TOMPKINS FINANCIAL CORP
Form 10-K
March 01, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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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, 2018
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ______to ______
Commission File Number 1-12709

Tompkins Financial Corporation
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| New York | 16-1482357 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 118 E. Seneca Street, P.O. Box 460, Ithaca, NY | 14850 |
| (Address of principal executive offices) | (Zip Code) |

Registrant’s telephone number, including area code: (888) 503-5753
Securities registered pursuant to Section 12(b) of the Act:

| | |
|---|---|
| Common Stock ($.10 Par Value Per Share) | NYSE American |
| (Title of class) | (Name of exchange on which traded) |

Securities registered pursuant to Section 12(g) of the Act: None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of Securities Act. Yes No .
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No .
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No .
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (S232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No .
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the 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.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a nonaccelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "nonaccelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| Large Accelerated Filer | Accelerated Filer | Nonaccelerated Filer | Smaller Reporting Company | Emerging Growth Company |
|---|---|---|---|---|

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

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

The aggregate market value of the registrant's common stock held by non-affiliates was $1.05 billion on June 30, 2018, based on the closing sales price of a share of the registrant's common stock, $.10 par value (the "Common Stock"), as reported on the NYSE American, on such date.

The number of shares of the registrant's Common Stock outstanding as of February 22, 2019, was 15,316,201 shares.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement relating to its 2019 Annual Meeting of stockholders, to be held on May 7, 2019, are incorporated by reference into Part III of this Form 10-K where indicated.

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TOMPKINS FINANCIAL CORPORATION

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For the Fiscal Year Ended December 31, 2018
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PART I

Item 1. Business

The disclosures set forth in this Item 1. Business are qualified by the section captioned “Forward-Looking Statements” in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations of this Report and other cautionary statements set forth elsewhere in this Report.

General

Tompkins Financial Corporation (“Tompkins” or the “Company”) is headquartered in Ithaca, New York and is registered as a Financial Holding Company with the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended. The Company is a locally oriented, community-based financial services organization that offers a full array of products and services, including commercial and consumer banking, leasing, trust and investment management, financial planning and wealth management, and insurance. At December 31, 2018, the Company’s subsidiaries included: four wholly-owned banking subsidiaries, Tompkins Trust Company (the “Trust Company”), The Bank of Castile (DBA Tompkins Bank of Castile), Mahopac Bank (DBA Tompkins Mahopac Bank), VIST Bank (DBA Tompkins VIST Bank); and a wholly-owned insurance agency subsidiary, Tompkins Insurance Agencies, Inc. (“Tompkins Insurance”). The Trust Company provides a full array of trust and investment services under the Tompkins Financial Advisors brand, including investment management, trust and estate, financial and tax planning as well as life, disability and long-term care insurance services. The Company’s principal offices are located at 118 E. Seneca St., P.O. Box 460, Ithaca, New York, 14850, and its telephone number is (888) 503-5753. The Company’s common stock is traded on the NYSE American under the symbol “TMP.”

Tompkins was organized in 1995, under the laws of the State of New York, as a bank holding company for the Trust Company, a commercial bank that has operated in Ithaca, New York and surrounding communities since 1836.

The Tompkins strategy centers around its core values and a commitment to delivering long-term value to our clients, communities, and shareholders. To achieve this, the Company has a variety of strategic initiatives focused on delivering high quality products and services; a continual focus on improving operational effectiveness, investing in our people through talent management and development, maintaining appropriate risk management programs, and delivering profitable growth across all of our business lines. The Company's growth strategy includes initiatives to grow organically through our current businesses, as well as through possible acquisitions of financial institutions, branches, and financial services businesses. As such, the Company has acquired, and from time to time considers acquiring, banks, thrift institutions, branch offices of banks or thrift institutions, or other businesses that would complement the Company’s business or its geographic reach. The Company generally targets merger or acquisition partners that are culturally similar and have experienced management and possess either significant market presence or have potential for improved profitability through financial management, economies of scale and expanded services. The Company has pursued acquisition opportunities in the past, and continues to review new opportunities.
Although Tompkins is a corporate entity, legally separate and distinct from its affiliates, bank holding companies such as Tompkins are generally required to act as a source of financial strength for their banking subsidiaries. Tompkins’ principal source of income is dividends from its subsidiaries. There are certain regulatory restrictions on the extent to which these subsidiaries can pay dividends or otherwise supply funds to Tompkins. See the section “Supervision and Regulation” for further details.

Narrative Description of Business

The Company has identified three business segments, consisting of banking, insurance and wealth management.

Banking services consist primarily of attracting deposits from the areas served by the Company's 4 banking subsidiaries' 66 banking offices (46 offices in New York and 20 offices in Pennsylvania), and using those deposits to originate a variety of commercial loans, agricultural loans, consumer loans, real estate loans, and leases in those same areas. The Company's lending function is managed within the guidelines of a comprehensive Board-approved lending policy. Policies and procedures are reviewed on a regular basis. Reporting systems are in place to provide management with ongoing information related to loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. The Company has an independent third party loan review process that reviews and validates the risk identification and assessment made by the lenders and credit personnel. The results of these reviews are presented to the Board of Directors of each of the Company's banking subsidiaries, and the Company's Audit Committee.



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The Company's principal expenses are interest on deposits, interest on borrowings, and operating and general administrative expenses, as well as provisions for loan and lease losses. Funding sources, other than deposits, include borrowings, securities sold under agreements to repurchase, and cash flow from lending and investing activities. The Company's principal source of revenue is interest income on loans and securities.

The Company maintains a portfolio of securities such as obligations of U.S. government agencies and U.S. government sponsored entities, obligations of states and political subdivisions thereof, and equity securities. Management typically invests in securities with short to intermediate average lives in order to better match the interest rate sensitivities of its assets and liabilities. Investment decisions are made within policy guidelines established by the Company's Board of Directors. The investment policy is based on the asset/liability management goals of the Company, and is monitored by the Company's Asset/Liability Management Committee. The intent of the policy is to establish a portfolio of high quality diversified securities, which optimizes net interest income within safety and liquidity limits deemed acceptable by the Asset/Liability Management Committee.

The Company has operated its insurance agency subsidiary, Tompkins Insurance Agencies Inc., since 2001. Insurance services include property and casualty insurance, employee benefit consulting, life, long-term care and disability insurance. Tompkins Insurance is headquartered in Batavia, New York. Over the years, Tompkins Insurance has acquired smaller insurance agencies in the market areas served by the Company's banking subsidiaries and successfully consolidated them into Tompkins Insurance. Tompkins Insurance offers services to customers of the Company's banking subsidiaries by sharing offices with Tompkins Bank of Castile, the Trust Company, and Tompkins VIST Bank. In addition to these shared offices, Tompkins Insurance has five stand-alone offices in Western New York, and one stand-alone office in Tompkins County, New York.

Wealth management services consist of investment management, trust and estate, financial and tax planning as well as life, disability and long-term care insurance services. Wealth management services are provided under the trade name Tompkins Financial Advisors. Tompkins Financial Advisors has office locations, and services are available, within all four of the Company's subsidiary banks.

Subsidiaries

The Company operates four banking subsidiaries, and an insurance agency subsidiary. In addition, the Company also owns 100% of the common stock of Sleepy Hollow Capital Trust I, Leesport Capital Trust II, and Madison Statutory Trust I. The Company's banking subsidiaries operate 66 offices, including 2 limited-service offices, with 46 banking offices located in New York and 20 banking offices located in southeastern Pennsylvania. The decision to operate as four locally managed community banks reflects management's commitment to community banking as a business strategy. For Tompkins, personal delivery of high quality services, a commitment to the communities in which we operate, and the convergence of a single-source financial service provider characterize management's community banking approach. The combined resources of the Tompkins organization provide increased capacity for growth and the greater capital resources necessary to make investments in technology and services. Tompkins has a comprehensive suite of products and services in the markets served by all four banking subsidiaries. These services include trust and investment services, insurance, leasing, card services, Internet banking, and remote deposit services.

Tompkins Trust Company (the "Trust Company")

The Trust Company is a New York State-chartered commercial bank that has operated in Ithaca, New York and surrounding communities since 1836. The Trust Company provides wealth management services through Tompkins Financial Advisors ("TFA"), a division of Tompkins Trust Company. The Trust Company operates 14 banking offices, including one limited-service banking office in Tompkins County, in New York. The Trust Company's largest market area is Tompkins County, which has a population of approximately 105,000. Education plays a significant role in the Tompkins County economy with Cornell University and Ithaca College being two of the county's major employers. The Trust Company has a full-service office in Cortland, New York and a full-service office in Auburn, New York.

Both of these offices are located in counties contiguous to Tompkins County. The Trust Company also has a full service branch in Fayetteville, New York which is located in Onondaga County. As of December 31, 2018, the Trust Company had total assets of $2.1 billion, total loans of $1.3 billion and total deposits of $1.6 billion.

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Tompkins Bank of Castile

Tompkins Bank of Castile is a New York State-chartered commercial bank and conducts its operations through its 18 banking offices, in towns situated in and around the areas commonly known as the Genesee Valley region of New York State. The main business office for Tompkins Bank of Castile is located in Batavia, New York and is shared with Tompkins Insurance. Tompkins Bank of Castile serves a six-county market, much of which is rural in nature, but also includes Monroe County (population approximately 748,000), where the city of Rochester is located, and Erie County (population 923,000) located near Buffalo, New York. The population of the counties served by Tompkins Bank of Castile, other than Monroe and Erie , is approximately 206,000. In 2018, Tompkins Bank of Castile opened a banking office in Amherst, New York, which is in Erie County and located near Buffalo, New York. As of December 31, 2018, Tompkins Bank of Castile had total assets of $1.5 billion, total loans of $1.2 billion and total deposits of $1.2 billion.

Tompkins Mahopac Bank

Tompkins Mahopac Bank is a New York State-chartered commercial bank that operates 14 banking offices. The 14 banking offices include 5 full-service offices in Putnam County, New York, 3 full-service offices in Dutchess County, New York, and 6 full-service offices in Westchester County, New York. Putnam County has a population of approximately 99,000 and is about 60 miles north of Manhattan. Dutchess County has a population of approximately 294,000, and Westchester County has a population of approximately 975,000. As of December 31, 2018, Tompkins Mahopac Bank had total assets of $1.4 billion, total loans of $1.0 billion and total deposits of $1.0 billion.

Tompkins VIST Bank

Tompkins VIST Bank is a full service Pennsylvania State-charted commercial bank that operates 20 banking offices in Pennsylvania, including one limited-service office. The 20 banking offices include 12 offices in Berks County, 5 offices in Montgomery County, 1 office in Philadelphia County, 1 office in Delaware County and 1 office in Schuylkill County. The population of the counties served by Tompkins VIST Bank is Philadelphia 1.6 million, Montgomery 823,000, Delaware 563,000, Berks 415,000 and Schuylkill 144,000. The main office is located in Wyomissing, Pennsylvania. As of December 31, 2018, Tompkins VIST Bank had total assets of $1.7 billion, total loans of $1.4 billion and total deposits of $1.2 billion.

Tompkins Insurance Agencies, Inc. ("Tompkins Insurance")

Tompkins Insurance is headquartered in Batavia, New York. Insurance services include property and casualty insurance, employee benefit consulting, and life, long-term care and disability insurance. Over the past 17 years, Tompkins Insurance has acquired smaller insurance agencies in the market areas serviced by the Company's banking subsidiaries and successfully consolidated them into Tompkins Insurance. Tompkins Insurance offers services to customers of the Company's banking subsidiaries by sharing offices with Tompkins Bank of Castile, Trust Company, and Tompkins VIST Bank. In addition to these shared offices, Tompkins Insurance has five stand-alone offices in Western New York, and one stand-alone office in Tompkins County.

Sleepy Hollow Capital Trust I

Sleepy Hollow Capital Trust I, a Delaware statutory business trust, was formed in 2003 and issued $4.0 million of floating rate (three-month LIBOR plus 3.05%) trust preferred securities. The Company acquired Sleepy Hollow Capital Trust I through the acquisition of Sleepy Hollow Bancorp, Inc. in 2008.

Leesport Capital Trust II

Leesport Capital Trust II, a Delaware statutory business trust, was formed in 2002 and issued $10.0 million of mandatory redeemable capital securities carrying a floating interest rate of three-month LIBOR plus 3.45%. The Company assumed the rights and obligations of VIST Financial Corporation ("VIST Financial") pertaining to the Leesport Capital Trust II through the Company’s acquisition of VIST Financial in 2012.

Madison Statutory Trust I

Madison Statutory Trust I, a Connecticut statutory business trust formed in 2003, issued $5.0 million of mandatory redeemable capital securities carrying a floating interest rate of three-month LIBOR plus 3.10%. VIST Financial assumed Madison Statutory Trust I pursuant to the purchase of Madison Bancshares Group, Ltd in 2004. The Company assumed the rights and obligations of VIST Financial pertaining to the Madison Statutory Trust I through the Company's acquisition of VIST Financial in 2012.

For additional details on the above capital trusts refer to "Note 10 - Trust Preferred Debentures" in the Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

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## Competition

Competition for commercial banking and other financial services is strong in the Company's market areas. In one or more aspects of its business, the Company's 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. Some of these competitors have substantially greater resources and lending capabilities and may offer services that the Company does not currently provide. In addition, many of the Company's non-bank competitors are not subject to the same extensive Federal regulations that govern financial holding companies and Federally-insured banks.

Competition among financial institutions is based upon interest rates offered on deposit accounts, interest rates charged on loans and other credit and service charges, the quality and scope of the services rendered, the convenience of facilities and services, and, in the case of loans to commercial borrowers, relative lending limits. Management believes that a community-based financial organization is better positioned to establish personalized financial relationships with both commercial customers and individual households. The Company's community commitment and involvement in its primary market areas, as well as its commitment to quality and personalized financial services, are factors that contribute to the Company's competitiveness. Management believes that each of the Company's subsidiary banks can compete successfully in its primary market areas by making prudent lending decisions quickly and more efficiently than its competitors, without compromising asset quality or profitability. In addition, the Company focuses on providing unparalleled customer service, which includes offering a strong suite of products and services. Although management feels that this business model has caused the Company to grow its customer base in recent years and allows it to compete effectively in the markets it serves, we cannot assure you that such factors will result in future success.

## Supervision and Regulation

### Regulatory Agencies

As a registered financial holding company, the Company is regulated under the Bank Holding Company Act of 1956 as amended ("BHC Act"), and is subject to examination and comprehensive regulation by the Federal Reserve Board ("FRB"). The Company is also subject to the jurisdiction of the Securities and Exchange Commission ("SEC") and is subject to disclosure and regulatory requirements under the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Company's activities are also subject to regulation under the Federal Reserve Act, the Federal Deposit Insurance Act, the Dodd-Frank Act, the Truth-in-Lending Act (which governs disclosures of credit terms to consumer borrowers), the Truth-in-Savings Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act (which governs the manner in which consumer debts may be collected by collection agencies), the Home Mortgage Disclosure Act (which requires financial institutions to provide certain information about home mortgage and refinanced loans), the Servicemembers Civil Relief Act, Section 5 of the Federal Trade Commission Act (which prohibits unfair or deceptive acts and practices in or affecting commerce), the Real Estate Settlement Procedures Act, and the Electronic Funds Transfer Act, as well as other federal, state and local laws. The Company's common stock is traded on the NYSE American under the Symbol "TMP" and as a result the Company is subject to the rules of the NYSE American for listed companies.

The Company's banking subsidiaries are subject to examination and comprehensive regulation by various regulatory authorities, including the Federal Deposit Insurance Corporation ("FDIC"), the New York State Department of Financial Services ("NYSDFS"), and the Pennsylvania Department of Banking and Securities ("PDBS"). Each of these agencies issues regulations and requires the filing of reports describing the activities and financial condition of the entities under its jurisdiction. Likewise, such agencies conduct examinations on a recurring basis to evaluate the safety and soundness of the institutions, and to test compliance with various regulatory requirements, including: consumer protection, privacy, fair lending, the Community Reinvestment Act, the Bank Secrecy Act, sales of non-deposit investments, electronic data processing, and trust department activities.

The Company's insurance subsidiary is subject to examination and regulation by the NYSDFS and the Pennsylvania Insurance Department.

The Company's wealth management subsidiary is subject to examination and regulation by various regulatory agencies, including the SEC and the Financial Industry Regulatory Authority ("FINRA"). The trust division of Tompkins Trust Company is subject to examination and comprehensive regulation by the FDIC and NYSDFS.

Federal Home Loan Bank System

The Company's banking subsidiaries are also members of the Federal Home Loan Bank ("FHLB"), which provides a central credit facility primarily for member institutions for home mortgage and neighborhood lending. The Company's banking subsidiaries are subject to the rules and requirements of the FHLB, including the requirement to acquire and hold shares of capital stock in the FHLB in an amount at least equal to the sum of 0.35% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year, up to a maximum of $25.0 million. The Company's banking subsidiaries were in compliance with FHLB rules and requirements as of December 31, 2018.

Regulatory Reform

The enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") placed U.S. banks and financial services firms under enhanced regulation and oversight. While many provisions of the Dodd- Frank Act are currently effective, certain provisions of the legislation are still subject to further rulemaking, guidance and interpretation by the federal regulatory agencies. The Dodd-Frank Act was amended on May 24, 2018, when the President signed the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA") into law. The EGRRCPA amended certain provisions of the Dodd-Frank Act and provided targeted modifications to other post-financial-crisis regulatory requirements. In addition, the legislation establishes new consumer protections and amends various securities-related and investment company-related requirements. Some EGRRCPA provisions were immediately effective, some have later-specified effective dates and still others are open-ended and subject to implementation by federal regulatory agency rule-making. EGRRCPA includes a variety of provisions that are likely to affect the Company, including the following:

- EGRRCPA includes a simplified capital rule change which directs federal banking agencies to adopt rules that exempt "qualifying community banks"--banks with assets of less than $10 billion--that exceed the "community bank leverage ratio" from all risk-based capital requirements, including Basel III, and deems such banks "well capitalized" for purposes of federal "prompt corrective action" capital standards. This exemption is not effective until federal banking agencies establish a community bank leverage ratio (a ratio of tangible equity to average consolidated assets) of between 8% and 10%. The Company was, as of December 31, 2018, a qualifying community bank.
- EGRRCPA requires federal banking agencies to amend the Liquidity Coverage Ratio Rule such that all qualifying investment-grade, liquid and readily-marketable municipal securities are treated as level 2B liquid assets;
- EGRRCPA modified and limited the definition of "high volatility commercial real estate" loans that trigger heightened risk-based capital requirements to ease the burden of those requirements;
- EGRRCPA provides that capped amounts of reciprocal deposits of certain FDIC-insured institutions shall not be considered "brokered deposits," subject to certain limitations, for institutions meeting minimum capital and exam-rating requirements;
- EGRRCPA exempts some community banks from mortgage escrow requirements, exempts certain transactions involving real property in rural areas and valued at less than $400,000 from appraisal requirements and implements a "qualified mortgage" exemption for community banks which satisfies, subject to certain limitations, the "ability to repay" requirements in the Truth in Lending Act; and
- EGRRCPA exempts certain qualifying financial institutions with less than $10 billion in total assets, such as the Company, from the Volcker Rule proprietary trading requirements implemented under the Dodd-Frank Act.

While EGRRCPA does and will continue to improve regulatory conditions for the Company, many provisions of the Dodd-Frank Act and its implementing regulations remain effective and will continue to result in additional operating and compliance costs that could have a material adverse effect on our business, financial condition and results of operation. In addition, the EGRRCPA requires the enactment of a number of implementing regulations, the details of which may change how this law ultimately impacts the Company. Further, it is possible that the current climate of regulatory reform will lead to new legislation in addition to or supplementing the Dodd-Frank Act and EGRRCPA which may subject the Company to additional or expanded regulation. The effects of any potential new legislation are

unknown and difficult to predict at this time.

Debit-Card Interchange Fees
FRB regulations mandated by the Dodd-Frank Act limit interchange fees on debit cards to a maximum of 21 cents per transaction plus 5 basis points of the transaction amount. Issuers that, together with their affiliates, have less than $10 billion in assets, such as the Company, are exempt from the debit card interchange fee standards. However, FRB regulations prohibit all card issuers, including the Company and its banking subsidiaries, from restricting the number of networks over which electronic debit transactions may be processed to fewer than two unaffiliated networks, or inhibiting a merchant's ability to direct the routing of the electronic debit transaction over any network that the card issuer has enabled to process them.

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Volcker Rule
The Dodd-Frank Act required the federal financial regulatory agencies to adopt rules that prohibit banks and their affiliates from engaging in proprietary trading and investing in and sponsoring certain unregistered investment companies (defined as hedge funds and private equity funds). The statutory provision is commonly called the “Volcker Rule.” As of December 31, 2018, the Company had outstanding investments of approximately $600,000 in covered funds (the "Legacy Investments") which we would have been required to divest no later than July 2022 per our agreement with the FRB. However, under the newly-enacted EGRRCPA, the Company, as a financial institution with less than $10 billion in total consolidated assets, is exempt from meeting the Volcker Rule's proprietary trading requirements. Therefore, no further Volcker Rule divestitures are required unless the Company crosses the $10 billion in total assets threshold.

Federal Bank Holding Company Regulation
We are a bank holding company subject to regulation under the BHC Act and the examination and reporting requirements of the FRB. In general, the BHC Act limits the business of bank holding companies to banking, managing or controlling banks and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. In addition, we qualified for the status of and elected to be a financial holding company under the BHC Act and therefore may engage in any activity, or acquire and retain the shares of a company engaged in any activity, that is either (i) financial in nature or incidental to such financial activity (as determined by the FRB in consultation with the Secretary of the Treasury) or (ii) complementary to a financial activity and does not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally (as solely determined by the FRB), without prior approval of the FRB.

If a bank holding company seeks to engage in the broader range of activities permitted under the BHC Act for financial holding companies, as we do, (i) the bank holding company and all of its depository institution subsidiaries must be “well-capitalized” and “well-managed,” as defined in the FRB's Regulation Y and (ii) it must file a declaration with the FRB that it elects to be a “financial holding company.” If we cease to meet these requirements, the Company will not be in compliance with the BHC Act’s requirements and the FRB may impose limitations or conditions on the conduct of its activities to encourage compliance. If the Company does not return to compliance within 180 days, the FRB may require divestiture of our depository institutions, among other potential penalties and limitations. To maintain financial holding company status, a financial holding company and all of its depository institution subsidiaries must be “well capitalized” and “well managed.” A depository institution subsidiary is considered to be “well capitalized” if it satisfies the requirements for this status discussed in the section captioned “Capital Adequacy and Prompt Corrective Action,” below. A depository institution subsidiary is considered “well managed” if it received a composite rating and management rating of at least “satisfactory” in its most recent examination. A financial holding company’s status will also depend upon it maintaining its status as “well capitalized” and “well managed” under applicable FRB regulations. If a financial holding company ceases to meet these capital and management requirements, the FRB’s regulations provide that the financial holding company must enter into an agreement with the FRB to comply with all applicable capital and management requirements. Until the financial holding company returns to compliance, the FRB may impose limitations or conditions on the conduct of its activities, and the company may not commence any of the broader financial activities permissible for financial holding companies or acquire a company engaged in such financial activities without prior approval of the FRB. If the company does not return to compliance within 180 days, the FRB may require divestiture of the holding company’s depository institutions. Bank holding companies and banks must also be “well-capitalized” and “well-managed” in order to acquire banks located outside their home state.

In order for a financial holding company to commence any new activity permitted by the BHC Act or to acquire a company engaged in any new activity permitted by the BHC Act, each insured depository institution subsidiary of the financial holding company must have received a rating of at least “satisfactory” in its most recent examination under the Community Reinvestment Act (“CRA”). See the section captioned “Community Reinvestment Act”, below.

The FRB has the power to order any bank holding company or its subsidiaries to terminate any activity or to terminate its ownership or control of any subsidiary when the FRB has reasonable grounds to believe that continuation of such activity or such ownership or control constitutes a serious risk to the financial soundness, safety or stability of any bank subsidiary of the bank holding company.

Share Repurchases and Dividends

Under FRB regulations, the Company may not, without providing prior notice to the FRB, purchase or redeem its own common stock if the gross consideration for the purchase or redemption, combined with the net consideration paid for all such purchases or redemptions during the preceding twelve months, is equal to ten percent or more of the Company’s consolidated net worth.

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FRB regulations provide that dividends shall not be paid except out of current earnings and unless the prospective rate of earnings retention by the Company appears consistent with its capital needs, asset quality, and overall financial condition. Tompkins' primary source of funds to pay dividends on its common stock is dividends from its subsidiary banks. The subsidiary banks are subject to regulations that limit the dividends that they may pay to Tompkins. Member banks may not declare or pay a dividend during the current calendar year that exceeds the sum of the bank's net income during the current calendar year and the retained net income of the prior two calendar years, unless approved by the pertinent regulatory agencies.

Transactions with Affiliates and Other Related Parties

There are Federal laws and regulations that govern transactions between the Company's non-bank subsidiaries and its banking subsidiaries, including Sections 23A and 23B of the Federal Reserve Act and related regulations. These laws establish certain quantitative limits and other prudent requirements for loans, purchases of assets, and certain other transactions between a member bank and its affiliates. In general, transactions between the Company's banking subsidiaries and its non-bank subsidiaries must be on terms and conditions, including credit standards, that are substantially the same or at least as favorable to the banking subsidiaries as those prevailing at the time for comparable transactions involving non-affiliated companies. The Dodd-Frank Act significantly expanded the coverage and scope of the limitations on affiliate transactions within a banking organization.

The Company's authority to extend credit to its directors, executive officers and 10% shareholders, as well as to entities controlled by such persons, is governed by the requirements of Sections 22(g) and 22(h) of the Federal Reserve Act and Regulation O as promulgated by the FRB. Among other things, these provisions require that extensions of credit to insiders (i) be made on terms that are substantially the same as, and follow credit underwriting procedures that are not less stringent than, those prevailing for comparable transactions with unaffiliated persons and that do not involve more than the normal risk of repayment or present other unfavorable features; and (ii) not exceed certain limitations on the amount of credit extended to such persons, individually and in the aggregate, which limits are based, in part, on the amount of the Bank's capital. In addition, extensions of credit in excess of certain limits must be approved by the Bank's board of directors.

Mergers and Acquisitions

The BHC Act, the Bank Merger Act, the Change in Bank Control Act and other federal and state statutes regulate acquisitions of interests in commercial banks. The BHC Act requires the prior approval of the FRB for the direct or indirect acquisition by a bank holding company of more than 5.0% of the voting shares of a commercial bank or its parent holding company and for a person, other than a bank holding company, to acquire 25% or more of any class of voting securities of a bank or bank holding company. Under the Bank Merger Act, the prior approval of the FRB or other appropriate bank regulatory authority is required for a member bank to merge with another bank or purchase the assets or assume the deposits of another bank. In reviewing applications seeking approval of merger and acquisition transactions, the bank regulatory authorities will consider, among other things, the competitive effect and public benefits of the transactions, the capital position of the combined organization, the risks to the stability of the U.S. banking or financial system, the applicant's performance record under the CRA (see the section captioned "Community Reinvestment Act" included elsewhere in this item) and fair housing laws and the effectiveness of the subject organizations in combating money laundering activities.

Source of Strength Doctrine

The Dodd-Frank Act requires bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. Under this requirement, Tompkins is expected to commit resources to support its banking subsidiaries, including at times when it may not be advantageous for Tompkins to do so. Any capital loans by a bank holding company to any of its subsidiary banks are subordinated in right of payment to deposits and to certain other indebtedness of such subsidiary banks. In the event of a bank holding company's bankruptcy, any commitment by the bank holding company to a federal bank regulatory agency to maintain the capital of a subsidiary bank will be assumed by the bankruptcy trustee and entitled to priority of payment.

Liability of Commonly Controlled Institutions

FDIC-insured depository institutions can be held liable for any loss incurred, or reasonably expected to be incurred, by the FDIC due to the default of an FDIC-insured depository institution controlled by the same bank holding company, or for any assistance provided by the FDIC to an FDIC-insured depository institution controlled by the same bank holding company that is in danger of default. “Default” means generally the appointment of a conservator or receiver. “In danger of default” means generally the existence of certain conditions indicating that default is likely to occur in the absence of regulatory assistance.

Capital Adequacy and Prompt Corrective Action

The Basel III Capital Rules were implemented by the FRB in 2013, became effective for Tompkins on January 1, 2015 and were subject to a phase-in period that concluded on January 1, 2019.

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The Basel III Capital Rules, among other things, (i) introduced a new capital measure called “Common Equity Tier 1” (“CET1”), (ii) specified that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting specified requirements, (iii) defined CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital and (iv) expanded the scope of the deductions/adjustments as compared to existing regulations.

Under the Basel III Capital Rules, the minimum capital ratios, capital conservation buffer and other deductions/adjustments are being phased in as follows:

Basel III Capital- Timeline & Transition Period
Phase-in Schedule

| Ratio | 2015 | 2016 | 2017 | 2018 | Full Phase-in 2019 |
|---|---|---|---|---|---|
| Minimum Tier 1 Leverage Capital Ratio | 4.0% | 4.0% | 4.0% | 4.0% | 4.0% |
| Minimum Common Equity Tier 1 Risk-based Capital Ratio | 4.5% | 4.5% | 4.5% | 4.5% | 4.5% |
| Minimum Tier 1 Risk-based Capital Ratio | 6.0% | 6.0% | 6.0% | 6.0% | 6.0% |
| Minimum Total Risk-based Capital Ratio | 8.0% | 8.0% | 8.0% | 8.0% | 8.0% |
| | | | | | |
| Buffer | | | | | |
| Capital Conservation Buffer | 0.00% | 0.625% | 1.25% | 1.875% | 2.50% |
| Minimum Common Equity Tier 1 Plus Capital Conservation Buffer | 4.5% | 5.125% | 5.75% | 6.375% | 7.00% |
| Minimum Tier 1 Capital Plus Capital Conservation Buffer | 6.0% | 6.625% | 7.25% | 7.875% | 8.50% |
| Minimum Total Capital Plus Capital Conservation Buffer | 8.0% | 8.625% | 9.25% | 9.875% | 10.50% |
| | | | | | |
| Deductions / Adjustments | | | | | |
| Phase-in of certain deductions and adjustments | 40% | 60% | 80% | 100% | |

Under Basel III, the Company is required to maintain a “capital conservation buffer” above the minimum risk-based capital requirements. The capital conservation buffer, fully phased in on January 1, 2019, is 2.5%. At December 31, 2018, the Company complied with the capital conservation buffer requirement.

As fully phased in on January 1, 2019, the Basel III Capital Rules require Tompkins to maintain (i) a minimum ratio of CET1 to risk-weighted assets of at least 4.5%, plus a 2.5% capital conservation buffer (which when fully phased in, effectively results in a minimum ratio of CET1 to risk-weighted assets of at least 7.0%), (ii) a minimum ratio of Tier 1 capital to risk- weighted assets of at least 6.0%, plus the capital conservation buffer (which when fully phased-in, effectively results in a minimum Tier 1 capital ratio of 8.5%), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which when fully phased in, effectively results in a minimum total capital ratio of 10.5%) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets. If we have a ratio of CET1 to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied), we will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The Basel III Capital Rules also provide for a “countercyclical capital buffer” that is applicable to only certain covered institutions and is not expected to apply to Tompkins for the foreseeable future.

The Basel III Capital Rules imposed stricter regulatory capital deductions from and adjustments to capital, with most deductions and adjustments taken against CET1 capital. These include, for example, the requirement that (i) mortgage

servicing assets, net of associated deferred tax liabilities; (ii) deferred tax assets, which cannot be realized through net operating loss carrybacks, net

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of any relative valuation allowances and net of deferred tax liabilities; and (iii) significant investments (i.e. 10% or greater ownership) in unconsolidated financial institutions be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1. Implementation of the deductions and other adjustments to CET1 began on January 1, 2015. The deductions were phased-in over a four-year period, beginning on January 1, 2015 and concluding on January 1, 2019.

Under the Basel III Capital Rules, the effect of certain accumulated other comprehensive items are not excluded, which could result in significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Company's securities portfolio. Contained within the rule was a one-time option to permanently opt-out of the inclusion of accumulated other comprehensive income in the capital calculation based upon asset size. Tompkins decided to opt out of this requirement in January 2015.

The Basel III Capital Rules also required the phase-out of certain hybrid securities, such as trust preferred securities, as Tier 1 capital of bank holding companies. However, because the trust preferred securities held by Tompkins were issued prior to May 19, 2010, and because Tompkins' total consolidated assets were less than $15.0 billion as of December 31, 2009, these trust preferred securities are permanently grandfathered under the final rule and may continue to be included as Tier 1 capital.

In addition, the Basel III Capital Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

The Standardized Approach Proposal expands the risk-weighting categories from the current four Basel I-derived categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories, including many residential mortgages and certain commercial real estate loans. Specifics include, among other things:

- Applying a 150% risk weight instead of a 100% risk weight for certain high volatility commercial real estate acquisition, development and construction loans.
- For residential mortgage exposures, the current approach of a 50% risk weight for high-quality seasoned mortgages and a 100% risk-weight for all other mortgages is replaced with a risk weight of between 35% and 200% depending upon the mortgage's loan-to-value ratio and whether the mortgage is a "category 1" or "category 2" residential mortgage exposure (based on eight criteria that include the term, use of negative amortization, balloon payments and certain rate increases).
- Assigning a 150% risk weight to exposures (other than residential mortgage exposures) that are 90 days past due.
- Providing for a 20% credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%).
- Providing for a risk weight, generally not less than 20% with certain exceptions, for securities lending transactions based on the risk weight category of the underlying collateral securing the transaction.
- Providing for a 100% risk weight for claims on securities firms.
- Eliminating the current 50% cap on the risk weight for OTC derivatives.

Section 38 of the Federal Deposit Insurance Act ("FDIA") requires federal banking agencies to take "prompt corrective action" ("PCA") should an insured depository institutions fail to meet certain capital adequacy standards. If an insured depository institution is classified in one of the undercapitalized categories, it is required to submit a capital restoration plan to the appropriate federal banking agency and the holding company must guarantee the performance of that plan. Based upon its capital levels, a bank that is classified as well- capitalized, adequately capitalized or undercapitalized, may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition or an unsafe or

unsound practice, warrants such treatment.

With respect to the Company's banking subsidiaries, the Basel III Capital Rules revised the PCA regulations, by: (i) introducing a CET1 ratio requirement at each PCA category (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to 6%); and (iii) eliminating the provision that permitted a bank with a composite supervisory rating of 1 and a 3% leverage ratio to be considered adequately capitalized. The Basel III Capital Rules did not change the total risk- based capital requirement for any PCA category. Additionally, Bank holding companies and insured depository institutions may also be subject to potential enforcement actions of varying levels of severity for unsafe or

unsound practices in conducting their business or for violation of any law, rule, regulation, condition imposed in writing by federal banking agencies or term of a written agreement with such agency. The Company is in compliance, and management believes that the Company will continue to be in compliance, with the targeted capital ratios as such requirements are phased in.

For further information concerning the regulatory capital requirements, actual capital amounts and the ratios of Tompkins and its bank subsidiaries, see the discussion in "Note 20 - Regulations and Supervision" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

Deposit Insurance

Substantially all of the deposits of the Company's banking subsidiaries are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC and are subject to deposit insurance assessments to maintain the DIF. The Dodd-Frank Act permanently increased the maximum amount of deposit insurance to $250,000 per deposit category, per depositor, per institution retroactive to January 1, 2008.

The Company's banking subsidiaries pay deposit insurance premiums to the FDIC based on assessment rates established by the FDIC. The assessment rates are based upon asset size and other risks the institution poses to the Deposit Insurance Fund, or DIF. Under this assessment system, risk is defined and measured using an institution's supervisory ratings with other risk measures, including financial ratios. The current total base assessment rates on an annualized basis range from 1.5 basis points for certain "well-capitalized," "well-managed" banks, with the highest ratings, to 40 basis points for institutions posing the most risk to the DIF. The FDIC may raise or lower these assessment rates on a quarterly basis based on various factors to achieve a reserve ratio, which the Dodd-Frank Act has mandated to be no less than 1.35 percent of insured deposits. In 2011, the FDIC redefined the deposit insurance assessment base to equal average consolidated total assets minus average tangible equity as required by the Dodd-Frank Act.

Under the FDIA, the FDIC may terminate deposit insurance upon a finding that the institution has engaged in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC.

FDIC insurance expense totaled $2.6 million, $2.5 million and $3.0 million in 2018, 2017 and 2016, respectively. FDIC insurance expense includes deposit insurance assessments, and Financing Corporation ("FICO") assessments related to outstanding FICO bonds. FICO is a mixed-ownership government corporation established by the Competitive Equality Banking Act of 1987 whose sole purpose was to function as a financing vehicle for the now defunct Federal Savings & Loan Insurance Corporation.

Depositor Preference

The FDIA provides that, in the event of the "liquidation or other resolution" of an insured depository institution, such as the Company's subsidiary banks, the claims of depositors of the institution, including the claims of the FDIC, as subrogee of the insured depositors, and certain claims for administrative expenses of the FDIC as receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institutions.

Community Reinvestment Act

The CRA and the regulations issued thereunder are intended to encourage banks to help meet the credit needs of their entire service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of such banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its

service area when considering applications to establish branches, merger applications and applications to acquire the assets and assume the liabilities of another bank. As of December 31, 2018, the Company's subsidiary banks all had ratings of satisfactory or better.

Federal Securities Laws

The common stock of the Company is registered with the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Therefore, the Company is subject to the reporting, information disclosure, proxy solicitation and other requirements imposed on public companies by the SEC under the Exchange Act. Additionally, Company insiders are subject to security trading limitations and are required to file insider ownership reports with the SEC. The SEC and NYSE American have adopted regulations under the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and the Dodd-Frank Act that apply to the Company as an exchange-traded, public company, which seek to improve corporate governance, accounting, and reporting requirements, provide enhanced penalties for financial reporting improprieties and improve the reliability of disclosures in SEC filings. For example, the Sarbanes-Oxley 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;

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(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.

