INTERCONTINENTAL HOTELS GROUP PLC /NEW/
Form 6-K
January 04, 2019

SECURITIES AND EXCHANGE COMMISSION

Washington DC 20549

FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER PURSUANT TO RULE 13a-16 AND 15d-16 OF THE SECURITIES EXCHANGE ACT OF 1934

For 04 January 2019

InterContinental Hotels Group PLC
(Registrant's name)

Broadwater Park, Denham, Buckinghamshire, UB9 5HJ, United Kingdom
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): Not applicable

EXHIBIT INDEX

99.1 Total Voting Rights dated 02 January 2019

Exhibit No: 99.1

InterContinental Hotels Group PLC (the "Company")

Total Voting Rights and Capital

In accordance with Disclosure and Transparency Rule 5.6.1, the Company announces that, as at 31 December 2018, its issued share capital consists of 197,597,600 ordinary shares of 19 17/21 pence each with each share carrying the right to one vote. 6,827,020 ordinary shares are held in treasury following a transfer of 100,651 ordinary shares from the Company's treasury account to the Trustees of InterContinental Hotels Group Employee Share Ownership Trust for no consideration on 10 December 2018. These numbers also reflect the cancellation of 10 ordinary shares purchased by the Company (as announced on 19 December 2018) in anticipation of the Company's $500m special dividend and share consolidation announced on 14 December 2018. The total number of voting rights in the Company is 190,770,580.

The above figure may be used by shareholders as the denominator for the calculations by which they may determine if they are required to notify their interest in, or a change to their interest in, the Company under the Financial Conduct Authority's Disclosure and Transparency Rules.

Nicolette Henfrey
SVP, Deputy Company Secretary & Head of Corporate Legal

For further information, please contact:
Corporate Legal & Secretariat (Nicolette Henfrey): +44 (0)1895 512 0

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

InterContinental Hotels Group PLC
(Registrant)

By:	/s/ F. Cuttell
Name:	F. CUTTELL
Title:	ASSISTANT COMPANY SECRETARY
Date:	04 January 2019

D9D9 ;border-left:1pt none #D9D9D9 ;border-bottom:1pt none #D9D9D9 ;border-right:1pt none #D9D9D9 ;background-color: #CCEEFF;height:11.25pt;padding:0pt;">

$

1,017,853

Interest-bearing liabilities:

Deposits:

Interest-bearing checking

$

250,390

$

239

0.13%

$

219,863

189

0.11%

Money Management

392,050

1,007

0.34%

383,011

1,128

0.39%

Savings

72,368

41

0.08%

65,558

36

0.07%

Time

81,960

363

0.59%

93,791

460

0.66%

Total interest-bearing deposits

796,768

1,650

0.28%

762,223

1,813

0.32%

Securities sold under agreements to repurchase

-

-

-

33

-

0.15%

Other borrowings

1,597

6

0.56%

497

1

0.35%

Total interest-bearing liabilities

798,365

1,656

0.28%

762,753

1,814

0.32%

Noninterest-bearing deposits

161,727

142,070

Other liabilities

4,795

6,921

Shareholders' equity

114,363

106,109

Total liabilities and shareholders' equity

$

1,079,250

$

1,017,853

T/E net interest income/Net interest margin

27,404

3.61%

25,521

3.59%

Tax equivalent adjustment

(1,626)

(1,512)

Net interest income

$

25,778

$

24,009

Provision for Loan Losses

Provision expense for the first nine months of 2016 was $3.3 million, compared to $1.0 million in 2015. The increase in the provision expense was due to a higher level of charge-offs and growth in the loan portfolio compared. For more information refer to the Loan Quality and Allowance for Loan Losses discussion in the Financial Condition section.

Noninterest Income

For the first nine months of 2016, noninterest income decreased $1.1 million from the same period in 2015. Investment and trust service fees decreased due to a decline in estate fees and insurance commissions from 2015 to 2016. Loan service charges decreased due to less loan prepayment fees in 2016, compared to 2015. Deposit service charges increased due to increased enrollment and use of the Bank's overdraft program. The change in debit card income was due to increased usage by customers in 2016. During 2016, five properties held as other real estate owned were sold with a total net loss, compared to one property sold at a gain in 2015. The Corporation recorded a nonrecurring gain on the conversion of an investment security in 2015. Other income in 2015 included a $171 thousand gain from an investment the Corporation owned in an offshore insurance company that liquidated and paid out the investors.

The following table presents a comparison of noninterest income for the nine months ended September 30, 2016 and 2015.

	For the Nine Months Ended September 30		Change	
(Dollars in thousands)	2016	2015	Amount	%
Noninterest Income				
Investment and trust services fees	$ 3,683	$ 3,805	$ (122)	(3.2)
Loan service charges	518	784	(266)	(33.9)
Deposit service charges and fees	1,815	1,700	115	6.8
Other service charges and fees	941	916	25	2.7
Debit card income	1,095	1,021	74	7.2
Increase in cash surrender value of life insurance	399	416	(17)	(4.1)
Net (loss) gain on sale of other real estate owned	(31)	32	(63)	(196.9)
OTTI losses on debt securities	(30)	(20)	(10)	50.0
Gain on conversion of investment security	-	728	(728)	(100.0)
Securities gains, net	4	8	(4)	(50.0)
Other	219	363	(144)	(39.7)
Total noninterest income	$ 8,613	$ 9,753	$ (1,140)	(11.7)

Noninterest Expense

Noninterest expense for the first nine months of 2016 increased $493 thousand compared to the same period in 2015. The increase in salaries and benefits was primarily due to a $436 thousand increase in salary expense due to merit increases and increased staffing levels, a $194 thousand increase in pension expense due to pension settlement expenses and $88 thousand for stock option compensation. Legal and professional fees increased due to fees associated with a lawsuit brought against the Corporation in 2015. This lawsuit was more thoroughly described on a Form 8-K that was filed on July 29, 2016. It is expected that the Corporation will incur additional legal expenses until this lawsuit is resolved. The shares tax increase was due to growth in the Bank's balance sheet and shareholders' equity that resulted in a higher premium. Intangible amortization expense decreased as the core deposit intangible was fully amortized as of June 2015. ATM/Debit card processing increased due to the purchase of EMV debit card inventory. Foreclosed real estate expense decreased in 2016, due to a $250 thousand write-down on one property in 2015. Other expense decreased due to a one-time expense taken in 2015 to fund a deferred director's compensation plan and several one-time expenses the Bank took in 2015 related to branch assets taken out of service.

