

CHEMUNG FINANCIAL CORP

Form 10-Q

May 09, 2014

---

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

FORM 10-Q

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

For Quarterly period ended March 31, 2014

Or

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

Commission File No. 0-13888

CHEMUNG FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

New York  
(State or other jurisdiction of incorporation or organization)

16-1237038  
I.R.S. Employer Identification No.

One Chemung Canal Plaza, P.O. Box 1522, Elmira, NY  
(Address of principal executive offices)

14902  
(Zip Code)

(607) 737-3711 or (800) 836-3711  
(Registrant's telephone number, including area code)

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

YES:  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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

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:

The number of shares of the registrant's common stock, \$.01 par value, outstanding on May 8, 2014 was 4,615,372.



## CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES

## INDEX

|                      | PAGES  |
|----------------------|--|
|                      | 3  |
|                      | 3  |
| <b>PART I.</b>       | <b>FINANCIAL INFORMATION</b>   |
| <b>Item 1:</b>       | <b>Financial Statements – Unaudited</b>  |
|                      | 4  |
|                      | 5  |
|                      | 6  |
|                      | 7  |
|                      | 8  |
|                      | 9  |
| <b>Item 2:</b>       | <b>Management's Discussion and Analysis of Financial Condition<br/>and Results of Operations</b> |
|                      | 30   |
| <b>Item 3:</b>       | <b>Quantitative and Qualitative Disclosures About Market Risk</b>                                |
|                      | 42   |
| <b>Item 4:</b>       | <b>Controls and Procedures</b>   |
|                      | 43   |
| <b>PART II.</b>      | <b>OTHER INFORMATION</b>   |
| <b>Item 1:</b>       | <b>Legal Proceedings</b>   |
|                      | 44   |
| <b>Item 1A:</b>      | <b>Risk Factors</b>  |
|                      | 44   |
| <b>Item 2:</b>       | <b>Unregistered Sales of Equity Securities and Use of Proceeds</b>                               |
|                      | 44   |
| <b>Item 3:</b>       | <b>Defaults Upon Senior Securities</b>   |
|                      | 44   |
| <b>Item 4:</b>       | <b>Mine Safety Disclosures</b>   |
|                      | 44   |
| <b>Item 5:</b>       | <b>Other Information</b>   |
|                      | 44   |
| <b>Item 6:</b>       | <b>Exhibits</b>  |
|                      | 45   |
| <b>SIGNATURES</b>    | <b>46</b>  |
| <b>EXHIBIT INDEX</b> |  |



## GLOSSARY OF TERMS AND ABBREVIATIONS

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

|             |   |
|-------------|---|
| BANK        | Chemung Canal Trust Company                   |
| CDO         | Collateralized Debt Obligation                |
| CORPORATION | Chemung Financial Corporation                 |
| FASB        | Financial Accounting Standards Board          |
| FDIC        | Federal Deposit Insurance Corporation         |
| FHLBNY      | Federal Home Loan Bank New York               |
| FRBNY       | Federal Reserve Bank of New York              |
| FREDDIE MAC | Federal Home Loan Mortgage Corporation        |
| GAAP        | U.S. generally accepted accounting principles |
| OTTI        | Other-than-temporary impairment               |
| PCI         | Purchased credit impaired                     |
| SEC         | Securities and Exchange Commission            |

## PART I. FINANCIAL INFORMATION

## Item 1: Financial Statements-Unaudited

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET  
UNAUDITED

| (dollars in thousands, except per share data)  | March 31,<br>2014  | December<br>31, 2013 |
|--|--------------------|----------------------|
| <b>ASSETS</b>  |                    |                      |
| Cash and due from financial institutions   | \$34,478           | \$31,600             |
| Interest-bearing deposits in other financial institutions  | 22,670             | 20,009               |
| Total cash and cash equivalents  | 57,148             | 51,609               |
| Trading assets, at fair value  | 413                | 366                  |
| Securities available for sale, at estimated fair value   | 337,134            | 346,016              |
| Securities held to maturity, estimated fair value at March 31, 2014 \$6,532 and \$6,930 at December 31, 2013                       | 6,126              | 6,495                |
| Federal Home Loan Bank and Federal Reserve Bank Stock, at cost   | 4,482              | 4,482                |
| Loans, net of deferred origination fees and costs, and unearned income   | 1,024,565          | 995,866              |
| Allowances for loan losses   | (13,155 )          | (12,776 )            |
| Loans, net   | 1,011,410          | 983,090              |
| Loans held for sale  | 75                 | 695                  |
| Premises and equipment, net  | 29,351             | 30,039               |
| Goodwill   | 21,824             | 21,824               |
| Other intangible assets, net   | 6,033              | 6,377                |
| Bank owned life insurance  | 2,815              | 2,796                |
| Accrued interest and other assets  | 20,720             | 22,354               |
| <b>Total assets</b>  | <b>\$1,497,531</b> | <b>\$1,476,143</b>   |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>  |                    |                      |
| Deposits:  |                    |                      |
| Non-interest-bearing   | \$354,727          | \$351,222            |
| Interest-bearing   | 937,163            | 915,034              |
| Total deposits   | 1,291,890          | 1,266,256            |
| Securities sold under agreements to repurchase   | 30,646             | 32,701               |
| Federal Home Loan Bank term advances   | 25,189             | 25,243               |
| Dividends payable  | 1,200              | 1,195                |
| Accrued interest payable and other liabilities   | 8,083              | 12,170               |
| Total liabilities  | 1,357,008          | 1,337,565            |
| Shareholders' equity:  |                    |                      |
| Common stock, \$.01 par value per share, 10,000,000 shares authorized;<br>5,310,076 issued at March 31, 2014 and December 31, 2013 | 53                 | 53                   |
| Additional-paid-in-capital   | 45,516             | 45,399               |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|  |             |             |
|--|-------------|-------------|
| Retained earnings  | 111,895     | 111,031     |
| Treasury stock, at cost (694,704 shares at March 31, 2014;<br>707,674 shares at December 31, 2013) | (17,728 )   | (18,060 )   |
| Accumulated other comprehensive income   | 787         | 155         |
| Total shareholders' equity   | 140,523     | 138,578     |
| Total liabilities and shareholders' equity   | \$1,497,531 | \$1,476,143 |

See accompanying notes to unaudited consolidated financial statements.



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

THREE MONTHS ENDED

(dollars in thousands, except per share and per share data)

|   | 2014      | MARCH 31,<br>2013 |
|---|-----------|-------------------|
| <b>Interest and dividend income:</b>                |           |                   |
| Loans, including fees                               | \$ 11,168 | \$ 11,304         |
| Taxable securities                                  | 1,503     | 1,131             |
| Tax exempt securities                               | 264       | 305               |
| Interest-bearing deposits                           | 19        | 8                 |
| Total interest and dividend income                  | 12,954    | 12,748            |
| <b>Interest Expense</b>                             |           |                   |
| Deposits  | 522       | 624               |
| Securities sold under agreements to repurchase      | 209       | 219               |
| Borrowed funds                                      | 190       | 188               |
| Total interest expense                              | 921       | 1,031             |
| Net interest income                                 | 12,033    | 11,717            |
| Provision for loan losses                           | 639       | 431               |
| Net interest income after provision for loan losses | 11,394    | 11,286            |
| <b>Other operating income:</b>                      |           |                   |
| Wealth management group fee income                  | 1,883     | 1,750             |
| Service charges on deposit accounts                 | 1,232     | 969               |
| Net gain on sales of loans held for sale            | 41        | 112               |
| Net losses on sales of other real estate owned      | (30 )     | -                 |
| Income from bank owned life insurance               | 19        | 21                |
| Other   | 1,819     | 1,170             |
| Total other operating income                        | 4,964     | 4,022             |
| <b>Other operating expense:</b>                     |           |                   |
| Salaries and wages                                  | 5,153     | 4,818             |
| Pension and other employee benefits                 | 1,359     | 1,424             |
| Net occupancy expenses                              | 1,793     | 1,362             |
| Furniture and equipment expenses                    | 630       | 518               |
| Data processing expense                             | 1,481     | 1,113             |
| Professional services                               | 222       | 329               |
| Amortization of intangible assets                   | 344       | 235               |
| Marketing and advertising expenses                  | 293       | 288               |
| Other real estate owned expenses                    | 87        | 36                |
| FDIC insurance                                      | 269       | 217               |
| Loan expense  | 149       | 143               |
| Merger and acquisition related expenses             | 86        | -                 |
| Other   | 1,477     | 1,242             |
| Total operating expenses                            | 13,343    | 11,725            |
| Income before income tax expense                    | 3,015     | 3,583             |
| Income tax expense                                  | 951       | 1,171             |
| Net Income  | \$ 2,064  | \$ 2,412          |
| Weighted average shares outstanding                 | 4,677,178 | 4,655,862         |

|                                      |    |      |    |      |
|--------------------------------------|----|------|----|------|
| Basic and diluted earnings per share | \$ | 0.44 | \$ | 0.52 |
|--------------------------------------|----|------|----|------|

See accompanying notes to unaudited consolidated financial statements.

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

| (dollars in thousands)  | Three Months Ended<br>March 31, |          |
|---|---------------------------------|----------|
|   | 2014                            | 2013     |
| Net income  | \$ 2,064                        | \$ 2,412 |
| Other comprehensive income:   |                                 |          |
| Unrealized holding gains (losses) on securities<br>available for sale               | 884                             | (70)     |
| Reclassification adjustment gains realized in net income                            | -                               | -        |
| Net unrealized gains (losses)   | 884                             | (70)     |
| Tax effect  | 340                             | (27)     |
| Net of tax amount   | 544                             | (43)     |
| Change in funded status of defined benefit<br>pension plan and other benefit plans: |                                 |          |
| Net gain (loss) arising during the period   | -                               | -        |
| Reclassification adjustment for amortization<br>of prior service costs              | (22)                            | (21)     |
| Reclassification adjustment for amortization<br>of net actuarial loss               | 165                             | 390      |
| Total before tax effect   | 143                             | 369      |
| Tax effect  | 55                              | 142      |
| Net of tax amount   | 88                              | 227      |
| Total other comprehensive income  | 632                             | 184      |
| Comprehensive income  | \$ 2,696                        | \$ 2,596 |

See accompanying notes to unaudited consolidated financial statements.

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

| (dollars in thousands except share data)                                   | Common Stock | Additional Paid-in Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total   |
|--|--------------|----------------------------|-------------------|----------------|---|---------|
| Balances at December 31, 2012  | \$ 53        | \$ 45,357                  | \$ 107,078        | \$ (18,566)    | \$ (2,807)                                    | 131,115 |
| Net income   | -            | -                          | 2,412             | -              | -   | 2,412   |
| Other comprehensive income   | -            | -                          | -                 | -              | 184   | 184     |
| Restricted stock awards  | -            | 60                         | -                 | -              | -   | 60      |
| Restricted stock units for directors' deferred compensation plan           | -            | 25                         | -                 | -              | -   | 25      |
| Cash dividends declared (\$.26 per share)                                  | -            | -                          | (1,194)           | -              | -   | (1,194) |
| Distribution of 7,969 shares of treasury stock for directors' compensation | -            | 14                         | -                 | 203            | -   | 217     |
| Distribution of 4,116 shares of treasury stock for employee compensation   | -            | 7                          | -                 | 105            | -   | 112     |
| Purchase of 3,094 shares of treasury stock                                 | -            | -                          | -                 | (93)           | -   | (93)    |
| Sale of 2,369 shares of treasury stock                                     | -            | 10                         | -                 | 60             | -   | 70      |
| Balances at March 31, 2013   | \$ 53        | \$ 45,473                  | \$ 108,296        | \$ (18,291)    | \$ (2,623)                                    | 132,908 |
|  |              |                            |                   |                |   |         |
| Balances at December 31, 2013  | \$ 53        | \$ 45,399                  | \$ 111,031        | \$ (18,060)    | \$ 155  | 138,578 |
| Net income   | -            | -                          | 2,064             | -              | -   | 2,064   |

|  |       |           |            |             |        |            |
|--|-------|-----------|------------|-------------|--------|------------|
| Other comprehensive income   | -     | -         | -          | -           | 632    | 632        |
| Restricted stock awards  | -     | 36        | -          | -           | -      | 36         |
| Restricted stock units for directors' deferred compensation plan                               | -     | 23        | -          | -           | -      | 23         |
| Distribution of 990 shares of treasury stock granted for employee restricted stock awards, net | -     | (26)      | -          | 26          | -      | -          |
| Cash dividends declared (\$.26 per share)  | -     | -         | (1,200)    | -           | -      | (1,200)    |
| Distribution of 8,385 shares of treasury stock for directors' compensation                     | -     | 59        | -          | 214         | -      | 273        |
| Distribution of 3,595 shares of treasury stock for employee compensation                       | -     | 25        | -          | 92          | -      | 117        |
| Balances at March 31, 2014   | \$ 53 | \$ 45,516 | \$ 111,895 | \$ (17,728) | \$ 787 | \$ 140,523 |

See accompanying notes to unaudited consolidated financial statements.

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

| (dollars in thousands)<br>CASH FLOWS FROM OPERATING ACTIVITIES:  | THREE MONTHS ENDED<br>MARCH 31, |          |
|--|---------------------------------|----------|
|  | 2014                            | 2013     |
| Net income   | \$ 2,064                        | \$ 2,412 |
| Adjustments to reconcile net income to net cash provided by operating activities:                                      |                                 |          |
| Amortization of intangible assets  | 344                             | 235      |
| Provision for loan losses  | 639                             | 431      |
| Depreciation and amortization of fixed assets  | 886                             | 749      |
| Amortization of premiums on securities, net  | 614                             | 538      |
| Gains on sales of loans held for sale, net   | (41)                            | (112)    |
| Proceeds from sales of loans held for sale   | 1,804                           | 3,455    |
| Loans originated and held for sale   | (1,143)                         | (3,071)  |
| Net gains on trading assets  | (12)                            | (19)     |
| Purchase of trading assets   | (35)                            | (17)     |
| Net losses on sales of other real estate owned   | 30                              | -        |
| Decrease (increase) in other assets  | 1,354                           | (58)     |
| Decrease in prepaid FDIC assessment  | -                               | 199      |
| Decrease in accrued interest payable   | (46)                            | (64)     |
| Expense related to restricted stock units for directors' deferred compensation plan                                    | 23                              | 25       |
| Expense related to employee stock compensation   | 117                             | 112      |
| Expense related to employee stock awards   | 36                              | 60       |
| Decrease in other liabilities  | (4,021)                         | (1,654)  |
| Income from bank owned life insurance  | (19)                            | (21)     |
| Net cash provided by operating activities  | 2,594                           | 3,200    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                                 |          |
| Proceeds from sales and calls of securities available for sale   | 5,000                           | 10,500   |
| Proceeds from maturities and principal collected on securities available for sale                                      | 5,027                           | 20,375   |
| Proceeds from maturities and principal collected on securities held to maturity  | 630                             | 257      |
| Purchases of securities available for sale   | (875)                           | (27,103) |
| Purchases of securities held to maturity   | (261)                           | (4,407)  |
| Purchase of Federal Home Loan Bank and Federal Reserve Bank stock  | -                               | (917)    |
| Redemption of Federal Home Loan Bank and Federal Reserve Bank stock  | -                               | 1,020    |
| Purchases of premises and equipment  | (198)                           | (65)     |
| Proceeds from sales of other real estate owned   | 249                             | -        |
| Net increase in loans  | (28,958)                        | (27,955) |
| Net cash used by investing activities  | (19,386)                        | (28,295) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                                 |          |
| Net increase in demand deposits, interest-bearing demand accounts, savings accounts, and insured money market accounts | 34,257                          | 36,964   |
| Net decrease in time deposits  | (8,623)                         | (4,599)  |
| Net decrease in securities sold under agreements to repurchase   | (2,055)                         | (1,283)  |
| Repayments of Federal Home Loan Bank long term advances  | (54)                            | (68)     |
| Purchase of treasury stock   | -                               | (93)     |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|  |           |           |
|--|-----------|-----------|
| Sale of treasury stock                         | -         | 70        |
| Cash dividends paid                            | (1,194)   | -         |
| Net cash provided by financing activities      | 22,331    | 30,991    |
| Net increase in cash and cash equivalents      | 5,539     | 5,896     |
| Cash and cash equivalents, beginning of period | 51,609    | 40,241    |
| Cash and cash equivalents, end of period       | \$ 57,148 | \$ 46,137 |

Supplemental disclosure of cash flow information:

Cash paid for:

|              |        |          |
|--------------|--------|----------|
| Interest     | \$ 967 | \$ 1,095 |
| Income taxes | \$ 68  | \$ 168   |

Supplemental disclosure of non-cash activity:

|                                  |          |          |
|----------------------------------|----------|----------|
| Dividends declared, not yet paid | \$ 1,200 | \$ 1,194 |
|----------------------------------|----------|----------|

See accompanying notes to unaudited consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Chemung Financial Corporation (the “Corporation”), through its wholly owned subsidiaries, Chemung Canal Trust Company (the “Bank”) and CFS Group, Inc., provides a wide range of banking, financing, fiduciary and other financial services to its clients. The Corporation and the Bank are subject to the regulations of certain federal and state agencies and undergo periodic examinations by those regulatory authorities.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with GAAP and include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions are eliminated in consolidation. Amounts in the prior periods' consolidated financial statements are reclassified whenever necessary to conform with the current period's presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and disclosures provided, and actual results could differ. The allowance for loan losses, fair value of financial instruments, other-than-temporary impairment of investment securities and goodwill and other intangibles are particularly subject to change.

