NBT BANCORP INC
Form 10-K
March 02, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2014
COMMISSION FILE NUMBER: 0-14703

NBT BANCORP INC.
(Exact name of registrant as specified in its charter)

Delaware	16-1268674
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

52 SOUTH BROAD STREET
NORWICH, NEW YORK 13815
(Address of principal executive office) (Zip Code)
(607) 337-2265 (Registrant’s telephone number, including area code)

Securities registered pursuant to section 12(b) of the Act:

Title of each class:	Name of each exchange on which registered:
Common Stock, par value $0.01 per share	The NASDAQ Stock Market LLC
Stock Purchase Rights Pursuant to Stockholders Rights Plan	

Securities registered pursuant to section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Based on the closing price of the registrant's common stock as of June 30, 2014, the aggregate market value of the voting stock, common stock, par value, $0.01 per share, held by non-affiliates of the registrant is $$1,001,148,554.

The number of shares of common stock outstanding as of February 13, 2015, was 44,213,717.

Table of Contents

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement for its Annual Meeting of Stockholders to be held on May 5, 2015 are incorporated by reference into Part III, Items 10, 11, 12, 13 and 14 of this Form 10-K.

Table of Contents
NBT BANCORP INC.
FORM 10-K – Year Ended December 31, 2014

TABLE OF CONTENTS

Table of Contents

PART I

ITEM 1. Business

NBT Bancorp Inc. (the "Registrant" or the "Company") is a registered financial holding company incorporated in the state of Delaware in 1986, with its principal headquarters located in Norwich, New York. The Company, on a consolidated basis, at December 31, 2014 had assets of $7.8 billion and stockholders' equity of $864.2 million. Return on average assets and return on average equity were 0.97% and 8.84%, respectively, for the year ending December 31, 2014. The Company had net income of $75.1 million or $1.69 per diluted share for 2014 and the 2014 fully taxable equivalent ("FTE") net interest margin was 3.61%.

The principal assets of the Registrant consist of all of the outstanding shares of common stock of its subsidiaries, including: NBT Bank, National Association (the "Bank"), NBT Financial Services, Inc. ("NBT Financial"), NBT Holdings, Inc. ("NBT Holdings"), Hathaway Agency, Inc., and CNBF Capital Trust I, NBT Statutory Trust I and NBT Statutory Trust II (collectively, the "Trusts"). The Company's principal sources of revenue are the management fees and dividends it receives from the Bank, NBT Financial and NBT Holdings.

The Company's business, primarily conducted through the Bank but also through its other subsidiaries, consists of providing commercial banking and financial services to customers in its market area, which includes central and upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts, Vermont, and the greater Portland, Maine area. The Company has been, and intends to continue to be, a community-oriented financial institution offering a variety of financial services. The Company's business philosophy is to operate as a community bank with local decision-making, principally in non-metropolitan markets, providing a broad array of banking and financial services to retail, commercial, and municipal customers. The financial condition and operating results of the Company are dependent on its net interest income which is the difference between the interest and dividend income earned on its earning assets, primarily loans and investments, and the interest expense paid on its interest bearing liabilities, primarily consisting of deposits and borrowings. Among other factors, net income is also affected by provisions for loan losses and noninterest income, such as service charges on deposit accounts, insurance and other financial services fees, trust revenue, and gains/losses on securities sales, bank owned life insurance income, ATM and debit card fees, and retirement plan administration fees as well as noninterest expense, such as salaries and employee benefits, occupancy, equipment, data processing and communications, professional fees and outside services, office supplies and postage, amortization, loan collection and other real estate owned expenses, advertising, FDIC expenses, and other expenses.

Substantially all of the Company's business activities are with customers located in the United States. Percentage of revenue and loan composition by state is summarized below:

	Interest and Fee Income	Noninterest Income	Total Revenue
New York	53%	31%	84%
Pennsylvania	6%	2%	8%
New Hampshire	3%	0%	3%
Vermont	4%	0%	4%
Massachusetts	1%	0%	1%
	67%	33%	100%

	Commercial	Consumer	Residential Real Estate	Total Loan Portfolio

New York	32%	28%	16%	76%
Pennsylvania	3%	4%	3%	10%
New Hampshire	4%	1%	1%	6%
Vermont	3%	2%	1%	6%
Massachusetts	1%	1%	0%	2%
	43%	36%	21%	100%

Table of Contents

Percentage of total loan portfolio secured by real estate is summarized below:

	Secured By Real Estate	Not Secured By Real Estate
New York	58%	42%
Pennsylvania	64%	36%
New Hampshire	83%	17%
Vermont	55%	45%
Massachusetts	74%	26%

Like the rest of the nation, the market areas that the Company serves are still experiencing economic challenges. A variety of factors (e.g., any substantial rise in inflation or rise in unemployment rates, decrease in consumer confidence, adverse international economic conditions, natural disasters, war, or political instability) may affect both the Company's markets and the national market. The Company will continue to emphasize managing its funding costs and lending and investment rates to effectively maintain profitability. In addition, the Company will continue to seek and maintain relationships that can generate noninterest income. We anticipate that this approach should help mitigate profit fluctuations that are caused by movements in interest rates, business and consumer loan cycles, and local economic factors.

NBT Bank, N.A.

The Bank is a full service commercial bank formed in 1856, which provides a broad range of financial products to individuals, corporations and municipalities throughout the central and upstate New York, northeastern Pennsylvania, western Massachusetts, southern New Hampshire, Vermont, and the greater Portland, Maine market areas.

Through its network of branch locations, the Bank offers a wide range of products and services tailored to individuals, businesses, and municipalities. Deposit products offered by the Bank include demand deposit accounts, savings accounts, negotiable order of withdrawal ("NOW") accounts, money market deposit accounts ("MMDA"), and certificate of deposit ("CD") accounts. The Bank offers various types of each deposit account to accommodate the needs of its customers with varying rates, terms, and features. Loan products offered by the Bank include consumer loans, home equity loans, mortgages, small business loans and commercial loans, with varying rates, terms and features to accommodate the needs of its customers. The Bank also offers various other products and services through its branch network such as trust and investment services and financial planning and life insurance services. In addition to its branch network, the Bank also offers access to certain products and services electronically enabling customers to check balances, transfer funds, pay bills, view statements, apply for loans and access various other product and service information. The Bank provides 24-hour access to an automated telephone line whereby customers can check balances, obtain account information, transfer funds, request statements, and perform various other activities.

NBT Financial Services, Inc.

Through NBT Financial Services, the Company operates EPIC Advisors, Inc. ("EPIC"), a retirement plan administrator. Through EPIC, the Company offers services including retirement plan consulting and recordkeeping services. EPIC's headquarters are located in Rochester, New York.

NBT Holdings, Inc.

Through NBT Holdings, the Company operates Mang Insurance Agency, LLC (“Mang”), a full-service insurance agency acquired by the Company on September 1, 2008. Mang’s headquarters are in Norwich, New York. Through Mang, the Company offers a full array of insurance products, including personal property and casualty, business liability and commercial insurance, tailored to serve the specific insurance needs of individuals as well as businesses in a range of industries operating in the markets served by the Company.

The Trusts

The Trusts were organized to raise additional regulatory capital and to provide funding for certain acquisitions. CNBF Capital Trust I (“Trust I”) and NBT Statutory Trust I are Delaware statutory business trusts formed in 1999 and 2005, respectively, for the purpose of issuing trust preferred securities and lending the proceeds to the Company. In connection with the acquisition of CNB Bancorp, Inc., the Company formed NBT Statutory Trust II (“Trust II”) in February 2006 to fund the cash portion of the acquisition as well as to provide regulatory capital. The Company raised $51.5 million through Trust II in February 2006. The Company guarantees, on a limited basis, payments of distributions on the trust preferred securities and payments on redemption of the trust preferred securities. The Trusts are variable interest entities (VIEs) for which the Company is not the primary beneficiary, as defined by Financial Accounting Standards Board Accounting Standards Codification (“FASB ASC”). In accordance with FASB ASC, the accounts of the Trusts are not included in the Company’s consolidated financial statements.

Table of Contents

Operating Subsidiaries of the Bank

The Bank has five operating subsidiaries, NBT Capital Corp., Pennstar Bank Services Company, Broad Street Property Associates, Inc., NBT Services, Inc., and CNB Realty Trust. NBT Capital Corp., formed in 1998, is a venture capital corporation formed to assist young businesses to develop and grow primarily in the markets they serve. Pennstar Bank Services Company was formed in 2002 to provide administrative and support services to the Bank. Broad Street Property Associates, Inc., formed in 2004, is a property management company. NBT Services, Inc., formed in 2004, has a 44% ownership interest in Land Record Services, LLC. Land Record Services, LLC, a title insurance agency, offers mortgagee and owner's title insurance coverage to both retail and commercial customers. CNB Realty Trust, formed in 1998, is a real estate investment trust.

Competition

The financial services industry, including commercial banking, is highly competitive, and we encounter strong competition for deposits, loans and other financial products and services in our market area. The increasingly competitive environment is the result of the continued low rate environment, changes in regulation, changes in technology and product delivery systems, additional financial service providers, and the accelerating pace of consolidation among financial services providers. The Company competes for loans, deposits, and customers with other commercial banks, savings and loan associations, securities and brokerage companies, mortgage companies, insurance companies, finance companies, money market funds, credit unions, and other nonbank financial service providers.

The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems.

Some of the Company's nonbanking competitors have fewer regulatory constraints and may have lower cost structures. In addition, some of the Company's competitors have assets, capital and lending limits greater than that of the Company, have greater access to capital markets and offer a broader range of products and services than the Company. These institutions may have the ability to finance wide-ranging advertising campaigns and may also be able to offer lower rates on loans and higher rates on deposits than the Company can offer. Some of these institutions offer services, such as credit cards and international banking, which the Company does not directly offer.

Various in-state market competitors and out-of-state banks continue to enter or have announced plans to enter or expand their presence in the market areas in which the Company currently operates. With the addition of new banking presences within our market, the Company expects increased competition for loans, deposits, and other financial products and services.

In order to compete with other financial services providers, the Company stresses the community nature of its banking operations and principally relies upon local promotional activities, personal relationships established by officers, directors, and employees with their customers, and specialized services tailored to meet the needs of the communities served. We also offer certain customer services, such as agricultural lending, that many of our larger competitors do not offer. While the Company's position varies by market, the Company's management believes that it can compete effectively as a result of local market knowledge, local decision making, and awareness of customer needs.

Table of Contents

The table below summarizes the Bank’s deposits and market share by the thirty-seven counties of New York, Pennsylvania, New Hampshire, Vermont, and Massachusetts in which it had customer facilities as of June 30, 2014. Market share is based on deposits of all commercial banks, credit unions, savings and loans associations, and savings banks.

County	State	Deposits (in thousands)	Market Share	Market Rank	Number of Branches*	Number of ATMs*
Chenango	NY	$673,872	88.02 %	1	11	13
Fulton	NY	403,646	60.91 %	1	5	6
Schoharie	NY	200,358	49.12 %	1	4	4
Hamilton	NY	41,449	44.99 %	2	1	1
Cortland	NY	252,924	40.06 %	1	5	6
Montgomery	NY	246,229	37.00 %	1	5	4
Otsego	NY	332,810	34.36 %	2	9	11
Delaware	NY	299,724	31.29 %	1	5	5
Essex	NY	163,820	27.35 %	2	3	5
Susquehanna	PA	159,718	21.10 %	2	5	7
Madison	NY	220,150	19.49 %	2	4	6
Pike	PA	82,102	13.08 %	4	2	2
Oneida	NY	375,081	12.00 %	5	7	11
Broome	NY	277,109	11.68 %	3	8	11
Saint Lawrence	NY	124,862	11.39 %	3	5	5
Oswego	NY	126,531	10.06 %	5	4	6
Herkimer	NY	52,435	9.07 %	4	2	1
Wayne	PA	107,603	8.95 %	4	3	4
Tioga	NY	31,992	8.08 %	5	1	1
Lackawanna	PA	390,679	7.55 %	7	14	17
Clinton	NY	91,917	7.40 %	5	3	2
Franklin	NY	27,000	6.19 %	5	1	1
Schenectady	NY	122,077	4.95 %	6	2	2
Onondaga	NY	377,284	4.23 %	8	11	13
Berkshire	MA	114,902	3.58 %	7	6	6
Greene	NY	38,562	3.54 %	6	2	2
Saratoga	NY	126,928	3.44 %	10	4	4
Monroe	PA	82,754	3.29 %	8	4	5
Warren	NY	38,712	2.63 %	8	2	3
Cheshire	NH	23,656	1.83 %	7	1	-
Chittenden	VT	71,514	1.79 %	7	3	3
Luzerne	PA	101,008	1.73 %	13	4	6
Albany	NY	175,695	1.14 %	10	4	6
Rensselaer	NY	17,568	0.95 %	12	1	1
Hillsborough	NH	68,148	0.64 %	10	2	2
Rockingham	NH	21,576	0.37 %	17	2	2
Rutland	VT	-	0.00 %	9	1	1
		$6,062,395			156	185

Deposit market share data is based on the most recent data available (as of June 30, 2014). Source: SNL Financial LLC

* Branch and ATM data is as of December 31, 2014.

Table of Contents

Supervision and Regulation

As a bank holding company, the Company is subject to extensive regulation, supervision, and examination by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board" or "FRB") as its primary federal regulator. The Company also has qualified for and elected to be registered with the FRB as a financial holding company. The Bank, as a nationally chartered bank, is subject to extensive regulation, supervision and examination by the Office of the Comptroller of the Currency ("OCC") as its primary federal regulator and to a limited extent by the Federal Deposit Insurance Corporation ("FDIC") as its deposit insurer. The Bank also is subject to certain regulations promulgated by the FRB and the Bureau of Consumer Financial Protection ("CFPB").

The Company is also under the jurisdiction of the Securities and Exchange Commission ("SEC") and is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended, as administered by the SEC. A summary of material information regarding the laws and regulations applicable to the Company are below. This summary is not complete and the reader should refer to these laws and regulations for more information. Failure to comply with applicable laws and regulations could result in a range of sanctions and enforcement actions, including the imposition of civil money penalties, formal agreements and cease and desist orders. Applicable laws and regulations may change in the future and any such change could have a material adverse impact on the Company.

Federal Bank Holding Company Regulation

In general, the Bank Holding Company Act ("BHC Act") limits the business of bank holding companies to banking, managing or controlling banks, and other activities that the FRB has determined to be so closely related to banking as to be a proper incident thereto. Under the Gramm-Leach Bliley Act ("GLB Act"), a financial holding company may engage in certain financial activities that a bank holding company may not otherwise engage in under the BHC Act. In addition to engaging in banking and activities closely related to banking as determined by the FRB by regulation or order prior to November 11, 1999, a financial holding company may engage in activities that are financial in nature or incidental to financial activities, or activities that are complementary to a financial activity and do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLB Act and the rules promulgated thereunder require all financial institutions, including the Company and the Bank, to adopt privacy policies, restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request, and establish procedures and practices to protect customer data from unauthorized access. In addition, the Fair Credit Reporting Act ("FCRA"), as amended by the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"), includes many provisions affecting the Company, Bank, and/or their affiliates, including provisions concerning obtaining consumer reports, furnishing information to consumer reporting agencies, maintaining a program to prevent identity theft, sharing of certain information among affiliated companies, and other provisions. The FACT Act requires persons subject to FCRA to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The CFPB and the Federal Trade Commission ("FTC") have extensive rulemaking authority under the FACT Act, and the Company and the Bank are subject to the rules that have been promulgated under the FACT Act, including rules regarding limitations on affiliate marketing and implementation of programs to identify, detect and mitigate certain identity theft red flags. The Company has developed policies and procedures for itself and its subsidiaries, including the Bank, and believes it is in compliance with all privacy, information sharing, and notification provisions of the GLB Act and the FACT Act. The Bank is also subject to data security standards and data breach notice requirements, chiefly those issued by the OCC.

The Company is subject to minimum leverage and risk-based capital requirements of the FRB. As of December 31, 2014, the Company was in compliance with all minimum capital guidelines and met the requirements to be considered well-capitalized. As of that date, the Company's leverage ratio was 9.39%, its ratio of Tier 1 capital to risk-weighted assets was 12.32%, and its ratio of qualifying total capital to risk-weighted assets was 13.50%. See "Changes to Capital Adequacy Requirements and Prompt Corrective Action" for a discussion of the changes to these requirements. The FRB may set higher minimum capital requirements for bank holding companies whose circumstances warrant it, such as companies anticipating significant growth or facing unusual risks. The FRB has not advised the Company of any special capital requirement applicable to it.

Any holding company whose capital does not meet the minimum capital adequacy guidelines is considered to be undercapitalized and is required to submit an acceptable plan to the FRB for achieving capital adequacy. Such a company's ability to pay dividends to its shareholders and expand its lines of business through the acquisition of new banking or nonbanking subsidiaries also could be restricted.

Pursuant to Federal Reserve Board regulations and supervisory policies that were largely codified in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), bank holding companies also are expected to serve as a source of financial and managerial strength to their subsidiary depository institutions. Therefore, to the extent the Bank is in need of capital, the Company could be expected to provide additional capital to the Bank, including, potentially, raising new capital for that purpose.

Table of Contents

Office of Comptroller of the Currency Regulation

The Bank is supervised and regularly examined by the OCC. The various laws and regulations administered by the OCC affect corporate practices such as payment of dividends, incurring debt, and acquisition of financial institutions and other companies. It also affects business practices, such as payment of interest on deposits, the charging of interest on loans, types of business conducted and location of offices. The OCC generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be undercapitalized. Undercapitalized institutions are subject to growth limitations and are required to submit a capital restoration plan to the OCC. If a depository institution fails to submit an acceptable capital restoration plan, it is treated as if it is "significantly undercapitalized." Significantly undercapitalized depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

The Bank is subject to minimum leverage and risk-based capital requirements of the OCC. As of December 31, 2014, the Bank was in compliance with all minimum capital requirements and met the requirements to be considered well-capitalized. As of that date, the Bank's leverage ratio was 8.79%, its ratio of Tier 1 capital to risk-weighted assets was 11.54%, and its ratio of qualifying total capital to risk-weighted assets was 12.72%. See "Changes to Capital Adequacy Requirements and Prompt Corrective Action" for a discussion of the new capital requirements that apply to the Bank.

