.1 million for 2015. Sales of securities resulted in a loss of $22 thousand in 2016 compared to a gain of $129 thousand in 2015, a net decrease of $151 thousand. Net gains on the sales of loans increased in 2016 to $821 thousand, from $692 thousand in 2015, an increase of $129 thousand, or 18.6%. Income from fiduciary activities increased from 2015 to 2016, by $21 thousand and insurance commissions decreased by $299 thousand, or 3.3% from 2015 to 2016, and other operating income decreased by $241 thousand, or 17.8% between the two years.

Assets under trust administration and investment management at December 31, 2016 were $1.301 billion, an increase of $68.5 million, or 5.6%, from the prior year-end balance of $1.233 billion. Income from fiduciary services for 2016 increased by $21 thousand, or 0.3% above the total for 2015. Much of the increase in balance of assets under trust administration and investment management was attributable to activity late in the third quarter, primarily in response to market performance. In addition, a significant portion of the current year's growth was derived from increased custodial accounts which are business lines that generate lower fee income as a percentage of assets under management.

Fees for other services to customers (primarily service charges on deposit accounts, revenues related to the sale of mutual funds to our customers by third party providers, income from debit card transactions, and servicing income on sold loans) were $8.5 million for 2016, an increase of $249 thousand, or 2.7%, from 2015. The principal cause of the increase was an increase in income from debit card transactions, offset in part by a decline in fee income from service changes on deposit accounts and overdraft fee income. In 2011, VISA reduced its debit interchange rates to comply with new Debit Charges Regulatory Requirements issued by the Federal Reserve Board. In subsequent years, this reduced rate structure imposed on large banks has resulted in smaller banks like ours reducing rates as well, for competitive reasons, which has negatively impacted our fee income. However, debit card usage by our customers continues to grow, which has had (and if such growth persists, will continue to have) a positive impact on our debit card fee income that in most subsequent periods has largely offset or more than offset the negative impact of lower rates.

Noninterest income from insurance commissions decreased by $299 thousand, or 3.3%, between the two periods. This net decrease was primarily attributable to our sale in October 2015 of a specialty line of insurance business previously maintained by one of our insurance agency subsidiaries, specifically, insurance services to out-of-market amateur sports management associations (see "Sale of Loomis Agency" below) which was partially offset by an increase in the contingent annual payments we receive based on the loss experience of our property and casualty insurance clients. We expect that income from insurance commissions will continue to constitute a significant and stable source of noninterest income for us in upcoming periods. We may continue in the future to expand our market profile in this line of business, including through suitable acquisitions, if favorable opportunities should arise.

Net gains on sales of loans amounted to $821 thousand during 2016 an increase of $129 thousand or 18.6% over the 2015 level. This reflects a similar percentage increase in total loans sold between the two years, which increased from $21.1 million in 2015 to $25.0 million in 2016, an 18.7% increase. The rate at which we sell mortgage loan originations in future periods will depend on various circumstances, including prevailing mortgage rates, other lending opportunities, capital and liquidity needs, and the ready availability of a market for such sales. We are unable to predict what our retention rate of such loans in future periods may be, although our retention rates have increased in each of the last 3 years, as the long-term decline in mortgage rates has bottomed out and rates have stabilized. We generally retain servicing rights for loans originated and sold by us, which also generates additional noninterest income in subsequent periods (fees for other services to customers). Other operating income includes net gains on the sale of other real estate owned as well as other miscellaneous revenues, which tend to fluctuate from year to year.

2015 Compared to 2014: Total noninterest income in 2015 was $28.1 million, a decrease of $192 thousand, or 0.7%, from total noninterest income of $28.3 million for 2014. Net gains on the sales of securities increased in 2015 to $129 thousand from $110 thousand in 2014, a net increase of $19 thousand or 17.3%, and net gains on the sales of loans decreased in 2015 to $692 thousand, from $784 thousand in 2014, a decrease of $92 thousand, or 11.7%. Income from fiduciary activities and other operating income both increased from 2014 to 2015, by $294 thousand and $116 thousand, respectively, while insurance commissions, net gains on the sale of loans and fees for other services to customers decreased from 2014 to 2015, by $488 thousand, $92 thousand and $41 thousand, respectively.

Assets under trust administration and investment management at December 31, 2015 were $1.233 billion, up from the prior year-end balance of $1.227 billion. Largely as a result of such increase our income from fiduciary services for 2015 increased by $294 thousand, or 3.9%, above the total for 2014. A significant portion of our fiduciary fees is indexed to the dollar amount of assets under administration. Any significant downturn in the U.S. stock or bond markets in future periods would likely have a corresponding negative impact on our income from fiduciary activities.

Fees for other services to customers (primarily service charges on deposit accounts, revenues related to the sale of mutual funds to our customers by third party providers, income from debit card transactions, and servicing income on sold loans) were $9.2 million for 2015, a decrease of $41 thousand, or .4%, from 2014. The principal cause of the decrease was decline in fee income from service charges on deposit accounts and overdraft fee income, offset in part by an increase in income from debit card transactions. Debit card usage by our customers continues to grow, which has had a positive impact on our debit card fee income.

Noninterest income from insurance commissions decreased by $488 thousand, or 5.2%, between the two periods. The decrease was primarily attributable to a change in the contingent annual payments we receive based on the loss experience of our customers, and to a lesser extent by our sale, in October 2015, of a specialty line of insurance business previously maintained by one of our insurance agency subsidiaries, specifically, insurance services to out-of-market amateur sports management associations. See "Sale of Loomis Agency", below. We expect that income from insurance commissions will continue to constitute a significant and stable source of noninterest income for us in upcoming periods. We may continue in the future to expand our market profile in this line of business, including through suitable acquisitions, if favorable opportunities should arise.

As noted above, our net gains on sales of loans decreased significantly, by 11.7%, between 2014 and 2015. Moreover, because our total mortgage loan originations increased significantly between the two years, loan sales as a percentage of our total originations decreased by an even higher percentage between the two years. Correspondingly, our retention rate of originations increased between 2014 and 2015.

Other operating income includes net gains on the sale of other real estate owned as well as other miscellaneous revenues, which tend to fluctuate from year to year. Included in other operating income for 2015 were a net gain on the sale of one of our

insurance agency subsidiaries ($204 thousand) and net gains recognized in our investment in limited partnerships ($260 thousand), offset in part, by the write-down of a bank-owned property ($404 thousand), which we transferred into other real estate owned and held for sale in the fourth quarter of 2015.I
Sale of Loomis Agency. In October 2015 we sold 100% of the stock of one of our wholly-owned subsidiary insurance agencies, Loomis and LaPann ("Loomis"), to a local insurance agency headquartered in Glens Falls, NY. Historically, Loomis specialized in servicing sports accident and health insurance needs of customers primarily located outside of New York State, and in addition sold property and casualty insurance in our local market area. Before selling Loomis, we transferred most of its property and casualty insurance accounts to another of our subsidiary insurance agencies.

IV. NONINTEREST EXPENSE

Noninterest expense is the measure of the delivery cost of services, products and business activities of a company. The key components of noninterest expense are presented in the following table.

ANALYSIS OF NONINTEREST EXPENSE
(Dollars In Thousands)

	Years Ended December 31,			Change From Prior Year			
				2015 to 2016		2014 to 2015	
	2016	2015	2014	Amount	%	Amount	%
Salaries and Employee Benefits	$34,330	$33,064	$30,941	$1,266	3.8 %	$2,123	6.9 %
Occupancy Expense of Premises, Net	4,983	5,005	4,898	(22)	(0.4)	107	2.2
Furniture and Equipment Expense	4,419	4,262	4,092	157	3.7	170	4.2
FDIC Regular Assessment	1,076	1,186	1,117	(110)	(9.3)	69	6.2
Amortization of Intangible Assets	297	327	387	(30)	(9.2)	(60)	(15.5)
Other Operating Expense	14,504	13,586	12,593	918	6.8	993	7.9
Total Noninterest Expense	$59,609	$57,430	$54,028	$2,179	3.8	$3,402	6.3
Efficiency Ratio	57.51 %	58.62 %	57.91 %	(1.11)%	(1.9)	0.71 %	1.2

2016 compared to 2015: Noninterest expense for 2016 amounted to $59.6 million, an increase of $2.2 million, or 3.8%, from 2015. For 2016, our efficiency ratio was 57.51%. This ratio, which is a commonly used non-GAAP financial measure in the banking industry, is a comparative measure of a financial institution's operating efficiency. The efficiency ratio (a ratio where lower is better), as we define it, is the ratio of operating noninterest expense (excluding intangible asset amortization and any FHLB prepayment penalties) to net interest income (on a tax-equivalent basis) plus operating noninterest income (excluding net securities gains or losses). See the discussion of the efficiency ratio on page 4 of this Report under the heading “Use of Non-GAAP Financial Measures.” Our efficiency ratios in recent periods compared favorably to the ratios of our peer group. For the nine month period ended September 30, 2016, our peer group ratio (as calculated by the Federal Reserve Bank's most recently available report) was 67.14%, compared to our ratio for such period (not adjusted) of 57.15%.
Salaries and employee benefits expense, which typically represents between 55% and 60% of total noninterest expense, increased by $1.3 million, or 3.8%, from 2015 to 2016. The net increase reflects a 2.9% increase in employee benefits, including increases in expenses related to our defined benefit pension and post retirement plans, health benefit plans and incentive compensation plans. Salary expenses increased by 4.2% and were attributable to increased staffing levels as we expanded in our southern market area and to normal salary increases.
Occupancy expense remained consistent while furniture and equipment expenses increased modestly from 2015 to 2016. The increase in equipment expense was primarily attributable to increased data processing costs.
Other operating expense increased $918.0 thousand, or 6.8%, from 2015. This was primarily the result of an increase in the cost of providing our customers with a wide and more complex variety of electronic banking products and services.

2015 compared to 2014: Noninterest expense for 2015 amounted to $57.4 million, an increase of $3.4 million, or 6.3%, from 2014. For 2015, our efficiency ratio was 58.09%. This ratio, which is a commonly used non-GAAP financial measure in the banking industry, is a comparative measure of a financial institution's operating efficiency. See the discussion of the efficiency ratio on page 4 of this Report under the heading “Use of Non-GAAP Financial Measures” and in the current period paragraph above. For the nine-month period ended September 30, 2015, our peer group ratio (as calculated by the Federal Reserve Bank's most recently available report) was 68.6%, compared to our ratio for such period (not adjusted) of 58.4%.

Salaries and employee benefits expense, which typically represents between 55% and 60% of total noninterest expense, increased by $2.1 million, or 6.9%, from 2014 to 2015. The net increase reflects a 10.2% increase in employee benefits, including increases in expenses related to our defined benefit pension and post retirement plans, health benefit plans and incentive compensation plans. Salary expenses increased by 5.7% and were attributable to increased staffing levels as we expanded in our southern market area and to normal salary increases.

Both building and equipment expenses increased modestly from 2014 to 2015. For buildings, the increase was primarily attributable to increases in maintenance and net rental expense, while the increase in equipment expense was primarily attributable to increased data processing costs.

Other operating expense increased $993.0 thousand, or 7.9% from 2014. This was primarily the result of an increase in outsourced third party providers, including operating costs to implement an Enterprise Performance Management (EPM) system. In addition, during 2015 there were increased legal and professional fees and an increase in the cost of providing our customers with a wide and more complex variety of electronic banking products and services.

V. INCOME TAXES

The following table sets forth our provision for income taxes and effective tax rates for the periods presented.

INCOME TAXES AND EFFECTIVE RATES
(Dollars In Thousands)

	Years Ended December 31,			Change From Prior Year			
				2015 to 2016		2014 to 2015	
	2016	2015	2014	Amount	%	Amount	%
Provision for Income Taxes	$11,215	$10,610	$10,174	$605	5.7 %	$436	4.3 %
Effective Tax Rate	29.7 %	30.1 %	30.3 %	(0.4)%	(1.3)%	(0.2)%	(0.7)%

The provisions for federal and state income taxes amounted to $11.2 million for 2016, $10.6 million for 2015, and $10.2 million for 2014. The effective income tax rates for 2016, 2015 and 2014 were 29.7%, 30.1% and 30.3%, respectively. The changes reflect fluctuations in the ratio of tax-equivalent income to pre-tax income.

C. FINANCIAL CONDITION

I. INVESTMENT PORTFOLIO

Investment securities are classified as held-to-maturity, trading, or available-for-sale, depending on the purposes for which such securities are acquired and thereafter held. Securities held-to-maturity are debt securities that we have both the positive intent and ability to hold to maturity; such securities are stated at amortized cost. Debt and equity securities that are bought and held principally for the purpose of sale in the near term are classified as trading securities and are reported at fair value with unrealized gains and losses included in earnings. Debt and equity securities not classified as either held-to-maturity or trading securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses excluded from earnings and reported net of taxes in accumulated other comprehensive income or loss. During 2016, 2015 and 2014, we held no trading securities. Set forth below is certain information about our securities available-for-sale portfolio and securities held-to-maturity portfolio as of recent year-ends.

Securities Available-for-Sale:

The following table sets forth the carrying value of our securities available-for-sale portfolio at year-end December 31, 2016, December 31, 2015 and December 31, 2014.

SECURITIES AVAILABLE-FOR-SALE
(In Thousands)

	December 31,		
	2016	2015	2014
U.S. Government & Agency Obligations	$147,377	$155,782	$137,603
State and Municipal Obligations	27,690	52,408	81,730
Mortgage-Backed Securities - Residential	167,239	178,588	128,827
Corporate and Other Debt Securities	3,308	14,299	16,725

Mutual Funds and Equity Securities	1,382	1,232	1,254
Total	$346,996	$402,309	$366,139

In all periods, Mortgage-Backed Securities-Residential consisted solely of mortgage pass-through securities and Collateralized Mortgage Obligations ("CMOs") issued or guaranteed by U.S. federal agencies. Mortgage pass-through securities provide to the investor monthly portions of principal and interest pursuant to the contractual obligations of the underlying mortgages. CMOs are pools of mortgage-backed securities, the repayments on which have been separated into two or more components (tranches), where each tranche has a separate estimated life and yield. Our practice has been to purchase only pass-through securities and CMOs that are issued or guaranteed by U.S. federal agencies, and the tranches of CMOs that we purchase generally are those having shorter maturities. Included in our Corporate and Other Debt Securities for each of the periods are corporate bonds that were highly rated (i.e., investment grade) at the time of purchase, although in some cases the securities had been downgraded before the reporting date, but were still investment grade.

The following table sets forth the maturities of the debt securities in our available-for-sale portfolio as of December 31, 2016. CMOs and other mortgage-backed securities are included in the table based on their expected average lives.