The following table presents a comparison of noninterest expense for the nine months ended September 30, 2016 and 2015:

(Dollars in thousands)	For the Nine Months Ended September 30		Change	
Noninterest Expense	2016	2015	Amount	%
Salaries and benefits	$ 13,282	$ 12,500	$ 782	6.3
Net occupancy expense	1,708	1,706	2	0.1
Furniture and equipment expense	655	702	(47)	(6.7)
Advertising	839	807	32	4.0
Legal and professional fees	1,114	811	303	37.4
Data processing	1,540	1,547	(7)	(0.5)
Pennsylvania bank shares tax	699	608	91	15.0
Intangible amortization	-	181	(181)	(100.0)
FDIC insurance	514	479	35	7.3
ATM/debit card processing	642	566	76	13.4
Foreclosed real estate	93	341	(248)	(72.7)
Telecommunications	300	379	(79)	(20.8)
Other	2,119	2,385	(266)	(11.2)
Total noninterest expense	$ 23,505	$ 23,012	$ 493	2.1

36

Provision for Income Taxes

For the first nine months of 2016, the Corporation recorded a Federal income tax expense of $1.2 million compared to $1.8 million for the same period in 2015. The effective tax rate was 15.8% for the first nine months of 2016 compared to 18.3% for the same period in 2015. The decrease in 2016 was due to a reduction in pretax income from increased provision expense. In addition, the 2015 rate was lower than normal due to the reversal of $250 thousand of the valuation allowance on the deferred tax asset, due to the large security gain on the conversion of Integrity Bancshares, established in prior years on other than temporary impairment charges in the equity portfolio. Without this reversal, the effective tax rate would have been 20.9% in 2015. The variances from the federal statutory rate are generally due to tax-exempt income from investments, loans and bank-owned life insurance. All taxable income for the Corporation is taxed at a rate of 34%.

Financial Condition

Summary:

At September 30, 2016, assets totaled $1.107 billion, an increase of $71.8 million from the 2015 year-end balance of $1.035 billion. Investment securities decreased $4.1 million, while net loans increased $76.0 million (9.8%) due to growth in the commercial loan portfolio. Deposits increased $60.0 million (6.5%) during the first nine months of 2016 due to increases in every deposit category except time deposits. Shareholders' equity increased $5.5 million during the first nine months as retained earnings increased $3.7 million, accumulated other comprehensive loss decreased $1.2 million and the Corporation's Dividend Reinvestment Plan (DRIP) added an additional $1.1 million in new capital.

Cash and Cash Equivalents:

Cash and cash equivalents totaled $40.6 million at September 30, 2016, an increase of $1.4 million from the prior year-end balance of $39.2 million. Interest-bearing deposits are held primarily at the Federal Reserve ($1.1 million) and in short-term bank owned certificates of deposit ($22.6 million).

Investment Securities:

The investment portfolio has decreased $5.7 million on a cost basis, since year-end 2015. The composition of the portfolio has remained consistent with municipal securities and U.S. Agency mortgage-backed securities comprising the greatest portion of the portfolio at approximately 44% and 43% of the portfolio fair value, respectively. The Bank invested $16.6 million during the first nine months of 2016 with the purchases spread between, U.S. Agency mortgage-backed securities and municipal securities. The average life of the portfolio was 3.74 years.

The investment portfolio had a net unrealized gain of $2.7 million at September 30, 2016 compared to $1.1 million at the prior year-end. The increase in the unrealized gain is due primarily to the decline in intermediate and long term interest rates. The portfolio averaged $159.2 million with a yield of 2.82% for the first nine months of 2016. This compares to an average of $175.2 million and a yield of 2.84% for the same period in 2015.

The Bank holds only one equity security, a Pennsylvania community bank. The municipal bond portfolio is well diversified geographically (issuers from within 28 states) and is comprised primarily of general obligation bonds (75%). Many municipal bonds have credit enhancements in the form of private bond insurance or other credit support. The largest geographic municipal bond exposure is to 16 issuers in the state of Pennsylvania with a fair value of $9.0 million and 14 issuers in the state of Texas with a fair value of $8.7 million. The average rating of the municipal portfolio from Moody's is Aa2. It contains $68.1 million of bonds rated A3 or higher and one bond of $600 thousand that is not rated by Moody's rating agency. No municipal bonds are rated below investment grade.

The holdings of trust preferred investments and private-label mortgage-backed securities (PLMBS) are unchanged since year-end and are detailed in separate tables.

37

The amortized cost and estimated fair value of investment securities available for sale as of September 30, 2016 and December 31, 2015 is as follows:

(Dollars in thousands) September 30, 2016	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Equity securities	$ 164	$ 86	$ -	$ 250
U.S. Government and Agency securities	12,728	292	(21)	12,999
Municipal securities	66,248	1,924	(92)	68,080
Trust preferred securities	5,973	-	(555)	5,418
Agency mortgage-backed securities	66,369	1,089	(79)	67,379
Private-label mortgage-backed securities	1,137	57	(7)	1,187
Asset-backed securities	34	-	(2)	32
	$ 152,653	$ 3,448	$ (756)	$ 155,345

(Dollars in thousands) December 31, 2015	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Equity securities	$ 164	$ 69	$ -	$ 233
U.S. Government and Agency securities	13,705	164	(33)	13,836
Municipal securities	67,851	1,555	(218)	69,188
Trust preferred securities	5,958	-	(669)	5,289
Agency mortgage-backed securities	69,284	621	(386)	69,519
Private-label mortgage-backed securities	1,335	39	(2)	1,372
Asset-backed securities	38	-	(2)	36
	$ 158,335	$ 2,448	$ (1,310)	$ 159,473

The investment portfolio contained fifty securities with $29.0 million of temporarily impaired fair value and $756 thousand in unrealized losses at September 30, 2016. The total unrealized loss position has improved from a $1.3 million unrealized loss at year-end 2015.

For securities with an unrealized loss, Management applies a systematic methodology in order to perform an assessment of the potential for other-than-temporary impairment. In the case of debt securities, investments considered for other-than-temporary impairment: (1) had a specified maturity or repricing date; (2) were generally expected to be redeemed at par, and (3) were expected to achieve a recovery in market value within a reasonable period of time. In addition, the Bank considers whether it intends to sell these securities or whether it will be forced to sell these securities before the earlier of amortized cost recovery or maturity. Equity securities are assessed for other-than-temporary impairment based on the length of time of impairment, dollar amount of the impairment and general market and financial conditions relating to specific issues. The impairment identified on debt and equity securities and subject to assessment at September 30, 2016, was deemed to be temporary and required no further adjustments to the financial statements, unless otherwise noted.