Subsequent Events

The Corporation has evaluated events and transactions through the time the unaudited consolidated financial statements were issued. Financial statements are considered issued when they are widely distributed to all shareholders and other financial statement users, or filed with the SEC. In conjunction with applicable accounting standards, all material subsequent events have been either recognized in the unaudited consolidated financial statements or disclosed in the notes to the unaudited consolidated financial statements.

Recent Accounting Pronouncements

In January, 2014 the FASB issued ASU-2014-04, an amendment to Receivables-Troubled Debt Restructurings by Creditors (Subtopic 310-40), Reclassification of Residential Real Estate and Collateralized Consumer Mortgage Loans upon Foreclosure. The objective of this ASU is to improve reporting by clarifying when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable is derecognized and the real estate property recognized. The amendments in this ASU are effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. The Corporation will adopt all provisions of this ASU as of January 1, 2015. We are currently evaluating the potential impact on our consolidated financial statements.

NOTE 2 EARNING PER COMMON SHARE



Basic earnings per share is net income divided by the weighted average number of common shares outstanding during the period. Issuable shares, including those related to directors' restricted stock units and directors' stock compensation, are considered outstanding and are included in the computation of basic earnings per share. All outstanding unvested share based payment awards that contain rights to nonforfeitable dividends are considered participating securities for this calculation. Restricted stock awards are grants of participating securities and are considered outstanding at grant date. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur. Earnings per share were computed by dividing net income by 4,677,178 and 4,655,862 weighted average shares outstanding for the three-month periods ended March 31, 2014 and 2013, respectively. There were no dilutive common stock equivalents during the three-month periods ended March 31, 2014 or 2013.

## NOTE 3 SECURITIES

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

|  | March 31, 2014    |                     |                      |                         |
|--|-------------------|---------------------|----------------------|-------------------------|
|  | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated Fair<br>Value |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 181,676        | \$ 1,767            | \$ 473               | \$ 182,970              |
| Mortgage-backed securities, residential                                  | 99,974            | 1,284               | 121                  | 101,137                 |
| Collateralized mortgage obligations                                      | 777               | 12                  | -                    | 789                     |
| Obligations of states and political subdivisions                         | 37,368            | 1,012               | 35                   | 38,345                  |
| Corporate bonds and notes  | 2,869             | 63                  | 6                    | 2,926                   |
| SBA loan pools   | 1,426             | 15                  | 3                    | 1,438                   |
| Trust Preferred securities   | 1,900             | 137                 | -                    | 2,037                   |
| Corporate stocks   | 443               | 7,051               | 2                    | 7,492                   |
| <b>Total</b>   | <b>\$ 326,433</b> | <b>\$ 11,341</b>    | <b>\$ 640</b>        | <b>\$ 337,134</b>       |

|  | December 31, 2013 |                     |                      |                         |
|--|-------------------|---------------------|----------------------|-------------------------|
|  | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated Fair<br>Value |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 187,098        | \$ 1,915            | \$ 907               | \$ 188,106              |
| Mortgage-backed securities, residential                                  | 104,069           | 1,036               | 749                  | 104,356                 |
| Collateralized mortgage obligations                                      | 1,001             | 14                  | -                    | 1,015                   |
| Obligations of states and political subdivisions                         | 37,339            | 1,059               | 22                   | 38,376                  |
| Corporate bonds and notes  | 2,879             | 76                  | 9                    | 2,946                   |
| SBA loan pools   | 1,471             | 17                  | -                    | 1,488                   |
| Trust preferred securities   | 1,898             | 136                 | -                    | 2,034                   |
| Corporate stocks   | 444               | 7,253               | 2                    | 7,695                   |
| <b>Total</b>   | <b>\$ 336,199</b> | <b>\$ 11,506</b>    | <b>\$ 1,689</b>      | <b>\$ 346,016</b>       |

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

|  | March 31, 2014 |                     |                      |                         |
|--|----------------|---------------------|----------------------|-------------------------|
|  | Amortized Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated Fair<br>Value |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|  |    |       |    |     |    |   |    |       |
|--|----|-------|----|-----|----|---|----|-------|
| Obligations of states and political subdivisions | \$ | 5,304 | \$ | 392 | \$ | - | \$ | 5,696 |
| Time deposits with other financial institutions  |    | 822   |    | 14  |    | - |    | 836   |
| Total  | \$ | 6,126 | \$ | 406 | \$ | - | \$ | 6,532 |

|  |                | December 31, 2013 |                   |                      |    |   |    |       |
|--|----------------|-------------------|-------------------|----------------------|----|---|----|-------|
|  | Amortized Cost | Unrealized Gains  | Unrealized Losses | Estimated Fair Value |    |   |    |       |
| Obligations of states and political subdivisions | \$             | 5,472             | \$                | 419                  | \$ | - | \$ | 5,891 |
| Time deposits with other financial institutions  |                | 1,023             |                   | 16                   |    | - |    | 1,039 |
| Total  | \$             | 6,495             | \$                | 435                  | \$ | - | \$ | 6,930 |

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

|   | March 31, 2014     |            |                  |            |
|---|--------------------|------------|------------------|------------|
|   | Available for Sale |            | Held to Maturity |            |
|   | Amortized Cost     | Fair Value | Amortized Cost   | Fair Value |
| Within One Year                         | \$ 23,856          | \$ 24,217  | \$ 2,537         | \$ 2,567   |
| After One, But Within Five Years        | 182,121            | 184,229    | 2,297            | 2,477      |
| After Five, But Within Ten Years        | 17,836             | 17,832     | 1,292            | 1,488      |
| After Ten Years                         | -                  | -          | -                | -          |
|   | 223,813            | 226,278    | 6,126            | 6,532      |
| Mortgage-backed securities, residential | 99,974             | 101,137    | -                | -          |
| Collateralized mortgage obligations     | 777                | 789        | -                | -          |
| SBA loan pools                          | 1,426              | 1,438      | -                | -          |
| Total                                   | \$ 325,990         | \$ 329,642 | \$ 6,126         | \$ 6,532   |

There were no proceeds from sales and calls of securities resulting in gains or losses at March 31, 2014 and 2013.

The following tables summarize the investment securities available for sale with unrealized losses at March 31, 2014 and December 31, 2013 by aggregated major security type and length of time in a continuous unrealized loss position (dollars in thousands):

|  | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| March 31, 2014   |                     |                   |                     |                   |            |                   |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 89,296           | \$ 444            | \$ 1,984            | \$ 29             | \$ 91,280  | \$ 473            |
| Mortgage-backed securities, residential                                  | 33,382              | 121               | -                   | -                 | 33,382     | 121               |
| Obligations of states and political subdivisions                         | 5,778               | 35                | -                   | -                 | 5,778      | 35                |
| Corporate bonds and notes  | 240                 | 6                 | -                   | -                 | 240        | 6                 |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|                                       |            |        |          |       |            |        |
|---------------------------------------|------------|--------|----------|-------|------------|--------|
| SBA loan pools                        | 631        | 3      | -        | -     | 631        | 3      |
| Corporate stocks                      | -          | -      | 2        | 2     | 2          | 2      |
| Total temporarily impaired securities | \$ 129,327 | \$ 609 | \$ 1,986 | \$ 31 | \$ 131,313 | \$ 640 |

| December 31, 2013  | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 83,840           | \$ 867            | \$ 1,978            | \$ 39             | \$ 85,818  | \$ 906            |
| Mortgage-backed securities, residential                                  | 63,115              | 750               | -                   | -                 | 63,115     | 750               |
| Obligations of states and political subdivisions                         | 4,589               | 22                | -                   | -                 | 4,589      | 22                |
| Corporate bonds and notes  | 238                 | 9                 | -                   | -                 | 238        | 9                 |
| Corporate stocks   | -                   | -                 | 2                   | 2                 | 2          | 2                 |
| Total temporarily impaired securities                                    | \$ 151,782          | \$ 1,648          | \$ 1,980            | \$ 41             | \$ 153,762 | \$ 1,689          |

## Other-Than-Temporary Impairment

As of March 31, 2014, the majority of the Corporation's unrealized losses in the investment securities portfolio related to obligations of U.S. Government and U.S. Government sponsored enterprises and mortgage-backed securities. Because the decline in fair value is attributable to changes in interest rates and not credit quality, and because the Corporation does not have the intent to sell these securities and it is not likely that it will be required to sell these securities before their anticipated recovery, the Corporation does not consider these securities to be other-than-temporarily impaired at March 31, 2014.

During the first quarter of 2014, the Corporation received notice that one CDO consisting of a pool of trust preferred securities was liquidated and recorded \$0.5 million in other operating income during the first quarter of 2014. The Corporation does not own any other CDO's in its investment securities portfolio.

The tables below present a roll forward of the cumulative credit losses recognized in earnings for the three-month periods ending March 31, 2014 and 2013 (dollars in thousands):

|   | 2014     | 2013     |
|---|----------|----------|
| Beginning balance, January 1,   | \$ 1,939 | \$ 3,506 |
| Amounts related to credit loss for which an other-than-temporary impairment was not previously recognized   | -        | -        |
| <b>Additions/Subtractions:</b>  |          |          |
| Amounts realized for securities sold during the period  | -        | -        |
| Amounts related to securities for which the company intends to sell or that it will be more likely than not that the company will be required to sell prior to recovery of amortized cost basis | -        | -        |
| Reductions for increase in cash flows expected to be collected that are recognized over the remaining life of the security  | -        | -        |
| Reductions for previous credit losses realized in securities liquidated during the period   | (1,939)  | -        |
| Increases to the amount related to the credit loss for which other-than-temporary impairment was previously recognized  | -        | -        |
| Ending balance, March 31,   | \$ -     | \$ 3,506 |

## NOTE 4

## LOANS AND ALLOWANCE FOR LOAN LOSSES

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

|                                     | March 31,<br>2014 | December<br>31, 2013 |
|-------------------------------------|-------------------|----------------------|
| <b>Commercial and agricultural:</b> |                   |                      |
| Commercial and industrial           | \$ 144,681        | \$ 144,787           |
| Agricultural                        | 534               | 576                  |
| <b>Commercial mortgages:</b>        |                   |                      |
| Construction                        | 29,692            | 27,440               |
| Commercial mortgages                | 367,175           | 345,707              |
| Residential mortgages               | 196,396           | 195,997              |
| Consumer loans:                     |                   |                      |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|  |              |            |
|--|--------------|------------|
| Credit cards   | 1,583        | 1,756      |
| Home equity lines and loans  | 95,827       | 95,905     |
| Indirect consumer loans  | 170,853      | 164,846    |
| Direct consumer loans  | 17,824       | 18,852     |
| Total loans, net of deferred origination fees and costs, and unearned income | \$ 1,024,565 | \$ 995,866 |
| Interest receivable on loans   | 2,367        | 2,597      |
| Total recorded investment in loans   | \$ 1,026,932 | \$ 998,463 |

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

The following tables present the activity in the allowance for loan losses by portfolio segment for the three-month periods ending March 31, 2014 and 2013 (dollars in thousands):

| Allowance for loan losses    | Three Months Ended<br>March 31, 2014 |                      |                       |                |             |           |
|------------------------------|--------------------------------------|----------------------|-----------------------|----------------|-------------|-----------|
|                              | Commercial and Agricultural          | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total     |
| Beginning balance:           | \$ 1,979                             | \$ 6,243             | \$ 1,517              | \$ 3,037       | \$ -        | \$ 12,776 |
| Charge Offs:                 | (55)                                 | (44)                 | (7)                   | (467)          | -           | (573)     |
| Recoveries:                  | 92                                   | 38                   | -                     | 183            | -           | 313       |
| Net recoveries (charge offs) | 37                                   | (6)                  | (7)                   | (284)          | -           | (260)     |
| Provision                    | (71)                                 | 247                  | 42                    | 421            | -           | 639       |
| Ending balance               | \$ 1,945                             | \$ 6,484             | \$ 1,552              | \$ 3,174       | \$ -        | \$ 13,155 |

| Allowance for loan losses    | Three Months Ended<br>March 31, 2013 |                      |                       |                |             |           |
|------------------------------|--------------------------------------|----------------------|-----------------------|----------------|-------------|-----------|
|                              | Commercial and Agricultural          | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total     |
| Beginning balance:           | \$ 1,707                             | \$ 4,428             | \$ 1,566              | \$ 2,706       | \$ 26       | \$ 10,433 |
| Charge Offs:                 | (17)                                 | -                    | (44)                  | (197)          | -           | (258)     |
| Recoveries:                  | 142                                  | 9                    | -                     | 68             | -           | 219       |
| Net recoveries (charge-offs) | 125                                  | 9                    | (44)                  | (129)          | -           | (39)      |
| Provision                    | 161                                  | 236                  | 35                    | 25             | (26)        | 431       |
| Ending balance               | \$ 1,993                             | \$ 4,673             | \$ 1,557              | \$ 2,602       | \$ -        | \$ 10,825 |