MATURITIES OF DEBT SECURITIES AVAILABLE-FOR-SALE
(In Thousands)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
U.S. Government & Agency Obligations	—	147,377	—	—	147,377
State and Municipal Obligations	16,994	9,628	508	560	27,690
Mortgage-Backed Securities - Residential	5,753	100,447	61,039	—	167,239
Corporate and Other Debt Securities	2,508	—	—	800	3,308
Total	25,255	257,452	61,547	1,360	345,614

The following table sets forth the tax-equivalent yields of the debt securities in our available-for-sale portfolio at December 31, 2016.

YIELDS ON SECURITIES AVAILABLE-FOR-SALE
(Fully Tax-Equivalent Basis)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
U.S. Government & Agency Obligations	— %	1.51 %	— %	— %	1.51 %
State and Municipal Obligations	1.40	2.15	7.25	8.14	1.90
Mortgage-Backed Securities - Residential	2.48	2.06	2.32	—	2.17
Corporate and Other Debt Securities	0.95	—	—	3.59	1.70
Total	1.60	1.75	2.36	5.22	1.86

The yields on obligations of states and municipalities exempt from federal taxation were computed on a fully tax-equivalent basis using a marginal tax rate of 35%. The yields on other debt securities shown in the table above are calculated by dividing annual interest, including accretion of discounts and amortization of premiums, by the amortized cost of the securities at December 31, 2016.

At December 31, 2016 and 2015, the weighted average maturity was 3.4 and 2.8 years, respectively, for debt securities in the available-for-sale portfolio.

At December 31, 2016, the net unrealized losses on securities available-for-sale amounted to $619 thousand. The net unrealized gain or loss on such securities, net of tax, is reflected in accumulated other comprehensive income/loss. For 2016, the net unrealized losses were primarily attributable to an average increase in market rates between the date of purchase and the balance sheet date, resulting in lower valuations of the portfolio securities. The net unrealized gains on securities available-for-sale was $1.0 million at December 31, 2015. For both periods, the net unrealized gain was primarily attributable to an average decrease in market rates between the date of purchase and the balance sheet date resulting in higher valuations of the portfolio securities.

For further information regarding our portfolio of securities available-for-sale, see Note 4 to the Consolidated Financial Statements contained in Part II, Item 8 of this Report.

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Securities Held-to-Maturity:
The following table sets forth the carrying value of our portfolio of securities held-to-maturity at December 31 of each of the last three years.

SECURITIES HELD-TO-MATURITY
(In Thousands)

	December 31, 2016	2015	2014
State and Municipal Obligations	$268,892	$226,053	$188,472
Mortgage Backed Securities - Residential	75,535	93,558	112,552
Corporate and Other Debt Securities	1,000	1,000	1,000
Total	$345,427	$320,611	$302,024

For a description of certain categories of securities held in the securities held-to-maturity portfolio on the reporting dates, as listed in the table above, specifically, "Mortgage-Backed Securities--Residential" and "Corporate and Other Debt Securities," see the paragraph under "SECURITIES AVAILABLE-FOR-SALE" table, above.
For information regarding the fair value of our portfolio of securities held-to-maturity at December 31, 2016, see Note 4 to the Consolidated Financial Statements contained in Part II, Item 8 of this Report.

The following table sets forth the maturities of our portfolio of securities held-to-maturity as of December 31, 2016.

MATURITIES OF DEBT SECURITIES HELD-TO-MATURITY
(In Thousands)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
State and Municipal Obligations	$32,456	$86,070	$146,603	$3,763	$268,892
Mortgage Backed Securities - Residential	—	61,712	13,823	—	75,535
Corporate and Other Debt Securities	1,000	—	—	—	1,000
Total	$33,456	$147,782	$160,426	$3,763	$345,427

The following table sets forth the tax-equivalent yields of our portfolio of securities held-to-maturity at December 31, 2016.

YIELDS ON SECURITIES HELD-TO-MATURITY
(Fully Tax-Equivalent Basis)

	Within One Year	After 1 But Within 5 Years	After 5 But Within 10 Years	After 10 Years	Total
State and Municipal Obligations	2.52 %	4.09 %	2.90 %	4.47 %	3.26 %
Mortgage Backed Securities - Residential	—	2.21	2.57	—	2.28 %
Corporate and Other Debt Securities	7.00	—	—	—	7.00 %
Total	2.52 %	2.38 %	2.65 %	5.00 %	2.56 %

The yields shown in the table above are calculated by dividing annual interest, including accretion of discounts and amortization of premiums, by the amortized cost of the securities at December 31, 2016. Yields on obligations of states and municipalities exempt from federal taxation were computed on a fully tax-equivalent basis using a marginal tax rate of 35%.
At December 31, 2016 and 2015, the weighted average maturity was 4.3 and 3.8 years, respectively, for the debt securities in the held-to-maturity portfolio.

II. LOAN PORTFOLIO

The amounts and respective percentages of loans outstanding represented by each principal category on the dates indicated were as follows:

a. Types of Loans
(Dollars In Thousands)

	December 31,									
	2016		2015		2014		2013		2012	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial	$105,155	6	$102,587	7	$99,511	7	$87,893	7	$105,536	9
Commercial Real Estate – Construction	36,948	2	31,018	2	18,815	1	27,815	2	29,149	2
Commercial Real Estate – Other	394,698	23	353,921	22	321,297	23	288,119	23	245,177	21
Consumer	537,361	31	464,523	29	437,041	31	401,853	32	355,784	31
Residential Real Estate	679,106	39	621,903	40	536,604	38	460,792	36	436,695	37
Total Loans	1,753,268	100	1,573,952	100	1,413,268	100	1,266,472	100	1,172,341	100
Allowance for Loan Losses	(17,012)		(16,038)		(15,570)		(14,434)		(15,298)	
Total Loans, Net	$1,736,256		$1,557,914		$1,397,698		$1,252,038		$1,157,043	

Maintenance of High Quality in the Loan Portfolio: For many reasons, including our credit underwriting standards and our market stability, we largely avoided the negative impact on asset quality that many other banks suffered during and after the 2008-2009 financial crisis. From the start of the crisis through the date of this Report, we did not experience a significant deterioration in our loan portfolios. In general, we underwrite our residential real estate loans to secondary market standards for prime loans. We have never engaged in subprime mortgage lending as a business line. We have not extended or purchased any so-called "Alt-A", "negative amortization", "option ARM", or "negative equity" mortgage loans. On occasion we have made loans to borrowers having a FICO score of 650 or below, where special circumstances justified doing so, or have had extensions of credit outstanding to borrowers who developed credit problems after origination resulting in deterioration of their FICO scores.
We also on occasion have extended community development loans to borrowers whose creditworthiness is below our normal standards as part of the community support program we have developed in fulfillment of our statutorily-mandated duty to support low- and moderate-income borrowers within our service area. However, we are a prime lender and apply prime lending standards and this, together with the fact that the service area in which we make most of our loans did not experience as severe a decline in property values or economic conditions generally as many other areas of the U.S. did, are the principal reasons that we did not experience significant deterioration during the crisis in our loan portfolio, including the real estate categories of our loan portfolio.
However, like all other banks we operate in an environment in which identifying opportunities for secure and profitable expansion of our loan portfolio remains challenging, competition is intense, and margins are very tight. If the U.S. economy and our regional economy continue to experience only very modest growth, our individual borrowers will presumably continue to proceed cautiously in taking on new or additional debt. Many small businesses are operating on very narrow margins and many families continue to live on very tight budgets. If the U.S. economy or our regional economy worsens in upcoming periods, which we think unlikely but possible, we may experience elevated charge-offs, higher provisions to our loan loss reserve, and increasing expense related to asset maintenance and supervision.

Residential Real Estate Loans: In recent years, residential real estate and home equity loans have represented the largest single segment of our loan portfolio (comprising approximately 39% of the entire portfolio at December 31, 2016), eclipsing both other consumer loans (31% of the portfolio) and our commercial and commercial real estate loans (31%). Our gross originations for residential real estate loans (including refinancings of mortgage loans) were $153.6 million, $144.2 million and $131.2 million for the years 2016, 2015, and 2014, respectively. During each of these years, these gross origination totals have significantly exceeded the sum of repayments and prepayments of such loans previously in the portfolio, but we have also sold significant portions of these originations in the secondary market, primarily to Freddie Mac, particularly when rates on conventional 30-year fixed rate real estate mortgages reached historically low levels in the 2013-2014 period. Sales of originations amounted to $25.0 million for 2016, $21.1 million for 2015 and $29.8 million for 2014, which represented a significant percentage of the gross originations in each year (16.3%, 14.6% and 22.7%, respectively). We expect to continue to sell a portion of our mortgage loan originations in upcoming periods, although perhaps a decreasing percentage of overall originations if rates continue their slow rise across longer maturities. At the same time, if prevailing rates rise substantially, we may see a slowdown in loan growth and perhaps decreasing total originations, particularly if the general economy also falters. At some point, it is possible that we may experience a decrease in our outstanding balances in this largest segment of our portfolio. Additionally, if our local economy or real estate market should suffer a major downturn, the quality of our real estate portfolio may also be negatively impacted.

The Federal Reserve wound down its quantitative easing program in 2014. Although it was expected that the winding down process might lead to, or accompany, a general rise in long-term mortgage loan rates, the 30-year and 15-year rates have not experienced any significant increase, and have in some markets actually decreased, in ensuing periods. While economic conditions have generally improved, which led in part to the Fed's decision to terminate its quantitative easing program in 2014, management is not able to predict at this point when, or if, mortgage rates or interest rates generally will experience a meaningful and substantial increase, or what the overall effect of such an increase would be on our mortgage loan portfolio or our loan portfolio generally, or on our net interest income, net income or financial results, in future periods.

Commercial, Commercial Real Estate and Construction and Land Development Loans: Over the last decade, we have experienced moderate and occasionally strong demand for commercial and commercial real estate loans. These loan balances have generally increased, both in dollar amount and as a percentage of the overall loan portfolio, and this segment of our portfolio was the segment least affected by the 2008-2009 crisis. Particularly over the last three years, commercial and commercial real estate loan growth was significant as outstanding balances increased by $49.3 million, $47.9 million, and $35.8 million in 2016, 2015 and 2014, respectively. Growth was restrained somewhat by heightened competition for credits in an extremely low rate environment.
Substantially all commercial and commercial real estate loans in our portfolio were extended to businesses or borrowers located in our regional markets. Many of the loans in the commercial portfolio have variable rates tied to prime or FHLBNY rates. Although on a national scale the commercial real estate market suffered a major downturn in the 2008-2009 period (from which it has largely recovered), we did not experience any significant weakening in the quality of our commercial loan portfolio even in the depths of the crisis, nor have we in the subsequent years. However, it is entirely possible that we may experience a reduction in the demand for commercial and commercial real estate loans and/or a weakening in the quality of our portfolio in upcoming periods. But at period-end 2016, the business sector, at least in our service area, appeared to be in reasonably good financial condition.

Automobile Loans (primarily through indirect lending): At December 31, 2016, our automobile loans (primarily loans originated through dealerships located primarily in upstate New York and Vermont) represented nearly a third of loans in our portfolio, and continue to be a significant component of our business.
During recent years. including 2016, there was a nationwide resurgence in automobile sales, due initially to an aging fleet but more recently to a modest growth in consumer optimism. Our automobile loan origination volume for the last three years was very strong at $286.7 million, $228.8 million and $222.9 million for 2016, 2015 and 2014, respectively.
Our indirect automobile loan portfolio reflects a modest shift to a slightly larger (but still very small in absolute terms) percentage of such loans that have been extended to individuals with lower credit scores matching a widely noted recent development auto lending generally. In addition, our average maturity for automobile loan originations has expanded in recent years as well, again reflective of a larger market development. In 2016, net charge-offs on our automobile loans remained very low. at 0.13% of average balances. Net charge-offs were $662 thousand for 2016 compared to net charge-offs of $498 thousand for 2015, an increase that reflected this modest shift in the quality of the portfolio noted above. Our experienced lending staff not only utilizes credit evaluation software tools but also reviews and evaluates each loan individually prior to the loan being funded. We believe our disciplined approach to evaluating risk has contributed to maintaining our strong loan quality in this portfolio. However, if weakness in auto demand returns, our portfolio is likely to experience limited, if any, overall growth, either in absolute amounts or as a percentage of the total portfolio, regardless of whether the auto company affiliates are offering highly-subsidized loans. If demand levels off, or slackens, so will our financial performance in this important loan category.

The following table indicates the changing mix in our loan portfolio by including the quarterly average balances for our significant loan products for the past five quarters. The remaining quarter-by-quarter tables present the percentage of total loans represented by each category and the annualized tax-equivalent yield of each category.

LOAN PORTFOLIO
Quarterly Average Loan Balances
(Dollars In Thousands)

	Quarters Ended				
	12/31/2016	9/30/2016	6/30/2016	3/31/2016	12/31/2015

Commercial and Commercial Real Estate	$532,456	$524,523	$519,775	$502,392	$495,173
Residential Real Estate	490,427	470,865	462,253	451,330	438,987
Home Equity	135,939	133,009	131,513	130,227	128,085
Consumer Loans[1]	567,916	552,454	535,860	511,069	493,989
Total Loans	$1,726,738	$1,680,851	$1,649,401	$1,595,018	$1,556,234

Percentage of Total Quarterly Average Loans

	Quarters Ended				
	12/31/2016	9/30/2016	6/30/2016	3/31/2016	12/31/2015
Commercial and Commercial Real Estate	30.8 %	31.2 %	31.5 %	31.5 %	31.8 %
Residential Real Estate	28.4	28.0	28.0	28.3	28.2
Home Equity	7.9	7.9	8.0	8.2	8.2
Consumer Loans[1]	32.9	32.9	32.5	32.0	31.8
Total Loans	100.0 %	100.0 %	100.0 %	100.0 %	100.0 %

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Quarterly Tax-Equivalent Yield on Loans

	Quarters Ended				
	12/31/2016	9/30/2016	6/30/2016	3/31/2016	12/31/2015
Commercial and Commercial Real Estate	4.29 %	4.28 %	4.44 %	4.32 %	4.37 %
Residential Real Estate	4.09	4.20	4.22	4.22	4.21
Home Equity	3.11	3.13	3.08	3.05	2.92
Consumer Loans[1]	3.18	3.19	3.18	3.17	3.19
Total Loans	3.78 %	3.82 %	3.86 %	3.82 %	3.83 %

[1] Other Consumer Loans includes certain home improvement loans secured by mortgages. However, these same loan balances are reported as
Residential Real Estate in the table of period-end balances on page 40, captioned "Types of Loans."