The following table reflects temporary impairment in the investment portfolio (excluding restricted stock), aggregated by investment category, length of time that individual securities have been in a continuous unrealized loss position and the number of securities in each category as of September 30, 2016 and December 31, 2015:

	September 30, 2016								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ -	$ -	-	$ 3,486	$ (21)	10	$ 3,486	$ (21)	10
Municipal securities	2,657	(7)	5	2,275	(85)	3	4,932	(92)	8
Trust preferred securities	-	-	-	5,418	(555)	7	5,418	(555)	7
Agency mortgage-backed securities	8,900	(35)	12	5,998	(44)	11	14,898	(79)	23
Private-label mortgage-backed securities	310	(7)	1	-	-	-	310	(7)	1
Asset-backed securities	-	-	-	4	(2)	1	4	(2)	1
Total temporarily impaired securities	$ 11,867	$ (49)	18	$ 17,181	$ (707)	32	$ 29,048	$ (756)	50

	December 31, 2015								
	Less than 12 months			12 months or more			Total		
(Dollars in thousands)	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count	Fair Value	Unrealized Losses	Count
U.S. Government and Agency securities	$ 479	$ (1)	3	$ 4,364	$ (32)	10	$ 4,843	$ (33)	13
Municipal securities	5,806	(35)	8	4,785	(183)	7	10,591	(218)	15
Trust preferred securities	-	-	-	5,289	(669)	7	5,289	(669)	7
Agency mortgage-backed securities	18,977	(215)	29	7,394	(171)	13	26,371	(386)	42
Private-label mortgage-backed securities	-	-	-	246	(2)	1	246	(2)	1
Asset-backed securities	-	-	-	5	(2)	1	5	(2)	1
	$ 25,262	$ (251)	40	$ 22,083	$ (1,059)	39	$ 47,345	$ (1,310)	79

Total temporarily impaired securities

The unrealized loss in the municipal bond portfolio decreased to $92 thousand from $218 thousand at December 31, 2015 as market prices improved during the quarter. There are three securities in this portfolio with an unrealized loss and the loss in this portfolio is deemed to be non-credit related and no other-than-temporary impairment charges have been recorded.

The trust preferred portfolio contains seven securities with a fair value of $5.4 million and an unrealized loss of $555 thousand The trust-preferred securities held by the Bank are single entity issues, not pooled trust preferred securities. Therefore, the impairment review of these securities is based only on the issuer and the security cannot be impaired by the performance of other issuers as if it was a pooled trust-preferred bond. All of the Bank's trust preferred securities are single issue, variable rate notes with long maturities (2027 – 2028). None of these bonds have suspended or missed a dividend payment. At September 30, 2016, the Bank believes it will be able to collect all interest and principal due on these bonds and no other-than-temporary-impairment charges were recorded.

There is one PLMBS bond showing a small unrealized loss of $7 thousand. However, the PLMBS sector as a whole is showing an unrealized gain of $50 thousand at quarter end. This is primarily a result of the cumulative OTTI charges recorded on this portfolio. Due to the nature of these bonds, they are evaluated closely. These bonds were all rated AAA at time of purchase, but have since experienced rating declines. Some have experienced increased delinquencies and defaults, while others have seen the credit support increase as the bonds paid-down. The Bank monitors the performance of the PLMBS investments on a regular basis and reviews delinquencies, default rates, credit support levels and various cash flow stress test scenarios. In determining the credit related loss, Management considers all principal past due 60 days or more as a loss. If additional principal moves beyond 60 days past due, it will also be considered a loss. The Bank recorded a $30 thousand impairment charge during the first nine months of 2016 and has recorded $585 thousand of cumulative impairment charges on this portfolio. Management continues to monitor these securities and it is possible that additional write-downs may occur if current loss trends continue.

The Bank held $1.1 million of restricted stock at September 30, 2016. Except for $30 thousand, this investment represents stock in FHLB Pittsburgh. The Bank is required to hold this stock to be a member of FHLB and it is carried at cost of $100 per share. The level of FHLB stock held is determined by FHLB and is comprised of a minimum membership amount plus a variable activity amount. FHLB stock is evaluated for impairment primarily based on an assessment of the ultimate recoverability of its cost. As a government sponsored entity, FHLB has the ability to raise funding through the U.S. Treasury that can be used to support its operations. There is not a public market for FHLB stock and the benefits of FHLB membership (e.g., liquidity and low cost funding) add value to the stock beyond purely financial measures. Management intends to remain a member of the FHLB and believes that it will be able to fully recover the cost basis of this investment.

Loans:

Residential real estate: This category is comprised of consumer purpose loans secured by residential real estate and to a lesser extent, commercial purpose loans secured by residential real estate. The consumer purpose category represents traditional residential mortgage loans and home equity products (primarily junior liens and lines of credit). Commercial purpose loans in this category represent loans made for various business needs, but are secured with residential real estate. In addition to the real estate collateral, it is possible that additional security is provided by personal guarantees or UCC filings. These loans are underwritten as commercial loans and are not originated to be sold.

Total residential real estate loans increased $3.2 million over 2015, primarily in the commercial first lien and consumer junior liens and lines of credit categories due to a home equity special promotion in 2015 and 2016. For the first nine months of 2016, the Bank originated $10.2 million in mortgages, including approximately $6.6 million for a fee through a third party brokerage agreement. The Bank does not originate or hold any loans that would be considered sub-prime or Alt-A, and does not generally originate mortgages outside of its primary market area.

Residential real estate construction: The largest component of this category represents loans to residential real estate developers ($7.1 million), while loans for individuals to construct personal residences totaled $1.6 million at September 30, 2016. The Bank’s exposure to residential construction loans is concentrated primarily in south central Pennsylvania.

Real estate construction loans, including residential real estate and land development loans, occasionally provide an interest reserve in order to assist the developer during the development stage when minimal cash flow is generated. All real estate construction loans are underwritten in the same manner, regardless of the use of an interest reserve. At September 30, 2016, the Bank had $7.3 million in residential real estate construction loans funded with an interest reserve and capitalized $93 thousand of interest from these reserves on active projects. Real estate construction loans are monitored on a regular basis by either an independent third party inspector or the assigned loan officer depending on loan amount or complexity of the project. This monitoring process includes at a minimum, the submission of invoices and AIA documents of costs incurred by the borrower, on-site inspections, and a signature by the assigned loan officer for disbursement of funds.

Commercial real estate (CRE): This category includes commercial, industrial, farm and agricultural loans, where real estate serves as the primary collateral for the loans. Total commercial real estate loans increased to $375.3 million from $340.7 million at the end of 2015, an increase of $34.6 million. The increases were primarily in commercial construction and multi-family units. The largest sectors (by collateral) in the commercial real estate category are: office buildings ($57.7 million), hotels and motels ($45.7 million), land development ($42.9 million), apartment units ($37.3 million), and auto dealerships ($32.8 million).

Commercial (C&I): This category includes commercial, industrial, farm, agricultural, and municipal loans. C&I loans increased $38.3 million to $254.3 million at September 30, 2016, compared to $215.9 million at the end of 2015, primarily in the municipal loan portfolio. The largest sectors (by industry) in the commercial loan category are: retail trade ($25.3 million), manufacturing ($15.8 million) and health care ($15.6 million). At September 30, 2016, the Bank had $137.8 million in municipal loans. The Bank is very active in its market in pursuing commercial lending opportunities, but has historically supplemented in-market growth with purchased loan participations, when appropriate. The Bank purchases commercial loan participations in an effort to increase its commercial lending and diversify its loan mix, both geographically and by industry sector. Purchased loans are originated primarily within the south central Pennsylvania market and are purchased from only a few select counter parties. For the first nine months of 2016, the Bank purchased $12.2 million of loan participations and commitments. At September 30, 2016, the Bank held $132.0 million in purchased loan participations in its portfolio.

Consumer loans decreased $381 thousand due primarily to regular payments and maturities. The majority of the Bank’s consumer loans, approximately $3.0 million, are personal lines of credit. The Bank believes the consumer portfolio will continue to decline.

