

COMMUNITY BANK SYSTEM, INC.

Form 10-Q

November 08, 2013

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

FORM 10-Q

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

For the quarterly period ended September 30, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number: 001-13695

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

16-1213679  
(I.R.S. Employer Identification No.)

5790 Widewaters Parkway,  
DeWitt, New York  
(Address of principal executive offices)

13214-1883  
(Zip Code)

(315) 445-2282  
(Registrant's telephone number, including area code)

NONE

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted to its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting  
company ☐.  
(Do not check if a smaller reporting company)

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date.

40,356,426 shares of Common Stock, \$1.00 par value, were outstanding on October 31, 2013.

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## Part I. Financial Information

## Item 1. Financial Statements

## COMMUNITY BANK SYSTEM, INC.

## CONSOLIDATED STATEMENTS OF CONDITION (Unaudited)

(In Thousands, Except Share Data)

	September 30, 2013	December 31, 2012
Assets:		
Cash and cash equivalents	\$174,205	\$228,558
Available-for-sale investment securities (cost of \$1,852,496 and \$1,989,938, respectively)	1,848,652	2,121,394
Held-to-maturity investment securities (fair value of \$656,688 and \$703,957, respectively)	617,910	637,894
Other securities, at cost	52,012	59,239
Loans held for sale, at fair value	945	0
Loans	4,025,455	3,865,576
Allowance for loan losses	(44,083)	(42,888)
Net loans	3,981,372	3,822,688
Goodwill, net	369,703	369,703
Core deposit intangibles, net	11,772	14,492
Other intangibles, net	2,260	2,939
Intangible assets, net	383,735	387,134
Premises and equipment, net	91,826	89,938
Accrued interest and fee receivable	27,729	32,305
Other assets	123,631	117,650
Total assets	\$7,302,017	\$7,496,800
Liabilities:		
Noninterest-bearing deposits	\$1,158,013	\$1,110,994
Interest-bearing deposits	4,529,320	4,517,045
Total deposits	5,687,333	5,628,039
Borrowings	567,116	728,061
Subordinated debt held by unconsolidated subsidiary trusts	102,091	102,073
Accrued interest and other liabilities	79,798	135,849
Total liabilities	6,436,338	6,594,022
Commitments and contingencies (See Note J)		

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Shareholders' equity:

Preferred stock \$1.00 par value, 500,000 shares authorized, 0 shares issued	-	-
Common stock, \$1.00 par value, 75,000,000 shares authorized; 41,078,215 and		
40,421,493 shares issued, respectively	41,078	40,421
Additional paid-in capital	392,549	378,413
Retained earnings	477,568	447,018
Accumulated other comprehensive (loss) income	(28,401)	54,334
Treasury stock, at cost (782,173 and 795,560 shares, respectively)	(17,115)	(17,408)
Total shareholders' equity	865,679	902,778
Total liabilities and shareholders' equity	\$7,302,017	\$7,496,800

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.  
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)  
(In Thousands, Except Per-Share Data)

	Three Months Ended September 30, 2013		2012		Nine Months Ended September 30, 2013		2012	
Interest income:								
Interest and fees on loans	\$47,606	\$48,590	\$141,136	\$143,305				
Interest and dividends on taxable investments	13,394	16,762	41,176	48,487				
Interest and dividends on nontaxable investments	5,132	6,042	15,885	17,658				
Total interest income	66,132	71,394	198,197	209,450				
Interest expense:								
Interest on deposits	2,530	4,402	8,375	14,291				
Interest on borrowings	2,368	7,535	10,473	22,648				
Interest on subordinated debt held by unconsolidated subsidiary trusts	633	682	1,891	2,056				
Total interest expense	5,531	12,619	20,739	38,995				
Net interest income	60,601	58,775	177,458	170,455				
Provision for loan losses	2,093	2,643	4,807	6,442				
Net interest income after provision for loan losses	58,508	56,132	172,651	164,013				
Noninterest income:								
Deposit service fees	12,703	12,057	36,643	33,461				
Other banking services	1,671	1,405	3,729	3,295				
Benefit trust, administration, consulting and actuarial fees	9,397	8,912	28,564	26,549				
Wealth management services	3,823	3,194	11,566	9,427				
Gain on sales of investment securities	0	291	63,799	291				
Loss on debt extinguishments	0	0	(63,500)	0				
Total noninterest income	27,594	25,859	80,801	73,023				
Noninterest expenses:								
	30,448	28,126	91,217	82,395				

Salaries and employee benefits				
Occupancy and equipment	6,448	6,541	20,263	19,134
Data processing and communications	6,998	6,085	20,334	17,502
Amortization of intangible assets	1,089	1,212	3,408	3,343
Legal and professional fees	1,897	1,703	5,363	5,650
Office supplies and postage	1,566	1,345	4,579	4,195
Business development and marketing	1,973	1,312	5,256	4,360
FDIC insurance premiums	923	919	2,923	2,728
Acquisition expenses	71	4,796	71	5,221
Other	3,631	4,046	10,558	10,330
Total noninterest expenses	55,044	56,085	163,972	154,858
Income before income taxes	31,058	25,906	89,480	82,178
Income taxes	9,069	7,539	26,128	23,914
Net income	\$21,989	\$18,367	\$63,352	\$58,264
Basic earnings per share	\$0.55	\$0.46	\$1.58	\$1.48
Diluted earnings per share	\$0.54	\$0.46	\$1.56	\$1.46

The accompanying notes are an integral part of the consolidated financial statements.



## COMMUNITY BANK SYSTEM, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME/(LOSS) (Unaudited)

(In Thousands)

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013		2012
Pension and other post retirement obligations:					
Amortization of actuarial losses included in net periodic pension cost, gross	\$1,011	\$924	\$3,032	\$2,774	
Tax effect	(392)	(359)	(1,176)	(1,076)	
Amortization of actuarial losses included in net periodic pension cost, net	619	565	1,856	1,698	
Amortization of prior service cost included in net periodic pension cost, gross	(30)	(242)	(91)	(727)	
Tax effect	11	94	35	282	
Amortization of prior service cost included in net periodic pension cost, net	(19)	(148)	(56)	(445)	
Other comprehensive income related to pension and other post retirement obligations, net of taxes	600	417	1,800	1,253	
Unrealized gains on securities:					
Net unrealized holding (losses) gains arising during period, gross	(1,852)	14,067	1,501	58,452	
Tax effect	567	(5,325)	26,746	(22,545)	
Net unrealized holding (losses) gains arising during period, net	(1,285)	8,742	14,755	35,907	
Reclassification adjustment for net gains included in net income, gross	0	(291)	63,799	(291)	
Tax effect	0	102	24,019	102	
Reclassification adjustment for net gains included in net income, net	0	(189)	89,780	(189)	
Other comprehensive loss related to unrealized (loss)gain on available-for-sale securities, net of taxes	(1,285)	8,558	84,535	35,718	
Other comprehensive (loss)income, net of tax	(685)	8,977	82,735	36,971	
Net income	21,989	18,367	63,352	58,264	
Comprehensive income(loss)	\$21,304	\$27,344	\$149,383	\$95,235	
	As of				
	September		December		
	30,		31,		

	2013	2012
Accumulated Other Comprehensive Income By Component:		
Unrealized loss for pension and other postretirement obligations	(\$42,292)	(\$45,232)
Tax effect	16,307	17,447
Net unrealized loss for pension and other postretirement obligations	(25,985)	(27,785)
Unrealized (loss)gain on available-for-sale securities	(3,844)	131,456
Tax effect	1,428	(49,337)
Net unrealized (loss)gain on available-for-sale securities	(2,416)	82,119
Accumulated other comprehensive (loss) income	(\$28,401)	\$54,334

The accompanying notes are an integral part of the consolidated financial statements.