Anti-Money Laundering and the USA Patriot Act
The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (“USA Patriot Act”), the Bank Secrecy Act, the Money Laundering Control Act, and other federal laws, collectively impose obligations on all financial institutions, including the Company, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Financial Privacy
The Gramm-Leach-Bliley Act of 1999 (“GLBA”) requires that financial institutions implement comprehensive written information security programs that include administrative, technical and physical safeguards designed to protect consumer information. Under the GLBA, federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies and certain security breaches to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These provisions affect, among other things, how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Office of Foreign Assets Control Regulation
The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are known as the “OFAC” rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control (“OFAC”). The OFAC-administered sanctions take many forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on “U.S. persons” engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to a U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences.

Consumer Protection Laws
In connection with their lending and leasing activities, the Company’s banking subsidiaries are subject to a number of federal and state laws designed to protect borrowers and promote lending. These laws include the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair and Accurate Credit Transaction Act of 2003, Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Truth in Lending Act, the Truth in Savings Act, the Home Mortgage Disclosure Act, and the Real Estate Settlement Procedures Act, and similar laws at the state level. The Company’s failure to comply with any of the consumer financial laws can result in civil actions, regulatory enforcement action by the federal banking agencies and the U.S. Department of Justice.

Additionally, the Dodd-Frank Act established a new Bureau of Consumer Financial Protection (“CFPB”) with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide

range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit "unfair, deceptive or abusive" acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. The Company and its subsidiaries are required to comply with the rules of the CFPB; however, these rules are generally enforced by our primary regulators, the FRB and the FDIC.

Cybersecurity

The Bank is also subject to data security standards and privacy and data breach notice requirements as established by federal and state regulators. Federal banking agencies, through the Federal Financial Institutions Examination Council, have adopted guidelines to encourage financial institutions to address cybersecurity risks and identify, assess and mitigate these risks, both internally and at critical third party service providers. For example, federal banking regulators have highlighted that financial institutions should establish several lines of defense and design their risk management processes to address the risk posed by compromised customer credentials. Further, financial institutions are expected to maintain sufficient business continuity planning processes designed to facilitate a recovery, resumption and maintenance of the institution's operations after a cyber-attack.

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Additionally, the Company must comply with a NYSDFS rule entitled “Cybersecurity Requirements for Financial Services Companies,” which became effective March 1, 2017, subject to a full phase-in over the following two years, concluding in 2019. This NYSDFS rule requires financial services companies, including Tompkins, to maintain a maintain a cybersecurity program designed to protect the confidentiality, integrity and availability of the company’s information systems, establish cybersecurity policies and procedures, identify persons responsible for implementing and enforcing the cybersecurity program and cybersecurity policies and procedures, and conduct periodic risk assessments of its information systems. See Item 1A. Risk Factors for a further discussion of risks related to cybersecurity.

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. The agencies proposed such regulations in May 2016. If these or other regulations are adopted in a form similar to that initially proposed, they will impose limitations on the manner in which the Company may structure compensation for its executives. Given the uncertainty at this time whether or when a final rule will be adopted, management cannot determine the potential impact on the Company.

Additionally, the FRB, OCC and FDIC have 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 reviews, 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.” The findings of the supervisory initiatives are included in reports of examination and deficiencies can lead to limitations on the Company’s abilities and even enforcement actions.

The Company is also subject to the NYSDFS rule “Guidance on Incentive Compensation Arrangements,” which directs all New York state regulated banks (including the Trust Company, Tompkins Bank of Castile, and Tompkins Mahopac Bank) to ensure that any employee incentive arrangements do not encourage inappropriate risk-taking or improper sales practices. Under this guidance, incentive compensation based on employee performance indicators may only be paid if the bank has effective risk management, oversight and control systems in place. We believe the Company is compliant with all state and federal regulation regarding incentive compensation

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, proposals to change the financial institution regulatory environment, or proposals that affect public companies generally. Such legislation could change banking laws and the operating environment of Tompkins 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.

Employees

At December 31, 2018, the Company had 1,035 employees, approximately 116 of whom were part-time. No employees are covered by a collective bargaining agreement and the Company believes its employee relations are excellent.

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Available Information

The Company maintains a website at www.tompkinsfinancial.com. The Company makes available free of charge through its website its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, its proxy statements related to its shareholders’ meetings, and amendments to these reports or statements, filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as soon as reasonably practicable after the Company electronically files such material with, or furnishes such material to, the SEC. Copies of these reports are also available at no charge to any person who requests them, with such requests directed to Tompkins Financial Corporation, Investor Relations Department, 118 E. Seneca St., P.O. Box 460, Ithaca, New York 14850, telephone no. (888) 503-5753. The SEC maintains an Internet website that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC, including material filed by the Company, at www.sec.gov. The information contained on the Company's website is provided for the information of the reader and it is not intended to be active links. The Company is not including the information contained on the Company’s website as a part of, or incorporating it by reference into, this Annual Report on Form 10-K, or into any other report filed with or furnished to the SEC by the Company.

Item 1A. Risk Factors

Our Company's success is dependent on management's ability to identify and manage the risks inherent in our financial services business. These risks include credit risk, market risk, liquidity risk, operational risk, model risk, compliance and legal risk, and strategic and reputation risk. We list below the material risk factors we face. Any of these risks could result in a material adverse impact on our business, operating results, financial condition, liquidity, and cash flow, or may cause our results to vary materially from recent results, or from the results implied by any forward-looking statements made by us.

Risks Related to the Company’s Business

The Company is subject to increased business risk because the Company has a significant concentration of commercial real estate and commercial business loans, repayment of which is often dependent on the cash flows of the borrower.

The Company offers different types of commercial loans to a variety of businesses, and we believe commercial loans will continue to comprise a significant concentration of our loan portfolio in 2019 and beyond. Real estate lending is generally considered to be collateral-based lending with loan amounts based on predetermined loan-to-collateral values. As such, declines in real estate valuations in the Company’s market area would lower the value of the collateral securing these loans. Additionally, the Company has experienced, and expects to continue experiencing, increased competition in commercial real estate lending. This increased competition may inhibit the Company's ability to generate additional commercial real estate loans or maintain its current inventory of commercial real estate loans. The Company’s commercial business loans are made based primarily on the cash flow and creditworthiness of the borrower and secondarily on the underlying collateral provided by the borrower, with liquidation of the underlying real estate collateral being viewed as the primary source of repayment in the event of borrower default. The borrowers’ cash flow may be difficult to predict, and collateral securing these loans may fluctuate in value. Although commercial business loans are often collateralized by equipment, inventory, accounts receivable, or other business assets, the liquidation of collateral in the event of default is often an insufficient source of repayment. As of December 31, 2018, commercial and commercial real estate loans totaled $3.4 billion or 70.7% of total loans.

The Company’s agricultural loans are often dependent upon the health of the agricultural industry in the location of the borrower, and the ability of the borrower to repay may be affected by many factors outside of the borrower’s control.

As part of the Company’s commercial business lending activities, the Company originates agricultural loans, consisting of agricultural real estate loans and agricultural operating loans. As of December 31, 2018, $277.7 million or 5.7% of the Company’s total loan portfolio consisted of agriculturally-related loans, including $170.2 million in

agricultural real estate loans and $107.5 million in agricultural operating loans. Payments on agricultural loans are dependent on the profitable operation or management of the related farm property. The success of the farm may be affected by many factors outside the control of the borrower, including adverse weather conditions that prevent the planting of a crop or limit crop yields (such as hail, drought and floods), loss of livestock due to disease or other factors, declines in market prices for agricultural products and the impact of governmental regulations and subsidies (including changes in price supports and environmental regulations). Many farms are dependent upon a limited number of key individuals whose injury or death may significantly affect the successful operation of the farm. If the cash flow from a farming operation is diminished, the borrower's ability to repay the loan may be impaired. While agricultural operating loans are generally secured by a blanket lien on the farm's operating assets, any repossessed collateral in respect of a defaulted loan may not provide an adequate source of repayment of the outstanding balance.

Additionally, the profitable operation or management of the related farm properties, and the value thereof, is impacted by changes in U.S. government trade policies. In 2018, the U.S. government implemented tariffs on certain products, and certain countries or

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entities, such as Mexico, Canada, China and the European Union, have issued or continue to threaten retaliatory tariffs against products from the United States, including agricultural products. Tariffs, retaliatory tariffs or other trade restrictions on products and materials that farm properties related to our agriculturally-related loans import or export could cause the costs of such farm operations and management to increase, could cause the price of products from such farm operations to increase, could cause demand for such products to decrease and could cause the margins on such products to decrease. Such potential adverse effects on related farm property operations and management could reduce the related farm properties' revenues, financial results and ability to service debt, which, in turn, could adversely affect our financial condition and results of operations. In addition, to the extent changes in the political environment have a negative impact on us or on the markets in which we operate, our business, results of operations and financial condition could be materially and adversely impacted in the future.

Declines in asset values may result in impairment charges and may adversely affect the value of the Company's results of operations, financial condition and cash flows.

A majority of the Company's investment portfolio is comprised of securities which are collateralized by residential mortgages. These residential mortgage-backed securities include securities of U.S. government agencies, U.S. government-sponsored entities, and private-label collateralized mortgage obligations. The Company's securities portfolio also includes obligations of
U.S. government-sponsored entities, obligations of states and political subdivisions thereof, U.S. corporate debt securities and equity securities. A more detailed discussion of the investment portfolio, including types of securities held, the carrying and fair values, and contractual maturities is provided in the Notes to Consolidated Financial Statements in Part II, Item 8 of this Report. Gains or losses on these instruments may have a direct impact on the results of operations, including higher or lower income and earnings, unless we adequately hedge our positions. The fair value of investments may be affected by factors other than the underlying performance of the issuer or composition of the obligations themselves, such as rating downgrades, adverse changes in the business climate, a lack of liquidity for resale of certain investment securities and changes in interest rates. For example, decreases in interest rates and increases in mortgage prepayment speeds, which are influenced by interest rates and other factors, could adversely impact the value of our securities collateralized by residential mortgages, causing a significant acceleration of purchase premium amortization on our mortgage portfolio because a decline in long-term interest rates shortens the expected lives of the securities. Conversely, increases in interest rates may result in a decrease in residential mortgage loan originations and mortgage prepayment speeds, directly impacting the value of these securities collateralized by residential mortgages. The Company periodically, but not less than quarterly, evaluates investments and other assets for impairment indicators in accordance with U.S. generally accepted accounting principles ("GAAP"). A decline in the fair value of the securities in our investment portfolio could result in an other-than temporary impairment ("OTTI") write-down that could reduce our earnings. Further, given the significant judgments involved, if we are incorrect in our assessment of OTTI, this error could have a material adverse effect on our results of operation, financial condition, and cash flows.

A decline in the value of our goodwill and other intangible assets could adversely affect our financial condition and results of operations.

As of December 31, 2018, the Company had $99.9 million of goodwill and other intangible assets. The Company is required to test its goodwill and intangible assets for impairment on a periodic basis. A significant decline in the Company's expected future cash flows, a significant adverse change in business climate, slower growth rates or a significant and sustained decline in the price of the Company's common stock, may necessitate our taking charges in the future related to the impairment of the Company's goodwill and intangible assets. If we make an impairment determination in a future reporting period, the Company's earnings and the book value of these intangible assets would be reduced by the amount of the impairment. Further, a goodwill impairment charge could significantly restrict the ability of our banking subsidiaries to make dividend payments to us without prior regulatory approval, which could have a material adverse effect on our financial condition and results of operations.

The FASB has recently issued an accounting standard update that will result in a significant change in how we recognize credit losses and may have a material impact on our financial condition or results of operations.

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13") , which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss ("CECL") model. Under the CECL model, we will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held to maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the "incurred loss" model required under current U.S. GAAP, which delays recognition until it is probable a loss has been incurred. Accordingly, the Company expects that the adoption of the CECL model will materially affect how we determine the

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allowance for loan losses and could require the Company to increase our allowance significantly. Moreover, the CECL model may create more volatility in the level of our allowance for loan losses. If the Company is required to materially increase our level of allowance for loan losses for any reason, such increase could adversely affect the Company's business, financial condition and results of operations.

The Company may be adversely affected by the soundness of other financial institutions.

Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. The Company has exposure to many different industries and counterparties, and routinely executes transactions with counterparties in the financial services industry. The most important counterparty for the Company, in terms of liquidity, is the Federal Home Loan Bank of New York ("FHLBNY"). The Company also has a relationship with the Federal Home Loan Bank of Pittsburgh ("FHLBPITT"). The Company uses FHLBNY as its primary source of overnight funds and also has long-term advances and repurchase agreements with FHLBNY. The Company has placed sufficient collateral in the form of commercial and residential real estate loans at FHLBNY. In addition, the Company is required to hold stock in FHLBNY and FHLBPITT. The amount of borrowed funds and repurchase agreements with the FHLBNY and FHLBPITT, and the amount of FHLBNY and FHLBPITT stock held by the Company, at its most recent fiscal year-end are discussed in Part II, Item 8 of this Report on Form 10-K.

There are 11 branches of the FHLB, including New York and Pittsburgh. The FHLBNY and the FHLBPITT are jointly and severally liable along with the other Federal Home Loan Banks for the consolidated obligations issued on behalf of the Federal Home Loan Banks through the Office of Finance. Dividends on, redemption of, or repurchase of shares of the FHLBNY's or FHLBPITT's capital stock cannot occur unless the principal and interest due on all consolidated obligations have been paid in full. If another Federal Home Loan Bank were to default on its obligation to pay principal or interest on any consolidated obligations, the Federal Home Loan Finance Agency (the "Finance Agency") may allocate the outstanding liability among one or more of the remaining Federal Home Loan Banks on a pro rata basis or on any other basis the Finance Agency may determine. As a result, the FHLBNY's or FHLBPITT's ability to pay dividends on, to redeem, or to repurchase shares of capital stock could be affected by the financial condition of one or more of the other Federal Home Loan Banks. Any such adverse effects on the FHLBNY or FHLBPITT could adversely affect our liquidity, the value of our investment in FHLBNY or FHLBPITT common stock, and could negatively impact our results of operations.

Systemic weakness in the FHLB could result in higher costs of FHLB borrowings, reduced value of FHLB stock, and increased demand for alternative sources of liquidity that are more expensive, such as brokered time deposits, the discount window at the Federal Reserve, or lines of credit with correspondent banks. Any of these scenarios could adversely affect our liquidity, the value of our investment in FHLB common stock and our financial condition.

The Company relies on cash dividends from its subsidiaries to fund its operations, and payment of those dividends could be discontinued at any time.

The Company is a financial holding company whose principal assets and sources of income are its wholly-owned subsidiaries. The Company is a separate and distinct legal entity from its subsidiaries, and therefore the Company relies primarily on dividends from these banking and other subsidiaries to meet its obligations and to provide funds for the payment of dividends to the Company's shareholders, to the extent declared by the Company's board of directors. Various federal and state laws and regulations limit the amount of dividends that a bank may pay to its parent company and impose regulatory capital and liquidity requirements on the Company and its banking subsidiaries. Further, as a holding company, the Company's right to participate in a distribution of assets upon the liquidation or reorganization of a subsidiary is subject to the prior claims of the subsidiary's creditors (including, in the case of the Company's banking subsidiaries, the banks' depositors). If the Company were unable to receive dividends from its subsidiaries it would materially and adversely affects the Company's liquidity and its ability to service its debt, pay its

other obligations, or pay cash dividends on its common stock.

The Company’s business may be adversely affected by general economic conditions in local and national markets, the possibility of the economy’s return to recessionary conditions and the possibility of further turmoil or volatility in the financial markets.

General economic conditions impact the banking and financial services industry. The U.S. and global economies have experienced volatility in recent years and may continue to do so for the foreseeable future. There can be no assurance that economic conditions will not deteriorate. Unfavorable or uncertain economic conditions can be caused by many macro and micro factors, including declines in economic growth, business activity or investor or business confidence, limitations on the availability or increases in the cost of credit and capital, increases in inflation or interest rates, the timing and impact of changing governmental policies and other factors. The Company is particularly affected by U.S domestic economic conditions, including U.S. interest rates, the

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unemployment rate, housing prices, the level of consumer confidence, changes in consumer spending, the number of personal bankruptcies and other factors. A decline in U.S. domestic business and economic conditions, without rapid recovery, could have adverse effects on our business, including the following:

- consumer and business confidence levels could be lowered and cause declines in credit usage, adverse changes in payment patterns, decreases in demand for loans or other financial products and services and decreases in deposits or investments in accounts with Company;
- the Company's ability to assess the creditworthiness of its customers may be impaired if the models and approaches the Company uses to select, manage and underwrite its customers become less predictive of future behaviors;
- demand for and income received from the Company's fee-based services, including investment services and insurance commissions and fees, could continue to decline, the cost to the Company to provide any or all products and services could increase and the levels of assets under management could materially impact revenues from our trust and wealth management businesses; and
- the credit quality or value of loans and other assets or collateral securing loans may decrease.

Our business is concentrated in and largely dependent upon the continued growth and welfare of the general geographic markets in which we operate.

Our operations are heavily concentrated in the New York State and, to a lesser extent, Pennsylvania and, as a result, our financial condition, results of operations and cash flows are significantly impacted by changes in the economic conditions in those areas. Therefore, the Company's financial performance generally, and in particular, the ability of borrowers to pay interest on and repay the principal of outstanding loans and the value of collateral securing these loans, is highly dependent upon the business environment in the markets where the Company operates, particularly New York State and Pennsylvania. Our success depends to a significant extent upon the business activity, population, income levels, deposits and real estate activity in these markets. Although our clients' business and financial interests may extend well beyond these markets, adverse economic conditions that affect these markets could disproportionately reduce our growth rate, affect the ability of our clients to repay their loans to us, affect the value of collateral underlying loans and generally affect our financial condition and results of operations. Because of our geographic concentration, we are less able than other regional or national financial institutions to diversify our credit risks across multiple markets. For additional information on our market area, see Part I, Item 1, "Business" of this Report on Form 10-K.

Our business may be adversely affected by changes in fiscal and monetary policy in the United States.

Uncertainties surrounding fiscal and monetary policies present economic challenges. For example, actions taken by the Federal Reserve, including the announced changes in the size of its balance sheet and the announced changes to its "quantitative easing" program and "tapering," are beyond our control, difficult to predict and can affect interest rates and the value and credit quality of our loan portfolio and the value of our other assets, and can adversely impact our borrowers' ability to borrow and ability to repay their debt to us. We cannot predict the timing or extent of future changes in fiscal and monetary policy and, as a result, we cannot predict the effect on our operations and revenues.

Our insurance agency subsidiary's commission revenues are based on premiums set by insurers and any decreases in these premium rates could adversely affect our operations and revenues.
Our insurance agency subsidiary, Tompkins Insurance, derives the bulk of its revenue from commissions paid by insurance underwriters on the sale of insurance products to clients. Tompkins Insurance does not determine the insurance premiums on which its commissions are based. Insurance premiums are cyclical in nature and may vary

widely based on market conditions. As a result, insurance brokerage revenues and profitability can be volatile. Revenue from insurance commissions and fees could be negatively affected by fluctuations in insurance premiums and other factors beyond the Company's control, including changes in laws and regulations impacting the healthcare and insurance markets. In addition, there have been and may continue to be various trends in the insurance industry toward alternative insurance markets including, among other things, increased use of self-insurance, captives, and risk retention groups. Even if Tompkins Insurance is able to participate in these activities, it is unlikely to realize revenues and profitability as favorable as those realized from our traditional brokerage activities. We cannot predict the timing or extent of future changes in premiums and thus commissions. As a result, we cannot predict the effect that future premium rates will have on our operations. Decreases in premium rates could adversely affect our operations and revenues.

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The Company is subject to fluctuations in interest rates and other market risks, which could materially and adversely affect our earnings, financial condition, and liquidity.

The Company's earnings, financial condition and liquidity are susceptible to fluctuations in market interest rates. Interest rates are affected by many factors which are outside of our control, including financial regulation, economic/monetary policy, and political conditions, and other factors. In particular, the recent changes in U.S. economic and monetary policy may indicate that the FRB will continue to raise short-term interest rates over the next several quarters. The announced ending of the FRB's program of "quantitative easing", and initiation of a "tapering" program, which may lead to a smaller FRB balance sheet and, in turn, impact market interest rates and liquidity availability. Net interest income, which is the difference between interest earned on loans and investments and interest paid on deposits and borrowings, is our primary source of revenue, and could be adversely impacted by fluctuations in interest rates. For example, if interest rates rise, our funding costs, particularly the cost of deposits, may also begin to rise with a trajectory influenced by the absolute level of interest rates, the pace of interest rate increases and the rate of loan growth.

A rise in the costs of deposits, influenced by the rates that our competitors pay on deposits, may result in an increase in our funding cost, either because we raise our rates to avoid losing deposits or because we lose deposits and must rely on more expensive sources of funding, either of which may adversely impact our net interest margin and net interest income. The cost of deposits has risen and may continue to rise. Changes in interest rates may have a different effect on the interest earned on our assets than it does on the interest paid on our borrowings or other liabilities. This is because our assets and liabilities reprice at different times and by different amounts as interest rates change. Generally, the impact on earnings stemming from interest rate shifts is more adverse when the slope of the yield curve flattens; that is, when short-term interest rates increase more than long-term interest rates or when long-term interest rates decrease more than short-term interest rates. The level of net interest income is dependent upon the volume and mix of interest-earning assets and interest-bearing liabilities, the level of nonperforming assets, and the level and trend of interest rates. Changes in market interest rates will also affect the level of prepayments on the Company's loans and payments on mortgage-backed securities, resulting in the receipt of proceeds that may be reinvested at a lower rate than the loan or mortgage-backed security being prepaid. Interest rates are highly sensitive to many factors, including: inflation, economic growth, employment levels, monetary policy and international markets. Significant fluctuations in interest rates could have a material adverse effect on the Company's earnings, financial condition, and liquidity. The Company's efforts to manage interest rate risk may not be sufficient to prevent these adverse outcomes.

Interest rate increases often result in larger payment requirements for the Company's borrowers, which increase the potential for default by our borrowers. At the same time, the marketability of the property securing a loan may be adversely affected by any reduced demand resulting from higher interest rates. In a declining interest rate environment, there may be an increase in prepayments on loans as borrowers refinance their loans at lower rates. Changes in interest rates can also affect the value of loans, securities and other assets which could have a material adverse effect on the Company's results of operations and cash flows.

For information about how the Company manages its interest rate risk, refer to Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" of this Report.

Our funding sources may prove insufficient to replace deposits and support our future growth.
We must maintain sufficient cash flow and liquid assets to satisfy current and future financial obligations, including demand for loans and deposit withdrawals, funding operating costs, and for other corporate purposes. As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. As we continue to grow, we are likely to become more dependent on these sources, which may include various short-term and long-term wholesale borrowings, including Federal funds purchased and securities sold under agreements to repurchase, brokered certificates of deposit, proceeds from the sale

of loans, and borrowings from the FHLBNY and FHLBPITT and others. We also maintain available lines of credit with the FHLBNY and FHLBPITT that are secured by loans. Adverse operating results or changes in industry conditions could make it difficult or impossible for us to access these additional funding sources and could make our existing funds more volatile. Our financial flexibility could be materially constrained if we are unable to maintain access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. If we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In that case, our operating margins and profitability would be adversely affected. Further, the volatility inherent in some of these funding sources, particularly including brokered deposits, may increase our exposure to liquidity risk. Any interruption in these sources of liquidity when needed could adversely affect our results of operations, financial condition, cash flow or regulatory capital levels. In addition, reduced liquidity could result from circumstances beyond our control, such as general market disruptions or operational problems that affect us or third parties. Management’s efforts to closely monitor our liquidity position for compliance with internal policies may not be successful or sufficient to deal with dramatic or unanticipated reductions in liquidity.

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The Company operates in a highly regulated environment and may be adversely impacted by current or future laws and regulations due to increased compliance costs, potential fines for noncompliance, and restrictions on our ability to offer products or buy or sell businesses.

The Company is subject to extensive state and federal laws and regulations, supervision and legislation that affect how it
conducts its business. The majority of these laws and regulations are for the protection of consumers, depositors and the deposit insurance funds. The regulations influence such things as the Company’s lending practices, capital structure, investment practices, and dividend policy. The Dodd-Frank Act, which established the CFPB, and enacted other reforms, has had, and will continue to have, a significant effect on the entire financial services industry. Compliance with these regulations and other initiatives negatively impacts revenue and increases the cost of doing business on an ongoing basis. Further, under the current climate of regulatory reform, the future of currently effective, proposed and potential future regulations and legislation is unclear. New regulatory requirements or changes to existing requirements could necessitate changes to the Company’s businesses, result in increased compliance costs and affect the profitability of such businesses. Refer to “Supervision and Regulation” in Part I, Item 1 - “Business” of this Report on Form 10 K for additional information on material laws and regulations impacting the Company’s business.

As discussed above under the “Supervision and Regulation” section, under Basel III and the Dodd-Frank Act the federal banking agencies established stricter risk-based capital requirements and leverage limits to apply to banks and bank holding companies. These requirements, and any additional requirements adopted in the future, could adversely affect the Company’s ability to pay dividends, or could require it to reduce business levels or to raise capital, including in ways that may adversely affect its results of operations or financial condition.

Additionally, banking regulators are authorized to take supervisory actions that may restrict or limit a financial institution's activities. Regulatory restrictions on our activities could adversely affect our costs and revenues, and may impair our ability to execute our strategic plans. In addition, if our regulators identify a compliance failure, we may be assessed a fine, prohibited from completing a strategic acquisition or divestiture, or subject to other actions imposed by the regulatory authorities. The recent regulatory activity and increased scrutiny have resulted, and may continue to result, in increases in our costs of doing business, and could result in decreased revenues and net income, reduce our ability to effectively compete to attract and retain customers, or make it less attractive for us to continue providing certain products and services. Any future changes in federal or state law and regulations, as well as the interpretations and implementations, or modifications or repeals, of such laws and regulations, could have a material adverse effect on our business, financial condition or results of operations.

As an organization focused on building comprehensive relationships with clients, employees and the communities we serve, our reputation is critical to our business, and damage to it could have a material adverse effect on our business and prospects.
Our success as a Company relies on maintaining the value of our brand and our good reputation with our current and potential customers and employees. Through our branding, we communicate to the market about our Company and our product and service offerings. Maintaining a positive reputation is critical to our attracting and retaining clients and employees. Accordingly, reputational damage would likely have a materially adverse impact on our business prospects and our ability to execute on our business strategy. Harm to our reputation can arise from many sources, including regulatory actions or fines, improperly handled conflicts of interest, operating system failures or security breaches, customer complaints, litigation, actual or perceived employee misconduct, misconduct by our outsourced service providers or other counterparties, or other unethical or improper behavior conducted by our Company or affiliated service providers or other counterparties could all cause harm to our reputation, impair our ability to attract and retain customers, make it more difficult or expensive to obtain external funding and have other adverse effects on our business, results of operations and financial condition. Negative publicity regarding us or any of our subsidiaries, whether or not accurate, may damage our reputation, which could have a material adverse effect on our assets,

business, prospects, financial condition and results of operations.

The Company could be subject to environmental risks and associated costs on real estate properties owned by the Company, real estate properties that collateralize the Company's loans or real estate properties that the Company obtains title to.

The Company owns various properties used in the operation of its business. In addition, from time to time, the Company forecloses on properties or may be deemed to become involved in the management of its borrowers' properties. The Company could be subject to environmental liabilities imposed by applicable federal and state laws with respect to any of these properties. For example, we may be held liable to a government entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to clean up hazardous or toxic substances, or chemical releases, at a property, or may be subject to common law claims by third parties for damages and costs



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resulting from environmental contamination emanating from the property. Additionally, a significant portion of our loan portfolio at December 31, 2018 was secured by real estate and, if the real estate securing our assets is subject to environmental liability, our collateral position may be substantially weakened. Any such environmental liabilities imposed on the Company could have a material adverse impact on the Company's financial condition or results of operations.

The Company may be exposed to regulatory sanctions or liability if we do not timely detect and report money laundering or other illegal activities.

We are required to comply with anti-money laundering and anti-terrorism laws. These laws and regulations require us, among things, to enact policies and procedures to confirm the identity of our customers, and to report suspicious transactions to regulatory agencies. These laws and regulations are complex and require costly, sophisticated monitoring systems and qualified personnel. The policies and procedures that we have adopted in order to detect and prevent such illegal transactions may not be successful in eliminating all instances of such transactions. To the extent we fail to fully comply with applicable laws and regulations, we face the possibility of fines or other penalties, such as restrictions on our business activities, and we may also suffer reputational harm, all of which could have a material adverse effect on our business, results of operations and financial condition. Refer to “Supervision and Regulation” in Part I, Item 1 - “Business” of this Report on Form 10 K for additional information on anti-money laundering and anti-terrorism laws impacting the Company’s business.

We will be subject to heightened regulatory requirements if we exceed $10 billion in total consolidated assets.

Based on our historical growth rates and current size, it is possible that our total assets could exceed $10 billion dollars in the future. Our total consolidated assets on December 31, 2018 were $6.8 billion. The Dodd-Frank Act and its implementing regulations impose enhanced supervisory requirements on bank holding companies with more than $10 billion in total consolidated assets.

In addition to the additional regulatory requirements that we will become subject to upon crossing this asset threshold, federal financial regulators may require the Company to, or the Company may proactively, take actions to prepare for compliance with such increased regulations before we exceed $10 billion in total consolidated assets. We may, therefore, incur significant compliance costs in an effort to ensure compliance before we reach $10 billion in total consolidated assets. These additional compliance costs, if they occur, may adversely affect our business, results of operations and financial condition.

Changes in U.S. federal, state and local tax law or interpretations of existing tax law could increase our tax burden or otherwise adversely affect our financial condition or results of operations.
The Company is subject to taxation at the federal, state and local levels in the United States. On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act (the "Tax Act"). The changes included in the Tax Act are broad and complex. The final transition impacts of the Tax Act may differ from the estimates provided elsewhere in this report, possibly materially, due to, among other things, changes in interpretations of the Tax Act, any legislative action to address questions that arise because of the Tax Act, any changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates the Company has utilized to calculate the transition impacts, including impacts from changes to current year earnings estimates. The estimated impact of the new law is based on management’s current knowledge and assumptions and recognized impacts could be materially different from current estimates based on our actual results in fiscal 2018 and our further analysis of the new law. Refer to "Note 14 Income Taxes" in the Notes to Consolidated Financial Statements in Part II, Item 8. of this Report for additional information on the impact of the Tax Act.

Our future success is dependent on our ability to compete effectively in a highly competitive industry and market areas.

Competition for commercial banking and other financial services is strong in the Company's market areas. In one or more aspects of its business, the Company's 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. In addition, a number of out-of-state financial intermediaries have opened production offices, or otherwise solicit deposits, or have announced plans to do so in the Company's market areas. Some of these competitors have substantially greater resources and lending capabilities than the Company and may offer services that the Company does not currently provide. In addition, many of the Company's non-bank competitors are not subject to the same extensive Federal regulations that govern financial holding companies and Federally-insured banks. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Additionally, 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. Failure to compete effectively to attract new and

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retain current customers could adversely affect our growth and profitability, which could have a materially adverse effect on our business, financial condition and results of operations.

We continually encounter technological changes and the failure to understand and adapt to these changes could hurt our business.

The financial services industry is continually undergoing rapid technological changes with frequent introductions of new technology-driven products and services which increase efficiency and enable financial institutions to serve customers better and to reduce costs. The Company’s future success depends, in part, upon its ability to leverage technology to increase our operational efficiency as well as address the current and evolving needs of our customers. However, our competitors may have greater resources to invest in technological improvements, we may not always have capital levels which are sufficient to support a robust investment in our technology infrastructure or we may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. Failure to successfully keep pace with technological changes affecting the financial services industry could have a material adverse effect on the Company’s business and, in turn, the Company’s financial condition and results of operations.

Our success depends on our ability to offer our customers an evolving suite of products and services, and we may not be able to effectively manage the risks inherent in the development of financial products and services.

We continually monitor our suite of products and services, and prioritize new offerings based on our determination of customer demand, within regulatory parameters for financial products. We may invest significant time and resources in new products which become obsolete, or do not generate the revenues we had anticipated, or which are ultimately deemed unacceptable by regulatory authorities. As we expand the range and complexity of our products and services, we are exposed to increasingly complex risks, including potential fraud, and our employees and risk management systems may not be adequate to mitigate such risks effectively. Our failure to effectively identify and manage these risks and uncertainties could have a material adverse effect on our business.
The Company may be adversely affected by fraud.

As a financial institution, the Company is inherently exposed to operational risk in the form of theft and other fraudulent activity by employees, customers and other third parties targeting the Company and/or the Company’s customers or data. Such activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering and other dishonest acts. Although the Company devotes substantial resources to maintaining effective policies and internal controls to identify and prevent such incidents, given the increasing sophistication of possible perpetrators, the Company may experience financial losses or reputational harm as a result of fraud. Fraudulent activity could have a material adverse effect on the Company’s business, financial condition and results of operations.

Our business requires the collection and retention of large volumes of sensitive data, which is subject to extensive regulation and oversight and exposes our business to additional risks.
In our ordinary course of business, we collect and retain large volumes of customer data, including personally identifiable information in various information systems that we maintain and in those maintained by third parties with whom we contract to provide data services. We also maintain important internal Company data such as personally identifiable information about our employees and information relating to our operations. Our customers and employees have been, and will continue to be, targeted by cybersecurity threats attempting to misappropriate passwords, bank account information or other personal information. Our attempts to mitigate these threats may not be successful as cybercrimes are complex and continue to evolve. Publicized information concerning security and cyber-related problems could cause us to incur reputational harm and discourage our customers from using our electronic or web-based applications or solutions, which could harm their utility as a means of conducting commercial

transactions.

Even the most well protected information, networks, systems and facilities remain potentially vulnerable because the techniques used in breach attempts or other disruptions are constantly evolving and generally are not recognized until launched against a target, and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures. A security breach or other significant disruption of our information systems or those related to our customers, merchants and our third party vendors, including as a result of cyber-attacks, could (i) disrupt the proper functioning of our internal, or our third-party vendors', networks and systems and therefore our operations and/or those of certain of our customers; (ii) result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers; (iii) result in a violation of applicable privacy, data breach and other laws, subjecting us to additional regulatory scrutiny and expose the us to civil litigation, governmental fines and possible financial liability; (iv) require significant management attention

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and resources to remedy the damages that result; or (v) harm our reputation or cause a decrease in the number of customers that choose to do business with us. The occurrence of any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

A breach of information or other technological security, including as a result of cyber-attacks, could have a material adverse effect on our business, financial condition and results of operations.

In the ordinary course of business we rely on electronic communications and information systems, both internal and provided by external third parties, to conduct our operations and to store, process, and/or transmit sensitive data on a variety of computing platforms and networks and over the Internet. We cannot be certain that all of our systems, or third-party systems upon which we rely, are free from vulnerability to attack or other technological difficulties or failures. Information security breaches and cybersecurity-related incidents may include attempts to access information, including customer and company information, malicious code, computer viruses, phishing, denial of service attacks and other means of intrusion that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer or employee information), account takeovers, unavailability of service or other events. These types of threats may derive from human error, fraud or malice on the part of external or internal parties, or may result from accidental technological failure. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. If information security is breached or difficulties or failures occur, despite the controls we and our third party vendors have instituted, information may be lost or misappropriated, resulting in financial loss or costs, reputational harm or damages and litigation, regulatory investigation costs or remediation costs to us or others. While we maintain specific “cyber” insurance coverage, which would apply in the event of many breach scenarios, the amount of coverage may not be adequate in any particular case. Furthermore, because cyber threat scenarios are inherently difficult to predict and can take many forms, some breaches may not be covered under our cyber insurance coverage. Any of these consequences could have a material adverse effect on our financial condition and results of operations.

The risk of a security breach or disruption, particularly through cyber-attack or cyber intrusion, has significantly increased, in part due to the expansion of new technologies, the increased use of the Internet and mobile services and the increased intensity and sophistication of attempted attacks and intrusions from around the world. The threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. Our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Our technologies, systems, networks and software, and those of other financial institutions have been, and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at us. 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 the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers. As cyber threats continue to evolve, we may be required to expend significant additional resources to modify our protective measures or to investigate and remediate any information security vulnerabilities.

The Company is subject to risks presented by acquisitions, which, if realized, could negatively affect our results of operations and financial condition.
The Company’s strategic initiatives include diversification within its markets, growth of its fee-based businesses, and growth internally and through acquisitions of financial institutions, branches, and financial services businesses. As such, the Company has acquired, and from time to time considers acquiring, banks, thrift institutions, branch offices of banks or thrift institutions, or other businesses within markets currently served by the Company or in other locations that would complement the Company’s business or its geographic reach. In 2018, the Company did not initiate or complete any acquisitions considering, in part, the increased competition with other regional banks for strategic acquisitions. Additionally, future acquisitions will be accompanied by the risks commonly encountered in

acquisitions. These risks include: the difficulty of integrating operations and personnel, the potential disruption of our ongoing business, the inability of management to realize or maximize anticipated financial and strategic positions, increased operating costs, the inability to maintain uniform standards, controls, procedures and policies, the difficulty and cost of obtaining adequate financing, the potential for litigation risk, the potential loss of members of a key executive management group, the potential reputational damage and the impairment of relationships with employees and customers as a result of changes in ownership and management. Further, the asset quality or other financial characteristics of an acquired company may deteriorate after the acquisition agreement is signed or after the acquisition closes. We cannot provide any assurance that we will be successful in overcoming these risks or any other problems encountered in connection with acquisitions and any of these risks, if realized, could have an adverse effect on our results of operations and financial condition.



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The Company's operations may be adversely affected if its external vendors do not perform as expected or if its access to third-party services is interrupted.
The Company relies on certain external vendors to provide products and services necessary to maintain the day-to-day operations of the Company. Some of the products and services provided by vendors include key components of our business infrastructure including data processing and storage and internet connections and network access, among other products and services. Accordingly, the Company’s operations are exposed to the risk that these vendors will not perform in accordance with the contracted arrangements or under service level agreements. The failure of an external vendor to perform in accordance with the contracted arrangements or under service level agreements, because of changes in the vendor’s organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could disrupt the Company’s operations. If we are unable to find alternative sources for our vendors’ services and products quickly and cost-effectively, the failures of our vendors could have a material adverse impact on the Company’s business and, in turn, the Company’s financial condition and results of operations.