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of March 31, 2014 and December 31, 2013 (dollars in thousands):

| Allowance for loan losses                       | March 31, 2014              |                      |                       |                |             |        |
|---|-----------------------------|----------------------|-----------------------|----------------|-------------|--------|
|   | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated | Total  |
| Ending allowance balance attributable to loans: |                             |                      |                       |                |             |        |
| Individually evaluated for impairment           | \$ 549                      | \$ 192               | \$ -                  | \$ 3           | \$ -        | \$ 744 |
| Collectively evaluated for                      | 1,396                       | 4,802                | 1,540                 | 3,171          | -           | 10,909 |



|   |          |          |          |          |      |           |
|---|----------|----------|----------|----------|------|-----------|
| impairment                                      |          |          |          |          |      |           |
| Loans acquired with deteriorated credit quality | -        | 1,490    | 12       | -        | -    | 1,502     |
| Total ending allowance balance                  | \$ 1,945 | \$ 6,484 | \$ 1,552 | \$ 3,174 | \$ - | \$ 13,155 |

| Allowance for loan losses                       | December 31, 2013           |                      |                       |                |             | Total     |
|---|-----------------------------|----------------------|-----------------------|----------------|-------------|-----------|
|   | Commercial and Agricultural | Commercial Mortgages | Residential Mortgages | Consumer Loans | Unallocated |           |
| Ending allowance balance attributable to loans: |                             |                      |                       |                |             |           |
| Individually evaluated for impairment           | \$ 576                      | \$ 466               | \$ -                  | \$ 4           | \$ -        | \$ 1,046  |
| Collectively evaluated for impairment           | 1,403                       | 4,407                | 1,497                 | 3,033          | -           | 10,340    |
| Loans acquired with deteriorated credit quality | -                           | 1,370                | 20                    | -              | -           | 1,390     |
| Total ending allowance balance                  | \$ 1,979                    | \$ 6,243             | \$ 1,517              | \$ 3,037       | \$ -        | \$ 12,776 |

March 31, 2014

| Loans:  | Commercial<br>and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Mortgages | Consumer<br>Loans | Total        |
|---|-----------------------------------|-------------------------|--------------------------|-------------------|--------------|
| Loans individually<br>evaluated for<br>impairment     | \$ 2,208                          | \$ 9,544                | \$ 114                   | \$ 129            | \$ 11,9951,  |
| Loans collectively<br>evaluated<br>for impairment     | 142,675                           | 379,366                 | 196,518                  | 286,616           | 1,005,175    |
| Loans acquired with<br>deteriorated<br>credit quality | 655                               | 8,841                   | 266                      | -                 | 9,762        |
| Total ending loans<br>balance                         | \$ 145,538                        | \$ 397,751              | \$ 196,898               | \$ 286,745        | \$ 1,026,932 |

December 31, 2013

| Loans:  | Commercial<br>and<br>Agricultural | Commercial<br>Mortgages | Residential<br>Mortgages | Consumer<br>Loans | Total      |
|---|-----------------------------------|-------------------------|--------------------------|-------------------|------------|
| Loans individually<br>evaluated for<br>impairment     | \$ 2,946                          | \$ 10,703               | \$ 117                   | \$ 131            | \$ 13,897  |
| Loans collectively<br>evaluated<br>for impairment     | 142,108                           | 354,636                 | 196,147                  | 281,979           | 974,870    |
| Loans acquired with<br>deteriorated<br>credit quality | 678                               | 8,757                   | 261                      | -                 | 9,696      |
| Total ending loans<br>balance                         | \$ 145,732                        | \$ 374,096              | \$ 196,525               | \$ 282,110        | \$ 998,463 |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

The following tables present loans individually evaluated for impairment recognized by class of loans as of March 31, 2014 and December 31, 2013, the average recorded investment and interest income recognized by class of loans as of the three-month periods ended March 31, 2014 and 2013 (dollars in thousands):

| With no related allowance recorded: | March 31, 2014           |                     |                                     | December 31, 2013        |                     |                                     |
|-------------------------------------|--------------------------|---------------------|-------------------------------------|--------------------------|---------------------|-------------------------------------|
|                                     | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated | Unpaid Principal Balance | Recorded Investment | Allowance for Loan Losses Allocated |
| Commercial and agricultural:        |                          |                     |                                     |                          |                     |                                     |
| Commercial and industrial           | \$ 1,398                 | \$ 1,403            | \$ -                                | \$ 1,906                 | \$ 1,909            | \$ -                                |
| Commercial mortgages:               |                          |                     |                                     |                          |                     |                                     |
| Construction                        | 2,286                    | 2,273               | -                                   | 2,329                    | 2,319               | -                                   |
| Commercial mortgages other          | 6,479                    | 6,490               | -                                   | 7,406                    | 7,439               | -                                   |
| Residential mortgages               | 114                      | 114                 | -                                   | 117                      | 117                 | -                                   |
| Consumer loans:                     |                          |                     |                                     |                          |                     |                                     |
| Home equity lines and loans         | 69                       | 71                  | -                                   | 71                       | 73                  | -                                   |
| With an allowance recorded:         |                          |                     |                                     |                          |                     |                                     |
| Commercial and agricultural:        |                          |                     |                                     |                          |                     |                                     |
| Commercial and industrial           | 804                      | 805                 | 549                                 | 1,037                    | 1,037               | 576                                 |
| Commercial mortgages:               |                          |                     |                                     |                          |                     |                                     |
| Commercial mortgages other          | 783                      | 781                 | 192                                 | 951                      | 945                 | 466                                 |
| Consumer loans:                     |                          |                     |                                     |                          |                     |                                     |
| Home equity lines and loans         | 57                       | 58                  | 3                                   | 58                       | 58                  | 4                                   |
| <b>Total</b>                        | <b>\$ 11,990</b>         | <b>\$ 11,995</b>    | <b>\$ 744</b>                       | <b>\$ 13,875</b>         | <b>\$ 13,897</b>    | <b>\$ 1,046</b>                     |

| With no related allowance recorded: | Three Months Ended March 31, 2014 |                                | Three Months Ended March 31, 2013 |                                |
|-------------------------------------|-----------------------------------|--------------------------------|-----------------------------------|--------------------------------|
|                                     | Average Recorded Investment       | Interest Income Recognized (1) | Average Recorded Investment       | Interest Income Recognized (1) |
| Commercial and agricultural:        |                                   |                                |                                   |                                |
| Commercial and industrial           | \$ 1,656                          | \$ 14                          | \$ 1,458                          | \$ 17                          |
| Commercial mortgages:               |                                   |                                |                                   |                                |
| Construction                        | 2,296                             | 25                             | 474                               | -                              |
|                                     | 7,005                             | 63                             | 5,583                             | 53                             |

|                               |           |        |          |       |
|-------------------------------|-----------|--------|----------|-------|
| Commercial mortgages<br>other |           |        |          |       |
| Residential mortgages         | 115       | -      | 130      | -     |
| Consumer loans:               |           |        |          |       |
| Home equity lines & loans     | 72        | 1      | 23       | -     |
| With an allowance recorded:   |           |        |          |       |
| Commercial and agricultural:  |           |        |          |       |
| Commercial and industrial     | 921       | -      | 387      | -     |
| Commercial mortgages:         |           |        |          |       |
| Commercial mortgages<br>other | 863       | -      | 361      | -     |
| Consumer loans:               |           |        |          |       |
| Home equity lines and loans   | 58        | 1      | 29       | -     |
| Direct consumer loans         | -         | -      | 8        | -     |
| Total                         | \$ 12,986 | \$ 104 | \$ 8,453 | \$ 70 |

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

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

The following tables present the recorded investment in past due and non-accrual status by class of loans as of March 31, 2014 and December 31, 2013 (dollars in thousands):

| March 31, 2014                  | Current   | 30-89<br>Days Past<br>Due | 90 Days or<br>more Past<br>Due and<br>accruing | Loans<br>acquired<br>with<br>deteriorated<br>credit<br>quality | Non-Accrual (1) | Total        |
|---------------------------------|-----------|---------------------------|--|--|-----------------|--------------|
| Commercial and<br>agricultural: |           |                           |  |  |                 |              |
| Commercial and<br>industrial    | \$42,750  | \$ 520                    | \$ -   | \$ 655   | \$ 1,078        | \$ 145,003   |
| Agricultural                    | 535       | -                         | -  | -  | -               | 535          |
| Commercial<br>mortgages:        |           |                           |  |  |                 |              |
| Construction                    | 27,037    | -                         | 1,451  | 774  | 496             | 29,758       |
| Commercial<br>mortgages others  | 356,618   | 1,002                     | -  | 8,067  | 2,306           | 367,993      |
| Residential<br>mortgages        | 189,719   | 3,073                     | -  | 266  | 3,840           | 196,898      |
| Consumer loans:                 |           |                           |  |  |                 |              |
| Credit cards                    | 1,568     | 8                         | 7  | -  | -               | 1,583        |
| Home equity lines<br>and loans  | 95,235    | 280                       | -  | -  | 543             | 96,058       |
| Indirect consumer<br>loans      | 169,838   | 1,091                     | -  | -  | 293             | 171,222      |
| Direct consumer<br>loans        | 17,822    | 49                        | -  | -  | 11              | 17,882       |
| Total                           | 1,001,122 | \$ 6,023                  | \$ 1,458                                       | \$ 9,762   | \$ 8,567        | \$ 1,026,932 |

(1) Includes all loans on non-accrual status regardless of the number of days such loans were delinquent as of March 31, 2014.

| December 31, 2013               | Current  | 30-89<br>Days Past<br>Due | 90 Days or<br>more Past<br>Due and<br>accruing | Loans<br>acquired<br>with<br>deteriorated<br>credit<br>quality | Non-Accrual (1) | Total      |
|---------------------------------|----------|---------------------------|--|--|-----------------|------------|
| Commercial and<br>agricultural: |          |                           |  |  |                 |            |
| Commercial and<br>industrial    | \$43,100 | \$ 29                     | \$ -   | \$ 678   | \$ 1,348        | \$ 145,155 |
| Agricultural                    | 577      | -                         | -  | -  | -               | 577        |
| Commercial<br>mortgages:        |          |                           |  |  |                 |            |
| Construction                    | 24,742   | -                         | 1,454  | 774  | 540             | 27,510     |
| Total                           | 335,123  | 1,138                     | -  | 7,983  | 2,342           | 346,586    |

|                             |         |          |          |          |          |            |
|-----------------------------|---------|----------|----------|----------|----------|------------|
| Commercial mortgages other  |         |          |          |          |          |            |
| Residential mortgages       | 187,448 | 5,458    | -`       | 261      | 3,358    | 196,525    |
| Consumer loans:             |         |          |          |          |          |            |
| Credit cards                | 1,729   | 9        | 19       | -        | -        | 1,757      |
| Home equity lines and loans | 95,349  | 150      | -        | -        | 635      | 96,134     |
| Indirect consumer loans     | 163,810 | 1,235    | -        | -        | 249      | 165,294    |
| Direct consumer loans       | 18,830  | 50       | -        | -        | 45       | 18,925     |
| Total                       | 970,708 | \$ 8,069 | \$ 1,473 | \$ 9,696 | \$ 8,517 | \$ 998,463 |

(1) Includes all loans on non-accrual status regardless of the number of days such loans were delinquent as of December 31, 2013.

### Troubled Debt Restructurings:

As of March 31, 2014 and December 31, 2013, the Corporation has a recorded investment in troubled debt restructurings of \$7.3 million and \$7.9 million, respectively. There were specific reserves of \$0.2 million and \$0.3 million allocated for troubled debt restructurings at March 31, 2014 and December 31, 2013, respectively. As of March 31, 2014, troubled debt restructurings totaling \$6.5 million were accruing interest under the modified terms and \$0.8 million were on non-accrual status. As of December 31, 2013, troubled debt restructurings totaling \$6.8 million were accruing interest under the modified terms and \$1.1 million were on non-accrual status. The Corporation has not committed to lend additional amounts as of March 31, 2014 to customers with outstanding loans that are classified as troubled debt restructurings. The Corporation had committed additional amounts totaling up to \$0.2 million as of December 31, 2013 to customers with outstanding loans that are classified as troubled debt restructurings.

During the three months ended March 31, 2014 and 2013, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: reduced scheduled payments for greater than three months or an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk.

The following table presents loans by class modified as troubled debt restructurings that occurred during the three months ended March 31, 2014 and March 31, 2013 (dollars in thousands):

|                               | Number of<br>Loans | Pre-Modification<br>Outstanding<br>Recorded<br>Investment | Post-Modification<br>Outstanding<br>Recorded<br>Investment |
|-------------------------------|--------------------|---|--|
| March 31, 2014                |                    |   |  |
| Troubled debt restructurings: |                    |   |  |
| Commercial and agricultural:  |                    |   |  |
| Commercial and industrial     | 1                  | \$ 503  | \$ 503   |
| Commercial mortgages:         |                    |   |  |
| Commercial mortgages          | 2                  | 367   | 323  |
| Total                         | 3                  | \$ 870  | \$ 826   |

March 31, 2013

### Troubled debt restructurings:

|                              |   |        |        |
|------------------------------|---|--------|--------|
| Commercial and agricultural: |   |        |        |
| Commercial and industrial    | 2 | \$ 431 | \$ 431 |
| Consumer loans:              |   |        |        |
| Home equity lines and loans  | 2 | \$ 104 | 104    |
| Total                        | 4 | \$ 535 | \$ 535 |

The troubled debt restructurings described above did not increase the allowance for loan losses and resulted in less than \$0.1 million in charge offs during the three months ended March 31, 2014. The troubled debt restructurings described above increased the allowance for loan losses by less than \$0.1 million and resulted in no charge offs during the three months ended March 31, 2013.

There were no payment defaults on any loans previously modified as troubled debt restructurings during the three months ending March 31, 2014 or March 31, 2013, within twelve months following the modification. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.



## Credit Quality Indicators

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

For the retail loans, which include lines of credit, installment, mortgage, and home equity loans, once a loan is properly approved and closed, the Corporation evaluates credit quality based upon loan repayment.