Affiliate Transactions

Transactions between the Bank and any of its affiliates, including the Company, are governed by sections 23A and 23B of the Federal Reserve Act ("FRA") and the FRB's implementing Regulation W. An "affiliate" of a bank includes any company or entity that controls, is controlled by, or is under common control with the bank. A subsidiary of a bank that is not also a depository institution is not treated as an affiliate of the bank for purposes of sections 23A and 23B, unless the subsidiary is also controlled through a non-bank chain of ownership by affiliates or controlling shareholders of the bank, the subsidiary is a financial subsidiary that operates under the expanded authority granted to national banks under the Financial Modernization Act of 1999, also known as the Gramm-Leach-Bliley Act ("GLB Act"), or the subsidiary engages in other activities that are not permissible for a bank to engage in directly (except insurance agency subsidiaries). Generally, sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by placing quantitative and qualitative limitations on covered transactions between a bank and with any one affiliate as well as all affiliates of the bank in the aggregate, and requiring that such transactions be on arms' length terms that are consistent with safe and sound banking practices.

Insurance of Deposit Accounts

The Bank is a member of the Deposit Insurance Fund ("DIF") and deposit accounts at the Bank are insured by the FDIC, generally up to the maximum amount permitted by law. The Dodd-Frank Act permanently increased the maximum amount of deposit insurance for banks, savings institutions and credit unions to $250,000 per depositor per insured institution, retroactive to January 1, 2008.

The Bank's FDIC assessment expenses were approximately $4.5 million in 2014 as compared with $4.6 million in 2013. In addition to the FDIC deposit insurance, the Federal Deposit Insurance Act provides for additional assessments to be imposed on insured depository institutions to pay for the cost of Financing Corporation ("FICO") funding. The FICO assessments are adjusted quarterly to reflect changes in the assessment base of the DIF and do not vary depending upon a depository institution's capitalization or supervisory evaluation. The Company incurred approximately $0.4 million in FICO expenses in 2014 and 2013.

Under FDIC regulations, no FDIC-insured bank can accept brokered deposits unless it is well capitalized, or is adequately capitalized and receives a waiver from the FDIC. In addition, these regulations prohibit any bank that is not well capitalized from paying an interest rate on brokered deposits in excess of three-quarters of one percentage point over certain prevailing market rates. As of December 31, 2014, the Bank's total brokered deposits were $292.1 million.

Federal Home Loan Bank

The Bank is also a member of the Federal Home Loan Bank ("FHLB") of New York, which provides a central credit facility primarily for member institutions for home mortgage and neighborhood lending. The Bank is subject to the rules and requirements of the FHLB, including the requirement to acquire and hold shares of capital stock in the FHLB in an amount at least equal to the sum of 0.35% of the aggregate principal amount of its unpaid residential mortgage loans and similar obligations at the beginning of each year. The Bank was in compliance with the rules and requirements of the FHLB at December 31, 2014.

Table of Contents

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

On July 21, 2010, President Obama signed into law the Dodd-Frank Act. This law significantly changed the bank regulatory landscape and impacted and will continue to impact the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new rules and regulations, and to prepare various studies and reports for Congress. Certain of these rules have not yet been finalized and many remain unwritten.

The Dodd-Frank Act requires publicly traded companies to give stockholders a non-binding vote on executive compensation and so-called “golden parachute” payments. The legislation also authorizes the SEC to promulgate rules that would allow stockholders to nominate their own candidates using the company’s proxy materials. Additionally, the Dodd-Frank Act directs the federal banking regulators to promulgate rules requiring the reporting of incentive-based compensation and prohibiting excessive incentive-based compensation paid to executives of depository institutions and their holding companies with assets in excess of $1.0 billion, regardless of whether the company is publicly traded or not. In April 2011, the FRB, along with other federal banking supervisors, issued a joint notice of proposed rulemaking implementing those requirements. This rule has not yet been finalized.

The Dodd-Frank Act created the CFPB, which has wide-ranging powers to supervise and enforce federal consumer protection laws, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. As the Company is below this threshold, the OCC continues to exercise primary examination authority over the Bank with regard to compliance with federal consumer protection laws and regulations. The Dodd-Frank Act also gave state attorneys general certain powers to enforce rules issued by the CFPB. Further, pursuant to Federal Reserve regulations mandated by the Dodd-Frank Act, interchange fees on debit cards are limited to a maximum of 21 cents per transaction plus 5 basis points of the transaction amount. A debit card issuer may recover an additional one cent per transaction for fraud prevention purposes if the issuer complies with certain fraud-related requirements prescribed by the Federal Reserve. Issuers that, together with their affiliates, have less than $10 billion in assets, such as the Company, are exempt from the debit card interchange fee standards. The FRB also adopted requirements in the final rule that issuers include two unaffiliated networks for routing debit transactions that are applicable to the Company and the Bank.

The scope and impact of many of the Dodd-Frank Act’s provisions will be determined over time as regulations are issued and become effective. As a result, we cannot predict the ultimate impact of the Act on the Company or the Bank at this time, including the extent to which it could increase costs or limit our ability to pursue business opportunities in an efficient manner, or otherwise adversely affect our business, financial condition and results of operations. Nor can we predict the impact or substance of other future legislation or regulation. However, it is expected that, at a minimum, they will increase our operating and compliance costs. As continued rules and regulations are issued, the Company may need to dedicate additional resources to ensure compliance, which may increase its costs of operations and adversely impact its earnings.

Changes to Capital Adequacy Requirements and Prompt Corrective Action

The former U.S. federal bank regulatory agencies' risk-based capital guidelines were based upon the 1988 capital accord (“Basel I”) of the Basel Committee on Banking Supervision (“Basel Committee”). The Basel Committee is a committee of central banks and bank supervisors/regulators from the major industrialized countries that meet under the auspices of the Bank for International Settlements in Basel, Switzerland to develop broad policy guidelines for use by each country's supervisors in determining the supervisory policies they apply.

In July 2013, the FRB, the OCC and the FDIC approved rules (the "New Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The New Capital Rules generally implement the Basel Committee's December 2010 final capital framework referred to as "Basel III" for strengthening international capital standards. The New Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and their depository institution subsidiaries, including the Company and the Bank, as compared to the current U.S. general risk-based capital rules. The New Capital Rules revise the definitions and the components of regulatory capital, as well as address other issues affecting the numerator in banking institutions' regulatory capital ratios. The New Capital Rules also address asset risk weights and other matters affecting the denominator in banking institutions' regulatory capital ratios and replace the existing general risk-weighting approach, which was derived from Basel I, with a more risk-sensitive approach based, in part, on the "standardized approach" in the Basel Committee's 2004 "Basel II" capital accords. In addition, the New Capital Rules implement certain provisions of the Dodd-Frank Act, including the requirements of Section 939A to remove references to credit ratings from the federal banking agencies' rules. The New Capital Rules are effective for the Company on January 1, 2015, subject to phase-in periods for certain components and other provisions.

Table of Contents

The New Capital Rules: (i) introduce a new capital measure called “Common Equity Tier 1” (“CET1”) and related regulatory capital ratio of CET1 to risk-weighted assets; (ii) specify that Tier 1 capital consists of CET1 and “Additional Tier 1 capital” instruments meeting certain revised requirements; (iii) mandate that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. Under the New Capital Rules, for most banking organizations, the most common form of Additional Tier 1 capital is non-cumulative perpetual preferred stock and the most common forms of Tier 2 capital are subordinated notes and a portion of the allocation for loan losses, in each case, subject to the New Capital Rules’ specific requirements.

Pursuant to the New Capital Rules, the minimum capital ratios as of January 1, 2015 are as follows:

4.5% CET1 to risk-weighted assets;

6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;

8.0% Total capital (that is, Tier 1 capital plus Tier 2 capital) to risk-weighted assets; and

4.0% Tier 1 capital to average consolidated assets as reported on consolidated financial statements (known as the “leverage ratio”).

The New Capital Rules also introduce a new “capital conservation buffer,” composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity and other capital instrument repurchases and compensation based on the amount of the shortfall. Thus, when fully phased-in on January 1, 2019, the capital standards applicable to the Company will include an additional capital conservation buffer of 2.5% of CET1, effectively resulting in minimum ratios inclusive of the capital conservation buffer of (i) CET1 to risk-weighted assets of at least 7%, (ii) Tier 1 capital to risk-weighted assets of at least 8.5%, and (iii) Total capital to risk-weighted assets of at least 10.5%.

The New Capital Rules provide for a number of deductions from and adjustments to CET1. These include, for example, the requirement that mortgage servicing rights, deferred tax assets arising from temporary differences that could not be realized through net operating loss carrybacks and significant investments in non-consolidated financial entities be deducted from CET1 to the extent that any one such category exceeds 10% of CET1 or all such items, in the aggregate, exceed 15% of CET1.

In addition, under the current general risk-based capital rules, the effects of accumulated other comprehensive income or loss (“AOCI”) items included in shareholders’ equity (for example, marks-to-market of securities held in the available-for-sale portfolio) under U.S. GAAP are reversed for the purposes of determining regulatory capital ratios. Pursuant to the New Capital Rules, the effects of certain AOCI items are not excluded; however, banking organizations not using the advanced approaches, including the Company, may make a one-time permanent election to continue to exclude these items. This election must be made concurrently with the first filing of certain of the Company's periodic regulatory reports in the beginning of 2015. The New Capital Rules also preclude certain hybrid securities, such as trust preferred securities issued after May 19, 2010, from inclusion in bank holding companies’ Tier 1 capital.

Implementation of the deductions and other adjustments to CET1 began on January 1, 2015 and will be phased-in over a 4-year period (beginning at 40% on January 1, 2015 and an additional 20% per year thereafter). The implementation of the capital conservation buffer will begin on January 1, 2016 at the 0.625% level and increase by 0.625% on each subsequent January 1, until it reaches 2.5% on January 1, 2019.

With respect to the Bank, the New Capital Rules revise the "prompt corrective action" ("PCA") regulations adopted pursuant to Section 38 of the Federal Deposit Insurance Act ("FDIA"), by: (i) introducing a CET1 ratio requirement at each PCA category (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being 8% (as compared to 6%); and (iii) eliminating the provision that permitted a bank with a composite supervisory rating of 1 and a 3% leverage ratio to be considered adequately capitalized. The New Capital Rules do not change the total risk-based capital requirement for any PCA category.

The New Capital Rules prescribe a new standardized approach for risk weightings that expand the risk-weighting categories from the four Basel I-derived categories (0%, 20%, 50% and 100%) to a larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset classes.

We believe that the Company will be able to comply with the targeted capital ratios upon implementation of the revised requirements, as finalized.

Table of Contents

Volcker Rule

In December, 2013, the federal banking agencies jointly adopted final rules implementing Section 619 of the Dodd-Frank Act, commonly known as the Volcker Rule. The Volcker Rule restricts the ability of banking entities, such as the Company, to engage in proprietary trading or to own, sponsor or have certain relationships with hedge funds or private equity funds—so-called "Covered Funds." The final rule definition of Covered Fund includes investments such as certain collateralized loan obligation ("CLO") and collateralized debt obligation ("CDO") securities. The Company does not believe the implementation of the Volcker Rule will have a significant effect on its financial statements.

Consumer Protection Laws

Financial institutions are prohibited from charging consumers fees for paying overdrafts on ATM and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those types of transactions. Overdrafts on the payment of checks and regular electronic bill payments are not covered by this rule.

Home mortgage lenders, including banks, are required under the Home Mortgage Disclosure Act to make available to the public expanded information regarding the pricing of home mortgage loans, including the "rate spread" between the annual percentage rate and the average prime offer rate for mortgage loans of a comparable type. The availability of this information has led to increased scrutiny of higher-priced loans at all financial institutions to detect illegal discriminatory practices and to the initiation of a limited number of investigations by federal banking agencies and the U.S. Department of Justice. The Company has no information that it or its affiliates is the subject of any HMDA investigation.

In addition, the Company is also subject to federal consumer protection statutes and regulations promulgated under these laws, including, but not limited to:

Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;

Fair Credit Reporting Act, governing the provision of consumer information to credit reporting agencies and the use of consumer information; and

Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies.

On January 10, 2013, the CFPB issued a final rule implementing the ability-to-repay and qualified mortgage (QM) provisions of the Truth in Lending Act, as amended by the Dodd-Frank Act (the "QM Rule"). The ability-to-repay provision requires creditors to make reasonable, good faith determinations that borrowers are able to repay their mortgages before extending the credit based on a number of factors and consideration of financial information about the borrower from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of "qualified mortgage" are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for prime loans meeting the QM Rule requirements, and a rebuttable presumption for higher-priced/subprime loans meeting the QM Rule requirements. The definition of a "qualified mortgage" incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43% debt-to-income ratio for borrowers if the loan is to meet the QM Rule definition, though some mortgages that meet GSE, FHA and VA underwriting guidelines may, for a period not to exceed seven years, meet the QM definition without being subject to the 43% debt-to-income limits. The QM Rule became effective January 10, 2014.

USA PATRIOT Act

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (“USA PATRIOT Act”) imposes obligations on U.S. financial institutions, including banks and broker-dealer subsidiaries, to implement policies, procedures and controls which are reasonably designed to detect and report instances of money laundering and the financing of terrorism. Under Title III of the USA PATRIOT Act all financial institutions, including the Company and the Bank, are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. The USA PATRIOT Act also encourages information-sharing among financial institutions, regulators, and law enforcement authorities by providing an exemption from the privacy provisions of the GLB Act for financial institutions that comply with this provision. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank, or the BHC Act, which applies to the Company. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences for the institution. As of December 31, 2014, the Company and the Bank believe they are in compliance with the USA PATRIOT Act, Bank Secrecy Act, and regulations thereunder.

Table of Contents

Community Reinvestment Act of 1977

The Bank has a responsibility under the Community Reinvestment Act of 1977 (“CRA”) to help meet the credit needs of its communities, including low- and moderate-income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution’s discretion to develop the types of products and services that it believes are best suited to its particular community, consistent with the CRA. Regulators periodically assess the Bank’s record of compliance with the CRA. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit discrimination in lending practices on the basis of characteristics specified in those statutes. The Bank’s failure to comply with the provisions of the CRA could, at a minimum, result in regulatory restrictions on its activities and the activities of the Company. The Bank’s failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in enforcement actions against it by its regulators as well as other federal regulatory agencies and the Department of Justice. The Bank’s latest CRA rating was “Satisfactory”.

Employees

At December 31, 2014, the Company had 1,840 full-time equivalent employees. The Company’s employees are not presently represented by any collective bargaining group.

Available Information

The Company’s website is http://www.nbtbancorp.com. The Company makes available free of charge through its website its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports as soon as reasonably practicable after such material is electronically filed or furnished with the SEC pursuant to Section 13(a) or 15(d) of the Exchange Act. We also make available through our website other reports filed with or furnished to the SEC under the Exchange Act, including our proxy statements and reports filed by officers and directors under Section 16(a) of that Act, as well as our Code of Business Conduct and Ethics and other codes/committee charters. The references to our website do not constitute incorporation by reference of the information contained in the website and such information should not be considered part of this document.

Any materials we file with the SEC may be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC, 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Table of Contents
ITEM 1A. Risk Factors

There are risks inherent to the Company's business. The material risks and uncertainties that management believes affect the Company are described below. Any of the following risks could affect the Company's financial condition and results of operations and could be material and/or adverse in nature. You should consider all of the following risks together with all of the other information in this Annual Report on Form 10-K.

Deterioration in local economic conditions may negatively impact our financial performance.

The Company's success depends primarily on the general economic conditions in central and upstate New York, northeastern Pennsylvania, southern New Hampshire, western Massachusetts, Vermont and the specific local markets in which the Company operates. Unlike larger national or other regional banks that are more geographically diversified, the Company provides banking and financial services to customers primarily in the upstate New York areas of Norwich, Syracuse, Oneonta, Amsterdam-Gloversville, Albany, Binghamton, Utica-Rome, Plattsburgh, Glens Falls and Ogdensburg-Massena, the northeastern Pennsylvania areas of Scranton, Wilkes-Barre and East Stroudsburg, Berkshire County, Massachusetts, southern New Hampshire, Vermont, and the greater Portland, Maine area. The local economic conditions in these areas have a significant impact on the demand for the Company's products and services as well as the ability of the Company's customers to repay loans, the value of the collateral securing loans and the stability of the Company's deposit funding sources.

As a lender with the majority of our loans secured by real estate or made to businesses in New York, Pennsylvania, Massachusetts, New Hampshire, Vermont, and Maine, a downturn in these local economies could cause significant increases in nonperforming loans, which could negatively impact our earnings. Declines in real estate values in our market areas could cause any of our loans to become inadequately collateralized, which would expose us to greater risk of loss. Additionally, a decline in real estate values could result in the decline of originations of such loans, as most of our loans, and the collateral securing our loans, are located in those areas.

Variations in interest rates may negatively affect our financial performance.

The Company's earnings and financial condition are largely dependent upon net interest income, which is the difference between interest earned from loans and investments and interest paid on deposits and borrowings. The narrowing of interest rate spreads could adversely affect the Company's earnings and financial condition. The Company cannot predict with certainty, or control, changes in interest rates. Regional and local economic conditions and the policies of regulatory authorities, including monetary policies of the FRB, affect interest income and interest expense. High interest rates could also affect the amount of loans that the Company can originate because higher rates could cause customers to apply for fewer mortgages or cause depositors to shift funds from accounts that have a comparatively lower cost to accounts with a higher cost. The Company may also experience customer attrition due to competitor pricing. With short-term interest rates at historic lows and the Federal Funds target rate at 25 bps as of December 31, 2014, the Company's interest-bearing deposit accounts, particularly core deposits, are repricing at historic lows as well. With the outlook of the FRB as of December 31, 2014 being to maintain the Fed Funds target rate at 25 bps for another 24 to 28 months, the Company's challenge will be managing the magnitude and scope of the repricing. If the cost of interest-bearing deposits increases at a rate greater than the yields on interest-earning assets increase, net interest income will be negatively affected. Changes in the asset and liability mix may also affect net interest income. Similarly, lower interest rates cause higher yielding assets to prepay and floating or adjustable rate assets to reset to lower rates. If the Company is not able to reduce its funding costs sufficiently, due to either competitive factors or the maturity schedule of existing liabilities, then the Company's net interest margin will decline.