Additionally, our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If sustained or repeated, a system failure or service denial could result in a deterioration of our ability to process new and renewal loans, gather deposits and provide customer service, compromise our ability to operate effectively, damage our reputation, result in a loss of customer business and subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on our financial condition and results of operations.

Risks Associated with the Company’s Common Stock

The Company’s stock price may be volatile.

The Company’s stock price can fluctuate widely in response to a variety of factors, including: actual or anticipated variations in our operating results; recommendations by securities analysts; significant acquisitions or business combinations; operating and stock price performance of other companies that investors deem comparable to Tompkins; new technology used, or services offered by our competitors; news reports relating to trends, concerns and other issues in the financial services industry; and changes in government regulations. Other factors, including general market fluctuations, industry-wide factors and economic and general political conditions and events, including foreign and national governmental policy decisions, terrorist attacks, economic slowdowns or recessions, interest rate changes, credit loss trends or currency fluctuations, may adversely affect the Company’s stock price even though they do not directly pertain to the Company’s operating results.

The trading volume in our common stock is less than that of larger financial services companies, which may adversely affect the price of our common stock.

The Company’s common stock is traded on the NYSE American. The trading volume in the Company’s common stock is less than that of larger financial services companies. A public trading market having the desired characteristics of depth, liquidity and orderliness depends on the presence in the marketplace of willing buyers and sellers of our common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. Given the lower trading volume of the Company’s common stock, significant sales of our common stock, or the expectation of these sales, could cause our stock price to fall.

An investment in our common stock is not an insured deposit.

The Company’s common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or by any other public or private entity. Investment in the Company’s common stock is inherently risky for the reasons described in this “Risk Factors” section and is subject to the same market forces that affect the price of common stock in any company. As a result, if you acquire the Company’s common stock, you may lose some or all of your investment.

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We may not pay, or may reduce, the dividends paid on our common stock.

Holders of Tompkins' common stock are only entitled to receive such dividends as its board of directors may declare out of funds legally available for such payments. While Tompkins has a long history of paying dividends on its common stock, Tompkins is not required to pay dividends on its common stock and could reduce or eliminate its common stock dividend in the future. This could adversely affect the market price of Tompkins' common stock. Also, Tompkins is a bank holding company, and its ability to declare and pay dividends is dependent on certain federal regulatory considerations, including the guidelines of the Federal Reserve regarding capital adequacy and dividends. See "Supervision and Regulation" for a description of certain material limitations on the Company's ability to pay dividends to shareholders.

## Item 1B. Unresolved Staff Comments

None.

## Item 2. Properties

The Company's executive offices are located at 118 East Seneca Street in Ithaca. Our new headquarters was completed at this location in the second quarter of 2018, resulting in the consolidation of some staff and operations into a single location; and enabling the Company to sell two previously-owned buildings in Ithaca, New York.

The Company's banking subsidiaries have 66 branch offices, of which 34 are owned and 32 are leased at market rents. The Company's insurance subsidiary has 5 stand-alone offices, of which 3 are owned by the Company and 2 are leased at market rents. The Company's wealth management and financial planning division has 2 offices which are leased at a market rent, and shares other locations with the Company's other subsidiaries. Management believes the current facilities are suitable for their present and intended purposes. For additional information about the Company's facilities, including rental expenses, see "Note 6 Premises and Equipment" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

## Item 3. Legal Proceedings

The Company is subject to various claims and legal actions that arise in the ordinary course of conducting business. Management does not expect the ultimate disposition of these matters to have a material adverse impact on the Company's financial statements.

## Item 4. Mine Safety Disclosures

Not applicable

## Executive Officers of the Registrant

The information concerning the Company's executive officers is provided below as of March 1, 2019.

| Name | Age | Title | Year Joined Company |
|---|---|---|---|
| Stephen S. Romaine | 54 | President and CEO | January 2000 |
| David S. Boyce | 52 | Executive Vice President | January 2001 |
| Francis M. Fetsko | 54 | Executive Vice President, COO, CFO and Treasurer | October 1996 |
| Alyssa H. Fontaine | 38 | Executive Vice President & General Counsel | January 2016 |
| Scott L. Gruber | 62 | Executive Vice President | April 2013 |

| | | | |
|---|---|---|---|
| Gregory J. Hartz | 58 | Executive Vice President | August 2002 |
| Brian A. Howard | 54 | Executive Vice President | July 2016 |
| Gerald J. Klein, Jr. | 60 | Executive Vice President | January 2000 |
| John M. McKenna | 52 | Executive Vice President | April 2009 |
| Susan M. Valenti | 64 | Executive Vice President of Corporate Marketing | March 2012 |
| Steven W. Cribbs | 42 | Senior Vice President, Chief Risk Officer | June 2018 |
| Bonita N. Lindberg | 62 | Senior Vice President, Director of Human Resources | December 2015 |

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Business Experience of the Executive Officers:

Stephen S. Romaine was appointed President and Chief Executive Officer of the Company effective January 1, 2007. From 2003 through 2006, he served as President and Chief Executive Officer of Mahopac Bank. Mr. Romaine currently serves on the board of the Federal Home Loan Bank of New York and the New York Bankers Association.

David S. Boyce has been employed by the Company since January 2001 and was promoted to Executive Vice President in April 2004. He was appointed President and Chief Executive Officer of Tompkins Insurance Agencies in 2002. He has been employed by Tompkins Insurance Agencies and a predecessor company to Tompkins Insurance Agencies for 29 years.

Francis M. Fetsko has been employed by the Company since 1996, and has served as Chief Financial Officer since December 2000. He also serves as the Chief Financial Officer for the Company's four banking subsidiaries. In July 2003, he was promoted to Executive Vice President and he assumed the additional role of Chief Operating Officer in April 2012.

Alyssa H. Fontaine joined the Company in January 2016 as Executive Vice President and General Counsel. She had previously been a partner in the corporate/securities practice group of Harris Beach PLLC, a regional law firm which she joined in 2006. Ms. Fontaine serves on the American Bankers Association General Counsels Committee.

Scott L. Gruber has been employed by the Company since April 2013 and was appointed President & COO of VIST Bank and Executive Vice President of the Company effective April 30, 2013. He was appointed President & CEO of VIST Bank effective January 1, 2014. Before joining VIST Bank, Mr. Gruber spent 16 years at National Penn Bank, most recently as Group Executive Vice President, where he led the Corporate Banking team.

Gregory J. Hartz has been employed by the Company since 2002 and was appointed President and Chief Executive Officer of Tompkins Trust Company and Executive Vice President of the Company effective January 1, 2007. Mr. Hartz is past Chair of the Independent Bankers Association of New York State.

Brian A. Howard has been employed by the Company since July 2016 and was appointed President of Tompkins Financial Advisors and Executive Vice President of the Company effective July 25, 2016. Prior to joining Tompkins, he served as a Senior Vice President, Market Manager for Key Bank covering the Central New York region from May 2012 to July 2016, where he oversaw the bank's full service wealth management division for high net worth clients.

Gerald J. Klein, Jr. has been employed by the Company since 2000 and was appointed President and Chief Executive Officer of Mahopac Bank and Executive Vice President of the Company effective January 1, 2007. Mr. Klein currently serves on the Board of the Independent Bankers Association of New York (IBANYS) and is as a member of the Community Depository Institutions Advisory Council of the Federal Reserve Bank of NY.

John M. McKenna has been employed by the Company since April 2009. He was appointed President and CEO of The Bank of Castile effective January 1, 2015. From 2009 to 2014, Mr. McKenna was a senior vice president at The Bank of Castile, concentrating in commercial lending. Mr. McKenna currently serves on the New York Bankers Association Political Action Committee (NYBA PAC).

Susan M. Valenti joined Tompkins in March of 2012 as Senior Vice President, Corporate Marketing. She was promoted to Executive Vice President of the Company in June 2014.

Steven W. Cribbs joined Tompkins in June 2018 as Senior Vice President, Chief Risk Officer. Prior to joining Tompkins, Mr. Cribbs served as Director of Enterprise Risk Management at Customers Bancorp, Inc. from 2016 to

2018 and Senior Vice President and Chief Risk Officer at Metro Bancorp, Inc. from 2012 to 2016.

Bonita N. Lindberg joined Tompkins in December 2015 as Senior Vice President, Director of Human Resources. Before joining the Company, Ms. Lindberg served as Director of Human Resources at Cortland Regional Medical Center (2014 - 2015); prior to that she served as the Director of Organizational Development at Albany International Corporation. Ms. Lindberg serves on the HR Conference Committee for New York Bankers Association.

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PART II

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

Market Price and Dividend Information

The Company's common stock is traded under the symbol "TMP" on the NYSE American.

While the Company has a long history of paying cash dividends on shares of its common stock, the Company's ability to pay dividends is generally limited to earnings from the prior year, although retained earnings and dividends from its subsidiaries may also be used to pay dividends under certain circumstances. The Company's primary source of funds to pay for shareholder dividends is receipt of dividends from its subsidiaries. Future dividend payments to the Company by its subsidiaries will be dependent on a number of factors, including earnings and the financial condition of each subsidiary, and are subject to regulatory limitations discussed in "Supervision and Regulation" in Part I, Item 1 of this Report.

The following table reflects all Company repurchases, including those made pursuant to publicly announced plans or programs, during the quarter ended December 31, 2018.

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased (a) | Average Price Paid Per Share (b) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (c) | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (d) |
|---|---|---|---|---|
| October 1, 2018 through October 31, 2018 | 2,741 | $ 75.20 | 1,483 | 398,517 |
| November 1, 2018 through November 30, 2018 | 13,826 | $ 76.64 | 1,500 | 397,017 |
| December 1, 2018 through December 31, 2018 | 14,000 | $ 73.30 | 14,000 | 383,017 |
| Total | 30,567 | $ 74.98 | 16,983 | 383,017 |

Included above are 1,258 shares purchased in October 2018, at an average cost of $78.92, and 547 shares purchased in November 2018, at an average cost of $78.35, by the trustee of the rabbi trust established by the Company under the Company's Stock Retainer Plan For Eligible Directors of Tompkins Financial Corporation and Participating Subsidiaries, which were part of the director deferred compensation under that plan. In addition, the table includes 11,779 shares delivered to the Company in November 2018 at an average cost of $77.02 to satisfy mandatory tax withholding requirements upon vesting of restricted stock under the Company's 2009 Equity Plan.

On July 19, 2018, the Company’s Board of Directors authorized a share repurchase plan for the Company to repurchase up to 400,000 shares of the Company’s common stock. Purchases may be made over the 24 months following adoption of the plan. The repurchase program may be suspended, modified or terminated by the Board of Directors at any time for any reason. This plan replaced the Company's 400,000 share plan announced on July 21, 2016 which expired in July 2018. Under the current plan, the Company repurchased 16,983 shares through December 31, 2018, at an average cost of $73.17.

Recent Sales of Unregistered Securities

None.

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Performance Graph

The following graph compares the Company's cumulative total stockholder return over the five-year period from December 31, 2013 through December 31, 2018, with (1) the total return for the NASDAQ Composite and (2) the total return for SNL Bank Index. The graph assumes $100.00 was invested on December 31, 2013, in the Company's common stock and the comparison groups and assumes the reinvestment of all cash dividends prior to any tax effect and retention of all stock dividends.

In accordance with and to the extent permitted by applicable law or regulation, the information set forth below under the heading "Performance Graph" shall not be incorporated by reference into any future filing under the Securities Act or Exchange Act and shall not be deemed to be "soliciting material" or to be "filed" with the SEC under the Securities Act or the Exchange Act, except to the extent that the Company specifically requests that such information be treated as soliciting material or specifically incorporates it by reference into such filings. The performance graph represents past performance and should not be considered an indication of future performance.

| | Period Ending | | | | | |
|---|---|---|---|---|---|---|
| Index | 12/31/13 | 12/31/14 | 12/31/15 | 12/31/16 | 12/31/17 | 12/31/18 |
| Tompkins Financial Corporation | 100.00 | 111.35 | 116.71 | 201.90 | 177.53 | 167.70 |
| NASDAQ Composite | 100.00 | 114.75 | 122.74 | 133.62 | 173.22 | 168.30 |
| SNL Bank | 100.00 | 111.79 | 113.69 | 143.65 | 169.64 | 140.98 |

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Item 6. Selected Financial Data

The following consolidated selected financial data is taken from the Company's audited financial statements as of and for the five years ended December 31, 2018. The following selected financial data should be read in conjunction with the consolidated financial statements and the notes thereto in Part II, Item 8. of this Report. All of the Company's acquisitions during the five year period were accounted for using the purchase method. Accordingly, the operating results of the acquired companies are included in the Company's results of operations since their respective acquisition dates.

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands except per share data) | 2018 | 2017 | 2016 | 2015 | 2014 |
| FINANCIAL STATEMENT HIGHLIGHTS | | | | | |
| Assets | $6,758,436 | $6,648,290 | $6,236,756 | $5,689,995 | $5,269,561 |
| Total loans | 4,833,939 | 4,669,120 | 4,258,033 | 3,772,042 | 3,393,288 |
| Deposits | 4,888,959 | 4,837,807 | 4,625,139 | 4,395,306 | 4,169,154 |
| Other borrowings | 1,076,075 | 1,071,742 | 884,815 | 536,285 | 356,541 |
| Total equity | 620,871 | 576,202 | 549,405 | 516,466 | 489,583 |
| Interest and dividend income | 251,592 | 226,764 | 202,739 | 188,746 | 184,493 |
| Interest expense | 39,792 | 25,460 | 22,103 | 20,365 | 20,683 |
| Net interest income | 211,800 | 201,304 | 180,636 | 168,381 | 163,810 |
| Provision for loan and lease losses | 3,942 | 4,161 | 4,321 | 2,945 | 2,306 |
| Net (losses) gains on securities transactions | (466) | (407) | 926 | 1,108 | 391 |
| Net income attributable to Tompkins Financial Corporation | 82,308 | 52,494 | 59,340 | 58,421 | 52,041 |
| PER SHARE INFORMATION | | | | | |
| Basic earnings per share | 5.39 | 3.46 | 3.94 | 3.91 | 3.51 |
| Diluted earnings per share | 5.35 | 3.43 | 3.91 | 3.87 | 3.48 |
| Adjusted diluted earnings per share[1] | 5.33 | 4.42 | 3.91 | 3.63 | 3.48 |
| Cash dividends per share | 1.94 | 1.82 | 1.77 | 1.70 | 1.62 |
| Common equity per share | 40.45 | 37.65 | 36.20 | 34.38 | 32.77 |
| SELECTED RATIOS | | | | | |
| Return on average assets | 1.23% | 0.82% | 1.01% | 1.07% | 1.03% |
| Return on average equity | 13.93% | 9.09% | 10.85% | 11.51% | 10.76% |
| Average shareholders' equity to average assets | 8.83% | 9.04% | 9.28% | 9.31% | 9.54% |
| Dividend payout ratio | 35.99% | 52.60% | 44.92% | 43.48% | 46.15% |
| | | | | | |
| OTHER SELECTED DATA (in whole numbers, unless otherwise noted) | | | | | |
| Employees (average full-time equivalent) | 1,035 | 1,041 | 1,019 | 998 | 1,000 |
| Banking offices | 66 | 65 | 66 | 63 | 65 |
| Bank access centers (ATMs) | 83 | 84 | 85 | 85 | 85 |
| Trust and investment services assets under management, or custody (in thousands) | $3,806,274 | $4,017,363 | $3,941,484 | $3,852,972 | $3,761,972 |

[1] Adjusted diluted earnings per share reflects adjustments made for certain nonrecurring items. Adjustments for nonrecurring items in 2018 included a $2.2 million gain on sale of real estate and a $1.9 million write-down of impaired leases ($0.02 per share). Adjustments in 2017 included a $14.9 million ($0.99 per share) one-time non-cash write-down of net deferred tax assets related to the Tax Cuts and Jobs Act of 2017. Adjustments in 2015 included a $3.6 million ($0.24 per share) after-tax gain on a pension plan curtailment. There were no adjustments in 2016 and 2014. Adjusted diluted earnings per share is a non-GAAP measure. Please see the discussion below under "Results of Operations (Comparison of December 31, 2018 and 2017 results) Non-GAAP Disclosure" for an

explanation of why management believes this non-GAAP financial measure is useful and a reconciliation to diluted earnings per share.

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## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis is intended to provide the reader with a further understanding of the consolidated financial condition and results of operations of the Company and its operating subsidiaries for the periods shown. This Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with other sections of this Report on Form 10-K, including Part I, "Item 1. Business," Part II, "Item 6. Selected Financial Data," and Part II, "Item 8. Financial Statements and Supplementary Data."

### OVERVIEW

Tompkins Financial Corporation ("Tompkins" or the "Company") is headquartered in Ithaca, New York and is registered as a Financial Holding Company with the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended. The Company is a locally oriented, community-based financial services organization that offers a full array of products and services, including commercial and consumer banking, leasing, trust and investment management, financial planning and wealth management, insurance, and brokerage services. At December 31, 2018, the Company's subsidiaries included: four wholly-owned banking subsidiaries, Tompkins Trust Company (the "Trust Company"), The Bank of Castile (DBA Tompkins Bank of Castile), Mahopac Bank (DBA Tompkins Mahopac Bank), VIST Bank (DBA Tompkins VIST Bank); and a wholly-owned insurance agency subsidiary, Tompkins Insurance Agencies, Inc. ("Tompkins Insurance"). The Trust Company provides a full array of trust and investment services under the Tompkins Financial Advisors brand, including investment management, trust and estate, financial and tax planning as well as life, disability and long-term care insurance services. The Company's principal offices are located at 118 E. Seneca Street, P.O. Box 460, Ithaca, NY, 14850, and its telephone number is (888) 503-5753. The Company's common stock is traded on the NYSE American under the Symbol "TMP."

### Forward-Looking Statements

This Annual Report on Form 10-K contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The statements contained in this Report that are not statements of historical fact may include forward-looking statements that involve a number of risks and uncertainties. Forward-looking statements may be identified by use of such words as "may", "will", "estimate", "intend", "continue", "believe", "expect", "plan", or "anticipate", and other similar words. Examples of forward-looking statements may include statements regarding; the asset quality of the Company's loan portfolios; the level of the Company's allowance for loan losses; the sufficiency of liquidity sources; the Company's exposure to changes in interest rates; the impact of changes in accounting standards; the likelihood that deferred tax assets will be realized and plans, prospects, growth and strategies. Forward-looking statements are made based on management's expectations and beliefs concerning future events impacting the Company and are subject to certain uncertainties and factors relating to the Company's operations and economic environment, all of which are difficult to predict and many of which are beyond the control of the Company, that could cause actual results of the Company to differ materially from those expressed and/or implied by forward-looking statements. The following factors, in addition to those listed as Risk Factors in Item 1A are among those that could cause actual results to differ materially from the forward-looking statements: changes in general economic, market and regulatory conditions; the development of an interest rate environment that may adversely affect the Company's interest rate spread, other income or cash flow anticipated from the Company's operations, investment and/or lending activities; changes in laws and regulations affecting banks, bank holding companies and/or financial holding companies, such as the Dodd-Frank Act, Basel III and the Economic Growth, Regulatory Relief, and Consumer Protection Act; technological developments and changes; the ability to continue to introduce competitive new products and services on a timely, cost-effective basis; governmental and public policy changes, including environmental regulation; reliance on large customers; and financial resources in the amounts, at the times and on the terms required to support the Company's future businesses.

Critical Accounting Policies

In the course of normal business activity, management must select and apply many accounting policies and methodologies and make estimates and assumptions that lead to the financial results presented in the Company's consolidated financial statements and accompanying notes. There are uncertainties inherent in making these estimates and assumptions, which could materially affect our results of operations and financial position.

Management considers accounting estimates to be critical to reported financial results if (i) the accounting estimates require management to make assumptions about matters that are highly uncertain, and (ii) different estimates that management reasonably could have used for the accounting estimate in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the Company's consolidated financial statements. Management considers the accounting policies relating to the allowance for loan and lease losses ("allowance"), and the review of the securities

portfolio for other-than-temporary impairment to be critical accounting policies because of the uncertainty and subjectivity involved in these policies and the material effect that estimates related to these areas can have on the Company's results of operations.

Allowance for loan and lease losses
Management considers the accounting policy relating to the allowance to be a critical accounting policy because of the high degree of judgment involved, the subjectivity of the assumptions used and the potential changes in the economic environment that could result in changes to the amount of the allowance.

The Company has developed a methodology to measure the amount of estimated loan loss exposure inherent in the loan portfolio to assure that an appropriate allowance is maintained. The Company's methodology is based upon guidance provided in SEC Staff Accounting Bulletin No. 102, Selected Loan Loss Allowance Methodology and Documentation Issues and includes allowance allocations calculated in accordance with Accounting Standards Codification ("ASC") Topic 310, Receivables, and allowance allocations calculated in accordance with ASC Topic 450 Contingencies. The model is comprised of evaluating impaired loans, criticized and classified loans, historical losses, and qualitative factors. Management has deemed these components appropriate in evaluating the appropriateness of the allowance for loan and lease losses. While none of these components, when used independently, is effective in arriving at an allowance level that appropriately measures the risk inherent in the portfolio, management believes that using them collectively, provides reasonable measurement of the loss exposure in the portfolio. The various factors used in the methodologies are reviewed on a quarterly basis.

Although we believe our process for determining the allowance adequately considers all of the factors that would likely result in credit losses, this evaluation is inherently subjective as it requires material estimates, including expected default probabilities, the loss emergence periods, the amounts and timing of expected future cash flows on impaired loans, and estimated losses based on historical loss experience and current economic conditions. All of these factors may be susceptible to significant change. To the extent that actual results differ from management estimates, additional loan loss provisions may be required that would adversely impact earnings for future periods. For example, if historical loan losses significantly worsen, or if current economic conditions significantly deteriorate, an additional provision for loan losses would be required to increase the allowance for loan and lease losses.

Additionally, in June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13") , which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss ("CECL") model. ASU 2016-13 will become effective for the Company for fiscal years beginning after December 15, 2019 and for interim periods within those fiscal years. Under the CECL model, we will be required to present certain financial assets carried at amortized cost at the net amount expected to be collected. Accordingly, the Company's management anticipates that this significant accounting rule adjustment will materially affect how we determine our allowance for loan and lease losses as well as our accounting for investment securities. For additional information on the CECL model's anticipated impact on our business and accounting practices, see Part I, Item 1A, "Risk Factors" of this Report on Form 10-K and "Note 1 Summary of Significant Accounting Policies" in Notes to Consolidated Financial Statements included in Part II, Item 8 of this Form 10-K.

Investment securities
Another critical accounting policy is the policy for reviewing available-for-sale securities and held-to-maturity securities to determine if declines in fair value below amortized cost are other-than-temporary as required by FASB ASC Topic 320, Investments – Debt and Equity Securities. When other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether the Company intends to sell the security and whether it is more likely than not will be required to sell the security before recovery of its

amortized cost basis less any current-period credit loss. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment 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 the Company does not intend to sell the security and it is not more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment 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. In estimating other-than-temporary impairment losses, management considers, among other factors, the length of time and extent to which the fair value has been less than cost, the financial condition and near term prospects of the issuer, underlying collateral of the security, and the structure of the security.

All accounting policies are important and the reader of the financial statements should review these policies, described in "Note 1 Summary of Significant Accounting Policies" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Form 10-K, to gain a better understanding of how the Company's financial performance is reported.

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RESULTS OF OPERATIONS
(Comparison of December 31, 2018 and 2017 results)

General

The Company reported diluted earnings per share of $5.35 in 2018, compared to diluted earnings per share of $3.43 in 2017. Net income for the year ended December 31, 2018, was $82.3 million, an increase of 56.8% compared to $52.5 million in 2017. The 2017 results were impacted by the Tax Cuts and Jobs Act of 2017 (the "TCJA"), resulting in a one-time, non-cash write-down of net deferred tax assets in the amount of $14.9 million. For additional financial information on the impact of the TCJA, refer to "Note 15 - Income Taxes" in the Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

In addition to earnings per share, key performance measurements for the Company include return on average shareholders' equity (ROE) and return on average assets (ROA). ROE was 13.93% in 2018, compared to 9.09% in 2017, while ROA was 1.23% in 2018 and 0.82% in 2017. Tompkins' ROE and ROA at September 30, 2018 (the most recent date for which peer data is publicly available) were in the 81$^{st}$ percentile for ROE and the 54$^{th}$ percentile for ROA of its peer group. The peer group data is derived from the FRB's "Bank Holding Company Performance Report", which covers banks and bank holding companies with assets between $3.0 billion and $10.0 billion as of September 30, 2018 (the most recent report available). Although the peer group data is presented based upon financial information that is one fiscal quarter behind the financial information included in this report, the Company believes that it is relevant to include certain peer group information for comparison to current quarter numbers.

Non-GAAP Disclosure

The following table summarizes the Company's results of operations on a GAAP basis and on an operating (non-GAAP) basis for the periods indicated. The Company believes the non-GAAP measures provide meaningful comparisons of our underlying operational performance and facilitates management's and investors' assessments of business and performance trends in comparison to others in the financial services industry. In addition, the Company believes the exclusion of the nonoperating items from our performance enables management and investors to perform a more effective evaluation and comparison of our results and to assess performance in relation to our ongoing operations. Tangible common equity per share is tangible common equity divided by total shares issued and outstanding. Tangible common equity 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. These non-GAAP financial measures should not be considered in isolation or as a measure of the Company's profitability or liquidity; they are in addition to, and are not a substitute for, financial measures under GAAP. Net operating income, adjusted diluted earnings per share, operating return on average tangible common equity, and tangible common equity per share as presented herein may be different from non-GAAP financial measures used by other companies, and may not be comparable to similarly titled measures reported by other companies. Further, the Company may utilize other measures to illustrate performance in the future. Non-GAAP financial measures have limitations since they do not reflect all of the amounts associated with the Company's results of operations as determined in accordance with GAAP.

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Reconciliation of Net Operating Income/Adjusted Diluted Earnings Per Share (Non-GAAP) to Net Income and Earnings Per Share

| | For the year ended December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands, except per share data) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Net income attributable to Tompkins Financial Corporation | $82,308 | $52,494 | $59,340 | $58,421 | $52,041 |
| Less: dividends and undistributed earnings allocated to unvested stock awards | (1,315) | (818) | (912) | (834) | (503) |
| Net income available to common shareholders (GAAP) | 80,993 | 51,676 | 58,428 | 57,587 | 51,538 |
| Diluted earnings per share (GAAP) | 5.35 | 3.43 | 3.91 | 3.87 | 3.48 |
| | | | | | |
| Adjustments for non-operating income and expense: | | | | | |
| Gain on pension plan curtailment, net of tax | 0 | 0 | 0 | (3,602) | 0 |
| Gain on sale of real estate, net of tax | (2,227) | 0 | 0 | 0 | 0 |
| Write-down of impaired leases, net of tax | 1,915 | 0 | 0 | 0 | 0 |
| Remeasurement of deferred taxes | 0 | 14,944 | 0 | 0 | 0 |
| Total adjustments | (312) | 14,944 | 0 | (3,602) | 0 |
| | | | | | |
| Net operating income available to common shareholders (Non-GAAP) | 80,681 | 66,620 | 58,428 | 53,985 | 51,538 |
| Adjusted diluted earnings per share (Non-GAAP) | 5.33 | 4.42 | 3.91 | 3.63 | 3.48 |

Operating Return on Average Tangible Common Equity (Non-GAAP)

| | For the year ended December 31, | |
|---|---|---|
| (in thousands, except per share data) | 2018 | 2017 |
| Net operating income available to common shareholders (Non-GAAP) | $80,681 | $66,620 |
| Amortization of intangibles, net of tax | 1,337 | 1,159 |
| Adjusted net operating income available to common shareholders (Non-GAAP) | 82,018 | 67,779 |
| | | |
| Average Tompkins Financial Corporation shareholders' common equity | 589,475 | 575,958 |
| Average goodwill and intangibles [1] | 99,999 | 101,583 |
| Average Tompkins financial Corporation shareholders' tangible common equity (Non-GAAP) | 489,476 | 474,375 |
| | | |
| Adjusted operating return on average shareholders' tangible common equity (Non-GAAP) | 16.76 % | 14.29 % |

[1] Average goodwill and intangibles excludes mortgage servicing rights.

Reconciliation of Tangible Common Equity Per Share (Non-GAAP) to Shareholders' Common Equity Per Share

| | As of December 31, | |
|---|---|---|
| (in thousands, except per share data) | 2018 | 2017 |
| Tompkins Financial Corporations Shareholders' common equity | 619,459 | 574,780 |
| Goodwill and intangibles [1] | 99,106 | 100,887 |
| Tangible common equity (Non-GAAP) | 520,353 | 473,893 |
| | | |
| Common equity per share | 40.45 | 37.65 |
| Tangible common equity per share (Non-GAAP) | 33.98 | 31.04 |

[1] Goodwill and intangibles excludes mortgage servicing rights.

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Segment Reporting

The Company operates in three business segments: banking, insurance and wealth management. Insurance is comprised of property and casualty insurance services and employee benefit consulting operated under the Tompkins Insurance Agencies, Inc. subsidiary. Wealth management activities include the results of the Company’s trust, financial planning, and wealth management services provided by Tompkins Financial Advisors, a division of the Trust Company. All other activities are considered banking. For additional financial information on the Company’s segments, refer to “Note 22 – Segment and Related Information” in the Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

Banking Segment

The banking segment reported net income of $74.9 million for the year ended December 31, 2018, representing a $27.9 million or 59.3% increase compared to 2017. Banking segment earnings in 2018 and 2017 were significantly impacted by the Tax Cuts and Jobs Act of 2017. Due to this legislation, a one-time, $14.9 million write-down was recorded for the remeasurement of net deferred tax assets and is reflected in the banking segment’s results of operations for the fourth quarter of 2017 as an additional charge to income tax expense. The legislation also decreased the Federal statutory tax rate from 35% in 2017 to 21% in 2018. Net interest income increased $10.5 million or 5.2% in 2018 compared to 2017, due primarily to loan growth, and an increase in average loan yields. Interest income increased $24.8 million or 10.9% compared to 2017, while interest expense increased $14.3 million or 56.3%.

The provision for loan and lease losses was $3.9 million in 2018, compared to $4.2 million in the prior year. The loan growth rate for 2018 was 3.5% compared to 12.8% for 2017, contributing to the year-over-year decrease in provision expense.

Noninterest income in the banking segment of $31.7 million in 2018 increased by $6.2 million or 24.5% when compared to 2017. The increase in noninterest income was mainly due to gain on sale of fixed assets (up $2.9 million), collection of fees and nonaccrual interest on a loan that was charged off in 2010 (up $2.5 million), card services income (up $594,000), net gain on sale of loans (up $408,000) and other fee income (up $281,000). These were partially offset by a decrease in BOLI (down $378,000).

Noninterest expenses increased by $9.3 million or 6.9% compared to 2017. The increase was mainly attributed to an increase in salary and wages and employee benefits reflecting normal annual merit and incentive adjustments and higher health insurance costs over the prior year, write-downs of $2.3 million on leases on space vacated in 2018 following completion of the Company's new headquarters in 2018, total technology expense (up $1.8 million), and professional fees and consulting (up $2.8 million). The increase in technology and professional fees primarily relates to investments in strengthening the Company's compliance and information security infrastructure.

Insurance Segment

The insurance segment reported net income of $3.2 million, up 11.9% when compared to 2017. The increase in net income is mainly a result of the decrease in the Federal statutory tax rate in 2018 described above. Net income before tax decreased by $269,000 or 5.8%, as a 2.2% increase in noninterest revenue was offset by a 3.8% increase in expenses. The increase in expenses was mainly attributed to an increase in salary and wages and employee benefits reflecting normal annual merit and incentive adjustments and higher health insurance costs, respectively, over the prior year. Noninterest income increased $654,000, or 2.2%, when compared to 2017, reflecting increases in all business lines (personal, commercial, and life and health). Revenues for 2017 included a non-recurring gain on the sale of certain customer relationships in the amount of $154,000.

Wealth Management Segment

The wealth management segment reported net income of $4.2 million for the year ended December 31, 2018, an increase of $1.6 million or 62.0% compared to 2017. Noninterest income of $18.0 million increased $1.7 million or 10.1% compared to 2017. Estate and terminating trust fees were up $1.1 million or 661.3% in 2018 over 2017, benefiting from the settlement of a large estate in 2018. Noninterest expenses were flat in 2018 compared to 2017, mainly due to lower staffing levels in 2018 compared to 2017. The market value of assets under management or in custody at December 31, 2018 totaled $3.8 billion, a decrease of 5.3% compared to year-end 2017.

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Net Interest Income

Net interest income is the Company’s largest source of revenue, representing 73.2% of total revenues for the year ended December 31, 2018, and 74.4% of total revenues for the year ended December 31, 2017. Net interest income in 2018 increased 5.2% over 2017. Net interest income is dependent on the volume and composition of interest earning assets and interest-bearing liabilities and the level of market interest rates. The Company’s net interest income over the past several years benefited from steady growth in average earning assets, which increased 5.3% in 2018 compared to 2017.

Table 1 – Average Statements of Condition and Net Interest Analysis shows average interest-earning assets and interest-bearing liabilities, and the corresponding yield or cost associated with each. Taxable-equivalent net interest income for 2018 increased 3.9% over 2017, benefiting from growth in average earning assets, which increased by 5.3% in 2018, and growth in average noninterest bearing deposits, which increased by 8.1% compared to the prior year. The net interest margin for 2018 was 3.37% compared to 3.41% for 2017. Tax equivalent net interest income and net interest margin were impacted by the reduction in the U.S. federal statutory income tax rate from 35% in 2017 to 21% in 2018 under the Tax Cuts and Jobs Act of 2017. Assuming a tax rate of 21% in 2017 would have reduced the net interest margin by about 4 basis points in 2017, resulting in a flat net interest margin compared to 2018. The rising interest rate environment resulted in funding costs rising at a faster pace than asset yields, which pressured the margin in 2018.

Tax-equivalent interest income increased $22.3 million or 9.6% in 2018 over 2017. The increase in taxable-equivalent interest income reflects a $317.8 million or 5.3% increase in average interest-earning assets and improved yields. The increase in average interest-earning assets was mainly in average loans and leases, which increased $356.4 million or 8.1% in 2018 compared to 2017. Average loan balances represented 75.0% of average earning assets in 2018 compared to 73.1% in 2017. The average yield on interest earning assets for 2018 was 4.0%, which increased by 16 basis points from 2017. The average yield on loans was 4.53% in 2018, an increase of 11 basis points compared to 4.42% in 2017. Average balances on securities decreased $45.4 million or 2.9% compared to 2017, while the average yield on the securities portfolio increased 5 basis points or 2.3% compared to 2017.

Interest expense for 2018 increased $14.3 million or 56.3% compared to 2017, and average interest bearing liabilities increased $187.8 million or 4.2% over 2017. The increase in interest expense was the result of the increase in the average rates paid on deposits and interest bearing liabilities in 2018 compared to 2017, as well as the growth in average borrowings during 2018 when compared to 2017. The average rate paid on interest bearing deposits was 0.48% in 2018, up 13 basis points from 0.35% in 2017, while the average costs of interest bearing liabilities increased to 0.85% in 2018 from 0.57% in 2017. Average other borrowings increased by $204.6 million or 23.2% year over year, mainly due to a higher volume of overnight borrowings with the FHLB in 2018, which were used to support loan growth that exceeded deposit growth in 2018. Average total deposits were up $89.7 million or 1.9% in 2018 over 2017, with the majority of the growth in average noninterest bearing deposits. Average interest bearing deposits in 2018 decreased $13.9 million or 0.4% compared to 2017. Average noninterest bearing deposit balances in 2018 increased $103.5 million or 8.1% over 2017 and represented 28.4% of average total deposits in 2018 compared to 26.8% in 2017.