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

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

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

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

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. Loans listed as not rated are included in groups of homogeneous loans. Based on the analyses performed as of March 31, 2014 and December 31, 2013, the risk category of the recorded investment of loans by class of loans is as follows (dollars in thousands):

|                              | March 31, 2014 |            |  |                    |             |          |
|------------------------------|----------------|------------|--|--------------------|-------------|----------|
|                              | Not<br>Rated   | Pass       | Loans<br>acquired<br>with<br>deteriorated<br>credit<br>quality | Special<br>Mention | Substandard | Doubtful |
| Commercial and agricultural: |                |            |  |                    |             |          |
| Commercial and industrial    | \$ -           | \$ 134,207 | \$ 655   | \$ 6,068           | \$ 3,268    | \$ 805   |
| Agricultural                 | -              | 535        | -  | -                  | -           | -        |
| Commercial mortgages:        |                |            |  |                    |             |          |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|                             |          |            |          |           |           |        |
|-----------------------------|----------|------------|----------|-----------|-----------|--------|
| Construction                | -        | 25,101     | 774      | 3,061     | 822       | -      |
| Commercial mortgages other  | -        | 333,719    | 8,067    | 16,394    | 9,753     | 60     |
| Residential mortgages       | 192,792  | -          | 266      | -         | 3,840     | -      |
| Consumer loans:             |          |            |          |           |           |        |
| Credit cards                | 1,583    | -          | -        | -         | -         | -      |
| Home equity lines and loans | 95,439   | -          | -        | -         | 619       | -      |
| Indirect consumer loans     | 170,920  | -          | -        | -         | 302       | -      |
| Direct consumer loans       | 17,871   | -          | -        | -         | 11        | -      |
| Total                       | 4\$8,605 | \$ 493,562 | \$ 9,762 | \$ 25,523 | \$ 18,615 | \$ 865 |

18

---

|                              | December 31, 2013 |            |   |           |             |          |
|------------------------------|-------------------|------------|---|-----------|-------------|----------|
|                              | Not               |            | Loans<br>acquired<br>with<br>deteriorated | Special   | Substandard | Doubtful |
|                              | Rated             | Pass       | credit<br>quality                         | Mention   |             |          |
| Commercial and agricultural: |                   |            |   |           |             |          |
| Commercial and industrial    | \$ -              | \$ 133,615 | \$ 678                                    | \$ 5,117  | \$ 4,724    | \$ 1,021 |
| Agricultural                 | -                 | 577        | -   | -         | -           | -        |
| Commercial mortgages:        |                   |            |   |           |             |          |
| Construction                 | -                 | 23,087     | 774                                       | 2,783     | 866         | -        |
| Commercial mortgages other   | -                 | 313,956    | 7,983                                     | 13,611    | 11,036      | -        |
| Residential mortgages        | 192,995           | -          | 261                                       | -         | 3,269       | -        |
| Consumer loans               |                   |            |   |           |             |          |
| Credit cards                 | 1,757             | -          | -   | -         | -           | -        |
| Home equity lines and loans  | 95,422            | -          | -   | -         | 712         | -        |
| Indirect consumer loans      | 165,045           | -          | -   | -         | 249         | -        |
| Direct consumer loans        | 18,880            | -          | -   | -         | 45          | -        |
| Total                        | \$ 440,999        | \$ 471,235 | \$ 9,696                                  | \$ 21,511 | \$ 20,901   | \$ 1,021 |

The Corporation considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Corporation also evaluates credit quality based on the aging status of the loan, which was previously presented, and by payment activity. The following table presents the recorded investment in residential and consumer loans based on payment activity as of March 31, 2014 and December 31, 2013 (dollars in thousands):

|                | March 31, 2014           |             |                                   |                               |                                   |
|----------------|--------------------------|-------------|-----------------------------------|-------------------------------|-----------------------------------|
|                | Consumer Loans           |             |                                   |                               |                                   |
|                | Residential<br>Mortgages | Credit Card | Home Equity<br>Lines and<br>Loans | Indirect<br>Consumer<br>Loans | Other Direct<br>Consumer<br>Loans |
| Performing     | \$ 193,058               | \$ 1,576    | \$ 95,515                         | \$ 170,929                    | \$ 17,871                         |
| Non-Performing | 3,840                    | 7           | 543                               | 293                           | 11                                |
| Total          | \$ 196,898               | \$ 1,583    | \$ 96,058                         | \$ 171,222                    | \$ 17,882                         |

December 31, 2013  
Consumer Loans

Credit Card

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|                | Residential<br>Mortgages |          | Home Equity<br>Lines and<br>Loans | Indirect<br>Consumer<br>Loans | Other Direct<br>Consumer<br>Loans |
|----------------|--------------------------|----------|-----------------------------------|-------------------------------|-----------------------------------|
| Performing     | \$ 193,167               | \$ 1,738 | \$ 95,499                         | \$ 165,045                    | \$ 18,880                         |
| Non-Performing | 3,358                    | 19       | 635                               | 249                           | 45                                |
|                | \$ 196,525               | \$ 1,757 | \$ 96,134                         | \$ 165,294                    | \$ 18,925                         |

At the time of the merger with Fort Orange Financial Corp., the Corporation identified certain loans with evidence of deteriorated credit quality, and the probability that the Corporation would be unable to collect all contractually required payments from the borrower. These loans are classified as PCI loans. The Corporation adjusted its estimates of future expected losses, cash flows, and renewal assumptions on the PCI loans during the current year. These adjustments were made for changes in expected cash flows due to loans refinanced beyond original maturity dates, impairments recognized subsequent to the acquisition, advances made for taxes or insurance to protect collateral held and payments received in excess of amounts originally expected.

The table below summarizes the changes in total contractually required principal and interest cash payments, management's estimate of expected total cash payments and carrying value of the PCI loans from January 1, 2014 to March 31, 2014 (dollars in thousands):

|   | Balance at<br>December 31,<br>2013 | Income<br>Accretion | All Other<br>Adjustments | Balance at<br>March 31,<br>2014 |
|---|------------------------------------|---------------------|--------------------------|---------------------------------|
| Contractually required principal and interest                                   | \$ 11,230                          | \$ -                | \$ (157)                 | \$ 11,073                       |
| Contractual cash flows not expected to be collected<br>(nonaccretable discount) | (543)                              | -                   | 108                      | (435)                           |
| Cash flows expected to be collected   | 10,687                             | -                   | (49)                     | 10,638                          |
| Interest component of expected cash flows<br>(accretable yield)                 | (991)                              | 199                 | (84)                     | (876)                           |
| Fair value of loans acquired with deteriorating credit quality                  | \$ 9,696                           | \$ 199              | \$ (133)                 | \$ 9,762                        |

#### NOTE 5 FAIR VALUE

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

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

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

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

The Corporation used the following methods and significant assumptions to estimate fair value:

**Investment Securities:** The fair values of securities available for sale are usually determined by obtaining quoted prices on nationally recognized securities exchanges (Level 1 inputs), or matrix pricing, which is a mathematical technique widely used to value debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2 inputs).

**Trading Assets:** Securities that are held to fund a deferred compensation plan are recorded at fair value with changes in fair value included in earnings. The fair values of trading assets are determined by quoted market prices (Level 1 inputs).

**Impaired Loans:** At the time a loan is considered impaired, it is valued at the lower of cost or fair value. Impaired loans carried at fair value have been partially charged-off or receive specific allocations as part of the allowance for

loan loss accounting. For collateral dependent loans, fair value is commonly based on real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, typically resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

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

Appraisals for both collateral-dependent impaired loans and other real estate owned (“OREO”) are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Corporation. Once received, appraisals are reviewed for reasonableness of assumptions, approaches utilized, Uniform Standards of Professional Appraisal Practice and other regulatory compliance, as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. Appraisals are generally completed within the previous 12-month period prior to a property being placed into OREO. On impaired loans, appraisal values are adjusted based on the age of the appraisal, the position of the lien, the type of the property and its condition.

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

| Financial Assets:<br>Obligations of U.S.<br>Government and U.S. | Fair Value | Fair Value Measurement at March 31, 2014 Using                                |   |  |
|---|------------|---|---|--|
|   |            | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Government sponsored enterprises                                | \$ 182,970 | \$ 31,258   | \$ 151,712  | \$ -   |
| Mortgage-backed securities, residential                         | 101,137    | -   | 101,137   | -  |
| Collateralized mortgage obligations                             | 789        | -   | 789   | -  |
| Obligations of states and political subdivisions                | 38,345     | -   | 38,345  | -  |
| Corporate bonds and notes                                       | 2,926      | -   | 2,926   | -  |
| SBA loan pools  | 1,438      | -   | 1,438   | -  |
| Trust Preferred securities                                      | 2,037      | -   | 2,037   | -  |
| Corporate stocks  | 7,492      | 7,075   | 417   | -  |
| Total available for sale securities                             | \$ 337,134 | \$ 38,333   | \$ 298,801  | \$ -   |
| Trading assets  | \$ 413     | \$ 413  | \$ -  | \$ -   |

| Financial Assets:<br>Obligations of U.S.<br>Government and U.S. | Fair Value | Fair Value Measurement at December 31, 2013 Using                             |   |  |
|---|------------|---|---|--|
|   |            | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets (Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|   | \$ 188,106 | \$ 31,262   | \$ 156,844  | \$ -   |

|  |            |           |            |      |
|--|------------|-----------|------------|------|
| Government sponsored enterprises                 |            |           |            |      |
| Mortgage-backed securities, residential          | 104,356    | -         | 104,356    | -    |
| Collateralized mortgage obligations              | 1,015      | -         | 1,015      | -    |
| Obligations of states and political subdivisions | 38,376     | -         | 38,376     | -    |
| Corporate bonds and notes                        | 2,946      | -         | 2,946      | -    |
| SBA loan pools                                   | 1,488      | -         | 1,488      | -    |
| Trust Preferred securities                       | 2,034      | -         | 2,034      | -    |
| Corporate stocks                                 | 7,695      | 7,279     | 416        | -    |
| Total available for sale securities              | \$ 346,016 | \$ 38,541 | \$ 307,475 | \$ - |
| Trading assets                                   | \$ 366     | \$ 366    | \$ -       | \$ - |

There were no transfers between Level 1 and Level 2 during the three-month period ending March 31, 2014 or the year ending December, 31, 2013.



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

|                                    | Fair Value | Fair Value Measurement at March 31, 2014 Using                                   |   |  |
|------------------------------------|------------|--|---|--|
|                                    |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Financial Assets:                  |            |  |   |  |
| Impaired Loans:                    |            |  |   |  |
| Commercial and agricultural:       |            |  |   |  |
| Commercial and industrial          | \$ 255     | \$ -   | \$ -  | \$ 255   |
| Commercial mortgages:              |            |  |   |  |
| Other                              | 591        | -  | -   | 591  |
| Consumer loans:                    |            |  |   |  |
| Home equity lines and loans        | 54         | -  | -   | 54   |
| Total Impaired Loans               | \$ 900     | \$ -   | \$ -  | \$ 900   |
| Other real estate owned:           |            |  |   |  |
| Commercial mortgages:              |            |  |   |  |
| Commercial mortgages other         | \$ 176     | \$ -   | \$ -  | \$ 176   |
| Consumer loans:                    |            |  |   |  |
| Home equity lines and loans        | 65         | -  | -   | 65   |
| Total Other Real Estate Owned, net | \$ 241     | \$ -   | \$ -  | \$ 241   |

|                              | Fair Value | Fair Value Measurement at December 31, 2013 Using                                |   |  |
|------------------------------|------------|--|---|--|
|                              |            | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Financial Assets:            |            |  |   |  |
| Impaired Loans:              |            |  |   |  |
| Commercial and agricultural: |            |  |   |  |
| Commercial and industrial    | \$ 460     | \$ -   | \$ -  | \$ 460   |
| Commercial mortgages:        |            |  |   |  |
| Commercial mortgages other   | 485        | -  | -   | 485  |
| Consumer loans:              |            |  |   |  |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|                                    |    |     |    |   |    |   |    |     |
|------------------------------------|----|-----|----|---|----|---|----|-----|
| Home equity lines and loans        |    | 54  |    | - |    | - |    | 54  |
| Total Impaired Loans               | \$ | 999 | \$ | - | \$ | - | \$ | 999 |
| Other real estate owned:           |    |     |    |   |    |   |    |     |
| Commercial and agricultural:       |    |     |    |   |    |   |    |     |
| Commercial and industrial          | \$ | 101 | \$ | - | \$ | - | \$ | 101 |
| Commercial mortgages:              |    |     |    |   |    |   |    |     |
| Commercial mortgages other         |    | 266 |    | - |    | - |    | 266 |
| Residential mortgages              |    | 106 |    | - |    | - |    | 106 |
| Consumer loans:                    |    |     |    |   |    |   |    |     |
| Home equity lines and loans        |    | 65  |    | - |    | - |    | 65  |
| Total Other Real Estate Owned, net | \$ | 538 | \$ | - | \$ | - | \$ | 538 |

The following table presents information related to Level 3 non-recurring fair value measurement at March 31, 2014 and December 31, 2013 (dollars in thousands):

| Description             | Fair Value<br>at March 31, 2014 | Technique              |   | Unobservable Inputs  |
|-------------------------|---------------------------------|------------------------|---|--|
| Impaired loans          | \$ 900                          | Third party appraisals | 1 | Management discount based on underlying collateral characteristics and market conditions |
| Other real estate owned | \$ 241                          | Third party appraisals | 1 | Estimated holding period   |
|                         |                                 |                        | 2 | Estimated closing costs  |

| Description             | Fair Value at December<br>31, 2013 | Technique              |   | Unobservable Inputs  |
|-------------------------|------------------------------------|------------------------|---|--|
| Impaired loans          | \$ 999                             | Third party appraisals | 1 | Management discount based on underlying collateral characteristics and market conditions |
| Other real estate owned | \$ 538                             | Third party appraisals | 1 | Estimated holding period   |
|                         |                                    |                        | 2 | Estimated closing costs  |

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a principal balance of \$1.6 million with a valuation allowance of \$0.7 million as of March 31, 2014, resulting in \$0.3 million decrease in the provision for loan losses for the three-month period ended March 31, 2014. Impaired loans had a principal balance of \$2.0 million, with a valuation allowance of \$1.0 million as of December 31, 2013, resulting in an increase of \$0.9 million in the provision for loan losses for the year ending December 31, 2013.

OREO, which is measured by the lower of cost or fair value less costs to sell, had a net carrying amount of \$0.2 million with no valuation allowance at March 31, 2014. There were no write downs for the three-month period ending March 31, 2014. OREO had a net carrying amount of \$0.5 million at December 31, 2013. The net carrying amount reflects the outstanding balance of \$0.7 million, net of a valuation allowance of \$0.2 million, at December 31, 2013, which resulted in an immaterial write down for the year ending December 31, 2013.

The carrying amounts and estimated fair values of other financial instruments, at March 31, 2014 and December 31, 2013, are as follows (dollars in thousands):

|   | Fair Value Measurements at March 31, 2014 Using |  |   |   |                          |
|---|---|--|---|---|--------------------------|
|   | Carrying Amount                                 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Estimated Fair Value (1) |
| Financial assets:   |   |  |   |   |                          |
| Cash and due from financial institutions                  | \$ 34,478                                       | \$ 34,478  | \$ -  | \$ -                                      | \$ 34,478                |
| Interest-bearing deposits in other financial institutions | 22,670  | 22,670   | -   | -   | 22,670                   |
| Trading assets  | 413   | 413  | -   | -   | 413                      |
| Securities available for sale                             | 337,134   | 38,333   | 298,801                                       | -   | 337,134                  |
| Securities held to maturity                               | 6,126   | -  | 6,532   | -   | 6,532                    |
| FHLB NY and FRBNY stock                                   | 4,482   | -  | -   | -   | N/A                      |
| Loans, net  | 1,011,410                                       | -  | -   | 1,037,728                                 | 1,037,728                |
| Loans held for sale                                       | 75  | -  | 75  | -   | 75                       |
| Accrued interest receivable                               | 4,436   | 361  | 1,747   | 2,328                                     | 4,436                    |
| Financial liabilities:                                    |   |  |   |   |                          |
| Deposits:   |   |  |   |   |                          |
| Demand, savings, and insured money market accounts        | \$ 1,056,021                                    | \$ 1,056,021   | \$ -  | \$ -                                      | \$ 1,056,021             |
| Time deposits   | 235,869   | -  | 236,679                                       | -   | 236,679                  |
| Securities sold under agreements to repurchase            | 30,646  | -  | 31,773  | -   | 31,773                   |
| FHLB NY term advances                                     | 25,189  | -  | 26,142  | -   | 26,142                   |
| Accrued interest payable                                  | 290   | 13   | 131   | 146                                       | 290                      |

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

|                   | Fair Value Measurements at December 31, 2013 Using |  |   |   |                          |
|-------------------|--|--|---|---|--------------------------|
|                   | Carrying Amount                                    | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Estimated Fair Value (1) |
| Financial assets: | \$ 31,600  | \$ 31,600  | \$ -  | \$ -                                      | \$ 31,600                |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|   |              |              |         |           |              |
|---|--------------|--------------|---------|-----------|--------------|
| Cash and due from financial institutions                  |              |              |         |           |              |
| Interest-bearing deposits in other financial institutions | 20,009       | 20,009       | -       | -         | 20,009       |
| Trading assets  | 366          | 366          | -       | -         | 366          |
| Securities available for sale                             | 346,016      | 38,541       | 307,475 | -         | 346,016      |
| Securities held to maturity                               | 6,495        | -            | 6,930   | -         | 6,930        |
| FHLB NY and FRBNY stock                                   | 4,482        | -            | -       | -         | N/A          |
| Loans, net  | 983,090      | -            | -       | 1,008,826 | 1,008,826    |
| Loans held for sale                                       | 695          | -            | 695     | -         | 695          |
| Accrued interest receivable                               | 4,166        | 145          | 1,468   | 2,553     | 4,166        |
| Financial liabilities:                                    |              |              |         |           |              |
| Deposits:   |              |              |         |           |              |
| Demand, savings, and insured money market accounts        | \$ 1,021,764 | \$ 1,021,764 | \$ -    | \$ -      | \$ 1,021,764 |
| Time deposits   | 244,492      | -            | 245,482 | -         | 245,482      |
| Securities sold under agreements to repurchase            | 32,701       | -            | 33,636  | -         | 33,636       |
| FHLB NY term advances                                     | 25,243       | -            | 26,064  | -         | 26,064       |
| Accrued interest payable                                  | 336          | 15           | 170     | 151       | 336          |

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

The methods and assumptions used to estimate fair value are described as follows:

#### Cash, Due From and Interest-Bearing Deposits in Other Financial Institutions

For those short-term instruments that generally mature in 90 days or less, the carrying value approximates fair value of which non interest-bearing deposits are classified as Level 1 and interest-bearing deposits with the FHLBNY and FRBNY are classified as Level 1.