During the fourth quarter of 2016, the average yield on our loan portfolio from the average yield during the fourth quarter of 2015, fell slightly from 3.83% to 3.78%. The yields on new 30 year fixed-rate residential real estate loans (the choice of most of our mortgage customers) remained very low during all five quarters. We continued to sell a portion of our originations to the secondary market, specifically, to Freddie Mac, although we retained a higher proportion of our gross originations in 2016 than in 2015, continuing a multi-year trend of expanding our retention rate versus our sale rate.

In 2016, the average yield on the loan portfolio continued to decline at a slightly faster pace then the cost of our deposits, although our net interest margin held steady during the year. We expect that average loan yields may begin to stabilize in 2017; any slight increase in origination rates are likely to be counterbalanced, for a period of time, by continuing repayments of even higher rate maturing loans.

In general, the yield (tax-equivalent interest income divided by average loans) on our loan portfolio and other earning assets has historically been impacted by changes in prevailing interest rates, as previously discussed in this Report beginning on page 31 under the heading "Impact of Interest Rate Changes." We expect that such will continue to be the case; that is, that loan yields will continue to rise and fall with changes in prevailing market rates, although the timing and degree of responsiveness will be influenced by a variety of other factors, including the extent of federal government and Federal Reserve participation in the home mortgage market, the makeup of our loan portfolio, the shape of the yield curve, consumer expectations and preferences, and the rate at which the portfolio expands. Additionally, there is a significant amount of cash flow from normal amortization and prepayments in all loan categories, and this cash flow reprices at current rates as new loans are generated at the current yields. Thus, even if prevailing rates remain flat or even increase slightly in upcoming periods, our average rate on our portfolio may continue to decline as older credits in our portfolio bearing generally higher rates continue to mature and roll over or are redeployed into lower priced loans.

The following table indicates the respective maturities and interest rate structure of our commercial and commercial real estate construction loans at December 31, 2016. For purposes of determining relevant maturities, loans are assumed to mature at (but not before) their scheduled repayment dates as required by contractual terms. Demand loans and overdrafts are included in the "Within 1 Year" maturity category. Most of the commercial construction loans are made with a commitment for permanent financing, whether extended by us or unrelated third parties. The maturity distribution below reflects the final maturity of the permanent financing.

b. Maturities and Sensitivities of Loans to Changes in Interest Rates
(In Thousands)

	Within 1 Year	After 1 But Within 5 Years	After 5 Years	Total
Commercial	$18,861	$58,159	$28,135	$105,155
Commercial Real Estate - Construction	10,602	18,225	8,121	36,948

Total	$29,463	$76,384	$36,256	$142,103
Fixed Interest Rates	$2,315	$38,576	$17,476	$58,367
Variable Interest Rates	27,148	37,808	18,780	83,736
Total	$29,463	$76,384	$36,256	$142,103

COMMITMENTS AND LINES OF CREDIT

Stand-by letters of credit represent extensions of credit granted in the normal course of business, which are not reflected in the financial statements at a given date because the commitments are not funded at that time. As of December 31, 2016, our total contingent liability for standby letters of credit amounted to $3.4 million. In addition to these instruments, we also have issued lines of credit to customers, including home equity lines of credit, commitments for residential and commercial construction loans and other personal and commercial lines of credit, which also may be unfunded or only partially funded from time-to-time. Commercial lines, generally issued for a period of one year, are usually extended to provide for the working capital requirements of the borrower. At December 31, 2016, we had outstanding unfunded loan commitments in the aggregate amount of approximately $383.6 million.

c. Risk Elements

1. Nonaccrual, Past Due and Restructured Loans
The amounts of nonaccrual, past due and restructured loans at year-end for each of the past five years are presented in the table on page 33 under the heading "Summary of the Allowance and Provision for Loan Losses."
Loans are placed on nonaccrual status either due to the delinquency status of principal and/or interest or a judgment by management that the full repayment of principal and interest is unlikely. Unless already placed on nonaccrual status, loans secured by home equity lines of credit are put on nonaccrual status when 120 days past due and residential real estate loans are put on nonaccrual status when 150 days past due. Commercial and commercial real estate loans are evaluated on a loan-by-loan basis and are placed on nonaccrual status when 90 days past due if the full collection of principal and interest is uncertain. Under the Uniform Retail Credit Classification and Account Management Policy established by banking regulators, fixed-maturity consumer loans not secured by real estate must generally be charged-off no later than when 120 days past due. Loans secured with non-real estate collateral in the process of collection are charged-down to the value of the collateral, less cost to sell. Open-end credits, residential real estate loans and commercial loans are evaluated for charge-off on a loan-by-loan basis when placed on nonaccrual status.
We had no material commitments to lend additional funds on outstanding nonaccrual loans at December 31, 2016.
Loans past due 90 days or more and still accruing interest are those loans which were contractually past due 90 days or more but because of expected repayments, were still accruing interest.
The balance of loans 30-89 days past due totaled $9.1 million at December 31, 2016 and represented 0.52% of loans outstanding at that date, as compared to approximately $8.1 million, or 0.51% of loans outstanding at December 31, 2015. These non-current loans at December 31, 2016 were composed of approximately $6.4 million of consumer loans (principally indirect automobile loans), $2.5 million of residential real estate loans and $0.3 million of commercial and commercial real estate loans.
We evaluate nonaccrual loans over $250 thousand and all troubled debt restructured loans individually for impairment. All our impaired loans are measured based on either (i) the present value of expected future cash flows discounted at the loan's effective interest rate, (ii) the loan's observable market price or (iii) the fair value of the collateral, less cost to sell, if the loan is collateral dependent. We determine impairment for collateralized loans based on the fair value of the collateral less estimated cost to sell. For other impaired loans, impairment is determined by comparing the recorded value of the loan to the present value of the expected cash flows, discounted at the loan's effective interest rate. We determine the interest income recognition method for impaired loans on a loan-by-loan basis. Based upon the borrowers' payment histories and cash flow projections, interest recognition methods include full accrual or cash basis. Our method for measuring all other loans is described in detail in Notes 2 and 5 to the consolidated financial statements.
The loan note to the consolidated financial statements, i.e., Note 5 (beginning on page 72) contains detailed information on modified loans and impaired loans.

2. Potential Problem Loans
On at least a quarterly basis, we re-evaluate our internal credit quality rating for commercial loans that are either past due or fully performing but exhibit certain characteristics that could reflect a potential weakness. Loans are placed on nonaccrual status when the likely amount of future principal and interest payments are expected to be less than the contractual amounts, even if such loans are not past due.
Periodically we review the loan portfolio for evidence of potential problem loans. Potential problem loans are loans that are currently performing in accordance with contractual terms, but where known information about possible credit problems of the borrower causes doubt about the ability of the borrower to comply with the loan payment terms and may result in disclosure of such loans as nonperforming at some time in the future. In our credit monitoring program, we treat loans that are classified as substandard but continue to accrue interest as potential problem loans. At December 31, 2016, we identified 101 commercial loans totaling $34.8 million as potential problem loans. At December 31, 2015, we identified 111 commercial loans totaling $24.6 million as potential problem loans. For these

loans, although positive factors such as payment history, value of supporting collateral, and/or personal or government guarantees led us to conclude that accounting for them as non-performing at year-end was not warranted, other factors, specifically, certain risk factors related to the loan or the borrower justified concerns that they may become nonperforming at some point in the future.

The overall level of our performing loans that demonstrate characteristics of potential weakness from time-to-time is for the most part dependent on economic conditions in northeastern New York State, which in turn are generally impacted at least in part by economic conditions in the U.S. On both the regional and national levels, economic conditions have largely recovered from the 2008-2009 financial crisis, although growth in the economy remained slow by comparison to previous historical post-recession recoveries. If growth remains weak , potential problem loans likely will continue at or near their present levels or may even increase.

3. Foreign Outstandings - None

4. Loan Concentrations

The loan portfolio is well diversified. There are no concentrations of credit that exceed 10% of the portfolio, other than the general categories reported in the preceding Section C.II.a. of this Item 7, beginning on page 40. For further discussion, see Note 1 to the Consolidated Financial Statements in Part II, Item 8 of this Report.

5. Other Real Estate Owned and Repossessed Assets

Other real estate owned ("OREO") primarily consists of real property acquired in foreclosure. OREO is carried at fair value less estimated cost to sell. We establish allowances for OREO losses, which are determined and monitored on a property-by-property basis and reflect our ongoing estimate of the property's estimated fair value less costs to sell. For all periods, all OREO was held for sale. All repossessed assets for each of the five years in the table below consist of motor vehicles.

Distribution of OREO and Repossessed Assets (In Thousands)	December 31,				
	2016	2015	2014	2013	2012
Single Family 1 - 4 Units	$795	$1,357	$—	$41	$552
Commercial Real Estate	790	521	312	40	418
Other Real Estate Owned, Net	1,585	1,878	312	81	970
Repossessed Assets	101	140	81	63	64
Total OREO and Repossessed Assets	$1,686	$2,018	$393	$144	$1,034

The following table summarizes changes in the net carrying amount of OREO and the number of properties for each of the periods presented.

Schedule of Changes in OREO (In Thousands)	2016	2015	2014	2013	2012
Balance at Beginning of Year	$1,878	$312	$81	$970	$460
Properties Acquired Through Foreclosure	1,009	1,889	469	392	950
Transfer of Bank Property	—	270	—	—	—
Subsequent Write-downs to Fair Value	(162)	(9)	—	—	—
Sales	(1,140)	(584)	(238)	(1,281)	(440)
Balance at End of Year	$1,585	$1,878	$312	$81	$970
Number of Properties, Beginning of Year	6	1	2	7	5
Properties Acquired During the Year	3	8	2	1	7
Properties Sold During the Year	(4)	(3)	(3)	(6)	(5)
Number of Properties, End of Year	5	6	1	2	7

III. SUMMARY OF LOAN LOSS EXPERIENCE

The information required in this section is presented in the discussion of the "Provision for Loan Losses and Allowance for Loan Losses" in Part II Item 7.B.II. beginning on page 33 of this Report, including:

- Charge-offs and Recoveries by loan type
- Factors that led to the amount of the Provision for Loan Losses
- Allocation of the Allowance for Loan Losses by loan type

The percent of loans in each loan category is presented in the table of loan types in the preceding section on page 40 of this report.

IV. DEPOSITS

The following table sets forth the average balances of and average rates paid on deposits for the periods indicated.

AVERAGE DEPOSIT BALANCES
(Dollars In Thousands)

	Years Ended December 31,					
	12/31/2016		12/31/2015		12/31/2014	
	Average Balance	Rate	Average Balance	Rate	Average Balance	Rate
Demand Deposits	$366,956	— %	$329,017	— %	$290,922	— %
Interest-Bearing Checking Accounts	912,461	0.14%	915,565	0.14	861,457	0.20
Savings Deposits	616,208	0.15%	554,330	0.13	521,595	0.16
Time Deposits of $100,000 or More	69,489	0.65%	59,967	0.59	70,475	1.09
Other Time Deposits	129,084	0.51%	136,396	0.54	158,592	0.85
Total Deposits	$2,094,198	0.16%	$1,995,275	0.16	$1,903,041	0.25

During 2016 average total deposit balances increased by $99 million, or 5.0%, over the average for 2015. Most of this growth occurred in the fourth quarter of 2016, which is the result of typical seasonal fluctuations primarily in our municipal deposit balances and was largely generated from our pre-existing branch network, although we did open one new branch, in Troy, New York, in September 2015.

During 2015 average total deposit balances increased by $92.2 million, or 4.8%, over the average for 2014. Most of this growth occurred in the fourth quarter of 2015, which is the result of typical seasonal fluctuations primarily in our municipal deposit balances and was largely generated from our pre-existing branch network, although we did recently open two new branches: in Troy, New York, in September 2015, and in Colonie, New York, in June 2014.

During 2014 average total deposit balances increased by $82.8 million, or 4.6%, over the average for 2013. Most of this growth occurred in the fourth quarter of 2014, consistent with our typical seasonal fluctuations in deposits and was largely generated from our pre-existing branch network, although we did recently open one new branch, in Colonie, New York, in June 2014.

We did not sell or close any branches during the covered period, 2014-2016. We did not hold any brokered deposits during 2014. However, in 2015 we began to use reciprocal brokered deposits for a select group of municipalities to reduce the amount of investment securities required to be pledged as collateral for municipal deposits where through a well-established brokerage program, we transferred amounts in municipal deposits in excess of our FDIC insurance coverage limits to other participating banks, divided into portions so as to qualify such transferred deposits for FDIC insurance coverage at each transferee bank, in return for reciprocal transfers to us of equal amounts of deposits from the participant banks. Our balances of reciprocal broker deposits were $57.1 million and $23.8 million at December 31, 2016 and 2015, respectively.

The following table presents the quarterly average balance by deposit type for each of the most recent five quarters.

DEPOSIT PORTFOLIO
Quarterly Average Deposit Balances
(Dollars In Thousands)

	Quarters Ended				
	Dec 2016	Sep 2016	Jun 2016	Mar 2016	Dec 2015
Demand Deposits	$383,226	$381,195	$357,285	$345,783	$348,748
Interest-Bearing Checking Accounts	921,971	869,439	928,904	929,898	953,609
Savings Deposits	649,928	607,850	602,625	604,151	582,140

Time Deposits of $100,000 or More	79,196	75,388	63,117	60,085	60,294
Other Time Deposits	125,835	129,960	130,518	130,047	131,035
Total Deposits	$2,160,156	$2,063,832	$2,082,449	$2,069,964	$2,075,826

Fluctuations in balances of our interest-bearing checking and savings accounts and time deposits of $100,000 or more are largely the result of municipal deposit fluctuations. Municipal deposits on average represent 28% to 34% of our total deposits. Municipal deposits are typically placed in interest-bearing checking and savings accounts, as well as time deposits of short duration.

In general, there is a seasonal pattern to municipal deposits which dip to a low point in August each year. Account balances tend to increase throughout the fall and into the winter months from tax deposits and increase again at the end of March from the electronic deposit of NYS Aid payments to school districts. In addition to these seasonal fluctuations within types of accounts, the overall level of municipal deposit balances fluctuates from year-to-year as some municipalities move their accounts in and out of our banks due to competitive factors. Often, the balances of municipal deposits at the end of a quarter are not representative of the average balances for that quarter. We expect that this shift from time deposits to nonmaturity deposit products may continue

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to occur in upcoming periods, although perhaps at a slower pace, if deposit rates and interest rates remain at their current extraordinarily low levels. Contrarily, if deposit rates should begin to climb, we anticipate the movement of time deposits to nonmaturity interest bearing deposits to halt altogether, and likely to reverse itself if the rate rise is continuing or significant.