Although management believes it has implemented effective asset and liability management strategies to mitigate the potential adverse effects of changes in interest rates on the Company's results of operations, any substantial or unexpected change in, or prolonged change in market interest rates could have a material adverse effect on the

Company's financial condition and results of operations. See the section captioned "Net Interest Income" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 7A. Quantitative and Qualitative Disclosure About Market Risk located elsewhere in this report for further discussion related to the Company's management of interest rate risk.

Changes in the equity markets could materially affect the level of assets under management and the demand for other fee-based services.

Economic downturns could affect the volume of income from and demand for fee-based services. Revenues from the trust and benefit plan administration businesses depend in large part on the level of assets under management and administration. Market volatility that leads customers to liquidate investments, as well as lower asset values, can reduce our level of assets under management and administration and thereby decrease our investment management and administration revenues.

Table of Contents

Our lending, and particularly our emphasis on commercial lending, exposes us to the risk of losses upon borrower default.

As of December 31, 2014, approximately 43% of the Company's loan portfolio consisted of commercial and industrial, agricultural, commercial construction and commercial real estate loans. These types of loans generally expose a lender to greater risk of non-payment and loss than residential real estate loans because repayment of the loans often depends on the successful operation of the property, the income stream of the borrowers and, for construction loans, the accuracy of the estimate of the property's value at completion of construction and the estimated cost of construction. Such loans typically involve larger loan balances to single borrowers or groups of related borrowers compared to residential real estate loans. Because the Company's loan portfolio contains a significant number of commercial and industrial, agricultural, construction and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in nonperforming loans. An increase in nonperforming loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses and/or an increase in loan charge-offs, all of which could have a material adverse effect on the Company's financial condition and results of operations. See the section captioned "Loans" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations located elsewhere in this report for further discussion related to commercial and industrial, agricultural, construction and commercial real estate loans.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings will decrease.

The Company maintains an allowance for loan losses, which is an allowance established through a provision for loan losses charged to expense, that represents management's best estimate of probable losses that could be incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management's continuing evaluation of industry concentrations; specific credit risks; loan loss experience; current loan portfolio quality; present economic, political, environmental, and regulatory conditions and unidentified losses inherent in the current loan portfolio. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and requires the Company to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans and other factors, both within and outside of the Company's control, may require an increase in the allowance for loan losses. In addition, bank regulatory agencies periodically review the Company's allowance for loan losses and may require an increase in the provision for loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for loan losses, the Company will need additional provisions to increase the allowance for loan losses. These potential increases in the allowance for loan losses would result in a decrease in net income and, possibly, capital, and may have a material adverse effect on the Company's financial condition and results of operations. See the section captioned "Risk Management – Credit Risk" in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations located elsewhere in this report for further discussion related to the Company's process for determining the appropriate level of the allowance for loan losses.

Strong competition within our industry and market area could hurt our performance and slow our growth.

The Company faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, and community banks within the various markets in which the Company operates. Additionally, various banks continue to enter or have announced plans to enter the market areas in which the Company currently operates. The Company also faces competition from many other types of financial institutions, including, without limitation, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, and such diversified organizations may have greater financial resources and be better able to attract customers than the Company. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of the Company’s competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than the Company can.

Table of Contents
The Company's ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- the ability to expand the Company's market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which the Company introduces new products and services relative to its competitors;
- customer satisfaction with the Company's level of service;
- industry and general economic trends; and
- the ability to attract and retain talented employees.

Failure to perform in any of these areas could significantly weaken the Company's competitive position, which could adversely affect the Company's growth and profitability, which, in turn, could have a material adverse effect on the Company's financial condition and results of operations.

We are subject to extensive government regulation and supervision, which may interfere with our ability to conduct our business and may negatively impact our financial results.

We, primarily through the Bank and certain non-bank subsidiaries, are subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, the Federal Deposit Insurance Fund and the safety and soundness of the banking system as a whole, not shareholders. These regulations affect the Company's lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect the Company in substantial and unpredictable ways. Such changes could subject the Company to additional costs, limit the types of financial services and products the Company may offer, and/or limit the pricing the Company may charge on certain banking services, among other things. Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has and will continue to change the current bank regulatory structure and affect the lending, investment, trading and operating activities of financial institutions and their holding companies. In addition to the self-implementing provisions of the statute, the Dodd-Frank Act calls for many administrative rulemakings by various federal agencies to implement various parts of the legislation, some of which have yet to be implemented. The Company cannot be certain when final rules affecting the Company will be issued through such rulemakings and what the specific content of such rules will be. The financial reform legislation and any implementing rules that are ultimately issued could have adverse implications on the financial industry, the competitive environment, and the Company's ability to conduct business. The Company will have to apply resources to ensure that it is in compliance with all applicable provisions of the Dodd-Frank Act and any implementing rules, which may increase the Company's costs of operations and adversely impact its earnings. Additionally, revised capital adequacy guidelines and prompt corrective action rules applicable to the Company became effective January 1, 2015. Compliance with these rules will impose additional costs on the Company.

Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputation damage, which could have a material adverse effect on our business, financial condition and results of operations. While the Company has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.   See the section captioned "Supervision and Regulation" in Item 1. Business of this report for further information.

The Company is subject to liquidity risk which could adversely affect net interest income and earnings

The purpose of the Company’s liquidity management is to meet the cash flow obligations of its customers for both deposits and loans. The primary liquidity measurement the Company utilizes is called Basic Surplus which captures the adequacy of the Company’s access to reliable sources of cash relative to the stability of its funding mix of average liabilities. This approach recognizes the importance of balancing levels of cash flow liquidity from short and long-term securities with the availability of dependable borrowing sources which can be accessed when necessary. However, competitive pressure on deposit pricing could result in a decrease in the Company’s deposit base or an increase in funding costs. In addition, liquidity will come under additional pressure if loan growth exceeds deposit growth. These scenarios could lead to a decrease in the Company’s basic surplus measure below the minimum policy level of 5%. To manage this risk, the Company has the ability to purchase brokered time deposits, borrow against established borrowing facilities with other banks (Federal funds), and enter into repurchase agreements with investment companies. Depending on the level of interest rates, the Company’s net interest income, and therefore earnings, could be adversely affected. See the section captioned “Liquidity Risk” in Item 7.

Table of Contents

Our ability to service our debt, pay dividends and otherwise pay our obligations as they come due is substantially dependent on capital distributions from our subsidiaries.

The Company is a separate and distinct legal entity from its subsidiaries. It receives substantially all of its revenue from dividends from its subsidiaries. These dividends are the principal source of funds to pay dividends on the Company’s common stock and interest and principal on the Company’s debt. Various federal and/or state laws and regulations limit the amount of dividends that the Bank may pay to the Company. Also, the Company’s right to participate in a distribution of assets upon a subsidiary’s liquidation or reorganization is subject to the prior claims of the subsidiary’s creditors. In the event the Bank is unable to pay dividends to the Company, the Company may not be able to service debt, pay obligations or pay dividends on the Company’s common stock. The inability to receive dividends from the Bank could have a material adverse effect on the Company’s business, financial condition and results of operations.

A breach of information security, including as a result of cyber attacks, could disrupt our business and impact our earnings.

We depend upon data processing, communication and information exchange on a variety of computing platforms and networks, and over the internet. In addition, we rely on the services of a variety of vendors to meet our data processing and communication needs. Despite existing safeguards, we cannot be certain that all of our systems are free from vulnerability to attack or other technological difficulties or failures. If information security is breached or difficulties or failures occur, despite the controls we and our third party vendors have instituted, information can be lost or misappropriated, resulting in financial loss or costs to us, reputational harm or damages to others. Such costs or losses could exceed the amount of insurance coverage, if any, which would adversely affect our earnings.

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

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Company’s future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Company’s operations. Many of the Company’s competitors have substantially greater resources to invest in technological improvements. The Company may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological changes affecting the financial services industry could have a material adverse impact on the Company’s business and, in turn, the Company’s financial condition and results of operations.

Provisions of our certificate of incorporation and bylaws, as well as Delaware law and certain banking laws, could delay or prevent a takeover of us by a third party.

Provisions of the Company’s certificate of incorporation and bylaws, the corporate law of the State of Delaware and state and federal banking laws, including regulatory approval requirements, could delay, defer or prevent a third party from acquiring the Company, despite the possible benefit to the Company’s stockholders, or otherwise adversely affect the market price of the Company’s common stock. These provisions include: supermajority voting requirements for certain business combinations; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to the Company’s board of directors and for proposing matters that stockholders may act on at stockholder meetings. In addition, the Company is subject to Delaware law, which among other things prohibits the Company from engaging in a business combination with any interested stockholder for a period of three years from the date the person became an interested stockholder unless certain conditions are met.

These provisions may discourage potential takeover attempts, discouraging bids for the Company's common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of the Company's common stock. These provisions could also discourage proxy contests and make it more difficult for you and other stockholders to elect directors other than candidates nominated by the Board.

The possibility of the economy's return to recessionary conditions and the possibility of further turmoil or volatility in the financial markets would likely have an adverse effect on our business, financial position and results of operations.

The economy in the United States and globally began to recover from severe recessionary conditions in mid-2009 and is currently in the midst of a moderate economic recovery. The sustainability of the moderate recovery is dependent on a number of factors that are not within the Company's control, such as a return to private sector job growth and investment, strengthening of housing sales and construction, and the timing and impact of changing governmental policies. The Company continues to face risks resulting from the aftermath of the severe recession generally and the moderate pace of the current recovery. A slowing or failure of the economic recovery would likely aggravate the adverse effects of these difficult economic and market conditions on the Company and on others in the financial services industry.

In particular, the Company may face the following risks in connection with the current economic and market environment:

investors may have less confidence in the equity markets in general and in financial services industry stocks in particular, which could place downward pressure on the Company's stock price and resulting market valuation;

economic and market developments may further affect consumer and business confidence levels and may cause declines in credit usage and adverse changes in payment patterns, causing increases in delinquencies and default rates;

Table of Contents

the Company's ability to assess the creditworthiness of its customers may be impaired if the models and approaches the Company uses to select, manage, and underwrite its customers become less predictive of future behaviors;

the Company could suffer decreases in customer desire to do business with it, whether as a result of a decreased demand for loans or other financial products and services or decreased deposits or other investments in accounts with the Company;

competition in the financial services industry could intensify as a result of the increasing consolidation of financial services companies in connection with current market conditions, or otherwise;

the Company faces increased regulation of its industry, and compliance with such regulation may increase its costs and limit its ability to pursue business opportunities; and;

the Company may be required to pay significantly higher FDIC deposit insurance premiums.

We are subject to other-than-temporary impairment risk which could negatively impact our financial performance.

The Company recognizes an impairment charge when the decline in the fair value of equity, debt securities and cost-method investments below their cost basis are judged to be other-than-temporary. Significant judgment is used to identify events or circumstances that would likely have a significant adverse effect on the future use of the investment. The Company considers various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, forecasted recovery, the financial condition and near-term prospects of the investee, and whether the Company has the intent to sell and whether it is more likely than not it will be forced to sell the security in question. Information about unrealized gains and losses is subject to changing conditions. The values of securities with unrealized gains and losses will fluctuate, as will the values of securities that we identify as potentially distressed. Our current evaluation of other-than-temporary impairments reflects our intent to hold securities for a reasonable period of time sufficient for a forecasted recovery of fair value. However, our intent to hold certain of these securities may change in future periods as a result of facts and circumstances impacting a specific security. If our intent to hold a security with an unrealized loss changes, and we do not expect the security to fully recover prior to the expected time of disposition, we will write down the security to its fair value in the period that our intent to hold the security changes.

The process of evaluating the potential impairment of goodwill and other intangibles is highly subjective and requires significant judgment. The Company estimates the expected future cash flows of its various businesses and determines the carrying value of these businesses. The Company exercises judgment in assigning and allocating certain assets and liabilities to these businesses. The Company then compares the carrying value, including goodwill and other intangibles, to the discounted future cash flows. If the total of future cash flows is less than the carrying amount of the assets, an impairment loss is recognized based on the excess of the carrying amount over the fair value of the assets. Estimates of the future cash flows associated with the assets are critical to these assessments. Changes in these estimates based on changed economic conditions or business strategies could result in material impairment charges and therefore have a material adverse impact on the Company's financial condition and performance.

The risks presented by acquisitions could adversely affect our financial condition and results of operations.

The business strategy of the Company has included and may continue to include growth through acquisition. Any future acquisitions will be accompanied by the risks commonly encountered in acquisitions. These risks may include, among other things: our ability to realize anticipated cost savings, the difficulty of integrating operations and personnel, the loss of key employees, the potential disruption of our or the acquired company's ongoing business in such a way that could result in decreased revenues, the inability of our management to maximize our financial and strategic position, the inability to maintain uniform standards, controls, procedures and policies, and the impairment of relationships with the acquired company's employees and customers as a result of changes in ownership and management.

Our controls and procedures may fail or be circumvented, which may result in a material adverse effect on our business.

Management regularly reviews and updates our internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on our business, results of operations and financial condition.

Table of Contents

We are exposed to risk of environmental liabilities with respect to properties to which we obtain title.

A significant portion of our loan portfolio at December 31, 2014 was secured by real estate. In the course of our business, we may foreclose and take title to real estate, and could be subject to environmental liabilities with respect to these properties. We may be held liable to a government entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation and remediation activities could be substantial. In addition, if we are the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. These costs and claims could adversely affect our business, results of operations and prospects.

We may be adversely affected by the soundness of other financial institutions including the FHLB of New York.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Financial services companies are interrelated as a result of trading, clearing, counterparty or other relationships. We have exposure to many different industries and counterparties, and we routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. As a result, defaults by, or even rumors or questions about, one or more financial services companies, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. Many of these transactions expose us to credit risk in the event of default of our counterparty or client. In addition, our credit risk may be exacerbated if the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure due us. There is no assurance that any such losses would not materially and adversely affect our business, financial condition or results of operations.

The Company owns common stock of FHLB of New York in order to qualify for membership in the FHLB system, which enables it to borrow funds under the FHLB of New York's advance program. The carrying value and fair market value of our FHLB of New York common stock was $17.2 million as of December 31, 2014.

There are 12 branches of the FHLB, including New York. The 12 FHLB branches are jointly liable for the consolidated obligations of the FHLB system. To the extent that one FHLB branch cannot meet its obligations to pay its share of the system's debt, other FHLB branches can be called upon to make the payment. Any such adverse effects on the FHLB of New York could adversely affect the value of our investment in its common stock and negatively impact our results of operations.

Trading activity in the Company's common stock could result in material price fluctuations.

The market price of the Company's common stock may fluctuate significantly in response to a number of factors including, but not limited to:

Changes in securities analysts' expectations of financial performance;
Volatility of stock market prices and volumes;
Incorrect information or speculation;
Changes in industry valuations;
Variations in operating results from general expectations;
Actions taken against the Company by various regulatory agencies;
Changes in authoritative accounting guidance by the Financial Accounting Standards Board or other regulatory agencies;

- Changes in general domestic economic conditions such as inflation rates, tax rates, unemployment rates, labor and healthcare cost trend rates, recessions, and changing government policies, laws and regulations; and
- Severe weather, natural disasters, acts of war or terrorism and other external events.

ITEM 1B. Unresolved Staff Comments

None.

Table of Contents

ITEM 2. Properties

The Company's headquarters are located at 52 South Broad Street, Norwich, New York 13815. The Company operated the following community banking branches and ATMs as of December 31, 2014:

County	Branches	ATMs	County	Branches	ATMs
New York			Pennsylvania		
Albany County	4	6	Lackawanna County	14	17
Broome County	8	11	Luzerne County	4	6
Chenango County	11	13	Monroe County	4	5
Clinton County	3	2	Pike County	2	2
Cortland County	5	6	Susquehanna County	5	7
Delaware County	5	5	Wayne County	3	4
Essex County	3	5			
Franklin County	1	1	Vermont		
Fulton County	5	6	Chittenden County	3	3
Greene County	2	2	Rutland County	1	1
Hamilton County	1	1			
Herkimer County	2	1	Massachusetts		
Madison County	4	6	Berkshire County	6	6
Montgomery County	5	4			
Oneida County	7	11	New Hampshire		
Onondaga County	11	13	Cheshire County	1	0
Oswego County	4	6	Hillsborough County	2	2
Otsego County	9	11	Rockingham County	2	2
Rensselaer County	1	1			
Saratoga County	4	4			
Schenectady County	2	2			
Schoharie County	4	4			
St. Lawrence County	5	5			
Tioga County	1	1			
Warren County	2	3			
			Total	156	185

The Company leases 70 of the above listed branches from third parties. The Company owns all other banking premises. The Company believes that its offices are sufficient for its present operations. All of the above ATMs are owned by the Company.

Table of Contents

ITEM 3. Legal Proceedings

There are no material legal proceedings, other than ordinary routine litigation incidental to the business, to which the Company or any of its subsidiaries is a party or of which any of their property is subject.

ITEM 4. Mine Safety Disclosures

None.

PART II

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

Market Information

The common stock of the Company, par value $0.01 per share (the "Common Stock"), is quoted on the Nasdaq Global Select Market under the symbol "NBTB." The following table sets forth the high and low sales prices and dividends declared for the Common Stock for the periods indicated:

	High	Low	Dividend
2014			
1st quarter	$25.81	$22.35	$0.21
2nd quarter	25.18	21.67	0.21
3rd quarter	24.81	22.50	0.21
4th quarter	26.77	22.22	0.21
2013			
1st quarter	$22.37	$20.15	$0.20
2nd quarter	22.23	19.45	0.20
3rd quarter	23.25	21.06	0.20
4th quarter	26.59	22.09	0.21

The closing price of the Common Stock on February 13, 2015 was $24.62.

As of February 13, 2015, there were 6,976 shareholders of record of Common Stock. No unregistered securities were sold by the Company during the year ended December 31, 2014.