#### FHLBNY and FRBNY Stock

It is not practicable to determine the fair value of FHLBNY and FRBNY stock due to restrictions placed on its transferability.

#### Loans Receivable

For variable-rate loans that reprice frequently, fair values approximate carrying values. The fair values for other loans are estimated through discounted cash flow analysis using interest rates currently being offered for loans with similar terms and credit quality. Loans are classified as Level 3. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price.

#### Loans Held for Sale

Certain mortgage loans are originated with the intent to sell. Loans held for sale are recorded at the lower of cost or fair value in the aggregate. Loans held for sale are classified as Level 2.

#### Deposits

The fair values disclosed for demand deposits, savings accounts and money market accounts are, by definition, equal to the amounts payable on demand at the reporting date (i.e., their carrying values) and classified as Level 1.

The fair value of certificates of deposits is estimated using a discounted cash flow approach that applies interest rates currently being offered on certificates to a schedule of the weighted-average expected monthly maturities and classified as Level 2.

#### Securities Sold Under Agreements to Repurchase

These instruments bear both variable and fixed rates of interest. Therefore, the carrying value approximates fair value for the variable rate instruments and the fair value of fixed rate instruments is based on discounted cash flows to maturity. These are classified as Level 2.

#### FHLBNY Term Advances

These instruments bear a stated rate of interest to maturity and, therefore, the fair value is based on discounted cash flows to maturity and classified as Level 2.

#### Commitments to Extend Credit

The fair value of commitments to extend credit is based on fees currently charged to enter into similar agreements, the counter-party's credit standing and discounted cash flow analysis. The fair value of these commitments to extend credit approximates the recorded amounts of the related fees and is not material at March 31, 2014 and December 31, 2013.

#### Accrued Interest Receivable and Payable

For these short-term instruments, the carrying value approximates fair value resulting in a classification of Level 1, Level 2 or Level 3 depending upon the classification of the asset/liability they are associated with.

## NOTE 6 GOODWILL AND INTANGIBLE ASSETS

The changes in goodwill included in the core banking segment during the periods ending March 31, 2014 and 2013 were as follows (dollars in thousands):

|                          | 2014      | 2013      |
|--------------------------|-----------|-----------|
| Beginning of year        | \$ 21,824 | \$ 21,824 |
| Acquired goodwill        | -         | -         |
| Ending balance March 31, | \$ 21,824 | \$ 21,824 |

Acquired intangible assets were as follows at March 31, 2014 and December 31, 2013 (dollars in thousands):

|   | At March 31, 2014   |                             | At December 31, 2013 |                             |
|---|---------------------|-----------------------------|----------------------|-----------------------------|
|   | Balance<br>Acquired | Accumulated<br>Amortization | Balance<br>Acquired  | Accumulated<br>Amortization |
| Core deposit intangibles                | \$ 5,975            | \$ 2,589                    | \$ 5,975             | \$ 2,338                    |
| Other customer relationship intangibles | 5,633               | 2,986                       | 6,063                | 3,323                       |
| Total                                   | \$ 11,608           | \$ 5,575                    | \$ 12,038            | \$ 5,661                    |

Aggregate amortization expense was \$0.3 million and \$0.2 million for the three-month periods ended March 31, 2014 and 2013, respectively.

The remaining estimated aggregate amortization expense at March 31, 2014 is listed below (dollars in thousands):

| Year                | Estimated<br>Expense |
|---------------------|----------------------|
| 2014                | \$ 967               |
| 2015                | 1,136                |
| 2016                | 986                  |
| 2017                | 859                  |
| 2018                | 734                  |
| 2019 and thereafter | 1,351                |
| Total               | \$ 6,033             |

## NOTE 7 ACCUMULATED OTHER COMPREHENSIVE INCOME OR LOSS

Accumulated other comprehensive income or loss represents the net unrealized holding gains or losses on securities available for sale and the funded status of the Corporation's defined benefit pension plan and other benefit plans, as of the consolidated balance sheet dates, net of the related tax effect.

The following is a summary of the changes in accumulated other comprehensive income or loss by component, net of tax, for the periods indicated (dollars in thousands):

| Unrealized<br>Gains and | Defined<br>Benefit and | Total |
|-------------------------|------------------------|-------|
|-------------------------|------------------------|-------|



Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|   | Losses on<br>Securities<br>Available<br>for Sale | Other<br>Benefit<br>Plans |        |
|---|--|---------------------------|--------|
| Balance at December 31, 2013  | \$ 6,043   | \$ (5,888)                | \$ 155 |
| Other comprehensive income before<br>Reclassification               | 544  | -                         | 544    |
| Amounts reclassified from accumulated other<br>comprehensive income | -  | 88                        | 88     |
| Net current period other comprehensive loss                         | 544  | 88                        | 632    |
| Balance at March 31, 2014   | \$ 6,587   | \$ (5,800)                | \$ 787 |

|   | Unrealized<br>Gains and<br>Losses on<br>Securities<br>Available<br>for Sale | Defined<br>Benefit and<br>Other<br>Benefit<br>Plans | Total      |
|---|---|---|------------|
| Balance at December 31, 2012  | \$ 8,023  | \$ (10,830)   | \$ (2,807) |
| Other comprehensive income before<br>Reclassification               | (43)  | -   | (43)       |
| Amounts reclassified from accumulated other<br>comprehensive income | -   | 227   | 227        |
| Net current period other comprehensive loss                         | (43)  | 227   | 184        |
| Balance at March 31, 2013   | \$ 7,980  | \$ (10,603)   | \$ (2,623) |

The following is the reclassification out of accumulated other comprehensive income for the periods indicated (dollars in thousands):

| Details about Accumulated Other Comprehensive<br>Income Components                         | Three Months Ended March 31, |          | Affected Line Item<br>in the Statement Where<br>Net Income is Presented |
|--|------------------------------|----------|---|
|  | 2014                         | 2013     |   |
| Unrealized gains and losses on securities<br>available for sale:                           |                              |          |   |
| Reclassification adjustment for other-than-<br>temporary gains (losses) realized in income | \$ -                         | \$ -     |   |
| Realized gains on securities available for sale  | -                            | -        | Net gains on securities<br>transactions                                 |
| Tax effect   | -                            | -        | Income tax expense  |
| Net of tax   | -                            | -        |   |
| Amortization of defined pension plan<br>and other benefit plan items:                      |                              |          |   |
| Prior service costs (a)  | 22                           | 21       | Pension and other<br>employee benefits                                  |
| Actuarial losses (a)   | (165)                        | (390)    | Pension and other<br>employee benefits                                  |
| Tax effect   | 55                           | 142      | Income tax expense  |
| Net of tax   | (88)                         | (227)    |   |
| Total reclassification for the period, net of tax  | \$ (88)                      | \$ (227) |   |

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension and other benefit plan costs (see Note 9 for additional information).

## NOTE 8

## COMMITMENTS AND CONTINGENCIES

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

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

The Bank is a party in two legal proceedings involving its Wealth Management Group. In both proceedings, the Bank, as trustee pursuant to written trust instruments, has sought judicial settlement of trust accounts in the New York Surrogate's Court for Chemung County. Individuals who are beneficiaries under the trusts have filed formal objections and/or demand letters with the Court in both of these accounting proceedings, objecting to the final settlement of the trust accounts. The objectants primarily assert that the Bank acted imprudently by failing to diversify the trusts' investments and they claim \$9.6 million and \$24.1 million, consisting of damages and disallowed trustee's commissions, plus unspecified legal fees in the respective proceedings. These proceedings are pending in the Surrogate's Court. While the outcome of litigation is not predictable the Bank believes that the claims are without merit and is vigorously defending them. As of March 31, 2014, no amount has been accrued for potential losses related to these proceedings as a potential loss is not considered probable or reasonably estimable in the opinion of management.

In the normal course of business, there are various outstanding claims and legal proceedings involving the Corporation or its subsidiaries. Except for the above matter, we believe that we are not a party to any pending legal, arbitration, or regulatory proceedings that could have a material adverse impact on our financial results or liquidity.

## NOTE 9 COMPONENTS OF QUARTERLY AND YEAR TO DATE NET PERIOD BENEFIT COSTS

The components of net periodic expense for the Corporation's pension and other benefit plans for the periods indicated are as follows (dollars in thousands):

| (dollars in thousands)                                | Three Months Ended |                   |
|---|--------------------|-------------------|
|   | March 31,<br>2014  | March 31,<br>2013 |
| <b>Qualified Pension</b>                              |                    |                   |
| Service cost, benefits earned during the period       | \$271              | \$349             |
| Interest cost on projected benefit obligation         | 435                | 409               |
| Expected return on plan assets                        | (793 )             | (727 )            |
| Amortization of unrecognized transition obligation    | -                  | -                 |
| Amortization of unrecognized prior service cost       | 2                  | 3                 |
| Amortization of unrecognized net loss                 | 160                | 380               |
| Net periodic pension expense                          | \$75               | \$414             |
| <b>Supplemental Pension</b>                           |                    |                   |
| Service cost, benefits earned during the period       | \$10               | \$10              |
| Interest cost on projected benefit obligation         | 13                 | 11                |
| Expected return on plan assets                        | -                  | -                 |
| Amortization of unrecognized prior service cost       | -                  | -                 |
| Amortization of unrecognized net loss                 | 5                  | 8                 |
| Net periodic supplemental pension expense             | \$28               | \$29              |
| <b>Postretirement, Medical and Life</b>               |                    |                   |
| Service cost, benefits earned during the period       | \$11               | \$11              |
| Interest cost on projected benefit obligation         | 18                 | 15                |
| Expected return on plan assets                        | -                  | -                 |
| Amortization of unrecognized prior service cost       | (24 )              | (24 )             |
| Amortization of unrecognized net loss                 | -                  | 1                 |
| Net periodic postretirement, medical and life expense | \$5                | \$3               |

## NOTE 10 SEGMENT REPORTING

The Corporation manages its operations through two primary business segments: core banking and wealth management group services. The core banking segment provides revenues by attracting deposits from the general public and using such funds to originate consumer, commercial, commercial real estate, and residential mortgage loans, primarily in the Corporation's local markets and to invest in securities. The wealth management group services segment provides revenues by providing trust and investment advisory services to clients.

Accounting policies for the segments are the same as those described in Note 1. Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results are shown in the following table. Income taxes are allocated based on the separate taxable income of each entity and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the Holding Company and Other column below, along with amounts to eliminate transactions between segments (dollars in thousands).

|                                     | Three Months Ended March 31, 2014 |            |          |  |              |
|-------------------------------------|-----------------------------------|------------|----------|--|--------------|
|                                     | Core                              | Wealth     | Holding  |  | Consolidated |
|                                     | Banking                           | Management | Company  |  | Totals       |
|                                     |                                   | Group      | And      |  |              |
|                                     |                                   | Services   | Other    |  |              |
| Net interest income                 | \$ 12,030                         | \$ -       | \$ 3     |  | \$ 12,033    |
| Provision for loan losses           | 639                               | -          | -        |  | 639          |
| Net interest income after provision |                                   |            |          |  |              |
| for loan losses                     | 11,391                            | -          | 3        |  | 11,394       |
| Other operating income              | 2,888                             | 1,883      | 193      |  | 4,964        |
| Other operating expenses            | 11,812                            | 1,318      | 213      |  | 13,343       |
| Income before income tax expense    | 2,467                             | 565        | (17)     |  | 3,015        |
| Income tax expense (benefit)        | 758                               | 217        | (24)     |  | 951          |
| Segment net income                  | \$ 1,709                          | \$ 348     | \$ 7     |  | \$ 2,064     |
| Segment assets                      | \$1,490,857                       | \$ 4,878   | \$ 1,796 |  | \$ 1,497,531 |

|   | Three Months Ended March 31, 2013 |   |                                 |                        |
|---|-----------------------------------|---|---------------------------------|------------------------|
|   | Core<br>Banking                   | Wealth<br>Management<br>Group<br>Services | Holding<br>Company<br>And Other | Consolidated<br>Totals |
| Net interest income                                       | \$ 11,715                         | \$ -                                      | \$ 2                            | \$ 11,717              |
| Provision for loan losses                                 | 431                               | -   | -                               | 431                    |
| Net interest income<br>after provision<br>for loan losses | 11,284                            | -   | 2                               | 11,286                 |
| Other operating income                                    | 1,995                             | 1,750                                     | 277                             | 4,022                  |
| Other operating expenses                                  | 9,931                             | 1,534                                     | 260                             | 11,725                 |
| Income before income tax<br>expense                       | 3,348                             | 216                                       | 19                              | 3,583                  |
| Income tax expense  | 1,081                             | 83  | 7                               | 1,171                  |
| Segment net income  | \$ 2,267                          | \$ 133                                    | \$ 12                           | \$ 2,412               |
| Segment assets  | \$ 1,272,340                      | \$ 5,118                                  | \$ 2,514                        | \$ 1,279,972           |

## NOTE 11 STOCK COMPENSATION

## Board of Director's Stock Compensation

Members of the Board of Directors receive common shares of the Corporation equal in value to the amount of fees individually earned during the previous year for service as a director. The common shares are distributed to the Corporation's individual board members from treasury shares of the Corporation on or about January 15 following the calendar year of service.

Additionally, the President and Chief Executive Officer of the Corporation, who does not receive cash compensation as a member of the Board of Directors, is awarded common shares equal in value to the average of those awarded to board members not employed by the Corporation who have served for 12 months during the prior year.

During January 2014 and 2013, 8,385 and 7,969 shares, respectively, were re-issued from treasury to fund the stock component of directors' compensation. An expense of \$56 thousand and \$68 thousand related to this compensation was recognized during the three month periods ending March 31, 2014 and March 31, 2013, respectively. This expense is accrued as shares are earned.

## Restricted Stock Plan

Pursuant to the Corporation's Restricted Stock Plan (the "Plan"), the Corporation may make discretionary grants of restricted stock to officers other than the Corporation's Chief Executive Officer. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at issue date.

A summary of restricted stock activity from December 31, 2013 to March 31, 2014 is presented below:

Shares Weighted-Average  
Grant Date Fair

|                                |        | Value    |
|--------------------------------|--------|----------|
| Nonvested at December 31, 2013 | 20,639 | \$ 27.17 |
| Granted                        | 990    | 30.33    |
| Vested                         | (215 ) | 23.18    |
| Forfeited or Cancelled         | -      | -        |
| Nonvested at March 31, 2014    | 21,414 | \$ 27.36 |

As of March 31, 2014, there was \$543 thousand of total unrecognized compensation cost related to nonvested shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 3.95 years. The total fair value of shares vested during the three months ended March 31, 2014 was \$6 thousand.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The purpose of this discussion is to focus on information about the financial condition and results of operations of the Corporation for the three month periods ended March 31, 2014 and 2013. Reference should be made to the accompanying unaudited consolidated financial statements and footnotes, and the Corporation's 2013 Annual Report on Form 10-K, which was filed with the SEC on March 14, 2014, for an understanding of the following discussion and analysis.