Table 1 - Average Statements of Condition and Net Interest Analysis

| | For the year ended December 31, | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2018 | | | | 2017 | | | | 2016 | | | |
| (dollar amounts in thousands) | Average Balance (YTD) | Interest | Average Yield/Rate | | Average Balance (YTD) | Interest | Average Yield/Rate | | Average Balance (YTD) | Interest | Average Yield/Rate | |
| ASSETS | | | | | | | | | | | | |
| Interest-earning assets | | | | | | | | | | | | |
| Interest-bearing balances due from banks | $2,139 | $31 | 1.45 | % | $4,599 | $37 | 0.80 | % | $2,019 | $6 | 0.30 | % |
| Securities[1] | | | | | | | | | | | | |
| U.S. Government securities | 1,429,875 | 31,645 | 2.21 | % | 1,471,717 | 31,006 | 2.11 | % | 1,443,894 | 29,318 | 2.03 | % |
| Trading securities | 0 | 0 | 0.00 | % | 0 | 0 | 0.00 | % | 4,893 | 220 | 4.50 | % |
| State and municipal[2] | 97,116 | 2,520 | 2.59 | % | 100,595 | 3,393 | 3.37 | % | 97,937 | 3,309 | 3.38 | % |
| Other securities[2] | 3,491 | 153 | 4.38 | % | 3,597 | 129 | 3.59 | % | 3,645 | 123 | 3.37 | % |
| Total securities | 1,530,482 | 34,318 | 2.24 | % | 1,575,909 | 34,528 | 2.19 | % | 1,550,369 | 32,970 | 2.13 | % |
| FHLBNY and FRB stock | 51,815 | 3,377 | 6.52 | % | 42,465 | 2,121 | 4.99 | % | 32,528 | 1,434 | 4.41 | % |
| Total loans and leases, net of unearned income[2,3] | 4,757,583 | 215,648 | 4.53 | % | 4,401,205 | 194,433 | 4.42 | % | 3,957,221 | 172,443 | 4.36 | % |
| Total interest-earning assets | 6,342,019 | 253,374 | 4.00 | % | 6,024,178 | 231,119 | 3.84 | % | 5,542,137 | 206,853 | 3.73 | % |
| Other assets | 350,659 | | | | 365,326 | | | | 355,943 | | | |
| Total assets | $6,692,678 | | | | $6,389,504 | | | | $5,898,080 | | | |
| LIABILITIES & EQUITY | | | | | | | | | | | | |
| Deposits | | | | | | | | | | | | |
| Interest-bearing deposits | | | | | | | | | | | | |
| Interest bearing checking, savings, & money market | 2,822,747 | 9,847 | 0.35 | % | 2,674,204 | 5,141 | 0.19 | % | 2,529,009 | 4,008 | 0.16 | % |
| Time deposits | 664,788 | 6,748 | 1.02 | % | 827,181 | 6,992 | 0.85 | % | 871,595 | 6,705 | 0.77 | % |
| Total interest-bearing deposits | 3,487,535 | 16,595 | 0.48 | % | 3,501,385 | 12,133 | 0.35 | % | 3,400,604 | 10,713 | 0.32 | % |
| Federal funds purchased & securities sold under agreements to repurchase | 63,472 | 152 | 0.24 | % | 64,888 | 235 | 0.36 | % | 99,622 | 2,228 | 2.24 | % |
| Other borrowings | 1,086,847 | 21,818 | 2.01 | % | 882,235 | 11,934 | 1.35 | % | 616,560 | 6,772 | 1.10 | % |
| Trust preferred debentures | 16,771 | 1,227 | 7.32 | % | 18,338 | 1,158 | 6.31 | % | 37,588 | 2,390 | 6.36 | % |
| Total interest-bearing liabilities | 4,654,625 | 39,792 | 0.85 | % | 4,466,846 | 25,460 | 0.57 | % | 4,154,374 | 22,103 | 0.53 | % |
| Noninterest bearing deposits | 1,382,550 | | | | 1,279,027 | | | | 1,130,406 | | | |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Accrued expenses and other liabilities | 64,559 | | | | 66,185 | | | | 66,243 | | |
| Total liabilities | 6,101,734 | | | | 5,812,058 | | | | 5,351,023 | | |
| Tompkins Financial Corporation Shareholders' equity | 589,475 | | | | 575,958 | | | | 545,545 | | |
| Noncontrolling interest | 1,469 | | | | 1,488 | | | | 1,512 | | |
| Total equity | 590,944 | | | | 577,446 | | | | 547,057 | | |
| Total liabilities and equity | $6,692,678 | | | | $6,389,504 | | | | $5,898,080 | | |
| Interest rate spread | | | 3.14 | % | | | 3.27 | % | | | 3.20 | %
| Net interest income /margin on earning assets | | 213,582 | 3.37 | % | | 205,659 | 3.41 | % | | 184,750 | 3.33 | %
| Tax Equivalent Adjustment | | (1,782 ) | | | | (4,355 ) | | | | (4,114 ) | | |
| Net interest income per consolidated financial statements | | $211,800 | | | | $201,304 | | | | $180,636 | | |

[1] Average balances and yields on available-for-sale securities are based on historical amortized cost.
[2] Interest income includes the tax effects of taxable-equivalent adjustments using a combined New York State and Federal effective income tax rate of 21% in 2018 and 40% in 2017 to increase tax exempt interest income to taxable-equivalent basis.
[3] Nonaccrual loans are included in the average asset totals presented above. Payments received on nonaccrual loans have been recognized as disclosed in Note 1 of the Company's consolidated financial statements included in Part 1 of this annual report on Form 10-K.

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Table 2 - Analysis of Changes in Net Interest Income

| (in thousands)(taxable equivalent) | 2018 vs. 2017 Increase (Decrease) Due to Change in Average Volume | Yield/Rate | Total | 2017 vs. 2016 Increase (Decrease) Due to Change in Average Volume | Yield/Rate | Total |
|---|---|---|---|---|---|---|
| INTEREST INCOME: | | | | | | |
| Certificates of deposit, other banks | $(28) | $22 | $(6) | $14 | $17 | $31 |
| Investments[1] | | | | | | |
| Taxable | (931) | 1,594 | 663 | 354 | 1,120 | 1,474 |
| Tax-exempt | (102) | (771) | (873) | 90 | (6) | 84 |
| FHLB and FRB stock | 538 | 718 | 1,256 | 438 | 249 | 687 |
| Loans, net[1] | 15,948 | 5,267 | 21,215 | 19,414 | 2,576 | 21,990 |
| Total interest income | $15,425 | $6,830 | $22,255 | $20,310 | $3,956 | $24,266 |
| INTEREST EXPENSE: | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Interest checking, savings and money market | 401 | 4,305 | 4,706 | 259 | 874 | 1,133 |
| Time | (1,505) | 1,261 | (244) | (342) | 629 | 287 |
| Federal funds purchased and securities sold under agreements to repurchase | (5) | (78) | (83) | (252) | (1,741) | (1,993) |
| Other borrowings | 3,339 | 6,614 | 9,953 | 2,078 | 1,852 | 3,930 |
| Total interest expense | $2,230 | $12,102 | $14,332 | $1,743 | $1,614 | $3,357 |
| Net interest income | $13,195 | $(5,272) | $7,923 | $18,567 | $2,342 | $20,909 |

[1] Interest income includes the tax effects of taxable-equivalent adjustments using a combined New York State and Federal effective income tax rate of 21% in 2018 and 40% in 2017 to increase tax exempt interest income to taxable-equivalent basis.

Changes in net interest income occur from a combination of changes in the volume of interest-earning assets and interest-bearing liabilities, and in the rate of interest earned or paid on them. The above table illustrates changes in interest income and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of the change. In 2018, net interest income increased by $7.9 million, resulting from a $22.3 million increase in interest income, partially offset by a $14.3 million increase in interest expense. Growth in average balances on interest-earning assets contributed $15.4 million to the increase in interest income, while the higher yields on average earning assets added $6.8 million. The increase in interest expense reflects higher rates paid on interest bearing liabilities and growth in average balances of interest bearing liabilities.

Provision for Loan and Lease Losses

The provision for loan and lease losses represents management's estimate of the expense necessary to maintain the allowance for loan and lease losses at an appropriate level. The provision for loan and lease losses was $3.9 million in 2018, compared to $4.2 million in 2017. Loan growth for 2018 was down from 2017, which contributed to the lower provision expense. See the section captioned "The Allowance for Loan and Lease Losses" included within "Management's Discussion and Analysis of Financial Condition and Results of Operations-Financial Condition" of this Report for further analysis of the Company's allowance for loan and lease losses.

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Noninterest Income

| | Year ended December 31, | | |
|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 |
| Insurance commissions and fees | $29,369 | $28,778 | $29,492 |
| Investment services | 17,288 | 15,665 | 15,203 |
| Service charges on deposit accounts | 8,435 | 8,437 | 8,793 |
| Card services | 9,693 | 9,100 | 8,058 |
| Net mark-to-market gains | 0 | 0 | 45 |
| Other income | 13,130 | 7,631 | 6,291 |
| Net (loss) gain on securities transactions | (466) | (407) | 926 |
| Total | $77,449 | $69,204 | $68,808 |

Noninterest income is a significant source of income for the Company, representing 26.8% of total revenues in 2018, and 25.6% in 2017, and is an important factor in the Company’s results of operations.

Insurance commissions and fees increased 2.1% to $29.4 million in 2018, compared to $28.8 million in 2017. Insurance revenues increased $654,000, or 2.2%, when compared to 2017, reflecting increases in all business lines (personal, commercial, and life and health). Revenues for 2017 included a non-recurring gain on the sale of certain customer relationships in the amount of $154,000.

Investment services income of $17.3 million in 2018 increased $1.6 million or 10.4% compared to 2017. Investment services income includes trust services, financial planning, and wealth management services. The increase in fees in 2018 over 2017 was mainly in trust and estate fees and included fees related to the settlement of a large estate as well as growth in higher fee accounts such as asset management accounts and an increase in fees on certain products. With fees largely based on the market value and the mix of assets managed, the general direction of the stock market can have a considerable impact on fee income. Global equity markets and the broad market index averages finished generally lower in 2018, when compared to 2017, which had an unfavorable impact on fees. The market value of assets managed by, or in custody of, the Trust Company was $3.8 billion at December 31, 2018, and $4.0 billion at December 31, 2017. These figures included $1.0 billion in 2018 and $1.0 billion in 2017, of Company-owned securities from which no income was recognized as the Trust Company was serving as custodian.

Service charges on deposit accounts in 2018 were flat compared to prior year. Overdraft/insufficient funds charges, the largest component of service charges on deposit accounts, were up $112,000 or 2.1% in 2018 compared to 2017, but were mainly offset by a decrease in service fees on personal and business accounts.

Card services income increased $593,000 or 6.5% over 2017. The primary components of card services income are fees related to interchange income and transactions fees for debit card transactions, credit card transactions and ATM usage. Increased revenue was largely driven by increased transaction volume in both credit and debit cards.

The Company recognized $466,000 of losses on sales/calls of available-for-sale securities in 2018, compared to $407,000 of losses in 2017. The losses are primarily related to the sales of available-for-sale securities, which are generally the result of general portfolio maintenance and interest rate risk management.

Other income of $13.1 million was up $5.5 million or 72.1% compared to 2017. The primary contributors for the increase in 2018 over 2017 were $2.9 million of gains on the sale of two properties we sold upon completion of the Company's new headquarters building and $2.5 million related to the collection of fees and nonaccrual interest for a credit that was charged off in 2010. Other income also included $458,000 of gains on the sales of residential mortgage loans, which were up $408,000 over 2017. These increases were partially offset by a $378,000 decrease in earnings on bank owned life insurance in 2018 when compared to 2017.

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Noninterest Expense

| | Year ended December 31, | | |
|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 |
| Salaries and wages | $85,625 | $81,948 | $77,379 |
| Other employee benefits | 22,090 | 21,458 | 19,909 |
| Net occupancy expense of premises | 13,309 | 13,214 | 12,521 |
| Furniture and fixture expense | 7,351 | 7,028 | 6,450 |
| FDIC insurance | 2,618 | 2,527 | 3,024 |
| Amortization of intangible assets | 1,771 | 1,932 | 2,090 |
| Other | 48,303 | 42,998 | 37,234 |
| Total | $181,067 | $171,105 | $158,607 |

Noninterest expense as a percentage of total revenue was 62.6% in 2018, compared to 63.3% in 2017. Expenses associated with salaries and wages and employee benefits are the largest component of total noninterest expense. In 2018, these expenses increased $4.3 million or 4.2% compared to 2017. Salaries and wages increased $3.7 million or 4.5% in 2018 over prior year, mainly as a result of annual merit pay increases as well as the Company's decision to raise the minimum wage paid to our employees. Other employee benefits increased $632,000 or 2.9% over 2017. The increase over prior year in other employee benefit expenses was mainly in health insurance, which was up $431,000 or 5.5% in 2018 over 2017.

Other operating expenses of $48.3 million increased by $5.3 million or 12.3% compared to 2017. The primary components of other operating expenses in 2018 were technology expense ($10.1 million), marketing expense ($5.5 million), professional fees ($8.6 million), cardholder expense ($3.3 million) and other miscellaneous expense ($20.8 million). Professional fees and technology related expenses in 2018 were up by $2.8 million and $1.8 million, respectively, over 2017, mainly as a result of investments in strengthening the Company's compliance and information security infrastructure. Other operating expenses in 2018 included $2.5 million of write-downs related to two leases on space vacated in 2018. Other operating expense in 2017 included $2.7 million related to a write-off of a historic tax credit investment. The historic tax credit project was placed in service in 2017 resulting in the write-off of $2.7 million and recognition of the $3.3 million of tax credits as a reduction of income tax expense for 2017.

Noncontrolling Interests

Net income attributable to noncontrolling interests represents the portion of net income in consolidated majority-owned subsidiaries that is attributable to the minority owners of a subsidiary. The Company had net income attributable to noncontrolling interests of $127,000 in 2018 and $128,000 in 2017. The noncontrolling interests relate to three real estate investment trusts, which are substantially owned by the Company’s New York banking subsidiaries.

Income Tax Expense

The provision for income taxes provides for Federal, New York State and Pennsylvania state income taxes. The 2018 provision was $21.8 million, which decreased $20.8 million or 48.8% compared to the 2017 provision. The effective tax rate for the Company was 20.9% in 2018, down from 44.8% in 2017. The effective rates for 2017 and 2018 differed from the U.S. statutory rate of 35.0% and 21.0% during those periods due to the effect of tax-exempt income from loans, securities, and life insurance assets, investments in tax credits, and excess tax benefits of stock based compensation. The effective rate in 2017 was significantly impacted by a $14.9 million one-time write down of net deferred tax assets due to the required remeasurement of the assets that resulted from the TCJA. The change in the effective rate in 2017 was partially offset by the recognition of $3.3 million of tax credits related to an investment in a historic tax credit. The changes to the tax laws approved in December 2017 reduced the federal statutory tax rate from 35% in 2017, to 21% in 2018 and beyond.

RESULTS OF OPERATIONS
(Comparison of December 31, 2017 and 2016 results)

General

Tompkins Financial Corporation's earnings for the period ended December 31, 2017, were impacted by the TCJA, which reduced the Federal statutory tax rate from 35% in 2017, to 21% in 2018 and beyond. The change in the tax law created a one-

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time, fourth quarter, non-cash write-down of net deferred tax assets in the amount of $14.9 million due to the required remeasurement of net deferred tax assets using the new lower tax rate.

A summary of the impact of the tax law changes on 2017 full year earnings per share was as follows:
GAAP diluted earnings per share for the year ended December 31, 2017, were $3.43, down 12.3% over 2016
Adjusted diluted earnings per share for the year ended December 31, 2017 (excluding the one-time charge related to tax reform) were $4.42, up 13.0% over 2016 (refer to table of "Non GAAP Disclosures" included above)

The Company reported diluted earnings per share of $3.43 in 2017, compared to diluted earnings per share of $3.91 in 2016. Net income for the year ended December 31, 2017, was $52.5 million, a decrease of 11.5% compared to $59.3 million in 2016. The 2017 results were impacted by the TCJA, resulting in a one-time, non-cash write-down of net deferred tax assets in the amount of $14.9 million.

In addition to earnings per share, key performance measurements for the Company included return on average shareholders' equity (ROE) and return on average assets (ROA). ROE was 9.09% in 2017, compared to 10.85% in 2016, while ROA was 0.82% in 2017 and 1.01% in 2016.

Segment Reporting

Banking Segment
The banking segment reported net income of $47.0 million for the year ending December 31, 2017, representing a $6.6 million or 12.3% decrease compared to 2016. Banking segment earnings were significantly impacted by the TCJA. Due to this legislation, a one-time, $14.9 million write-down was recorded for the remeasurement of net deferred tax assets and was reflected in the banking segment's results of operations for the fourth quarter of 2017 as an additional charge to income tax expense. Net interest income increased $20.7 million or 11.4% in 2017 compared to 2016, due primarily to loan growth, and a slight increase in average loan yields. Interest income increased $24.0 million or 11.9%, while interest expense increased $3.4 million or 15.2% compared to 2016.

The provision for loan and lease losses was $4.2 million in 2017, compared to $4.3 million in the prior year. The loan growth rate for 2017 was 12.8% compared to 16.7% for 2016, contributing to the year-over-year decrease in provision expense.

Noninterest income in the banking segment of $25.5 million in 2017 increased by $1.1 million or 4.5% when compared to 2016. The increase in noninterest income was mainly due to card services income (up $1.0 million), gain on sale of other real estate owned (OREO) (up $127,000), other income which included the recognition of income related to previously charged off credits (up $835,000) and other fee income (up $263,000). These were partially offset by decreases in service charges on deposit accounts (down $356,000) and realized gain/loss on available for sale securities (down $1.3 million).

Noninterest expenses increased by $12.7 million or 10.4% compared to 2016. The increase was mainly attributed to an increase in salary and wages and employee benefits reflecting normal annual merit and incentive adjustments and higher health insurance costs, respectively, over the prior year.

Insurance Segment
The insurance segment reported net income of $2.9 million, down 11.4% when compared to 2016. The decrease in net income was mainly a result of lower revenue, as total noninterest expenses were in line with 2016. Noninterest income decreased $635,000, or 2.1%, when compared to 2016. The decrease in noninterest income was mainly in life and health insurance commissions and largely reflected impacts of the sale of certain customer relationships in the Pennsylvania market in the second half of 2016 and first quarter of 2017.

Wealth Management Segment

The wealth management segment reported net income of $2.6 million for the year ended December 31, 2017, an increase of $149,000 or 6.2% compared to 2016. Noninterest income of $16.3 million increased $503,000 or 3.2% compared to 2016. In addition, noninterest expense increased $381,000 or 3.1% compared to 2016, mainly due to increases in salaries and wages, reflecting annual merit increases and higher staffing levels in 2017 compared to 2016. The market value of assets under management or in custody at December 31, 2017 totaled $4.0 billion, an increase of 1.9% compared to year-end 2016.

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Net Interest Income

Net interest income is the Company's largest source of revenue, representing 74.4% of total revenues for the year ended December 31, 2017, and 72.4% of total revenues for the year ended December 31, 2016. Net interest income in 2017 increased 11.4% over 2016. Net interest income is dependent on the volume and composition of interest earning assets and interest-bearing liabilities and the level of market interest rates. The Company's net interest income over the past several years benefited from steady growth in average earning assets, which increased 8.7% in 2017 compared to 2016. The net interest margin for 2017 was 3.41% compared to 3.33% for 2016. Improved yields on average interest-earning assets contributed to the year-over-year improved margin.

Tax-equivalent interest income increased $24.3 million or 11.7% in 2017 over 2016. The increase in taxable-equivalent interest income reflects the $482.0 million or 8.7% increase in average interest-earning assets and an improved net interest margin. The increase in average interest-earning assets was mainly in average loans and leases, which were up $444.0 million or 11.2% in 2017 compared to 2016. The average yield on interest earning assets for 2017 was 3.84%, which increased by 11 basis points from 2016. The average yield on loans was 4.42% in 2017, an increase of 6 basis points compared to 4.36% in 2016. Average loan balances represented 73.1% of average earning assets in 2017 compared to 71.4% in 2016. Average balances on securities increased $25.5 million or 1.6% compared to 2016, while the average yield on the securities portfolio increased 6 basis points or 2.8% compared to 2016.

Interest expense for 2017 increased $3.4 million or 15.2% compared to 2016, and average interest bearing liabilities increased $312.5 million or 7.5% over 2016. The increase in interest expense reflected higher average deposits and borrowings during 2017 when compared to 2016, as well as an increase in the average rate paid on deposits and average interest bearing liabilities. The average rate paid on interest bearing deposits was 0.35% in 2017, up 3 basis points from 0.32% in 2016. Average interest bearing deposits in 2017 increased $100.8 million or 3.0% compared to 2016. Average noninterest bearing deposit balances in 2017 increased $148.6 million or 13.2% over 2016 and represented 26.8% of average total deposits compared to 24.9% in 2016. Average other borrowings increased by $265.7 million or 43.1% year over year, mainly due to a higher volume of overnight borrowings with the FHLB in 2017, which were used to support loan growth that exceeded deposit growth in 2017.

Provision for Loan and Lease Losses

The provision for loan and lease losses was $4.2 million in 2017, compared to $4.3 million in 2016.

Noninterest Income

Noninterest income represented 25.6% of total revenues in 2017, and 27.6% in 2016.

Insurance commissions and fees decreased 2.4% to $28.8 million in 2017, compared to $29.5 million in 2016. The decrease in insurance commissions and fees was mainly in life and health insurance commissions and largely reflected the impact of the sale of certain customer relationships in the Pennsylvania market in the second half of 2016 and first quarter of 2017.

Investment services income of $15.7 million in 2017 increased $462,000 or 3.0% compared to 2016. Investment services income includes trust services, financial planning, and wealth management services. With fees largely based on the market value and the mix of assets managed, the general direction of the stock market can have a considerable impact on fee income. Global equity markets and the broad market index averages finished higher in 2017, when compared to 2016. The market value of assets managed by, or in custody of, the Trust Company was $4.0 billion at December 31, 2017, and $3.9 billion at December 31, 2016. These figures included $1.0 billion in 2017 and $1.2 billion in 2016, of Company-owned securities from which no income was recognized as the Trust Company was serving as custodian.

Service charges on deposit accounts in 2017 decreased 4.1% compared to prior year. Service fees on commercial and personal accounts were down $429,000 or 13.8%. The decrease over prior year was mainly due to management's decision to waive certain service fees during the core system conversion completed in 2017. The decrease in service fees was partially offset by an increase in overdraft/insufficient funds charges, the largest component of service charges on deposit accounts, which were up $112,000 or 2.1% in 2017 compared to 2016.

Card services income increased $1.0 million or 12.9% over 2016. The primary components of card services income are fees related to interchange income and transactions fees for debit card transactions, credit card transactions and ATM usage. Increased revenue was largely driven by increased transaction volume in both credit and debit cards. 2017 revenues also included approximately $500,000 of volume based incentives related to our branding agreement with MasterCard.

There were no net mark-to-market losses on securities and borrowings held at fair value in 2017, compared to $45,000 in 2016. Mark-to-market losses or gains relate to the change in the fair value of securities and borrowings where the Company has elected the fair value option. During 2016, the Company sold its remaining portfolio of trading securities and prepaid its outstanding trading liability.

The Company recognized $407,000 of losses on sales/calls of available-for-sale securities in 2017, compared to $926,000 of gains in 2016. Sales of available-for-sale securities are generally the result of general portfolio maintenance and interest rate risk management.

Other income of $7.6 million was up $1.3 million or 21.3% compared to 2016. The significant components of other income are other service charges, gains on the sale of other real estate, and loan related income. The increase over prior year included recoveries of nonaccrual interest and prior year legal fees on loans previously charged off.

Noninterest Expense

Noninterest expense as a percentage of total revenue was 63.3% in 2017, compared to 63.6% in 2016. Salaries and wages and pension and other employee benefit expenses in 2017 increased $6.0 million or 6.2% compared to 2016. For 2017, salaries and wages increased $4.6 million or 6.0% over the prior year. The increase reflects additional employees, annual merit increases and higher accruals for incentive compensation. Pension and other employee benefits increased $1.4 million or 6.7% over 2016. The increase over prior year in pension and other employee benefit expenses was mainly in health insurance, which was up $900,000 or 13.2% in 2017 over 2016.

Other operating expenses of $42.9 million increased by $5.9 million or 15.8% compared to 2016. The primary components of other operating expenses in 2017 were technology expense ($8.3 million), marketing expense ($5.0 million), professional fees ($5.7 million), cardholder expense ($3.4 million) and other miscellaneous expense ($20.5 million). Other operating expenses in 2017 included certain nonrecurring items, including: $2.7 million related to a write off of a historic tax credit investment and $731,000 of deconversion expenses related to a core system conversion in 2017. The historic tax credit project was placed in service in 2017 resulting in the write-off of the $2.7 million and recognition of the $3.3 million of tax credits as a reduction of income tax expense. The 2016 other operating expenses included $546,000 of deconversion expenses related to the core system conversion, and $313,000 of expense related to the early termination of an FDIC loss share agreement.

Noncontrolling Interests

The Company had net income attributable to noncontrolling interests of $128,000 in 2017 and $131,000 in 2016. The noncontrolling interests relate to three real estate investment trusts, which are substantially owned by the Company's New York banking subsidiaries.

Income Tax Expense

The provision for income taxes provides for Federal, New York State and Pennsylvania State income taxes. The 2017 provision was $42.6 million, which was up $15.6 million or 57.6% over the 2016 provision. The effective tax rate for the Company was 44.8% in 2017, up from 31.3% in 2016. The effective rates for 2016 and 2017 differed from the U.S. statutory rate of 35.0% during the those periods due to the effect of tax-exempt income from loans, securities, and life insurance assets, investments in tax credits, and excess tax benefits of stock based compensation. The increase in the effective rate in 2017 was mainly due to the $14.9 million one-time write down of net deferred tax assets due to the required remeasurement of the assets that resulted from the Tax Cuts and Jobs Act of 2017. The change in the effective rate in 2017 was partially offset by the recognition of $3.3 million of tax credits related to an investment in a historic tax credit. The changes to the tax laws approved in December 2017, reduced the federal statutory tax rate from

35% in 2017, to 21% in 2018 and beyond.

FINANCIAL CONDITION

Total assets were $6.8 billion at December 31, 2018, increasing by 1.7% or $110.1 million over the previous year end. The growth was mainly in the loan portfolio, which increased $164.8 million or 3.5% over year-end 2017. Securities at year-end 2018 were down $57.9 million or 3.8% from year-end 2017.

Loans and leases were 71.5% of total assets at December 31, 2018, compared to 70.2% of total assets at December 31, 2017. A more detailed discussion of the loan portfolio is provided below in this section under the caption “Loans and Leases”.

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As of December 31, 2018, total securities comprised 21.8% of total assets, compared to 23.0% of total assets at year-end 2017. The securities portfolio primarily contains mortgage-backed securities, obligations of U.S. Government sponsored entities, and obligations of states and political subdivisions. A more detailed discussion of the securities portfolio is provided below in this section under the caption “Securities”.

Total deposits increased by $51.2 million or 1.1% compared to December 31, 2017. Noninterest bearing deposits decreased by $39.5 million or 2.7%, while time deposit balances decreased by 14.8% compared to 2017 year-end. Checking, savings and money market accounts increased $201.6 million or 7.6% compared to December 31, 2017. Other borrowings, consisting mainly of short term advances with the FHLB, increased $4.3 million from December 31, 2017. A more detailed discussion of deposits and borrowings is provided below in this section under the caption “Deposits and Other Liabilities”.

Shareholders’ Equity

The Consolidated Statements of Changes in Shareholders’ Equity included in the Consolidated Financial Statements of the Company contained in Part II, Item 8. of this Report, detail the changes in equity capital. Total shareholders’ equity was up $44.7 million or 7.8% to $620.9 million at December 31, 2018, from $576.2 million at December 31, 2017. Additional paid-in capital increased by $2.6 million, from $364.0 million at December 31, 2017, to $366.6 million at December 31, 2018. The $2.6 million increase included the following: $3.5 million related to stock-based compensation; $3.1 million related to shares issued for the employee stock ownership plan; and $410,000 related to shares issued for the Company's director deferred compensation plan. These were partially offset by the repurchase of Company stock of $2.4 million; and net payout of $1.4 million and $541,000 from restricted stock activity and stock option exercises, respectively. Retained earnings increased by $54.4 million, reflecting net income of $82.3 million, less dividends paid of $29.6 million.

Accumulated other comprehensive loss increased from $51.3 million at December 31, 2017 to $63.2 million at December 31, 2018; reflecting a $10.6 million increase in unrealized losses on available-for-sale securities due to market interest rates, and a $1.3 million actuarial loss associated with employee benefit plans. Under regulatory requirements, amounts reported as accumulated other comprehensive income/loss related to net unrealized gain or loss on available-for-sale securities and the funded status of the Company’s defined benefit post-retirement benefit plans do not increase or reduce regulatory capital and are not included in the calculation of risk-based capital and leverage capital ratios.

Total shareholders’ equity was up $26.8 million or 4.9% to $576.2 million at December 31, 2017, from $549.4 million at December 31, 2016. Additional paid-in capital increased by $6.6 million, from $357.4 million at December 31, 2016, to $364.0 million at December 31, 2017. The $6.6 million increase included the following: $3.0 million related to stock-based compensation; $2.9 million in connection with the Company's dividend reinvestment plan; $2.3 million related to shares issued for the employee stock ownership plan; and $441,000 related to shares issued for the Company's director deferred compensation plan. These were partially offset by the net payout of $1.2 million and $643,000 from restricted stock activity and stock option exercises, respectively. Retained earnings increased by $34.8 million, reflecting net income of $52.5 million, less dividends paid of $27.6 million, and a positive, one-time $10.0 million reclassification adjustment of the disproportionate tax effect from accumulated other comprehensive income due to tax law changes associated with the enactment of the TCJA.

Accumulated other comprehensive loss increased from $37.1 million at December 31, 2016 to $51.3 million at December 31, 2017; reflecting a $2.4 million increase in unrealized losses on available-for-sale securities due to market interest rates, and a $1.8 million actuarial loss associated with employee benefit plans. The increase also includes the one-time $10.0 million reclassification adjustment mentioned above attributed to the disproportionate tax effect resulting from the recent tax law changes associated with the enactment of the TCJA.

The Company continued its long history of increasing cash dividends with a per share increase of 6.6% in 2018, which followed an increase of 2.8% in 2017. Dividends per share amounted to $1.94 in 2018, compared to $1.82 in 2017, and $1.77 in 2016. Cash dividends paid represented 36.0%, 52.6%, and 44.8% of after-tax net income in 2018, 2017, and 2016, respectively.

On July 19, 2018, the Company's Board of Directors authorized a stock repurchase plan (the "2018 Repurchase Plan") for the Company to repurchase up to 400,000 shares of the Company's common stock. Purchases may be made over the 24 months following adoption of the plan. The repurchase program may be suspended, modified or terminated by the Board of Directors at any time for any reason. The 2018 Repurchase Plan replaced the Company's previous 400,000 share repurchase plan announced on July 21, 2016 (the "2016 Repurchase Plan"). 16,983 shares have been purchased to date under the 2018 Repurchase Plan at an average price of $73.17.

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The Company repurchased an aggregate of 15,500 shares under the 2016 Repurchase Plan at an average price of $77.85; all of those shares were repurchased in the first quarter of 2018.

The Company and its subsidiary banks are subject to quantitative capital measures established by regulation to ensure capital adequacy. Consistent with the objective of operating a sound financial organization, the Company and its subsidiary banks maintain capital ratios well above regulatory minimums and meet the requirements to be considered well-capitalized under the regulatory guidelines.

As of December 31, 2018, the capital ratios for the Company's 4 subsidiary banks exceeded the minimum levels required to be considered well capitalized. Additional information on the Company's capital ratios and regulatory requirements is provided in "Note 20 - Regulations and Supervision" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report on Form 10-K.

Securities

The Company maintains a portfolio of securities such as U.S. Treasuries, U.S. government sponsored entities securities, U.S. government agencies, non-U.S. Government agencies or sponsored entities mortgage-backed securities, obligations of states and political subdivisions thereof and equity securities. Management typically invests in securities with short to intermediate average lives in order to better match the interest rate sensitivities of its assets and liabilities. Investment decisions are made within policy guidelines established by the Company's Board of Directors. The investment policy established by the Company's Board of Directors is based on the asset/liability management goals of the Company, and is monitored by the Company's Asset/Liability Management Committee. The intent of the policy is to establish a portfolio of high quality diversified securities, which optimizes net interest income within safety and liquidity limits deemed acceptable by the Asset/Liability Management Committee.

The Company classifies its securities at date of purchase as available-for-sale, held-to-maturity or trading. Securities, other than certain obligations of states and political subdivisions thereof, are generally classified as available-for-sale. Securities available-for-sale may be used to enhance total return, provide additional liquidity, or reduce interest rate risk. The held-to-maturity portfolio consists of obligations of U.S. Government sponsored entities and obligations of state and political subdivisions. The securities in the trading portfolio reflect those securities that the Company elects to account for at fair value, with the adoption of ASC Topic 825, Financial Instruments.

The Company's total securities portfolio at December 31, 2018 totaled $1.47 billion compared to $1.53 billion at December 31, 2017. The table below shows the composition of the available-for-sale securities portfolio as of year-end 2018, 2017 and 2016. The available-for-sale portfolio has decreased over the past two years as maturities, calls and sales have exceeded purchases in the portfolio. In addition, fair values were unfavorably impacted by changes in market interest rates. The balance of held-to-maturity securities has been fairly stable the past few years. The decrease in fair value in the held-to-maturity portfolio was primarily due to changes in market interest rates. Additional information on the securities portfolio is available in "Note 2 Securities" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report, which details the types of securities held, the carrying and fair values, and the contractual maturities as of December 31, 2018 and 2017.

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| Available-for-Sale Securities | As of December 31, 2018 | | 2017 | | 2016 | |
|---|---|---|---|---|---|---|
| (in thousands) | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| U.S. Treasuries | $289 | $289 | $0 | $0 | $0 | $0 |
| Obligations of U.S. Government sponsored entities | $493,371 | $485,898 | $507,248 | $504,193 | $527,057 | $527,627 |
| Obligations of U.S. states and political subdivisions | 86,260 | 85,440 | 91,659 | 91,519 | 89,910 | 89,056 |
| Mortgage-backed securities-residential, issued by | | | | | | |
| U.S. Government agencies | 131,831 | 128,267 | 139,747 | 137,735 | 159,417 | 158,226 |
| U.S. Government sponsored entities | 649,620 | 630,558 | 667,767 | 656,178 | 662,724 | 651,430 |
| Non-U.S. Government agencies or sponsored entities | 31 | 31 | 75 | 75 | 116 | 116 |
| U.S. corporate debt securities | 2,500 | 2,175 | 2,500 | 2,162 | 2,500 | 2,162 |
| Total available-for-sale securities | $1,363,902 | $1,332,658 | $1,408,996 | $1,391,862 | $1,441,724 | $1,428,617 |

| Held-to-Maturity Securities | 2018 | | 2017 | | 2016 | |
|---|---|---|---|---|---|---|
| (in thousands) | Amortized Cost | Fair Value | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Obligations of U.S. Government sponsored entities | $131,306 | $130,108 | $131,707 | $132,720 | $132,098 | $132,619 |
| Obligations of U.S. states and political subdivisions | 9,273 | 9,269 | 7,509 | 7,595 | 10,021 | 10,213 |
| Total held-to-maturity securities | $140,579 | $139,377 | $139,216 | $140,315 | $142,119 | $142,832 |

Quarterly, the Company evaluates all investment securities with a fair value less than amortized cost to identify any other-than-temporary impairment as defined under generally accepted accounting principles. The Company did not recognize any net credit impairment charge to earnings on investment securities in 2018, 2017, and 2016.

The Company uses a two-step modeling approach to analyze each non-agency CMO issue to determine whether or not the current unrealized losses are due to credit impairment and therefore other-than-temporarily impaired ("OTTI"). Step one in the modeling process applies default and severity credit vectors to each security based on current credit data detailing delinquency, bankruptcy, foreclosure and real estate owned (REO) performance. The results of the credit vector analysis are compared to the security's current credit support coverage to determine if the security has adequate collateral support. If the security's current credit support coverage falls below certain predetermined levels, step two is initiated. In step two, the Company uses a third party to assist in calculating the present value of current estimated cash flows to ensure there are no adverse changes in cash flows during the quarter leading to an other-than-temporary-impairment. Management's assumptions used in step two include default and severity vectors and prepayment assumptions along with various other criteria including: percent decline in fair value; credit rating downgrades; probability of repayment of amounts due, credit support and changes in average life. As a result of the modeling process, the Company does not consider any investment security to be other-than-temporarily impaired at December 31, 2018. Future changes in interest rates or the credit quality and credit support of the underlying issuers may reduce the market value of these and other securities. If such decline is determined to be other than temporary, the Company will record the necessary charge to earnings and/or accumulated other comprehensive income to reduce the securities to their then current fair value.

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The Company also holds non-marketable Federal Home Loan Bank New York ("FHLBNY") stock, non-marketable Federal Home Loan Bank Pittsburgh ("FHLBPITT") stock and non-marketable Atlantic Community Bankers Bank ("ACBB") stock, all of which are required to be held for regulatory purposes and for borrowing availability. The required investment in FHLB stock is tied to the Company's borrowing levels with the FHLB. Holdings of FHLBNY stock, FHLBPITT stock and ACBB stock totaled $37.4 million, $14.8 million and $95,000 at December 31, 2018, respectively. These securities are carried at par, which is also cost. The FHLBNY and FHLBPITT continue to pay dividends and repurchase stock. As such, the Company has not recognized any impairment on its holdings of FHLBNY and FHLBPITT stock. At December 31, 2017, the Company's holdings of FHLBNY stock, FHLBPITT stock, and ACBB stock totaled $34.2 million, $16.2 million, and $95,000, respectively.

Management's policy is to purchase investment grade securities that, on average, have relatively short expected durations. This policy helps mitigate interest rate risk and provides sources of liquidity without significant risk to capital. The contractual maturity distribution of debt securities and mortgage-backed securities as of December 31, 2018, along with the weighted average yield of each category, is presented in Table 3-Maturity Distribution below. Balances are shown at amortized cost and weighted average yields are calculated on a fully taxable-equivalent basis. Expected maturities will differ from contractual maturities presented in Table 3-Maturity Distribution below, because issuers may have the right to call or prepay obligations with or without penalty and mortgage-backed securities will pay throughout the periods prior to contractual maturity.

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Table 3 - Maturity Distribution

| | As of December 31, 2018 | | | |
|---|---|---|---|---|
| | Securities Available-for-Sale[1] | | Securities Held-to-Maturity | |
| (dollar amounts in thousands) | Amount | Yield[2] | Amount | Yield[2] |
| U.S. Treasury | | | | |
| Within 1 year | $289 | 0.00% | $0 | 0.00 % |
| | $289 | 0.00% | $0 | 0.00 % |
| Obligations of U.S. Government sponsored entities | | | | |
| Within 1 year | $69,123 | 1.73% | $0 | 0.00 % |
| Over 1 to 5 years | 327,326 | 2.02% | 86,170 | 2.32 % |
| Over 5 to 10 years | 96,922 | 2.83% | 45,136 | 2.71 % |
| | $493,371 | 2.14% | $131,306 | 2.45 % |
| Obligations of U.S. state and political subdivisions | | | | |
| Within 1 year | $8,748 | 2.57% | $8,850 | 3.09 % |
| Over 1 to 5 years | 28,173 | 2.30% | 350 | 4.60 % |
| Over 5 to 10 years | 42,638 | 2.84% | 73 | 7.11 % |
| Over 10 years | 6,701 | 3.59% | 0 | 0.00 % |
| | $86,260 | 2.69% | $9,273 | 3.18 % |
| Mortgage-backed securities - residential | | | | |
| Within 1 year | $0 | 0.00% | $0 | 0.00 % |
| Over 1 to 5 years | 1,577 | 4.52% | 0 | 0.00 % |
| Over 5 to 10 years | 184,968 | 2.17% | 0 | 0.00 % |
| Over 10 years | 594,937 | 2.46% | 0 | 0.00 % |
| | $781,482 | 2.40% | $0 | 0.00 % |
| Other securities | | | | |
| Over 10 years | $2,500 | 5.61% | $0 | 0.00 % |
| | $2,500 | 5.61% | $0 | 0.00 % |
| Total securities | | | | |
| Within 1 year | $78,160 | 1.82% | $8,850 | 3.09 % |
| Over 1 to 5 years | 357,076 | 2.05% | 86,520 | 2.33 % |
| Over 5 to 10 years | 324,528 | 2.46% | 45,209 | 2.72 % |
| Over 10 years | 604,138 | 2.49% | 0 | 0.00 % |
| | $1,363,902 | 2.33% | $140,579 | 2.50 % |

[1] Balances of available-for-sale securities are shown at amortized cost.
[2] Interest income includes the tax effects of taxable-equivalent adjustments using a combined New York State and Federal effective income tax rate of 24.5% to increase tax exempt interest income to taxable-equivalent basis.