## COMMUNITY BANK SYSTEM, INC.

## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)

Nine months ended September 30, 2013

(In Thousands, Except Share Data)

	Common Stock Shares Outstanding	Amount Issued	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at December 31, 2012	39,625,933	\$40,421	\$378,413	\$447,018	\$54,334	(\$17,408)	\$902,778
Net income				63,352			63,352
Other comprehensive loss, net of tax					(82,735)		(82,735)
Cash dividends declared: Common, \$0.82 per share				(32,802)			(32,802)
Common stock issued under employee stock plan, including tax benefits of \$1,183	670,109	657	11,122			293	12,072
Stock-based compensation			3,014				3,014
Balance at September 30, 2013	40,296,042	\$41,078	\$392,549	\$477,568	(\$28,401)	(\$17,115)	\$865,679

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
(In Thousands)

	Nine Months Ended September 30, 2013      2012	
Operating activities:		
Net income	\$63,352	\$58,264
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,058	8,487
Amortization of intangible assets	3,408	3,343
Net accretion of premiums and discounts on securities and borrowings	(4,081)	(4,167)
Stock-based compensation	3,014	2,855
Provision for loan losses	4,807	6,442
Amortization of mortgage servicing rights	409	536
Income from bank-owned life insurance policies	(775)	(833)
Gain on sales of investment securities	(63,799)	(291)
Loss on debt extinguishments	63,500	0
Net loss/(gain) from sale of loans and other assets	248	229
Net change in loans held for sale	(913)	488
Change in other assets and liabilities	(6,297)	12,815
Net cash provided by operating activities	71,931	88,168
Investing activities:		
Proceeds from sales of available-for-sale investment securities	711,540	5,378
Proceeds from maturities of available-for-sale investment securities	158,849	144,958
Proceeds from maturities of held-to-maturity investment securities	27,074	20,517
Proceeds from sale of other investment securities	7,229	275
Purchases of available-for-sale investment securities	(666,841)	(745,074)
Purchases of held-to-maturity investment securities	(5,298)	(107,317)
Purchases of other securities	(2)	(14)
Net increase in loans	(163,491)	(187,154)
Cash received from acquisition, net of cash paid of \$0 and \$0	0	600,972
Purchases of premises and equipment, net	(11,226)	(7,103)
Net cash provided by (used in) investing activities	57,834	(274,562)
Financing activities:		
Net increase in deposits	59,294	115,422
	(224,445)	(165)

Net change in borrowings, net of payments of  
\$565,145 and \$165

Issuance of common stock	12,072	63,083
Cash dividends paid	(32,222)	(30,084)
Tax benefits from share-based payment arrangements	1,183	1,013
Net cash (used in) provided by financing activities	(184,118)	149,269
Change in cash and cash equivalents	(54,353)	(37,125)
Cash and cash equivalents at beginning of period	228,558	324,878
Cash and cash equivalents at end of period	\$174,205	\$287,753

Supplemental disclosures of cash flow information:

Cash paid for interest	\$23,935	\$39,355
Cash paid for income taxes	19,328	16,217

Supplemental disclosures of noncash financing and investing activities:

Dividends declared and unpaid	11,279	10,682
Transfers from loans to other real estate	5,024	2,571

Acquisitions:

Fair value of assets acquired, excluding acquired cash and intangibles	0	165,885
Fair value of liabilities assumed	0	798,031

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

September 30, 2013

NOTE A: BASIS OF PRESENTATION

The interim financial data as of and for the three and nine months ended September 30, 2013 is unaudited; however, in the opinion of Community Bank System, Inc. (the "Company"), the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in conformity with generally accepted accounting principles ("GAAP"). The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period.

NOTE B: ACQUISITIONS

In July 2013, Community Bank, N.A. (the "Bank") entered into a purchase and assumption agreement to acquire eight branch-banking locations across its Northeast Pennsylvania markets from Bank of America, N.A. Under the terms of the agreement, Community Bank will acquire approximately \$340 million in deposits at a deposit premium of approximately 2.4% and approximately \$1 million of loans. The transaction is expected to close during the fourth quarter of 2013.

On September 7, 2012, the Bank completed its acquisition of three branches in Western New York from First Niagara Bank, N.A. ("First Niagara"), acquiring approximately \$54 million of loans and \$101 million of deposits. The assumed deposits consisted primarily of core deposits (checking, savings and money market accounts) and the purchased loans consisted of in-market performing loans, primarily residential real estate loans. Under the terms of the purchase agreement, the Bank paid a blended deposit premium of 3.1%, or approximately \$3 million. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date.

On July 20, 2012, the Bank completed its acquisition of 16 retail branches in Central, Northern and Western New York from HSBC Bank USA, N.A. ("HSBC"), acquiring approximately \$106 million in loans and \$697 million of deposits. The assumed deposits consisted primarily of core deposits (checking, savings and money markets accounts) and the purchased loans consisted of in-market performing loans, primarily residential real estate loans. Under the terms of the purchase agreement, the Bank paid First Niagara (who acquired HSBC's Upstate New York banking business and assigned its right to purchase the 16 branches to the Bank) a blended deposit premium of 3.4%, or approximately \$24 million. The effects of the acquired assets and liabilities have been included in the consolidated financial statements since that date.

The assets and liabilities assumed in the acquisitions were recorded at their estimated fair values based on management's best estimates using information available at the dates of the acquisition, and are subject to adjustment based on updated information not available at the time of acquisition. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed during 2012.

(000s omitted)

Consideration  
received:

Cash/Total net consideration received	(\$595,462)
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Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash and cash equivalents	5,510
Loans	160,116
Premises and equipment	4,941
Accrued interest receivable	588
Other assets and liabilities, net	171
Core deposit intangibles	6,521
Deposits	(797,962)
Total identifiable liabilities, net	(620,115)
Goodwill	\$24,653

The following is a summary of the loans acquired from HSBC and First Niagara at the date of acquisition:

(000's omitted)	Acquired Impaired Loans	Acquired Non-Impaired Loans	Total Acquired Loans
Contractually required principal and interest at acquisition	\$0	\$201,745	\$201,745
Contractual cash flows not expected to be collected	0	(3,555)	(3,555)
Expected cash flows at acquisition	0	198,190	198,190
Interest component of expected cash flows	0	(38,074)	(38,074)
Fair value of acquired loans	\$0	\$160,116	\$160,116



The fair value of checking, savings and money market deposit accounts acquired were assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. Certificate of deposit accounts were valued as the present value of the certificates' expected contractual payments discounted at market rates for similar certificates.