Forward-looking Statements

This discussion contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in the PSLRA. Forward-looking statements are not historical in nature, but instead are based on our assumptions, estimates and projections about future events and trends. All statements regarding the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing the Corporation's growth, competition, changes in law or the regulatory environment, including the Dodd-Frank Act, and changes in general business and economic trends. Information concerning these and other factors can be found in the Corporation's periodic filings with the SEC, including the discussion under the heading "Item 1A. Risk Factors" in the Corporation's 2013 Annual Report on Form 10-K. These filings are available publicly on the SEC's web site at <http://www.sec.gov>, on the Corporation's web site at <http://www.chemungcanal.com> or upon request from the Corporate Secretary at (607) 737-3746. Except as otherwise required by law, the Corporation undertakes no obligation to publicly update or revise its forward-looking statements, whether as a result of new information, future events, or otherwise.

Overview

The Corporation is a bank holding company and a financial holding company registered with the Federal Reserve. The Bank is a New York chartered commercial bank established in 1833 and is a wholly owned subsidiary of the Corporation. Through the Bank and CFS Group, Inc., its wholly owned financial services subsidiary, the Corporation provides a wide range of services, including demand, savings and time deposits; commercial, residential and consumer loans and letter of credit; wealth management services, employee benefit plans and securities and insurance brokerage services. The Bank relies substantially on a foundation of locally generated deposits.

The Corporation does not engage in any material operations apart from its ownership on the Bank and CFS Group, Inc. The Bank derives its income primarily from interest and fees on loans, interest on investment securities, Wealth Management Group fee income and fees received in connection with deposit and other services. The Bank's operating expenses are interest expense paid on deposits and borrowings, salaries and employee benefit plans and general operating expenses.

Three Months Ended March 31, 2014 Highlights

- Net income for the first quarter of 2014 was \$2.1 million, or \$0.44 per share, compared with \$2.4 million, or \$0.52 per share, for the same quarter in the prior year.



- Net interest margin (fully taxable equivalent) for the first quarter of 2014 was 3.58%, compared with 3.72% for the preceding quarter and 4.14% for the same quarter in the prior year. Average interest-earning assets increased \$215.0 million year-over-year, due to the fourth quarter 2013 Bank of America branch acquisition in addition to organic growth.
- Total loans increased \$28.7 million, or 2.9%, from \$995.9 million at December 31, 2013 to \$1.025 billion at March 31, 2014. This increase was attributable to growth of \$23.6 million, or 4.5%, in commercial loans.

- Non-performing assets to total assets ratio was 0.59% at March 31, 2014 compared with 0.61% at December 31, 2013.
- Book value per share was \$30.03 at March 31, 2014 compared with \$29.67 at December 31, 2013, an increase of \$0.36, or 1.2%. Tangible book value per share was \$24.08 at March 31, 2014 compared with \$23.63 at December 31, 2013, an increase of \$0.45, or 1.9%.
- Dividends declared during the quarter ended March 31, 2014 were \$0.26 per share, level with the prior year.

#### Critical Accounting Policies, Estimates and Risks and Uncertainties

Critical accounting policies include the areas where the Corporation has made what it considers to be particularly difficult, subjective or complex judgments concerning estimates, and where these estimates can significantly affect the Corporation's financial results under different assumptions and conditions. The Corporation prepares its financial statements in conformity with GAAP. As a result, the Corporation is required to make certain estimates, judgments and assumptions that it believes are reasonable based upon the information available at that time. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the uncertainty in evaluating the level of the allowance required to cover probable incurred credit losses inherent in the loan portfolio, and the material effect that such judgments can have on the Corporation's results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under adversely different conditions or assumptions the allowance would need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Corporation's non-performing loans and potential problem loans, and the associated evaluation of the related collateral coverage for these loans, has a significant impact on the overall analysis of the adequacy of the allowance for loan losses. Real estate values in the Corporation's market area did not increase dramatically in the prior several years, and, as a result, any declines in real estate values have been modest. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral evaluations were significantly lowered, the Corporation's allowance for loan losses policy would also require additional provisions for loan losses.

Management also considers the accounting policy relating to the valuation of goodwill and other intangible assets to be a critical accounting policy. The initial carrying value of goodwill and other intangible assets is determined using estimated fair values developed from various sources and other generally accepted valuation techniques. Estimates are based upon financial, economic, market and other conditions as they existed as of the date of a particular acquisition. These estimates of fair value are the results of judgments made by the Corporation based upon estimates that are inherently uncertain and changes in the assumptions upon which the estimates were based may have a significant impact on the resulting estimates. In addition to the initial determination of the carrying value, on an ongoing basis management must assess whether there is any impairment of goodwill and other intangible assets that would require an adjustment in carrying value and recognition of a loss in the consolidated statement of income.

## Financial Condition

### Summary

Consolidated assets at March 31, 2014 totaled \$1.498 billion, an increase of \$21.4 million, or 1.4%, since December 31, 2013. The growth was due primarily to increases of \$28.7 million, or 2.9%, in total portfolio loans and \$5.5 million in cash and cash equivalents, partially offset by a decrease of \$9.3 million in investment securities. The increase in portfolio loans was due to strong growth of \$23.6 million in commercial loans and \$4.7 million in consumer loans.

Total liabilities increased \$19.4 million to \$1.357 billion at March 31, 2014, due primarily to an increase of \$25.6 million in deposits, partially offset by decreases of \$4.1 million in other liabilities and \$2.1 million in securities sold under agreement to repurchase. The increase was due primarily to growth in public deposits.

Total shareholders' equity was \$140.5 million at March 31, 2014, an increase of \$1.9 million from December 31, 2013, due primarily to the Corporation's net income of \$2.1 million and an increase of \$0.6 million in accumulated other comprehensive income, partially offset by declared dividends of \$1.2 million.

The market value of total assets under management or administration in the Corporation's Wealth Management Group was \$1.923 billion at March 31, 2014 compared with \$1.888 billion at December 31, 2013.

### Cash and Cash Equivalents

Total cash and cash equivalents increased since December 31, 2013, due primarily to increases of \$2.9 million in cash and due from financial institutions and \$2.7 million in interest-bearing deposits in other financial institutions. The increases were due to normal fluctuations in Bank activities. The Corporation continues to evaluate alternative investment of these funds with caution, given the low interest rate environment.

### Securities

The Corporation's Funds Management Policy includes an investment policy that in general, requires debt securities purchased for the bond portfolio to carry a minimum agency rating of "A". After an independent credit analysis is performed, the policy also allows the Corporation to purchase local municipal obligations that are not rated. The Corporation intends to maintain a reasonable level of securities to provide adequate liquidity and in order to have securities available to pledge to secure public deposits, repurchase agreements and other types of transactions. Fluctuations in the fair value of the Corporation's securities relate primarily to changes in interest rates.

Marketable securities are classified as Available for Sale, while investments in local municipal obligations are generally classified as Held to Maturity. The composition of the available for sale segment of the securities portfolio is summarized in Table 1 as follows (in thousands of dollars):

TABLE 1. SECURITIES AVAILABLE FOR SALE  
March 31, 2014

| Securities Available for Sale   | March 31, 2014 |                      |                           | December 31, 2013 |                      |                           |
|---|----------------|----------------------|---------------------------|-------------------|----------------------|---------------------------|
|   | Amortized Cost | Estimated Fair Value | Unrealized Gains (Losses) | Amortized Cost    | Estimated Fair Value | Unrealized Gains (Losses) |
| Obligations of U.S. Government and U.S Government sponsored enterprises | \$ 181,676     | \$ 182,970           | \$ 1,294                  | \$ 187,098        | \$ 188,106           | \$ 1,008                  |
| Mortgage-backed securities, residential                                 | 99,974         | 101,137              | 1,163                     | 104,069           | 104,356              | 287                       |
| Collateralized mortgage obligations                                     | 777            | 789                  | 12                        | 1,001             | 1,015                | 14                        |
| Obligations of states and political subdivisions                        | 37,368         | 38,345               | 977                       | 37,339            | 38,376               | 1,037                     |
| Corporate bonds and notes   | 2,869          | 2,926                | 57                        | 2,879             | 2,946                | 67                        |
| SBA loan pools  | 1,426          | 1,438                | 12                        | 1,471             | 1,488                | 17                        |
| Trust preferred securities  | 1,900          | 2,037                | 137                       | 1,898             | 2,034                | 136                       |
| Corporate stocks  | 443            | 7,492                | 7,049                     | 444               | 7,695                | 7,251                     |
| Totals  | \$ 326,433     | \$ 337,134           | \$ 10,701                 | \$ 336,199        | \$ 346,016           | \$ 9,817                  |

The available for sale segment of the securities portfolio totaled \$337.1 million at March 31, 2014, a decrease of \$8.9 million, or 2.6%, from \$346.0 million at December 31, 2013. The decrease resulted primarily from sales and calls of \$5.0 million, and maturities and principal collected of \$5.0 million, partially offset by purchases of \$0.9 million. The decrease in securities was used to help fund the growth in the loan portfolio.

The held to maturity segment of the securities portfolio consists of obligations of political subdivisions in the Corporation's market areas. These securities totaled \$6.1 million at March 31, 2014, a net decrease of \$0.4 million due primarily to maturities and principal collected, from December 31, 2013.

#### Loans

The Corporation has reporting systems to monitor: (i) loan origination and concentrations, (ii) delinquent loans, (iii) non-performing assets, including non-performing loans, troubled debt restructurings, other real estate owned, (iv) impaired loans, and (v) potential problem loans. Management reviews these systems on a regular basis.

Table 2 shows the Corporation's loan composition by segment for the periods indicated, and the dollar and percent change from December 31, 2013 to March 31, 2014 (in thousands of dollars):

TABLE 2. LOANS

|                              | March 31,<br>2014 | December 31,<br>2013 | Dollar<br>Change | Percent<br>Change |
|------------------------------|-------------------|----------------------|------------------|-------------------|
| Commercial and agricultural: | \$ 145,215        | \$ 145,363           | \$ (148 )        | -0.1 %            |
| Commercial mortgages         | 396,867           | 373,147              | 23,720           | 6.4 %             |
| Residential mortgages        | 196,396           | 195,997              | 399              | 0.2 %             |
| Indirect consumer loans      | 170,853           | 164,846              | 6,007            | 3.6 %             |
| Consumer loans               | 115,234           | 116,513              | (1,279 )         | -1.1 %            |
| Loans, net                   | \$ 1,024,565      | \$ 995,866           | \$ 28,699        | 2.9 %             |

Portfolio loans totaled \$1.025 billion at March 31, 2014, an increase of \$28.7 million, or 2.9%, from \$995.9 million at December 31, 2013. The increase in portfolio loans was due to strong growth of \$23.7 million, or 6.4% in commercial mortgages and \$6.0 million in indirect consumer loans. The growth in commercial mortgages was due primarily to an increase in the Capital Bank division in the Albany, New York region. The growth in indirect consumer loans was a result of the Corporation's plan to extend into 2014 its loan program with reduced pricing on high quality indirect auto loans.

Residential mortgage loans totaled \$196.4 million at March 31, 2014, an increase of \$0.4 million, or 0.2%, from December 31, 2013. In addition, during the three months ended March 31, 2014, \$1.7 million of newly originated residential mortgages were sold in the secondary market to Freddie Mac and \$0.1 million in residential mortgages were sold to the State of New York Mortgage Agency. During the twelve months ended December 31, 2013, \$18.8 million of residential mortgages were sold in the secondary market to Freddie Mac, with an additional \$0.7 million of residential mortgages sold to the State of New York Mortgage Agency.

The Corporation anticipates that future growth in portfolio loans will continue to be in commercial mortgages and indirect consumer loans.

#### Non-Performing Assets

Non-performing assets consist of non-accrual loans, non-accrual troubled debt restructurings and other real estate owned that has been acquired in partial or full satisfaction of loan obligations or upon foreclosure.

Past due status on all loans is based on the contractual terms of the loan. It is generally the Corporation's policy that a loan 90 days past due be placed in non-accrual status unless factors exist that would eliminate the need to place a loan in this status. A loan may also be designated as non-accrual at any time if payment of principal or interest in full is not expected due to deterioration in the financial condition of the borrower. At the time loans are placed in non-accrual status, the accrual of interest is discontinued and previously accrued interest is reversed. All payments received on non-accrual loans are applied to principal. Loans are considered for return to accrual status when they become current as to principal and interest and remain current for a period of six consecutive months or when, in the opinion of management, the Corporation expects to receive all of its original principal and interest. In the case of non-accrual loans where a portion of the loan has been charged off, the remaining balance is kept in non-accrual status until the entire principal balance has been recovered.

Table 3 summarizes the Corporation's non-performing assets, excluding acquired PCI loans (in thousands of dollars):

|  | March 31, 2014 | December 31, 2013 |
|--|----------------|-------------------|
| Non-accrual loans                        | \$ 7,780       | \$ 7,456          |
| Non-accrual troubled debt restructurings | 787            | 1,061             |
| Total non-performing loans               | \$ 8,567       | \$ 8,517          |
| Other real estate owned                  | 241            | 538               |
| Total non-performing assets              | \$ 8,808       | \$ 9,055          |

|  |         |        |   |
|--|---------|--------|---|
| Ratio of non-performing loans to total loans               | 0.84%   | 0.86   | % |
| Ratio of non-performing assets to total assets             | 0.59%   | 0.61   | % |
| Ratio of allowance for loan losses to non-performing loans | 153.55% | 150.01 | % |

|   |          |          |
|---|----------|----------|
| Accruing loans past due 90 days or more (1) | \$ 1,458 | \$ 1,473 |
| Accruing troubled debt restructurings (1)   | \$ 6,462 | \$ 6,831 |

(1) These loans are not included in non-performing assets above.

### Non-Performing Loans

The recorded investment in non-performing loans at March 30, 2014 totaled \$8.6 million compared to \$8.5 million at December 31, 2013, an increase of \$0.1 million. The increase in non-performing loans was due primarily to an increase of \$0.5 million in non-accrual residential mortgages, partially offset by decreases of \$0.3 million in non-accrual commercial and industrial loans and \$0.1 million in non-accrual consumer loans.

The recorded investment in accruing loans past due 90 days or more totaled \$1.5 million at March 31, 2014, level with December 31, 2013.

Not included in non-performing loan totals are \$9.8 million of acquired loans which the Corporation has identified as PCI loans. The PCI loans are accounted for under separate accounting guidance, Accounting Standards Codification (“ASC”) Subtopic 310-30, “Receivables - Loans and Debt Securities Acquired with Deteriorated Credit Quality” as disclosed in Note 4 of the financial statements.

#### Troubled Debt Restructurings

The Corporation works closely with borrowers that have financial difficulties to identify viable solutions that minimize the potential for loss. In that regard, the Corporation modified the terms of select loans to maximize their collectability. The modified loans are considered TDRs under current accounting guidance. Modifications generally involve short-term deferrals of principal and/or interest payments, reductions of scheduled payment amounts, interest rates or principal of the loan, and forgiveness of accrued interest. As of March 31, 2014, the Corporation had \$0.8 million of non-accrual TDRs compared with \$1.1 million as of December 31, 2013. As of March 31, 2014, the Corporation had \$6.5 million of accruing TDRs compared with \$6.8 million as of December 31, 2013. The decrease in total TDRs was primarily in the commercial loan segment of the loan portfolio.