The average taxable-equivalent yield on the securities portfolio was 2.24% in 2018, 2.19% in 2017 and 2.13% in 2016.

At December 31, 2018, there were no holdings of any one issuer, other than the U.S. Government sponsored entities, in an amount greater than 10% of the Company’s shareholders’ equity.

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Loans and Leases

Table 4 - Composition of Loan and Lease Portfolio

| Originated Loans and Leases | As of December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Commercial and industrial | | | | | |
| Agriculture | $107,494 | $108,608 | $118,247 | $88,299 | $78,507 |
| Commercial and industrial other | 926,429 | 932,067 | 847,055 | 768,024 | 688,529 |
| Subtotal commercial and industrial | 1,033,923 | 1,040,675 | 965,302 | 856,323 | 767,036 |
| Commercial real estate | | | | | |
| Construction | 164,285 | 202,486 | 135,834 | 103,037 | 72,427 |
| Agriculture | 170,005 | 129,712 | 102,509 | 86,935 | 58,994 |
| Commercial real estate other | 1,827,279 | 1,660,782 | 1,431,690 | 1,167,250 | 979,621 |
| Subtotal commercial real estate | 2,161,569 | 1,992,980 | 1,670,033 | 1,357,222 | 1,111,042 |
| Residential real estate | | | | | |
| Home equity | 208,459 | 212,812 | 209,277 | 202,578 | 186,957 |
| Mortgages | 1,083,802 | 1,039,040 | 947,378 | 823,841 | 710,904 |
| Subtotal residential real estate | 1,292,261 | 1,251,852 | 1,156,655 | 1,026,419 | 897,861 |
| Consumer and other | | | | | |
| Indirect | 12,663 | 12,144 | 14,835 | 17,829 | 18,298 |
| Consumer and other | 57,565 | 50,214 | 44,393 | 40,904 | 35,874 |
| Subtotal consumer and other | 70,228 | 62,358 | 59,228 | 58,733 | 54,172 |
| Leases | 14,556 | 14,467 | 16,650 | 14,861 | 12,251 |
| Total loans and leases | 4,572,537 | 4,362,332 | 3,867,868 | 3,313,558 | 2,842,362 |
| Less: unearned income and deferred costs and fees | (3,796) | (3,789) | (3,946) | (2,790) | (2,388) |
| Total originated loans and leases, net of unearned income and deferred costs and fees | $4,568,741 | $4,358,543 | $3,863,922 | $3,310,768 | $2,839,974 |
| | | | | | |
| Acquired Loans | | | | | |
| Commercial and industrial | | | | | |
| Commercial and industrial other | $43,712 | $50,976 | $79,317 | $84,810 | $97,034 |
| Subtotal commercial and industrial | 43,712 | 50,976 | 79,317 | 84,810 | 97,034 |
| Commercial real estate | | | | | |
| Construction | 1,384 | 1,480 | 8,936 | 4,892 | 35,906 |
| Agriculture | 224 | 247 | 267 | 2,095 | 3,182 |
| Commercial real estate other | 177,484 | 206,020 | 241,605 | 284,952 | 308,488 |
| Subtotal commercial real estate | 179,092 | 207,747 | 250,808 | 291,939 | 347,576 |
| Residential real estate | | | | | |
| Home equity | 21,149 | 28,444 | 37,737 | 42,092 | 56,008 |
| Mortgages | 20,484 | 22,645 | 25,423 | 27,491 | 32,282 |
| Subtotal residential real estate | 41,633 | 51,089 | 63,160 | 69,583 | 88,290 |
| Consumer and other | | | | | |
| Indirect | 0 | 0 | 0 | 0 | 0 |
| Consumer and other | 761 | 765 | 826 | 911 | 1,095 |
| Subtotal consumer and other | 761 | 765 | 826 | 911 | 1,095 |
| Covered loans | 0 | 0 | 0 | 14,031 | 19,319 |
| Total acquired loans and leases | $265,198 | $310,577 | $394,111 | $461,274 | $553,314 |

Total loans and leases of $4.8 billion at December 31, 2018 were up $164.8 million or 3.5% from December 31, 2017. The growth was mainly due to organic loan growth. On August 1, 2012, the Company acquired $889.3 million of loans in the VIST Financial acquisition. These loans are shown in the table under the acquired loan heading. All other loans, including loans originated by VIST Bank since the acquisition date of August 1, 2012, are considered originated loans. Originated loan balances at December 31, 2018 were up 4.8% over year-end 2017. The increase in originated loans, over prior year-end, was in all loan categories except commercial and industrial, which was relatively flat compared to prior year-end. As of December 31, 2018, total loans and leases represented 71.5% of total assets compared to 70.2% of total assets at December 31, 2017.

Residential real estate loans of $1.3 billion at December 31, 2018, including home equity loans, increased by $31.0 million or 2.4% from $1.3 billion at year-end 2017, and comprised 27.6% of total loans and leases at December 31, 2018. Growth in residential loan balances is impacted by the Company's decision to retain these loans or sell them in the secondary market due to interest rate considerations. The Company's Asset/Liability Committee meets regularly and establishes standards for selling and retaining residential real estate mortgage originations.

The Company may sell residential real estate loans in the secondary market based on interest rate considerations. These residential real estate loans are generally sold to Federal Home Loan Mortgage Corporation ("FHLMC") or State of New York Mortgage Agency ("SONYMA") without recourse in accordance with standard secondary market loan sale agreements. These residential real estate loans also are subject to customary representations and warranties made by the Company, including representations and warranties related to gross incompetence and fraud. The Company has not had to repurchase any loans as a result of these representations and warranties.

Over the past several years, the Company has retained the vast majority of residential real estate loan originations. However, the amount of residential real estate loans sold in the secondary market in 2018 was up over 2017. During 2018, 2017, and 2016, the Company sold residential mortgage loans totaling $27.7 million, $4.6 million, and $3.9 million, respectively, and realized net gains on these sales of $458,000, $50,000, and $95,000, respectively. When residential mortgage loans are sold to FHLMC or SONYMA, the Company typically retains all servicing rights, which provides the Company with a source of fee income. In connection with the sales in 2018, 2017, and 2016, the Company recorded mortgage-servicing assets of $207,000, $38,000, and $21,000, respectively.

The Company originates fixed rate and adjustable rate residential mortgage loans, including loans that have characteristics of both, such as a 7/1 adjustable rate mortgage, which has a fixed rate for the first seven years and then adjusts annually thereafter. The majority of residential mortgage loans originated over the last several years have been fixed rate given the low interest rate environment. Adjustable rate residential real estate loans may be underwritten based upon an initial rate which is below the fully indexed rate; however, the initial rate is generally less than 100 basis points below the fully indexed rate. As such, the Company does not believe that this practice creates any significant credit risk.

Commercial real estate loans totaled $2.3 billion at December 31, 2018; an increase of $139.9 million compared to December 31, 2017, and represented 48.4% of total loans and leases at December 31, 2018, compared to 47.1% at December 31, 2017.

Commercial and industrial loans totaled $1.1 billion at December 31, 2018, which is a decrease of $14.0 million from December 31, 2017. Commercial and industrial loans represented 22.3% of total loans at December 31, 2018 compared to 23.4% at December 31, 2017.

As of December 31, 2018, agriculturally-related loans totaled $277.7 million or 5.7% of total loans and leases compared to $238.6 million or 5.1% of total loans and leases at December 31, 2017. Agriculturally-related loans include loans to dairy farms and cash and vegetable crop farms. Agriculturally related loans are primarily made based

on identified cash flows of the borrower with consideration given to underlying collateral, personal guarantees, and government related guarantees. Agriculturally-related loans are generally secured by the assets or property being financed or other business assets such as accounts receivable, livestock, equipment or commodities/crops.

The consumer loan portfolio includes personal installment loans, indirect automobile financing, and overdraft lines of credit. Consumer and other loans were $71.0 million at December 31, 2018, compared to $63.1 million at December 31, 2017.

The lease portfolio increased by 0.6% to $14.6 million at December 31, 2018 from $14.5 million at December 31, 2017. As of December 31, 2018, commercial leases and municipal leases represented 100.0% of total leases.

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Acquired loans were recorded at fair value pursuant to the purchase accounting guidelines in FASB ASC 805 – "Fair Value Measurements and Disclosures" (as determined by the present value of expected future cash flows) with no valuation allowance (i.e., the allowance for loan losses). At acquisition, the Company evaluated whether each acquired loan (regardless of size) was within the scope of ASC 310-30, "Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality".

The carrying value of loans acquired from VIST and accounted for in accordance with ASC Subtopic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality," was $11.0 million at December 31, 2018, compared to $12.0 million at December 31, 2017 due to normal loan run off. Under ASC Subtopic 310-30, loans may be aggregated and accounted for as pools of loans if the loans being aggregated have common risk characteristics. The Company elected to account for the loans with evidence of credit deterioration individually rather than aggregate them into pools. The difference between the undiscounted cash flows expected at acquisition and the investment in the acquired loans, or the "accretable yield," is recognized as interest income utilizing the level-yield method over the life of each loan. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "non-accretable difference," are not recognized as a yield adjustment, as a loss accrual or as a valuation allowance.

Increases in expected cash flows subsequent to the acquisition are recognized prospectively through an adjustment of the yield on the loans over the remaining life, while decreases in expected cash flows are recognized as impairment through a loss provision and an increase in the allowance for loan losses. Valuation allowances (recognized in the allowance for loan losses) on these impaired loans reflect only losses incurred after the acquisition (representing all cash flows that were expected at acquisition but currently are not expected to be received).

The carrying value of loans not exhibiting evidence of credit impairment at the time of the acquisition (i.e. loans outside of the scope of ASC 310-30) was $254.2 million at December 31, 2018 as compared to $298.6 million at December 31, 2017 due to normal loan run off. The fair value of the acquired loans not exhibiting evidence of credit impairment was determined by projecting contractual cash flows discounted at risk-adjusted interest rates.

The carrying value of the acquired loans reflects management's best estimate of the amount to be realized from the acquired loan and lease portfolios. However, the amounts the Company actually realizes on these loans could differ materially from the carrying value reflected in these financial statements, based upon the timing of collections on the acquired loans in future periods, underlying collateral values and the ability of borrowers to continue to make payments.

Purchased performing loans were recorded at fair value, including a credit discount. Credit losses on acquired performing loans are estimated based on analysis of the performing portfolio. Such estimated credit losses are recorded as an accretable discount in a manner similar to purchased impaired loans. The fair value discount other than for credit loss is accreted as an adjustment to yield over the estimated lives of the loans. Interest is accrued daily on the outstanding principal balances of purchased performing loans. Fair value adjustments are also accreted into income over the estimated lives of the loans on a level yield basis.

The Company has adopted comprehensive lending policies, underwriting standards and loan review procedures. There were no significant changes to the Company's existing policies, underwriting standards and loan review during 2018. The Company's Board of Directors approves the lending policies at least annually. The Company recognizes that exceptions to policy guidelines may occasionally occur and has established procedures for approving exceptions to these policy guidelines. Management has also implemented reporting systems to monitor loan originations, loan quality, concentrations of credit, loan delinquencies and nonperforming loans and potential problem loans.

The Company’s loan and lease customers are located primarily in the New York and Pennsylvania communities served by its 4 subsidiary banks. Although operating in numerous communities in New York State and Pennsylvania, the Company is still dependent on the general economic conditions of these states. Other than geographic and general economic risks, management is not aware of any material concentrations of credit risk to any industry or individual borrower.

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Analysis of Past Due and Nonperforming Loans

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Loans 90 days past due and accruing* | | | | | |
| Commercial real estate | $0 | $0 | $0 | $0 | $0 |
| Residential real estate | 0 | 0 | 0 | 58 | 106 |
| Consumer and other | 0 | 44 | 0 | 0 | 0 |
| Total loans 90 days past due and accruing | 0 | 44 | 0 | 58 | 106 |
| Nonaccrual loans | | | | | |
| Commercial and industrial | 1,883 | 2,852 | 738 | 1,738 | 2,116 |
| Commercial real estate | 8,007 | 5,948 | 9,076 | 6,054 | 7,520 |
| Residential real estate | 12,072 | 10,363 | 9,061 | 9,863 | 9,043 |
| Consumer and other | 234 | 354 | 166 | 182 | 349 |
| Leases | 0 | 0 | 0 | 0 | 0 |
| Total nonaccrual loans and leases | 22,196 | 19,517 | 19,041 | 17,837 | 19,028 |
| Troubled debt restructurings not included above | 4,395 | 3,449 | 2,631 | 3,915 | 3,444 |
| Total nonperforming loans and leases | 26,591 | 23,010 | 21,672 | 21,810 | 22,578 |
| Other real estate owned | 1,595 | 2,047 | 908 | 2,692 | 5,683 |
| Total nonperforming assets | $28,186 | $25,057 | $22,580 | $24,502 | $28,261 |
| Total nonperforming loans and leases as a percentage of total loans and leases | 0.55 % | 0.49 % | 0.51 % | 0.58 % | 0.67 % |
| Total nonperforming assets as a percentage of total assets | 0.42 % | 0.38 % | 0.36 % | 0.43 % | 0.54 % |
| Allowance as a percentage of nonperforming loans and leases | 163.25 % | 172.84 % | 164.98 % | 146.74 % | 128.43 % |

* The 2018, 2017, 2016, 2015 and 2014 columns in the above table exclude $1.3 million, $1.1 million, $2.6 million, $2.5 million, and $3.5 million, respectively, of acquired loans that are 90 days past due and accruing interest. These loans were originally recorded at fair value on the acquisition date of August 1, 2012. These loans are considered to be accruing as the Company can reasonably estimate future cash flows on these acquired loans and the Company expects to fully collect the carrying value of these loans. Therefore, the Company is accreting the difference between the carrying value of these loans and their expected cash flows into interest income.

The level of nonperforming assets at the past five year-ends is illustrated in the table above. The ratio of nonperforming loans to total loans improved between 2014 and 2017, but was up slightly at year-end 2018. The Company's total nonperforming assets as a percentage of total assets was 0.42% at December 31, 2018, up from 0.38% at December 31, 2017, but continues to compare favorably to its peer group's most recent ratio of 0.61% at September 30, 2018. The peer data is from the Federal Reserve Board and represents banks or bank holding companies with assets between $3.0 billion and $10.0 billion.

A breakdown of nonperforming loans by portfolio segment is shown above. Nonperforming loans at December 31, 2018 were up 15.6% from December 31, 2017. Nonperforming loans represented 0.55% of total loans at December 31, 2018, compared to 0.49% of total loans at December 31, 2017, and 0.51% of total loans at December 31, 2016. The increase in nonperforming loans at year-end 2018 compared to year-end 2017 was mainly in commercial real estate and residential real estate loans, and partially offset by a decrease in commercial and industrial loans. The increase in commercial real estate nonaccrual loans was mainly due to the addition of one relationship loan totaling $4.8 million. The decrease in commercial and industrial nonaccrual loans reflects paydowns and loans returned to accruing status due to improved performance. At December 31, 2018, other real estate owned was down $452,000 from prior year-end and represented 5.7% of total nonperforming assets, down from 8.2% at December 31, 2017. The decrease in other real estate owned was mainly due to the write-down of one commercial real estate property during

2018.

Loans are considered modified in a troubled debt restructuring (“TDR”) when, due to a borrower’s financial difficulties, the Company makes a concession(s) to the borrower that the Company would not otherwise consider. When modifications are provided for reasons other than as a result of the financial distress of the borrower, these loans are not classified as TDRs or impaired. These modifications may include, among others, an extension of the term of the loan, and granting a period when interest-only payments can be made, with the principal payments made over the remaining term of the loan or at maturity. TDRs are included in the above table within the following categories: “loans 90 days past due and accruing”, “nonaccrual loans”, or “troubled debt restructurings not included above”. Loans in the latter category include loans that meet the definition of a TDR but are performing in accordance with the modified terms and have shown a satisfactory period of repayment (generally six consecutive months) and where full collection of all is reasonably assured. At December 31, 2018, the Company had $6.9 million in TDR balances, which are included in the above table; $4.4 million are included in the line captioned “Troubled debt restructurings not included above” and the remainder within nonaccrual loans.

In general, the Company places a loan on nonaccrual status if principal or interest payments become 90 days or more past due and/or management deems the collectability of the principal and/or interest to be in question, as well as when called for by regulatory requirements. Although in nonaccrual status, the Company may continue to receive payments on these loans. These payments are generally recorded as a reduction to principal and interest income is recorded only after principal recovery is reasonably assured. For additional financial information on the difference between the interest income that would have been recorded if these loans and leases had been paid in accordance with their original terms and the interest income that was recorded, refer to “Note 3 – Loans and Leases” in the Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

The Company’s recorded investment in originated loans and leases that are considered impaired totaled $14.2 million at December 31, 2018, and $12.1million at December 31, 2017. A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans consist of our non-homogenous nonaccrual loans and loans that are 90 days or more past due. Specific reserves on individually identified impaired loans that are not collateral dependent are measured based on the present value of expected future cash flows discounted at the original effective interest rate of each loan. For loans that are collateral dependent, impairment is measured based on the fair value of the collateral less estimated selling costs, and such impaired amounts are generally charged off.

At December 31, 2018, there was a specific reserve of $3.8 million on seven commercial loans in the originated loan portfolio, compared to a $441,000 reserve on seven commercial real estate loans at December 31, 2017. The increase in the specific reserve was mainly due to the addition of a $3.0 million specific reserve added to one loan in the fourth quarter of 2018. The majority of the remaining impaired loans are collateral dependent impaired loans that have limited exposure or require limited specific reserves because of the amount of collateral support with respect to these loans or the loans have been written down to fair value. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured. In these cases, interest is recognized on a cash basis. There was no interest income recognized on impaired loans and leases for 2018, 2017 and 2016.

The ratio of the allowance to nonperforming loans (loans past due 90 days and accruing, nonaccrual loans and restructured troubled debt) was 163.25% at December 31, 2018, compared to 172.84% at December 31, 2017. The Company’s nonperforming loans are mostly made up of collateral dependent impaired loans requiring little to no specific allowance due to the level of collateral available with respect to these loans and/or previous charge-offs.

Management reviews the loan portfolio for evidence of potential problem loans and leases. Potential problem loans and leases are loans and leases that are currently performing in accordance with contractual terms, but where known information about possible credit problems of the related borrowers causes management to have doubt as to the ability of such borrowers to comply with the present loan payment terms and may result in such loans and leases becoming

nonperforming at some time in the future. Management considers loans and leases classified as Substandard, which continue to accrue interest, to be potential problem loans and leases. The Company, through its credit administration function, identified 29 commercial relationships from the originated portfolio and 6 commercial relationships from the acquired portfolio totaling $33.7 million and $1.2 million, respectively at December 31, 2018 that were potential problem loans. At December 31, 2017, there were 28 relationships totaling $11.2 million in the originated portfolio and 10 relationships totaling $3.6 million in the acquired portfolio that were considered potential problem loans.

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Of the 29 commercial relationships from the originated portfolio that were classified as potential problem loans at December 31, 2018, there were 11 relationships that equaled or exceeded $1.0 million, which in aggregate totaled $30.1 million. Of the 6 commercial relationships from the acquired loan portfolio, there were no relationships that equaled or exceeded $1.0 million. The potential problem loans remain in a performing status due to a variety of factors, including payment history, the value of collateral supporting the credits, and personal or government guarantees. These factors, when considered in the aggregate, give management reason to believe that the current risk exposure on these loans does not warrant accounting for these loans as nonperforming. However, these loans do exhibit certain risk factors, which have the potential to cause them to become nonperforming. Accordingly, management's attention is focused on these credits, which are reviewed on at least a quarterly basis.

The Allowance for Loan and Lease Losses

Originated loans and leases

The methodology for determining the allowance is considered by management to be a critical accounting policy due to the high degree of judgment involved, the subjectivity of the assumptions utilized and the potential for changes in the economic environment that could result in changes to the amount of the allowance. Management's determination of the adequacy of the allowance is based on periodic evaluations of the loan portfolio and of current economic conditions.

Tompkins' model has been designed with certain key concepts in mind, including:

1. An acknowledgment that arriving at an appropriate allowance requires a high degree of management judgment.
2. The allowance should be maintained at a level appropriate to cover estimated losses on loans individually evaluated for impairment, as well as estimated credit losses inherent in the remainder of the portfolio.
3. Estimates of credit losses should consider all significant factors that affect the collectability of the portfolio as of the evaluation date.
4. Loss emergence period is a critical assumption in the allowance estimate, which represents the average amount of time between when loss events occur for specific loan types and when such problem loans are identified and the related loss amounts are confirmed through charge-offs.
5. The allowance should be based on a comprehensive, well-documented, and consistently applied analysis of the loan portfolio.

The model is comprised of four major components that management has deemed appropriate in evaluating the appropriateness of the allowance for loan and lease losses. While none of these components, when used independently, is effective in arriving at a reserve level that appropriately measures the risk inherent in the portfolio, management believes that using them collectively, provides reasonable measurement of the loss exposure in the portfolio. The components include:

1. Impaired Loans - Management considers a loan to be impaired if, based on current information, it is probable that the Company will be unable to collect all scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the effective interest rate of the loan or, as a practical expedient, at the observable market price or the fair value of collateral (less costs to sell) if the loan is collateral dependent. Management excludes large groups of smaller balance homogeneous loans such as residential mortgages, consumer loans, and leases, which are collectively evaluated.
2. Criticized and Classified Credits – For loans that are not impaired, but are rated special mention or worse, management evaluates credits based on elevated risk characteristics and assigns reserves based upon analysis of historical loss experience of loans with similar risk characteristics.
3.

Historical Loss Experience - For loans that are not impaired, or reviewed individually, management assigns a reserve based upon historical loss experience over a designated look-back period. Management has evaluated a variety of look-back periods and has determined that an eight year look back period is appropriate to capture a full range of economic cycles.

4. Qualitative/Subjective Analysis – The model also includes an analysis of a variety of subjective factors to support the reserve estimate. These subjective factors may include reserve allocations for risks that may not otherwise be fully recognized in other components of the model. Among the subjective factors that are routinely considered as part of this analysis are: growth trends in the portfolio, changes in management and/or polices related to lending activities, trends in classified or past due/nonaccrual loans, concentrations of credit, local and national economic trends, and industry trends.

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Periodically, management conducts an analysis to estimate the loss emergence period for various loan categories based on samples of historical charge-offs. Model output by loan category is reviewed to evaluate the reasonableness of the reserve levels in comparison to the estimated loss emergence period applied to historical loss experience.

In addition to the components discussed above, management reviews the model output for reasonableness by analyzing the results in comparisons to recent trends in the loan/lease portfolio, through back-testing of results from prior models in comparison to actual loss history, and by comparing our reserves and loss history to industry peer results.

The model results are reviewed by management at the Corporate Credit Policy Committee and at the Audit Committee of the Board of Directors. Additionally, on an annual basis, management conducts a validation process of the model. This validation includes reviewing the appropriateness of model calculations, back testing of model results and appropriateness of key assumptions used in the model.

Although we believe our process for determining the allowance adequately considers all of the factors that would likely result in credit losses, this evaluation is inherently subjective as it requires material estimates, including expected default probabilities, loss emergence periods, the amounts and timing of expected future cash flows on impaired loans, and estimated losses based on historical loss experience and current economic conditions. All of these factors may be susceptible to significant change. To the extent that actual results differ from management estimates, additional loan loss provisions may be required that would adversely impact earnings for future periods. Based on its evaluation of the allowance as of December 31, 2018, management considers the allowance to be appropriate. Under adversely or positively different conditions or assumptions, the Company would need to increase or decrease the allowance.

Acquired Loans and Leases
As part of our determination of the fair value of our acquired loans at the time of acquisition, the Company established a credit mark to provide for expected losses in our acquired loan portfolio. There was no allowance for loan losses carried over from the acquired company. To the extent that credit quality deteriorates subsequent to acquisition, such deterioration would result in the establishment of an allowance for the acquired loan portfolio.

Acquired loans accounted for under ASC 310-30

Acquired loans were accounted for under ASC 310-30, and our allowance for loan losses is estimated based upon our expected cash flows for these loans. To the extent that we experience a deterioration in borrower credit quality resulting in a decrease in our expected cash flows subsequent to the acquisition of the loans, an allowance for loan losses would be established based on our estimate of future credit losses over the remaining life of the loans.

Acquired loans accounted for under ASC 310-20

We establish our allowance for loan losses through a provision for credit losses based upon an evaluation process that is similar to our evaluation process used for originated loans. This evaluation, which includes a review of loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical net loan loss experience, carrying value of the loans, which includes the remaining net purchase discount or premium, and other factors that warrant recognition in determining our allowance for loan losses.

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The allocation of the Company's allowance as of December 31, 2018, and each of the previous four years is illustrated in Table 5- Allocation of the Allowance for Loan and Lease Losses, below.

Table 5 - Allocation of the Allowance for Originated and Acquired Loan and Lease Losses

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Originated loans outstanding at end of year | $4,568,741 | $4,358,543 | $3,863,922 | $3,310,768 | $2,839,974 |
| Allocation of the originated allowance by originated loan type: | | | | | |
| Commercial and industrial | $11,217 | $11,812 | $9,389 | $10,495 | $9,157 |
| Commercial real estate | 23,483 | 20,412 | 19,836 | 15,479 | 12,069 |
| Residential real estate | 7,317 | 6,161 | 5,149 | 4,070 | 5,030 |
| Consumer and other | 1,304 | 1,301 | 1,224 | 1,268 | 1,900 |
| Total | $43,321 | $39,686 | $35,598 | $31,312 | $28,156 |
| Allocation of the originated allowance as a percentage of total originated allowance: | | | | | |
| Commercial and industrial | 26 % | 30 % | 27 % | 34 % | 32 % |
| Commercial real estate | 54 % | 51 % | 56 % | 49 % | 43 % |
| Residential real estate | 17 % | 16 % | 14 % | 13 % | 18 % |
| Consumer and other | 3 % | 3 % | 3 % | 4 % | 7 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |
| Loan and lease types as a percentage of total originated loans and leases: | | | | | |
| Commercial and industrial | 23 % | 24 % | 25 % | 26 % | 27 % |
| Commercial real estate | 47 % | 46 % | 43 % | 41 % | 39 % |
| Residential real estate | 28 % | 29 % | 30 % | 31 % | 32 % |
| Consumer and other | 2 % | 1 % | 2 % | 2 % | 2 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |

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| | As of December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Acquired loans outstanding at end of year | $265,198 | $310,577 | $394,111 | $461,274 | $553,314 |
| | | | | | |
| Allocation of the acquired allowance by acquired loan type: | | | | | |
| Commercial and industrial | $55 | $25 | $0 | $433 | $431 |
| Commercial real estate | 0 | 0 | 97 | 61 | 337 |
| Residential real estate | 28 | 54 | 54 | 198 | 51 |
| Consumer and other | 6 | 6 | 6 | 0 | 22 |
| Total | $89 | $85 | $157 | $692 | $841 |
| | | | | | |
| Allocation of the acquired allowance as a percentage of total acquired allowance: | | | | | |
| Commercial and industrial | 62 % | 29 % | 0 % | 62 % | 51 % |
| Commercial real estate | 0 % | 0 % | 62 % | 9 % | 40 % |
| Residential real estate | 31 % | 64 % | 34 % | 29 % | 6 % |
| Consumer and other | 7 % | 7 % | 4 % | 0 % | 3 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |
| Loan and lease types as a percentage of total acquired loans and leases: | | | | | |
| Commercial and industrial | 16 % | 16 % | 20 % | 18 % | 18 % |
| Commercial real estate | 68 % | 67 % | 64 % | 64 % | 63 % |
| Residential real estate | 16 % | 17 % | 16 % | 15 % | 16 % |
| Consumer and other | 0 % | 0 % | 0 % | 0 % | 0 % |
| Covered | 0 % | 0 % | 0 % | 3 % | 3 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |

The above tables provide, as of the dates indicated, an allocation of the allowance for probable and inherent loan losses by loan type. The allocation is neither indicative of the specific amounts or the loan categories in which future charge-offs may occur, nor is it an indicator of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

The five year trend in the allowance is shown above. Over the five year period, the originated allowance has steadily increased driven in large part by growth in originated loans, while the acquired portfolio has steadily decreased, reflecting run-off of the acquired portfolio, improving asset quality metrics in the acquired portfolio, and net charge-offs. As of December 31, 2018, the total allowance for loan and lease losses was $43.4 million, which was up $3.6 million or 9.2% from year-end 2017. The year-end allowance for originated loans and leases was up $3.6 million compared to prior year end, and the allowance for acquired loans was up $4,000 from year-end 2017. At December 31, 2018, the total allowance was 163.25% of total nonperforming loans compared to 172.84% at December 31, 2017.

The Company's allowance for originated loan and lease losses totaled $43.3 million at December 31, 2018, which represented 0.95% of total originated loans, compared to 0.91% reported at December 31, 2017. The $3.6 million or 9.2% increase in the allowance for originated loans in 2018 over 2017 was mainly due to the 4.8% growth in the originated loan portfolio over 2017, and an impairment reserve related to the downgrade of a single commercial real estate relationship in the fourth quarter of 2018. The latter contributed to the increase in the allocation for commercial real estate loans shown in the originated allowance table above. Asset quality metrics in the originated portfolio remain favorable at December 31, 2018 but did show some deterioration from December 31, 2017. Originated loans internally-classified as Special Mention and Substandard totaled $72.0 million at December 31, 2018, up from $66.7 million at year-end 2017. Loans classified as Substandard increased by $23.4 million over December 31, 2017, while loans classified as Special Mention were down by $16.3 million. Nonaccrual originated loans were $19.3 million as of December 31, 2018, up $3.1 million from year-end 2017. Net charge-offs of originated loans were $262,000 or 0.1%

of average originated loans in 2018 compared to net charge-offs of $140,000 or 0.0% of average originated loans in 2017.

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The allowance for acquired loans and leases was $89,000 at December 31, 2018, up 4.7% over prior year end. The amount of acquired loans internally-classified as Special Mention and Substandard at December 31, 2018 was down $4.3 million or 55.8% compared to December 31, 2017, reflecting successful workouts and related paydowns and charge-offs during 2018. Net charge-offs of acquired loans totaled $41,000 in 2018 compared to net charge-offs of $5,000 in 2017. Acquired nonaccrual loans totaled $2.9 million at December 31, 2018, compared to $3.3 million at December 31, 2017.

The level of future charge-offs is dependent upon a variety of factors such as national and local economic conditions, trends in, various industries, underwriting characteristics, and conditions unique to each borrower. Given uncertainties surrounding these factors, it is difficult to estimate future losses.

Table 6 - Analysis of the Allowance for Originated and Acquired Loan and Lease Losses

| | December 31, | | | | |
|---|---|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 | 2015 | 2014 |
| Average originated loans outstanding during year | $4,472,682 | $4,051,298 | $3,525,649 | $3,023,456 | $2,624,282 |
| Balance of allowance at beginning of year | 39,686 | 35,598 | 31,312 | 28,156 | 26,700 |
| | | | | | |
| Originated loans charged-off: | | | | | |
| Commercial and industrial | 293 | 291 | 878 | 221 | 470 |
| Commercial real estate | 60 | 21 | 12 | 363 | 639 |
| Residential real estate | 424 | 584 | 263 | 338 | 512 |
| Consumer and other | 1,350 | 960 | 521 | 1,074 | 1,308 |
| Leases | 0 | 0 | 0 | 0 | 0 |
| Total loans charged-off | $2,127 | $1,856 | $1,674 | $1,996 | $2,929 |
| | | | | | |
| Recoveries of originated loans previously charged-off: | | | | | |
| Commercial and industrial | 50 | 119 | 576 | 809 | 636 |
| Commercial real estate | 812 | 980 | 859 | 1,277 | 1,832 |
| Residential real estate | 324 | 212 | 63 | 112 | 88 |
| Consumer and other | 679 | 405 | 325 | 487 | 536 |
| Total loan recoveries | $1,865 | $1,716 | $1,823 | $2,685 | $3,092 |
| Net loan charge-offs and (recoveries) | 262 | 140 | (149) | (689) | (163) |
| Additions to allowance charged to operations | 3,897 | 4,228 | 4,137 | 2,467 | 1,293 |
| Balance of originated allowance at end of year | $43,321 | $39,686 | $35,598 | $31,312 | $28,156 |
| Originated allowance as a percentage of originated loans and leases outstanding | 0.95% | 0.91% | 0.92% | 0.95% | 0.99% |
| Net (recoveries) charge-offs as a percentage of average originated loans and leases outstanding during the year | 0.01% | 0.00% | 0.00% | (0.02)% | (0.01)% |

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| (in thousands) | December 31, 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Average acquired loans outstanding during year | $284,901 | $349,915 | $431,572 | $508,490 | $614,740 |
| Balance of allowance at beginning of year | 85 | 157 | 692 | 841 | 1,270 |
| Acquired loans charged-off: | | | | | |
| Commercial and industrial | 41 | 74 | 698 | 77 | 293 |
| Commercial real estate | 82 | 159 | 181 | 400 | 631 |
| Residential real estate | 190 | 483 | 35 | 302 | 484 |
| Consumer and other | 0 | 2 | 121 | 6 | 51 |
| Total loans charged-off | $313 | $718 | $1,035 | $785 | $1,459 |
| Recoveries of acquired loans previously charged-off: | | | | | |
| Commercial and industrial | 106 | 24 | 20 | 7 | 0 |
| Commercial real estate | 31 | 637 | 268 | 142 | 0 |
| Residential real estate | 135 | 44 | 0 | 9 | 0 |
| Consumer and other | 0 | 8 | 28 | 0 | 17 |
| Total loan recoveries | $272 | $713 | $316 | $158 | $17 |
| Net loans charged-off | 41 | 5 | 719 | 627 | 1,442 |
| Additions (reductions) to allowance charged to operations | 45 | (67) | 184 | 478 | 1,013 |
| Balance of acquired allowance at end of year | $89 | $85 | $157 | $692 | $841 |
| Acquired allowance as a percentage of acquired loans outstanding | 0.03% | 0.02% | 0.04% | 0.14% | 0.14% |
| Net charge-offs as a percentage of average acquired loans and leases outstanding during the year | 0.01% | 0.00% | 0.17% | 0.12% | 0.23% |
| Total net charge-offs as a percentage of average total loans and leases outstanding during the year | 0.01% | 0.00% | 0.00% | 0.00% | 0.04% |

The provision for loan and lease losses represents management's estimate of the expense necessary to maintain the allowance for loan and lease losses at an appropriate level. The above table generally shows an increase in provision expense for the originated portfolio and a decrease in provision expense for the acquired portfolio over the period from 2014 to 2018. The increase in provision expense for the originated portfolio largely reflects the growth in the originated portfolio over that period. Asset quality has been generally favorable over the period. The provision expense for originated loans over the past five years benefited from significant recoveries on two commercial/commercial real estate relationships that resulted in net loan recoveries on originated loans in 2016, 2015, and 2014 and smaller net charge-offs in 2018 and 2017. Provision expense for the acquired portfolio showed an increase from 2017, but showed decreases from 2014 through 2017. Asset quality trends for the acquired portfolio continue to show improvement as evidenced by low net charge-offs and lower Special Mention and Substandard loans.

The ratio of the allowance for originated loan and lease losses as a percentage of total originated loans was 0.95% at year-end 2018 compared to 0.91% at year-end 2017. The allowance coverage to nonperforming loans and leases was 163.25% at December 31, 2018 compared to 172.84% at December 31, 2017. Management believes that, based upon its evaluation as of December 31, 2018, the allowance is appropriate.

Deposits and Other Liabilities

Total deposits were $4.9 billion at December 31, 2018, an increase of $51.2 million or 1.1% compared to year-end 2017. The increase from year-end 2017 consisted of savings and money market balances (up $201.6 million), which is partially offset by noninterest bearing deposits (down $39.5 million) and time deposits (down $111.0 million).

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The most significant source of funding for the Company is core deposits. The Company defines core deposits as total deposits less time deposits of $250,000 or more, brokered deposits and municipal money market deposits. Core deposits increased by $113.4 million or 2.8% to $4.1 billion at year-end 2018 from $4.0 billion at year-end 2017. Core deposits represented 84.0% of total deposits at December 31, 2018, compared to 82.6% of total deposits at December 31, 2017.

Municipal money market accounts totaled $577.6 million at year-end 2018, which was an increase of 5.8% over year-end 2017. In general, there is a seasonal pattern to municipal deposits starting with a low point during July and August. Account balances tend to increase throughout the fall and into the winter months from tax deposits and receive an additional inflow at the end of March from the electronic deposit of state funds.

Table 1-Average Statements of Condition and Net Interest Analysis, shows the average balance and average rate paid on the Company's primary deposit categories for the years ended December 31, 2018, 2017, and 2016. Average interest-bearing deposits were flat for 2018 when compared to 2017. The average cost of interest-bearing deposits was 0.48% for 2018 and 0.35% for 2017. Average noninterest bearing deposits at December 31, 2018 were up $103.5 million or 8.1% over year-end 2017. A maturity schedule of time deposits outstanding at December 31, 2018 is included in "Note 7 Deposits" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

The Company uses both retail and wholesale repurchase agreements. Retail repurchase agreements are arrangements with local customers of the Company, in which the Company agrees to sell securities to the customer with an agreement to repurchase those securities at a specified later date. Retail repurchase agreements totaled $81.8 million at December 31, 2018, and $75.2 million at December 31, 2017. Management generally views local repurchase agreements as an alternative to large time deposits. Refer to "Note 8 Federal Funds Purchased and Securities Sold Under Agreements to Repurchase" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report for further details on the Company's repurchase agreements.

The Company's other borrowings totaled $1.1 billion at year-end 2018, which was in line with prior year. The increase was to support loan growth in excess of deposit growth. The $1.1 billion in borrowings at December 31, 2018, included $647.1 million in overnight advances from the FHLB, $425.0 million in term advances from the FHLB and a $4.0 million advance from a third party bank. Borrowings at year-end 2017 included $587.7 million in overnight advances from the FHLB, $475.0 million of FHLB term advances, and a $9.0 million advance from a bank. Of the $425.0 million of the FHLB term advances at year-end 2018, $150.0 million are due in over one year. Refer to "Note 9 Other Borrowings" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report for further details on the Company's term borrowings with the FHLB.