Table of Contents

Stock Performance Graph

The following stock performance graph compares the cumulative total stockholder return (i.e., price change, reinvestment of cash dividends and stock dividends received) on our Common Stock against the cumulative total return of the NASDAQ Stock Market (U.S. Companies) Index and the KBW Regional Bank Index (Peer Group). The stock performance graph assumes that $100 was invested on December 31, 2009. The graph further assumes the reinvestment of dividends into additional shares of the same class of equity securities at the frequency with which dividends are paid on such securities during the relevant fiscal year. The yearly points marked on the horizontal axis correspond to December 31 of that year. We calculate each of the referenced indices in the same manner. All are market-capitalization-weighted indices, so companies judged by the market to be more important (i.e., more valuable) count for more in all indices.

	Period Ending					
Index	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14
NBT Bancorp	$100.00	$122.87	$116.88	$111.10	$147.04	$154.37
KBW Regional Bank Index	$100.00	$120.36	$114.18	$129.24	$189.62	$194.12
NASDAQ Composite Index	$100.00	$118.11	$117.20	$137.94	$193.29	$221.89

Source: Bloomberg, L.P.

Table of Contents

Dividends

We depend primarily upon dividends from our subsidiaries for a substantial part of our revenue. Accordingly, our ability to pay dividends to our shareholders depends primarily upon the receipt of dividends or other capital distributions from our subsidiaries. Payment of dividends to the Company from the Bank is subject to certain regulatory and other restrictions. Under OCC regulations, the Bank may pay dividends to the Company without prior regulatory approval so long as it meets its applicable regulatory capital requirements before and after payment of such dividends and its total dividends do not exceed its net income to date over the calendar year plus retained net income over the preceding two years. At December 31, 2014, the Bank was in compliance with all applicable minimum capital requirements and had the ability to pay dividends of $88.7 million to the Company without the prior approval of the OCC.

If the capital of the Company is diminished by depreciation in the value of its property or by losses, or otherwise, to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets, no dividends may be paid out of net profits until the deficiency in the amount of capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets has been repaired. See the section captioned “Supervision and Regulation” in Item 1. Business and Note 15 – Stockholders’ Equity in the notes to consolidated financial statements is included in Item 8. Financial Statements and Supplementary Data, which are located elsewhere in this report.

Stock Repurchase

The Company purchased 3,288 shares of its common stock during the year ended December 31, 2014 at an average price of $22.02 per share under a previously announced plan which expired on December 31, 2014. As of December 31, 2014, there were 1,000,000 shares available for repurchase under a plan authorized on October 27, 2014, which expires on December 31, 2016.

Table of Contents

ITEM 6. Selected Financial Data

The following summary of financial and other information about the Company is derived from the Company's audited consolidated financial statements for each of the last five fiscal years ended December 31 and should be read in conjunction with Item 7 and the Company's consolidated financial statements and accompanying notes, included elsewhere in this report:

	Year ended December 31,				
(In thousands, except share and per share data)	2014	2013 (1)	2012 (2)	2011	2010
Interest, fee and dividend income	$275,081	$268,723	$239,397	$239,997	$255,738
Interest expense	23,203	30,644	35,194	39,721	53,210
Net interest income	251,878	238,079	204,203	200,276	202,528
Provision for loan losses	19,539	22,424	20,269	20,737	29,809
Noninterest income excluding securities gains	125,935	101,789	86,728	80,161	80,614
Securities gains, net	92	1,426	599	150	3,274
Noninterest expense	246,063	228,927	193,887	180,676	178,291
Income before income taxes	112,303	89,943	77,374	79,174	78,316
Net income	75,074	61,747	54,558	57,901	57,404
Per common share					
Basic earnings	$1.71	$1.47	$1.63	$1.72	$1.67
Diluted earnings	1.69	1.46	1.62	1.71	1.66
Cash dividends paid	0.84	0.81	0.80	0.80	0.80
Book value at year-end	19.69	18.77	17.24	16.23	15.51
Tangible book value at year-end	13.22	12.09	12.23	11.70	11.67
Average diluted common shares outstanding	44,395	42,351	33,719	33,924	34,509
Securities available for sale, at fair value	$1,013,171	$1,364,881	$1,147,999	$1,244,619	$1,129,368
Securities held to maturity, at amortized cost	454,361	117,283	60,563	70,811	97,310
Loans	5,595,271	5,406,795	4,277,616	3,800,203	3,610,006
Allowance for loan losses	66,359	69,434	69,334	71,334	71,234
Assets	7,797,926	7,652,175	6,042,259	5,598,406	5,338,856
Deposits	6,299,605	5,890,224	4,784,349	4,367,149	4,134,352
Borrowings	548,943	866,061	605,855	627,358	604,730
Stockholders' equity	864,181	816,569	582,273	538,110	533,572
Key ratios					
Return on average assets	0.97 %	0.85 %	0.93 %	1.06 %	1.05 %
Return on average equity	8.84	8.09	9.72	10.73	10.92
Average equity to average assets	10.95	10.50	9.55	9.90	9.63
Net interest margin	3.61	3.66	3.86	4.09	4.15
Dividend payout ratio	49.16	55.48	49.38	46.78	48.19
Tier 1 leverage	9.39	8.93	8.54	8.74	9.16
Tier 1 risk-based capital	12.32	11.74	11.00	11.56	12.44
Total risk-based capital	13.50	12.99	12.25	12.81	13.70

(1) Includes the impact of the acquisition of Alliance Financial Corporation ("Alliance") on March 8, 2013.

(2) Includes the impact of the acquisition of Hampshire First Bank on June 8, 2012.

Selected Quarterly Financial Data

	2014				2013			
(Dollars in thousands, except share and per share data)	Fourth	Third	Second	First	Fourth	Third	Second	First
Interest, fee and dividend income	$69,414	$69,134	$68,456	$68,077	$69,181	$69,569	$69,604	$60,369
Interest expense	5,390	5,371	5,882	6,560	7,123	7,343	7,949	8,229
Net interest income	64,024	63,763	62,574	61,517	62,058	62,226	61,655	52,140
Provision for loan and lease losses	6,892	4,885	4,166	3,596	5,166	5,198	6,402	5,658
Noninterest income excluding net securities gains (losses)	27,013	26,639	46,013	26,270	25,289	26,818	25,598	24,084
Net securities gains (losses)	33	38	14	7	13	329	(61)	1,145
Noninterest expense	56,743	69,067	62,736	57,517	55,486	56,286	56,450	60,705
Net income	18,513	10,912	27,640	18,009	17,925	19,257	16,916	7,649
Basic earnings per share	$0.42	$0.25	$0.63	$0.41	$0.41	$0.44	$0.39	$0.21
Diluted earnings per share	$0.42	$0.25	$0.62	$0.41	$0.41	$0.44	$0.38	$0.21
Annualized net interest margin	3.61%	3.61%	3.60%	3.63%	3.61%	3.65%	3.69%	3.68%
Annualized return on average assets	0.94%	0.55%	1.43%	0.95%	0.94%	1.01%	0.90%	0.48%
Annualized return on average equity	8.46%	5.06%	13.12%	8.81%	8.81%	9.62%	8.42%	4.83%
Average diluted common shares outstanding	44,535	44,405	44,364	44,296	44,121	44,135	44,317	36,794

Table of Contents

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

Forward Looking Statements

Certain statements in this filing and future filings by the Company with the SEC, in the Company's press releases or other public or shareholder communications, or in oral statements made with the approval of an authorized executive officer, contain forward-looking statements, as defined in the Private Securities Litigation Reform Act. These statements may be identified by the use of phrases such as "anticipate," "believe," "expect," "forecasts," "projects," "will," "ca "would," "should," "could," "may," or other similar terms. There are a number of factors, many of which are beyond the Company's control that could cause actual results to differ materially from those contemplated by the forward looking statements. Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, among others, the following possibilities: (1) local, regional, national and international economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact; (2) changes in the level of non-performing assets and charge-offs; (3) changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements; (4) the effects of and changes in trade and monetary and fiscal policies and laws, including the interest rate policies of the Federal Reserve Board; (5) inflation, interest rate, securities market and monetary fluctuations; (6) political instability; (7) acts of war or terrorism; (8) the timely development and acceptance of new products and services and perceived overall value of these products and services by users; (9) changes in consumer spending, borrowings and savings habits; (10) changes in the financial performance and/or condition of the Company's borrowers; (11) technological changes; (12) acquisitions and integration of acquired businesses; (13) the ability to increase market share and control expenses; (14) changes in the competitive environment among financial holding companies; (15) the effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiaries must comply including those under the Dodd-Frank Act; (16) the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters; (17) changes in the Company's organization, compensation and benefit plans; (18) the costs and effects of legal and regulatory developments including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews; (19) greater than expected costs or difficulties related to the integration of new products and lines of business; and (20) the Company's success at managing the risks involved in the foregoing items.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors including, but not limited to, those described above, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

Except as required by law, the Company does not undertake, and specifically disclaims any obligations to, publicly release any revisions that may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

General

The financial review which follows focuses on the factors affecting the consolidated financial condition and results of operations of the Company and its wholly owned subsidiaries, the Bank, NBT Financial Services and NBT Holdings during 2014 and, in summary form, the preceding two years. Collectively, the Registrant and its subsidiaries are referred to herein as "the Company." Net interest margin is presented in this discussion on a fully taxable equivalent (FTE) basis. Average balances discussed are daily averages unless otherwise described. The audited consolidated financial statements and related notes as of December 31, 2014 and 2013 and for each of the years in the three-year period ended December 31, 2014 should be read in conjunction with this review. Amounts in prior period consolidated financial statements are reclassified whenever necessary to conform to the 2014 presentation.

Critical Accounting Policies

The Company has identified policies as being critical because they require management to make particularly difficult, subjective and/or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts would be reported under different conditions or using different assumptions. These policies relate to the allowance for loan losses, pension accounting, other-than-temporary impairment, provision for income taxes and impairment of goodwill and intangible assets.

Management of the Company 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 credit losses inherent in the loan portfolio and the material effect that such judgments can have on the 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 may need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provision for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal reviews of the Company’s nonperforming loans and potential problem loans have a significant impact on the overall analysis of the adequacy of the allowance for loan losses. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral values were significantly lower, the Company’s allowance for loan loss policy would also require additional provision for loan losses.

Table of Contents

Management is required to make various assumptions in valuing its pension assets and liabilities. These assumptions include the expected rate of return on plan assets, the discount rate, and the rate of increase in future compensation levels. Changes to these assumptions could impact earnings in future periods. The Company takes into account the plan asset mix, funding obligations, and expert opinions in determining the various rates used to estimate pension expense. The Company also considers the Citigroup Pension Liability Index, market interest rates and discounted cash flows in setting the appropriate discount rate. In addition, the Company reviews expected inflationary and merit increases to compensation in determining the rate of increase in future compensation levels.

Management of the Company considers the accounting policy relating to other-than-temporary impairment to be a critical accounting policy. Management systematically evaluates certain assets for other-than-temporary declines in fair value, primarily investment securities. Management considers historical values and current market conditions as a part of the assessment. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings and the amount of the total other-than-temporary impairment related to other factors is generally recognized in other comprehensive income, net of applicable taxes.

The Company is subject to examinations from various taxing authorities. Such examinations may result in challenges to the tax return treatment applied by the Company to specific transactions. Management believes that the assumptions and judgments used to record tax-related assets or liabilities have been appropriate. Should tax laws change or the taxing authorities determine that management’s assumptions were inappropriate, an adjustment may be required which could have a material effect on the Company’s results of operations.

As a result of acquisitions, the Company has acquired goodwill and identifiable intangible assets. Goodwill represents the cost of acquired companies in excess of the fair value of net assets at the acquisition date. Goodwill is evaluated at least annually or when business conditions suggest that an impairment may have occurred. Goodwill will be reduced to its carrying value through a charge to earnings if impairment exists. Core deposits and other identifiable intangible assets are amortized to expense over their estimated useful lives. The determination of whether or not impairment exists is based upon discounted cash flow modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires them to select a discount rate that reflects the current return requirements of the market in relation to present risk-free interest rates, required equity market premiums and Company-specific risk indicators, all of which are susceptible to change based on changes in economic conditions and other factors. Future events or changes in the estimates used to determine the carrying value of goodwill and identifiable intangible assets could have a material impact on the Company’s results of operations.

The Company’s policies on the allowance for loan losses, pension accounting, other-than-temporary impairments, provision for income taxes, goodwill and intangible assets are disclosed in Note 1 to the consolidated financial statements. A more detailed description of the allowance for loan losses is included in the section captioned “Risk Management – Credit Risk” in Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K. All significant pension accounting assumptions, income tax assumptions, and intangible asset assumptions and detail are disclosed in Notes 13, 12 and 7 to the consolidated financial statements, respectively. All accounting policies are important, and as such, the Company encourages the reader to review each of the policies included in Note 1 to obtain a better understanding of how the Company’s financial performance is reported.

Non-GAAP Measures

This Annual Report on Form 10-K contains financial information determined by methods other than in accordance with accounting principles generally accepted in the United States of America (GAAP). These measures adjust GAAP to exclude the effects of sales of securities, merger-related expenses, and other items not considered core to the Company's operations. Where non-GAAP disclosures are used in this Annual Report on Form 10-K, the comparable GAAP measure, as well as a reconciliation to the comparable GAAP measure, is provided in the accompanying table.

Management believes that these non-GAAP measures provide useful information that is important to an understanding of the operating results of the Company’s core business due to the nature of the excluded items not considered core to operations. Non-GAAP measures should not be considered a substitute for financial measures determined in accordance with GAAP and investors should consider the Company’s performance and financial condition as reported under GAAP and all other relevant information when assessing the performance or financial condition of the Company.

Table of Contents

Overview

Significant factors management reviews to evaluate the Company's operating results and financial condition include, but are not limited to: net income and earnings per share, return on assets and equity, net interest margin, noninterest income, operating expenses, asset quality indicators, loan and deposit growth, capital management, liquidity and interest rate sensitivity, enhancements to customer products and services, technology advancements, market share and peer comparisons. The following information should be considered in connection with the Company's results for the fiscal year ended December 31, 2014:

Reported net income for 2014 was $75.1 million, the highest in the Company's history, and up from $61.7 million in 2013. Reported results for 2014 include the full year impact of the acquisition of Alliance.

Core net income was $75.8 million for 2014 up 8.5% from $69.9 million for 2013. Core diluted earnings per share for 2014 was $1.71 up from $1.65 for 2013. Core return on average assets and return on average equity were 0.98% and 8.92%, respectively, for 2014, compared with 0.96% and 9.16%, respectively for 2013 (a reconciliation of these "core" results is presented in the following table).

Reconciliation of Non-GAAP Financial Measures:	2014	2013
Reported net income (GAAP)	$75,074	$61,747
Adj: Gain on sale of securities, net (net of tax)	(61)	(990)
Adj: Other adjustments (net of tax) (1)	209	512
Adj: Gain on sale of Springstone (net of tax and related incentive compensation)	(11,168)	-
Adj: Prepayment penalties related to debt restructuring (net of tax)	11,758	-
Plus: Merger related expenses (net of tax)	-	8,588
Total Adjustments	738	8,110
Core net income	$75,812	$69,857
Profitability:		
Core Diluted Earnings Per Share	$1.71	$1.65
Core Return on Average Assets	0.98 %	0.96 %
Core Return on Average Equity	8.92 %	9.16 %
Core Return on Average Tangible Common Equity (2)	14.03 %	14.76 %

(1) Primarily net gain on settlement of litigation and reorganization expenses for 2014 and reorganization expenses for 2013

(2) Excludes amortization of intangible assets (net of tax) from net income and average tangible common equity is calculated as follows:

	2014	2013
Average stockholders' equity	$849,465	$763,026
Less: average goodwill and other intangibles	287,013	269,683
Average tangible common equity	$562,452	$493,343

Table of Contents

Net interest margin for 2014 declined 5 basis points as a result of the continued low rate environment on loans and investments.

Asset quality indicators showed stability or improvement from last year:

Nonperforming loans to total loans improved to 0.82% at December 31, 2014 from 0.99% at December 31, 2013;

Past due loans to total loans improved to 0.69% at December 31, 2014 from 0.77% at December 31, 2013;

Net charge-offs to average loans improved to 0.41% for 2014 from 0.44% in 2013.

Noninterest income was up 22.1% over last year driven primarily by gain on the sale of the Springstone equity investment recorded in 2014. Excluding this gain and gains on securities sales noninterest income was up 4.7% over last year.

Restructured $165 million in long-term borrowings, resulting in $17.9 million in gross prepayment penalties (non-core) recognized in 2014, which lowered the cost of the restructured long-term funding by approximately 200 basis points.

Continued strategic expansion in New England in 2014 with new locations in Pittsfield, Ma., Rutland, Vt. and most recently Portland, Me. with the opening of our Maine Regional Headquarters.

The Company continued to experience pressure on net interest income in 2014 as low rates continued to have the effect of causing many assets to prepay or to be redeemed. While interest earning assets increased 6.8% from 2013, this was partially offset by the reinvestment of cash flows in lower yielding assets resulting in a modest increase in interest income in 2014. The yield on interest earning assets decreased from 4.12% in 2013 to 3.94% in 2014, with drops in the yields on loans and securities held to maturity being the primary drivers. Rates paid on interest bearing liabilities also decreased in the low rate environment, which partially offset the decrease in earning asset yields. In particular, the decrease in rates paid on long-term borrowings and the rates paid on time deposits contributed approximately $1.7 million and $1.6 million, respectively, to the decrease in interest expense in 2014 as compared with 2013. Average interest bearing liabilities increased approximately $211.5 million from 2013 to 2014, with the primary driver being the increase in interest bearing deposits. The Company also took the following steps in 2014 in an effort to help offset the margin pressure created by the low interest rate environment:

Continued the sale of conforming residential real estate mortgages, taking advantage of favorable interest rate conditions;

Increased efforts to grow noninterest income with focus on organic growth of our trust, financial services, retirement plan administration and insurance businesses;

Restructured long-term borrowings as previously mentioned; and

Continued demand deposit growth strategies resulting in 11.7% growth from 2013 to 2014.