For a variety of reasons, including the seasonality of municipal deposits, we typically experience little net growth or a small contraction in average deposit balances in the first quarter of each calendar year, some growth in the second quarter, contraction in the third quarter and substantial growth in the fourth quarter. Deposit balances followed this seasonal pattern during 2016, as in the prior two years. From 2015 to 2016, growth occurred in both municipal accounts (0.6%) as well as other deposit accounts (4.2%). The growth in our non-municipal account balances during 2016 was distributed among all our deposit categories.

The total quarterly average balances as a percentage of total deposits are illustrated in the table below.

Percentage of Total Quarterly Average Deposits	Quarters Ended				
	Dec 2016	Sep 2016	Jun 2016	Mar 2016	Dec 2015
Demand Deposits	17.7 %	18.5 %	17.2 %	16.7 %	16.8 %
Interest-Bearing Checking Accounts	42.7	42.1	44.6	44.9	46.0
Savings Deposits	30.1	29.5	28.9	29.2	28.0
Time Deposits of $100,000 or More	3.7	3.7	3.0	2.9	2.9
Other Time Deposits	5.8	6.3	6.3	6.3	6.3
Total Deposits	100.0%	100.0%	100.0%	100.0%	100.0 %

Time deposits, including time deposits of $100,000 or more, decreased significantly and consistently in recent years, both absolutely and as a percentage of total deposits, as deposit rates generally continued their fall during these years. A portion of our time deposits of $100,000 or more are comprised of municipal deposits and are typically obtained on a competitive bid basis. We, like virtually all insured depository institutions, have experienced a steady decrease in the cost of our deposits extending from mid-2007 through the end of 2015. Our cost of deposits remain virtually unchanged over the past 5 quarters, as evidenced in the table below, although the Fed increased the federal funds rate twice during that period.

The total quarterly interest cost of our deposits, by type of deposit and in total, for each of the most recent five quarters is set forth in the table below:

Quarterly Cost of Deposits	Quarters Ended				
	Dec 2016	Sep 2016	Jun 2016	Mar 2016	Dec 2015
Demand Deposits	— %	— %	— %	— %	— %
Interest-Bearing Checking Accounts	0.15%	0.15	0.13	0.13	0.13
Savings Deposits	0.16%	0.15	0.15	0.15	0.14
Time Deposits of $100,000 or More	0.70%	0.68	0.62	0.58	0.59
Other Time Deposits	0.51%	0.50	0.51	0.52	0.53
Total Deposits	0.16%	0.16	0.15	0.15	0.15

In general, rates paid by us on various types of deposit accounts are influenced by the rates being offered or paid by our competitors, which in turn are influenced by prevailing interest rates in the economy as impacted from time-to-time by the actions of the Federal Reserve Bank. There typically is a time lag between the Federal Reserve's actions undertaken to influence rates, upward or downward, and the actual repricing of our deposit liabilities up or down, although this lag may be shorter or longer than the lag between Federal Reserve rate actions and the repricing of our loans and other earning assets, depending upon the particular circumstances.

In 2015, we began to use reciprocal brokered deposits for a select group of municipal deposit relationships. The balances of deposits transfered to, and received from, reciprocating banks was $57.1 million at December 31, 2016. Except for these certain municipal reciprocal relationships, we do not use traditional brokered deposits as a regular funding source and there were not any additional such brokered deposit balances carried during 2016, 2015 or 2014.

The maturities of time deposits of $100,000 or more at December 31, 2016 are presented below. (In Thousands)

Maturing in:	
Under Three Months	$17,228
Three to Six Months	15,661
Six to Twelve Months	19,732
2018	7,078
2019	7,366
2020	2,488
2021	3,050
Later	2,175
Total	$74,778

V. SHORT-TERM BORROWINGS
(Dollars in Thousands)

	12/31/2016	12/31/2015	12/31/2014
Overnight Advances from the Federal Home Loan Bank of New York, Federal Funds Purchased and Securities Sold Under Agreements to Repurchase:			
Balance at December 31	$158,836	$105,173	$60,421
Maximum Month-End Balance	158,836	105,173	60,421
Average Balance During the Year	94,103	45,595	29,166
Average Rate During the Year	0.42 %	0.29 %	0.25 %
Rate at December 31	0.59 %	0.27 %	0.26 %

D. LIQUIDITY

The objective of effective liquidity management is to ensure that we have the ability to raise cash when we need it at a reasonable cost. We must be capable of meeting expected and unexpected obligations to our customers at any time. Given the uncertain nature of customer demands as well as the need to maximize earnings, we must have available reasonably priced sources of funds, both on- and off-balance sheet, that can be accessed quickly in time of need.

Our primary sources of available liquidity are overnight investments in federal funds sold, interest bearing bank balances at the Federal Reserve Bank, and cash flow from investment securities and loans. Certain investment securities are selected at purchase as available-for-sale based on their marketability and collateral value, as well as their yield and maturity. Our securities available-for-sale portfolio was $347.0 million million at year-end 2016, a decrease of $55.3 million from the year-end 2015 level. Due to the potential for volatility in market values, we are not always able to assume that securities may be sold on short notice at their carrying value, even to provide needed liquidity.

In addition to liquidity from short-term investments, investment securities and loans, we have supplemented available operating liquidity with additional off-balance sheet sources such as federal funds lines of credit with correspondent banks and credit lines with the Federal Home Loan Bank of New York ("FHLBNY"). Our federal funds lines of credit are with two correspondent banks totaling $35 million; we did not draw on these lines during 2016.

To support our borrowing relationship with the FHLBNY, we have pledged collateral, including residential mortgage and home equity loans. At December 31, 2016, we had outstanding collateral obligations with the FHLBNY of $183 million; on such date, our unused borrowing capacity at the FHLBNY was approximately $263 million. In addition we have identified brokered certificates of deposit as an appropriate off-balance sheet source of funding accessible in a relatively short time period. Also, our two bank subsidiaries have each established a borrowing facility with the Federal Reserve Bank of New York, pledging certain consumer loans as collateral for potential "discount window" advances, which we maintain for contingency liquidity purposes. At December 31, 2016, the amount available under this facility was approximately $370 million, and there were no advances then outstanding.

We measure and monitor our basic liquidity as a ratio of liquid assets to total short-term liabilities, both with and without the availability of borrowing arrangements. Based on the level of overnight funds investments, available liquidity from our investment securities portfolio, cash flows from our loan portfolio, our stable core deposit base and our significant borrowing capacity, we believe that our liquidity is sufficient to meet all funding needs that may arise in connection with any reasonably likely events or occurrences. At December 31, 2016, our basic liquidity ratio, including our FHLB collateralized borrowing capacity, was 11.2% of total assets, or $188 million in excess of our internally-set minimum target ratio of 4%.

Because of our consistently favorable credit quality and strong balance sheet, we did not experience any significant liquidity constraints in 2016 and did not experience any such constraints in any prior year, back to and including the financial crisis years. We have not at any time during such period been forced to pay premium rates to obtain retail deposits or other funds from any source.

E. CAPITAL RESOURCES AND DIVIDENDS

Important Regulatory Capital Standards

Revised Bank Capital Rules.

The Dodd-Frank Act enacted in 2010 directed U.S. bank regulators to promulgate revised bank capital standards, which were required to be at least as strict as the regulatory capital standards then in effect. The revised bank regulatory capital standards were adopted by the Federal bank regulatory agencies in 2013 and became effective for our holding company and our subsidiary banks on January 1, 2015. These revised capital rules are summarized in an earlier section of this Report, "Regulatory Capital Standards," on pages 7 and 8.

The table below sets forth the various capital ratios achieved by our holding company and our subsidiary banks, Glens Falls National and Saratoga National, as of December 31, 2016, as determined under the revised bank regulatory capital standards in effect on that date, as well as the minimum levels for such capital ratios that bank holding companies and banks are required to maintain under the revised rules. As demonstrated in the table, all of our holding company and bank capital ratios at year-end were well in excess of the minimum required levels for such ratios, as established by the regulators under these revised rules. In addition, on December 31, 2016, our holding company and each of our banks qualified as "well-capitalized", the highest capital classification category under the revised capital classification scheme recently established by the federal bank regulators, as in effect on that date.

Capital Ratios:	Arrow	GFNB	SNB	Minimum Required Ratio
Tier 1 Leverage Ratio	9.5 %	9.1 %	8.9 %	4.0 %
Common Equity Tier 1 Capital Ratio	13.0%	13.9%	11.9%	4.5 %
Tier 1 Risk-Based Capital Ratio	14.1%	14.0%	11.9%	6.0 %
Total Risk-Based Capital Ratio	15.2%	15.0%	12.8%	8.0 %

Stockholders' Equity at Year-end 2016: Stockholders' equity was $232.9 million at December 31, 2016, an increase of $18.9 million, or 8.8%, from the prior year-end. During 2016 stockholders' equity was positively impacted by (a) net income of $26.5 million, (b) equity received from our various stock-based compensation plans of $3.1 million, and (c) other comprehensive income of $1.1 million, while stockholders' equity was reduced by (d) cash dividends of $13.1 million, and (e) purchases of our own common stock of $2.1 million.

Trust Preferred Securities: In each of 2003 and 2004, we issued $10 million of trust preferred securities (TRUPs) in a private placement. Under the Federal Reserve Board's regulatory capital rules then in effect, TRUPs proceeds typically qualified as Tier 1 capital for bank holding companies such as ours, but only in amounts up to 25% of Tier 1 capital, net of goodwill less any associated deferred tax liability. Under the Dodd-Frank Act, any trust preferred securities that Arrow might issue on or after the grandfathering date set forth in Dodd-Frank (May 19, 2010) would no longer qualify as Tier 1 capital under bank regulatory capital guidelines, whereas TRUPs outstanding prior to the grandfathering cutoff date set forth in Dodd-Frank (May 19, 2010) would continue to qualify as Tier 1 capital until maturity or redemption, subject to limitations. Thus, our outstanding TRUPs continue to qualify as Tier 1 regulatory capital, subject to such limitations.

Dividends: The source of funds for the payment by our holding company of cash dividends to stockholders consists primarily of dividends declared and paid to the holding company by our bank subsidiaries. In addition to legal and regulatory limitations on payments of dividends by our holding company (i.e., the need to maintain adequate regulatory capital), there are also legal and regulatory limitations applicable to the payment of dividends by our bank subsidiaries to our holding company. As of December 31, 2016, under the statutory limitations in national banking law, the maximum amount that could have been paid by the bank subsidiaries to the holding company, without special

regulatory approval, was approximately $37.1 million. The ability of our holding company and our banks to pay dividends in the future is and will continue to be influenced by regulatory policies, capital guidelines and applicable laws.
See Part II, Item 5, "Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" for a recent history of our cash dividend payments.

Stock Repurchase Program: In October 2016, the Board of Directors approved a $5.0 million stock repurchase program, effective January 1, 2017 (the 2017 program), under which management is authorized, in its discretion, to repurchase from time-to-time during 2017, in the open market or in privately negotiated transactions, up to $5 million of Arrow common stock, to the extent management believes the Company's stock is reasonably priced and such repurchases appear to be an attractive use of available capital and in the best interests of stockholders. This 2017 program replaced a similar repurchase program which was in effect during 2016 (the 2016 program), which also authorized the repurchase of up to $5.0 million of Arrow common stock. As of December 31, 2016 approximately $495 thousand had been used under the 2016 program to repurchase Arrow shares. This total does not include approximately $1.6 million of Arrow's Common Stock that the Company repurchased during 2016 other than through its repurchase program, i.e., repurchases of Arrow shares on the market utilizing funds accumulated under Arrow's Dividend Reinvestment Plan and the surrender or deemed surrender of Arrow stock to the Company in connection with employees' stock-for-stock exercises of compensatory stock options to buy Arrow stock.

F. OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of operations, we may engage in a variety of financial transactions or arrangements, including derivative transactions or arrangements, that in accordance with generally accepted accounting principles are not recorded in the financial statements, or are recorded in amounts that differ from the notional amounts. These transactions or arrangements involve, to varying degrees, elements of credit, interest rate, and liquidity risk. Such transactions or arrangements may be used by us or our customers for general corporate purposes, such as managing credit, interest rate, or liquidity risk or to optimize capital, or may be used by us or our customers to manage funding needs.

We have no off-balance sheet arrangements that are reasonably likely to have a material current or future effect on our financial condition, revenues or expenses, results of operations, liquidity or capital expenditures. As of December 31, 2016, we had no derivative securities, including interest rate swaps, credit default swaps, or equity puts or calls, in our investment portfolio.

G. CONTRACTUAL OBLIGATIONS (In Thousands)

	Payments Due by Period				
Contractual Obligation	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Long-Term Debt Obligations:					
Federal Home Loan Bank Advances [1]	$55,000	$—	$30,000	$25,000	$—
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts [2]	20,000	—	—	—	20,000
Operating Lease Obligations [3]	2,251	675	895	403	278
Obligations under Retirement Plans [4]	35,358	3,354	6,527	7,039	18,438
Total	$112,609	$4,029	$37,422	$32,442	$38,716

[1] See Note 10 to the Consolidated Financial Statements in Item 8 of this Report for additional information on Federal Home Loan Bank Advances, including call provisions.
[2] See Note 10 to the Consolidated Financial Statements in Item 8 of this Report for additional information on Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts (trust preferred securities).
[3] See Note 18 to the Consolidated Financial Statements in Item 8 of this Report for additional information on our Operating Lease Obligations.
[4] See Note 13 to the Consolidated Financial Statements in Item 8 of this Report for additional information on our Retirement Benefit Plans.

H. FOURTH QUARTER RESULTS

We reported net income of $6.6 million for the fourth quarter of 2016, an increase of $31 thousand, or 0.5%, from the net income of $6.57 million we reported for the fourth quarter of 2015. Diluted earnings per common share for the fourth quarter of 2016 were $0.49, was unchanged from the fourth quarter of 2015. The net change in earnings between the two quarters was primarily affected by the following: (a) a $1.1 million increase in tax-equivalent net interest income, (b) a $39 thousand decrease in noninterest income, (c) an $18 thousand increase in the provision for loan losses, (d) a $1.0 million increase in noninterest expense, and (e) a $31 thousand decrease in the provision for income taxes. The principal factors contributing to these quarter-to-quarter changes are included in the discussion of the year-to-year changes in net income set forth elsewhere in this Item 7, specifically, in Section B, "Results of Operations," above, as well as in the Company's Current Report on Form 8-K, as filed with the SEC on January 20, 2017, incorporating by reference the Company's earnings release for the year ended December 31, 2016.