The following table presents a summary of loans outstanding, by primary collateral as of:

(Dollars in thousands)	September 30, 2016	December 31, 2015	Change Amount	%
Residential Real Estate 1-4 Family				
Consumer first liens	$ 99,571	$ 103,698	$ (4,127)	(4.0)
Commercial first lien	63,515	57,780	5,735	9.9
Total first liens	163,086	161,478	1,608	1.0
Consumer junior liens and lines of credit	46,688	44,996	1,692	3.8
Commercial junior liens and lines of credit	5,837	5,917	(80)	(1.4)
Total junior liens and lines of credit	52,525	50,913	1,612	3.2
Total residential real estate 1-4 family	215,611	212,391	3,220	1.5
Residential real estate - construction				
Consumer	1,589	545	1,044	191.6
Commercial	7,067	7,343	(276)	(3.8)
Total residential real estate construction	8,656	7,888	768	9.7
Commercial real estate	375,316	340,695	34,621	10.2
Commercial	254,274	215,942	38,332	17.8
Total commercial	629,590	556,637	72,953	13.1
Consumer	4,719	5,100	(381)	(7.5)
	858,576	782,016	76,560	9.8
Less: Allowance for loan losses	(10,685)	(10,086)	(599)	5.9
Net Loans	$ 847,891	$ 771,930	$ 75,961	9.8

Loan Quality:

Management utilizes a risk rating scale ranging from 1 (Prime) to 9 (Loss) to evaluate loan quality. This risk rating scale is used primarily for commercial purpose loans. Consumer purpose loans are identified as either a pass or substandard rating. Substandard consumer loans are loans that are 90 days or more past due and still accruing. Loans rated 1 – 4 are considered pass credits. Loans that are rated 5 are pass credits, but have been identified as credits that are likely to warrant additional attention and monitoring. Loans rated 6 (Special Mention) or worse begin to receive enhanced monitoring and reporting by the Bank. Loans rated 7 (Substandard) or 8 (Doubtful) exhibit the greatest financial weakness and present the greatest possible risk of loss to the Bank. Nonaccrual loans are rated no better than 7. The following factors represent some of the factors used in determining the risk rating of a borrower: cash flow, debt coverage, liquidity, management, and collateral. Risk ratings, for pass credits, are generally reviewed annually for term debt and at renewal for revolving or renewing debt. The Bank monitors loan quality by reviewing four measurements: (1) loans rated 6 or worse (collectively "watch list"), (2) delinquent loans, (3) other real estate owned (OREO), and (4) net-charge-offs. Management compares trends in these measurements with the Bank's internally established targets, as well as its national peer group.

Watch list loans exhibit financial weaknesses that increase the potential risk of default or loss to the Bank. However, inclusion on the watch list, does not by itself, mean a loss is certain. The watch list totaled $23.1 million at quarter end and includes both performing and nonperforming loans. It is comprised of $4.4 million rated 6 and $18.7 million rated 7. The Bank has no loans rated 8-doubtful or 9-loss. The watch list totaled $27.3 million at June 30, 2016 and $27.9 million at the prior year-end. The decrease in the watch list from year-end, and the prior quarter is due primarily to a $5.6 million credit (year-end balance) that was partially charged-off in 2016 and sold during the third quarter of 2016 (see the Allowance for Loan Losses discussion). The credit composition of the portfolio, by primary collateral is shown in Note 7 of the accompanying financial statements. The Bank's Loan Management Committee reviews these loans and risk ratings on a quarterly basis in order to proactively identify and manage problem loans. In addition, a committee meets monthly to discuss possible workout strategies for OREO and all credits rated 7 or worse. Management also tracks other commercial loan risk measurements including high loan to value loans, concentrations, participations and policy exceptions and reports these to the Credit Risk Oversight Committee of the Board of Directors. The Bank also uses a third-party consultant to assist with internal loan review with a goal of reviewing 60% of commercial loans each year. The FDIC defines certain supervisory loan-to-value lending limits. The Bank's internal loan–to-value limits are all equal to, or have

41

a lower loan-to-value limit, than the supervisory limits. At September 30, 2016, the Bank had loans of $18.5 million that exceeded the supervisory limit.

Delinquent loans are a result of borrowers' cash flow and/or alternative sources of cash being insufficient to repay loans. The Bank's likelihood of collateral liquidation to repay the loans becomes more probable the further behind a borrower falls, particularly when loans reach 90 days or more past due. Management monitors the performance status of loans by the use of an aging report. The aging report can provide an early indicator of loans that may become severely delinquent and possibly result in a loss to the Bank. See Note 6 in the accompanying financial statements for a note that presents the aging of payments in the loan portfolio.

Nonaccruing loans generally represent Management's determination that the borrower will be unable to repay the loan in accordance with its contractual terms and that collateral liquidation may or may not fully repay both interest and principal. It is the Bank's policy to evaluate the probable collectability of principal and interest due under terms of loan contracts for all loans 90-days or more, nonaccrual loans, or impaired loans. Further, it is the Bank's policy to discontinue accruing interest on loans that are not adequately secured and in the process of collection. Upon determination of nonaccrual status, the Bank subtracts any current year accrued and unpaid interest from its income, and any prior year accrued and unpaid interest from the allowance for loan losses. Management continually monitors the status of nonperforming loans, the value of any collateral and potential of risk of loss. Nonaccrual loans are rated no better than 7 (Substandard).

Loan quality, as measured by the balance of nonperforming loans, has declined from year-end. The following table presents a summary of nonperforming assets:

(Dollars in thousands)	September 30, 2016	December 31, 2015
Nonaccrual loans		
Residential Real Estate 1-4 Family		
First liens	$ 422	$ 806
Junior liens and lines of credit	96	105
Total	518	911
Residential real estate - construction	545	502
Commercial real estate	4,156	3,681
Commercial	24	276
Total nonaccrual loans	5,243	5,370
Loans past due 90 days or more and not included above		
Residential Real Estate 1-4 Family		
First liens	38	214
Junior liens and lines of credit	61	-
Total	99	214
Residential real estate - construction	-	-
Commercial real estate	568	152
Commercial	26	-
Consumer	-	2
Total loans past due 90 days or more and still accruing	693	368
Total nonperforming loans	5,936	5,738
Other real estate owned	5,872	6,451
Total nonperforming assets	$ 11,808	$ 12,189
Nonperforming loans to total gross loans	0.69%	0.73%
Nonperforming assets to total assets	1.07%	1.18%
Allowance for loan losses to nonperforming loans	180.00%	175.78%

43

The following table identifies the most significant loans in nonaccrual status. These three nonaccrual loans account for 80% of the total nonaccrual balance. The table also indicates those significant nonaccrual loans that are classified as troubled debt restructurings (TDR). A TDR loan is maintained on nonaccrual status until a satisfactory repayment history is established. All loans on the watch list that are not on nonaccrual or past due 90 days more are considered potential problem loans. Potential problem loans at September 30, 2016 totaled $17.1 million compared to $22.1 million at year-end 2015.