## LIQUIDITY MANAGEMENT

The objective of liquidity management is to ensure the availability of adequate funding sources to satisfy the demand for credit, deposit withdrawals, operating expenses, and business investment opportunities. The Company's large, stable core deposit base and strong capital position are the foundation for the Company's liquidity position. The Company uses a variety of resources to meet its liquidity needs, which include deposits, cash and cash equivalents, short-term investments, cash flow from lending and investing activities, repurchase agreements, and borrowings. The Company may also use borrowings as part of a growth strategy. Asset and liability positions are monitored primarily through the Asset/Liability Management Committee of the Company's subsidiary banks. This Committee reviews periodic reports on the liquidity and interest rate sensitivity positions. Comparisons with industry and peer groups are also monitored. The Company's strong reputation in the communities it serves, along with its strong financial condition, provides access to numerous sources of liquidity as described below. Management believes these diverse liquidity sources provide sufficient means to meet all demands on the Company's liquidity that are reasonably likely to occur.

Core deposits, discussed above under “Deposits and Other Liabilities”, are a primary and low cost funding source obtained primarily through the Company’s branch network. In addition to core deposits, the Company uses non-core funding sources to support asset growth. These non-core funding sources include time deposits of $250,000 or more, brokered time deposits, national deposit listing services, municipal money market deposits, bank borrowings, securities sold under agreements to repurchase, overnight borrowings and term advances from the FHLB and other funding sources. Rates and terms are the primary determinants of the mix of these funding sources.

Non-core funding sources totaled $1.9 billion at December 31, 2018, a decrease of $51.3 million or 2.6% from $2.0 billion at December 31, 2017. Non-core funding sources decreased year-over-year as the Company experienced sufficient growth in core deposits to fund earning asset growth. Non-core funding sources as a percentage of total liabilities decreased from 32.8% at year-end 2017 to 31.6% at year-end 2018.

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Non-core funding sources may require securities to be pledged against the underlying liability. Securities carried at $1.2 billion at December 31, 2018 and $1.3 billion at December 31, 2017, were either pledged or sold under agreements to repurchase. Pledged securities or securities sold under agreements to repurchase represented 77.8% of total securities at December 31, 2018, compared to 84.3% of total securities at December 31, 2017.

Cash and cash equivalents totaled $80.4 million as of December 31, 2018, down from $84.3 million at December 31, 2017. Short-term investments, consisting of securities due in one year or less, increased from $57.9 million at December 31, 2017, to $86.8 million at December 31, 2018.

Cash flow from the loan and investment portfolios provides a significant source of liquidity. These assets may have stated maturities in excess of one year, but they have monthly principal reductions. Total mortgage-backed securities, at fair value, were $758.9 million at December 31, 2018 compared with $794.0 million at December 31, 2017. Outstanding principal balances of residential mortgage loans, consumer loans, and leases totaled approximately $1.4 billion at December 31, 2018 as compared to $1.4 billion at December 31, 2017. Aggregate amortization from monthly payments on these assets provides significant additional cash flow to the Company.

Liquidity is enhanced by ready access to national and regional wholesale funding sources including Federal funds purchased, repurchase agreements, brokered certificates of deposit, and FHLB advances. Through its subsidiary banks, the Company has borrowing relationships with the FHLB and correspondent banks, which provide secured and unsecured borrowing capacity. At December 31, 2018, the unused borrowing capacity on established lines with the FHLB was $1.0 billion.

As members of the FHLB, the Company’s subsidiary banks can use certain unencumbered mortgage-related assets and securities to secure additional borrowings from the FHLB. At December 31, 2018, total unencumbered mortgage loans and securities of the Company were $554.3 million. Additional assets may also qualify as collateral for FHLB advances upon approval of the FHLB.

The Company has not identified any trends or circumstances that are reasonably likely to result in material increases or decreases in liquidity in the near term.

Table 7 - Loan Maturity

| Remaining maturity of originated loans | December 31, 2018 | | | |
|---|---|---|---|---|
| (in thousands) | Total | Less than 1 year | After 1 year to 5 years | After 5 years |
| Commercial and industrial | $1,033,923 | $258,420 | $301,245 | $474,258 |
| Commercial real estate | 2,161,569 | 107,468 | 254,418 | 1,799,683 |
| Residential real estate | 1,292,261 | 255 | 14,982 | 1,277,024 |
| Total | $4,487,753 | $366,143 | $570,645 | $3,550,965 |

| Remaining maturity of acquired loans | December 31, 2018 | | | |
|---|---|---|---|---|
| (in thousands) | Total | Less than 1 year | After 1 year to 5 years | After 5 years |
| Commercial and industrial | $43,712 | $9,392 | $15,538 | $18,782 |
| Commercial real estate | 179,092 | 13,309 | 84,977 | 80,806 |
| Residential real estate | 41,633 | 139 | 3,880 | 37,614 |
| Total | $264,437 | $22,840 | $104,395 | $137,202 |

Of the loan amounts shown above in Table 7 - Loan Maturity, maturing over 1 year, $1.9 billion have fixed rates and $2.4 billion have adjustable rates.

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## OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of business the Company is party to certain financial instruments, which in accordance with accounting principles generally accepted in the United States, are not included in its Consolidated Statements of Condition. These transactions include commitments under standby letters of credit, unused portions of lines of credit, and commitments to fund new loans and are undertaken to accommodate the financing needs of the Company's customers. Loan commitments are agreements by the Company to lend monies at a future date. These loan and letter of credit commitments are subject to the same credit policies and reviews as the Company's loans. Because most of these loan commitments expire within one year from the date of issue, the total amount of these loan commitments as of December 31, 2018, are not necessarily indicative of future cash requirements. Further information on these commitments and contingent liabilities is provided in "Note 17 Commitments and Contingent Liabilities" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report.

## CONTRACTUAL OBLIGATIONS

The Company leases land, buildings, and equipment under operating lease arrangements extending to the year 2090. Most leases include options to renew for periods ranging from 5 to 20 years. In addition, the Company has a software contract for its core banking application through June 30, 2024 along with contracts for more specialized software programs through 2020. Further information on the Company's lease arrangements is provided in "Note 6 Premises and Equipment" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Report. The Company's contractual obligations as of December 31, 2018, are shown in Table 8-Contractual Obligations and Commitments below.

Table 8 - Contractual Obligations and Commitments

| Contractual cash obligations | At December 31, 2018<br>Payments due within | | | | |
|---|---|---|---|---|---|
| (in thousands) | Total | 1 year | 1-3 years | 3-5 years | After 5 years |
| Long-term debt | $437,366 | $285,442 | $151,924 | $0 | $0 |
| Trust Preferred Debentures[1] | 35,518 | 1,149 | 2,298 | 2,298 | 29,773 |
| Operating leases | 32,267 | 4,790 | 7,640 | 6,815 | 13,022 |
| Software contracts | 8,984 | 2,168 | 3,383 | 2,727 | 706 |
| Total contractual cash obligations | $514,135 | $293,549 | $165,245 | $11,840 | $43,501 |

[1] Dollar amounts include interest payments and contractual payments due until maturity without conversion to stock or early redemption for the remainder of the Company's Trust Preferred Debentures.

## RECENTLY ISSUED ACCOUNTING STANDARDS

Refer to "Note 1 Summary of Significant Accounting Policies" in Notes to Consolidated Financial Statements in Part II, Item 8. of this Form 10-K for details of recently issued accounting pronouncements and their expected impact on the Company's financial statements.

## Fourth Quarter Summary

Net income for the fourth quarter of 2018 was $18.9 million, up from $2.5 million for the same period in 2017. Diluted earnings per share of $1.23 for the fourth quarter of 2018 were up from $0.16 in the fourth quarter of 2017. Fourth quarter 2017 net income was adversely impacted by the TCJA, which reduced the Federal statutory tax rate from 35% in 2017 to 21% in 2018 and beyond. The change in the tax law created a one-time, non-cash write-down of net deferred tax assets in the amount of $14.9 million in the fourth quarter of 2017 due to the required remeasurement

of the net deferred tax assets using the new lower tax rate. Removing the impact of that one-time charge from 2017 fourth quarter earnings would have resulted in diluted earnings per share of $1.15 for the fourth quarter of 2017. For the fourth quarter of 2018, adjusted diluted earnings per share of $1.23 reflected an increase of 7.0% over the $1.15 adjusted diluted earnings per share reported in same quarter last year. Please see the discussion above under "Results of Operations (Comparison of December 31, 2018 and 2017 results) Non-GAAP Disclosure" for an explanation of why management believes this non-GAAP financial measure is useful, and a reconciliation to diluted earnings per share.

Net interest income of $53.2 million for the fourth quarter of 2018 was up 2.4% over the same period in 2017. The increase reflects growth in average earning assets of $204.7 million or 3.3% over the same quarter in 2017. The growth in average earning assets

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was mainly in average loans and leases, which were up $262.6 million or 5.8% over average loans and leases for the fourth quarter of 2017. The yield on average interest earning assets of 4.10% for the fourth quarter of 2018 was up 23 basis points from 3.87% for the fourth quarter of 2017. The average cost of interest bearing liabilities for the fourth quarter of 2018 of 1.04% was up 42 basis points compared to the fourth quarter of 2017. Average deposits for the fourth quarter of 2018 increased $78.1 million, or 1.6% compared to the same period in 2017. Included in the growth of average deposits during 2018 was a $39.7 million increase in average noninterest bearing deposits, up 2.9% from the fourth quarter of 2017.

Net interest margin for the fourth quarter of 2018 was 3.34%, down from 3.42% for the fourth quarter of 2017. The decline in margin over the prior year period was largely due to increases in market interest rates, which resulted in funding costs rising at a faster pace than asset yields.

Provision for loan and lease losses was $2.1 million for the fourth quarter of 2018 compared to $2.0 million in the fourth quarter of 2017. The provision in the fourth quarter of 2018 was mainly driven by an impairment reserve related to the downgrade of a single commercial real estate relationship in the fourth quarter of 2018. The provision expense for the fourth quarter of 2017 was mainly due to the growth in the originated loan portfolio during the quarter. Growth in the originated portfolio in the fourth quarter of 2017 totaled $191.3 million or 4.6% over the third quarter of 2017, compared to growth in the fourth quarter of 2018 of $37.5 million or 0.8% over the third quarter of 2018. Net charge-offs for the fourth quarter of 2018 were $6,000 compared to net charge-offs of $281,000 in the fourth quarter of 2017.

Noninterest income was $19.9 million for the fourth quarter of 2018, up $2.5 million or 14.7% compared to the same period in 2017. Contributing to the increase in noninterest income was $2.5 million related to the collection of fees and nonaccrual interest for a credit that was charged off in 2010.

Noninterest expense was $47.2 million for the fourth quarter of 2018, up $0.9 million or 2.0% over the fourth quarter of 2017. Expenses associated with salaries and wages and employee benefits are the largest component of total noninterest expense. For the fourth quarter of 2018, these expenses increased $1.1 million or 4.0% compared to the fourth quarter of 2017. Salaries and wages increased $0.5 million or 2.4% in the fourth quarter of 2018 over the same period in the prior year, mainly as a result of annual merit-based adjustments as well as some wage increases related to tax reform initiatives. Other employee benefits increased $0.6 million or 9.8% over 2017. The increase over prior year in other employee benefit expenses was mainly in health insurance, which was up $0.6 million or 25.6% in the fourth quarter of 2018 over the fourth quarter of 2017. Other expenses for the fourth quarter of 2018 included an increase of $1.5 million in professional fees, primarily related to investments in strengthening the Company’s compliance and information security infrastructure. Other expenses for the fourth quarter of 2017 included a $2.7 million write-off of a historic tax credit investment, which was placed in service in 2017, resulting in the write-off of the investment and recognition of the $3.3 million of tax credits as a reduction of income tax expense.

Income tax expense for the fourth quarter of 2018 was $4.6 million compared to $18.5 million for the fourth quarter of 2017. The decrease is a direct result of the change in the Federal statutory rate from 35% in 2017 to 21% in 2018 as a result of the Tax Cuts and Jobs Act of 2017. In addition, the change in the tax rate also resulted in a $14.9 million non-cash write-down of net deferred tax assets recorded in the fourth quarter of 2017, which was partially offset by the $3.3 million historic tax credit recognized in the fourth quarter of 2017.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market Risk

Interest rate risk is the primary market risk category associated with the Company's operations. Interest rate risk refers to the volatility of earnings caused by changes in interest rates. The Company manages interest rate risk using income simulation to measure interest rate risk inherent in its on-balance sheet and off-balance sheet financial instruments at a given point in time by showing the potential effect of interest rate shifts on net interest income for future periods. Each quarter the Company's Asset/Liability Management Committee reviews the simulation results to determine whether the exposure of net interest income to changes in interest rates remains within Board-approved levels. The Committee also discusses strategies to manage this exposure and incorporates these strategies into the investment and funding decisions of the Company. The Company does not currently use derivatives, such as interest rate swaps, to manage its interest rate risk exposure, but may consider such instruments in the future.

The Company's Board of Directors has set a policy that interest rate risk exposure will remain within a range whereby net interest income will not decline by more than 10% in one year as a result of a 100 basis point parallel change in rates. Based upon the simulation analysis performed as of November 30, 2018, a 200 basis point parallel upward change in interest rates over a one-year time frame would result in a one-year decrease in net interest income of approximately 3.7% from the base case, while a 200 basis

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point parallel decline in interest rates over a one-year period would result in a one-year increase in net interest income of approximately 0.9% from the base case. The simulation assumes no balance sheet growth and no management action to address balance sheet mismatches.

The decrease in net interest income in the rising rate scenario is a result of the balance sheet showing a more liability sensitive position over a one year time horizon. As such, in the short-term net interest income is expected to trend slightly below the base assumption, as upward adjustments to rate sensitive deposits and short-term funding outpace increases to asset yields which are concentrated in intermediate to longer-term products. As intermediate and longer-term assets continue to reprice/adjust into higher rate environment and funding costs stabilize, net interest income is expected to trend upwards.

The exposure in the 200 basis point decline scenario results from the Company's assets repricing downward to a greater degree than the rates on the Company's interest-bearing liabilities, mainly deposits. Rates on savings and money market accounts have recently experienced slight increases compared with the historically low interest rate environment experienced in prior years; allowing for some interest expense relief in the first year of the declining rate scenario. In addition, the model assumes that prepayments accelerate in the down interest rate environment resulting in additional pressure on asset yields as proceeds are reinvested at lower rates.

The most recent simulation of a base case scenario, which assumes interest rates remain unchanged from the date of the simulation, reflects a net interest margin that is stable to higher over the next 12 to 18 months.

Although the simulation model is useful in identifying potential exposure to interest rate movements, actual results may differ from those modeled as the repricing, maturity, and prepayment characteristics of financial instruments may change to a different degree than modeled. In addition, the model does not reflect actions that management may employ to manage its interest rate risk exposure. The Company's current liquidity profile, capital position, and growth prospects, offer a level of flexibility for management to take actions that could offset some of the negative effects of unfavorable movements in interest rates. Management believes the current exposure to changes in interest rates is not significant in relation to the earnings and capital strength of the Company.

In addition to the simulation analysis, management uses an interest rate gap measure. Table 9-Interest Rate Risk Analysis below is a Condensed Static Gap Report, which illustrates the anticipated repricing intervals of assets and liabilities as of December 31, 2018. The Company's one-year interest rate gap was a negative $897.7 million or 13.28% of total assets at December 31, 2018, compared with a negative $762.6 million or 11.47% of total assets at December 31, 2017. A negative gap position exists when the amount of interest-bearing liabilities maturing or repricing exceeds the amount of interest-earning assets maturing or repricing within a particular time period. This analysis suggests that the Company's net interest income is more vulnerable to an increasing rate environment than it is to a prolonged declining interest rate environment. An interest rate gap measure could be significantly affected by external factors such as a rise or decline in interest rates, loan or securities prepayments, and deposit withdrawals.

Table 9 - Interest Rate Risk Analysis

| Condensed Static Gap - December 31, 2018 | Repricing Interval | | | | |
|---|---|---|---|---|---|
| (in thousands) | Total | 0-3 months | 3-6 months | 6-12 months | 12 months |
| Interest-earning assets* | $6,393,434 | $1,210,120 | $290,091 | $513,464 | $2,013,675 |
| Interest-bearing liabilities | 4,665,265 | 2,408,280 | 168,420 | 334,711 | 2,911,411 |
| Net gap position | | (1,198,160) | 121,671 | 178,753 | (897,736) |
| Net gap position as a percentage of total assets | | (17.73)% | 1.80% | 2.64% | (13.28)% |

*Balances of available-for-sale securities are shown at amortized cost.

The Company anticipates that, if the recent trend of rising short-term interest rates continues, the trajectory of net interest income will depend significantly on the Company's ability to manage deposit pricing, quantity and retention in a competitive market considering that the cost of deposits significantly influences our net interest income. Throughout 2018, the cost of interest-bearing deposits increased 13 basis points over the prior year through four increases in the federal funds rate. The Company will continue to focus on increasing earning assets and funding growth through lower cost funding sources, including working to stabilize our deposit pricing.

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Item 8. Financial Statements and Supplementary Data

Financial Statements and Supplementary Data consist of the consolidated financial statements as indexed and presented below and the Unaudited Quarterly Financial Data presented in Part II, Item 8. of this Report.

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Management's Statement of Responsibility

Management is responsible for preparation of the consolidated financial statements and related financial information contained in all sections of this annual report, including the determination of amounts that must necessarily be based on judgments and estimates. It is the belief of management that the consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America.

Management establishes and monitors the Company's system of internal accounting controls to meet its responsibility for reliable financial statements. The system is designed to provide reasonable assurance that assets are safeguarded, and that transactions are executed in accordance with management's authorization and are properly recorded.

The Audit/Examining Committee of the board of directors, composed solely of outside directors, meets periodically and privately with management, internal auditors, and the independent registered public accounting firm, KPMG LLP, to review matters relating to the quality of financial reporting, internal accounting control, and the nature, extent, and results of audit efforts. The independent registered public accounting firm and internal auditors have unlimited access to the Audit/Examining Committee to discuss all such matters. The consolidated financial statements have been audited by KPMG LLP for the purpose of expressing an opinion on the consolidated financial statements. In addition, KPMG LLP has audited internal control over financial reporting, as of December 31, 2018.

| /s/ Stephen S. Romaine | /s/ Francis M. Fetsko | Date: | March 1, 2019 |
|---|---|---|---|
| Stephen S. Romaine<br>Chief Executive Officer | Francis M. Fetsko<br>Chief Financial Officer<br>Chief Operating Officer | | |

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## Report of Independent Registered Public Accounting Firm

To the shareholders and board of directors
Tompkins Financial Corporation:

### Opinion on Internal Control Over Financial Reporting

We have audited Tompkins Financial Corporation and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated statements of condition of the Company as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders' equity for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the "consolidated financial statements"), and our report dated March 1, 2019 expressed an unqualified opinion on those consolidated financial statements.

### Basis for Opinion

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's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. 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 of internal control over financial reporting 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.

### Definition and Limitations of Internal Control Over Financial Reporting

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.

/s/ KPMG LLP
Albany, New York
March 1, 2019



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Report of Independent Registered Public Accounting Firm

To the shareholders and board of directors
Tompkins Financial Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated statements of condition of Tompkins Financial Corporation and subsidiaries (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, cash flows, and changes in shareholders' equity for each of the years in the three year period ended December 31, 2018, and the related notes (collectively, the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2018, 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) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 1, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

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 are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as
the Company's
auditor since 1995.

Albany, New York
March 1, 2019

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TOMPKINS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CONDITION

| (In thousands, except share and per share data)<br>ASSETS | As of<br>12/31/2018 | As of<br>12/31/2017 |
|---|---|---|
| Cash and noninterest bearing balances due from banks | $78,524 | $77,688 |
| Interest bearing balances due from banks | 1,865 | 6,615 |
| Cash and Cash Equivalents | 80,389 | 84,303 |
| Available-for-sale securities, at fair value (amortized cost of $1,363,902 at December 31, 2018 and $1,408,996 at December 31, 2017) | 1,332,658 | 1,391,862 |
| Held-to-maturity securities, at amortized cost (fair value of $139,377 at December 31, 2018 and $140,315 at December 31, 2017) | 140,579 | 139,216 |
| Equity securities, at fair value (amortized cost $1,000 at December 31, 2018 and $1,000 at December 31, 2017) | 887 | 913 |
| Originated loans and leases, net of unearned income and deferred costs and fees | 4,568,741 | 4,358,543 |
| Acquired loans | 265,198 | 310,577 |
| Less: Allowance for loan and lease losses | 43,410 | 39,771 |
| Net Loans and Leases | 4,790,529 | 4,629,349 |
| Federal Home Loan Bank and other stock | 52,262 | 50,498 |
| Bank premises and equipment, net | 97,202 | 86,995 |
| Corporate owned life insurance | 81,928 | 80,106 |
| Goodwill | 92,283 | 92,291 |
| Other intangible assets, net | 7,628 | 9,263 |
| Accrued interest and other assets | 82,091 | 83,494 |
| Total Assets | 6,758,436 | 6,648,290 |
| LIABILITIES | | |
| Deposits: | | |
| Interest bearing: | | |
| Checking, savings and money market | 2,853,190 | 2,651,632 |
| Time | 637,295 | 748,250 |
| Noninterest bearing | 1,398,474 | 1,437,925 |
| Total Deposits | 4,888,959 | 4,837,807 |
| Federal funds purchased and securities sold under agreements to repurchase | 81,842 | 75,177 |
| Other borrowings | 1,076,075 | 1,071,742 |
| Trust preferred debentures | 16,863 | 16,691 |
| Other liabilities | 73,826 | 70,671 |
| Total Liabilities | 6,137,565 | 6,072,088 |
| EQUITY | | |
| Tompkins Financial Corporation shareholders' equity: | | |
| Common Stock - par value $.10 per share: Authorized 25,000,000 shares; Issued: 15,348,287 at December 31, 2018; and 15,301,524 at December 31, 2017 | 1,535 | 1,530 |
| Additional paid-in capital | 366,595 | 364,031 |
| Retained earnings | 319,396 | 265,007 |
| Accumulated other comprehensive loss | (63,165) | (51,296) |
| Treasury stock, at cost – 122,227 shares at December 31, 2018, and 120,805 shares at December 31, 2017 | (4,902) | (4,492) |

| | | |
|---|---|---|
| Total Tompkins Financial Corporation Shareholders' Equity | 619,459 | 574,780 |
| Noncontrolling interests | 1,412 | 1,422 |
| Total Equity | $620,871 | $576,202 |
| Total Liabilities and Equity | $6,758,436 | $6,648,290 |

See notes to consolidated financial statements.

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TOMPKINS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

| | Year ended December 31, | | |
|---|---|---|---|
| (in thousands, except per share data) | 2018 | 2017 | 2016 |
| INTEREST AND DIVIDEND INCOME | | | |
| Loans | $214,370 | $191,410 | $169,630 |
| Due from banks | 31 | 37 | 6 |
| Trading securities | 0 | 0 | 220 |
| Available-for-sale securities | 30,377 | 29,721 | 27,846 |
| Held-to-maturity securities | 3,437 | 3,475 | 3,603 |
| Federal Home Loan Bank stock and Federal Reserve Bank stock | 3,377 | 2,121 | 1,434 |
| Total Interest and Dividend Income | 251,592 | 226,764 | 202,739 |
| INTEREST EXPENSE | | | |
| Time certificates of deposits of $250,000 or more | 1,712 | 1,880 | 1,654 |
| Other deposits | 14,883 | 10,253 | 9,059 |
| Federal funds purchased and securities sold under agreements to repurchase | 152 | 235 | 2,228 |
| Trust preferred debentures | 1,227 | 1,158 | 2,390 |
| Other borrowings | 21,818 | 11,934 | 6,772 |
| Total Interest Expense | 39,792 | 25,460 | 22,103 |
| Net Interest Income | 211,800 | 201,304 | 180,636 |
| Less: Provision for loan and lease losses | 3,942 | 4,161 | 4,321 |
| Net Interest Income After Provision for Loan and Lease Losses | 207,858 | 197,143 | 176,315 |
| NONINTEREST INCOME | | | |
| Insurance commissions and fees | 29,369 | 28,778 | 29,492 |
| Investment services income | 17,288 | 15,665 | 15,203 |
| Service charges on deposit accounts | 8,435 | 8,437 | 8,793 |
| Card services income | 9,693 | 9,100 | 8,058 |
| Mark-to-market loss on trading securities | 0 | 0 | (182) |
| Mark-to-market gain on liabilities held at fair value | 0 | 0 | 227 |
| Other income | 13,130 | 7,631 | 6,291 |
| Net (loss) gain on securities transactions | (466) | (407) | 926 |
| Total Noninterest Income | 77,449 | 69,204 | 68,808 |
| NONINTEREST EXPENSES | | | |
| Salaries and wages | 85,625 | 81,948 | 77,379 |
| Other employee benefits | 22,090 | 21,458 | 19,909 |
| Net occupancy expense of premises | 13,309 | 13,214 | 12,521 |
| Furniture and fixture expense | 7,351 | 7,028 | 6,450 |
| FDIC insurance | 2,618 | 2,527 | 3,024 |
| Amortization of intangible assets | 1,771 | 1,932 | 2,090 |
| Other operating expenses | 48,303 | 42,998 | 37,234 |
| Total Noninterest Expenses | 181,067 | 171,105 | 158,607 |
| Income Before Income Tax Expense | 104,240 | 95,242 | 86,516 |
| Income Tax Expense | 21,805 | 42,620 | 27,045 |
| Net Income Attributable to Noncontrolling Interests and Tompkins Financial Corporation | 82,435 | 52,622 | 59,471 |
| Less: Net income attributable to noncontrolling interests | 127 | 128 | 131 |
| Net Income Attributable to Tompkins Financial Corporation | $82,308 | $52,494 | $59,340 |
| Basic Earnings Per Share | $5.39 | $3.46 | $3.94 |
| Diluted Earnings Per Share | $5.35 | $3.43 | $3.91 |

See notes to consolidated financial statements.

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TOMPKINS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Year ended December 31, | | |
|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 |
| Net income attributable to noncontrolling interests and Tompkins Financial Corporation | $82,435 | $52,622 | $59,471 |
| Other comprehensive income (loss), net of tax: | | | |
| Available-for-sale securities: | | | |
| Change in net unrealized gain/loss during the period | (10,981) | (2,681) | (4,615) |
| Reclassification adjustment for net realized loss (gain) on sale included in available-for-sale securities | 332 | 244 | (556) |
| Employee benefit plans: | | | |
| Net retirement plan loss | (2,594) | (3,434) | (1,673) |
| Net retirement plan prior service (credit) cost | 0 | 728 | (113) |
| Amortization of net retirement plan actuarial gain | 1,298 | 905 | 803 |
| Amortization of net retirement plan prior service cost (credit) | 11 | 9 | 46 |
| Other comprehensive loss | (11,934) | (4,229) | (6,108) |
| Subtotal comprehensive income attributable to noncontrolling interests and Tompkins Financial Corporation | 70,501 | 48,393 | 53,363 |
| Less: Total comprehensive income attributable to noncontrolling interests | (127) | (128) | (131) |
| Total comprehensive income attributable to Tompkins Financial Corporation | $70,374 | $48,265 | $53,232 |

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year ended December 31, | | |
|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 |
| OPERATING ACTIVITIES | | | |
| Net income attributable to Tompkins Financial Corporation | $82,308 | $52,494 | $59,340 |
| Adjustments to reconcile net income, attributable to Tompkins Financial Corporation, to net cash provided by operating activities: | | | |
| Provision for loan and lease losses | 3,942 | 4,161 | 4,321 |
| Depreciation and amortization of premises, equipment, and software | 9,554 | 8,269 | 6,829 |
| Accretion related to purchase accounting | (1,948) | (2,978) | (3,324) |
| Amortization of intangible assets | 1,771 | 1,932 | 2,090 |
| Earnings from corporate owned life insurance, net | (1,818) | (2,196) | (2,106) |
| Net amortization on securities | 8,816 | 10,483 | 11,623 |
| Mark-to-market loss on trading securities | 0 | 0 | 182 |
| Mark-to-market loss on liabilities held at fair value | 0 | 0 | (227) |
| Deferred income tax expense | 2,354 | 14,598 | 1,859 |
| Net loss (gain) on sale of securities transactions | 466 | 407 | (926) |
| Net gain on sale of loans | (458) | (50) | (95) |
| Proceeds from sale of loans | 28,195 | 4,601 | 4,001 |
| Loans originated for sale | (30,151) | (4,831) | (3,360) |
| Net (gain) loss on sale of bank premises and equipment | (2,946) | (30) | 7 |
| Net excess tax benefit from stock based compensation | 680 | 1,635 | 1,433 |
| Stock-based compensation expense | 3,477 | 2,956 | 2,270 |
| Decrease in interest receivable | (800) | (2,731) | (957) |
| Increase (decrease) in accrued interest payable | 355 | 152 | (71) |
| Proceeds from maturities, calls and principal paydowns of trading securities | 0 | 0 | 5,781 |
| Proceeds from sales of trading securities | 0 | 0 | 1,397 |
| Contribution to pension plan | 0 | (1,750) | (1,300) |
| Other, net | 3,468 | (1,057) | 2,093 |
| Net Cash Provided by Operating Activities | 107,265 | 86,065 | 90,860 |
| INVESTING ACTIVITIES | | | |
| Proceeds from maturities, calls and principal paydowns of available-for-sale securities | 151,053 | 166,625 | 244,456 |
| Proceeds from sales of available-for-sale securities | 70,652 | 64,106 | 97,296 |
| Proceeds from maturities, calls and principal paydowns of held-to-maturity securities | 6,729 | 8,068 | 11,776 |
| Purchases of available-for-sale securities | (185,467) | (208,502) | (404,528) |
| Purchases of held-to-maturity securities | (8,492) | (5,556) | (8,207) |
| Net increase in loans and leases | (161,760) | (411,770) | (485,067) |
| Net increase in Federal Home Loan Bank stock | (1,764) | (7,365) | (13,164) |
| Proceeds from sale of bank premises and equipment | 3,317 | 157 | 100 |
| Purchases of bank premises, equipment and software | (18,084) | (35,290) | (16,274) |
| Other, net | 216 | 2,576 | 119 |
| Net Cash Used in Investing Activities | (143,600) | (426,951) | (573,493) |
| FINANCING ACTIVITIES | | | |
| Net increase in demand, money market, and savings deposits | 162,107 | 335,207 | 214,178 |
| Net (decrease) increase in time deposits | (109,732) | (121,459) | 16,946 |
| Net increase (decrease) in securities sold under agreements to repurchase and Federal funds purchased | 6,665 | 6,115 | (67,279) |
| Increase in other borrowings | 524,492 | 750,918 | 761,001 |
| Redemption of trust preferred debentures | 0 | (21,161) | 0 |

| | | | |
|---|---|---|---|
| Repayment of other borrowings | (520,159) | (563,991) | (412,245) |
| Net shares issued related to restricted stock awards | (1,403 ) | (1,294 ) | (835 ) |
| Cash dividends | (29,634 ) | (27,627 ) | (26,603 ) |
| Repurchase of common stock | (2,448 ) | 0 | (1,166 ) |
| Shares issued for dividend reinvestment plan | 0 | 2,872 | 3,201 |
| Shares issued for employee stock ownership plan | 3,073 | 2,296 | 1,938 |
| Net proceeds from exercise of stock options | (540 ) | (641 ) | (806 ) |
| Net Cash Provided by Financing Activities | 32,421 | 361,235 | 488,330 |
| Net (Decrease) Increase Cash and Cash Equivalents | (3,914 ) | 20,349 | 5,697 |
| Cash and cash equivalents at beginning of year | 84,303 | 63,954 | 58,257 |
| Total Cash & Cash Equivalents at End of Year | $80,389 | $84,303 | $63,954 |

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CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

Supplemental Cash Flow Information

| (in thousands) | Year ended December 31, 2018 | 2017 | 2016 |
|---|---|---|---|
| Cash paid during the year for - Interest | $40,660 | $26,387 | $23,465 |
| Cash paid, net of refunds, during the year for - Income taxes | 16,949 | 31,011 | 24,665 |
| Non-cash investing and financing activities: | | | |
| Transfer of loans to other real estate owned | 518 | 2,886 | 1,179 |

See notes to consolidated financial statements.

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TOMPKINS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| (in thousands except share and per share data) | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Treasury Stock | Non-controlling Interests | Total |
|---|---|---|---|---|---|---|---|
| Balances at December 31, 2015 | $1,502 | $350,823 | $197,445 | $ (31,001) | $(3,755) | $ 1,452 | $516,466 |
| Net income attributable to noncontrolling interests and Tompkins Financial Corporation | | | 59,340 | | | 131 | 59,471 |
| Other comprehensive loss | | | | (6,108) | | | (6,108) |
| Total Comprehensive Income | | | | | | | 53,363 |
| Cash dividends ($1.77 per share) | | | (26,603) | | | | (26,603) |
| Net exercise of stock options (39,931 shares, net) | 4 | (810) | | | | | (806) |
| Common stock repurchased and returned to unissued status (22,356 shares) | (2) | (1,164) | | | | | (1,166) |
| Stock-based compensation expense | | 2,270 | | | | | 2,270 |
| Shares issued for dividend reinvestment plan (45,148 shares) | 4 | 3,197 | | | | | 3,201 |
| Shares issued for employee stock ownership plan (31,435 shares) | 3 | 1,935 | | | | | 1,938 |
| Directors deferred compensation plan (1,871 shares) | | 296 | | | (296) | | 0 |
| Restricted stock activity (29,511 shares) | 3 | (838) | | | | | (835) |
| Shares issued for purchase acquisition (32,553 shares) | 3 | 1,705 | | | | | 1,708 |
| Dividend to noncontrolling interests | | | | | | (131) | (131) |
| Balances at December 31, 2016 | $1,517 | $357,414 | $230,182 | $ (37,109) | $(4,051) | $ 1,452 | $549,405 |
| Reclassification due to the adoption of ASU No. 2018-02 | | | 9,958 | (9,958) | | | 0 |
| Net income attributable to noncontrolling interests and Tompkins Financial Corporation | | | 52,494 | | | 128 | 52,622 |
| Other comprehensive loss | | | | (4,229) | | | (4,229) |
| Total Comprehensive Income | | | | | | | 48,393 |
| Cash dividends ($1.82 per share) | | | (27,627) | | | | (27,627) |
| Net exercise of stock options (22,277 shares, net) | 2 | (643) | | | | | (641) |
| Stock-based compensation expense | | 2,956 | | | | | 2,956 |
| Shares issued for dividend reinvestment plan (34,750 shares) | 4 | 2,868 | | | | | 2,872 |
| Shares issued for employee stock ownership plan (27,412 shares) | 3 | 2,293 | | | | | 2,296 |
| Directors deferred compensation plan (2,808 shares) | | 441 | | | (441) | | 0 |
| | 4 | (1,298) | | | | | (1,294) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Restricted stock activity (45,269 shares) | | | | | | | |
| Partial repurchase of noncontrolling interest | | | | | | (30) | (30) |
| Dividend to noncontrolling interests | | | | | | (128) | (128) |
| Balances at December 31, 2017 | $1,530 | $364,031 | $265,007 | $ (51,296) | $(4,492) | $ 1,422 | $576,202 |

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TOMPKINS FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (continued)

| (in thousands except share and per share data) | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Treasury Stock | Non-controlling Interests | Total |
|---|---|---|---|---|---|---|---|
| Balances at December 31, 2017 | $1,530 | $364,031 | $265,007 | $ (51,296) | $(4,492) | $ 1,422 | $576,202 |
| Net income attributable to noncontrolling interests and Tompkins Financial Corporation | | | 82,308 | | | 127 | 82,435 |
| Other comprehensive loss | | | | (11,934) | | | (11,934) |
| Total Comprehensive Income | | | | | | | 70,501 |
| Cash dividends ($1.94 per share) | | | (29,634) | | | | (29,634) |
| Net exercise of stock options (10,786 shares) | 1 | (541) | | | | | (540) |
| Common stock repurchased and returned to unissued status (32,483 shares) | (3) | (2,445) | | | | | (2,448) |
| Stock-based compensation expense | | 3,477 | | | | | 3,477 |
| Shares issued for employee stock ownership plan (38,883 shares) | 4 | 3,069 | | | | | 3,073 |
| Directors deferred compensation plan (1,422 shares) | 0 | 410 | | | (410) | | 0 |
| Restricted stock activity (29,577 shares) | 3 | (1,406) | | | | | (1,403) |
| Adoption of Accounting Guidance ASU 2016-01 | | | (65) | 65 | | | 0 |
| Adoption of Accounting Guidance ASU 2014-09 | | | 1,780 | | | | 1,780 |
| Partial repurchase of noncontrolling interest | | | | | | (10) | (10) |
| Dividend to noncontrolling interests | | | | | | (127) | (127) |
| Balances at December 31, 2018 | $1,535 | $366,595 | $319,396 | $ (63,165) | $(4,902) | $ 1,412 | $620,871 |

See notes to consolidated financial statements.

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Note 1 Summary of Significant Accounting Policies

Basis Of Presentation
Tompkins Financial Corporation ("Tompkins" or "the Company") is a registered Financial Holding Company with the Federal Reserve Board pursuant to the Bank Holding Company Act of 1956, as amended, organized under the laws of New York State, and is the parent company of Tompkins Trust Company (the "Trust Company"), The Bank of Castile, Mahopac Bank, VIST Bank, and Tompkins Insurance Agencies, Inc. ("Tompkins Insurance"). The Trust Company provides a full array of trust and investment services under the Tompkins Financial Advisors brand. Unless the context otherwise requires, the term "Company" refers to Tompkins Financial Corporation and its subsidiaries.

The consolidated financial information included herein combines the results of operations, the assets, liabilities, and shareholders' equity (including comprehensive income or loss) of the Company and all entities in which the Company has a controlling financial interest. All significant intercompany balances and transactions are eliminated in consolidation.

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 U.S. accounting principles generally accepted. 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 (VIEs) 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, Sleepy Hollow Capital Trust I, Leesport Capital Trust II, and Madison Statutory Trust I are VIE's 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.