The core deposit intangible related to the HSBC acquisition is being amortized using an accelerated method over the estimated useful life of eight years. The goodwill associated with the First Niagara and HSBC acquisitions, which is not amortized for book purposes, was assigned to the Banking segment. The goodwill arising from the HSBC branch and First Niagara branch acquisitions is deductible for tax purposes.

Direct costs related to the acquisitions were expensed as incurred. Merger and acquisition integration-related expenses amount to \$0.1 million in the three and nine months ended September 30, 2013 and \$4.8 million and \$5.2 million in the three and nine months ended September 30, 2012, respectively, and have been separately stated in the Consolidated Statements of Income.

Supplemental pro forma financial information related to the HSBC and First Niagara acquisitions has not been provided as it would be impracticable to do so. Historical financial information regarding the acquired branches is not accessible and thus the amounts would require estimates so significant as to render the disclosure irrelevant.

#### NOTE C: ACCOUNTING POLICIES

The accounting policies of the Company, as applied in the consolidated interim financial statements presented herein, are substantially the same as those followed on an annual basis as presented on pages 55 through 60 of the Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Securities and Exchange Commission ("SEC") on March 1, 2013.

##### Critical Accounting Policies

###### Acquired loans

Acquired loans are initially recorded at their acquisition date fair values. The carryover of allowance for loan losses is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. Fair values for acquired loans are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, prepayment risk, liquidity risk, default rates, loss severity, payment speeds, collateral values and discount rate.

For acquired loans that are not deemed impaired at acquisition, credit discounts representing principal losses expected over the life of the loan are a component of the initial fair value. Subsequent to the purchase date, the methods used to estimate the required allowance for loan losses for these loans is similar to originated loans. However, the Company records a provision for loan losses only when the required allowance exceeds any remaining credit discount. The remaining differences between the purchase price and the unpaid principal balance at the date of acquisition are recorded in interest income over the life of the loan.

Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments are accounted for as impaired loans under ASC 310-30. The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loans. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the non-accretable discount. The non-accretable discount represents estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows require the

Company to evaluate the need for an allowance for loan losses on these loans. Subsequent improvements in expected cash flows result in the reversal of a corresponding amount of the non-accretable discount which the Company then reclassifies as an accretable discount that is recognized into interest income over the remaining life of the loans using the interest method.

Acquired loans that met the criteria for non-accrual of interest prior to acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company 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, the Company may no longer consider the loan to be non-accrual or non-performing and may accrue interest on these loans, including the impact of any accretable discount. For acquired loans that are not deemed impaired at acquisition, purchase discounts representing the principal losses expected over the life of the loan are a component of the initial fair value and amortized over the life of the asset. Subsequent to the purchase date, the methods utilized to estimate the required allowance for loan losses for these loans is similar to originated loans, however, the Company records a provision for loan losses only when the required allowance exceeds any remaining purchase discounts for loans evaluated collectively for impairment.

#### Allowance for Loan Losses

Management continually evaluates the credit quality of the Company's loan portfolio, and performs a formal review of the adequacy of the allowance for loan losses on a quarterly basis. The allowance reflects management's best estimate of probable losses inherent in the loan portfolio. Determination of the allowance is subjective in nature and requires significant estimates. The Company's allowance methodology consists of two broad components - general and specific loan loss allocations.

The general loan loss allocation is composed of two calculations that are computed on five main loan segments: business lending, consumer installment - direct, consumer installment - indirect, home equity and consumer mortgage. The first calculation is quantitative and determines an allowance level based on the latest 36 months of historical net charge-off data for each loan class (commercial loans exclude balances with specific loan loss allocations). The second calculation is qualitative and takes into consideration eight qualitative environmental factors: levels and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. A component of the qualitative calculation is the unallocated allowance for loan loss. The qualitative and quantitative calculations are added together to determine the general loan loss allocation. The specific loan loss allocation relates to individual commercial loans that are both greater than \$0.5 million and in a nonaccruing status with respect to interest. Specific loan losses are based on discounted estimated cash flows, including any cash flows resulting from the conversion of collateral or collateral shortfalls. The allowance levels computed from the specific and general loan loss allocation methods are combined with unallocated allowances and allowances needed for acquired loans, if any, to derive the total required allowance for loan losses to be reflected on the Consolidated Statement of Condition.

Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan losses is charged to operations based on management's periodic evaluation of factors previously mentioned.

#### Investment Securities

The Company has classified its investments in debt and equity securities as held-to-maturity or available-for-sale. Held-to-maturity securities are those for which the Company has the positive intent and ability to hold until maturity, and are reported at cost, which is adjusted for amortization of premiums and accretion of discounts. Securities not classified as held-to-maturity are classified as available-for-sale and are reported at fair value with net unrealized gains and losses reflected as a separate component of shareholders' equity, net of applicable income taxes. None of the Company's investment securities have been classified as trading securities at September 30, 2013. Certain equity securities are stated at cost and include restricted stock of the Federal Reserve Bank of New York ("Federal Reserve") and Federal Home Loan Bank of New York ("FHLB").

Fair values for investment securities are based upon quoted market prices, where available. If quoted market prices are not available, fair values are based upon quoted market prices of comparable instruments, or a discounted cash flow model using market estimates of interest rates and volatility.

The Company conducts an assessment of all securities in an unrealized loss position to determine if other-than-temporary impairment ("OTTI") exists on a quarterly basis. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. The OTTI assessment considers the security structure, recent security collateral performance metrics, if applicable, external credit ratings, failure of the issuer to make scheduled interest or principal payments, judgment about and expectations of future performance, and relevant independent industry research, analysis and forecasts. The severity of the impairment and the length of time the

security has been impaired is also considered in the assessment. The assessment of whether an OTTI decline exists is performed on each security, regardless of the classification of the security as available-for-sale or held-to-maturity and involves a high degree of subjectivity and judgment that is based on the information available to management at a point in time.

An OTTI loss must be recognized for a debt security in an unrealized loss position if there is intent to sell the security or it is more likely than not the Company will be required to sell the security prior to recovery of its amortized cost basis. In this situation, the amount of loss recognized in income is equal to the difference between the fair value and the amortized cost basis of the security. Even if management does not have the intent, and it is not more likely than not that the Company will be required to sell the securities, an evaluation of the expected cash flows to be received is performed to determine if a credit loss has occurred. For debt securities, a critical component of the evaluation for OTTI is the identification of credit-impaired securities, where the Company does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. In the event of a credit loss, only the amount of impairment associated with the credit loss would be recognized in income. The portion of the unrealized loss relating to other factors, such as liquidity conditions in the market or changes in market interest rates, is recorded in accumulated other comprehensive loss.

Equity securities are also evaluated to determine whether the unrealized loss is expected to be recoverable based on whether evidence exists to support a realizable value equal to or greater than the amortized cost basis. If it is probable that the amortized cost basis will not be recovered, taking into consideration the estimated recovery period and the ability to hold the equity security until recovery, OTTI is recognized in earnings equal to the difference between the fair value and the amortized cost basis of the security.