The Company reported net income of $75.1 million or $1.69 per diluted share for 2014, up 21.6% from net income of $61.7 million or $1.46 per diluted share for 2013. The provision for loan losses totaled $19.5 million for the year ended December 31, 2014, down $2.9 million, or 12.9%, from $22.4 million for the year ended December 31, 2013. The decrease in provision is attributable to the improvement in asset quality in 2014. Noninterest income increased $22.8 million, or 22.1%, from 2013 primarily due to a $19.4 million gain on the sale of the Company's investment in Springstone during 2014. In addition, trust revenue increased approximately $2.3 million in 2014 as a result of the acquisition of Alliance in March 2013 and improved market conditions in 2014. ATM and debit card fees increased $1.6 million in 2014 due to increased usage from expansion and acquisition activity during 2013. Bank owned life insurance income increased $1.6 million in 2014 due primarily to death benefits received during the year. Noninterest expense for the year ended December 31, 2014 was $246.1 million, up from $228.9 million, or 7.5% from the year ended December 31, 2013. This increase was in large part due to the $17.9 million prepayment penalties incurred in 2014 resulting from long-term debt restructuring. The comparative impact of these prepayment penalties were partially offset by $12.4 million in merger related expenses recorded in 2013. In addition, salaries and employee benefits were up $6.1 million, or 5.4%, largely due to expansion activity as well as incremental incentive compensation recorded in 2014 related to the Springstone transaction, partially offset by reduced pension expenses.

Table of Contents

2015 Outlook

The Company’s 2014 earnings reflected the Company’s continued ability to manage through the existing and near future economic conditions and challenges in the financial services industry, while investing in the Company’s future. The Company believes effects of the economic crisis still exist and, as a result, there will be certain challenges faced in 2015. Significant items that may have an impact on 2015 results include:

The Company expects that it will experience some additional margin compression from the 2014 fourth quarter net interest margin of 3.61%. We expect that payments representing interest and principal on currently outstanding loans and investments will continue to be reinvested at rates that are lower than the rates currently outstanding on those loans and investments. In addition, deposit and borrowing rates are historically low and there are minimal opportunities for them to be lowered. Furthermore, the industry as a whole must focus on asset growth to increase interest income, thereby creating general pricing pressure in the entire industry.

If asset quality trends continue to show improvement, the Company would expect the level of provisioning to continue to decrease. However, the economy may have an adverse affect on asset quality indicators, particularly indicators related to loans secured by real estate, which could adversely affect charge-offs, the allowance for loan losses, and the provision for loan losses.

Compliance with regulatory mandates could continue to negatively impact certain fee generating products as well as increase costs to comply, which could negatively impact noninterest income, noninterest expense and earnings.

Competitive pressure on deposits could result in an increase in interest expense if interest rates begin to rise.

The Company’s 2015 outlook is subject to factors in addition to those identified above and those risks and uncertainties that could impact the Company’s future results are explained in ITEM 1A. RISK FACTORS.

Table of Contents

Asset/Liability Management

The Company attempts to maximize net interest income and net income, while actively managing its liquidity and interest rate sensitivity through the mix of various core deposit products and other sources of funds, which in turn fund an appropriate mix of earning assets. The changes in the Company's asset mix and sources of funds, and the resulting impact on net interest income, on a fully tax equivalent basis, are discussed below. The following table includes the condensed consolidated average balance sheet, an analysis of interest income/expense and average yield/rate for each major category of earning assets and interest bearing liabilities on a taxable equivalent basis. Interest income for tax-exempt securities and loans has been adjusted to a taxable-equivalent basis using the statutory Federal income tax rate of 35%.

Average Balances and Net Interest Income

	2014			2013			2012		
(Dollars in thousands)	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate	Average Balance	Interest	Yield/Rate
ASSETS									
Short-term interest bearing accounts	$4,344	$28	0.64%	$30,522	$116	0.38%	$66,207	$179	0.27%
Securities available for sale (1)	1,258,999	25,760	2.05%	1,349,887	27,357	2.03%	1,177,969	28,904	2.45%
Securities held to maturity (1)	233,465	6,558	2.81%	88,193	3,692	4.19%	65,582	3,583	5.46%
Investment in FRB and FHLB Banks	39,290	2,005	5.10%	37,998	1,771	4.66%	28,358	1,378	4.86%
Loans (2)	5,528,015	244,162	4.42%	5,106,607	239,572	4.69%	4,053,420	209,370	5.17%
Total interest earning assets	$7,064,113	$278,513	3.94%	$6,613,207	$272,508	4.12%	$5,391,536	$243,414	4.51%
Other assets	691,934			653,432			483,248		
Total assets	$7,756,047			$7,266,639			$5,874,784		
LIABILITIES AND STOCKHOLDERS' EQUITY									
Money market deposit accounts	$1,457,770	$2,532	0.17%	$1,343,801	$2,004	0.15%	$1,116,583	$2,054	0.18%
NOW deposit accounts	949,759	509	0.05%	882,629	1,468	0.17%	709,889	1,854	0.26%
Savings deposits	1,020,974	760	0.07%	929,226	789	0.08%	680,092	522	0.08%
Time deposits	1,015,748	9,837	0.97%	1,069,228	12,029	1.13%	993,117	14,418	1.45%
Total interest bearing deposits	$4,444,251	$13,638	0.31%	$4,224,884	$16,290	0.39%	$3,499,681	$18,848	0.54%
Short-term borrowings	382,451	845	0.22%	280,848	515	0.18%	165,742	188	0.11%
Junior Subordinated Debt	101,196	2,165	2.14%	96,536	2,084	2.16%	75,422	1,730	2.29%
Long-term debt	224,556	6,555	2.92%	338,697	11,755	3.47%	368,270	14,428	3.92%
Total interest bearing liabilities	$5,152,454	$23,203	0.45%	$4,940,965	$30,644	0.62%	$4,109,115	$35,194	0.86%
Demand deposits	1,670,188			1,484,193			1,139,896		

Other liabilities	83,940			78,455			64,551		
Stockholders' equity	849,465			763,026			561,222		
Total liabilities and stockholders' equity	$7,756,047			$7,266,639			$5,874,784		
Net interest income (FTE)		255,310			241,864			208,220	
Interest rate spread			3.49%			3.50%			3.65%
Net interest margin			3.61%			3.66%			3.86%
Taxable equivalent adjustment		3,432			3,785			4,017	
Net interest income		$251,878			$238,079			$204,203	

1. Securities are shown at average amortized cost.

2. For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding. The interest collected thereon is included in interest income based upon the characteristics of the related loans.

Table of Contents

2014 OPERATING RESULTS AS COMPARED TO 2013 OPERATING RESULTS

Net Interest Income

Net interest income was $251.9 million for the year ended December 31, 2014, up 5.8% from 2013. Fully taxable equivalent ("FTE") net interest margin was 3.61% for the year ended December 31, 2014, down from 3.66% for 2013. Average interest earning assets were up $450.9 million, or 6.8%, for the year ended December 31, 2014 as compared to the same period in 2013. This increase was driven primarily by the acquisition of Alliance in March 2013 as well as organic loan production during the past several quarters. The net interest impact from the increase in average interest earning assets was partially offset by rate compression on earning assets, as their yield decreased from 4.12% during the year ended December 31, 2013 to 3.94% for 2014. This rate compression was driven primarily by decreasing loan yields from 4.69% in 2013 to 4.42% for 2014. As a result of the increase in average earning assets, interest income was up 2.4% for the year ended December 31, 2014 as compared to 2013. Average interest bearing liabilities increased $211.5 million, or 4.3%, for the year ended December 31, 2014 as compared to 2013. This increase was due primarily to an increase in deposits resulting from organic deposit growth as well as the aforementioned acquisition of Alliance. The rates paid on interest bearing liabilities for 2014 decreased by 17 basis points from 2013. This decrease was primarily driven by a decrease of 8 basis points in rates paid on deposits from improved funding mix as well as a 55 basis point decrease in the rate paid on long-term debt due primarily to maturity of long-term debt in the prior year, as well as the debt restructuring completed in the third quarter of 2014. The following table presents changes in interest income, on a FTE basis, and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

Analysis of Changes in Taxable Equivalent Net Interest Income

	Increase (Decrease) 2014 over 2013			Increase (Decrease) 2013 over 2012		
(In thousands)	Volume	Rate	Total	Volume	Rate	Total
Short-term interest-bearing accounts	$(138)	$50	$(88)	$(119)	$56	$(63)
Securities available for sale	(1,857)	260	(1,597)	3,884	(5,431)	(1,547)
Securities held to maturity	4,414	(1,548)	2,866	1,063	(954)	109
Investment in FRB and FHLB Banks	63	171	234	451	(58)	393
Loans	19,093	(14,503)	4,590	50,712	(20,510)	30,202
Total interest income	21,575	(15,570)	6,005	55,991	(26,897)	29,094
Money market deposit accounts	179	349	528	377	(427)	(50)
NOW deposit accounts	104	(1,063)	(959)	385	(771)	(386)
Savings deposits	74	(103)	(29)	207	60	267
Time deposits	(580)	(1,612)	(2,192)	1,042	(3,431)	(2,389)
Short-term borrowings	211	119	330	173	155	328
Junior subordinated debt	100	(19)	81	461	(107)	354
Long-term debt	(3,534)	(1,666)	(5,200)	(1,104)	(1,570)	(2,674)
Total interest expense	(3,446)	(3,995)	(7,441)	1,541	(6,091)	(4,550)
Change in FTE net interest income	$25,021	$(11,575)	$13,446	$54,450	$(20,806)	$33,644

Loans and Corresponding Interest and Fees on Loans

The average balance of loans increased by approximately $421.4 million, or 8.3%, from 2013 to 2014. The yield on average loans decreased from 4.69% in 2013 to 4.42% in 2014, as loan rates declined due to the continued low rate environment in 2014. Interest income from loans on a FTE basis increased 1.9%, from $239.6 million in 2013 to

$244.2 million in 2014. This increase was due to the increase in average loan balances noted above, partially offset by the decrease in yields.

Total loans increased $188.5 million, or 3.5%, from December 31, 2013 to December 31, 2014. Increases in residential real estate mortgages, commercial real estate loans, and consumer loans were the primary drivers of the increase in total loans from 2013 as the Company experienced strong originations in 2014 in the upstate New York and Vermont markets.

Table of Contents

The following table reflects the loan portfolio by major categories as of December 31 for the years indicated:

Composition of Loan and Lease Portfolio

	December 31,				
(In thousands)	2014	2013	2012	2011	2010
Residential real estate mortgages	$1,115,589	$1,041,637	$651,107	$581,511	$548,394
Commercial	839,770	859,026	694,799	611,298	577,731
Commercial real estate	1,442,989	1,328,313	1,072,807	888,879	844,458
Real estate construction and development	83,750	93,247	123,078	93,977	45,444
Agricultural and agricultural real estate	107,195	112,035	112,687	108,423	112,738
Consumer	1,436,382	1,352,638	1,047,856	946,470	905,563
Home equity	569,596	619,899	575,282	569,645	575,678
Total loans	$5,595,271	$5,406,795	$4,277,616	$3,800,203	$3,610,006

Residential real estate mortgages consist primarily of loans secured by first or second deeds of trust on primary residences. Loans in the commercial and agricultural categories, including commercial and agricultural real estate mortgages, consist primarily of short-term and/or floating rate loans made to small and medium-sized entities. Consumer loans consist primarily of indirect installment credit to individuals, of which approximately 75% is secured by automobiles and other personal property including marine, recreational vehicles and manufactured housing. Consumer loans also consist of direct installment loans to individuals secured by similar collateral. Indirect installment loans represent $1.3 billion of total consumer loans at December 31, 2014, or 92%. Installment credit for automobiles accounts for approximately 74% of total consumer loans. Although automobile loans have generally been originated through dealers, all applications submitted through dealers are subject to the Company’s normal underwriting and loan approval procedures. Real estate construction and development loans include commercial construction and development and residential construction loans. Commercial construction loans are for small and medium sized office buildings and other commercial properties and residential construction loans are primarily for projects located in upstate New York and northeastern Pennsylvania.

Risks associated with the commercial real estate portfolio include the ability of borrowers to pay interest and principal during the loan’s term, as well as the ability of the borrowers to refinance at the end of the loan term.

The following table, Maturities and Sensitivities of Certain Loans to Changes in Interest Rates, summarizes the maturities of the commercial and agricultural and real estate construction and development loan portfolios and the sensitivity of those loans to interest rate fluctuations at December 31, 2014. Scheduled repayments are reported in the maturity category in which the contractual payment is due.

Maturities and Sensitivities of Certain Loans to Changes in Interest Rates

	Remaining maturity at December 31, 2014			
(In thousands)	Within One Year	After One Year But Within Five Years	After Five Years	Total
Floating/adjustable rate				
Commercial, commercial real estate, agricultural, and agricultural real estate	$408,348	$338,854	$978,024	$1,725,226
Real estate construction and development	13,733	7,362	32,199	53,294
Total floating rate loans	422,081	346,216	1,010,223	1,778,520

Fixed rate				
Commercial, commercial real estate, agricultural, and agricultural real estate	54,237	351,691	258,800	664,728
Real estate construction and development	6,750	12,647	11,059	30,456
Total fixed rate loans	60,987	364,338	269,859	695,184
Total	$483,068	$710,554	$1,280,082	$2,473,704

Securities and Corresponding Interest and Dividend Income

The average balance of securities available for sale decreased $90.9 million, or 6.7%, from 2013 to 2014. The yield on average securities available for sale was 2.05% for 2014 compared to 2.03% in 2013.

The average balance of securities held to maturity increased from $88.2 million in 2013 to $233.5 million in 2014. At December 31, 2014, securities held to maturity were comprised primarily of tax-exempt municipal securities. The yield on securities held to maturity decreased from 4.19% in 2013 to 2.81% in 2014.

Table of Contents

During the third quarter of 2014, the Company transferred approximately $340 million in securities from the available for sale portfolio to the held to maturity portfolio to mitigate the impact of volatility of interest rate changes on tangible book value.

The average balance of FRB and FHLB stock increased to $39.3 million in 2014 from $38.0 million in 2013. The yield from investments in FRB and FHLB banks increased from 4.66% in 2013 to 5.10% in 2014.

Securities Portfolio

	As of December 31,					
	2014		2013		2012	
(In thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Securities available for sale						
U.S. Treasury	$23,041	$23,111	$43,279	$43,616	$63,668	$64,425
Federal agency	332,193	329,914	285,880	278,915	281,398	282,814
State & municipal	37,035	37,570	113,435	113,665	82,675	86,802
Mortgage-backed	356,557	364,727	359,590	364,164	237,461	250,281
Collateralized mortgage obligations	240,074	242,129	565,200	549,528	443,972	449,723
Other securities	12,818	15,720	12,367	14,993	11,210	13,954
Total securities available for sale	$1,001,718	$1,013,171	$1,379,751	$1,364,881	$1,120,384	$1,147,999
Securities held to maturity						
Mortgage-backed	$755	$868	$953	$1,081	$1,168	$1,352
Collateralized mortgage obligations	317,628	317,597	62,025	57,456	-	-
State & municipal	135,978	136,529	54,305	54,739	59,395	60,183
Total securities held to maturity	$454,361	$454,994	$117,283	$113,276	$60,563	$61,535

Our mortgage backed securities, U.S. agency notes, and CMOs are all “prime/conforming” and are guaranteed by Fannie Mae, Freddie Mac, the FHLB, the Federal Farm Credit Banks, or Ginnie Mae (“GNMA”). GNMA securities are considered equivalent to U.S. Treasury securities, as they are backed by the full faith and credit of the U.S. government. Currently, there are no securities backed by subprime mortgages in our investment portfolio.

The following tables set forth information with regard to contractual maturities of debt securities at December 31, 2014:

(In thousands)	Amortized cost	Estimated fair value	Weighted Average Yield	
Debt securities classified as available for sale				
Within one year	$28,193	$28,310	2.15	%
From one to five years	356,696	356,107	1.75	%
From five to ten years	160,816	163,924	2.78	%
After ten years	443,195	449,110	2.49	%
Total	$988,900	$997,451		
Debt securities classified as held to maturity				
Within one year	$22,999	$23,075	2.77	%
From one to five years	15,506	15,606	4.06	%
From five to ten years	87,326	87,640	3.29	%
After ten years	328,530	328,673	1.67	%

Total	$454,361	$454,994

Funding Sources and Corresponding Interest Expense

The Company utilizes traditional deposit products such as time, savings, NOW, money market, and demand deposits as its primary source for funding. Other sources, such as short-term FHLB advances, federal funds purchased, securities sold under agreements to repurchase, brokered time deposits, and long-term FHLB borrowings are utilized as necessary to support the Company's growth in assets and to achieve interest rate sensitivity objectives. The average balance of interest-bearing liabilities increased $211.5 million from 2013 primarily due to the acquisition of Alliance in March 2013 as well as organic deposit growth, and totaled $5.2 billion in 2014. The rate paid on interest-bearing liabilities decreased from 0.62% in 2013 to 0.45% in 2014. This decrease in rates, partially offset by an increase in average balances, caused a decrease in interest expense of $7.4 million, or 24.3%, from $30.6 million in 2013 to $23.2 million in 2014.

Table of Contents

Deposits

Average interest bearing deposits increased $219.4 million, or 5.2%, from 2013 to 2014, due primarily to the acquisition of Alliance in March 2013 as well as organic deposit growth. Average money market deposits increased $114.0 million or 8.5% during 2014 when compared to 2013. Average NOW accounts increased $67.1 million or 7.6% during 2014 as compared to 2013. The average balance of savings accounts increased $91.7 million or 9.9% during 2014 when compared to 2013. These increases were partially offset by a decrease in average time deposits, which decreased $53.5 million, or 5.0%, from 2013 to 2014. The average balance of demand deposits increased $186.0 million, or 12.5%, during 2014 when compared to 2013. This growth in demand deposits was driven principally by increases in accounts from retail, municipal, and commercial customers spurred by strategic expansion into new markets as well as the aforementioned acquisition of Alliance in March 2013.