(Dollars in thousands)	Balance	ALL Reserve	Nonaccrual Date	TDR Status	Collateral	Location	Last Appraisal(1)	
Credit 1 - Residential real estate	1,755	-	Mar-12	Y	1st and 2nd liens on commercial real estate, residential real estate and business assets	PA	Jan-16	$ 3,810
Credit 2 - Commercial real estate	1,138	-	Dec-14	N	Hotel and entertainment complex	PA	Apr-16	$ 4,200
Credit 3 - Agricultural	1,281	-	Sep-16	Y	1st lien on farmland	PA	Jul-14	$ 2,391
	$ 4,174	$ -						

(1) Appraisal value, as reported, does not reflect the pay-off of any senior liens or the cost to liquidate the collateral, but does reflect only the Bank's share of the collateral if it is a participated loan.

Credit 1 is a TDR that is performing in accordance with the modified terms. Credit 2 is a hotel and entertainment complex being operated as part of an estate liquidation and is currently listed for sale. Credit 3is a new nonaccrual loan as a result of a TDR default.

In addition to monitoring nonaccrual loans, the Bank also closely monitors impaired loans and troubled debt restructurings (TDR). A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Nonaccrual loans and TDR loans are always considered impaired. For impaired commercial loans with balances less than $250 thousand and all consumer purpose loans, a specific reserve analysis is not performed and these loans are added to the general allocation pool. In accordance with financial accounting standards, TDR loans are always considered impaired until they are paid off. However, an impaired TDR loan can be a performing loan. Impaired loans totaled $15.7 million at quarter-end compared to $16.8 million at year-end 2015.

A loan is considered a troubled debt restructuring (TDR) if the creditor (the Bank), for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. These concessions may include lowering the rate, extending the maturity, reamortization of the payment, or a combination of multiple concessions. The Bank reviews all loans rated 6 or worse when it is providing a loan restructure, modification or new credit facility to determine if the action is a TDR. If a TDR loan is placed on nonaccrual status, it remains on nonaccrual status for at least six months to ensure performance. All TDR loans are in compliance with their modified terms. See Note 6 in the accompanying financial statements for information on TDR loans in the portfolio.

44

The following table shows the composition of impaired loans as of:

	September 30, 2016			
(Dollars in thousands)	Nonaccrual		Accruing	Total
	Non-TDR	TDR	TDR	Impaired
Residential Real Estate 1-4 Family				
First liens	$ 271	$ 151	$ 728	$ 1,150
Junior liens and lines of credit	96	-	-	96
Total	367	151	728	1,246
Residential real estate - construction	59	486	-	545
Commercial real estate	1,604	2,551	9,660	13,815
Commercial	24	-	-	24
Total	$ 2,054	$ 3,188	$ 10,388	$ 15,630

Allowance for Loan Losses:

Management performs a quarterly evaluation of the adequacy of the allowance for loan losses (ALL). The ALL is determined by segmenting the loan portfolio based on the loan's collateral. The Bank further classifies the portfolio based on the primary purpose of the loan, either consumer or commercial. When calculating the ALL, consideration is given to a variety of factors in establishing this estimate including, but not limited to, current economic conditions, diversification of the loan portfolio, delinquency statistics, results of internal loan reviews, historical charge-offs, the adequacy of the underlying collateral (if collateral dependent) and other relevant factors. The Bank begins enhanced monitoring of all loans rated 6 (OAEM) or worse, and obtains a new appraisal or asset valuation for any loan rated 7 (substandard) or worse. Management, at its discretion, may determine that additional adjustments to the appraisal or valuation are required. Valuation adjustments will be made as necessary based on factors, including, but not limited to: the economy, deferred maintenance, industry, type of property/equipment, age of the appraisal, etc. and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. When determining the allowance for loan losses, certain factors involved in the evaluation are inherently subjective and require material estimates that may be susceptible to significant change, including the amounts and timing of future cash flows expected to be received on impaired loans. Management monitors the adequacy of the allowance for loan losses on an ongoing basis and reports its adequacy quarterly to the Credit Risk Oversight Committee of the Board of Directors. Management believes that the allowance for loan losses at September 30, 2016 is adequate.

The analysis for determining the ALL is consistent with guidance set forth in generally accepted accounting principles (GAAP) and the Interagency Policy Statement on the Allowance for Loan and Lease Losses. The analysis has two components, specific and general allocations. The specific component addresses specific reserves established for impaired loans. A loan is considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all interest and principal payments due according to the originally contracted terms of the loan agreement. Collateral values discounted for market conditions and selling costs are used to establish specific allocations for impaired loans. It is possible that as a result of the credit analysis, a specific reserve is not required for an impaired loan. For impaired commercial loans with balances less than $250 thousand and all consumer purpose loans, a specific reserve analysis is not performed and these loans are added to the general allocation pool. At September 30, 2016, impaired loans totaled $15.7 million compared to $16.8 million at year-end 2015. The Bank does not have a specific reserve established for any of its impaired loans. At year-end 2015, the Bank had one impaired loan with a specific reserve of $9 thousand that paid-off during the first quarter of 2016. Note 6 in the accompanying financial statements provide additional information about the ALL established for impaired loans.

The general allocation component addresses the reserves established for pools of homogenous loans. The general component includes a quantitative and qualitative analysis. When calculating the general allocation, the Bank segregates its loan portfolio into the following sectors based primarily on the type of supporting collateral: residential real estate, commercial, industrial or agricultural real estate; commercial and industrial (C&I non-real estate), and consumer. The residential real estate sector is further segregated by first lien loans, junior liens and home equity products, and residential real estate construction. The quantitative analysis uses the Bank's twenty quarter rolling historical loan loss experience adjusted for factors derived from current economic and market conditions that have been determined to have an effect on the probability and magnitude of a loss. Prior to 2015, the Bank was using an eight quarter rolling history for the quantitative analysis. The change to a longer historical period is based upon improving charge-offs and a more stable and slowly improving economy. As credit quality improved the Bank began to see lower charge-offs. The Bank believes that

45

an eight quarter historical period presented the loss history during a very favorable period and it may not accurately reflect historical trends. It believes that a twenty quarter period covers a longer economic cycle and more accurately reflects its loss history and therefore is a more appropriate factor for calculating the general reserve in the current environment. The historical loss experience factor for the general allocation was 1.02% of gross loans ($8.8 million) at September 30, 2016 compared to 1.07% and $8.4 million at the prior year-end. Included in the general loan loss reserve is an unallocated reserve of $1.3 million, unchanged from December 31, 2015.

The qualitative analysis utilizes a risk matrix that incorporates qualitative and environmental factors such as: loan volume, management, loan review process, credit concentrations, competition, and legal and regulatory issues. These factors are each risk rated from minimal to high risk and in total can add up to a maximum qualitative factor of 37.5 basis points. At quarter-end, this factor was 22.5 basis points compared to 21.5 at year-end 2015. These factors are determined on the basis of Management's observation, judgment and experience.