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclose contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the allowance for loan and lease losses, valuation of goodwill and intangible assets, deferred income tax assets, other-than-temporary impairment on investments, and obligations related to employee benefits. Amounts in the prior years' consolidated financial statements are reclassified when necessary to conform to the current year's presentation.

The consolidated financial information included herein combines the results of operations, the assets, liabilities, and shareholders' equity of the Company and its subsidiaries. Amounts in the prior periods' unaudited condensed consolidated financial statements are reclassified when necessary to conform to the current periods' presentation.

The Company has evaluated subsequent events for potential recognition and/or disclosure and determined that no further disclosures were required.

Cash and Cash Equivalents
Cash and cash equivalents in the Consolidated Statements of Cash Flows include cash and noninterest bearing balances due from banks, interest-bearing balances due from banks, Federal funds sold, and money market funds.

Management regularly evaluates the credit risk associated with the counterparties to these transactions and believes that the Company is not exposed to any significant credit risk on cash and cash equivalents. Each bank subsidiary is required to maintain reserve balances by the Federal Reserve Bank of New York. At December 31, 2018, and December 31, 2017, the reserve requirements for the Company's banking subsidiaries totaled $6.6 million and $6.6 million, respectively.

Securities

Management determines the appropriate classification of debt and equity securities at the time of purchase. Securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. Debt securities not classified as held-to-maturity and marketable equity securities are classified as either available-for-sale or trading. Available-for-sale securities are stated at fair value with the unrealized gains and losses, net of tax, excluded from earnings and reported as a separate component of accumulated comprehensive income or loss, in shareholders' equity. Trading securities are stated at fair value, with unrealized gains or losses included in earnings.

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Beginning January 1, 2018, upon adoption of ASU 2016-01, equity securities with readily determinable fair values are stated at fair value with realized and unrealized gains and losses reported in income. For periods prior to January 1, 2018, equity securities were classified as available-for-sale and stated at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive income, net of tax. Securities with limited marketability or restricted equity securities, such as Federal Home Loan Bank stock and Federal Reserve Bank stock, are carried at cost, less any impairment, if any.

Premiums and discounts are amortized or accreted over the expected life of the related security as an adjustment to yield using the interest method. Dividend and interest income are recognized when earned. Realized gains and losses on the sale of securities are included in net gain (loss) on securities transactions. The cost of securities sold is based on the specific identification method.

At least quarterly, the Company performs an assessment to determine whether there have been any events or economic circumstances indicating that a security with an unrealized loss has suffered other-than-temporary impairment. A debt security is considered impaired if the fair value is less than its amortized cost basis at the reporting date. If impaired, the Company then assesses whether the unrealized loss is other-than-temporary. An unrealized loss on a debt security is generally deemed to be other-than-temporary and a credit loss is deemed to exist if the present value, discounted at the security's effective rate, of the expected future cash flows is less than the amortized cost basis of the debt security. As a result, the credit loss component of an other-than-temporary impairment write-down for debt securities is recorded in earnings while the remaining portion of the impairment loss is recognized, net of tax, in other comprehensive income provided that the Company does not intend to sell the underlying debt security and it is more-likely-than not that the Company would not have to sell the debt security prior to recovery of the unrealized loss, which may be to maturity. If the Company intended to sell any securities with an unrealized loss or it is more-likely-than not that the Company would be required to sell the investment securities, before recovery of their amortized cost basis, then the entire unrealized loss would be recorded in earnings.

Loans and Leases

Loans are reported at their principal outstanding balance, net of deferred loan origination fees and costs, and unearned income. The Company has the ability and intent to hold its loans for the foreseeable future, except for certain residential real estate loans held-for-sale. The Company provides motor vehicle and equipment financing to its customers through direct financing leases. These leases are carried at the aggregate of lease payments receivable, plus estimated residual values, less unearned income. Unearned income on direct financing leases is amortized over the lease terms, resulting in a level rate of return.

Residential real estate loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated fair value. Fair value is determined on the basis of the rates quoted in the secondary market. Net unrealized losses attributable to changes in market interest rates are recognized through a valuation allowance by charges to income. Loans are generally sold on a non-recourse basis with servicing retained. Any gain or loss on the sale of loans is recognized at the time of sale as the difference between the recorded basis in the loan and the net proceeds from the sale. The Company may use commitments at the time loans are originated or identified for sale to mitigate interest rate risk. The commitments to sell loans and the commitments to originate loans held-for-sale at a set interest rate, if originated, are considered derivatives under ASC Topic 815. The impact of the estimated fair value adjustment was not significant to the consolidated financial statements.

Interest income on loans is accrued and credited to income based upon the principal amount outstanding. Loan origination fees and costs are deferred and recognized over the life of the loan as an adjustment to yield. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments are due. Loans and leases, including impaired loans, are generally classified as nonaccrual if they are past due as to maturity or payment of principal or interest for a period of more than 90 days, unless such loans are well

secured and in the process of collection. Loans that are past due less than 90 days may also be classified as nonaccrual if repayment in full of principal or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment within an acceptable time period, and there is a sustained period (generally six consecutive months) of repayment performance by the borrower in accordance with the contractual terms of the loan agreement. When interest accrual is discontinued, all unpaid accrued interest is reversed. Payments received on loans on nonaccrual are generally applied to reduce the principal balance of the loan.

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The Company applies the provisions of ASC Topic 310-10-35, Loan Impairment, to all impaired commercial and commercial real estate loans over $250,000 and to all loans restructured in a troubled debt restructuring. Allowances for loan losses for the remaining loans are recognized in accordance with ASC Topic 450, Contingencies ("ASC Topic 450"). Management considers a loan to be impaired if, based on current information, it is probable that the Company will be unable to collect all scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the effective interest rate of the loan or, as a practical expedient, at the observable market price or the fair value of collateral (less costs to sell) if the loan is collateral dependent. Management excludes large groups of smaller balance homogeneous loans such as residential mortgages, consumer loans, and leases, which are collectively evaluated.

Loans are considered modified in a troubled debt restructuring ("TDR") when, due to a borrower's financial difficulties, the Company makes a concession(s) to the borrower that it would not otherwise consider. These modifications may include, among others, an extension for the term of the loan, and granting a period when interest-only payments can be made with the principal payments and interest caught up over the remaining term of the loan or at maturity. Generally, a nonaccrual loan that has been modified in a TDR remains on non-accrual status for a period of six months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on nonaccrual status.

In general, the principal balance of a loan is charged off in full or in part when management concludes, based on the available facts and circumstances, that collection of principal in full is not probable. For commercial and commercial real estate loans, this conclusion is generally based upon a review of the borrower's financial condition and cash flow, payment history, economic conditions, and the conditions in the various markets in which the collateral, if any, may be liquidated. In general, consumer loans are charged-off in accordance with regulatory guidelines which provide that such loans be charged-off when the Company becomes aware of the loss, such as from a triggering event that may include new information about a borrower's intent/ability to repay the loan, bankruptcy, fraud or death, among other things, but in no case will the charge-off exceed specified delinquency timeframes. Such delinquency timeframes state that closed-end retail loans (loans with pre-defined maturity dates, such as real estate mortgages, home equity loans and consumer installment loans) that become past due 120 cumulative days and open-end retail loans (loans that roll-over at the end of each term, such as home equity lines of credit) that become past due 180 cumulative days should be classified as a loss and charged-off. For residential real estate loans, charge-off decisions are based upon past due status, current assessment of collateral value, and general market conditions in the areas where the properties are located.

Acquired Loans and Leases
Loans acquired in acquisitions, subsequent to the effective date of ASC Topic 805, Business Combination, are recorded at fair value and subsequently accounted for in accordance with ASC Topic 310, and there is no carryover of the related allowance for loan and lease losses. Loans acquired with evidence of credit impairment are accounted for under ASC Subtopic 310-30. These loans may be aggregated and accounted for as pools of loans if the loans being aggregated have common risk characteristics. In the VIST acquisition, the Company elected to account for the loans with evidence of credit deterioration individually rather than aggregate them into pools. The difference between the undiscounted cash flows expected at acquisition and the investment in the acquired loans, or the "accretable yield," is recognized as interest income utilizing the level-yield method over the life of each loan. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "non-accretable difference," are not recognized as a yield adjustment, as a loss accrual or as a valuation allowance.

Increases in expected cash flows subsequent to the acquisition are recognized prospectively through an adjustment of the yield on the loans over the remaining life, while decreases in expected cash flows are recognized as impairment through a loss provision and an increase in the allowance for loan losses. Valuation allowances (recognized in the allowance for loan losses) on these impaired loans reflect only losses incurred after the acquisition (representing all cash flows that were expected at acquisition but currently are not expected to be received).

Acquired loans not exhibiting evidence of credit impairment at the time of acquisition are accounted for under ASC Subtopic 310-20. The Company amortizes/accretes into interest income the premium/discount determined at the date of purchase over the life of the loan on a level yield basis. Subsequent to the acquisition date, the methods used to estimate the appropriate allowance for loan losses are similar to originated loans. These loans are placed on nonaccrual status in accordance with the Company's policy for originated loans.

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Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if we can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, we may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable discount. The Company determined at acquisition that it could reasonably estimate future cash flows on acquired loans that were past due 90 days or more and on which the Company expects to fully collect the carrying value of the loans net of the allowance for acquired loan losses. As such, the Company does not consider these loans to be nonaccrual or nonperforming.

Allowance For Loan and Lease Losses
The Company has developed a methodology to measure the amount of estimated loan loss exposure inherent in the loan portfolio to assure that an appropriate allowance is maintained. The Company's methodology is based upon guidance provided in SEC Staff Accounting Bulletin No. 102, Selected Loan Loss Allowance Methodology and Documentation Issues and allowance allocations are calculated in accordance with ASC Topic 310, Receivables and ASC Topic 450, Contingencies. The model is comprised of four major components that management has deemed appropriate in evaluating the appropriateness of the allowance for loan and lease losses. While none of these components, when used independently, is effective in arriving at a reserve level that appropriately measures the risk inherent in the portfolio, management believes that using them collectively, provides reasonable measurement of the loss exposure in the portfolio. The components include: impaired loans; criticized and classified credits; historical loss experience; and qualitative or subjective analysis. For impaired loans, an allowance is recognized if the fair value of the loan is less than the recorded investment in the loan (recorded investment in the loan is the principal balance plus any accrued interest, net of deferred loan fees or costs and unamortized premium or discount). A loan's fair value reflects the present value of expected future cash flows discounted at the loan's effective interest rate, or if the loan is collateral dependent, the fair value of the collateral, less estimated disposal costs. If the loan is collateral dependent, the principal balance of the loan is charged-off in an amount equal to the impairment measurement. The fair value of collateral dependent loans is derived primarily from collateral appraisals performed by independent third-party appraisers. For loans that are not impaired, but are rated special mention or worse, management evaluates credits based on elevated risk characteristics and assigns reserves based upon analysis of historical loss experience of loans with similar risk characteristics. For loans that are not impaired or reviewed individually, management assigns a reserve based upon historical loss experience over a designated look-back period. Management has evaluated a variety of look-back periods and has determined that an eight year look back period is appropriate to capture a full range of economic cycles. Management has also evaluated a variety of statistical methods in analyzing loss history, including averages, weighted averages and loss emergence periods and has determined that by applying a loss emergence period analysis to historical losses over a full economic cycle has resulted in a reasonable estimate of losses inherent in the loan portfolio. The model also includes an analysis of a variety of subjective factors to support the reserve estimate. These subjective factors may include allowance allocations for risks that may not otherwise be fully recognized in other components of the model. Among the subjective factors that are routinely considered as part of this analysis are: growth trends in the portfolio, changes in management and/or polices related to lending activities, trends in classified or nonaccrual loans, concentrations of credit, local and national economic trends, and industry trends.

Periodically, management conducts an analysis to estimate the loss emergence period for various loan categories based on samples of historical charge-offs. Model output by loan category is reviewed to evaluate the reasonableness of the reserve levels in comparison to the estimated loss emergence period applied to historical loss experience.

In addition to the components discussed above, management reviews the model output for reasonableness by analyzing the results in comparisons to recent trends in the loan/lease portfolio, through back-testing of results from prior models in comparison to actual loss history, and by comparing our reserves and loss history to industry peer results.

The model results are reviewed by management at the Corporate Credit Policy Committee and presented to the Board of Directors. Additionally, on an annual basis, management conducts a validation process of the model. This validation includes reviewing the appropriateness of model calculations, back testing of model results and appropriateness of key assumptions used in the model. In addition, various Federal and State regulatory agencies, as part of their examination process, review the Company's allowance and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

For acquired credit impaired loans accounted for under FASB ASC Topic 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, ("ASC Topic 310-30"), the Company's allowance for loan and lease losses is estimated based upon our expected cash flows for these loans. To the extent that we experience a deterioration in borrower credit quality resulting in a decrease in our expected cash flows subsequent to the acquisition of the loans, an allowance for loan losses would be established based on our estimate of future credit losses over the remaining life of the loans.

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For acquired non-credit impaired loans accounted for under FASB ASC Topic 310-20, Nonrefundable Fees and Other Costs, (“ASC Topic 310-20”), the Company’s allowance for loan and lease losses is maintained through provisions for loan losses based upon an evaluation process that is similar to our evaluation process used for originated loans. This evaluation, which includes a review of loans on which full collectability may not be reasonably assured, considers, among other matters, the estimated fair value of the underlying collateral, economic conditions, historical net loan loss experience, carrying value of the loans, which includes the remaining net purchase discount or premium, and other factors that warrant recognition in determining our allowance for loan losses.

Additionally, in June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"), which replaces the current "incurred loss" model for recognizing credit losses with an "expected loss" model referred to as the Current Expected Credit Loss ("CECL") model. ASU 2016-13 will become effective for the Company for fiscal years beginning after December 15, 2019 and for interim periods within those fiscal years. Under the CECL model, we will be required to present certain financial assets carried at amortized cost at the net amount expected to be collected. Accordingly, the Company’s management anticipates that this significant accounting rule adjustment will materially affect how we determine our allowance for loan and lease losses as well as our accounting for investment securities.

Premises and Equipment
Land is carried at cost. Premises and equipment are stated at cost, less allowances for depreciation. The provision for depreciation for financial reporting purposes is computed generally by the straight-line method at rates sufficient to write-off the cost of such assets over their estimated useful lives. Buildings are amortized over a period of 10-39 years, and furniture, fixtures, and equipment are amortized over a period of 2-20 years. Leasehold improvements are generally depreciated over the lesser of the lease term or the estimated lives of the improvements. Maintenance and repairs are charged to expense as incurred. Gains or losses on disposition are reflected in earnings.

Other Real Estate Owned
Other real estate owned consists of properties formerly pledged as collateral to loans, which have been acquired by the Company through foreclosure proceedings or acceptance of a deed in lieu of foreclosure. Upon transfer of a loan to foreclosure status, an appraisal is generally obtained and any excess of the loan balance over the fair value, less estimated costs to sell, is charged against the allowance for loan/lease losses. Expenses and subsequent adjustments to the fair value are treated as other operating expense.

Goodwill
Goodwill represents the excess of purchase price over the fair value of assets acquired in a transaction using purchase accounting. Goodwill has an indefinite useful life and is not amortized, but is tested for impairment. Goodwill impairment tests are performed on an annual basis or when events or circumstances dictate. The Company tests goodwill annually as of December 31st. The Company has the option to perform a qualitative assessment of goodwill, which considers company-specific and economic characteristics that might impact its carrying value. If based on this qualitative assessment, it is more likely than not that the fair value of the reporting unit is less than its carrying amount, then a quantitative test (Step 1) is performed, which compares the fair value of the reporting unit to the carrying amount of the reporting unit in order to identify potential impairment. If the estimated fair value of a reporting unit exceeds its carrying amount, the goodwill of the reporting unit is not considered impaired. However, if the carrying amount of the reporting unit were to exceed its estimated fair value, a second step (Step 2) would be performed that would compare the implied fair value of the reporting unit’s goodwill with the carrying amount of the goodwill for the reporting unit. The implied fair value of goodwill is determined in the same manner as goodwill that is recognized in a business combination. Significant judgment and estimates are involved in estimating the fair value of the assets and liabilities of the reporting units.

Other Intangible Assets

Other intangible assets include core deposit intangibles, customer related intangibles, covenants not to compete, and mortgage servicing rights. Core deposit intangibles represent a premium paid to acquire a base of stable, low cost deposits in the acquisition of a bank, or a bank branch, using purchase accounting. The amortization period for core deposit intangible ranges from 5 to 10 years, using an accelerated method. The covenants not to compete are amortized on a straight-line basis over 3 to 6 years, while customer related intangibles are amortized on an accelerated basis over a range of 6 to 15 years. The amortization period is monitored to determine if circumstances require such periods to be revised. The Company periodically reviews its intangible assets for changes in circumstances that may indicate the carrying amount of the asset is impaired. The Company tests its intangible assets for impairment on an annual basis or more frequently if conditions indicate that an impairment loss has more likely than not been incurred.

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Income Taxes

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 in the period that includes the enactment date. Deferred taxes are reviewed quarterly and reduced by a valuation allowance if, based upon the information available, it is more likely than not that some or all of the deferred tax assets will not be realized. Realization of deferred tax assets is dependent upon the generation of a sufficient level of future taxable income and recoverable taxes paid in prior years. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized. The Company’s policy is to recognize interest and penalties on unrecognized tax benefits in income tax expense in the Consolidated Statements of Income.

Tax Credit Investments

The Company accounts for its investments in qualified affordable housing projects using the proportional amortization method. Under that method, the Company amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. As of December 31, 2018 and 2017, the Company's remaining investment in qualified affordable housing projects, net of amortization totaled $1.0 million and $1.4 million, respectively.

Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase (repurchase agreements) are agreements in which the Company transfers the underlying securities to a third-party custodian’s account that explicitly recognizes the Company’s interest in the securities. The agreements are accounted for as secured financing transactions provided the Company maintains effective control over the transferred securities and meets other criteria as specified in FASB ASC Topic 860, Transfers and Servicing (“ASC Topic 860”). The Company’s agreements are accounted for as secured financings; accordingly, the transaction proceeds are reflected as liabilities and the securities underlying the agreements continue to be carried in the Company’s securities portfolio.

Treasury Stock

The cost of treasury stock is shown on the Consolidated Statements of Condition as a separate component of shareholders’ equity, and is a reduction to total shareholders’ equity. Shares are released from treasury at fair value, identified on an average cost basis.

Trust and Investment Services

Assets held in fiduciary or agency capacities for customers are not included in the accompanying Consolidated Statements of Condition, since such items are not assets of the Company. Fees associated with providing trust and investment services are included in noninterest income.

Earnings Per Share

Basic earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the year, exclusive of shares represented by the unvested portion of restricted stock and restricted stock units. Diluted earnings per share is calculated by dividing net income available to common shareholders by the weighted average number of shares outstanding during the year plus the dilutive effect of the unvested portion of restricted stock and restricted stock units and stock issuable upon conversion of common stock equivalents (primarily stock options) or certain other contingencies. The Company currently uses authoritative accounting guidance under ASC Topic 260, Earnings Per Share, which provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class

method. The Company issues stock-based compensation awards that included restricted stock awards that contain such rights.

Segment Reporting

The Company manages its operations through three reportable business segments in accordance with the standards set forth in FASB ASC Topic 280, “Segment Reporting”. The three segments are: (i) banking (“Banking”), (ii) insurance (“Tompkins Insurance Agencies, Inc.”) and (iii) wealth management (“Tompkins Financial Advisors”). The Company’s insurance services and wealth management services are managed separately from the Bank. Additional information on the segments is presented in Note 22- “Segment and Related Information.”

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Comprehensive Income (Loss)
For the Company, comprehensive income (loss) represents net income plus the net change in unrealized gains or losses on securities available-for-sale for the period (net of taxes), and the actuarial gain or loss and amortization of unrealized amounts in the Company's defined-benefit retirement and pension plan, supplemental employee retirement plan, and post-retirement life and healthcare benefit plan (net of taxes), and is presented in the Consolidated Statements of Comprehensive Income (Loss) and Consolidated Statements of Changes in Shareholders' Equity. Accumulated other comprehensive income (loss) represents the net unrealized gains or losses on securities available-for-sale (net of tax) and unrecognized net actuarial gain or loss, unrecognized prior service costs, and unrecognized net initial obligation (net of tax) in the Company's defined-benefit retirement and pension plan, supplemental employee retirement plan, and post-retirement life and healthcare benefit plan.

Pension and Other Employee Benefits
The Company maintains noncontributory defined-benefit and defined contribution plans, which cover substantially all employees of the Company. In addition, the Company also maintains supplemental employee retirement plans for certain executives and a post-retirement life and healthcare plan. These plans are discussed in detail in Note 11 "Employee Benefit Plans". The Company incurs certain employment-related expenses associated with these plans. In order to measure the expense associated with these plans, various assumptions are made including the discount rate used to value certain liabilities, expected return on plan assets, anticipated mortality rates, and expected future healthcare costs. The assumptions are based on historical experience as well as current facts and circumstances. A third-party actuarial firm is used to assist management in measuring the expense and liability associated with the plans. The Company uses a December 31 measurement date for its plans. As of the measurement date, plan assets are determined based on fair value, generally representing observable market prices. The projected benefit obligation is primarily determined based on the present value of projected benefit distributions at an assumed discount rate.

The expenses associated with these plans are charged to current operating expenses. The Company recognizes an asset for a plan's overfunded status or a liability for a plan's underfunded status in the Company's consolidated statements of condition, and recognizes changes in the funded status of these plans in comprehensive income, net of applicable taxes, in the year in which the change occurred.

Fair Value Measurements
The Company accounts for the provisions of FASB ASC Topic 820, Fair Value Measurements and Disclosures ("ASC Topic 820"), for financial assets and financial liabilities. ASC Topic 820 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. See Note 19 "Fair Value Measurements".

In general, fair values of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Company's creditworthiness, among others.

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Revenue Recognition
Tompkins adopted Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606) as of January 1, 2018, the impact of which is discussed below. Under ASU 2014-09, the Company adopted new policies related to revenue recognition. In general, for revenue not associated with financial instruments, guarantees and lease contracts, the Company applies the following steps when recognizing revenue from contracts with customers: (i) identify the contract, (ii) identify the performance obligations, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations and (v) recognize revenue when a performance obligation is satisfied. Tompkins' contracts with customers are generally short term in nature, typically due within one year or less or cancellable by the Company or the Company's customer upon a short notice period. Performance obligations for the Company's customer contracts are generally satisfied at a single point in time, typically when the transaction is complete, or over time. For performance obligations satisfied over time, Tompkins primarily uses the output method, directly measuring the value of the products/services transferred to the customer, to determine when performance obligations have been satisfied. The Company typically receives payment from customers and recognizes revenue concurrent with the satisfaction of the Company's performance obligations. In most cases, this occurs within a single financial reporting period. For payments received in advance of the satisfaction of performance obligations, revenue recognition is deferred until such time as the performance obligations have been satisfied. In cases where the Company has not received payment despite satisfaction of the Company's performance obligations, the Company accrues an estimate of the amount due in the period the Company's performance obligations have been satisfied. For contracts with variable components, only amounts for which collection is probable are accrued. The Company generally acts in a principal capacity, on the Company's own behalf, in most of the Company's contracts with customers. In such transactions, Tompkins recognizes revenue and the related costs to provide the services on a gross basis in the Company's financial statements. In some cases, Tompkins acts in an agent capacity, deriving revenue through assisting other entities in transactions with the Company's customers. In such transactions, Tompkins recognizes revenue and the related costs to provide the services on a net basis in the Company's financial statements. These transactions recognized on a net basis primarily relate to insurance and brokerage commissions and fees derived from the Company's customers' use of various interchange and ATM/debit card networks.

Accounting Standards Updates

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” ("ASC 606"). The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies generally will be required to use more judgment and make more estimates than under current guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. For financial reporting purposes, the standard allows for either full retrospective adoption, meaning the standard is applied to all of the periods presented, or modified retrospective adoption, meaning the standard is applied only to the most current period presented in the financial statements with the cumulative effect of initially applying the standard recognized at the date of initial application. Since the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, including interest income and expense. The Company completed its overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including trust and asset management fees, deposit related fees, interchange fees, merchant income, and annuity and insurance commissions.

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method for all contracts. Results for reporting periods beginning January 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with the Company’s historic accounting under Topic 605, Revenue Recognition. The Company recorded a net increase to beginning retained earnings of $1.8 million as of January 1,

2018 due to the cumulative impact of adopting ASC 606. The impact on beginning retained earnings was primarily driven by the recognition of $1.8 million of contingency income related to our insurance business segment. The adoption of ASC 606 did not have a significant impact on the Company's consolidated financial statements as of and for the twelve months ended December 31, 2018 and, as a result, comparisons of revenues and operating profit performance between periods are not significantly affected by the adoption of this ASU. Refer to Note 14 "Revenue Recognition" for additional disclosures required by ASC 606.

In January 2016, the FASB issued ASU No. 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the

identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value; (3) eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. The Company adopted ASU No. 2016-01 effective January 1, 2018, and recognized a cumulative-effect adjustment of $65,000 for the after-tax impact of the unrealized loss on equity securities. In addition, the Company measured the fair value of its loan portfolio as of December 31, 2018 using an exit price notion. Refer to Note 19 - "Fair Value".

In August 2016, the FASB issued ASU No. 2016-15, “Classification of Certain Cash Receipts and Cash Payments.” ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. The Company adopted ASU No. 2016-15 on January 1, 2018. ASU No. 2016-15 did not have a material impact on the Company’s consolidated financial statements.

In February 2017, the FASB issued ASU 2017-05, “Other Income - Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20) - Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets.” ASU 2017-05 clarifies the scope of Subtopic 610-20 and adds guidance for partial sales of nonfinancial assets, including partial sales of real estate. Historically, U.S. GAAP contained several different accounting models to evaluate whether the transfer of certain assets qualified for sale treatment. ASU 2017-05 reduces the number of potential accounting models that might apply and clarifies which model does apply in various circumstances. The Company adopted ASU No. 2017-05 on January 1, 2018. ASU No. 2017-15 did not have a material impact on the Company’s consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, “Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.” Under the new guidance, employers are required to present the service cost component of the net periodic benefit cost in the same income statement line item (e.g., Salaries and Benefits) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components of net periodic benefit cost separately (e.g., Other Noninterest Expense) from the line item that includes the service cost. ASU No. 2017-07 is effective for interim and annual reporting periods beginning after December 15, 2017. Employers will apply the guidance on the presentation of the components of net periodic benefit cost in the income statement retrospectively. The guidance limiting the capitalization of net periodic benefit cost in assets to the service cost component will be applied prospectively. The Company adopted ASU No. 2017-07 on January 1, 2018 and utilized the ASU’s practical expedient allowing entities to estimate amounts for comparative periods using the information previously disclosed in their pension and other postretirement benefit plan footnote. ASU No. 2017-07 did not have a material impact on the Company’s consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, “Compensation-Stock Compensation (Topic 718)- Scope of Modification Accounting.” ASU 2017-09 clarifies when changes to the terms or conditions of a share-based payment

award must be accounted for as modifications. Under ASU 2017-09, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: (i) the award's fair value, (ii) the award's vesting conditions and (iii) the award's classification as an equity or liability instrument. ASU 2017-09 became effective for us on January 1, 2018 and did not have a significant impact on our consolidated financial statements.

ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" was issued to address a narrow-scope financial reporting issue that arose as a consequence of the change in the tax law. On December 22, 2017, the U.S. federal government enacted a tax bill, H.R.1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act of 2017). ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate of 35 percent and the newly enacted 21 percent corporate income tax rate. ASU 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018,

and interim periods within those fiscal years with early adoption permitted, including adoption in any interim period, for (i) public business entities for reporting periods for which financial statements have not yet been issued and (ii) all other entities for reporting periods for which financial statements have not yet been made available for issuance. The changes are applied retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017 is recognized. The Company early adopted ASU 2018-02 in 2017, which resulted in the reclassification from accumulated other comprehensive income (loss) to retained earnings totaling $10.0 million, reflected in the consolidated statements of changes in shareholders' equity.

ASU 2018-05, "Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 118." ASU 2018-05 amends the Accounting Standards Codification to incorporate various SEC paragraphs pursuant to the issuance of SAB 118. SAB 118 addresses the application of generally accepted accounting principles in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act of 2017. See Note 15 - "Income Taxes".

ASU 2016-02,“Leases (Topic 842).” ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee‘s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016-2 will be effective for Tompkins on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company occupies certain banking offices and uses certain equipment under noncancelable operating lease agreements, which currently are not reflected in its consolidated statement of condition. Tompkins has prepared an inventory of its leases and evaluated the impact of this ASU on these leases. Upon adoption of the guidance, the Company expects to report increased assets and increased liabilities as a result of recognizing right-of-use assets and lease liabilities on its consolidated statement of condition.

ASU 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 will be effective on January 1, 2020. Tompkins is currently evaluating the requirements of the new guidance to determine what modifications to our existing allowance methodology may be required. The Company has formed a cross-functional committee that is assessing our data and system needs and developing a CECL compliant model while gathering the requisite data. The Company expects that the new guidance will likely result in an increase in the allowance; however, Tompkins is unable to quantify the impact at this time since we are still reviewing the guidance. The extent of any impact to our allowance will depend, in part, upon the composition of our loan portfolio at the adoption date as well as economic conditions and loss forecasts at that date.

The guidance of ASU 2016-13 was recently amended by ASU 2018-19, “Codification Improvements to Topic 326, Financial Instruments - Credit Losses,” which changed the effective date for non-public companies and clarified that operating lease receivables are not within the scope of the standard.

ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment.” ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value

of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for us on January 1, 2020, with early adoption permitted for interim or annual impairment tests beginning in 2017. Tompkins is currently evaluating the potential impact of ASU 2017-04 on our consolidated financial statements.

ASU 2017-08 "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20) - Premium Amortization on Purchased Callable Debt Securities." ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does

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not change the accounting for callable debt securities held at a discount. ASU 2017-08 became effective for us on January 1, 2019 and is not expected to have a significant impact on our consolidated financial statements.

ASU 2017-12, “Derivatives and Hedging (Topic 815) - Targeted Improvements to Accounting for Hedging Activities.” ASU 2017-12 amends the hedge accounting recognition and presentation requirements in ASC 815 to improve the transparency and understandability of information conveyed to financial statement users about an entity’s risk management activities to better align the entity’s financial reporting for hedging relationships with those risk management activities and to reduce the complexity of and simplify the application of hedge accounting. ASU 2017-12 became effective for us on January 1, 2019 and is not expected to have a significant impact on our consolidated financial statements.

ASU 2018-13, “Fair Value Measurement (Topic 820) - Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement.” ASU 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820. The amendments in this update remove disclosures that no longer are considered cost beneficial, modify/clarify the specific requirements of certain disclosures, and add disclosure requirements identified as relevant. ASU 2018-13 will be effective for us on January 1, 2020, with early adoption permitted, and is not expected to have a significant impact on our consolidated financial statements.

ASU 2018-14, “Compensation - Retirement Benefits-Defined Benefit Plans-General (Subtopic 715-20).” ASU 2018-14 amends and modifies the disclosure requirements for employers that sponsor defined benefit pension or other post-retirement plans. The amendments in this update remove disclosures that no longer are considered cost beneficial, clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant. ASU 2018-14 will be effective for us on January 1, 2021, with early adoption permitted, and is not expected to have a significant impact on our consolidated financial statements.

ASU 2018-15, “Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40) - Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.” ASU 2018-15 clarifies certain aspects of ASU 2015-05, “Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement,” which was issued in April 2015. Specifically, ASU 2018-15 aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). ASU 2018-15 does not affect the accounting for the service element of a hosting arrangement that is a service contract. ASU 2018-15 will be effective for us on January 1, 2020, with early adoption permitted. Tompkins is currently evaluating the potential impact of ASU 2018-15 on our consolidated financial statements.

ASU 2018-16, “Derivatives and Hedging (Topic 815) - Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes.” The amendments in this update permit use of the OIS rate based on SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815 in addition to the interest rates on direct U.S. Treasury obligations, the LIBOR swap rate, the OIS rate based on the Fed Funds Effective Rate and the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate. ASU 2018-16 became effective for us on January 1, 2019 and is not expected to have a significant impact on our consolidated financial statements.

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Note 2 Securities

Available-for-Sale Securities

The following tables summarize available-for-sale securities held by the Company at December 31, 2018 and 2017:

| | Available-for-Sale Securities | | | |
|---|---|---|---|---|
| December 31, 2018 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| (in thousands) | | | | |
| U.S. Treasuries | $289 | $ 0 | $ 0 | $289 |
| Obligations of U.S. Government sponsored entities | $493,371 | $ 80 | $ 7,553 | $485,898 |
| Obligations of U.S. states and political subdivisions | 86,260 | 113 | 933 | 85,440 |
| Mortgage-backed securities – residential, issued by | | | | |
| U.S. Government agencies | 131,831 | 168 | 3,732 | 128,267 |
| U.S. Government sponsored entities | 649,620 | 537 | 19,599 | 630,558 |
| Non-U.S. Government agencies or sponsored entities | 31 | 0 | 0 | 31 |
| U.S. corporate debt securities | 2,500 | 0 | 325 | 2,175 |
| Total available-for-sale securities | $1,363,902 | $ 898 | $ 32,142 | $1,332,658 |

| | Available-for-Sale Securities | | | |
|---|---|---|---|---|
| December 31, 2017 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| (in thousands) | | | | |
| Obligations of U.S. Government sponsored entities | $507,248 | $ 278 | $ 3,333 | $504,193 |
| Obligations of U.S. states and political subdivisions | 91,659 | 281 | 421 | 91,519 |
| Mortgage-backed securities – residential, issued by | | | | |
| U.S. Government agencies | 139,747 | 659 | 2,671 | 137,735 |
| U.S. Government sponsored entities | 667,767 | 1,045 | 12,634 | 656,178 |
| Non-U.S. Government agencies or sponsored entities | 75 | 0 | 0 | 75 |
| U.S. corporate debt securities | 2,500 | 0 | 338 | 2,162 |
| Total debt securities | 1,408,996 | 2,263 | 19,397 | 1,391,862 |
| Equity securities | 1,000 | 0 | 87 | 913 |
| Total available-for-sale securities | $1,409,996 | $ 2,263 | $ 19,484 | $1,392,775 |

Held-to-Maturity Securities

The following tables summarize held-to-maturity securities held by the Company at December 31, 2018 and 2017:

| | Held-to-Maturity Securities | | | |
|---|---|---|---|---|
| December 31, 2018 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| (in thousands) | | | | |
| Obligations of U.S. Government sponsored entities | $131,306 | $ 0 | $ 1,198 | $130,108 |
| Obligations of U.S. states and political subdivisions | 9,273 | 20 | 24 | 9,269 |
| Total held-to-maturity debt securities | $140,579 | $ 20 | $ 1,222 | $139,377 |

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Held-to-Maturity Securities

| December 31, 2017 | Held-to-Maturity Securities | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| (in thousands) | | | | |
| Obligations of U.S. Government sponsored entities | $131,707 | $ 1,103 | $ 90 | $132,720 |
| Obligations of U.S. states and political subdivisions | 7,509 | 93 | 7 | 7,595 |
| Total held-to-maturity debt securities | $139,216 | $ 1,196 | $ 97 | $140,315 |

The following table sets forth information with regard to sales transactions of securities available-for-sale:

| | Year ended December 31, | | |
|---|---|---|---|
| (in thousands) | 2018 | 2017 | 2016 |
| Proceeds from sales | $70,652 | $64,106 | $97,296 |
| Gross realized gains | 327 | 19 | 894 |
| Gross realized losses | (767 ) | (426 ) | 0 |
| Net (losses) gains on sales of available-for-sale securities | $(440 ) | $(407 ) | $894 |

There were no sales of held-to-maturity securities in 2018, 2017, and 2016.

The Company also recognized losses of $26,000 on equity securities for the twelve months ended December 31, 2018, reflecting the change in fair value.

The following table summarizes available-for-sale securities that had unrealized losses at December 31, 2018:

| December 31, 2018<br>Available-for-Sale Securities | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| (in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government sponsored entities | $21,660 | $ 183 | $449,141 | $ 7,370 | $470,801 | $ 7,553 |
| Obligations of U.S. states and political subdivisions | 11,971 | 19 | 49,756 | 914 | 61,727 | 933 |
| Mortgage-backed securities – residential, issued by | | | | | | |
| U.S. Government agencies | 16,854 | 22 | 96,247 | 3,710 | 113,101 | 3,732 |
| U.S. Government sponsored entities | 61,163 | 662 | 512,216 | 18,937 | 573,379 | 19,599 |
| U.S. corporate debt securities | 0 | 0 | 2,175 | 325 | 2,175 | 325 |
| Total available-for-sale securities | $111,648 | $ 886 | $1,109,535 | $ 31,256 | $1,221,183 | $ 32,142 |

The following table summarizes held-to-maturity securities that had unrealized losses at December 31, 2018:

| Held-to-Maturity Securities | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| (in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government sponsored entities | $4,980 | $ 9 | $125,128 | $ 1,189 | $130,108 | $ 1,198 |
| Obligations of U.S. sponsored entities | 8,127 | 24 | 0 | 0 | 8,127 | 24 |
| Total held-to-maturity securities | $13,107 | $ 33 | $125,128 | $ 1,189 | $138,235 | $ 1,222 |

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The following table summarizes available-for-sale securities that had unrealized losses at December 31, 2017:

| December 31, 2017 | | | | | | |
|---|---|---|---|---|---|---|
| Available-for-Sale Securities | Less than 12 Months | | 12 Months or Longer | | Total | |
| (in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government sponsored entities | $319,545 | $ 2,301 | $39,791 | $ 1,032 | $359,336 | $ 3,333 |
| Obligations of U.S. states and political subdivisions | 39,571 | 219 | 11,729 | 202 | 51,300 | 421 |
| Mortgage-backed securities – residential, issued by | | | | | | |
| U.S. Government agencies | 33,056 | 452 | 86,562 | 2,219 | 119,618 | 2,671 |
| U.S. Government sponsored entities | 208,524 | 1,941 | 410,767 | 10,693 | 619,291 | 12,634 |
| U.S. corporate debt securities | 0 | 0 | 2,163 | 338 | 2,163 | 338 |
| Equity securities | 0 | 0 | 913 | 87 | 913 | 87 |
| Total available-for-sale securities | $600,696 | $ 4,913 | $551,925 | $ 14,571 | $1,152,621 | $ 19,484 |

The following table summarizes held-to-maturity securities that had unrealized losses at December 31, 2017:

| Held-to-Maturity Securities | Less than 12 Months | | 12 Months or Longer | | Total | |
|---|---|---|---|---|---|---|
| (in thousands) | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government sponsored entities | $20,505 | $ 90 | $ 0 | $ 0 | $20,505 | $ 90 |
| Obligations of U.S. sponsored entities | 5,094 | 7 | 0 | 0 | 5,094 | 7 |
| Total held-to-maturity securities | $25,599 | $ 97 | $ 0 | $ 0 | $25,599 | $ 97 |

The gross unrealized losses reported for residential mortgage-backed securities relate to investment securities issued by U.S. government sponsored entities such as Federal National Mortgage Association and Federal Home Loan Mortgage Corporation, and U.S. government agencies such as Government National Mortgage Association. The total gross unrealized losses, shown in the tables above, were primarily attributable to changes in interest rates and levels of market liquidity, relative to when the investment securities were purchased, and not due to the credit quality of the investment securities.