The rate paid on average interest-bearing deposits decreased from 0.39% during 2013 to 0.31% in 2014. The decrease in the rate on interest-bearing deposits was driven primarily by pricing decreases from NOW accounts and time deposits, which are sensitive to interest rate changes. The pricing decreases for these products resulted from the FRB maintaining a historic low Fed Funds target rate as well as an overall decrease in all interest rates. The rate paid for NOW accounts decreased from 0.17% during 2013 to 0.05% during 2014. The rate paid for time deposits decreased from 1.13% during 2013 to 0.97% during 2014.

The following table presents the maturity distribution of time deposits of $100,000 or more at December 31:

Maturity Distribution of Time Deposits of $100,000 or More

	December 31,	
(In thousands)	2014	2013
Within three months	$57,811	$93,489
After three but within twelve months	86,553	172,613
After one but within three years	71,938	79,990
Over three years	53,543	29,316
Total	$269,845	$375,408

Borrowings

Average short-term borrowings increased to $382.5 million in 2014 from $280.8 million in 2013. The average rate paid on short-term borrowings increased from 0.18% in 2013 to 0.22% in 2014. Average long-term debt decreased from $338.7 million in 2013 to $224.6 million in 2014. This decrease was due to the long-term debt restructure completed in the third quarter of 2014 which resulted in the prepayment of $165.0 million of long-term debt.

The average balance of junior subordinated debt increased to $101.2 million in 2014 compared to $96.5 million in 2013 due to the acquisition of Alliance. The average rate paid for junior subordinated debt in 2014 was 2.14%, down slightly from 2.16% in 2013.

Short-term borrowings consist of Federal funds purchased and securities sold under repurchase agreements, which generally represent overnight borrowing transactions, and other short-term borrowings, primarily FHLB advances, with original maturities of one year or less. The Company has unused lines of credit and access to brokered deposits available for short-term financing of approximately $1.8 billion and $1.7 billion at December 31, 2014 and 2013, respectively. Securities collateralizing repurchase agreements are held in safekeeping by non-affiliated financial institutions and are under the Company’s control. Long-term debt, which is comprised primarily of FHLB advances, are collateralized by the FHLB stock owned by the Company, certain of its mortgage-backed securities and a blanket lien on its residential real estate mortgage loans.

Noninterest Income

Noninterest income is a significant source of revenue for the Company and an important factor in the Company's results of operations. The following table sets forth information by category of noninterest income for the years indicated:

	Years ended December 31,		
(In thousands)	2014	2013	2012
Insurance and other financial services revenue	$24,517	$24,447	$22,387
Service charges on deposit accounts	17,941	19,307	18,225
ATM and debit card fees	17,135	15,558	12,358
Retirement plan administration fees	12,129	11,497	10,097
Trust	18,950	16,682	9,172
Bank owned life insurance income	5,349	3,793	3,077
Net securities gains	92	1,426	599
Gain on the sale of Springstone investment	19,401	-	-
Other	10,513	10,505	11,412
Total noninterest income	$126,027	$103,215	$87,327

Table of Contents

Noninterest income for the year ended December 31, 2014 was $126.0 million, up $22.8 million, or 22.1%, from the year ended December 31, 2013. The increase from 2013 was primarily driven by the previously disclosed sale of our ownership interest in Springstone recorded in the second quarter of 2014. Excluding this non-core gain, noninterest income for the year ended December 31, 2014 was $106.6 million, up $3.4 million, or 3.3%, from 2013. This increase from 2013 was due primarily to increases in trust and ATM and debit card fees, due in large part to the full year impact from the acquisition of Alliance in 2014. In addition, bank owned life insurance income was up approximately $1.6 million over 2013 due to death benefits recorded in 2014. These increases were partially offset by a $1.4 million decrease in service charges on deposit accounts from 2013 and net securities gains totaling $1.4 million in 2013 as compared to only $0.1 million in 2014. The decrease in service charges on deposit accounts from the prior year was primarily the result of lower nonsufficient funds fees recorded during 2014 due to changes in customer behavior, improving macroeconomic conditions, and continued customer outreach and education.

Noninterest Expense

Noninterest expenses are also an important factor in the Company's results of operations. The following table sets forth the major components of noninterest expense for the years indicated:

	Years ended December 31,		
(In thousands)	2014	2013	2012
Salaries and employee benefits	$119,667	$113,580	$104,815
Occupancy	22,128	20,720	17,415
Data processing and communications	16,137	15,353	13,437
Professional fees and outside services	14,426	13,309	10,463
Equipment	12,658	11,493	9,627
Office supplies and postage	6,983	6,563	6,489
FDIC expenses	4,944	4,960	3,832
Advertising	2,831	3,204	2,889
Amortization of intangible assets	5,047	4,872	3,394
Loan collection and other real estate owned	3,248	2,619	2,560
Merger expenses	-	12,364	2,608
Prepayment penalties on long-term debt	17,902	-	-
Other	20,092	19,890	16,358
Total noninterest expense	$246,063	$228,927	$193,887

Noninterest expense for the year ended December 31, 2014 was $246.1 million, up $17.1 million from 2013. Excluding the non-core $17.9 million prepayment penalties in 2014 and the non-core merger related expenses totaling $12.4 million in 2013, noninterest expense for the year ended December 31, 2014 was $228.2 million, up $11.6 million, or 5.4% from 2013. This increase from 2013 was due primarily to the full twelve months of Alliance occupancy, salaries and employee benefits, data processing, professional fees, and equipment expenses. In addition, the increase in salaries and benefits in 2014 included incremental incentive compensation related to the Springstone transaction, partially offset by lower retirement plan expenses due mainly to plan asset performance and a previous plan amendment.

Table of Contents

Income Taxes

Income tax expense for the year ended December 31, 2014 was $37.2 million, up from $28.2 million for the same period in 2013. The effective tax rate was 33.2% for the year ended December 31, 2014, compared to 31.3% for the same period in 2013. The increase in the effective tax rate was due to a higher level of taxable income primarily due to the full year impact of Alliance in 2014, no merger costs in 2014, a lower level of tax exempt municipal interest income as a percentage of total income in 2014, and an increase in the value of bank owned life .

The income tax expense on the Company's income was different than the income tax expense at the Federal statutory rate of 35% due primarily to tax exempt income and, to a lesser extent, the effect of state income taxes and Federal low income housing tax credits.

We calculate our current and deferred tax provision based on estimates and assumptions that could differ from the actual results reflected in income tax returns filed during the subsequent year. Adjustments based on filed returns are recorded when identified, which is generally in the third quarter of the subsequent year for U.S. federal and state provisions.

The amount of income taxes the Company pays is subject at times to ongoing audits by federal and state tax authorities, which may result in proposed assessments. Future results may include favorable or unfavorable adjustments to the estimated tax liabilities in the period the assessments are proposed or resolved or when statutes of limitation on potential assessments expire. As a result, the Company's effective tax rate may fluctuate significantly on a quarterly or annual basis.

Risk Management – Credit Risk

Credit risk is managed through a network of loan officers, credit committees, loan policies, and oversight from the senior credit officers and Board of Directors. Management follows a policy of continually identifying, analyzing, and grading credit risk inherent in each loan portfolio. An ongoing independent review, subsequent to management's review, of individual credits in the commercial loan portfolio is performed by the independent loan review function. These components of the Company's underwriting and monitoring functions are critical to the timely identification, classification, and resolution of problem credits.

Nonperforming Assets

	As of December 31,									
(Dollars in thousands)	2014	%	2013	%	2012	%	2011	%	2010	%
Nonaccrual loans										
Commercial and agricultural loans and real estate	$18,226	45 %	$27,033	54 %	$20,923	53 %	$17,506	46 %	$24,402	57 %
Real estate mortgages	10,867	26 %	10,296	21 %	8,083	20 %	8,090	21 %	8,338	20 %
Consumer	8,086	20 %	7,213	14 %	8,440	21 %	8,724	23 %	8,765	21 %
Troubled debt restructured loans	3,895	9 %	5,423	11 %	2,230	6 %	3,970	10 %	962	2 %
Total nonaccrual loans	41,074	100%	49,965	100%	39,676	100%	38,290	100%	42,467	100%

Loans 90 days or more past due and still accruing										
Commercial and agricultural loans and real estate	84	2 %	105	3 %	148	6 %	50	2 %	94	4 %
Real estate mortgages	1,927	39 %	808	22 %	330	13 %	763	24 %	919	40 %
Consumer	2,930	59 %	2,824	75 %	1,970	81 %	2,377	74 %	1,312	56 %
Total loans 90 days or more past due and still accruing	4,941	100%	3,737	100%	2,448	100%	3,190	100%	2,325	100%
Total nonperforming loans	46,015		53,702		42,124		41,480		44,792	
Other real estate owned	3,964		2,904		2,276		2,160		901	
Total nonperforming assets	$49,979		$56,606		$44,400		$43,640		$45,693	
Total nonperforming loans to loans	0.82 %		0.99 %		0.98 %		1.09 %		1.24 %	
Total nonperforming assets to total assets	0.64 %		0.74 %		0.73 %		0.78 %		0.86 %	
Total allowance for loan losses to nonperforming loans	144.21%		129.29%		164.60%		171.97%		159.03%	

Total nonperforming assets were $50.0 million at December 31, 2014, compared to $56.6 million at December 31, 2013. Nonperforming loans at December 31, 2014 were $46.0 million or 0.82% of total loans compared with $53.7 million or 0.99% at December 31, 2013. Included in nonperforming loans are $10.2 million of nonaccrual loans in the acquired loan portfolio. Excluding nonaccrual acquired loans, originated nonaccruals to originated loans was 0.64% at December 31, 2014. The Company recorded a provision for loan losses of $19.5 million for the year ended December 31, 2014 compared with $22.4 million for the year ended December 31, 2013. Net charge-offs to average loans for the year ended December 31, 2014 were 0.41%, compared with 0.44% for the year ended December 31, 2013. The allowance for loan losses was 144.21% of nonperforming loans at December 31, 2014 as compared to 129.29% at December 31, 2013. Excluding acquired loans, the allowance for loan losses as a percentage of total originated loans was 1.36% at December 31, 2014 compared to 1.55% at December 31, 2013.

Impaired loans, which primarily consist of nonaccruing commercial, commercial real estate, agricultural, agricultural real estate loans and business banking loans, as well as certain consumer and residential real estate mortgage loans that have been modified in a troubled debt restructuring ("TDR"), decreased to $25.8 million at December 31, 2014 as compared to $31.4 million at December 31, 2013. At December 31, 2014, $5.8 million of the total impaired loans had a specific reserve allocation of $1.1 million compared to $5.0 million of impaired loans at December 31, 2013 which had a specific reserve allocation of $0.7 million.

The allowance for loan losses is maintained at a level estimated by management to provide adequately for risk of probable losses inherent in the current loan portfolio. The adequacy of the allowance for loan losses is continuously monitored. It is assessed for adequacy using a methodology designed to ensure the level of the allowance reasonably reflects the loan portfolio's risk profile. It is evaluated to ensure that it is sufficient to absorb all reasonably estimable credit losses inherent in the current loan portfolio.

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the inherent uncertainty in evaluating the levels of the allowance required to cover credit losses in the portfolio and the material effect that such judgments can have on the consolidated results of operations.

For purposes of evaluating the adequacy of the allowance, the Company considers a number of significant factors that affect the collectability of the portfolio. For individually analyzed loans, these include estimates of loss exposure, which reflect the facts and circumstances that affect the likelihood of repayment of such loans as of the evaluation date. For homogeneous pools of loans, estimates of the Company's exposure to credit loss reflect a current assessment of a number of factors, which could affect collectability. These factors include: past loss experience; size, trend, composition, and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experienced across one or more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions to the allowance for loan losses are made periodically by charges to the provision for loan losses. These charges are necessary to maintain the allowance at a level which management believes is reasonably reflective of overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions to the allowance may fluctuate from one reporting period to another. These fluctuations are reflective of changes in risk associated with portfolio content and/or changes in management's assessment of any or all of the determining factors discussed above.

Total net charge-offs for 2014 were $22.6 million, up slightly from $22.3 million in 2013. Net charge-offs to average loans was 0.41% for 2014 as compared with 0.44% for 2013. For the originated portfolio, net charge-offs to average loans for the year ended December 31, 2014 was 0.38%, compared to 0.51% for last year. Gross charge-offs were down slightly to $27.4 million for 2014 from $27.7 million for 2013. Recoveries decreased from $5.4 million for the year ended December 31, 2013 to $4.8 million for the year ended December 31, 2014.

Allowance for Loan Losses

(Dollars in thousands)	2014	2013	2012	2011	2010
Balance at January 1	$69,434	$69,334	$71,334	$71,234	$66,550
Loans charged-off					
Commercial and agricultural	9,414	10,459	8,750	8,969	12,969
Residential real estate mortgages	1,417	1,771	1,906	1,310	1,176
Consumer*	16,642	15,459	15,848	14,209	15,692
Total loans charged-off	27,473	27,689	26,504	24,488	29,837
Recoveries					
Commercial and agricultural	1,774	1,956	1,641	1,438	1,922
Residential real estate mortgages	285	272	38	7	43
Consumer*	2,800	3,137	2,556	2,406	2,747
Total recoveries	4,859	5,365	4,235	3,851	4,712
Net loans charged-off	22,614	22,324	22,269	20,637	25,125
Provision for loan losses	19,539	22,424	20,269	20,737	29,809
Balance at December 31	$66,359	$69,434	$69,334	$71,334	$71,234
Allowance for loan losses to loans outstanding at end of year	1.19 %	1.28 %	1.62 %	1.88 %	1.97 %
Net charge-offs to average loans outstanding	0.41 %	0.44 %	0.55 %	0.56 %	0.69 %

* Consumer charge-off and recoveries include consumer and home equity.

In addition to the nonperforming loans discussed above, the Company has also identified approximately $93.6 million in potential problem loans at December 31, 2014 as compared to $89.9 million at December 31, 2013. Potential problem loans are loans that are currently performing, with a possibility of loss if weaknesses are not corrected. Such loans may need to be disclosed as nonperforming at some time in the future. Potential problem loans are classified by the Company's loan rating system as "substandard." At December 31, 2014, there were 18 potential problem loans exceeding $1.0 million, totaling $40.8 million in aggregate, compared to 26 potential problem loans exceeding $1.0 million, totaling $47.5 million at December 31, 2013. Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on nonaccrual, become restructured, or require increased allowance coverage and provision for loan losses. To mitigate this risk, the Company maintains a diversified loan portfolio, has no significant concentration in any particular industry, and originates loans primarily within its footprint.

The following table sets forth the allocation of the allowance for loan losses by category, as well as the percentage of loans in each category to total loans, as prepared by the Company. This allocation is based on management's assessment of the risk characteristics of each of the component parts of the total loan portfolio as of a given point in time and is subject to changes as and when the risk factors of each such component part change. The allocation is not indicative of either the specific amounts of the loan categories in which future charge-offs may be taken, nor should it be taken as an indicator of future loss trends. The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

Allocation of the Allowance for Loan Losses

	December 31,									
	2014		2013		2012		2011		2010	
(Dollars in thousands)	Allowance	Category Percent of	Allowance	Category Percent of	Allowance	Category Percent of	Allowance	Category Percent of	Allowance	Category Percent of

		Loans			Loans			Loans			Loans			of Loans	
Commercial and agricultural	$32,433	44	%	$35,090	44	%	$35,624	47	%	$38,831	45	%	$40,101	44	%
Real estate mortgages	7,130	20	%	6,520	19	%	6,252	15	%	6,249	15	%	4,627	15	%
Consumer	26,720	36	%	27,694	37	%	27,162	38	%	26,049	40	%	26,126	41	%
Unallocated	76	0	%	130	0	%	296	0	%	205	0	%	380	0	%
Total	$66,359	100	%	$69,434	100	%	$69,334	100	%	$71,334	100	%	$71,234	100	%

The Company's accounting policy relating to the allowance for loan losses requires a review of each significant loan type within the loan portfolio, considering asset quality trends for each type, including, but not limited to, delinquencies, nonaccruals, historical charge-off experience, and specific economic factors (e.g. milk prices are considered when reviewing agricultural loans). Based on this review, management believes the reserve allocations are adequate to address any trends in asset quality indicators. As a result of the general improvement and stabilization of asset quality indicators in 2014, as well as the aforementioned review of the loan portfolio, the allowance for loan losses as a percentage of originated loans decreased from 1.55% as of December 31, 2013 to 1.36% as of December 31, 2014. Acquired loans were recorded at fair value on the date of acquisition, with no carryover of the related allowance for loan losses. Generally, the fair value discount represents expected credit losses, net of market interest rate adjustments. The discount on loans receivable will be amortized to interest income over the estimated remaining life of the acquired loans using the level yield method.

At December 31, 2014, approximately 59% of the Company's loans were secured by real estate located in central and northern New York, northeastern Pennsylvania, western Massachusetts, southern New Hampshire, and Vermont. Accordingly, the ultimate collectability of a substantial portion of the Company's portfolio is susceptible to changes in market conditions of those areas. Management is not aware of any material concentrations of credit to any industry or individual borrowers.

Subprime mortgage lending, which has been the riskiest sector of the residential housing market, is not a market that the Company has ever actively pursued. The market does not apply a uniform definition of what constitutes "subprime" lending. Our reference to subprime lending relies upon the "Statement on Subprime Mortgage Lending" issued by the OTS and the other federal bank regulatory agencies (the "Agencies"), on June 29, 2007, which further referenced the "Expanded Guidance for Subprime Lending Programs," or the Expanded Guidance, issued by the Agencies by press release dated January 31, 2001. In the Expanded Guidance, the Agencies indicated that subprime lending does not refer to individual subprime loans originated and managed, in the ordinary course of business, as exceptions to prime risk selection standards. The Agencies recognize that many prime loan portfolios will contain such accounts. The Agencies also excluded prime loans that develop credit problems after acquisition and community development loans from the subprime arena. According to the Expanded Guidance, subprime loans are other loans to borrowers which display one or more characteristics of reduced payment capacity. Five specific criteria, which are not intended to be exhaustive and are not meant to define specific parameters for all subprime borrowers and may not match all markets or institutions' specific subprime definitions, are set forth, including having a FICO score of 660 or below. Based upon the definition and exclusions described above, the Company is a prime lender. Within the loan portfolio, there are loans that, at the time of origination, had FICO scores of 660 or below. However, since the Company is a portfolio lender, it reviews all data contained in borrower credit reports and does not base underwriting decisions solely on FICO scores. We believe the aforementioned loans, when made, were amply collateralized and otherwise conformed to our prime lending standards.