Real estate appraisals and collateral valuations are an important part of the Bank's process for determining potential loss on collateral dependent loans and thereby have a direct effect on the determination of loan reserves, charge-offs and the calculation of the allowance for loan losses. As long as the loan remains a performing loan, no further updates to appraisals are required. If a loan or relationship migrates to risk rating of 7 or worse, an evaluation for impairment status is made based on the current information available at the time of downgrade and a new appraisal or collateral valuation is obtained.

In determining the allowance for loan losses, Management, at its discretion, may determine that additional adjustments to the fair value obtained from an appraisal or collateral valuation are required. Adjustments will be made as necessary based on factors, including, but not limited to the economy, deferred maintenance, industry, type of property or equipment etc., and the knowledge Management has about a particular situation. In addition, the cost to sell or liquidate the collateral is also estimated and deducted from the valuation in order to determine the net realizable value to the Bank. If an appraisal is not available, Management may make its best estimate of the real value of the collateral or use last known market value and apply appropriate discounts. If an adjustment is made to the collateral valuation, this will be documented with appropriate support and reported to the Loan Management Committee.

The following table shows the loans that were evaluated for the allowance for loan losses under a specific reserve (individually) and those that were evaluated under a general reserve (collectively), and the amount of the allowance established in each loan class as of September 30, 2016 and December 31, 2015:

	Residential Real Estate 1-4 Family							
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
September 30, 2016								
Loans evaluated for ALL:								
Individually	$ 632	$ 52	$ 545	$ 13,815	$ -	$ -	$ -	$ 15,044
Collectively	162,454	52,473	8,111	361,501	254,274	4,719	-	843,532
Total	$ 163,086	$ 52,525	$ 8,656	$ 375,316	$ 254,274	$ 4,719	$ -	$ 858,576
ALL established for loans evaluated:								
Individually	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Collectively	1,021	320	213	6,045	1,735	98	1,253	10,685
ALL at September 30, 2016	$ 1,021	$ 320	$ 213	$ 6,045	$ 1,735	$ 98	$ 1,253	$ 10,685
December 31, 2015								
Loans evaluated for ALL:								
Individually	$ 930	$ 51	$ 502	$ 14,309	$ 230	$ -	$ -	$ 16,022
Collectively	160,548	50,862	7,386	326,386	215,712	5,100	-	765,994
Total	$ 161,478	$ 50,913	$ 7,888	$ 340,695	$ 215,942	$ 5,100	$ -	$ 782,016
ALL established for loans evaluated:								
Individually	$ -	$ -	$ -	$ -	$ 9	$ -	$ -	$ 9
Collectively	989	308	194	5,649	1,510	102	1,325	10,077
ALL at December 31, 2015	$ 989	$ 308	$ 194	$ 5,649	$ 1,519	$ 102	$ 1,325	$ 10,086

During the first nine months of 2016, the Bank recorded $3.3 million for the loan loss provision expense compared to $1.0 thousand during the prior year. Charged-off loans usually result from: (1) a borrower being legally relieved of loan repayment responsibility through bankruptcy, (2) insufficient collateral sale proceeds to repay a loan; or (3) the borrower and/or guarantor does not own other assets that, if sold, would generate sufficient sale proceeds to repay a loan. The Bank recorded net loan charge-offs of $2.7 million for the first nine months of 2016.

At December 31, 2015, Special Mention loans included a $5.4 million commercial real estate loan. The loan represented the Bank's portion of a participated loan transaction where the Bank was not the lead lender. The Bank placed the loan on nonaccrual at March 31, 2016 with a specific loan loss reserve of $74 thousand. The reserve was determined using a September 2015 property appraisal obtained by the lead bank that showed a collateral value in excess of $19.0 million. Based on its ownership percentage, the Bank discounted the appraised value by 30% plus costs, to calculate its specific loan loss reserve. The bank group subsequently negotiated a forbearance agreement with the borrower that required the sale of the property. A specialty broker was engaged by the lead bank to provide an opinion of value and to sell the property. The broker's opinion of value was less than half the September 2015 appraised value. Due to the significant decline in value since the 2015 appraisal, the Bank raised questions about the broker's valuation with the bank group. Despite objections raised by the Bank, the lead bank listed the property at a price consistent with the broker's valuation. This decision resulted in a $1.9 million charge-off on this credit during the second quarter of 2016. During the third quarter of 2016, the bank group agreed to sell the loan and this decision resulted in an additional $759 thousand charge-off. Overall, the total charge-off on this credit, $2.7 million, accounted for 91% of the total gross charge-offs of $3.0 million in 2016.

The following table presents an analysis of the allowance for loan losses for the periods ended:

	Residential Real Estate 1-4 Family							
(Dollars in thousands)	First Liens	Junior Liens & Lines of Credit	Construction	Commercial Real Estate	Commercial	Consumer	Unallocated	Total
ALL at June 30, 2016	$ 1,023	$ 319	$ 205	$ 5,940	$ 1,596	$ 97	$ 1,138	$ 10,318
Charge-offs	-	-	-	(776)	-	(42)	-	(818)
Recoveries	1	-	-	5	7	22	-	35
Provision	(3)	1	8	876	132	21	115	1,150
ALL at September 30, 2016	$ 1,021	$ 320	$ 213	$ 6,045	$ 1,735	$ 98	$ 1,253	$ 10,685
ALL at December 31, 2015	$ 989	$ 308	$ 194	$ 5,649	$ 1,519	$ 102	$ 1,325	$ 10,086
Charge-offs	(49)	-	-	(2,730)	(66)	(126)	-	(2,971)
Recoveries	34	-	-	18	129	64	-	245
Provision	47	12	19	3,108	153	58	(72)	3,325
ALL at September 30, 2016	$ 1,021	$ 320	$ 213	$ 6,045	$ 1,735	$ 98	$ 1,253	$ 10,685

Other Real Estate Owned:

The Bank holds $5.8 million of other real estate owned (OREO), comprised of four properties compared to $6.5 million and seven properties at December 31, 2015. The most significant OREO holdings are listed in the table below. Property 1 was part of a participated loan and the workout is being handled by the lead bank. In early May 2016, an agreement of sale was executed. The agreement allows for a lengthy due diligence and approval process prior to settlement. Therefore, the final outcome is not certain. Property 2 was part of a participated loan and the workout is being handled by the lead bank. During 2016, the Bank sold five properties for a loss of $31 thousand, recorded a write down of $46 thousand on one property and incurred expense of $47 thousand to hold and maintain OREO. Note 7 of the accompanying financial statements provides additional information on activity in OREO.

The following table provides additional information on significant other real estate owned properties:

September 30, 2016

(Dollars in thousands)	Date Acquired	Balance	Collateral	Location
Property 1	2012	2,508	1st, 2nd, and 3rd liens residential development land - four tracts with 196 acres	PA
Property 2	2015	3,039	1st lien on 90 acres undeveloped commercial real estate	PA
		$ 5,547		

At September 30, 2016, the Bank had $349 thousand of residential properties in the process of foreclosure compared to $218 thousand at the end of 2015.