The specific identification method is used in determining the realized gains and losses on sales of investment securities and OTTI charges. Premiums and discounts on securities are amortized and accreted, respectively, on the interest method basis over the period to maturity or estimated life of the related security. Purchases and sales of securities are recognized on a trade date basis.

### Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. Provisions for income taxes are based on taxes currently payable or refundable as well as deferred taxes that are based on temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are reported in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled.

Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority having full knowledge of all relevant information. A tax position meeting the more-likely-than-not recognition threshold should be measured at the largest amount of benefit for which the likelihood of realization upon ultimate settlement exceeds 50 percent.

### Intangible Assets

Intangible assets include core deposit intangibles, customer relationship intangibles and goodwill arising from acquisitions. Core deposit intangibles and customer relationship intangibles are amortized on either an accelerated or straight-line basis over periods ranging from 7 to 20 years. The initial and ongoing carrying value of goodwill and other intangible assets is based upon discounted cash flow modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires use of a discount rate that reflects the current return requirements of the market in relation to present risk-free interest rates, required equity market premiums, peer volatility indicators, and company-specific risk indicators.

The Company evaluates goodwill for impairment on an annual basis, or more often if events or circumstances indicate there may be impairment. The implied fair value of a reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value. The fair value of each reporting unit is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated.

### Retirement Benefits

The Company provides defined benefit pension benefits to eligible employees and post-retirement health and life insurance benefits to certain eligible retirees. The Company also provides deferred compensation and supplemental executive retirement plans for selected current and former employees, officers, and directors. Expense under these plans is charged to current operations and consists of several components of net periodic benefit cost based on various actuarial assumptions regarding future experience under the plans, including discount rate, rate of future compensation increases and expected return on plan assets.

## NOTE D: INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities as of September 30, 2013 and December 31, 2012 are as follows:

(000's omitted)	September 30, 2013				December 31, 2012			
	Amortized Cost	Gross Gains	Gross Losses	Fair Value	Amortized Cost	Gross Gains	Gross Losses	Fair Value
Held-to-Maturity Portfolio:								
U.S. Treasury and agency securities	\$540,649	\$38,553	\$2,717	\$576,485	\$548,634	\$59,081	\$0	\$607,715
Obligations of state and political subdivisions	61,638	2,863	0	64,501	65,742	5,850	0	71,592
Government agency mortgage-backed securities	12,706	41	1	12,746	20,578	1,079	0	21,657
Corporate debt securities	2,909	39	0	2,948	2,924	53	0	2,977
Other securities	8	0	0	8	16	0	0	16
Total held-to-maturity portfolio	\$617,910	\$41,496	\$2,718	\$656,688	\$637,894	\$66,063	\$0	\$703,957
Available-for-Sale Portfolio:								
U.S. Treasury and agency securities	\$888,404	\$2,824	\$13,956	\$877,272	\$988,217	\$91,040	\$0	\$1,079,257
Obligations of state and political subdivisions	621,802	15,352	11,159	625,995	629,883	33,070	61	662,892
Government agency mortgage-backed securities	238,348	9,191	2,640	244,899	253,013	16,989	51	269,951
Pooled trust preferred securities	56,540	0	5,289	51,251	61,979	0	12,379	49,600
Corporate debt securities	24,055	930	178	24,807	24,136	1,265	44	25,357
Government agency collateralized mortgage obligations	22,996	940	0	23,936	32,359	1,579	3	33,935
	351	150	9	492	351	94	43	402

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Marketable equity securities								
Total available-for-sale portfolio	\$1,852,496	\$29,387	\$33,231	\$1,848,652	\$1,989,938	\$144,037	\$12,581	\$2,121,394
Other Securities:								
Federal Home Loan Bank common stock	\$31,187			\$31,187	\$38,111			\$38,111
Federal Reserve Bank common stock	16,050			16,050	16,050			16,050
Other equity securities	4,775			4,775	5,078			5,078
Total other securities	\$52,012			\$52,012	\$59,239			\$59,239

A summary of investment securities that have been in a continuous unrealized loss position for less than, or greater, than twelve months is as follows:

As of September 30, 2013

	Less than 12 Months			12 Months or Longer			Total		
		Fair Value	Gross Unrealized Losses		Fair Value	Gross Unrealized Losses		Fair Value	Gross Unrealized Losses
(000's omitted)	#			#			#		
Held-to-Maturity Portfolio:									
U.S. Treasury and agency securities	5	\$99,031	\$2,717	0	\$0	\$0	5	\$99,031	\$2,717
Government agency mortgage-backed securities	2	1,127	1	0	0	0	2	1,127	1
Total held-to-maturity portfolio	7	\$100,158	\$2,718	0	\$0	\$0	7	\$100,158	\$2,718
Available-for-Sale Portfolio:									
U.S. Treasury and agency securities	25	\$641,200	\$13,956	0	\$0	\$0	25	\$641,200	\$13,956
Obligations of state and political subdivisions	314	206,198	11,125	2	904	34	316	207,102	11,159
Government agency mortgage-backed securities	45	61,198	2,508	1	1,555	132	46	62,753	2,640
Pooled trust preferred securities	0	0	0	3	51,251	5,289	3	51,251	5,289

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Corporate debt securities	1	3,038	23	1	2,749	155	2	5,787	178
Government agency collateralized mortgage obligations	0	0	0	1	7	0	1	7	0
Marketable equity securities	1	192	9	0	0	0	1	192	9
Total available-for-sale portfolio	386	911,826	27,621	8	56,466	5,610	394	968,292	33,231
Total investment portfolio	393	\$1,011,984	\$30,339	8	\$56,466	\$5,610	401	\$1,068,450	\$35,949



As of December 31, 2012

	Less than 12 Months			12 Months or Longer			Total		
	#	Fair Value	Gross Unrealized Losses	#	Fair Value	Gross Unrealized Losses	#	Fair Value	Gross Unrealized Losses
(000's omitted)									
Available-for-Sale Portfolio:									
Obligations of state and political subdivisions	19	\$11,503	\$61	0	\$0	\$0	19	\$11,503	\$61
Government agency mortgage-backed securities	8	14,354	51	0	0	0	8	14,354	51
Pooled trust preferred securities	0	0	0	3	49,600	12,379	3	49,600	12,379
Corporate debt securities	1	2,905	44	0	0	0	1	2,905	44
Government agency collateralized mortgage obligations	4	426	2	2	1,041	1	6	1,467	3
Marketable equity securities	0	0	0	1	158	43	1	158	43
Total available-for-sale/investment portfolio	32	\$29,188	\$158	6	\$50,799	\$12,423	38	\$79,987	\$12,581

Included in the available-for-sale portfolio are pooled trust preferred, class A-1 securities with a current total par value of \$57.7 million and unrealized losses of \$5.3 million at September 30, 2013. The underlying collateral of these assets is principally trust preferred securities of smaller regional banks and insurance companies. The Company's securities are in the super-senior cash flow tranche of the investment pools. All other tranches in these pools will incur losses before the super senior tranche is impacted. As of September 30, 2013, an additional 41% - 44% of the underlying collateral in these securities would have to be in deferral or default concurrently to result in an expectation of non-receipt of contractual cash flows.