For acquired loans that are not deemed to be impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value and amortized over the life of the asset.

As a result of the application of this accounting methodology, certain credit-related ratios may not necessarily be directly comparable with periods prior to acquisitions, or comparable with other institutions. The credit metrics most impacted by our acquisition of loans related to the Alliance merger were the allowance for loans losses to total loans, and total allowance for loan losses to nonperforming loans. As of December 31, 2014, the allowance for loan losses to total originated loans and the total allowance for loan losses to originated nonperforming loans were 1.36% and 187.88%, respectively.

Loans acquired from Alliance that were not deemed to be impaired at acquisition and were classified as non-accrual and greater than 90 days past due and still accruing prior to acquisition, continued to be classified as non-accrual and

90 days past due and still accruing immediately after the acquisition. Loans acquired from Alliance that were classified as troubled debt restructurings prior to acquisition are no longer classified as such immediately following the acquisition. Acquired credit impaired loans from the Alliance acquisition were not classified non-accrual, even though they may be contractually past due, because we expect to fully collect the recorded investment of such loans

Table of Contents
Liquidity Risk

Liquidity involves the ability to meet the cash flow requirements of customers who may be depositors wanting to withdraw funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. The Asset Liability Committee (ALCO) is responsible for liquidity management and has developed guidelines which cover all assets and liabilities, as well as off balance sheet items that are potential sources or uses of liquidity. Liquidity policies must also provide the flexibility to implement appropriate strategies. Requirements change as loans grow, deposits and securities mature, and payments on borrowings are made. Liquidity management includes a focus on interest rate sensitivity management with a goal of avoiding widely fluctuating net interest margins through periods of changing economic conditions.

The primary liquidity measurement the Company utilizes is called “Basic Surplus,” which captures the adequacy of its access to reliable sources of cash relative to the stability of its funding mix of average liabilities. This approach recognizes the importance of balancing levels of cash flow liquidity from short and long-term securities with the availability of dependable borrowing sources which can be accessed when necessary. At December 31, 2014, the Company’s Basic Surplus measurement was 15.4% of total assets, or $1.2 billion, which was above the Company’s minimum of 5% (calculated at $390 million of period end total assets at December 31, 2014) set forth in its liquidity policies.

This Basic Surplus approach enables the Company to adequately manage liquidity from both operational and contingency perspectives. By tempering the need for cash flow liquidity with reliable borrowing facilities, the Company is able to operate with a more fully invested and, therefore, higher interest income generating securities portfolio. The makeup and term structure of the securities portfolio is, in part, impacted by the overall interest rate sensitivity of the balance sheet. Investment decisions and deposit pricing strategies are impacted by the liquidity position. At December 31, 2014, the Company considered its Basic Surplus position to be strong. However, certain events may adversely impact the Company’s liquidity position in 2015. Improvement in the economy may increase demand for equity related products or increase competitive pressure on deposit pricing, which, in turn, could result in a decrease in the Company’s deposit base or increase funding costs. Additionally, liquidity will come under additional pressure if loan growth exceeds deposit growth in 2015. These scenarios could lead to a decrease in the Company’s Basic Surplus measure below the minimum policy level of 5%. To manage this risk, the Company has the ability to purchase brokered time deposits, borrow against established borrowing facilities with other banks (Federal funds), and enter into repurchase agreements with investment companies. The additional liquidity that could be provided by these measures was $1.5 billion at December 31, 2014. In addition, the Bank has enhanced its “Borrower-in-Custody” program with the FRB with the addition of the ability to pledge automobile loans. At December 31, 2014, the Bank had the capacity to borrow $763 million from this program.

At December 31, 2014 and 2013, FHLB advances outstanding totaled $352 million and $638 million, respectively. The Bank is a member of the FHLB system and had additional borrowing capacity from the FHLB of approximately $958 million at December 31, 2014 and $497 million at December 31, 2013. In addition, unpledged securities could have been used to increase borrowing capacity at the FHLB by an additional $502 million at December 31, 2014 or used to collateralize other borrowings, such as repurchase agreements.

At December 31, 2014, a portion of the Company’s loans and securities were pledged as collateral on borrowings. Therefore, future growth of earning assets will depend upon the Company’s ability to obtain additional funding, through growth of core deposits and collateral management, and may require further use of brokered time deposits, or other higher cost borrowing arrangements.

Net cash flows provided by operating activities totaled $87.8 million in 2014 and $119.3 million in 2013. The critical elements of net operating cash flows include net income, adjusted for non-cash income and expense items such as the provision for loan losses, deferred income tax expense, depreciation and amortization, and cash flows generated through changes in other assets and liabilities.

Net cash flows used by investing activities totaled $143.7 million and $183.8 million in 2014 and 2013, respectively. Critical elements of investing activities are loan and investment securities transactions.

Net cash flows provided by financing activities totaled $43.6 million in 2014 as compared to $59.7 million in 2013. The critical elements of financing activities are proceeds from deposits, borrowings, and stock issuances. In addition, financing activities are impacted by dividends and treasury stock transactions.

Table of Contents

In connection with its financing and operating activities, the Company has entered into certain contractual obligations. The Company's future minimum cash payments, excluding interest, associated with its contractual obligations pursuant to its borrowing agreements, operating leases, and other obligations at December 31, 2014 are as follows:

Contractual Obligations
(In thousands)

	Payments Due by Period						
	2015	2016	2017	2018	2019	Thereafter	Total
Long-term debt obligations	$217	$50,626	$40,000	$40,000	$-	$102	$130,945
Junior subordinated debt	-	-	-	-	-	101,196	101,196
Operating lease obligations	7,369	7,215	6,811	6,122	5,655	26,257	59,429
Retirement plan obligations	6,549	6,770	10,044	7,692	7,531	43,232	81,818
Capital lease obligations	198	143	68	41	29	-	479
Data processing commitments	11,558	10,446	9,382	6,946	6,107	6,107	50,546
Total contractual obligations	$25,891	$75,200	$66,305	$60,801	$19,322	$176,894	$424,413

Commitments to Extend Credit

The Company makes contractual commitments to extend credit, which include unused lines of credit, which are subject to the Company's credit approval and monitoring procedures. At December 31, 2014 and 2013, commitments to extend credit in the form of loans, including unused lines of credit, amounted to $1.2 billion and $1.1 billion, respectively. In the opinion of management, there are no material commitments to extend credit, including unused lines of credit that represent unusual risks. All commitments to extend credit in the form of loans, including unused lines of credit, expire within one year.

Standby Letters of Credit

The Company does not issue any guarantees that would require liability-recognition or disclosure, other than its standby letters of credit. The Company guarantees the obligations or performance of customers by issuing stand-by letters of credit to third parties. These standby letters of credit are frequently issued in support of third party debt, such as corporate debt issuances, industrial revenue bonds, and municipal securities. The risk involved in issuing standby letters of credit is essentially the same as the credit risk involved in extending loan facilities to customers, and they are subject to the same credit origination, portfolio maintenance and management procedures in effect to monitor other credit and off-balance sheet products. Typically, these instruments have terms of five years or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. At December 31, 2014 and 2013, outstanding standby letters of credit were approximately $35.2 million and $36.8 million, respectively. The fair value of the Company's standby letters of credit at December 31, 2014 and 2013 was not significant. The following table sets forth the commitment expiration period for standby letters of credit at December 31, 2014:

Commitment Expiration of Standby Letters of Credit	
Within one year	$31,061
After one but within three years	3,822
After three but within five years	361
After five years	-
Total	$35,244

Table of Contents
Interest Rate Swaps

The Bank offers interest rate swap agreements to its customers. These agreements allow the Bank's customers to effectively fix the interest rate on a variable rate loan by entering into a separate agreement. Simultaneous with the execution of such an agreement with a customer, the Bank enters into a matching interest rate swap agreement with an unrelated third party provider, which allows the Bank to continue to receive the historical variable rate under the loan agreement with the customer. The agreement with the third party is not a hedge contract therefore changes in fair value are recorded through earnings. Assets and liabilities associated with the agreements are recorded in other assets and other liabilities on the balance sheet. Gains and losses are recorded as other noninterest income. The Bank is not subject to any fee or penalty should the customer elect to terminate the interest rate swap agreement prior to maturity. The Bank is exposed to credit loss equal to the fair value of the derivatives (not the notional amount of the derivatives) in the event of nonperformance by the counterparty to the interest rate swap agreements. Additionally, the Bank receives a fee from the customer that is recognized when the Bank has fulfilled its obligations under each agreement, which is generally upon execution of the agreement with the Bank's customer. Since the terms of the two interest rate swap agreements are identical, the income statement impact to the Bank is limited to the fees it receives from the customer. The Bank recognized approximately $0.9 million in swap fee income in 2014. At December 31, 2014, the Bank maintained a $5.8 million deposit with the counterparty to collateralize the swap agreements.

Loans Serviced for Others and Loans Sold with Recourse

The total amount of loans serviced by the Company for unrelated third parties was approximately $626.0 million and $685.6 million at December 31, 2014 and 2013, respectively. At December 31, 2014 and 2013, the Company had approximately $1.5 million and $2.2 million, respectively, of mortgage servicing rights. At December 31, 2014 and 2013, the Company serviced $23.4 million and $15.7 million, respectively, of agricultural loans sold with recourse. Due to sufficient collateral on these loans, no reserve is considered necessary at December 31, 2014 and 2013.

Capital Resources

Consistent with its goal to operate a sound and profitable financial institution, the Company actively seeks to maintain a "well-capitalized" institution in accordance with regulatory standards. The principal source of capital to the Company is earnings retention. The Company's capital measurements are in excess of both regulatory minimum guidelines and meet the requirements to be considered well-capitalized.

The Company's principal source of funds to pay interest on trust preferred debentures and pay cash dividends to its shareholders are dividends from its subsidiaries. Various laws and regulations restrict the ability of banks to pay dividends to their shareholders. Generally, the payment of dividends by the Company in the future as well as the payment of interest on the capital securities will require the generation of sufficient future earnings by its subsidiaries.

Table of Contents

The Bank also is subject to substantial regulatory restrictions on its ability to pay dividends to the Company. Under OCC regulations, the Bank may not pay a dividend, without prior OCC approval, if the total amount of all dividends declared during the calendar year, including the proposed dividend, exceeds the sum of its retained net income to date during the calendar year and its retained net income over the preceding two years. At December 31, 2014, approximately $88.7 million of the total stockholders' equity of the Bank was available for payment of dividends to the Company without approval by the OCC. The Bank's ability to pay dividends also is subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements.

Stock Repurchase Plan

The Company purchased 3,288 shares of its common stock during the year ended December 31, 2014 at an average price of $22.02 per share under a previously announced plan which expired on December 31, 2014. As of December 31, 2014, there were 1,000,000 shares available for repurchase under a plan authorized on October 27, 2014, which expires on December 31, 2016.

2013 OPERATING RESULTS AS COMPARED TO 2012 OPERATING RESULTS

Net Interest Income

While the rate paid on interest bearing liabilities decreased 24 basis points, the yield on interest earning assets declined 39 basis points compared to the same period for 2012, resulting in margin compression for the year ended December 31, 2013. The yield on securities available for sale was 2.03% for the year ended December 31, 2013, compared with 2.45% for the year ended December 31, 2012. This decrease was due primarily to the reinvestment of cash flows from maturing securities and cash received from branch acquisitions in 2012 into lower yielding securities in the current rate environment. The average balance of securities available for sale for the year ended December 31, 2013 was $1.3 billion, up approximately $171.9 million, or 14.6%, from the year ended December 31, 2012. This increase was due primarily to investment of liquidity from acquisition activity and deposit growth. The yield on loans was 4.69% for the year ended December 31, 2013, compared with 5.17% for the year ended December 31, 2012. The average balance of loans for the year ended December 31, 2013 was $5.1 billion, up approximately $1.1 billion (including approximately $904 million of acquired loans from the Alliance acquisition), or 26.0%, from the year ended December 31, 2012. The reduction in yields on earning assets was partially offset by a reduction in rates paid on interest bearing liabilities. The rate on time deposits was 1.13% for the year ended December 31, 2013, compared with 1.45% for the year ended December 31, 2012. The rate on NOW accounts was 0.17% for the year ended December 31, 2013, compared with 0.26% for the year ended December 31, 2012. The following table presents changes in interest income, on a FTE basis, and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

Loans and Corresponding Interest and Fees on Loans

The average balance of loans increased by approximately $1.1 billion, or 26.0%, from 2012 to 2013. The yield on average loans decreased from 5.17% in 2012 to 4.69% in 2013, as loan rates declined due to the continued low rate environment in 2013. Interest income from loans on a FTE basis increased 14.4%, from $209.4 million in 2012 to $239.6 million in 2013. This increase was due to the increase in average loan balances noted above, and was partially offset by the decrease in yields.
Total loans increased $1.1 billion, or 26.4% (5.3% organic growth) from December 31, 2012 to December 31, 2013. In March 2013, the Company acquired Alliance, including approximately $904 million in loans, which contributed to this loan growth. Commercial loans increased $164.2 million, or 23.6%, from $694.8 million at December 31, 2012

to $859.0 million at December 31, 2013, due to strong originations in 2013, particularly in our upstate New York markets and Vermont, as well as from the aforementioned acquisition. Commercial real estate loans increased $255.5 million, or 23.8%, from $1.1 billion at December 31, 2012 to $1.3 billion at December 31, 2013, in large part due to the acquisition of Alliance as well as strong originations in our upstate New York markets and from new markets, particularly Vermont. The Company acquired approximately $117.8 million in commercial real estate loans from the aforementioned acquisition. Residential real estate loans increased $390.5 million (including approximately $333.1 million from the aforementioned acquisition), from $651.1 million at December 31, 2012 to $1.0 billion at December 31, 2013. The Company sold more fixed rate mortgages during 2012 than 2013 as market conditions in 2013 were not as favorable for such sales. Consumer loans increased $304.8 million from $1.0 billion at December 31, 2012 to $1.4 billion at December 31, 2013 in large part due to the aforementioned acquisition, as well as strong originations in our upstate New York markets and from new markets. Home equity loans increased modestly in 2013.

Securities and Corresponding Interest and Dividend Income

The average balance of securities available for sale increased $171.9 million, or 14.6%, from 2012 to 2013. The yield on average securities available for sale was 2.03% for 2013 compared to 2.45% in 2012.

The average balance of securities held to maturity increased from $65.6 million in 2012 to $88.2 million in 2013. At December 31, 2013, securities held to maturity were comprised primarily of tax-exempt municipal securities. The yield on securities held to maturity decreased from 5.46% in 2012 to 4.19% in 2013.

The average balance of FRB and FHLB stock increased to $38.0 million in 2013 from $28.4 million in 2012. The yield from investments in FRB and FHLB banks decreased from 4.86% in 2012 to 4.66% in 2013.

Table of Contents

Deposits

Average interest bearing deposits increased $725.2 million, or 20.7%, from 2012 to 2013, due primarily to the acquisition of Alliance in March 2013. Average time deposits increased $76.1 million, or 7.7%, during 2013 as compared to 2012. Average money market deposits increased $227.2 million or 20.3% during 2013 when compared to 2012. Average NOW accounts increased $172.7 million or 24.3% during 2013 as compared to 2012. The average balance of savings accounts increased $249.1 million or 36.6% during 2013 when compared to 2012. The average balance of demand deposits increased $344.3 million, or 30.2%, during 2013 when compared to 2012. This growth in demand deposits was driven principally by increases in accounts from retail, municipal, and commercial customers spurred by strategic expansion into new markets.

The rate paid on average interest-bearing deposits decreased from 0.54% during 2012 to 0.39% in 2013. The decrease in the rate on interest-bearing deposits was driven primarily by pricing decreases from money market accounts, NOW accounts and time deposits, which are sensitive to interest rate changes. The pricing decreases for these products resulted from the FRB maintaining a historic low Fed Funds target rate as well as an overall decrease in all interest rates. The rate paid for money market deposit accounts decreased from 0.18% during 2012 to 0.15% during 2013. The rate paid for NOW accounts decreased from 0.26% during 2012 to 0.17% during 2013. The rate paid for time deposits decreased from 1.45% during 2012 to 1.13% during 2013.

Borrowings

Average short-term borrowings increased to $280.8 million in 2013 from $165.7 million in 2012. The average rate paid on short-term borrowings increased from 0.11% in 2012 to 0.18% in 2013. Average long-term debt decreased from $368.3 million in 2012 to $338.7 million in 2013.

The average balance of trust preferred debentures increased to $96.5 million in 2013 compared to $75.4 million in 2012 due to the acquisition of Alliance. The average rate paid for trust preferred debentures in 2013 was 2.16%, down slightly from 2.29% in 2012.

Short-term borrowings consist of Federal funds purchased and securities sold under repurchase agreements, which generally represent overnight borrowing transactions, and other short-term borrowings, primarily FHLB advances, with original maturities of one year or less. The Company has unused lines of credit and access to brokered deposits available for short-term financing of approximately $1.6 billion and $1.3 billion at December 31, 2013 and 2012, respectively. Securities collateralizing repurchase agreements are held in safekeeping by non-affiliated financial institutions and are under the Company’s control. Long-term debt, which is comprised primarily of FHLB advances, are collateralized by the FHLB stock owned by the Company, certain of its mortgage-backed securities and a blanket lien on its residential real estate mortgage loans.

Noninterest Income

Noninterest income for the year ended December 31, 2013 was $103.2 million, up 18.2% from 2012, with the primary drivers being increases in trust revenue and ATM and debit card fees driven primarily by the acquisition of Alliance. In addition, NBT experienced a 9.2% increase in insurance and financial services revenue for the year ended December 31, 2013 as compared to 2012, due primarily to a $1.0 million, or 6.0%, increase in insurance revenue as well as a $1.0 million, or 19.5%, increase in financial services revenue. Retirement plan administration fees were also up $1.4 million, or 13.9% for the year ended December 31, 2013 as compared to 2012 due to growth in new business during 2013.