#### Impaired Loans

Impaired loans at March 31, 2014 totaled \$12.0 million, including TDRs of \$7.3 million, compared to \$13.9 million at December 31, 2013, including TDRs of \$7.9 million. Not included in the impaired loan totals are acquired loans which the Corporation has identified as PCI loans, as these loans are accounted for under ASC Subtopic 310-30 as noted under the above discussion of non-performing loans. The decrease in impaired loans was due primarily to decreases of \$1.2 million in commercial mortgages and \$0.7 million in commercial and industrial loans. Included in the impaired loan total at March 31, 2014, are loans totaling \$1.6 million for which impairment allowances of \$0.7 million have been specifically allocated to the allowance for loan losses. As of December 31, 2013, the impaired loan total included \$2.0 million of loans for which specific impairment allowances of \$1.0 million were allocated to the allowance for loan losses. The decrease in the amount of impaired loans for which specific allowances were allocated to the allowance for loan losses was due primarily to a decrease in impaired commercial loans.

The majority of the Corporation's impaired loans are secured and measured for impairment based on collateral evaluations. It is the Corporation's policy to obtain updated appraisals, by independent third parties, on loans secured by real estate at the time a loan is determined to be impaired. An impairment measurement is performed based upon the most recent appraisal on file to determine the amount of any specific allocation or charge-off. In determining the amount of any specific allocation or charge-off, the Corporation will make adjustments to reflect the estimated costs to sell the property. Upon receipt and review of the updated appraisal, an additional measurement is performed to determine if any adjustments are necessary to reflect the proper provisioning or charge-off. Impaired loans are reviewed on a quarterly basis to determine if any changes in credit quality or market conditions would require any additional allocation or recognition of additional charge-offs. Real estate values in the Corporation's market area had not increased dramatically in the prior several years and, as a result, declines in real estate values have been modest. Non-real estate collateral may be valued using (i) an appraisal, (ii) net book value of the collateral per the borrower's financial statements, or (iii) aging reports, that may be adjusted based on management's knowledge of the client and client's business. If market conditions warrant, future appraisals are obtained for both real estate and non-real estate collateral.





## Allowance for Loan Losses

The allowance is an amount that management believes will be adequate to absorb probable incurred losses on existing loans. The allowance is established based on management's evaluation of the probable inherent losses in our portfolio in accordance with GAAP, and is comprised of both specific valuation allowances and general valuation allowances.

A loan is classified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect both the principal and interest due under the contractual terms of the loan agreement. Specific valuation allowances are established based on management's analyses of individually impaired loans. Factors considered by management in determining impairment include payment status, evaluations of the underlying collateral, expected cash flows, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. If a loan is determined to be impaired and is placed on nonaccrual status, all future payments received are applied to principal and a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

The general component covers non-impaired loans and is based on historical loss experience adjusted for current factors. Loans not impaired but classified as substandard and special mention use a historical loss factor on a rolling five year history of net losses. For all other unclassified loans, the historical loss experience is determined by portfolio class and is based on the actual loss history experienced by the Corporation over the most recent two years. This actual loss experience is supplemented with other qualitative factors based on the risks present for each portfolio class. These qualitative factors include consideration of the following: (1) lending policies and procedures, including underwriting standards and collection, charge-off and recovery policies, (2) national and local economic and business conditions and developments, including the condition of various market segments, (3) loan profiles and volume of the portfolio, (4) the experience, ability, and depth of lending management and staff, (5) the volume and severity of past due, classified and watch-list loans, non-accrual loans, troubled debt restructurings, and other modifications (6) the quality of the Bank's loan review system and the degree of oversight by the Bank's Board of Directors, (7) collateral related issues: secured vs. unsecured, type, declining valuation environment and trend of other related factors, (8) the existence and effect of any concentrations of credit, and changes in the level of such concentrations, (9) the effect of external factors, such as competition and legal and regulatory requirements, on the level of estimated credit losses in the Bank's current portfolio and (10) the impact of the global economy.

The allowance for loan losses is increased through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses when management believes that the collectability of all or a portion of the principal is unlikely. Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as the credit risk grade assigned to the loan, historical loan loss experience and review of specific impaired loans. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.



The allowance for loan losses was \$13.2 million at March 31, 2014, up from \$12.8 million at December 31, 2013. The ratio of allowance for loan losses to total loans was 1.28% at March 31, 2014, level with December 31, 2013. The increase in the allowance for loan losses was due primarily to loan portfolio growth, and allowances for the growth after consideration of the factors discussed above, and higher net charge-offs. Net charge-offs for the three months ended March 31, 2014 were \$0.3 million compared with less than \$0.1 million for the prior year. The increase in net charge-offs was primarily in the consumer loan portfolio.

Table 4 summarizes the Corporation's loan loss experience for the three months ended March 31, 2014 and 2013 (in thousands of dollars, except ratio data):

TABLE 4. SUMMARY OF LOAN LOSS EXPERIENCE

|   | Three Months Ended |                |
|---|--------------------|----------------|
|   | March 31, 2014     | March 31, 2013 |
| Balance at beginning of period                                | \$ 12,776          | \$ 10,433      |
| Charge-offs:  |                    |                |
| Commercial and agricultural                                   | 55                 | 17             |
| Commercial mortgages  | 44                 | -              |
| Residential mortgages   | 7                  | 44             |
| Consumer loans  | 467                | 197            |
| Total charge-offs   | 573                | 258            |
| Recoveries:   |                    |                |
| Commercial and agricultural                                   | 92                 | 142            |
| Commercial mortgages  | 38                 | 9              |
| Consumer loans  | 183                | 68             |
| Total recoveries  | 313                | 219            |
| Net charge-offs   | 260                | 39             |
| Provision charged to operations                               | 639                | 431            |
| Balance at end of period                                      | \$ 13,155          | \$ 10,825      |
| Ratio of net charge-offs to average loans outstanding         | 0.10 %             | 0.02 %         |
| Ratio of allowance for loan losses to total loans outstanding | 1.28 %             | 1.17 %         |

## Deposits

Table 5 shows the Corporation's deposit composition by segment for the periods indicated, and the dollar and percent change from December 31, 2013 to March 31, 2014 (in thousands of dollars):

|                                      | TABLE 5. DEPOSITS |                   |               |                |
|--------------------------------------|-------------------|-------------------|---------------|----------------|
|                                      | March 31, 2014    | December 31, 2013 | Dollar Change | Percent Change |
| Non-interest-bearing demand deposits | \$ 354,727        | \$ 351,222        | \$ 3,505      | 1.0%           |
| Interest-bearing demand deposits     | 114,507           | 114,679           | (172)         | -0.1%          |

Edgar Filing: CHEMUNG FINANCIAL CORP - Form 10-Q

|                               |              |              |           |       |
|-------------------------------|--------------|--------------|-----------|-------|
| Insured money market accounts | 387,912      | 361,095      | 26,817    | 7.4%  |
| Savings deposits              | 198,876      | 194,768      | 4,108     | 2.1%  |
| Time deposits                 | 235,868      | 244,492      | (8,624)   | -3.5% |
| Total                         | \$ 1,291,890 | \$ 1,266,256 | \$ 25,634 | 2.0 % |

Deposits totaled \$1.292 billion at March 31, 2014, compared with \$1.266 billion at December 31, 2013, an increase of \$25.6 million, or 2.0%. The increase was due primarily to growth in public deposits. At March 31, 2014, demand deposit and money market accounts comprised 66.3% of total deposits compared with 65.3% at December 31, 2013. Sorted by public, commercial and consumer sources, the growth in deposits was due to increases of \$29.7 million in public funds and \$7.8 million in consumer accounts, partially offset by a decrease of \$11.9 million in commercial accounts.

In addition to consumer, commercial and public deposits, other sources of funds include brokered deposits. Brokered deposits include funds obtained through brokers, and the Bank's participation in the Certificate of Deposit Account Registry Service ("CDARS") program. The CDARS program involves a network of financial institutions that exchange funds among members in order to ensure FDIC insurance coverage on customer deposits above the single institution limit. Using a sophisticated matching system, funds are exchanged on a dollar-for-dollar basis, so that the equivalent of an original deposit comes back to the originating institution. Deposits obtained through brokers were \$3.9 million at March 31, 2014 compared with \$5.0 million as of December 31, 2013. Deposits obtained through the CDARS program were \$47.0 million at March 31, 2014 compared with \$35.7 million as of December 31, 2013. The increase in CDARS deposits was due to the Corporation offering the CDARS program to local municipalities.

The Corporation's deposit strategy is to fund the Bank with stable, low-cost deposits, primarily checking account deposits and other low interest-bearing deposit accounts. A checking account is the driver of a banking relationship and consumers consider the bank where they have their checking account as their primary bank. These customers will typically turn to their primary bank first when in need of other financial services. Strategies that have been developed and implemented to generate these deposits include: (i) acquire deposits by entering new markets through de novo branching, (ii) an annual checking account marketing campaign, (iii) training branch employees to identify and meet client financial needs with Bank products and services, (iv) link business and consumer loans to primary checking account at the Bank, (v) aggressively promote direct deposit of client's payroll checks or benefit checks and (vi) constantly monitor the Corporation's pricing strategies to ensure competitive products and services.

The Corporation also considers brokered deposits to be an element of its deposit strategy and anticipates that it will continue using brokered deposits as a secondary source of funding to support growth.

#### Borrowings

FHLB term advances were \$25.2 million at March 31, 2014, level with December 31, 2013. Securities sold under agreements to repurchase decreased \$2.1 million from \$32.7 million at December 31, 2013 to \$30.6 million at March 31, 2014. The decrease in securities sold under agreements to repurchase was related to normal fluctuations in client accounts.

#### Shareholders' Equity

Total shareholders' equity was \$140.5 million at March 31, 2014 compared with \$138.6 million at December 31, 2013. The increase was due primarily to the Corporation's net income of \$2.1 million and an increase of \$0.6 million in accumulated other comprehensive income, partially offset by declared dividends of \$1.2 million. The total shareholders' equity to total assets ratio was 9.38% at March 31, 2014 compared with 9.39% at December 31, 2013. The tangible equity to tangible assets ratio was 7.67% at March 31, 2014 compared with 7.62% at December 31, 2013. Book value per share increased to \$30.03 at March 31, 2014 from \$29.67 at December 31, 2013.

The Corporation and the Bank are subject to capital adequacy guidelines of the Federal Reserve which establish a framework for the classification of financial holding companies and financial institutions into five categories: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. As of March 31, 2014, both the Corporation's and the Bank's capital ratios were in excess of those required to be considered well-capitalized under regulatory capital guidelines.

## Liquidity and Capital Resources

Liquidity management involves the ability to meet the cash flow requirements of deposit clients, borrowers, and the operating, investing and financing activities of the Corporation. The Corporation uses a variety of resources to meet its liquidity needs. These include short term investments, cash flow from lending and investing activities, core-deposit growth and non-core funding sources, such as time deposits of \$100,000 or more, securities sold under agreements to repurchase and other borrowings.

The Corporation is a member of the FHLBNY which allows it to access borrowings which enhance management's ability to satisfy future liquidity needs. Based on available collateral and current advances outstanding, the Corporation was eligible to borrow up to a total of \$103.7 million and \$73.1 million at March 31, 2014 and December 31, 2013, respectively. The Corporation also had a total of \$28.0 million of unsecured lines of credit with four different financial institutions, all of which was available at March 31, 2014 and December 31, 2013.

During the three months ended March 31, 2014, cash and cash equivalents increased \$5.5 million. The major sources of cash during the three months ended March 31, 2014 included \$2.6 million provided by operating activities, \$10.7 million in proceeds from sales, maturities, calls and principal reductions on securities and \$25.6 million in organic deposit growth. These proceeds were used primarily to fund purchases of securities totaling \$1.1 million, a \$29.0 million net increase in loans and payment of cash dividends in the amount of \$1.2 million.

## Results of Operations

### Comparison of Three Months Ended March 31, 2014 and 2013

#### Net Income

Net income for the three months ended March 31, 2014 was \$2.1 million, a decrease of \$0.3 million, or 14.4%, compared with \$2.4 million for the three months ended March 31, 2013. Earnings per share for the three months ended March 31, 2014 was \$0.44 compared with \$0.52 for the three months ended March 31, 2013. Return on average assets and return on average equity for the three months ended March 31, 2014 were 0.56% and 5.93%, respectively, compared with 0.77% and 7.37%, respectively, for the same period in the prior year.

The decrease in net income for the three months ended March 31, 2014 was due primarily to increases of \$1.6 million in non-interest expense and \$0.2 million in the provision for loan losses. These items were partially offset by increases of \$0.3 million in net interest income and \$0.9 million in non-interest income, and a reduction of \$0.2 million in income taxes.

#### Net Interest Income

Net interest income, which is the difference between the income we receive on interest-earning assets, such as loans and securities and the interest we pay on interest-bearing liabilities, such as deposits and borrowings, is the largest contributor to the Corporation's earnings.

Net interest income for the three months ended March 31, 2014 totaled \$12.0 million, an increase of \$0.3 million, or 2.7%, compared with \$11.7 million for the same period in the prior year. Fully taxable equivalent net interest margin was 3.58% for the three months ended March 31, 2014 compared with 4.14% for the same period in the prior year. The increase in net interest income was due primarily to an increase of \$215.0 million in interest-earning assets

related to the branch acquisition in the fourth quarter of 2013. The decline in net interest margin was due in part to a 65 basis point decrease in the yield on interest-earning assets, partially offset by a 12 basis point decline in the cost of funds and the increase in interest-earning assets. The decrease in yield on interest-earning assets was attributable to a 55 basis point decrease in yield on loans, a result of loans continuing to reprice at current historically low market rates.



## Average Consolidated Balance Sheet and Interest Analysis

Table 6 sets forth certain information related to the Corporation's average consolidated balance sheets and its consolidated statements of income for the three month periods ended March 31, 2014 and 2013. Table 6 also reflects the average yield on assets and average cost of liabilities for the three month periods ended March 31, 2014 and 2013. For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding. Daily balances were used for average balance computations. Investment securities are stated at amortized cost. Tax equivalent adjustments have been made in calculating yields on obligations of states and political subdivisions, tax-free commercial loans and dividends on equity investments.