SELECTED FOURTH QUARTER FINANCIAL INFORMATION
(Dollars In Thousands, Except Per Share Amounts)

	For the Quarters Ended December 31,			
	12/31/2016		12/31/2015	
Interest and Dividend Income	$19,770		$18,510	
Interest Expense	1,404		1,231	
Net Interest Income	18,366		17,279	
Provision for Loan Losses	483		465	
Net Interest Income after Provision for Loan Losses	17,883		16,814	
Noninterest Income	6,648		6,687	
Noninterest Expense	15,272		14,242	
Income Before Provision for Income Taxes	9,259		9,259	
Provision for Income Taxes	2,659		2,690	
Net Income	$6,600		$6,569	
SHARE AND PER SHARE DATA:				
Weighted Average Number of Shares Outstanding:				
Basic	13,441		13,306	
Diluted	13,565		13,368	
Basic Earnings Per Common Share	$0.49		0.49	
Diluted Earnings Per Common Share	0.49		0.49	
Cash Dividends Per Common Share	0.250		0.243	
AVERAGE BALANCES:				
Assets	$2,572,425		$2,442,964	
Earning Assets	2,446,375		2,317,784	
Loans	1,726,738		1,556,234	
Deposits	2,160,156		2,075,825	
Stockholders' Equity	230,198		213,219	
SELECTED RATIOS (Annualized):				
Return on Average Assets	1.02	%	1.07	%
Return on Average Equity	11.41	%	12.22	%
Net Interest Margin [1]	3.14	%	3.11	%
Net Charge-offs to Average Loans	0.10	%	0.05	%
Provision for Loan Losses to Average Loans	0.11	%	0.12	%

[1] Net Interest Margin is the ratio of tax-equivalent net interest income to average earning assets. (See “Use of Non-GAAP Financial Measures” on page 4).

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SUMMARY OF QUARTERLY FINANCIAL DATA (Unaudited)

The following quarterly financial information for 2016 and 2015 is unaudited, but, in the opinion of management, fairly presents the results of Arrow.

SELECTED QUARTERLY FINANCIAL DATA

(In Thousands, Except Per Share Amounts)

	2016			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total Interest and Dividend Income	$18,626	$19,237	$19,282	$19,770
Net Interest Income	17,363	17,953	17,877	18,366
Provision for Loan Losses	401	669	480	483
Net Securities Gains (Losses)	—	144	—	(166)
Income Before Provision for Income Taxes	9,467	9,594	9,429	9,259
Net Income	6,549	6,647	6,738	6,600
Basic Earnings Per Common Share	0.49	0.50	0.50	0.49
Diluted Earnings Per Common Share	0.49	0.49	0.50	0.49
	2015			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total Interest and Dividend Income	$16,990	$17,407	$17,831	$18,510
Net Interest Income	15,904	16,164	16,578	17,279
Provision for Loan Losses	275	70	537	465
Net Securities Gains	90	16	—	23
Income Before Provision for Income Taxes	8,530	9,155	8,328	9,259
Net Income	5,855	6,305	5,933	6,569
Basic Earnings Per Common Share	0.44	0.48	0.45	0.49
Diluted Earnings Per Common Share	0.44	0.47	0.45	0.49

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

In addition to credit risk in our loan portfolio and liquidity risk, discussed earlier, our business activities also generate market risk. Market risk is the possibility that changes in future market rates (interest rates) or prices (fees for products and services) will make our position (i.e., our assets and operations) less valuable. The ongoing monitoring and management of interest rate and market risk is an important component of our asset/liability management process, which is governed by policies that are reviewed and approved annually by the Board of Directors. The Board of Directors delegates responsibility for carrying out asset/liability oversight and control to management's Asset/Liability Committee ("ALCO"). In this capacity ALCO develops guidelines and strategies impacting our asset/liability profile based upon estimated market risk sensitivity, policy limits and overall market interest rate levels and trends. We have not made use of derivatives, such as interest rate swaps, in our risk management process.

Interest rate risk is the most significant market risk affecting us. Interest rate risk is the exposure of our net interest income to changes in interest rates. Interest rate risk is directly related to the different maturities and repricing characteristics of interest-bearing assets and liabilities, as well as to the risk of prepayment of loans and early withdrawal of time deposits, and the fact that the speed and magnitude of responses to interest rate changes varies by product.

ALCO utilizes the results of a detailed and dynamic simulation model to quantify the estimated exposure of net interest income to sustained interest rate changes. While ALCO routinely monitors simulated net interest income sensitivity over a rolling two-year horizon, it also utilizes additional tools to monitor potential longer-term interest rate risk, including periodic stress testing involving hypothetical sudden and significant interest rate spikes.

Our standard simulation model attempts to capture the impact of changing interest rates on the interest income received and interest expense paid on all interest-sensitive assets and liabilities reflected on our consolidated balance sheet. This sensitivity analysis is compared to ALCO policy limits which specify a maximum tolerance level for net interest income exposure over a one- year horizon, assuming no balance sheet growth and a 200 basis point upward and a 100 basis point downward shift in interest rates, and a repricing of interest-bearing assets and liabilities at their earliest reasonably predictable repricing date. We normally apply a parallel and pro rata shift in rates over a 12-month period. However, at year-end 2016 the targeted federal funds rate was only 50 basis points above the rate where it had been from late 2008 to December 16, 2015, a range of 0 to .25%. Thus, for purposes of our decreasing rate simulation, we applied a hypothetical 100 basis point downward shift in interest rates for assets and liabilities at the long end of the yield curve with hypothetical short-term rate decreases for particular assets and liabilities equal to the lesser of 100 basis points or such lower rate (below 100 basis points) as was actually borne by such asset or liability.

Applying the simulation model analysis as of December 31, 2016, a 200 basis point increase in interest rates demonstrated a 3.3% decrease in net interest income, and a 100 basis point (as adjusted) decrease in interest rates demonstrated a 0.3% decrease in net interest income. These amounts were within our ALCO policy limits.

Historically, there has existed an inverse relationship between changes in prevailing rates and our net interest income, reflecting the fact that our liabilities and sources of funds generally reprice more quickly than our earning assets. However, when current prevailing interest rates are already extremely low, a further decline in prevailing rates may not produce the otherwise expected increase in net interest income, even over a relatively short time horizon, because as noted above, further decreases in rates with respect to liabilities (deposits) may be significantly impeded by the assumed boundary of a zero rate, whereas further decreases in asset rates are not as likely to run up against the assumed boundary of zero, and thus may be experienced in full or nearly full, across the asset portfolio, even if assets reprice more slowly than liabilities. Thus, even in the short run, rate decreases in the current environment may not be beneficial to income.

If the impact of rate change on our income is projected over a longer time horizon, e.g., two years or longer, it might be expected that a decrease in prevailing rates would have a greater negative impact on our income, as compared to the short-term result, as assets continue to reprice downward in full response, while liabilities do not further reprice but remain trapped by the assumed zero rate boundary. On the other hand, an increase in prevailing rates would have a much less negative impact over the longer term, and perhaps even a neutral or positive impact on our net interest income, as our asset portfolios eventually reprice upward. However, other factors may play a significant role in any analysis of the impact of rising rates on our income, including a possible softening of loan demand and/or slowing of the economy that might be expected to accompany any general rate rise.The preceding sensitivity analysis does not represent a forecast on our part and should not be relied upon as being indicative of expected operating results.

The hypothetical estimates underlying the sensitivity analysis are based upon numerous assumptions including: the nature and timing of changes in interest rates including yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, reinvestment/replacement of asset and liability cash flows, and others. While assumptions are developed based upon current economic and local market conditions, we cannot make any assurance as to the predictive nature of these assumptions including how customer preferences or competitor influences might change.

Also, as market conditions vary from those assumed in the sensitivity analysis, actual results will differ due to: prepayment/refinancing levels likely deviating from those assumed, the varying impact of interest rate changes on caps or floors on adjustable rate assets, the potential effect of changing debt service levels on customers with adjustable rate loans, depositor early withdrawals and product preference changes, unanticipated shifts in the yield curve and other internal/external variables. Furthermore, the sensitivity analysis does not reflect actions that ALCO might take in responding to or anticipating changes in interest rates.

Item 8. Financial Statements and Supplementary Data

The following audited consolidated financial statements and unaudited supplementary data are submitted herewith:

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Arrow Financial Corporation:

We have audited the accompanying consolidated balance sheets of Arrow Financial Corporation and subsidiaries (the Company) as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2016. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Arrow Financial Corporation and subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 14, 2017, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Albany, New York
March 14, 2017

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Arrow Financial Corporation:

We have audited Arrow Financial Corporation and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Arrow Financial Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Arrow Financial Corporation and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2016, and our report dated March 14, 2017 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Albany, New York
March 14, 2017

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share and Per Share Amounts)

	December 31, 2016	December 31, 2015
ASSETS		
Cash and Due From Banks	$ 43,024	$ 34,816
Interest-Bearing Deposits at Banks	14,331	16,252
Investment Securities:		
Available-for-Sale	346,996	402,309
Held-to-Maturity (Approximate Fair Value of $343,751 at December 31, 2016, and $325,930 at December 31, 2015)	345,427	320,611
Other Investments	10,912	8,839
Loans	1,753,268	1,573,952
Allowance for Loan Losses	(17,012)	(16,038)
Net Loans	1,736,256	1,557,914
Premises and Equipment, Net	26,938	27,440
Goodwill	21,873	21,873
Other Intangible Assets, Net	2,696	3,107
Other Assets	56,789	53,027
Total Assets	$ 2,605,242	$ 2,446,188
LIABILITIES		
Noninterest-Bearing Deposits	$ 387,280	$ 358,751
Interest-Bearing Checking Accounts	877,988	887,317
Savings Deposits	651,965	594,538
Time Deposits of $100,000 or More	74,778	59,792
Other Time Deposits	124,535	130,025
Total Deposits	2,116,546	2,030,423
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	35,836	23,173
Federal Home Loan Bank Overnight Advances	123,000	82,000
Federal Home Loan Bank Term Advances	55,000	55,000
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	20,000	20,000
Other Liabilities	22,008	21,621
Total Liabilities	2,372,390	2,232,217
STOCKHOLDERS’ EQUITY		
Preferred Stock, $5 Par Value; 1,000,000 Shares Authorized	—	—
Common Stock, $1 Par Value; 20,000,000 Shares Authorized (17,943,201 Shares Issued at December 31, 2016, and 17,420,776 Shares Issued at December 31, 2015)	17,943	17,421
Additional Paid-in Capital	270,880	250,680
Retained Earnings	28,644	32,139
Unallocated ESOP Shares (19,466 Shares at December 31, 2016, and 55,275 Shares at December 31, 2015)	(400)	(1,100)
Accumulated Other Comprehensive Loss	(6,834)	(7,972)
Treasury Stock, at Cost (4,441,093 Shares at December 31, 2016, and 4,426,072 Shares at December 31, 2015)	(77,381)	(77,197)
Total Stockholders’ Equity	232,852	213,971

Total Liabilities and Stockholders’ Equity	$ 2,605,242	$ 2,446,188

See Notes to Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In Thousands, Except Per Share Amounts)

	Years Ended December 31,		
	2016	2015	2014
INTEREST AND DIVIDEND INCOME			
Interest and Fees on Loans	$62,823	$56,856	$53,194
Interest on Deposits at Banks	152	94	80
Interest and Dividends on Investment Securities:			
Fully Taxable	7,934	8,043	7,954
Exempt from Federal Taxes	6,006	5,745	5,633
Total Interest and Dividend Income	76,915	70,738	66,861
INTEREST EXPENSE			
Interest-Bearing Checking Accounts	1,280	1,276	1,722
Savings Deposits	932	741	839
Time Deposits of $100,000 or More	453	356	770
Other Time Deposits	658	742	1,354
Federal Funds Purchased and Securities Sold Under Agreements to Repurchase	33	20	22
Federal Home Loan Bank Advances	1,340	1,097	490
Junior Subordinated Obligations Issued to Unconsolidated Subsidiary Trusts	660	581	570
Total Interest Expense	5,356	4,813	5,767
NET INTEREST INCOME	71,559	65,925	61,094
Provision for Loan Losses	2,033	1,347	1,848
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	69,526	64,578	59,246
NONINTEREST INCOME			
Income From Fiduciary Activities	7,783	7,762	7,468
Fees for Other Services to Customers	9,469	9,220	9,261
Net (Loss) Gain on Securities Transactions	(22)	129	110
Insurance Commissions	8,668	8,967	9,455
Net Gain on Sales of Loans	821	692	784
Other Operating Income	1,113	1,354	1,238
Total Noninterest Income	27,832	28,124	28,316
NONINTEREST EXPENSE			
Salaries and Employee Benefits	34,330	33,064	30,941
Occupancy Expenses, Net	9,402	9,267	8,990
FDIC Assessments	1,076	1,186	1,117
Other Operating Expense	14,801	13,913	12,980
Total Noninterest Expense	59,609	57,430	54,028
INCOME BEFORE PROVISION FOR INCOME TAXES	37,749	35,272	33,534
Provision for Income Taxes	11,215	10,610	10,174
NET INCOME	$26,534	$24,662	$23,360
Average Shares Outstanding:			
Basic	13,391	13,281	13,242
Diluted	13,476	13,330	13,272

Per Common Share:			
Basic Earnings	$1.98	$1.86	$1.76
Diluted Earnings	1.97	1.85	1.76

Share and Per Share Amounts have been restated for the September 29, 2016 3% stock dividend.
See Notes to Consolidated Financial Statements.

ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In Thousands)

	Years Ended December 31,		
	2016	2015	2014
Net Income	$26,534	$24,662	$23,360
Other Comprehensive Income (Loss), Net of Tax:			
Unrealized Net Securities Holding (Losses) Gains Arising During the Year	(1,024)	(1,832)	232
Reclassification Adjustment for Net Securities Losses (Gains) Included in Net Income	13	(78)	(67)
Net Retirement Plan Gain (Loss)	1,721	848	(2,846)
Net Retirement Plan Prior Service (Cost) Credit	—	(224)	(347)
Amortization of Net Retirement Plan Actuarial Loss	435	514	288
Accretion of Net Retirement Plan Prior Service Credit	(7)	(34)	(53)
Other Comprehensive Income (Loss)	1,138	(806)	(2,793)
Comprehensive Income	$27,672	$23,856	$20,567

See Notes to Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(In Thousands, Except Share and Per Share Amounts)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unallo-cated ESOP Shares	Accumu-lated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2013	$ 16,744	$ 229,290	$ 27,457	$ (1,800)	$ (4,373)	$ (75,164)	$ 192,154
Net Income	—	—	23,360	—	—	—	23,360
Other Comprehensive Income (Loss)	—	—	—	—	(2,793)	—	(2,793)
2% Stock Dividend (334,890 Shares)	335	8,617	(8,952)	—	—	—	—
Cash Dividends Paid, $.94 per Share 1	—	—	(12,407)	—	—	—	(12,407)
Shares Issued for Stock Option Exercises, net (61,364 Shares)	—	852	—	—	—	602	1,454
Shares Issued Under the Directors' Stock Plan (7,584 Shares)	—	123	—	—	—	74	197
Shares Issued Under the Employee Stock Purchase Plan (19,575 Shares)	—	296	—	—	—	192	488
Stock-Based Compensation Expense	—	360	—	—	—	—	360
Tax Benefit for Exercises of Stock Options	—	25	—	—	—	—	25
Purchase of Treasury Stock (95,064 Shares)	—	—	—	—	—	(2,455)	(2,455)
Acquisition of Subsidiaries (3,595 Shares)	—	56	—	—	—	35	91
Allocation of ESOP Stock (17,300 Shares)	—	102	—	350	—	—	452
Balance at December 31, 2014	$ 17,079	$ 239,721	$ 29,458	$ (1,450)	$ (7,166)	$ (76,716)	$ 200,926
Balance at December 31, 2014	$ 17,079	$ 239,721	$ 29,458	$ (1,450)	$ (7,166)	$ (76,716)	$ 200,926
Net Income	—	—	24,662	—	—	—	24,662
Other Comprehensive (Loss) Income	—	—	—	—	(806)	—	(806)
2% Stock Dividend (341,400 Shares)	342	8,939	(9,281)	—	—	—	—
Cash Dividends Paid, $.96 per Share 1	—	—	(12,700)	—	—	—	(12,700)
Shares Issued for Stock Option Exercises, net (43,096 Shares)	—	489	—	—	—	429	918
Shares Issued Under the Directors' Stock Plan (8,480 Shares)	—	143	—	—	—	84	227
Shares Issued Under the Employee Stock	—	306	—	—	—	188	494

Purchase Plan (19,036 Shares)							
Shares Issued for Dividend Reinvestment Plans (32,171 Shares)	—	570	—	—	—	316	886
Stock-Based Compensation Expense	—	308	—	—	—	—	308
Tax Benefit for Exercises of Stock Options	—	59	—	—	—	—	59
Purchase of Treasury Stock (55,368 Shares)	—	—	—	—	—	(1,498)	(1,498)
Allocation of ESOP Stock (17,645 Shares)	—	145	—	350	—	—	495
Balance at December 31, 2015	$ 17,421	$ 250,680	$ 32,139	$ (1,100)	$ (7,972)	$ (77,197)	$ 213,971

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY, Continued
(In Thousands, Except Share and Per Share Amounts)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Unallo-cated ESOP Shares	Accumu-lated Other Com-prehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2015	$17,421	$250,680	$32,139	$ (1,100)	$ (7,972)	$(77,197)	$213,971
Net Income	—	—	26,534	—	—	—	26,534
Other Comprehensive (Loss) Income	—	—	—	—	1,138	—	1,138
3% Stock Dividend (522,425 Shares) [2]	522	16,415	(16,937)	—	—	—	—
Cash Dividends Paid, $.98 per Share [1]	—	—	(13,092)	—	—	—	(13,092)
Shares Issued for Stock Option Exercises, net (109,651 Shares)	—	1,265	—	—	—	1,139	2,404
Shares Issued Under the Directors' Stock Plan (6,005 Shares)	—	138	—	—	—	67	205
Shares Issued Under the Employee Stock Purchase Plan (17,113 Shares)	—	318	—	—	—	175	493
Shares Issued for Dividend Reinvestment Plans (55,432 Shares)	—	1,167	—	—	—	576	1,743
Stock-Based Compensation Expense	—	287	—	—	—	—	287
Tax Benefit for Exercises of Stock Options	—	188	—	—	—	—	188
Purchase of Treasury Stock (72,723 Shares)	—	—	—	—	—	(2,141)	(2,141)
Allocation of ESOP Stock (36,927 Shares)	—	422	—	700	—	—	1,122
Balance at December 31, 2016	$17,943	$270,880	$28,644	$ (400)	$ (6,834)	$(77,381)	$232,852

[1] Cash dividends paid per share have been adjusted for the September 29, 2016 3% stock dividend.
[2] Included in the shares issued for the 3% stock dividend in 2016 were treasury shares of 130,499 and unallocated ESOP shares of 1,118.

See Notes to Consolidated Financial Statements.

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ARROW FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)

	December 31,		
Cash Flows from Operating Activities:	2016	2015	2014
Net Income	$26,534	$24,662	$23,360
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:			
Provision for Loan Losses	2,033	1,347	1,848
Depreciation and Amortization	5,940	6,293	7,042
Allocation of ESOP Stock	1,122	495	452
Gains on the Sale of Securities Available-for-Sale	(317)	(172)	(137)
Losses on the Sale of Securities Available-for-Sale	339	43	27
Loans Originated and Held-for-Sale	(23,787)	(20,731)	(23,156)
Proceeds from the Sale of Loans Held-for-Sale	24,422	21,524	23,606
Net Gains on the Sale of Loans	(821)	(692)	(784)
Net Losses on the Sale or Write-down of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	232	297	77
Net Gain on the Sale of a Subsidiary	—	(204)	—
Contributions to Pension & Postretirement Plans	(690)	(3,858)	(921)
Deferred Income Tax (Benefit) Expense	(283)	1,036	(299)
Shares Issued Under the Directors’ Stock Plan	205	227	197
Stock-Based Compensation Expense	287	308	360
Net (Increase) in Other Assets	(1,598)	(1,147)	(806)
Net Increase (Decrease) in Other Liabilities	1,077	(502)	(225)
Net Cash Provided By Operating Activities	34,695	28,926	30,641
Cash Flows from Investing Activities:			
Proceeds from the Sale of Securities Available-for-Sale	97,930	66,551	49,928
Proceeds from the Maturities and Calls of Securities Available-for-Sale	88,719	93,817	153,127
Purchases of Securities Available-for-Sale	(134,950)	(201,820)	(113,953)
Proceeds from the Maturities and Calls of Securities Held-to-Maturity	56,461	48,409	56,714
Purchases of Securities Held-to-Maturity	(82,433)	(68,210)	(60,906)
Net Increase in Loans	(182,065)	(164,710)	(148,482)
Proceeds from the Sales or Write-down of Premises and Equipment, Other Real Estate Owned and Repossessed Assets	1,991	1,901	1,237
Purchase of Premises and Equipment	(1,441)	(1,621)	(1,468)
Cash Paid for Subsidiaries, Net	—	—	(75)
Proceeds from the Sale of a Subsidiary, Net	72	132	—
Net (Increase) Decrease in Federal Home Loan Bank Stock	(2,073)	(3,988)	1,430
Purchase of Bank Owned Life Insurance	—	—	(5,245)
Net Cash Used In Investing Activities	(157,789)	(229,539)	(67,693)
Cash Flows from Financing Activities:			
Net Increase in Deposits	86,123	127,475	60,618
Net Increase (Decrease) in Short-Term Federal Home Loan Bank Borrowings	41,000	41,000	(12,000)
Net Increase in Short-Term Borrowings	12,663	3,752	7,644
Federal Home Loan Bank Advances	—	55,000	—
Repayments of Federal Home Loan Bank Advances	—	(10,000)	(10,000)
Purchase of Treasury Stock	(2,141)	(1,498)	(2,455)
Shares Issued for Stock Option Exercises, net	2,404	918	1,454
Shares Issued Under the Employee Stock Purchase Plan	493	494	488

Tax Benefit for Exercises of Stock Options	188	59	25
Shares Issued for Dividend Reinvestment Plans	1,743	886	—
Cash Dividends Paid	(13,092)	(12,700)	(12,407)
Net Cash Provided By Financing Activities	129,381	205,386	33,367
Net Increase (Decrease) in Cash and Cash Equivalents	6,287	4,773	(3,685)
Cash and Cash Equivalents at Beginning of Year	51,068	46,295	49,980
Cash and Cash Equivalents at End of Year	$57,355	$51,068	$46,295
Supplemental Disclosures to Statements of Cash Flow Information:			
Interest on Deposits and Borrowings	$5,341	$4,856	$5,932
Income Taxes	11,961	9,357	10,060
Non-cash Investing and Financing Activity:			
Transfer of Loans to Other Real Estate Owned and Repossessed Assets	1,876	3,046	1,308
Shares Issued for Acquisition of Subsidiary	—	—	91

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1: RISKS AND UNCERTAINTIES

Nature of Operations - Arrow Financial Corporation, a New York corporation, was incorporated on March 21, 1983 and is registered as a bank holding company within the meaning of the Bank Holding Company Act of 1956. Arrow derives most of its earnings from the ownership of two nationally chartered commercial banks and through the ownership of four insurance agencies. The two banks provide a full range of services to individuals and small to mid-size businesses in northeastern New York State from Albany, the State's capitol, to the Canadian border. Both banks have trust departments which provide investment management and administrative services. The insurance agencies specialize in property and casualty insurance, group health insurance and individual life insurance.

Management’s Use of Estimates - The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Our most significant estimates are the allowance for loan losses, the evaluation of other-than-temporary impairment of investment securities, goodwill impairment, pension and other postretirement liabilities, analysis of a need for a valuation allowance for deferred tax assets and other fair value calculations. Actual results could differ from those estimates.
A material estimate that is particularly susceptible to significant change in the near term is the allowance for loan losses. The allowance for loan losses is management’s best estimate of probable loan losses incurred as of the balance sheet date. While management uses available information to recognize losses on loans, future adjustments to the allowance for loan losses may be necessary based on changes in economic conditions.

Concentrations of Credit - Virtually all of Arrow's loans are with borrowers in upstate New York. Although the loan portfolios of the subsidiary banks are well diversified, tourism has a substantial impact on the northeastern New York economy. The commitments to extend credit are fairly consistent with the distribution of loans presented in Note 5, generally have the same credit risk and are subject to normal credit policies. Generally, the loans are secured by assets and are expected to be repaid from cash flow or the sale of selected assets of the borrowers. Arrow evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by Arrow upon extension of credit, is based upon management's credit evaluation of the counterparty. The nature of the collateral varies with the type of loan and may include: residential real estate, cash and securities, inventory, accounts receivable, property, plant and equipment, income producing commercial properties and automobiles.

Note 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation - The financial statements of Arrow and its wholly owned subsidiaries are consolidated and all material inter-company transactions have been eliminated. In the “Parent Company Only” financial statements in Note 20, the investment in wholly owned subsidiaries is carried under the equity method of accounting. When necessary, prior years’ consolidated financial statements have been reclassified to conform to the current-year financial statement presentation.
The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under GAAP. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity’s activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities (VIE) are entities that

lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when the Company has both the power and ability to direct the activities of the VIE that most significantly impact the VIE's economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. The Company's wholly owned subsidiaries Arrow Capital Statutory Trust II and Arrow Capital Statutory Trust III are VIEs for which the Company is not the primary beneficiary. Accordingly, the accounts of these entities are not included in the Company's consolidated financial statements.

Segment Reporting - Arrow operations are primarily in the community banking industry, which constitutes Arrow's only segment for financial reporting purposes. Arrow provides other services, such as trust administration, retirement plan administration, advice to our proprietary mutual funds and insurance products, but these services do not rise to the quantitative thresholds for separate disclosure. Arrow operates primarily in the northeastern region of New York State in Warren, Washington, Saratoga, Essex, Clinton and Albany counties and surrounding areas.

Cash and Cash Equivalents - Cash and cash equivalents include the following items: cash at branches, due from bank balances, cash items in the process of collection, interest-bearing bank balances and federal funds sold.

Securities - Management determines the appropriate classification of securities at the time of purchase. Securities reported as held-to-maturity are those debt securities which Arrow has both the positive intent and ability to hold to maturity and are stated at amortized cost. Securities available-for-sale are reported at fair value, with unrealized gains and losses reported in accumulated other comprehensive income or loss, net of taxes. Realized gains and losses are based upon the amortized cost of the specific security sold. A decline in the fair value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in an impairment to reduce the carrying amount to fair value. To determine whether an impairment is other-than-temporary, we consider all available information relevant to the collectibility of the security, including past events, current conditions, and reasonable and supportable forecasts when developing an estimate of cash flows expected to be collected. Evidence considered in this assessment includes the reasons for impairment, the severity and duration of the impairment, changes in value subsequent to year-end, forecasted performance of the investee, and the general market condition in the geographic area or industry the investee operates in. When an other-than-temporary impairment has occurred on a debt security, the amount of the other-than-temporary impairment recognized in earnings depends on whether we intend to sell the debt security or more likely than not will be required to sell the debt security before recovery of its amortized cost basis less any current-period credit loss. If we intend to sell the debt security or it is more likely than not that we will be required to sell the debt security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment is recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If we do not intend to sell the debt security and it is not more likely than not that we will be required to sell the debt security before recovery of its amortized cost basis, the other-than-temporary impairment is separated into the amount representing the credit loss and the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings. The amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable income taxes.

Loans and Allowance for Loan Losses - Interest income on loans is accrued and credited to income based upon the principal amount outstanding. Loan fees and costs directly associated with loan originations are deferred and amortized/accreted as an adjustment to yield over the lives of the loans originated.

From time-to-time, Arrow has sold (most with servicing retained) residential real estate loans at or shortly after origination. Any gain or loss on the sale of loans, along with the value of the servicing right, is recognized at the time of sale as the difference between the recorded basis in the loan and net proceeds from the sale. Loans held for sale are recorded at the lower of cost or fair value on an aggregate basis.

Loans are placed on nonaccrual status either due to the delinquency status of principal and/or interest or a judgment by management that the full repayment of principal and interest is unlikely. Unless already placed on nonaccrual status, loans secured by home equity lines of credit are put on nonaccrual status when 120 days past due; residential real estate loans when 150 days past due; commercial and commercial real estate loans are evaluated on a loan-by-loan basis and are placed on nonaccrual status when 90 days past due if the full collection of principal and interest is uncertain. The balance of any accrued interest deemed uncollectible at the date the loan is placed on nonaccrual status is reversed, generally against interest income. A loan is returned to accrual status at the later of the date when the past due status of the loan falls below the threshold for nonaccrual status or management deems that it is likely that the borrower will repay all interest and principal. For payments received while the loan is on nonaccrual status, we may recognize interest income on a cash basis if the repayment of the remaining principal and accrued interest is deemed likely.