48

Deposits:

Total deposits increased $60.0 million during the first nine months of 2016 to $978.6 million. Non-interest bearing deposits increased $22.3 million, while savings and interest-bearing checking increased $46.2 million and time deposits decreased $8.4 million. The increase in non-interest bearing checking accounts occurred primarily in state/municipal accounts ($11.4 million) and small business checking accounts ($10.6 million). Interest bearing checking increased by $13.1 million, primarily from commercial deposits. The Bank's Money Management product increased $26.9 million, primarily from state/municipal deposits. Retail time deposits decreased since year-end, as customers moved funds to more liquid accounts. As of September 30, 2016, the Bank had $3.3 million in CDARS reciprocal time deposits included in brokered time deposits.

(Dollars in thousands)	September 30, 2016	December 31, 2015	Change Amount	%
Noninterest-bearing checking	$ 174,390	$ 152,095	$ 22,295	14.7
Interest-bearing checking	245,310	232,181	13,129	5.7
Money management	406,262	379,331	26,931	7.1
Savings	75,273	69,174	6,099	8.8
Total interest-bearing checking and savings	726,845	680,686	46,159	6.8
Retail time deposits	74,049	82,468	(8,419)	(10.2)
Brokered time deposits	3,268	3,263	5	0.2
Total time deposits	77,317	85,731	(8,414)	(9.8)
Total deposits	$ 978,552	$ 918,512	$ 60,040	6.5
Overdrawn deposit accounts reclassified as loans	$ 133	$ 128		

Borrowings:

The Corporation had short-term borrowings of $8.5 million at September 30, 2016 and no borrowings at September 30, 2015.

Shareholders' Equity:

Total shareholders' equity increased $5.5 million to $116.9 million at September 30, 2016, compared to $111.4 million at the end of 2015. The increase in retained earnings from the Corporation's net income of $6.4 million was partially offset by the cash dividend of $2.6 million. The Corporation's dividend payout ratio is 41.1% for the first nine months of 2016 compared to 29.4% in 2015.

As part of its quarterly dividend decision, the Corporation considers current and future income projections, dividend yield, payout ratio, and current and future capital ratios. Year-to-date, the Corporation paid dividends of $0.61 per share, compared to $0.55 for the same period in 2015, a 10.9% increase. For the third quarter of 2016, the Corporation paid a $0.21 per share dividend, compared to $0.19 paid in the third quarter of 2015. On October 13, 2016 the Board of Directors declared a $0.21 per share regular quarterly dividend for the fourth quarter of 2016, which will be paid on November 23, 2016.

In addition, the Corporation considers how dividend decisions may affect the Dividend Reinvestment Plan (DRIP), which has raised $1.1 million in new capital this year with 49,401 new shares purchased. On April 14, 2016, the

Board of Directors approved a stock repurchase program that authorizes the repurchase of up to $350,000 in shares of common stock during each calendar quarter through March 31, 2017. In 2016, the Corporation repurchased 30,196 shares of its common stock for $700 thousand.

49

In July 2013, Federal banking regulators approved the final rules from the Basel Committee on Banking Supervision for the regulation of capital requirements for bank holding companies and U.S banks, generally referred to as "Basel III." The Basel III standards were effective for the Corporation and the Bank, effective January 1, 2015 (subject to a phase-in period for certain provisions). Basel III imposes significantly higher capital requirements and more restrictive leverage and liquidity ratios than those previously in place. The capital ratios to be considered "well capitalized" under Basel III are: (1) Common Equity Tier 1(CET1) of 6.5%, (2) Tier 1 Leverage of 5%, (3)Tier 1 Risk-Based Capital of 8%, and (4) Total Risk-Based Capital of 10%. The CET1 ratio is a new capital ratio under Basel III and the Tier 1 risk-based capital ratio of 8% has been increased from 6%. The rules also include changes in the risk weights of certain assets to better reflect credit and other risk exposures. In addition, a capital conservation buffer will be phased-in beginning January 1, 2016 at 0.625%, increasing each year until fully implemented in 2019 at 2.5% above the minimum capital ratios required to avoid any capital distribution restrictions. The capital conservation buffer will be applicable to all of the capital ratios except for the Tier1 Leverage ratio. When fully implemented, the capital conservation buffer will have the effect of increasing the minimum capital ratios by 2.5%. As of September 30, 2016, the Bank was "well capitalized' under the Basel III requirements and believes it would be "well capitalized" on a fully-phased in basis had such a requirement been in effect.

The following table summarizes regulatory capital information as of September 30, 2016 and December 31, 2015 (restated) for the Corporation and the Bank. The adequately capitalized minimum ratios, except for the Tier 1 Leverage Ratio, include the 0.625% Capital Conservation buffer effective for 2016.

			Regulatory Ratios	
			Adequately Capitalized	Well Capitalized
(Dollars in thousands)	September 30, 2016	December 31, 2015	Minimum	Minimum
Common Equity Tier 1 Risk-based Capital Ratio (1)				
Franklin Financial Services Corporation	14.60%	14.77%	5.125%	N/A
Farmers & Merchants Trust Company	14.53%	14.76%	5.125%	6.50%
Tier 1 Risk-based Capital Ratio (2)				
Franklin Financial Services Corporation	14.60%	14.77%	6.625%	N/A
Farmers & Merchants Trust Company	14.53%	14.76%	6.625%	8.00%
Total Risk-based Capital Ratio (3)				
Franklin Financial Services Corporation	15.86%	16.03%	8.625%	N/A
Farmers & Merchants Trust Company	15.79%	16.02%	8.625%	10.00%
Tier 1 Leverage Ratio (4)				
Franklin Financial Services Corporation	10.07%	10.38%	4.000%	N/A
Farmers & Merchants Trust Company	10.03%	10.37%	4.000%	5.00%

(1) Common equity Tier 1 capital/ total risk-weighted assets (2) Tier 1 capital / total risk-weighted assets
(3) Total risk-based capital / total risk-weighted assets, (4) Tier 1 capital / average quarterly assets

Economy

The Corporation's primary market area includes Franklin, Fulton, Cumberland and Huntingdon County, PA. This area is diverse in demographic and economic makeup. County populations range from a low of approximately 15,000 in Fulton County to over 238,000 in Cumberland County. Unemployment in the Bank's market area has remained virtually unchanged over the past year and ranges from a low of 4.7% in Cumberland County to high of 7.1% in Huntingdon County. The market area has a diverse economic base and local industries include warehousing, truck & rail shipping centers, light and heavy manufacturers, health-care, higher education institutions, farming and agriculture, and a varied service sector. The Corporation's primary market area is located in south central Pennsylvania and provides easy access to the major metropolitan markets on the east coast via trucking and rail transportation. Because of this, warehousing and distribution companies continue to find the area attractive. The local economy is not overly dependent on any one industry or business and Management believes that the Bank's primary market area continues to be well suited for growth as the recession eases.