A detailed review of the pooled trust preferred securities was completed as of September 30, 2013 and management concluded that it does not believe any individual unrealized loss represents an other-than-temporary impairment. This review included an analysis of collateral reports, a cash flow analysis, including varying degrees of projected deferral/default scenarios, and a review of various financial ratios of the underlying issuers. Based on the analysis performed, significant further deferral/defaults and further erosion in other underlying performance conditions would have to exist before the Company would incur a loss. To date, the Company has received all scheduled principal and interest payments and expects to fully collect all future contractual principal and interest payments. The Company does not intend to sell and it is not more likely than not that the Company will be required to sell the underlying securities. Subsequent changes in market or credit conditions could change those evaluations.

Management believes the unrealized losses in the portfolios are primarily attributable to changes in interest rates. The unrealized losses reported pertaining to government guaranteed mortgage-backed securities relate primarily to securities issued by GNMA, FNMA and FHLMC, which are currently rated AAA by Moody's Investor Services, AA+ by Standard & Poor's and are guaranteed by the U.S. government. The obligations of state and political subdivisions are typically general purpose debt obligations of various states and political subdivisions. The majority of the obligations of state and political subdivisions carry a credit rating of A or better, as well as a secondary level of credit enhancement. The Company does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell these securities, prior to recovery of the amortized cost. Thus, management does not believe

any individual unrealized loss as of September 30, 2013 represents OTTI.

The amortized cost and estimated fair value of debt securities at September 30, 2013, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

(000's omitted)	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$8,413	\$8,465	\$31,654	\$32,117
Due after one through five years	427,267	463,526	148,887	153,709
Due after five years through ten years	121,465	120,742	988,465	987,770
Due after ten years	48,059	51,209	421,795	405,729
Subtotal	605,204	643,942	1,590,801	1,579,325
Government agency collateralized mortgage obligations	0	0	22,996	23,936
Government agency mortgage-backed securities	12,706	12,746	238,348	244,899
Total	\$617,910	\$656,688	\$1,852,145	\$1,848,160

During the first quarter of 2013, the Company initiated a balance sheet restructuring program through the sale of certain longer duration investment securities and retirement of a portion of the Company's existing FHLB borrowings. During the first half of 2013, the Company sold \$648.7 million of U.S. Treasury and agency securities, realizing \$63.8 million of gains. The proceeds from those sales were utilized to retire \$501.6 million of FHLB borrowings with \$63.5 million of associated early extinguishments costs.

## NOTE E: LOANS

The segments of the Company's loan portfolio are disaggregated into the following classes that allow management to monitor risk and performance:

- Consumer mortgages - consist primarily of fixed rate residential instruments, typically 15 – 30 years in contractual term, secured by first liens on real property.
- Business lending - is comprised of general purpose commercial and industrial loans including, but not limited to agricultural-related and dealer floor plans, as well as mortgages on commercial property.
  - Consumer indirect - consists primarily of installment loans originated through selected dealerships and are secured by automobiles, marine and other recreational vehicles.
  - Consumer direct - all other loans to consumers such as personal installment loans and lines of credit.
- Home equity products - are consumer purpose installment loans or lines of credit most often secured by a first or second lien position on residential real estate with terms typically of 15 years or less.

The balance of these classes are summarized as follows:

	September 30,	December 31,
(000's omitted)	2013	2012
Consumer mortgage	\$1,570,607	\$1,448,415
Business lending	1,214,796	1,233,944
Consumer indirect	713,310	647,518
Consumer direct	178,496	171,474
Home equity	348,246	364,225
Gross loans, including deferred origination costs	4,025,455	3,865,576
Allowance for loan losses	(44,083)	(42,888)
Loans, net of allowance for loan losses	\$3,981,372	\$3,822,688

The outstanding balance related to credit impaired acquired loans was \$17.6 million and \$22.4 million at September 30, 2013 and December 31, 2012, respectively. The changes in the accretable discount related to the credit impaired acquired loans are as follows:

(000's omitted)	
Balance at December 31, 2012	\$1,770
Accretion recognized, year-to-date	(846)
Net reclassification to accretable from	73

nonaccretable	
Balance at	
September 30,	
2013	\$997

## Credit Quality

Management monitors the credit quality of its loan portfolio on an ongoing basis. Measurement of delinquency and past due status are based on the contractual terms of each loan. Past due loans are reviewed on a monthly basis to identify loans for non-accrual status. The following is an aged analysis of the Company's past due loans, by class as of September 30, 2013:

## Legacy Loans (excludes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 - 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total		Total Loans
				Past Due	Current	
Consumer mortgage	\$15,159	\$1,914	\$10,026	\$27,099	\$1,460,227	\$1,487,326
Business lending	4,901	5	5,318	10,224	1,015,686	1,025,910
Consumer indirect	9,510	380	14	9,904	698,625	708,529
Consumer direct	1,551	137	4	1,692	167,003	168,695
Home equity	2,064	35	2,003	4,102	270,360	274,462
Total	\$33,185	\$2,471	\$17,365	\$53,021	\$3,611,901	\$3,664,922

## Acquired Loans (includes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 - 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total Past Due	Acquired Impaired(1)	Current	Total Loans
Consumer mortgage	\$930	\$57	\$1,596	\$2,583	\$0	\$80,698	\$83,281
Business lending	405	0	2,387	2,792	9,937	176,157	188,886
Consumer indirect	237	0	0	237	0	4,544	4,781
Consumer direct	290	24	0	314	0	9,487	9,801
Home equity	350	98	365	813	0	72,971	73,784
Total	\$2,212	\$179	\$4,348	\$6,739	\$9,937	\$343,857	\$360,533

- (1) Acquired impaired loans were not classified as nonperforming assets as the loans are considered to be performing under ASC 310-30. As a result interest income, through the accretion of the difference between the carrying amount of the loans and the expected cashflows, is being recognized on all acquired impaired loans.

The following is an aged analysis of the Company's past due loans by class as of December 31, 2012:

Legacy Loans (excludes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 - 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total Past Due	Current	Total Loans
Consumer mortgage	\$16,334	\$1,553	\$8,866	\$26,753	\$1,318,534	\$1,345,287
Business lending	6,012	167	12,010	18,189	984,665	1,002,854
Consumer indirect	9,743	73	0	9,816	627,541	637,357
Consumer direct	1,725	71	8	1,804	154,462	156,266
Home equity	4,124	491	1,044	5,659	270,798	276,457
Total	\$37,938	\$2,355	\$21,928	\$62,221	\$3,356,000	\$3,418,221

Acquired Loans (includes loans acquired after January 1, 2009)

(000's omitted)	Past Due 30 - 89 Days	90+ Days Past Due and Still Accruing	Nonaccrual	Total Past Due	Acquired Impaired(1)	Current	Total Loans
Consumer mortgage	\$1,726	\$265	\$2,420	\$4,411	\$0	\$98,717	\$103,128
Business lending	3,665	80	1,681	5,426	13,761	211,903	231,090
Consumer indirect	434	0	0	434	0	9,727	10,161
Consumer direct	470	0	0	470	0	14,738	15,208
Home equity	959	48	331	1,338	0	86,430	87,768
Total	\$7,254	\$393	\$4,432	\$12,079	\$13,761	\$421,515	\$447,355

(1) Acquired impaired loans were not classified as nonperforming assets as the loans are considered to be performing under ASC 310-30. As a result interest income, through the accretion of the difference between the carrying amount of the loans and the expected cashflows, is being recognized on all acquired impaired loans.