The allowance for loan losses is maintained by charges to operations based upon our best estimate of the probable amount of loans that we will be unable to collect based on current information and events. Provisions to the allowance for loan losses are offset by actual loan charge-offs (net of any recoveries). We evaluate the loan portfolio for potential charge-offs on a monthly basis. In general, automobile and other consumer loans are charged-off when 120 days delinquent. Residential real estate loans are charged-off when a loss becomes known or based on a new appraisal at the earlier of 180 days past due or repossession. Commercial and commercial real estate loans loans are evaluated early in their delinquency status and are charged-off when management concludes that not all principal will be repaid from on-going cash flows or liquidation of collateral. An evaluation of estimated proceeds from the liquidation of the loan's collateral is compared to the loan carrying amount and a charge to the allowance for loan losses is taken for any deficiency. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions in Arrow's market area. In addition, various Federal regulatory agencies, as an integral part of their examination process, review Arrow's allowance for loan losses. Such agencies may require Arrow to recognize additions to the allowance in future periods, based on their judgments about information available to them at the time of their examination, which may not be currently available to management.

We consider nonaccrual loans over $250 thousand and all troubled debt restructured loans to be impaired loans and we evaluate these loans individually to determine the amount of impairment, if any. The amount of impairment, if any, related to individual impaired loans is measured based on either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. Arrow determines impairment for collateral dependent loans based on the fair value of the collateral less estimated costs to sell. Any excess of the recorded investment in the collateral dependent impaired loan over the estimated collateral value, less costs to sell, is typically charged off. For impaired loans which are not collateral dependent, impairment is measured by comparing the recorded investment in the loan to the present value of the expected cash flows, discounted at the loan’s effective interest rate. If this amount is less than the recorded investment in the loan, an impairment reserve is recognized as part of the allowance for loan losses, or based upon the judgment of management all or a portion of the excess of the recorded investment in the loan over the present value of the estimated future cash flow may be charged off.

The allowance for loan losses on the remaining loans is primarily determined based upon consideration of the historical loss factor incorporating a rolling twelve quarter look-back period of the respective segment that have occurred within each pool of loans over the loss emergence period (LEP), adjusted as necessary based upon consideration of qualitative considerations impacting the inherent risk of loss in the respective loan portfolios. The LEP is an estimate of the average amount of time from the point at which a loss is incurred on a loan to the point at which the loss is recognized in the financial statements. Since the LEP may change under various economic environments, we update the LEP calculation on an annual basis. We also consider and adjust historical net loss factors for qualitative factors that impact the inherent risk of loss associated with our loan categories within our total loan portfolio. These include:

- Changes in the volume and severity of past due, nonaccrual and adversely classified loans
- Changes in the nature and volume of the portfolio and in the terms of loans
- Changes in the value of the underlying collateral for collateral dependent loans
- Changes in lending policies and procedures, including changes in underwriting standards and collection, charge-off, and recovery practices not considered elsewhere in estimating credit losses
- Changes in the quality of the loan review system
- Changes in the experience, ability, and depth of lending management and other relevant staff
- Changes in international, national, regional, and local economic and business conditions and developments that affect the collectability of the portfolio
- The existence and effect of any concentrations of credit, and changes in the level of such concentrations
- The effect of other external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio or pool

In management's opinion, the balance of the allowance for loan losses, at each balance sheet date, is sufficient to provide for probable loan losses inherent in the corresponding loan portfolio.

Other Real Estate Owned and Repossessed Assets - Real estate acquired by foreclosure and assets acquired by repossession are recorded at the fair value of the property less estimated costs to sell at the time of repossession. Subsequent declines in fair value, after transfer to other real estate owned and repossessed assets are recognized through a valuation allowance. Such declines in fair value along with related operating expenses to administer such properties or assets are charged directly to operating expense.

Premises and Equipment - Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization included in operating expenses are computed largely on the straight-line method. Depreciation is based on the estimated useful lives of the assets (buildings and improvements 20-40 years; furniture and equipment 7-10 years; data processing equipment 5-7 years) and, in the case of leasehold improvements, amortization is computed over the terms of the respective leases or their estimated useful lives, whichever is shorter. Gains or losses on disposition are reflected in earnings.

Investments in Real Estate Limited Partnerships - These limited partnerships acquire, develop and operate low and moderate-income housing. As a limited partner in these projects, we receive low income housing tax credits and tax deductions for losses incurred by the underlying properties. We apply the proportional amortization method allowed in Accounting Standards Update 2014-01 "Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects." The proportional amortization method permits an entity to amortize the initial cost of the investment in proportion to the amount of the tax credits and other tax benefits received and to recognize the net investment performance in the income statement as a component of income tax expense.

Income Taxes - Arrow accounts for income taxes under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period that includes the enactment date. Arrow's policy is that deferred tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

Goodwill and Other Intangible Assets - Identifiable intangible assets acquired in a business combination are capitalized and amortized. Any remaining unidentifiable intangible asset is classified as goodwill, for which amortization is not required but which must be evaluated for impairment. Arrow tests for impairment of goodwill on an annual basis, or when events and circumstances indicate potential impairment. In evaluating goodwill for impairment, Arrow first assesses certain qualitative factors to determine if it is more likely than not that the fair value of the reporting unit is less than its carrying value. If it is more likely than not that the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any.

The carrying amounts of other recognized intangible assets that meet recognition criteria and for which separate accounting records have been maintained (core deposit intangibles and mortgage servicing rights), have been included in the consolidated balance sheet as “Other Intangible Assets, Net.” Core deposit intangibles are being amortized on a straight-line basis over a period of ten to fifteen years.

Arrow has sold residential real estate loans, primarily to Freddie Mac, with servicing retained. Mortgage servicing rights are recognized as an asset when loans are sold with servicing retained, by allocating the cost of an originated mortgage loan between the loan and servicing right based on estimated relative fair values. The cost allocated to the servicing right is capitalized as a separate asset and amortized in proportion to, and over the period of, estimated net servicing income. Capitalized mortgage servicing rights are evaluated for impairment by comparing the asset’s carrying value to its current estimated fair value. Fair values are estimated using a discounted cash flow approach, which considers future servicing income and costs, current market interest rates, and anticipated prepayment, and default rates. Impairment losses are recognized through a valuation allowance for servicing rights having a current fair value that is less than amortized cost on an aggregate basis. Adjustments to increase or decrease the valuation allowance are charged or credited to income as a component of other operating income.

Pension and Postretirement Benefits - Arrow maintains a non-contributory, defined benefit pension plan covering substantially all employees, a supplemental pension plan covering certain executive officers selected by the Board of Directors, and certain post-retirement medical, dental and life insurance benefits for employees and retirees. The costs of these plans, based on actuarial computations of current and future benefits for employees, are charged to current operating expenses. The cost of post-retirement benefits other than pensions is recognized on an accrual basis as employees perform services to earn the benefits. Arrow recognizes the overfunded or underfunded status of our single employer defined benefit pension plan as an asset or liability on its consolidated balance sheet and recognizes changes in the funded status in comprehensive income in the year in which the change occurred.

Prior service costs or credits are amortized on a straight-line basis over the average remaining service period of active participants. Gains and losses in excess of 10% of the greater of the benefit obligation or the fair value of assets are amortized over the average remaining service period of active participants.

The discount rate assumption is determined by preparing an analysis of the respective plan's expected future cash flows and high-quality fixed-income investments currently available and expected to be available during the period to maturity of the pension benefits.

Stock-Based Compensation Plans - Arrow has two stock option plans, which are described more fully in Note 12. The Company expenses the grant date fair value of options granted. The expense is recognized over the vesting period of the grant, typically four years, on a straight-line basis. Shares are generally issued from treasury for the exercise of stock options.

Arrow sponsors an Employee Stock Purchase Plan ("ESPP") under which employees may purchase Arrow's common stock at a 5% discount below market price at the time of purchase. This stock purchase plan is not considered a compensatory plan.

Arrow sponsors an Employee Stock Ownership Plan ("ESOP"), a qualified defined contribution plan. The ESOP has borrowed funds from one of Arrow's subsidiary banks to purchase Arrow common stock. The shares pledged as collateral are reported as a reduction of Arrow's stockholders' equity. Compensation expense is recognized as shares are released for allocation to individual employee accounts equal to the current average market price.

Securities Sold Under Agreements to Repurchase - In securities repurchase agreements, Arrow receives cash from a counterparty in exchange for the transfer of securities to a third party custodian's account that explicitly recognizes Arrow's interest in the securities. These agreements are accounted for by Arrow as secured financing transactions, since it maintains effective control over the transferred securities, and meets other criteria for such accounting. Accordingly, the cash proceeds are recorded as borrowed funds, and the underlying securities continue to be carried in Arrow's securities available-for-sale portfolio.

Earnings Per Share ("EPS") - Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as Arrow's stock options), computed using the treasury stock method. Unallocated common shares held by Arrow's Employee Stock Ownership Plan are not included in the weighted average number of common shares outstanding for either the basic or diluted EPS calculation.

Financial Instruments - Arrow is a party to certain financial instruments with off-balance sheet risk, such as: commercial lines of credit, construction lines of credit, overdraft protection, home equity lines of credit and standby letters of credit. Arrow's policy is to record such instruments when funded. Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time Arrow's entire holdings of a particular financial instrument. Because no market exists for a significant portion of Arrow's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. 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.

Fair value estimates are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, Arrow has a trust department that contributes net fee income annually. The value of trust department customer relationships is not considered a financial instrument of the Company, and therefore this value has not been incorporated into the fair value estimates. Other significant assets and liabilities that are not considered financial assets or liabilities include deferred taxes, premises and equipment, the value of low-cost, long-term core deposits and goodwill. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in any of the estimates.

The carrying amount of the following short-term assets and liabilities is a reasonable estimate of fair value: cash and due from banks, federal funds sold and purchased, securities sold under agreements to repurchase, demand deposits, savings, N.O.W. and money market deposits, other short-term borrowings, accrued interest receivable and accrued interest payable. The fair value estimates of other on- and off-balance sheet financial instruments, as well as the method of arriving at fair value estimates, are included in the related footnotes and summarized in Note 17.

Fair Value Measures - We determine the fair value of financial instruments under the following hierarchy:

- Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
- Level 2 – Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;
- Level 3 – Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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

Management's Use of Estimates -The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of income and expenses during the reporting period. Our most significant estimates are the allowance for loan losses, the evaluation of other-than-temporary impairment of investment securities, goodwill impairment, pension and other postretirement liabilities and an analysis of a need for a valuation allowance for deferred tax assets. Actual results could differ from those estimates.

A material estimate that is particularly susceptible to significant change in the near term is the allowance for loan losses. In connection with the determination of the allowance for loan losses, management obtains appraisals for properties. The allowance for loan losses is management's best estimate of probable loan losses incurred as of the balance sheet date. While management uses available information to recognize losses on loans, future adjustments to the allowance for loan losses may be necessary based on changes in economic conditions.

Recent Accounting Pronouncements

During 2016, through the date of this report, the FASB issued 15 accounting standards updates. Some of the standards listed below did not have an immediate impact on Arrow, but could in the future.

ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities" will significantly change the income statement impact of equity investments. For Arrow, the standard is effective for the first quarter of 2018, and will require that equity investments be measured at fair value, with changes in fair value measured in net income. As of December 31, 2016 , we hold a $1.1 million cost basis in a small portfolio of equity investments and we do not expect that the adoption of this change in accounting for equity investments will have a material impact on our financial position or the results of operations in periods subsequent to its adoption.

ASU 2016-02 "Leases" will require the recognition of operating leases. For Arrow, the standard becomes effective in the first quarter of 2019. We do not expect that the adoption of this change in accounting for operating leases will have a material impact on our financial position or the results of operations in periods subsequent to its adoption. As of December 31, 2016, we have $2.3 million in minimum lease payments for existing operating leases of branch and insurance locations with varying expiration dates from 2017 to 2031.

ASU 2016-09 "Compensation - Stock Compensation" simplifies certain aspects of accounting for share-based payment transactions, including the tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. For Arrow, the standard becomes effective in the first quarter of 2017. We do not expect that the adoption of this change in accounting for stock-based compensation will have a material impact on our financial position or the results of operations in periods subsequent to its adoption. Although we do have previously granted Non-qualifying Stock Options (NQSO's), none are scheduled to expire during 2017 and 2018. The exercise of these NQSO's as well as any disqualifying dispositions from Incentive Stock Option exercises will create an income tax benefit which in prior years would have created an increase in Stockholders' Equity. Due to the fluctuation in fair value of these stock options and the unpredictability of the number that will be exercised, it is not practical for us to estimate the potential impact of the increase to earnings in the future.

ASU 2016-13 "Financial Instruments - Credit Losses" will change the way we and other financial entities recognize losses on assets measured at amortized costs and change the method for recognizing credit losses on securities available-for-sale. Currently, loan losses are recognized using an "incurred loss" methodology. Under ASU 2016-13, the methodology will change to a current expected loss over the life of the loan. Currently, credit losses on available-for-sale securities reduce the carrying value of the instrument and cannot be reversed. Under ASU 2016-13, the amount of the credit loss is carried as a valuation allowance and can be reversed. For Arrow, the standard is effective for the first quarter of 2020 and early adoption is allowed in 2019. The Company is currently evaluating the impact of the pending adoption of the ASU on its consolidated financial statements. The initial adjustment will not be reported in earnings, but as the cumulative effect of a change in accounting principle. At this time we have not calculated the estimated impact that this Update will have on our Allowance for Loan Losses, however, we anticipate it will have a significant impact on the methodology process we utilize to calculate the allowance.

ASU 2016-15 "Statement of Cash Flows" provides guidance on the classification of eight specific cash flow issues in order to increase consistency in reporting. Currently, GAAP is either unclear or does not include specific guidance on the cash flow issues addressed in this Update. Arrow currently reports the specifically identified cash flow transactions using the appropriate classification as outlined in the Update. For Arrow, the standard becomes effective in the first quarter of 2017. We do not expect that the adoption of this change in classification for financial reporting will have a material impact on our financial position or the results of operations in periods subsequent to its adoption.

ASU 2017-01 "Business Combinations" defines when a set of assets and activities constitutes a business for the purposes of determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Currently, the three elements required to be present in a business are inputs, processes, and outputs. The amendments in this Update allow for a business to consist of inputs, processes, and the ability to create output. For Arrow, the standard becomes effective in the first quarter of 2018. This Update will likely have no effect on our accounting for acquisitions and dispositions of businesses.

ASU 2017-04 "Intangibles-Goodwill and Other" changes the procedures for evaluating impairment of goodwill. Prior to this Update, entities were required to perform procedures o determine the fair value of the underlying assets and liabilities following the guidance for determining the fair value of assets and liabilities in a business combination. This additional step to impairment testing has been eliminated. Under the amendments in this Update, entities should perform goodwill impairment testing by comparing the fair value of a reporting unit to its carrying value. This amendment should reduce the cost and complexity of evaluating goodwill for impairment. For Arrow, the standard becomes effective in the first quarter of 2019, however, early adoption is permitted as early as the first quarter of 2017. This amendment will not affect our assessment of goodwill impairment since we currently perform the analysis of comparing carrying value to fair value of our reporting units that have goodwill.