The following provides selected economic data for the Bank's primary market:

Economic Data

	September 30, 2016	December 31, 2015
Unemployment Rate (seasonally adjusted)		
Market area range (1)	4.7% - 7.1%	3.5 - 5.5%
Pennsylvania	5.2%	5.0%
United States	4.9%	5.0%
Housing Price Index - year over year change		
PA, nonmetropolitan statistical area	2.7%	2.0%
United States	5.6%	5.6%
Franklin County Building Permits - year over year change		
Residential, estimated	7.4%	-15.6%
Multifamily, estimated	10.5%	-65.0%

(1) Franklin, Cumberland, Fulton and Huntingdon Counties

Unlike many companies, the assets and liabilities of the Corporation are financial in nature. As such, interest rates and changes in interest rates may have a more significant effect on the Corporation's financial results than on other types of industries. Because of this, the Corporation watches the actions of the Federal Reserve Open Market Committee (FOMC) as it makes decisions about interest rate changes. The FOMC continues to hold short-term rates at historic lows. It continues to monitor employment and inflation data as it considers the timing of an increase in the Fed Funds rate.

Liquidity

The Corporation must meet the financial needs of the customers that it serves, while providing a satisfactory return on the shareholders' investment. In order to accomplish this, the Corporation must maintain sufficient liquidity in order to respond quickly to the changing level of funds required for both loan and deposit activity. The goal of liquidity management is to meet the ongoing cash flow requirements of depositors who want to withdraw funds and of borrowers who request loan disbursements. The Bank regularly reviews it liquidity position by measuring its projected net cash flows (in and out) at a 30 and 90-day interval. The Bank stresses this measurement by assuming a level of deposit out-flows that have not historically been realized. In addition to this forecast, other funding sources are reviewed as a method to provide emergency funding if necessary. The objective of this measurement is to identify the amount of cash that could be raised quickly without the need to liquidate assets. The Bank also stresses its liquidity position utilizing different longer-term scenarios. The varying degrees of stress create pressure on deposit flows in its local market, reduce access to wholesale funding and limit access of funds available through brokered deposit channels. In addition to stressing cash flow, specific liquidity risk indicators are monitored to help identify risk areas. This analysis will help identify and quantify the potential cash surplus/deficit over a variety of time horizons to ensure the Bank has adequate funding resources. Assumptions used for liquidity stress testing are subjective. Should an evolving liquidity situation or business cycle present new data, potential assumption changes will be considered. The Bank believes it can meet all anticipated liquidity demands.

Historically, the Corporation has satisfied its liquidity needs from earnings, repayment of loans and amortizing investment securities, maturing investment securities, loan` sales, deposit growth and its ability to access existing lines of credit. All investment securities are classified as available for sale; therefore, securities that are not pledged as collateral for borrowings are an additional source of readily available liquidity, either by selling the security or, more preferably, to provide collateral for additional borrowing. At September 30, 2016, the Bank had approximately $86.0 million (fair value) in its investment portfolio pledged as collateral for deposits. Another source of available liquidity for the Bank is a line of credit with the FHLB. At September 30, 2016, the Bank had approximately $130 million available on this line of credit and $6.0 million of unsecured lines of credit at a correspondent bank. At September 30, 2016, the Bank had an excess borrowing capacity at FHLB of $266.7 million, which includes the amount available on the line of credit. The Bank has established credit at the Federal Reserve Discount Window and as of quarter-end had the ability to borrow approximately $23 million.

Off Balance Sheet Commitments

The Corporation's financial statements do not reflect various commitments that are made in the normal course of business, which may involve some liquidity risk. These commitments consist mainly of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Corporation. Unused commitments and standby letters of credit totaled $299.1 million and $291.4 million, respectively, at September 30, 2016 and December 31, 2015.

The Corporation has entered into various contractual obligations to make future payments. These obligations include time deposits, long-term debt, operating leases, deferred compensation and pension payments. These amounts have not changed materially from those reported in the Corporation's 2015 Annual Report on Form 10-K.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in the Corporation's exposure to market risk during the nine months ended September 30, 2016. For more information on market risk refer to the Corporation's 2015 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of Controls and Procedures

The Corporation carried out an evaluation, under the supervision and with the participation of the Corporation's management, including the Corporation's Chief Executive Officer and Chief Financial Officer, of the effectiveness of its disclosure controls and procedures, as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon the evaluation, the Corporation's Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2016, the Corporation's disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in the Corporation's reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There were no changes in the Corporation's internal control over financial reporting during the quarterly period ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, the internal control over financial reporting.

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control system is 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.

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.

Part II – OTHER INFORMATION

Item 1. Legal Proceedings

The nature of the Corporation's business generates a certain amount of litigation involving matters arising in the ordinary course of business, including the matter disclosed in our Form 8-K filed July 29, 2016. In management's opinion, we do not anticipate, at the present time, that the ultimate aggregate liability, if any, arising out of such litigation will have a material adverse effect on our financial position. We cannot now determine, however, whether or not any claims asserted against us, including the disclosed matter, will have a material adverse effect on our results of operations in any future reporting period, which will depend on, among other things, the amount of loss resulting from the claim and the amount of income otherwise reported for the reporting period. In addition, no material proceedings are pending or are known to be threatened or contemplated against us by governmental authorities.

Item 1A. Risk Factors

There were no material changes in the Corporation's risk factors during the nine months ended September 30, 2016. For more information, refer to the Corporation's 2015 Annual Report on Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Board of Directors approved a stock repurchase plan on April 14, 2016 that authorizes the repurchase of up to $350,000 in shares of common stock during each calendar quarter through March 31, 2017.

As of September 30, 2016, 30,196 shares have been purchased under this plan. The following table reports stock repurchases made during the 2016 and total shares repurchased under this plan:

(Dollars in thousands, except per share) Period	Number of Shares Purchased	Weighted Average Price Paid per Share	Dollar Amount of Shares Purchased as Part of Publically Announced Program	Dollar Amount of Shares that May Yet Be Purchased Under Program
April 2016	15,521	$ 22.55	$ 350	$ 1,050
August 2016	14,675	23.80	350	700
	30,196	$ 23.16		

Item 3. Defaults by the Company on its Senior Securities

None

Item 4. Mine Safety Disclosures

Not Applicable

Item 5. Other Information

None

Item 6. Exhibits

Exhibits

3.1 Articles of Incorporation of the Corporation. (Filed as Exhibit 3.1 to Annual Report on Form 10-K for the year ended December 31, 2015 and incorporated herein by reference.)

3.2 Bylaws of the Corporation. (Filed as Exhibit 99 to Current Report on Form 8-K filed on December 20, 2014 and incorporated herein by reference.)

31.1 Rule 13a – 14(a)/15d-14(a) Certifications – Principal Executive Officer

31.2 Rule 13a – 14(a)/15d-14(a) Certifications – Principal Financial Officer

32.1 Section 1350 Certifications – Principal Executive Officer

32.2 Section 1350 Certifications – Principal Financial Officer

101 Interactive Data File (XBRL)

FRANKLIN FINANCIAL SERVICES CORPORATION

and SUBSIDIARIES

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Franklin Financial Services Corporation

November 7, 2016	/s/ Timothy G. Henry Timothy G. Henry Chief Executive Office and President (Principal Executive Officer)
November 7, 2016	/s/ Mark R. Hollar Mark R. Hollar Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)