The Company uses several credit quality indicators to assess credit risk in an ongoing manner. The Company's primary credit quality indicator for its business lending portfolio is an internal credit risk rating system that categorizes loans as "pass", "special mention", or "classified". Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. In general, the following are the definitions of the Company's credit quality indicators:

Pass	The condition of the borrower and the performance of the loans are satisfactory or better.
Special Mention	The condition of the borrower has deteriorated although the loan performs as agreed.
Classified	The condition of the borrower has significantly deteriorated and the performance of the loan could further deteriorate, if deficiencies are not corrected.
Doubtful	The condition of the borrower has deteriorated to the point that collection of the balance is improbable based on current facts and conditions.

The following table shows the amount of business lending loans by credit quality category:

	September 30, 2013			December 31, 2012		
(000's omitted)	Legacy	Acquired	Total	Legacy	Acquired	Total
Pass	\$842,417	\$118,256	\$960,673	\$818,469	\$144,869	\$963,338
Special mention	95,057	30,698	125,755	92,739	32,328	125,067
Classified	86,915	29,995	116,910	90,035	40,132	130,167
Doubtful	1,521	0	1,521	1,611	0	1,611
Acquired impaired	0	9,937	9,937	0	13,761	13,761
Total	\$1,025,910	\$188,886	\$1,214,796	\$1,002,854	\$231,090	\$1,233,944

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or nonperforming. Performing loans include current, 30 – 89 days past due and acquired impaired loans. Nonperforming loans include 90+ days past due and still accruing and nonaccrual loans.

The following table details the balances in all other loan categories at September 30, 2013:

Legacy loans (excludes loans acquired after January 1, 2009)

	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
(000's omitted)					
Performing	\$1,475,386	\$708,135	\$168,554	\$272,424	\$2,624,499
Nonperforming	11,940	394	141	2,038	14,513
Total	\$1,487,326	\$708,529	\$168,695	\$274,462	\$2,639,012

Acquired loans (includes loans acquired after January 1, 2009)



	Consumer (000's omitted)	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
Performing	\$81,628	4,781	9,777	73,321	\$169,507	
Nonperforming	1,653	0	24	463	2,140	
Total	\$83,281	\$4,781	\$9,801	\$73,784	\$171,647	

The following table details the balances in all other loan categories at December 31, 2012:

Legacy loans (excludes loans acquired after January 1, 2009)

	Consumer (000's omitted)	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
Performing	\$1,334,868	\$637,284	\$156,187	\$274,922	\$2,403,261	
Nonperforming	10,419	73	79	1,535	12,106	
Total	\$1,345,287	\$637,357	\$156,266	\$276,457	\$2,415,367	

Acquired loans (includes loans acquired after January 1, 2009)

	Consumer (000's omitted)	Consumer Mortgage	Consumer Indirect	Consumer Direct	Home Equity	Total
Performing	\$100,443	\$10,161	\$15,208	\$87,389	\$213,201	
Nonperforming	2,685	0	0	379	3,064	
Total	\$103,128	\$10,161	\$15,208	\$87,768	\$216,265	

All loan classes are collectively evaluated for impairment except business lending, as described in Note B. A summary of individually evaluated impaired loans as of September 30, 2013 and December 31, 2012 follows:

	September 30, 2013	December 31, 2012
(000's omitted)		
Loans with allowance allocation	\$1,746	\$1,611
Loans without allowance allocation	1,653	7,798
Carrying balance	3,399	9,409
Contractual balance	5,100	12,804
Specifically allocated allowance	654	800

In the course of working with borrowers, the Company may choose to restructure the contractual terms of certain loans. In this scenario, the Company attempts to work-out an alternative payment schedule with the borrower in order to optimize collectability of the loan. Any loans that are modified are reviewed by the Company to identify if a troubled debt restructuring ("TDR") has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial standing and the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two. With regard to determination of the amount of the allowance for loan losses, troubled debt restructured loans are considered to be impaired. As a result, the determination of the amount of allowance for loan losses related to impaired loans for each portfolio segment within troubled debt restructurings is the same as detailed previously.

Loans are considered modified in a 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 primarily include, among others, an extension of the term of the loan or granting a period with reduced or no principal and/or interest payments that can be caught up with payments made over the remaining term of the loan or at maturity. During 2012, clarified guidance was issued by the OCC addressing the accounting for certain loans that have been discharged in Chapter 7 bankruptcy. In accordance with this clarified guidance, loans that have been discharged in Chapter 7 bankruptcy, but not reaffirmed by the borrower, are classified as TDRs, irrespective of payment history or delinquency status, even if the repayment terms for the loan have not been otherwise modified. The Company's lien position against the underlying collateral remains unchanged. Pursuant to that guidance, the Company records a charge-off equal to any portion of the carrying value that exceeds the net realizable value of the collateral. The amount of loss incurred in 2012 and 2013 was immaterial. In reporting periods prior to December 31, 2012, such loans were classified as TDRs only if there had been a change in contractual payment terms that represented a concession to the borrower. The impact on prior periods was determined to be immaterial and therefore, prior period disclosure has not been made.

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Commercial loans greater than \$0.5 million are individually evaluated for impairment, and if necessary, a specific allocation of the allowance for loan losses is provided. Included in the impaired loan balances above was one TDR totaling \$1.6 million with a specific reserve of \$0.4 million. TDRs less than \$0.5 million are collectively included in the general loan loss allocation and the qualitative review, if necessary.

Information regarding troubled debt restructurings as of September 30, 2013 and December 31, 2012 is as follows:

(000's omitted)	September 30, 2013						December 31, 2012					
	Nonaccrual		Accruing		Total		Nonaccrual		Accruing		Total	
	#	Amount	#	Amount	#	Amount	#	Amount	#	Amount	#	Amount
Consumer mortgage	11	\$814	50	\$2,291	61	\$3,105	3	\$160	45	\$2,074	48	\$2,234
Business lending	7	2,095	3	303	10	2,398	10	3,046	0	0	10	3,046
Consumer indirect	2	10	103	706	105	716	0	0	106	718	106	718
Consumer direct	0	0	31	143	31	143	0	0	19	116	19	116
Home equity	6	67	21	378	27	445	5	70	19	266	24	336
Total	26	\$2,986	208	\$3,821	234	\$6,807	18	\$3,276	189	\$3,174	207	\$6,450

The following table presents information related to loans modified in a TDR during the three and nine months ended September 30, 2013. Of the loans noted in the table below, all loans for the three months ended September 30, 2013, and all but two loans for nine months ended September 30, 2013, were modified due to a Chapter 7 bankruptcy as described previously. The others were a business loan restructured via an extension of term and a consumer mortgage restructured via an extension of term and a rate concession. The financial effects of these restructurings were immaterial.