Note 3: CASH AND CASH EQUIVALENTS (Dollars In Thousands)

The following table is the schedule of cash and cash equivalents at December 31, 2016 and 2015:

	2016	2015
Cash and Due From Banks	$43,024	$34,816
Interest-Bearing Deposits at Banks	14,331	16,252
Total Cash and Cash Equivalents	$57,355	$51,068
Supplemental Information:		
Total required reserves, including vault cash and Federal Reserve Bank deposits	$28,610	$23,446

The Company is required to maintain reserve balances with the Federal Reserve Bank of New York. The required reserve is calculated on a fourteen day average and the amounts presented in the table above represent the average for the period that includes December 31.

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Note 4. INVESTMENT SECURITIES (Dollars In Thousands)

The following table is the schedule of Available-For-Sale Securities at December 31, 2016 and 2015:
Available-For-Sale Securities

	U.S. Government & Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
December 31, 2016						
Available-For-Sale Securities, at Amortized Cost	$ 147,110	$ 27,684	$ 168,189	$ 3,512	$ 1,120	$ 347,615
Available-For-Sale Securities, at Fair Value	147,377	27,690	167,239	3,308	1,382	346,996
Gross Unrealized Gains	304	24	986	—	262	1,576
Gross Unrealized Losses	37	18	1,936	204	—	2,195
Available-For-Sale Securities, Pledged as Collateral, at Fair Value						262,852
Maturities of Debt Securities, at Amortized Cost:						
Within One Year	—	17,001	5,716	2,512		25,229
From 1 - 5 Years	147,110	9,615	101,008	—		257,733
From 5 - 10 Years	—	508	61,465	—		61,973
Over 10 Years	—	560	—	1,000		1,560
Maturities of Debt Securities, at Fair Value:						
Within One Year	—	16,994	5,753	2,508		25,255
From 1 - 5 Years	147,377	9,628	100,447	—		257,452
From 5 - 10 Years	—	508	61,039	—		61,547
Over 10 Years	—	560	—	800		1,360
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$ 70,605	$ 12,165	$ 126,825	$ 500	$ —	$ 210,095
12 Months or Longer	—	7,377	—	2,809	—	10,186
Total	$ 70,605	$ 19,542	$ 126,825	$ 3,309	$ —	$ 220,281
Number of Securities in a Continuous Loss Position	19	84	40	4	—	147
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$ 37	$ 13	$ 1,936	$ 1	$ —	$ 1,987
12 Months or Longer	—	5	—	203	—	208
Total	$ 37	$ 18	$ 1,936	$ 204	$ —	$ 2,195

Disaggregated Details:		
US Treasury Obligations, at Amortized Cost	$ 54,701	
US Treasury Obligations, at Fair Value	54,706	
US Agency Obligations, at Amortized Cost	92,409	
US Agency Obligations, at Fair Value	92,671	
US Government Agency Securities, at Amortized Cost		$ 3,694
US Government Agency Securities, at Fair Value		3,724
Government Sponsored Entity Securities, at Amortized Cost		164,495
Government Sponsored Entity Securities, at Fair Value		163,515

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Available-For-Sale Securities

	U.S. Government & Agency Obligations	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Mutual Funds and Equity Securities	Total Available-For-Sale Securities
December 31, 2015						
Available-For-Sale Securities, at Amortized Cost	$ 155,932	$ 52,306	$ 177,376	$ 14,544	$ 1,120	$ 401,278
Available-For-Sale Securities, at Fair Value	155,782	52,408	178,588	14,299	1,232	402,309
Gross Unrealized Gains	264	105	2,236	—	112	2,717
Gross Unrealized Losses	414	3	1,024	245	—	1,686
Available-For-Sale Securities, Pledged as Collateral, at Fair Value						310,857
Securities in a Continuous Loss Position, at Fair Value:						
Less than 12 Months	$ 76,802	$ 4,289	$ 99,569	$ 3,616	$ —	$ 184,276
12 Months or Longer	—	1,443	903	10,671	—	13,017
Total	$ 76,802	$ 5,732	$ 100,472	$ 14,287	$ —	$ 197,293
Number of Securities in a Continuous Loss Position	21	19	30	19	—	89
Unrealized Losses on Securities in a Continuous Loss Position:						
Less than 12 Months	$ 413	$ 2	$ 1,023	$ 2	$ —	$ 1,440
12 Months or Longer	1	1	1	243	—	246
Total	$ 414	$ 3	$ 1,024	$ 245	$ —	$ 1,686
Disaggregated Details:						
US Agency Obligations, at Amortized Cost	$ 155,932					
US Agency Obligations, at Fair Value	155,782					
US Government Agency Securities, at Amortized Cost			$ 15,701			
US Government Agency Securities, at Fair Value			15,848			
Government Sponsored Entity Securities, at Amortized Cost			161,675			
Government Sponsored Entity Securities, at Fair Value			162,740			

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The following table is the schedule of Held-To-Maturity Securities at December 31, 2016 and 2015:
Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
December 31, 2016				
Held-To-Maturity Securities, at Amortized Cost	$ 268,892	$ 75,535	$ 1,000	$ 345,427
Held-To-Maturity Securities, at Fair Value	267,127	75,624	1,000	343,751
Gross Unrealized Gains	2,058	258	—	2,316
Gross Unrealized Losses	3,823	169	—	3,992
Held-To-Maturity Securities, Pledged as Collateral, at Fair Value				321,202
Maturities of Debt Securities, at Amortized Cost:				
Within One Year	32,456	—	1,000	33,456
From 1 - 5 Years	86,070	61,712	—	147,782
From 5 - 10 Years	146,603	13,823	—	160,426
Over 10 Years	3,763	—	—	3,763
Maturities of Debt Securities, at Fair Value:				
Within One Year	32,505	—	—	32,505
From 1 - 5 Years	87,486	61,764	—	149,250
From 5 - 10 Years	143,375	13,860	—	157,235
Over 10 Years	3,761	—	1,000	4,761
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$ 107,255	$ 13,306	$ —	$ 120,561
12 Months or Longer	12,363	—	—	12,363
Total	$ 119,618	$ 13,306	$ —	$ 132,924
Number of Securities in a Continuous Loss Position	347	13	—	360
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$ 3,129	$ 169	$ —	$ 3,298
12 Months or Longer	694	—	—	694
Total	$ 3,823	$ 169	$ —	$ 3,992

Held-To-Maturity Securities

	State and Municipal Obligations	Mortgage-Backed Securities - Residential	Corporate and Other Debt Securities	Total Held-To Maturity Securities
Disaggregated Details:				
US Government Agency Securities, at Amortized Cost		$ 3,206		
US Government Agency Securities, at Fair Value		3,222		
Government Sponsored Entity Securities, at Amortized Cost		72,329		
Government Sponsored Entity Securities, at Fair Value		72,402		
December 31, 2015				
Held-To-Maturity Securities, at Amortized Cost	$ 226,053	$ 93,558	$ 1,000	$ 320,611
Held-To-Maturity Securities, at Fair Value	230,621	94,309	1,000	325,930
Gross Unrealized Gains	4,619	868	—	5,487
Gross Unrealized Losses	51	117	—	168
Held-To-Maturity Securities, Pledged as Collateral, at Fair Value				299,767
Securities in a Continuous Loss Position, at Fair Value:				
Less than 12 Months	$ 2,302	$ 6,000	$ —	$ 8,302
12 Months or Longer	11,764	4,154	—	15,918
Total	$ 14,066	$ 10,154	$ —	$ 24,220
Number of Securities in a Continuous Loss Position	54	8	—	62
Unrealized Losses on Securities in a Continuous Loss Position:				
Less than 12 Months	$ 11	$ 93	$ —	$ 104
12 Months or Longer	40	24	—	64
Total	$ 51	$ 117	$ —	$ 168
Disaggregated Details:				
US Government Agency Securities, at Amortized Cost		$ 3,802		
US Government Agency Securities, at Fair Value		3,852		
Government Sponsored Entity Securities, at Amortized Cost		89,756		
		90,457		

Government Sponsored Entity
Securities, at Fair Value

In the tables above, maturities of mortgage-backed-securities - residential are included based on their expected average lives. Actual maturities will differ from the table below because issuers may have the right to call or prepay obligations with or without prepayment penalties.

Securities in a continuous loss position, in the tables above for December 31, 2016 and December 31, 2015 do not reflect any deterioration of the credit worthiness of the issuing entities. U.S. agency issues, including mortgage-backed securities, are all rated Aaa by Moody's and AA+ by Standard and Poor's. The state and municipal obligations are general obligations supported by the general taxing authority of the issuer, and in some cases are insured. Obligations issued by school districts are supported by state aid. For any non-rated municipal securities, credit analysis is performed in-house based upon data that has been submitted by the issuers to the NY State Comptroller. That analysis shows no deterioration in the credit worthiness of the municipalities. Subsequent to December 31, 2016, there were no securities downgraded below investment grade.
The unrealized losses on these temporarily impaired securities are primarily the result of changes in interest rates for fixed rate securities where the interest rate received is less than the current rate available for new offerings of similar securities, changes in

market spreads as a result of shifts in supply and demand, and/or changes in the level of prepayments for mortgage related securities. Because we do not currently intend to sell any of our temporarily impaired securities, and because it is not more likely-than-not we would be required to sell the securities prior to recovery, the impairment is considered temporary.
Pledged securities, in the tables above, are primarily used to collateralize state and municipal deposits, as required under New York State law. A small portion of the pledged securities are used to collateralize repurchase agreements and pooled deposits of our trust customers.

Schedule of Federal Reserve Bank and Federal Home Loan Bank Stock

Federal Reserve Bank and Federal Home Loan Bank Stock are carried at cost.

	December 31,	
	2016	2015
Federal Reserve Bank Stock	$1,071	$1,060
Federal Home Loan Bank Stock	9,841	7,779
Total Federal Reserve Bank and Federal Home Loan Bank Stock	$10,912	$8,839

Note 5: LOANS (Dollars In Thousands)

Loan Categories and Past Due Loans

The following table presents loan balances outstanding as of December 31, 2016 and December 31, 2015 and an analysis of the recorded investment in loans that are past due at these dates. Generally, Arrow considers a loan past due 30 or more days if the borrower is two or more payments past due.

Schedule of Past Due Loans by Loan Category

	Commercial	Commercial Real Estate	Consumer	Residential	Total
December 31, 2016					
Loans Past Due 30-59 Days	$ 112	$ 121	$ 5,593	$ 2,368	$ 8,194
Loans Past Due 60-89 Days	29	—	898	142	1,069
Loans Past Due 90 or More Days	148	—	513	1,975	2,636
Total Loans Past Due	289	121	7,004	4,485	11,899
Current Loans	104,866	431,525	530,357	674,621	1,741,369
Total Loans	$ 105,155	$ 431,646	$ 537,361	$ 679,106	$ 1,753,268
Loans 90 or More Days Past Due and Still Accruing Interest	$ —	$ —	$ 158	$ 1,043	$ 1,201
Nonaccrual Loans	$ 155	$ 875	$ 589	$ 2,574	$ 4,193
December 31, 2015					
Loans Past Due 30-59 Days	$ 98	$ —	$ 4,598	$ 955	$ 5,651
Loans Past Due 60-89 Days	186	—	1,647	1,370	3,203
Loans Past Due 90 or more Days	203	1,469	295	2,184	4,151
Total Loans Past Due	487	1,469	6,540	4,509	13,005
Current Loans	102,100	383,470	457,983	617,394	1,560,947
Total Loans	$ 102,587	$ 384,939	$ 464,523	$ 621,903	$ 1,573,952
Loans 90 or More Days Past Due and Still Accruing Interest	$ —	$ —	$—	$ 187	$ 187
Nonaccrual Loans	$ 387	$ 2,401	$ 450	$ 3,195	$ 6,433

The Company disaggregates its loan portfolio into the following four categories:

Commercial - The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable and generally have a lower liquidation value than real estate. In the event of default by the borrower, the Company may be required to liquidate collateral at deeply discounted values. To reduce the risk, management usually obtains personal guarantees of the borrowers.

Commercial Real Estate - The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to finance the purchases of real property which generally consists of real estate with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and both owner and non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings, and are generally originated in amounts of no more than 80% of the appraised value of the property. However, the Company also offers commercial construction and land development loans to finance projects, primarily within the communities that we serve. Many projects will ultimately be used by the borrowers' businesses, while others are developed for resale. These real estate loans are also secured by first liens on the real estate, which may include apartments, commercial structures, housing business, healthcare facilities and both owner-occupied and non-owner-occupied facilities. There is enhanced risk during the construction period, since the loan is secured by an incomplete project.

Consumer Loans - The Company offers a variety of consumer installment loans to finance personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to five years, based upon the nature of the collateral and the size of the loan. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. Several loans are unsecured, which carry a higher risk of loss. Also included in this category are automobile loans. The Company primarily finances the purchases of automobiles indirectly through dealer relationships located throughout upstate New York and Vermont. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to seven years. Indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Residential - Residential real estate loans consist primarily of loans secured by first or second mortgages on primary residences. We originate adjustable-rate and fixed-rate one-to-four-family residential real estate loans for the construction, purchase or refinancing of an existing mortgage. These loans are collateralized primarily by owner-occupied properties generally located in the Company's market area. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 80% of the purchase price or appraised value (whichever is lower), or have private mortgage insurance. The Company's underwriting analysis for residential mortgage loans typically includes credit verification, independent appraisals, and a review of the borrower's financial condition. Mortgage title insurance and hazard insurance are normally required. It is our general practice to underwrite our residential real estate loans to secondary market standards. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period. In addition, the Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Our policy allows for a maximum loan to value ratio of 80%, although periodically higher advances are allowed. The Company originates home equity lines of credit and second mortgage loans (loans secured by a second junior lien position on one-to-four-family residential real estate). Risk is generally reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Allowance for Loan Losses

The following table presents a rollforward of the allowance for loan losses and other information pertaining to the allowance for loan losses:

Allowance for Loan Losses

	Commercial	Commercial Real Estate	Consumer	Residential	Unallocated	Total
Rollfoward of the Allowance for Loan Losses for the Year Ended:						
December 31, 2015	$ 1,827	$ 4,520	$ 5,554	$ 3,790	$ 347	$ 16,038
Charge-offs	(97)	(195)	(871)	(107)	—	(1,270)
Recoveries	23	—	182	6	—	211
Provision	(736)	1,352	1,255	509	(347)	2,033
December 31, 2016	$ 1,017	$ 5,677	$ 6,120	$ 4,198	$ —	$ 17,012