The Company does not intend to sell the investment securities that are in an unrealized loss position until recovery of unrealized losses (which may be until maturity), and it is not more-likely-than not that the Company will be required to sell the investment securities before recovery of their amortized cost basis, which may be at maturity. Accordingly, as of December 31, 2018, and December 31, 2017, management believes the unrealized losses detailed in the tables above are not other-than-temporary.

The Company did not recognize any net credit impairment charge to earnings on investment securities in 2018 or 2017.

The amortized cost and estimated fair value of debt securities by contractual maturity are shown in the following table. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are shown separately since they are not due at a single maturity date.

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| December 31, 2018 | | |
|---|---|---|
| (in thousands) | Amortized Cost | Fair Value |
| Available-for-sale securities: | | |
| Due in one year or less | $78,160 | $77,930 |
| Due after one year through five years | 355,499 | 350,470 |
| Due after five years through ten years | 139,560 | 136,734 |
| Due after ten years | 9,201 | 8,668 |
| Total | 582,420 | 573,802 |
| Mortgage-backed securities | 781,482 | 758,856 |
| Total available-for-sale debt securities | $1,363,902 | $1,332,658 |

| December 31, 2017 | | |
|---|---|---|
| (in thousands) | Amortized Cost | Fair Value |
| Available-for-sale securities: | | |
| Due in one year or less | $51,909 | $51,932 |
| Due after one year through five years | 368,846 | 367,377 |
| Due after five years through ten years | 162,061 | 160,374 |
| Due after ten years | 18,591 | 18,191 |
| Total | 601,407 | 597,874 |
| Mortgage-backed securities | 807,589 | 793,988 |
| Total available-for-sale debt securities | $1,408,996 | $1,391,862 |

| December 31, 2018 | | |
|---|---|---|
| (in thousands) | Amortized Cost | Fair Value |
| Held-to-maturity securities: | | |
| Due in one year or less | $8,850 | $8,832 |
| Due after one year through five years | 86,520 | 85,645 |
| Due after five years through ten years | 45,209 | 44,900 |
| Due after ten years | 0 | 0 |
| Total held-to-maturity debt securities | $140,579 | $139,377 |

| December 31, 2017 | | |
|---|---|---|
| (in thousands) | Amortized Cost | Fair Value |
| Held-to-maturity securities: | | |
| Due in one year or less | $5,980 | $5,979 |
| Due after one year through five years | 51,936 | 52,227 |
| Due after five years through ten years | 81,300 | 82,109 |
| Due after ten years | 0 | 0 |
| Total held-to-maturity debt securities | $139,216 | $140,315 |

Trading Securities

The Company had no securities designated as trading during 2018 or at year-end 2017.

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Pledged Securities

The Company pledges securities as collateral for public deposits and other borrowings, and sells securities under agreements to repurchase. See “Note 8 - Securities Sold Under Agreements to Repurchase and Federal Funds Purchased” for further discussion. Securities carried of $1.2 billion and $1.3 billion, at December 31, 2018 and 2017, respectively, were either pledged or sold under agreements to repurchase.

Concentrations of Securities

Except for U.S. government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of shareholders’ equity at December 31, 2018.

Investment in Small Business Investment Companies

The Company has equity investments in small business investment companies (“SBIC”) established for the purpose of providing financing to small businesses in market areas served by the Company. These investments totaled $1.4 million at December 31, 2018, and $1.7 million at December 31, 2017, and were included in other assets on the Company’s Consolidated Statements of Condition. These investments are accounted for either under the cost method or the equity method of accounting. As of December 31, 2018, the Company reviewed these investments and determined that there was no impairment.

Federal Home Loan Bank Stock

The Company also holds non-marketable Federal Home Loan Bank New York (“FHLBNY”) stock, non-marketable Federal Home Loan Bank Pittsburgh (“FHLBPITT”) stock and non-marketable Atlantic Community Bankers Bank (“ACBB”) stock, all of which are required to be held for regulatory purposes and for borrowing availability. The required investment in FHLB stock is tied to the Company’s borrowing levels with the FHLB. Holdings of FHLBNY stock, FHLBPITT stock and ACBB stock totaled $37.4 million, $14.8 million and $95,000 at December 31, 2018, respectively. These securities are carried at par, which is also cost. The FHLBNY and FHLBPITT continue to pay dividends and repurchase stock. As such, the Company has not recognized any impairment on its holdings of FHLBNY and FHLBPITT stock.

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Note 3 Loans and Leases

Loans and Leases at December 31, 2018 and December 31, 2017 were as follows:

| | December 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| (in thousands) | Originated | Acquired | Total Loans and Leases | Originated | Acquired | Total Loans and Leases |
| Commercial and industrial | | | | | | |
| Agriculture | $107,494 | $0 | $107,494 | $108,608 | $0 | $108,608 |
| Commercial and industrial other | 926,429 | 43,712 | 970,141 | 932,067 | 50,976 | 983,043 |
| Subtotal commercial and industrial | 1,033,923 | 43,712 | 1,077,635 | 1,040,675 | 50,976 | 1,091,651 |
| Commercial real estate | | | | | | |
| Construction | 164,285 | 1,384 | 165,669 | 202,486 | 1,480 | 203,966 |
| Agriculture | 170,005 | 224 | 170,229 | 129,712 | 247 | 129,959 |
| Commercial real estate other | 1,827,279 | 177,484 | 2,004,763 | 1,660,782 | 206,020 | 1,866,802 |
| Subtotal commercial real estate | 2,161,569 | 179,092 | 2,340,661 | 1,992,980 | 207,747 | 2,200,727 |
| Residential real estate | | | | | | |
| Home equity | 208,459 | 21,149 | 229,608 | 212,812 | 28,444 | 241,256 |
| Mortgages | 1,083,802 | 20,484 | 1,104,286 | 1,039,040 | 22,645 | 1,061,685 |
| Subtotal residential real estate | 1,292,261 | 41,633 | 1,333,894 | 1,251,852 | 51,089 | 1,302,941 |
| Consumer and other | | | | | | |
| Indirect | 12,663 | 0 | 12,663 | 12,144 | 0 | 12,144 |
| Consumer and other | 57,565 | 761 | 58,326 | 50,214 | 765 | 50,979 |
| Subtotal consumer and other | 70,228 | 761 | 70,989 | 62,358 | 765 | 63,123 |
| Leases | 14,556 | 0 | 14,556 | 14,467 | 0 | 14,467 |
| Total loans and leases | 4,572,537 | 265,198 | 4,837,735 | 4,362,332 | 310,577 | 4,672,909 |
| Less: unearned income and deferred costs and fees | (3,796 ) | 0 | (3,796 ) | (3,789 ) | 0 | (3,789 ) |
| Total loans and leases, net of unearned income and deferred costs and fees | $4,568,741 | $265,198 | $4,833,939 | $4,358,543 | $310,577 | $4,669,120 |

The outstanding principal balance and the related carrying amount of the Company’s loans acquired in the VIST Acquisition were as follows at December 31:

| (in thousands) | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Acquired Credit Impaired Loans | | |
| Outstanding principal balance | $12,822 | $14,337 |
| Carrying amount | 11,036 | 11,962 |
| | | |
| Acquired Non-Credit Impaired Loans | | |
| Outstanding principal balance | 256,265 | 301,128 |
| Carrying amount | 254,162 | 298,615 |
| | | |
| Total Acquired Loans | | |
| Outstanding principal balance | $269,087 | $315,465 |
| Carrying amount | $265,198 | $310,577 |

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The Company has adopted comprehensive lending policies, underwriting standards and loan review procedures. There were no significant changes to the Company's existing lending policies, underwriting standards or loan review procedures during 2018. The Company's Board of Directors approves the lending policies at least annually. The Company recognizes that exceptions to policy guidelines may occasionally occur and has established procedures for approving exceptions to these policy guidelines. Management has also implemented reporting systems to monitor loan originations, loan quality, concentrations of credit, loan delinquencies and nonperforming loans and potential problem loans.

Residential real estate loans

The Company's policy is to underwrite residential real estate loans in accordance with secondary market guidelines in effect at the time of origination, including loan-to-value ("LTV") and documentation requirements. LTVs exceeding 80% for fixed rate loans and 85% for adjustable rate loans require private mortgage insurance to reduce the exposure to 78%. The Company verifies applicants' income, obtains credit reports and independent real estate appraisals in the underwriting process to ensure adequate collateral coverage and that loans are extended to individuals with good credit and income sufficient to repay the loan. In limited circumstances, the Company will make exceptions to secondary market underwriting standards to support community reinvestment activities.

The Company originates fixed rate and adjustable rate residential mortgage loans, including loans that have characteristics of both, such as a 7/1 adjustable rate mortgage, which has a fixed rate for the first seven years and then adjusts annually thereafter. The majority of residential mortgage loans originated over the last several years have been fixed rate loans due to the low interest rate environment. Adjustable rate residential real estate loans may be underwritten based upon an initial rate which is below the fully indexed rate; however, the initial rate is generally less than 100 basis points below the fully indexed rate. As such, the Company does not believe that this practice creates any significant credit risk.

The Company may sell residential real estate loans in the secondary market based on interest rate considerations. These residential real estate loans are generally sold to Federal Home Loan Mortgage Corporation ("FHLMC") or State of New York Mortgage Agency ("SONYMA") without recourse in accordance with standard secondary market loan sale agreements. These residential real estate loan sales are subject to customary representations and warranties, including representations and warranties related to gross incompetence and fraud. The Company has not had to repurchase any loans as a result of these general representations and warranties.

During 2018, 2017, and 2016, the Company sold residential mortgage loans totaling $27.7 million, $4.6 million, and $3.9 million, respectively, and realized net gains on these sales of $458,000, $50,000, and $95,000, respectively. These residential real estate loans are generally sold without recourse in accordance with standard secondary market loan sale agreements. When residential mortgage loans are sold to FHLMC or SONYMA, the Company typically retains all servicing rights, which provides the Company with a source of fee income. In connection with the sales in 2018, 2017, and 2016, the Company recorded mortgage-servicing assets of $207,000, $38,000, and $21,000, respectively.

Amortization of mortgage servicing assets amounted to $69,000 in 2018, $122,000 in 2017, and $157,000 in 2016. At December 31, 2018 and 2017, the Company serviced residential mortgage loans aggregating $120.9 million and $104.1 million, including loans securitized and held as available-for-sale securities. Mortgage servicing rights, at amortized basis, totaled $805,000 at December 31, 2018 and $667,000 at December 31, 2017. These mortgage servicing rights were evaluated for impairment at year-end 2018 and 2017 and no impairment was recognized. Loans held for sale, which are included in residential real estate totaled $2.7 million and $280,000 at December 31, 2018 and 2017, respectively.

As members of the FHLB, the Company's subsidiary banks may use unencumbered mortgage related assets to secure borrowings from the FHLB. At December 31, 2018 and 2017, the Company had $425.0 million and $475.0 million, respectively, of term advances from the FHLB that were secured by residential mortgage loans.

Commercial and industrial loans

The Company's Commercial Loan Policy sets forth guidelines for debt service coverage ratios, LTV's and documentation standards. Commercial and industrial loans are primarily made based on identified cash flows of the borrower with consideration given to underlying collateral and personal or government guarantees. The Company's policy establishes debt service coverage ratio limits that require a borrower's cash flow to be sufficient to cover principal and interest payments on all new and existing debt. Commercial and industrial loans are generally secured by the assets being financed or other business assets such as accounts receivable or inventory. Many of the loans in the commercial portfolio have variable interest rates tied to Prime Rate, FHLBNY borrowing rates, or U.S. Treasury indices.

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Commercial real estate
The Company’s Commercial Loan Policy sets forth guidelines for debt service coverage ratios, LTV’s and documentation standards. Commercial real estate loans are primarily made based on identified cash flows of the borrower with consideration given to underlying real estate collateral and personal or government guarantees. The Company’s policy establishes a maximum LTV of 75% and debt service coverage ratio limits that require a borrower’s cash flow to be sufficient to cover principal and interest payments on all new and existing debt. Commercial real estate loans may be fixed or variable rate loans with interest rates tied to Prime Rate, FHLBNY borrowing rates, or U.S. Treasury indices.

Agriculture loans
Agriculturally-related loans include loans to dairy farms and vegetable crop farms. Agriculturally-related loans are primarily made based on identified cash flows of the borrower with consideration given to underlying collateral, personal guarantees, and government related guarantees. Agriculturally-related loans are generally secured by the assets or property being financed or other business assets such as accounts receivable, livestock, equipment, or commodities/crops. The Company’s Commercial Loan Policy establishes a maximum LTV of 75% for real estate secured loans and debt service coverage ratio limits that require a borrower’s cash flow to be sufficient to cover principal and interest payments on all new and existing debt. The policy also establishes maximum LTV ratios for non-real estate collateral, such as livestock, commodities/crops, equipment and accounts receivable. Agriculturally-related loans may be fixed or variable rate with interest tied to Prime Rate, FHLBNY borrowing rates, or U.S. Treasury indices.

Consumer and other loans
The consumer loan portfolio includes personal installment loans, direct and indirect automobile financing, and overdraft lines of credit. The majority of the consumer portfolio consists of indirect and direct automobile loans. Consumer loans are generally short-term and have fixed rates of interest that are set giving consideration to current market interest rates, the financial strength of the borrower, and internal profitability targets. The Company's Consumer Loan Underwriting Guidelines Policy establishes maximum debt to income ratios and includes guidelines for verification of applicants’ income and receipt of credit reports.

Leases
Leases are primarily made to commercial customers and the origination criteria typically includes the value of the underlying assets being financed, the useful life of the assets being financed, and identified cash flows of the borrower. Most leases carry a fixed rate of interest that is set giving consideration to current market interest rates, the financial strength of the borrower, and internal profitability targets.

Loan and Lease Customers
The Company’s loan and lease customers are located primarily in the upstate New York communities served by its three subsidiary banks and in the Pennsylvania communities served by VIST Bank. The Trust Company operates fourteen banking offices in the counties of Tompkins, Cayuga, Cortland, Onondaga and Schuyler, New York. The Bank of Castile operates eighteen banking offices in the counties of Wyoming, Livingston, Genesee, Orleans and Monroe, New York. Mahopac Bank operates fourteen banking offices in the counties of Putnam County, Dutchess County and Westchester, New York. VIST Bank operates twenty offices in the counties of Berks, Montgomery, Philadelphia, Delaware and Schuylkill, Pennsylvania. Other than general economic risks, management is not aware of any material concentrations of credit risk to any industry or individual borrower.

Directors and officers of the Company and its affiliated companies were customer of, and had other transactions with, the Company's banking subsidiaries in the ordinary course of business. Such loans and commitments were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons not related to the Company, and did not involve more than normal risk of collectability

or present other unfavorable features.

Loans to Related Parties

Loan transactions with related parties at December 31 are summarized as follows:

| (in thousands) | 2018 | 2017 |
| --- | --- | --- |
| Balance at beginning of year | $14,503 | $11,662 |
| New Directors/Executive Officers | 467 | 0 |
| New loans and advancements | 30,570 | 3,972 |
| Loan payments | (5,945 ) | (1,131 ) |
| Balance at end of year | $39,595 | $14,503 |

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Nonaccrual Loans and Leases

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments are due. Loans are placed on nonaccrual status either due to the delinquency status of principal and/or interest (generally when past due 90 or more days) or a judgment by management that the full repayment of principal and interest is unlikely. When interest accrual is discontinued, all unpaid accrued interest is reversed. Payments received on loans on nonaccrual are generally applied to reduce the principal balance of the loan. Loans are generally returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. When management determines that the collection of principal in full is improbable, management will charge-off a partial amount or full amount of the loan balance. Management considers specific facts and circumstances relative to each individual credit in making such a determination. For residential and consumer loans, management uses specific regulatory guidance and thresholds for determining charge-offs.

Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if we can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, we may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable discount. The Company has determined that it can reasonably estimate future cash flows on our current portfolio of acquired loans that are past due 90 days or more and on which the Company is accruing interest and expect to fully collect the carrying value of the loans net of the allowance for acquired loan losses.

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The below table is an aging analysis of past due loans, segregated by originated and acquired loan and lease portfolios, and by class of loans, as of December 31, 2018 and 2017.
December 31, 2018

| (in thousands) | 30-89 days | 90 days or more | Current Loans | Total Loans | 90 days and accruing[1] | Nonaccrual |
|---|---|---|---|---|---|---|
| Originated Loans and Leases | | | | | | |
| Commercial and industrial | | | | | | |
| Agriculture | $0 | $0 | $107,494 | $107,494 | $ 0 | $ 0 |
| Commercial and industrial other | 2,367 | 1,659 | 922,403 | 926,429 | 0 | 1,861 |
| Subtotal commercial and industrial | 2,367 | 1,659 | 1,029,897 | 1,033,923 | 0 | 1,861 |
| Commercial real estate | | | | | | |
| Construction | 0 | 0 | 164,285 | 164,285 | 0 | 0 |
| Agriculture | 71 | 0 | 169,934 | 170,005 | 0 | 0 |
| Commercial real estate other | 1,201 | 1,856 | 1,824,222 | 1,827,279 | 0 | 7,691 |
| Subtotal commercial real estate | 1,272 | 1,856 | 2,158,441 | 2,161,569 | 0 | 7,691 |
| Residential real estate | | | | | | |
| Home equity | 986 | 1,026 | 206,447 | 208,459 | 0 | 1,784 |
| Mortgages | 2,693 | 4,027 | 1,077,082 | 1,083,802 | 0 | 7,770 |
| Subtotal residential real estate | 3,679 | 5,053 | 1,283,529 | 1,292,261 | 0 | 9,554 |
| Consumer and other | | | | | | |
| Indirect | 333 | 59 | 12,271 | 12,663 | 0 | 155 |
| Consumer and other | 187 | 24 | 57,354 | 57,565 | 0 | 79 |
| Subtotal consumer and other | 520 | 83 | 69,625 | 70,228 | 0 | 234 |
| Leases | 0 | 0 | 14,556 | 14,556 | 0 | 0 |
| Total loans and leases | 7,838 | 8,651 | 4,556,048 | 4,572,537 | 0 | 19,340 |
| Less: unearned income and deferred costs and fees | 0 | 0 | (3,796 ) | (3,796 ) | 0 | 0 |
| Total originated loans and leases, net of unearned income and deferred costs and fees | $7,838 | $8,651 | $4,552,252 | $4,568,741 | $ 0 | $ 19,340 |
| Acquired Loans and Leases | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $0 | $10 | $43,702 | $43,712 | $ 10 | $ 22 |
| Subtotal commercial and industrial | 0 | 10 | 43,702 | 43,712 | 10 | 22 |
| Commercial real estate | | | | | | |
| Construction | 0 | 0 | 1,384 | 1,384 | 0 | 0 |
| Agriculture | 0 | 0 | 224 | 224 | 0 | 0 |
| Commercial real estate other | 0 | 839 | 176,645 | 177,484 | 525 | 316 |
| Subtotal commercial real estate | 0 | 839 | 178,253 | 179,092 | 525 | 316 |
| Residential real estate | | | | | | |
| Home equity | 46 | 803 | 20,300 | 21,149 | 59 | 1,414 |
| Mortgages | 18 | 969 | 19,497 | 20,484 | 722 | 1,104 |
| Subtotal residential real estate | 64 | 1,772 | 39,797 | 41,633 | 781 | 2,518 |
| Consumer and other | | | | | | |
| Consumer and other | 3 | 0 | 758 | 761 | 0 | 0 |
| Subtotal consumer and other | 3 | 0 | 758 | 761 | 0 | 0 |
| Total acquired loans and leases, net of unearned income and deferred costs and fees | $67 | $2,621 | $262,510 | $265,198 | $ 1,316 | $ 2,856 |

[1] Includes acquired loans that were recorded at fair value at the acquisition date.

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December 31, 2017

| (in thousands) | 30-89 days | 90 days or more | Current Loans | Total Loans | 90 days and accruing[1] | Nonaccrual |
|---|---|---|---|---|---|---|
| Originated loans and leases | | | | | | |
| Commercial and industrial | | | | | | |
| Agriculture | $0 | $0 | $108,608 | $108,608 | $ 0 | $ 0 |
| Commercial and industrial other | 431 | 849 | 930,787 | 932,067 | 0 | 2,852 |
| Subtotal commercial and industrial | 431 | 849 | 1,039,395 | 1,040,675 | 0 | 2,852 |
| Commercial real estate | | | | | | |
| Construction | 0 | 0 | 202,486 | 202,486 | 0 | 0 |
| Agriculture | 0 | 0 | 129,712 | 129,712 | 0 | 0 |
| Commercial real estate other | 1,583 | 2,125 | 1,657,074 | 1,660,782 | 0 | 5,402 |
| Subtotal commercial real estate | 1,583 | 2,125 | 1,989,272 | 1,992,980 | 0 | 5,402 |
| Residential real estate | | | | | | |
| Home equity | 1,045 | 448 | 211,319 | 212,812 | 0 | 1,537 |
| Mortgages | 3,153 | 2,692 | 1,033,195 | 1,039,040 | 0 | 6,108 |
| Subtotal residential real estate | 4,198 | 3,140 | 1,244,514 | 1,251,852 | 0 | 7,645 |
| Consumer and other | | | | | | |
| Indirect | 449 | 205 | 11,490 | 12,144 | 6 | 278 |
| Consumer and other | 130 | 42 | 50,042 | 50,214 | 38 | 76 |
| Subtotal consumer and other | 579 | 247 | 61,532 | 62,358 | 44 | 354 |
| Leases | 0 | 0 | 14,467 | 14,467 | 0 | 0 |
| Total loans and leases | 6,791 | 6,361 | 4,349,180 | 4,362,332 | 44 | 16,253 |
| Less: unearned income and deferred costs and fees | 0 | 0 | (3,789) | (3,789) | 0 | 0 |
| Total originated loans and leases, net of unearned income and deferred costs and fees | $6,791 | $6,361 | $4,345,391 | $4,358,543 | $ 44 | $ 16,253 |
| Acquired loans and leases | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $12 | $61 | $50,903 | $50,976 | $ 61 | $ 0 |
| Subtotal commercial and industrial | 12 | 61 | 50,903 | 50,976 | 61 | 0 |
| Commercial real estate | | | | | | |
| Construction | 0 | 0 | 1,480 | 1,480 | 0 | 0 |
| Agriculture | 0 | 0 | 247 | 247 | 0 | 0 |
| Commercial real estate other | 167 | 727 | 205,126 | 206,020 | 515 | 546 |
| Subtotal commercial real estate | 167 | 727 | 206,853 | 207,747 | 515 | 546 |
| Residential real estate | | | | | | |
| Home equity | 601 | 564 | 27,279 | 28,444 | 130 | 1,604 |
| Mortgages | 472 | 942 | 21,231 | 22,645 | 440 | 1,114 |
| Subtotal residential real estate | 1,073 | 1,506 | 48,510 | 51,089 | 570 | 2,718 |
| Consumer and other | | | | | | |
| Consumer and other | 4 | 0 | 761 | 765 | 0 | 0 |
| Subtotal consumer and other | 4 | 0 | 761 | 765 | 0 | 0 |
| Total acquired loans and leases, net of unearned income and deferred costs and fees | $1,256 | $2,294 | $307,027 | $310,577 | $ 1,146 | $ 3,264 |

[1] Includes acquired loans that were recorded at fair value at the acquisition date.

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The difference between the interest income that would have been recorded if nonaccrual loans and leases had paid in accordance with their original terms and the interest income that was recorded, was $1.0 million for each of the years ended December 31, 2018, 2017 and 2016. The Company had no material commitments to make additional advances to borrowers with nonperforming loans.

Note 4 Allowance for Loan and Lease Losses

Originated Loans and Leases
Management reviews the appropriateness of the allowance for loan and lease losses (“allowance”) on a regular basis. Management considers the accounting policy relating to the allowance to be a critical accounting policy, given the inherent uncertainty in evaluating the levels of the allowance required to cover credit losses in the portfolio and the material effect that assumptions could have on the Company’s results of operations. The Company has developed a methodology to measure the amount of estimated loan loss exposure inherent in the loan portfolio to assure that an appropriate allowance is maintained. The Company’s methodology is based upon guidance provided in SEC Staff Accounting Bulletin No. 102, Selected Loan Loss Allowance Methodology and Documentation Issues and allowance allocations are calculated in accordance with ASC Topic 310, Receivables and ASC Topic 450, Contingencies.

The model is comprised of four major components that management has deemed appropriate in evaluating the appropriateness of the allowance for loan and lease losses. While none of these components, when used independently, is effective in arriving at a reserve level that appropriately measures the risk inherent in the portfolio, management believes that using them collectively, provides reasonable measurement of the loss exposure in the portfolio. The four components include: impaired loans; criticized and classified credits; historical loss experience; and qualitative or subjective analysis.

Since the methodology is based upon historical experience and trends as well as management’s judgment, factors may arise that result in different estimations. Significant factors that could give rise to changes in these estimates may include, but are not limited to, changes in economic conditions in the local area, concentration of risk, changes in interest rates, and declines in local property values. While management’s evaluation of the allowance as of December 31, 2018, considers the allowance to be appropriate, under different conditions or assumptions, the Company may need to adjust the allowance.

Acquired Loans and Leases
As part of our determination of the fair value of our acquired loans at the time of acquisition, the Company established a credit mark to provide for future losses in our acquired loan portfolio. To the extent that credit quality deteriorates subsequent to acquisition, such deterioration would result in the establishment of an allowance for the acquired loan portfolio.

Changes in the allowance for loan and lease losses for the twelve months ended December 31, 2018, 2017 and 2016 are summarized as follows:

| (in thousands) | 2018 | 2017 | 2016 |
|---|---|---|---|
| Total allowance at beginning of year | $39,771 | $35,755 | $32,004 |
| Provisions charged to operations | 3,942 | 4,161 | 4,321 |
| Recoveries on loans and leases | 2,137 | 2,429 | 2,139 |
| Charge-offs on loans and leases | (2,440 ) | (2,574 ) | (2,709 ) |
| Total allowance at end of year | $43,410 | $39,771 | $35,755 |

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The following tables detail activity in the allowance for originated and acquired loan and lease losses by portfolio segment for the twelve months ended December 31, 2018 and 2017.

December 31, 2018

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Allowance for originated loans and leases: | | | | | | |
| Beginning balance | $ 11,812 | $ 20,412 | $ 6,161 | $ 1,301 | $ 0 | $ 39,686 |
| Charge-offs | (293) | (60) | (424) | (1,350) | 0 | (2,127) |
| Recoveries | 50 | 812 | 324 | 679 | 0 | 1,865 |
| Provision | (352) | 2,319 | 1,256 | 674 | 0 | 3,897 |
| Ending Balance | $ 11,217 | $ 23,483 | $ 7,317 | $ 1,304 | $ 0 | $ 43,321 |

December 31, 2018

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Allowance for acquired loans: | | | | | | |
| Beginning balance | $ 25 | $ 0 | $ 54 | $ 6 | $ 0 | $ 85 |
| Charge-offs | (41) | (82) | (190) | 0 | 0 | (313) |
| Recoveries | 106 | 31 | 135 | 0 | 0 | 272 |
| Provision | (35) | 51 | 29 | 0 | 0 | 45 |
| Ending Balance | $ 55 | $ 0 | $ 28 | $ 6 | $ 0 | $ 89 |

December 31, 2017

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Allowance for originated loans and leases: | | | | | | |
| Beginning balance | $ 9,389 | $ 19,836 | $ 5,149 | $ 1,224 | $ 0 | $ 35,598 |
| Charge-offs | (291) | (21) | (584) | (960) | 0 | (1,856) |
| Recoveries | 119 | 980 | 212 | 405 | 0 | 1,716 |
| Provision | 2,595 | (383) | 1,384 | 632 | 0 | 4,228 |
| Ending Balance | $ 11,812 | $ 20,412 | $ 6,161 | $ 1,301 | $ 0 | $ 39,686 |

December 31, 2017

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Allowance for acquired loans: | | | | | | |
| Beginning balance | $ 0 | $ 97 | $ 54 | $ 6 | $ 0 | $ 157 |
| Charge-offs | (74) | (159) | (483) | (2) | 0 | (718) |
| Recoveries | 24 | 637 | 44 | 8 | 0 | 713 |
| Provision | 75 | (575) | 439 | (6) | 0 | (67) |
| Ending Balance | $ 25 | $ 0 | $ 54 | $ 6 | $ 0 | $ 85 |

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At December 31, 2018 and 2017, the allocation of the allowance for loan and lease losses summarized on the basis of the Company's impairment methodology was as follows:

December 31, 2018

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Allowance for originated loans and leases: | | | | | | |
| Individually evaluated for impairment | $ 397 | $ 3,365 | $ 0 | $ 0 | $ 0 | $3,762 |
| Collectively evaluated for impairment | 10,820 | 20,118 | 7,317 | 1,304 | 0 | 39,559 |
| Ending balance | $ 11,217 | $ 23,483 | $ 7,317 | $ 1,304 | $ 0 | $43,321 |
| Allowance for acquired loans: | | | | | | |
| Individually evaluated for impairment | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $0 |
| Collectively evaluated for impairment | 55 | 0 | 28 | 6 | 0 | 89 |
| Ending balance | $ 55 | $ 0 | $ 28 | $ 6 | $ 0 | $89 |

December 31, 2017

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Allowance for originated loans and leases: | | | | | | |
| Individually evaluated for impairment | $ 441 | $ 0 | $ 0 | $ 0 | $ 0 | $441 |
| Collectively evaluated for impairment | 11,371 | 20,412 | 6,161 | 1,301 | 0 | 39,245 |
| Ending balance | $ 11,812 | $ 20,412 | $ 6,161 | $ 1,301 | $ 0 | $39,686 |
| Allowance for acquired loans: | | | | | | |
| Individually evaluated for impairment | $ 25 | $ 0 | $ 0 | $ 0 | $ 0 | $25 |
| Collectively evaluated for impairment | 0 | 0 | 54 | 6 | 0 | 60 |
| Ending balance | $ 25 | $ 0 | $ 54 | $ 6 | $ 0 | $85 |

The recorded investment in loans and leases summarized on the basis of the Company's impairment methodology as of December 31, 2018 and December 31, 2017 was as follows:
December 31, 2018

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Originated loans and leases: | | | | | | |
| Individually evaluated for impairment | $1,864 | $8,388 | $3,915 | $0 | $0 | $14,167 |
| Collectively evaluated for impairment | 1,032,059 | 2,153,181 | 1,288,346 | 70,228 | 14,556 | 4,558,370 |
| Total | $1,033,923 | $2,161,569 | $1,292,261 | $70,228 | $14,556 | $4,572,537 |

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December 31, 2018

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Acquired loans: | | | | | | |
| Individually evaluated for impairment | $ 32 | $ 842 | $ 2,564 | $ 0 | $ 0 | $3,438 |
| Loans acquired with deteriorated credit quality | 153 | 5,852 | 5,031 | 0 | 0 | 11,036 |
| Collectively evaluated for impairment | 43,527 | 172,398 | 34,038 | 761 | 0 | 250,724 |
| Total | $ 43,712 | $ 179,092 | $ 41,633 | $ 761 | $ 0 | $265,198 |

December 31, 2017

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Originated loans and leases: | | | | | | |
| Individually evaluated for impairment | $1,759 | $6,626 | $3,965 | $0 | $0 | $12,350 |
| Collectively evaluated for impairment | 1,038,916 | 1,986,354 | 1,247,887 | 62,358 | 14,467 | 4,349,982 |
| Total | $1,040,675 | $1,992,980 | $1,251,852 | $62,358 | $14,467 | $4,362,332 |

December 31, 2017

| (in thousands) | Commercial and Industrial | Commercial Real Estate | Residential Real Estate | Consumer and Other | Finance Leases | Total |
|---|---|---|---|---|---|---|
| Acquired loans: | | | | | | |
| Individually evaluated for impairment | $ 276 | $ 1,372 | $ 1,823 | $ 0 | $ 0 | $3,471 |
| Loans acquired with deteriorated credit quality | 506 | 7,481 | 3,975 | 0 | 0 | 11,962 |
| Collectively evaluated for impairment | 50,194 | 198,894 | 45,291 | 765 | 0 | 295,144 |
| Total | $ 50,976 | $ 207,747 | $ 51,089 | $ 765 | $ 0 | $310,577 |

A loan is impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans consist of our non-homogenous nonaccrual loans, and all loans restructured in a troubled debt restructuring (TDR). Specific reserves on individually identified impaired loans that are not collateral dependent are measured based on the present value of expected future cash flows discounted at the original effective interest rate of each loan. For loans that are collateral dependent, impairment is measured based on the fair value of the collateral less estimated selling costs, and such impaired amounts are generally charged off. The majority of impaired loans are collateral dependent impaired loans that have limited exposure or require limited specific reserves because of the amount of collateral support with respect to these loans, and previous charge-offs. Interest payments on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured. In these cases, interest is recognized on a cash basis. There was no interest income recognized on impaired loans and leases for 2018, 2017 and 2016.

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The recorded investment on impaired loans as of December 31, 2018, and 2017 was as follows:

| | December 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| (in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Originated loans and leases with no related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $183 | $271 | $ 0 | $1,246 | $1,250 | $ 0 |
| Commercial real estate | | | | | | |
| Commercial real estate other | 3,205 | 3,405 | 0 | 6,626 | 6,633 | 0 |
| Residential real estate | | | | | | |
| Home equity | 3,915 | 4,168 | 0 | 3,965 | 4,049 | 0 |
| Subtotal | $7,303 | $7,844 | $ 0 | $11,837 | $11,932 | $ 0 |
| Originated loans and leases with related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $5,183 | $5,183 | $ 3,365 | $513 | $532 | $ 441 |
| Commercial real estate | | | | | | |
| Commercial real estate other | 1,681 | 1,681 | 397 | 0 | 0 | 0 |
| Subtotal | 6,864 | 6,864 | 3,762 | 513 | 532 | 441 |
| Total | $14,167 | $14,708 | $ 3,762 | $12,350 | $12,464 | $ 441 |

| | December 31, 2018 | | | December 31, 2017 | | |
|---|---|---|---|---|---|---|
| (in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Acquired loans with no related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $32 | $ 32 | $ 0 | $226 | $ 226 | $ 0 |
| Commercial real estate | | | | | | |
| Commercial real estate other | 842 | 924 | 0 | 1,372 | 1,474 | 0 |
| Residential real estate | | | | | | |
| Home equity | 2,564 | 2,696 | 0 | 1,823 | 1,854 | 0 |
| Subtotal | $3,438 | $ 3,652 | $ 0 | $3,421 | $ 3,554 | $ 0 |
| Acquired loans with related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $0 | $ 0 | $ 0 | $50 | $ 50 | $ 25 |
| Subtotal | 0 | 0 | 0 | 50 | 50 | 25 |
| Total | $3,438 | $ 3,652 | $ 0 | $3,471 | $ 3,604 | $ 25 |

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The average recorded investment and interest income recognized on impaired originated loans for the twelve months ended December 31, 2018, 2017, and 2016 was as follows:

| Twelve Months Ended December 31, | | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | |
| (in thousands) | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| Originated loans and leases with no related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $1,979 | $ 0 | $718 | $ 0 | $249 | $ 0 |
| Commercial real estate | | | | | | |
| Commercial real estate other | 5,165 | 0 | 7,287 | 0 | 6,089 | 0 |
| Residential real estate | | | | | | |
| Home equity | 3,983 | 0 | 3,551 | 0 | 3,003 | 0 |
| Subtotal | $11,127 | $ 0 | $11,556 | $ 0 | $9,341 | $ 0 |
| Originated loans and leases with related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $1,374 | $ 0 | $276 | $ 0 | $114 | $ 0 |
| Commercial real estate | | | | | | |
| Commercial real estate other | 1,357 | 0 | 0 | 0 | 1,715 | 0 |
| Subtotal | $2,731 | $ 0 | $276 | $ 0 | $1,829 | $ 0 |
| Total | $13,858 | $ 0 | $11,832 | $ 0 | $11,170 | $ 0 |

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The average recorded investment and interest income recognized on impaired acquired loans for the twelve months ended December 31, 2018, 2017 and 2016 was as follows:

| Twelve Months Ended December 31, | | | | | | |
|---|---|---|---|---|---|---|
| | 2018 | | 2017 | | 2016 | |
| (in thousands) | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized | Average Recorded Investment | Interest Income Recognized |
| Acquired loans with no related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $ 50 | $ 0 | $ 111 | $ 0 | $ 183 | $ 0 |
| Commercial real estate | | | | | | |
| Construction | 0 | 0 | 0 | 0 | 152 | 0 |
| Commercial real estate other | 999 | 0 | 2,141 | 0 | 4,141 | 0 |
| Residential real estate | | | | | | |
| Home equity | 2,945 | 0 | 1,861 | 0 | 1,316 | 0 |
| Subtotal | $ 3,994 | $ 0 | $ 4,113 | $ 0 | $ 5,792 | $ 0 |
| Acquired loans with related allowance | | | | | | |
| Commercial and industrial | | | | | | |
| Commercial and industrial other | $ 0 | $ 0 | $ 10 | $ 0 | $ 0 | $ 0 |
| Commercial real estate | | | | | | |
| Commercial real estate other | 0 | 0 | | | | |