**TABLE 6. AVERAGE BALANCES AND YIELDS**  
Distribution of Assets, Liabilities and Shareholders' Equity, Interest Rates and Interest Differential

| (in thousands of dollars)   | Three Months Ended<br>March 31, 2014 |               |                | Three Months Ended<br>March 31, 2013 |               |                |
|---|--------------------------------------|---------------|----------------|--------------------------------------|---------------|----------------|
|   | Average<br>Balance                   | Interest      | Yield/<br>Rate | Average<br>Balance                   | Interest      | Yield/<br>Rate |
| <b>Assets</b>   |                                      |               |                |                                      |               |                |
| <b>Earning assets:</b>  |                                      |               |                |                                      |               |                |
| Loans   | \$ 1,007,415                         | \$ 11,199     | 4.51%          | \$ 909,166                           | \$ 11,337     | 5.06%          |
| Taxable securities  | 301,507                              | 1,525         | 2.05%          | 198,012                              | 1,151         | 2.36%          |
| Tax-exempt securities   | 42,857                               | 386           | 3.65%          | 46,708                               | 445           | 3.87%          |
| Interest-bearing deposits   | 29,825                               | 19            | 0.25%          | 12,704                               | 8             | 0.25%          |
| <b>Total earning assets</b>   | <b>1,381,604</b>                     | <b>13,129</b> | <b>3.85%</b>   | <b>1,166,590</b>                     | <b>12,941</b> | <b>4.50%</b>   |
| <b>Non-earning assets:</b>  |                                      |               |                |                                      |               |                |
| Cash and due from banks   | 27,353                               |               |                | 24,327                               |               |                |
| Premises and equipment,<br>net  | 29,781                               |               |                | 25,495                               |               |                |
| Other assets  | 51,687                               |               |                | 47,502                               |               |                |
| Allowance for loan losses   | (12,881)                             |               |                | (10,559)                             |               |                |
| AFS valuation allowance   | 11,033                               |               |                | 13,024                               |               |                |
| <b>Total</b>  | <b>\$ 1,488,577</b>                  |               |                | <b>\$ 1,266,379</b>                  |               |                |
| <b>Liabilities and Shareholders' Equity</b>                               |                                      |               |                |                                      |               |                |
| <b>Interest-bearing liabilities:</b>                                      |                                      |               |                |                                      |               |                |
| Interest-bearing demand<br>deposits                                       | \$ 126,500                           | 25            | 0.08%          | \$ 103,752                           | 27            | 0.10%          |
| Savings and insured<br>money  |                                      |               |                |                                      |               |                |
| market deposits   | 569,504                              | 229           | 0.16%          | 434,671                              | 199           | 0.19%          |
| Time deposits   | 238,874                              | 268           | 0.46%          | 233,565                              | 398           | 0.69%          |
| FHLB advances and<br>securities<br>sold under agreements to<br>repurchase | 55,611                               | 399           | 2.91%          | 59,204                               | 407           | 2.79%          |
| <b>Total interest-bearing<br/>liabilities</b>                             | <b>990,489</b>                       | <b>921</b>    | <b>0.38%</b>   | <b>831,192</b>                       | <b>1,031</b>  | <b>0.50%</b>   |

|   |              |       |              |
|---|--------------|-------|--------------|
| Non-interest-bearing liabilities:                 |              |       |              |
| Demand deposits                                   | 348,039      |       | 293,920      |
| Other liabilities                                 | 8,988        |       | 8,484        |
| Total liabilities                                 | 1,347,516    |       | 1,133,596    |
| Shareholders' equity                              | 141,061      |       | 132,783      |
| Total   | \$ 1,488,577 |       | \$ 1,266,379 |
| Fully taxable equivalent net interest income      |              |       |              |
|   | 12,208       |       | 11,910       |
| Net interest rate spread(1)                       |              | 3.47% | 4.00%        |
| Net interest margin, fully taxable equivalent (2) |              | 3.58% | 4.14%        |
| Taxable equivalent adjustment                     |              |       |              |
|   | 175          |       | 193          |
| Net interest income                               | \$ 12,033    |       | \$ 11,717    |

(1) Net interest rate spread is the difference in the yield received on earning assets less the rate paid on interest-bearing liabilities.

(2) Net interest margin is the ratio of fully taxable equivalent net interest income divided by average earning assets.

## Changes Due to Volume and Rate

Net interest income can be analyzed in terms of the impact of changes in rates and volumes. Table 7 illustrates the extent to which changes in interest rates and in the volume of average interest-earning assets and interest-bearing liabilities have affected the Corporation's interest income and interest expense during the three month periods ended March 31, 2014 and 2013. Information is provided in each category with respect to (i) changes attributable to changes in volume (changes in volume multiplied by prior rate); (ii) changes attributable to changes in rates (changes in rates multiplied by prior volume); and (iii) the net changes. For purposes of this table, changes that are not due solely to volume or rate changes have been allocated to these categories based on the respective percentage changes in average volume and rate. Due to the numerous simultaneous volume and rate changes during the periods analyzed, it is not possible to precisely allocate changes between volume and rates. In addition, average earning assets include non-accrual loans and taxable equivalent adjustments were made.

TABLE 7. RATE/VOLUME ANALYSIS OF NET INTEREST INCOME

| (in thousands of dollars)   | Three Months Ended March 31, 2014 vs. Three<br>Months Ended March 31, 2013 |                     |                     |
|---|--|---------------------|---------------------|
|   | Total<br>Change  | Increase/(Decrease) |                     |
|   |  | Due to<br>Volume    | Due to<br>Rate      |
| Interest and dividends earned on:                                   |  |                     |                     |
| Loans   | \$ (138)   | \$ 1,159            | \$ (1,297)          |
| Taxable investment securities                                       | 374  | 539                 | (165)               |
| Tax-exempt investment securities                                    | (59)   | (36)                | (23)                |
| Interest-bearing deposits   | 11   | 11                  | -                   |
| Total earning assets  | 188  | 1,673               | (1,485)             |
| Interest paid on:   |  |                     |                     |
| Interest-bearing demand deposits                                    |  | (2)                 | 5 (7)               |
| Savings and insured money market deposits                           |  | 30                  | 56 (26)             |
| Time deposits   |  | (130)               | 9 (139)             |
| FHLB advances and securities sold under<br>agreements to repurchase |  | (8)                 | (26) 18             |
| Total interest-bearing liabilities                                  |  | (110)               | 44 (154)            |
| Net interest income   |  | \$ 298              | \$ 1,629 \$ (1,331) |

## Provision for Loan Losses

The provision for loan losses for the three months ended March 31, 2014 totaled \$0.6 million compared with \$0.4 million for the three months ended March 31, 2013. The increase in the allowance for loan losses was due primarily to loan portfolio growth and higher net charge-offs.

## Non-Interest Income

Non-interest income for the three months ended March 31, 2014 totaled \$5.0 million, an increase of \$1.0 million, or 23.4%, compared with \$4.0 million for the same period in the prior year. The increase was due primarily to a gain of \$0.5 million from the liquidation of the Corporation's investment in a pool of trust preferred securities and increases of

\$0.3 million in service charges on deposit accounts attributable to branches acquired in the fourth quarter of 2013, and \$0.1 million in Wealth Management fee income.

#### Non-Interest Expense

Non-interest expense for the three months ended March 31, 2014 totaled \$13.3 million, an increase of \$1.6 million, or 13.8%, compared with \$11.7 million for the same period in the prior year. The increase was due primarily to increases of \$0.4 million in occupancy expense, \$0.4 million in data processing costs and \$0.3 million in salaries and wages. These increases were attributable to the branches acquired in the fourth quarter of 2013.

## Income Taxes

Income tax expense for the three months ended March 31, 2014 totaled \$1.0 million, a decrease of \$0.2 million, compared with \$1.2 million for the same period in the prior year. Income tax expense reflects an effective tax rate of 31.5% for the three months ended March 31, 2014 compared with 32.7% for the same period in the prior year. The decrease in the effective tax rate was due primarily to lower pre-tax income and an increase in the relative percentage of tax exempt income to pre-tax income.

## ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Interest Rate Risk

Management considers interest rate risk to be the most significant market risk for the Corporation. Market risk is the risk of loss from adverse changes in market prices and rates. Interest rate risk is the exposure to adverse changes in the net income of the Corporation as a result of changes in interest rates.

The Corporation's primary earnings source is net interest income, which is affected by changes in the level of interest rates, the relationship between rates, the impact of interest rate fluctuations on asset prepayments, the level and composition of deposits and liabilities, and credit quality of earning assets.

The Corporation's objectives in its asset and liability management are to maintain a strong, stable net interest margin, to utilize its capital effectively without taking undue risks, to maintain adequate liquidity, and to reduce vulnerability of its operations to changes in interest rates. The Corporation's Asset/Liability Committee ("ALCO") has the strategic responsibility for setting the policy guidelines on acceptable exposure to interest rate risk. These guidelines contain specific measures and limits regarding the risks, which are monitored on a regular basis. The ALCO is made up of the president and chief executive officer, the chief financial officer, the asset liability management officer, and other officers representing key functions.

Interest rate risk is the risk that net interest income will fluctuate as a result of a change in interest rates. It is the assumption of interest rate risk, along with credit risk, that drives the net interest margin of a financial institution. For that reason, the ALCO has established tolerance limits based upon a 200-basis point change in interest rates, with appropriate floors set for interest-bearing liabilities. At March 31, 2014, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the next 12 months net interest income by 11.52% and an immediate 200-basis point increase would negatively impact the next 12 months net interest income by 8.62%. Both are within the Corporation's policy guideline of 15%. Given the overall low level of current interest rates and the unlikely event of a 200-basis point decline from this point, management additionally modeled an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates. When applied, it is estimated these scenarios would result in negative impacts to net interest income of 4.97% and 12.95%, respectively.

A related component of interest rate risk is the expectation that the market value of the Corporation's capital account will fluctuate with changes in interest rates. This component is a direct corollary to the earnings-impact component: an institution exposed to earnings erosion is also exposed to shrinkage in market value. At March 31, 2014, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the market value of the Corporation's capital account by 8.73% and an immediate 200-basis point increase in interest rates would negatively impact the market value by 3.84%. Both are within the Corporation's policy guideline of 15%. Management also modeled the impact to the market value of the Corporation's capital with an immediate 100-basis point decline and an immediate 300-basis point increase in interest rates, based on the current interest rate environment. When applied, it

is estimated these scenarios would result in negative impacts to the market value of the Corporation's capital of 4.15% and 6.20%, respectively.

Management does recognize the need for certain hedging strategies during periods of anticipated higher fluctuations in interest rates and the Funds Management Policy provides for limited use of certain derivatives in asset liability management. These strategies were not employed during the three months ended March 31, 2014.

## Credit Risk

The Corporation manages credit risk consistent with state and federal laws governing the making of loans through written policies and procedures; loan review to identify loan problems at the earliest possible time; collection procedures (continued even after a loan is charged off); an adequate allowance for loan losses; and continuing education and training to ensure lending expertise. Diversification by loan product is maintained through offering commercial loans, 1-4 family mortgages, and a full range of consumer loans.

The Corporation monitors its loan portfolio carefully. The Loan Committee of the Corporation's Board of Directors is designated to receive required loan reports, oversee loan policy, and approve loans above authorized individual and Senior Loan Committee lending limits. The Senior Loan Committee, consisting of the President and Chief Executive Officer, Chief Financial Officer (non-voting member) Chief Administrative and Risk Officer (non-voting member), business client division manager, retail client division manager, commercial loan manager, consumer loan manager, mortgage loan manager, and the President and commercial loan manager of the Capital Bank division, implements the Board-approved loan policy.

## ITEM 4: CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

The Corporation's management, with the participation of our President and Chief Executive Officer, who is the Corporation's principal executive officer, and our Chief Financial Officer and Treasurer, who is the Corporation's principal financial officer, have evaluated the effectiveness of the Corporation's disclosure controls and procedures as of March 31, 2014 pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the principal executive officer and principal financial officer have concluded that the Corporation's disclosure controls and procedures are not effective as a result of the material weakness that existed in the Corporation's internal control over financial reporting as previously described in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013.

### Previously Identified Material Weakness

As of December 31, 2013 management concluded that its internal control over financial reporting was not effective because a material weakness existed in its internal control over the identification and evaluation of troubled debt restructurings. The process surrounding the identification of troubled debt restructurings is to include the completion of a checklist which guides the identification process for all loans modified, renewed or extended which meet certain credit grade and principal balance criteria. A key control to identify all loans which may be subject to a checklist has been implemented and will be tested for effectiveness during 2014.

In response to the material weakness, during the quarter ended March 31, 2014, the Corporation improved its process of identifying and evaluating trouble debt restructurings in order to remediate the material weakness. The Corporation has provided additional guidance and strengthened processes regarding the identification and evaluation of trouble debt restructurings, within our loan underwriting and credit administration functions, and provided additional training to our loan underwriting and credit administration staff. Additionally, the Corporation's internal audit personnel will be sampling and testing transactions related to troubled debt restructurings as a part of the Corporation's internal audit plan for 2014.





The remediation of the material weakness described above is ongoing. Management believes that its efforts, when fully implemented, will be effective in remediating the material weakness by the end of the second quarter of 2014. In addition, management will continue to monitor the results of the remediation activities and test the new controls as part of its review of its internal control over financial reporting for 2014. Management remains committed to a strong internal control environment.

Except for the material weakness noted above, there have been no changes in the Corporation's internal control over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

For information related to this item, please see Note 8 to the Corporation's financial statements included herein.

### ITEM 1A. RISK FACTORS

There have been no material changes in the risk factors set forth in the Corporation's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission on March 14, 2014.

### ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

#### (c) Issuer Purchases of Equity Securities (1)

| Period                | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|-----------------------|----------------------------------|------------------------------|--|--|
| 1/1/14-1/31/14        | -                                | \$ -                         | -  | 121,906  |
| 2/1/14-2/28/14        | -                                | \$ -                         | -  | 121,906  |
| 3/1/14-3/31/14        | -                                | \$ -                         | -  | 121,906  |
| Quarter ended 3/31/14 | -                                | \$ -                         | -  | 121,906  |

(1) On December 19, 2012, the Corporation's Board of Directors approved a stock repurchase plan authorizing the purchase of up to 125,000 shares of the Corporation's outstanding common stock. Purchases may be made from time to time on the open market or in private negotiated transactions and will be at the discretion of management. As of March 31, 2014, a total of 3,094 shares had been purchased under this plan.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

**ITEM 5. OTHER INFORMATION**

Not applicable

ITEM 6. EXHIBITS

The following exhibits are either filed with this Form 10-Q or are incorporated herein by reference. The Corporation's Securities Exchange Act File number is 000-13888.

3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984. (Filed as Exhibit 3.1 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference).

3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988. (Filed as Exhibit 3.2 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference).

3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998. (Filed as Exhibit 3.4 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated herein by reference).

3.4 Amended and Restated Bylaws of the Registrant, as amended to February 26, 2014. (Filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on March 4, 2014 and incorporated herein by reference).

31.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*

31.2 Certification of Chief Financial Officer and Treasurer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*

32.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.\*

32.2 Certification of Chief Financial Officer and Treasurer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.\*

101.INS Instance Document\*

101.SCH XBRL Taxonomy Schema\*

101.CAL XBRL Taxonomy Calculation Linkbase\*

101.DEF XBRL Taxonomy Definition Linkbase\*

101.LAB XBRL Taxonomy Label Linkbase\*

101.PRE XBRL Taxonomy Presentation Linkbase\*

\* Filed herewith.



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.

CHEMUNG FINANCIAL CORPORATION

DATED: May 9, 2014

By: /s/ Ronald M. Bentley  
Ronald M. Bentley, President and Chief Executive Officer  
(Principal Executive Officer)

DATED: May 9, 2014

By: /s/ Karl F. Krebs  
Karl F. Krebs, Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

The following exhibits are either filed with this Form 10-Q or are incorporated herein by reference. The Corporation's Securities Exchange Act File number is 000-13888

3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984. (Filed as Exhibit 3.1 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference).

3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988. (Filed as Exhibit 3.2 to Registrant's Form 10-K filed with the SEC on March 13, 2008 and incorporated herein by reference).

3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998. (Filed as Exhibit 3.4 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated herein by reference).

3.4 Amended and Restated Bylaws of the Registrant, as amended to February 26, 2014. (Filed as Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed with the SEC on March 4, 2014 and incorporated herein by reference).

31.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*

31.2 Certification of Chief Financial Officer and Treasurer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.\*

32.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.\*

32.2 Certification of Chief Financial Officer and Treasurer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. §1350.\*

101.INS Instance Document\*

101.SCH XBRL Taxonomy Schema\*

101.CAL XBRL Taxonomy Calculation Linkbase\*

101.DEF XBRL Taxonomy Definition Linkbase\*

101.LAB XBRL Taxonomy Label Linkbase\*

101.PRE XBRL Taxonomy Presentation Linkbase\*