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	Number	Outstanding	Number	Outstanding
(000's omitted)	of loans modified	Balance	of loans modified	Balance
Consumer mortgage	6	\$384	20	\$1,151
Business lending	1	155	4	437
Consumer indirect	5	83	27	253
Consumer direct	2	2	15	67
Home equity	4	148	9	192
Total	18	\$772	75	\$2,100

#### Allowance for Loan Losses

The allowance for loan losses is general in nature and is available to absorb losses from any loan type despite the analysis below. The following presents by class the activity in the allowance for loan losses:

Three Months Ended September 30, 2013								
	Consumer	Business	Consumer	Consumer	Home	Acquired		
(000's omitted)	Mortgage	Lending	Indirect	Direct	Equity	Unallocated	Impaired	Total
Beginning balance	\$7,373	\$18,283	\$9,369	\$3,054	\$1,674	\$2,745	\$975	\$43,473
Charge-offs	(217)	(1,012)	(1,186)	(348)	(59)	0	(59)	(2,881)
Recoveries	2	375	811	206	4	0	0	1,398
Provision	443	625	1,074	253	95	(500)	103	2,093
Ending balance	\$7,601	\$18,271	\$10,068	\$3,165	\$1,714	\$2,245	\$1,019	\$44,083

Three Months Ended September 30, 2012								
	Consumer	Business	Consumer	Consumer	Home	Acquired		
(000's omitted)	Mortgage	Lending	Indirect	Direct	Equity	Unallocated	Impaired	Total
Beginning balance	\$6,313	\$18,698	\$8,670	\$3,223	\$1,392	\$3,112	\$420	\$41,828
Charge-offs	(293)	(1,100)	(1,460)	(344)	(39)	0	0	(3,236)

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Recoveries	17	454	850	259	2	0	0	1,582
Provision	730	510	1,340	220	40	(390)	193	2,643
Ending balance	\$6,767	\$18,562	\$9,400	\$3,358	\$1,395	\$2,722	\$613	\$42,817

Nine Months Ended September 30, 2013

	Consumer	Business	Consumer	Consumer	Home	Acquired		
(000's omitted)	Mortgage	Lending	Indirect	Direct	Equity	Unallocated	Impaired	Total
Beginning balance	\$7,070	\$18,013	\$9,606	\$3,303	\$1,451	\$2,666	\$779	\$42,888
Charge-offs	(817)	(2,075)	(3,075)	(1,300)	(379)	0	(59)	(7,705)
Recoveries	15	619	2,682	761	16	0	0	4,093
Provision	1,333	1,714	855	401	626	(421)	299	4,807
Ending balance	\$7,601	\$18,271	\$10,068	\$3,165	\$1,714	\$2,245	\$1,019	\$44,083

Nine Months Ended September 30, 2012

	Consumer	Business	Consumer	Consumer	Home	Acquired		
(000's omitted)	Mortgage	Lending	Indirect	Direct	Equity	Unallocated	Impaired	Total
Beginning balance	\$4,651	\$20,574	\$8,960	\$3,290	\$1,130	\$3,222	\$386	\$42,213
Charge-offs	(712)	(4,327)	(3,633)	(1,074)	(220)	0	0	(9,966)
Recoveries	34	787	2,674	613	20	0	0	4,128
Provision	2,794	1,528	1,399	529	465	(500)	227	6,442
Ending balance	\$6,767	\$18,562	\$9,400	\$3,358	\$1,395	\$2,722	\$613	\$42,817

## NOTE F: GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

The gross carrying amount and accumulated amortization for each type of identifiable intangible asset are as follows:

	September 30, 2013			December 31, 2012		
	Gross		Net	Gross		Net
	Carrying	Accumulated	Carrying	Carrying	Accumulated	Carrying
(000's omitted)	Amount	Amortization	Amount	Amount	Amortization	Amount
Amortizing intangible assets:						
Core deposit intangibles	\$38,958	(\$27,186)	\$11,772	\$38,958	(\$24,466)	\$14,492
Other intangibles	9,442	(7,182)	2,260	9,432	(6,493)	2,939
Total amortizing intangibles	\$48,400	(\$34,368)	\$14,032	\$48,390	(\$30,959)	\$17,431

The estimated aggregate amortization expense for each of the five succeeding fiscal years ended December 31 is as follows:

Oct - Dec	
2013	\$1,034
2014	3,599
2015	2,806
2016	2,096
2017	1,479
Thereafter	3,018
Total	\$14,032

Shown below are the components of the Company's goodwill at September 30, 2013:

(000's omitted)	December 31, 2012	Activity	September 30, 2013
Goodwill	\$374,527	\$0	\$374,527
Accumulated impairment	(4,824)	0	(4,824)
Goodwill, net	\$369,703	\$0	\$369,703

## NOTE G: MANDATORILY REDEEMABLE PREFERRED SECURITIES

The Company sponsors two business trusts, Community Statutory Trust III and Community Capital Trust IV, of which 100% of the common stock is owned by the Company. The trusts were formed for the purpose of issuing company-obligated mandatorily redeemable preferred securities to third-party investors and investing the proceeds from the sale of such preferred securities solely in junior subordinated debt securities of the Company. The

debentures held by each trust are the sole assets of that trust. Distributions on the preferred securities issued by each trust are payable quarterly at a rate per annum equal to the interest rate being earned by the trust on the debentures held by that trust and are recorded as interest expense in the consolidated financial statements. The preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the preferred securities subject to the terms of each of the guarantees. The terms of the preferred securities of each trust are as follows:

Issuance		Par	Maturity		Call
Trust	Date	Amount	Interest Rate	Date	Price
3 month					
LIBOR plus					
\$24.5					
3.58%					
III	7/31/2001	million	(3.85%)	7/31/2031	Par
3 month					
LIBOR plus					
\$75					
1.65%					
IV	12/8/2006	million	(1.90%)	12/15/2036	Par

## NOTE H: BENEFIT PLANS

The Company provides a qualified defined benefit pension to eligible employees and retirees, other post-retirement health and life insurance benefits to certain retirees, an unfunded supplemental pension plan for certain key executives, and an unfunded stock balance plan for certain of its nonemployee directors. The Company accrues for the estimated cost of these benefits through charges to expense during the years that employees earn these benefits. The net periodic benefit cost for the three and nine months ended September 30, 2013 and 2012 is as follows:

	Pension Benefits				Post-retirement Benefits			
	Three Months		Nine Months		Three Months		Nine Months	
	Ended		Ended		Ended		Ended	
	September 30,		September 30,		September 30,		September 30,	
(000's omitted)	2013	2012	2013	2012	2013	2012	2013	2012
Service cost	\$985	\$848	\$2,955	\$2,544	\$0	\$0	\$0	\$0
Interest cost	1,029	1,098	3,086	3,295	22	29	66	86
Expected return on plan assets	(2,710)	(2,299)	(7,612)	(6,897)	0	0	0	0
Amortization of unrecognized net loss	1,008	922	3,023	2,765	3	3	9	9
Amortization of prior service cost	14	(37)	43	(110)	(45)	(206)	(134)	(617)
Net periodic benefit cost	\$326	\$532	\$1,495	\$1,597	(\$20)	(\$174)	(\$59)	(\$522)

During July 2013, the Company made a contribution to its defined benefit pension plan of \$10.0 million. No other contributions are required in 2013.

## NOTE I: EARNINGS PER SHARE

Basic earnings per share are computed based on the weighted-average of the common shares outstanding for the period. Diluted earnings per share are based on the weighted-average of the shares outstanding adjusted for the dilutive effect of restricted stock and the assumed exercise of stock options during the year. The dilutive effect of options is calculated using the treasury stock method of accounting. The treasury stock method determines the number of common shares that would be outstanding if all the dilutive options (those where the average market price is greater than the exercise price) were exercised and the proceeds were used to repurchase common shares in the open market at the average market price for the applicable time period. There were approximately 0.3 million weighted-average anti-dilutive stock options outstanding for the three months ended September 30, 2013 and approximately 0.5 million weighted-average anti-dilutive stock options outstanding for the nine months ended September 30, 2013, compared to approximately 0.6 million weighted-average anti-dilutive stock options outstanding for the three months September 30, 2012 and approximately 0.5 million weighted-average anti-dilutive stock options outstanding for the nine months September 30, 2012 that were not included in the computation below.

The following is a reconciliation of basic to diluted earnings per share for the three and nine months ended September 30, 2013 and 2012.



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	Three Months Ended September 30,		Nine Months Ended September 30,	
(000's omitted, except per share data)	2013	2012	2013	2012
Net income	\$21,989	\$18,367	\$63,352	\$58,264
Income attributable to unvested stock-based compensation awards	(121)	(125)	(315)	(372)
Income available to common shareholders	21,868	18,242	63,037	57,892
Weighted-average common shares outstanding – basic	40,121	39,384	39,914	39,095
Basic earnings per share	\$0.55	\$0.46	\$1.58	\$1.48
Net income	\$21,989	\$18,367	\$63,352	\$58,264
Income attributable to unvested stock-based compensation awards	(121)	(125)	(315)	(372)
Income available to common shareholders	21,868	18,242	63,037	57,892
Weighted-average common shares outstanding – basic	40,121	39,384	39,914	39,095
Assumed exercise of stock options	506	486	474	496
Weighted-average common shares outstanding – diluted	40,627	39,870	40,388	39,591
Diluted earnings per share	\$0.54	\$0.46	\$1.56	\$1.46
Cash dividends declared per share	\$0.28	\$0.27	\$0.82	\$0.79

### Stock Repurchase Program

At its December 2012 meeting, the Company's Board of Directors approved a new repurchase program authorizing the repurchase of up to 2,000,000 of its outstanding shares in open market transactions or privately negotiated transactions in accordance with securities laws and regulations, through December 31, 2013. Any repurchased shares will be used for general corporate purposes, including those related to stock plan activities. The timing and extent of repurchases will depend on market conditions and other corporate considerations as determined at the Company's discretion. There were no open market treasury stock purchases in 2012 or the first nine months of 2013. There were approximately 24,000 common shares repurchased during the nine months ended September 30, 2013 that were acquired by the Company in connection with satisfaction of tax withholding obligations on vested restricted stock.

### NOTE J: COMMITMENTS, CONTINGENT LIABILITIES AND RESTRICTIONS

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist primarily of commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to customers, generally having fixed expiration dates or other termination clauses that may require payment of a fee. These commitments consist principally of unused commercial and consumer credit lines. Standby letters of credit generally are contingent upon the failure of the customer to perform according to the terms of an underlying contract with a third party. The credit risks associated with commitments to extend credit and standby letters of credit are essentially the same as that involved with extending loans to customers and are subject to the Company's normal credit policies. Collateral may be obtained based on management's assessment of the customer's creditworthiness. The fair value of the standby letters of credit is immaterial for disclosure.

The contract amount of commitments and contingencies are as follows:

	September	December
(000's omitted)	30, 2013	31, 2012
Commitments to extend credit	\$758,837	\$750,178
Standby letters of credit	24,090	24,168
Total	\$782,927	\$774,346

The Company and its subsidiaries are subject in the normal course of business to various pending and threatened legal proceedings in which claims for monetary damages are asserted. As of September 30, 2013, management, after consultation with legal counsel, does not anticipate that the aggregate ultimate liability arising out of litigation pending or threatened against the Company or its subsidiaries will be material to the Company's consolidated financial position. On at least a quarterly basis the Company assesses its liabilities and contingencies in connection with such legal proceedings. For those matters where it is probable that the Company will incur losses and the amounts of the losses can be reasonably estimated, the Company records an expense and corresponding liability in its consolidated financial statements.

### NOTE K: FAIR VALUE

Accounting standards allow entities an irrevocable option to measure certain financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in

earnings. The Company has elected to value loans held for sale at fair value in order to more closely match the gains and losses associated with loans held for sale with the gains and losses on forward sales contracts. Accordingly, the impact on the valuation will be recognized in the Company's consolidated statement of income. All mortgage loans held for sale are current and in performing status.

Accounting standards establish a framework for measuring fair value and require certain disclosures about such fair value instruments. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. exit price). Inputs used to measure fair value are classified into the following hierarchy:

- Level 1 – Quoted prices in active markets for identical assets or liabilities.
- Level 2 – Quoted prices in active markets for similar assets or liabilities, or quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability.
- Level 3 – Significant valuation assumptions not readily observable in a market.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables set forth the Company's financial assets and liabilities that were accounted for at fair value on a recurring basis. There were no transfers between any of the levels for the periods presented.

September 30, 2013				
(000's omitted)	Level 1	Level 2	Level 3	Total Fair Value
Available-for-sale investment securities:				
U.S. Treasury and agency securities	\$862,068	\$15,204	\$0	\$877,272
Obligations of state and political subdivisions	0	625,995	0	625,995
Government agency mortgage-backed securities	0	244,899	0	244,899
Pooled trust preferred securities	0	0	51,251	51,251
Corporate debt securities	0	24,807	0	24,807
Government agency collateralized mortgage obligations	0	23,936	0	23,936
Marketable equity securities	492	0	0	492
Total available-for-sale investment securities	862,560	934,841	51,251	1,848,652
Forward sales commitments	0	(129)	0	(129)
Commitments to originate real estate loans for sale	0	0	268	268
Mortgage loans held for sale	0	945	0	945
Total	\$862,560	\$935,657	\$51,519	\$1,849,736

December 31, 2012				
(000's omitted)	Level 1	Level 2	Level 3	Total Fair Value
Available-for-sale investment securities:				