Noninterest Expense

Noninterest expense for the year ended December 31, 2013 was $228.9 million, up $35.0 million or 18.1%, from 2012. Excluding merger expenses totaling $12.4 million and $2.6 million for the years ended December 31, 2013 and 2012, respectively, noninterest expense was up $25.3 million, or 13.2%, for 2013 as compared to 2012. Several noninterest expense categories were affected by the acquisition of Alliance in March 2013 and the full year impact of the June 2012 acquisition of Hampshire First Bank, with salaries and employee benefits and occupancy expenses being the primary drivers of the increase.

Recent Accounting Updates

In June 2014, the Financial Accounting Standards Board (“FASB”) and the International Accounting Standards Board ("IASB") issued their converged standard on revenue recognition. Accounting Standards Update ("ASU") 2014-09, Revenue from Contracts with Customers, and IFRS 15 with the same title create a new, principle-based revenue recognition framework that will affect nearly every revenue-generating entity. ASU 2014-09 creates a new topic in the FASB Accounting Standards Codification® (ASC or Codification), Topic 606. In addition to superseding and replacing nearly all existing U.S. GAAP revenue recognition guidance, including industry-specific guidance, ASC 606 also

· Establishes a new control-based revenue recognition model
· Changes the basis for deciding when revenue is recognized over time or at a point in time
· Provides new and more detailed guidance on specific topics
· Expands and improves disclosures about revenue

Table of Contents

In addition, ASU 2014-09 adds a new Subtopic to the Codification, ASC 340-40, Other Assets and Deferred Costs: Contracts with Customers, to provide guidance on costs related to obtaining a contract with a customer and costs incurred in fulfilling a contract with a customer that are not in the scope of another ASC Topic. The guidance in ASU 2014-09 is effective for public entities for annual reporting periods beginning after December 15, 2016, including interim periods therein. Nonpublic entities are required to apply the guidance for annual periods beginning after December 15, 2017 and for interim and annual reporting periods thereafter. Early application is not permitted for public entities. A nonpublic entity may apply the guidance as early as annual reporting periods, and interim periods within those years, beginning after December 15, 2016 . The Company does not expect the adoption of this ASU to have a material impact on the financial statements.

In June 2014, the FASB issued ASU No. 2014-11 - Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures (Topic 860). The amendments in this Update require two accounting changes. First, the amendments in this Update change the accounting for repurchase-to-maturity transactions to secured borrowing accounting. Second, for repurchase financing arrangements, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty, which will result in secured borrowing accounting for the repurchase agreement. The amendments in this Update require disclosures for certain transactions comprising (1) a transfer of a financial asset accounted for as a sale and (2) an agreement with the same transferee entered into in contemplation of the initial transfer that results in the transferor retaining substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. For those transactions outstanding at the reporting date, the transferor is required to disclose the following by type of transaction (for example, repurchase agreements, securities lending arrangements, and a sale with a total return swap):

1. The carrying amount of assets derecognized as of the date of derecognition
2. The amount of gross proceeds received by the transferor at the time of derecognition for the assets derecognized
3. The information about the transferor’s ongoing exposure to the economic return on the transferred financial assets
4. The amounts that are reported in the statement of financial position arising from the transaction, such as those represented by derivative contracts.

The amendments in this Update also require the following disclosures for repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions that are accounted for as secured borrowings:

1. A disaggregation of the gross obligation by the class of collateral pledged
2. The remaining contractual tenor of the agreements
3. A discussion of the potential risks associated with the agreements and the related collateral pledged, including obligations arising from a decline in the fair value of the collateral pledged and how those risks are managed.

For public business entities, many of the standard’s provisions are effective for the first interim or annual period beginning after December 15, 2014. For all other entities, all of the provisions are effective for annual periods beginning after December 15, 2014, and interim periods beginning after December 15, 2015. Early application for public companies is prohibited, but all other entities may apply the standard to interim periods beginning after December 15, 2014. The Company does not expect the adoption of this ASU to have a material impact on the financial statements.

In June 2014, the FASB issued ASU No. 2014-12 - Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (Topic 718). The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. As indicated in the definition of vest, the stated vesting period (which includes the period in which the performance target could be achieved) may differ from the requisite service period. For all entities, the amendments in this Update are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company does not expect the adoption of this ASU to have a material impact on the financial statements.

Table of Contents

ITEM 7A. Quantitative and Qualitative Disclosure About Market Risk

Interest rate risk is the most significant market risk affecting the Company. Other types of market risk, such as foreign currency exchange rate risk and commodity price risk, do not arise in the normal course of the Company's business activities or are immaterial to the results of operations.

Interest rate risk is defined as an exposure to a movement in interest rates that could have an adverse effect on the Company's net interest income. Net interest income is susceptible to interest rate risk to the degree that interest-bearing liabilities mature or reprice on a different basis than earning assets. When interest-bearing liabilities mature or reprice more quickly than earning assets in a given period, a significant increase in market rates of interest could adversely affect net interest income. Similarly, when earning assets mature or reprice more quickly than interest-bearing liabilities, falling interest rates could result in a decrease in net interest income.

In an attempt to manage the Company's exposure to changes in interest rates, management monitors the Company's interest rate risk. Management's asset/liability committee (ALCO) meets monthly to review the Company's interest rate risk position and profitability, and to recommend strategies for consideration by the Board of Directors. Management also reviews loan and deposit pricing, and the Company's securities portfolio, formulates investment and funding strategies, and oversees the timing and implementation of transactions to assure attainment of the Board's objectives in the most effective manner. Notwithstanding the Company's interest rate risk management activities, the potential for changing interest rates is an uncertainty that can have an adverse effect on net income.

In adjusting the Company's asset/liability position, the Board and management attempt to manage the Company's interest rate risk while minimizing the net interest margin compression. At times, depending on the level of general interest rates, the relationship between long and short-term interest rates, market conditions and competitive factors, the Board and management may determine to increase the Company's interest rate risk position somewhat in order to increase its net interest margin. The Company's results of operations and net portfolio values remain vulnerable to changes in interest rates and fluctuations in the difference between long and short-term interest rates.

The primary tool utilized by ALCO to manage interest rate risk is a balance sheet/income statement simulation model (interest rate sensitivity analysis). Information such as principal balance, interest rate, maturity date, cash flows, next repricing date (if needed), and current rates is uploaded into the model to create an ending balance sheet. In addition, ALCO makes certain assumptions regarding prepayment speeds for loans and mortgage related investment securities along with any optionality within the deposits and borrowings. The model is first run under an assumption of a flat rate scenario (i.e. no change in current interest rates) with a static balance sheet over a 12-month period. Two additional models are run in which a gradual increase of 200 bps and a gradual decrease of 100 bps takes place over a 12 month period with a static balance sheet. Under these scenarios, assets subject to prepayments are adjusted to account for faster or slower prepayment assumptions. Any investment securities or borrowings that have callable options embedded into them are handled accordingly based on the interest rate scenario. The resultant changes in net interest income are then measured against the flat rate scenario.

In the declining rate scenario, net interest income is projected to decrease slightly when compared to the forecasted net interest income in the flat rate scenario through the simulation period. The decrease in net interest income is a result of earning assets repricing downward, given potential higher prepayments and lower reinvestment rates, slightly faster than the interest bearing liabilities that are at or near their floors. In the rising rate scenarios, net interest income is projected to experience a decline from the flat rate scenario; however, the potential impact on earnings is dependent on the ability to lag deposit repricing on NOW, savings, MMDA, and CD accounts. Net interest income for the next twelve months in the +200/-100 bp scenarios, as described above, is within the internal policy risk limits of not more than a 7.5% change in net interest income. The following table summarizes the percentage change in net interest income in the rising and declining rate scenarios over a 12-month period from the forecasted net interest income in the flat rate scenario using the December 31, 2014 balance sheet position:

Interest Rate Sensitivity Analysis

Change in interest rates (In basis points)	Percent change in net interest income
+200	(2.43%)
-100	(1.63%)

The Company anticipates that under the current low rate environment, on a monthly basis, interest income is expected to decrease at a faster rate than interest expense given the potential higher prepayments and reinvestment into lower rates as deposit rates are at or near their respective floors. In order to protect net interest income from anticipated net interest margin compression in 2015, the Company will continue to focus on increasing earning assets through loan growth, asset mix of loans and investments, and leverage opportunities.

Table of Contents

ITEM 8. Financial Statements and Supplementary Data

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
NBT Bancorp Inc.:

We have audited the accompanying consolidated balance sheets of NBT Bancorp Inc. and subsidiaries (the Company) as of December 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2014. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of NBT Bancorp Inc. and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control — Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 2, 2015 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/S/ KPMG LLP
Albany, New York
March 2, 2015

Table of Contents

Consolidated Balance Sheets

(In thousands, except share and per share data)	As of December 31, 2014	2013
Assets		
Cash and due from banks	$139,635	$157,625
Short-term interest bearing accounts	7,001	1,301
Securities available for sale, at fair value	1,013,171	1,364,881
Securities held to maturity (fair value $454,994 and $113,276)	454,361	117,283
Trading securities	7,793	5,779
Federal Reserve and Federal Home Loan Bank stock	32,626	46,864
Loans	5,595,271	5,406,795
Less allowance for loan losses	66,359	69,434
Net loans	5,528,912	5,337,361
Premises and equipment, net	89,258	88,327
Goodwill	263,634	264,997
Intangible assets, net	20,317	25,557
Bank owned life insurance	114,251	114,966
Other assets	126,967	127,234
Total assets	$7,797,926	$7,652,175
Liabilities		
Demand (noninterest bearing)	$1,838,622	$1,645,641
Savings, NOW, and money market	3,417,160	3,223,441
Time	1,043,823	1,021,142
Total deposits	6,299,605	5,890,224
Short-term borrowings	316,802	456,042
Long-term debt	130,945	308,823
Junior subordinated debt	101,196	101,196
Other liabilities	85,197	79,321
Total liabilities	6,933,745	6,835,606
Stockholders’ equity		
Preferred stock, $0.01 par value; authorized 2,500,000 shares at December 31, 2014 and 2013	-	-
Common stock, $0.01 par value; authorized 100,000,000 shares at December 31, 2014 and December 31, 2013; issued 49,651,494 at December 31, 2014 and 49,651,494 at December 31, 2013	497	497
Additional paid-in-capital	576,504	574,152
Retained earnings	423,956	385,787
Accumulated other comprehensive loss	(17,027)	(16,765)
Common stock in treasury, at cost, 5,755,040 and 6,138,444 shares at December 31, 2014 and 2013, respectively	(119,749)	(127,102)
Total stockholders’ equity	864,181	816,569
Total liabilities and stockholders’ equity	$7,797,926	$7,652,175

See accompanying notes to consolidated financial statements.

Table of Contents

Consolidated Statements of Income

	Years ended December 31,		
(In thousands, except per share data)	2014	2013	2012
Interest, fee, and dividend income			
Interest and fees on loans	$243,324	$238,672	$208,458
Securities available for sale	24,464	25,510	27,005
Securities held to maturity	5,261	2,660	2,378
Other	2,032	1,881	1,556
Total interest, fee, and dividend income	275,081	268,723	239,397
Interest expense			
Deposits	13,638	16,290	18,848
Short-term borrowings	845	515	188
Long-term debt	6,555	11,755	14,428
Junior subordinated debt	2,165	2,084	1,730
Total interest expense	23,203	30,644	35,194
Net interest income	251,878	238,079	204,203
Provision for loan losses	19,539	22,424	20,269
Net interest income after provision for loan losses	232,339	215,655	183,934
Noninterest income			
Insurance and other financial services revenue	24,517	24,447	22,387
Service charges on deposit accounts	17,941	19,307	18,225
ATM and debit card fees	17,135	15,558	12,358
Retirement plan administration fees	12,129	11,497	10,097
Trust	18,950	16,682	9,172
Bank owned life insurance income	5,349	3,793	3,077
Net securities gains	92	1,426	599
Gain on the sale of Springtone investment	19,401	-	-
Other	10,513	10,505	11,412
Total noninterest income	126,027	103,215	87,327
Noninterest expense			
Salaries and employee benefits	119,667	113,580	104,815
Occupancy	22,128	20,720	17,415
Data processing and communications	16,137	15,353	13,437
Professional fees and outside services	14,426	13,309	10,463
Equipment	12,658	11,493	9,627
Office supplies and postage	6,983	6,563	6,489
FDIC expenses	4,944	4,960	3,832
Advertising	2,831	3,204	2,889
Amortization of intangible assets	5,047	4,872	3,394
Loan collection and other real estate owned	3,248	2,619	2,560
Merger expenses	-	12,364	2,608
Prepayment penalties on long term debt	17,902	-	-
Other	20,092	19,890	16,358
Total noninterest expense	246,063	228,927	193,887
Income before income tax expense	112,303	89,943	77,374
Income tax expense	37,229	28,196	22,816
Net income	$75,074	$61,747	$54,558
Earnings per share			
Basic	$1.71	$1.47	$1.63

Diluted	1.69	1.46	1.62

See accompanying notes to consolidated financial statements.

Table of Contents

Consolidated Statements of Comprehensive Income

	Years ended December 31,		
(In thousands)	2014	2013	2012
Net income	$75,074	$61,747	$54,558
Other comprehensive (loss) income, net of tax			
Unrealized net holding gains (losses) arising during the year (pre-tax amounts of $18,069, $(41,059), and $(2,471))	11,447	(24,794)	(1,492)
Reclassification adjustment for net gains related to securities available for sale included in net income (pre-tax amounts of $92, $1,426, and $599)	(56)	(861)	(362)
Amortization of unrealized net gains and losses related to the reclassification of available for sale investment securities to held to maturity (pre-tax amounts of $421, $0, and $0)	(257)	-	-
Pension and other benefits:			
Amortization of prior service cost and actuarial gains (pre-tax amounts of $75, $2,790, and $3,593)	46	1,601	2,092
(Increase) Decrease in prior service costs and unrecognized actuarial loss (pre-tax amounts of $(19,245), $21,923 , and $(24))	(11,442)	13,169	(14)
Total other comprehensive (loss) income	(262)	(10,885)	224
Comprehensive income	$74,812	$50,862	$54,782

See accompanying notes to consolidated financial statements.

Table of Contents

Consolidated Statements of Changes in Stockholders' Equity

(In thousands except share and per share data)	Common stock	Additional paid-in-capital	Retained earnings	Accumulated other comprehensive (loss) income	Common stock in treasury	Total
Balance at December 31, 2011	$ 380	$ 317,329	$ 329,981	$ (6,104)	$ (103,476)	$ 538,110
Net income	-	-	54,558	-	-	54,558
Cash dividends - $0.80 per share	-	-	(26,712)	-	-	(26,712)
Purchase of 769,568 treasury shares	-	-	-	-	(15,490)	(15,490)
Net issuance of 1,269,592 shares for acquisition	13	25,811	-	-	-	25,824
Net issuance of 118,616 shares to employee stock plans, including tax benefit	-	(812)	(269)	-	2,476	1,395
Stock-based compensation	-	4,364	-	-	-	4,364
Other comprehensive income	-	-	-	224	-	224
Balance at December 31, 2012	$ 393	$ 346,692	$ 357,558	$ (5,880)	$ (116,490)	$ 582,273
Net income	-	-	61,747	-	-	61,747
Cash dividends - $0.81 per share	-	-	(33,518)	-	-	(33,518)
Purchase of 584,925 treasury shares	-	-	-	-	(12,459)	(12,459)
Net issuance of 10,346,363 shares for acquisition	104	225,447	-	-	(5,779)	219,772
Net issuance of 385,219 shares to employee stock plans, including tax benefit	-	(2,292)	-	-	7,626	5,334
Stock-based compensation	-	4,305	-	-	-	4,305
Other comprehensive loss	-	-	-	(10,885)	-	(10,885)
Balance at December 31, 2013	$ 497	$ 574,152	$ 385,787	$ (16,765)	$ (127,102)	$ 816,569
Net income	-	-	75,074	-	-	75,074
Cash dividends - $0.84 per share	-	-	(36,905)	-	-	(36,905)
Purchase of 3,288 treasury shares	-	-	-	-	(72)	(72)
Net issuance of 386,692 shares to employee stock plans, including tax benefit	-	(1,169)	-	-	7,425	6,256
Stock-based compensation	-	3,521	-	-	-	3,521
Other comprehensive loss	-	-	-	(262)	-	(262)
Balance at December 31, 2014	$ 497	$ 576,504	$ 423,956	$ (17,027)	$ (119,749)	$ 864,181

See accompanying notes to consolidated financial statements.

Table of Contents

Consolidated Statements of Cash Flows

	Years ended December 31,		
(In thousands)	2014	2013	2012
Operating activities			
Net income	$75,074	$61,747	$54,558
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	19,539	22,424	20,269
Depreciation and amortization of premises and equipment	8,324	7,948	6,276
Net accretion on securities	3,216	5,058	2,408
Amortization of intangible assets	5,047	4,872	3,394
Stock based compensation	3,521	4,305	4,364
Bank owned life insurance income	(5,349)	(3,793)	(3,077)
Trading security purchases	(1,626)	(1,085)	(753)
(Gains) losses in trading securities	(388)	(776)	(103)
Deferred income tax expense (benefit)	8,347	2,344	(10)
Proceeds from sale of loans held for sale	7,050	71,342	65,160
Originations and purchases of loans held for sale	(10,215)	(66,512)	(66,252)
Net gains on sales of loans held for sale	(17)	(1,288)	(2,469)
Net security gains	(92)	(1,426)	(599)
Net gains on sales of other real estate owned	(459)	(1,106)	(988)
Gain on sale of equity investment	(19,401)	-	-
Prepayment penalties on long-term debt	17,903	-	-
Net (increase) decrease in other assets	(27,949)	20,463	6,804
Net increase (decrease) in other liabilities	5,286	(5,219)	(128)
Net cash provided by operating activities	87,811	119,298	88,854
Investing activities			
Net cash provided by acquisitions	-	80,883	52,871
Securities available for sale:			
Proceeds from maturities, calls, and principal paydowns	236,133	376,509	573,828
Proceeds from sales	189	27,593	1,790
Purchases	(197,652)	(353,714)	(483,858)
Securities held to maturity:			
Proceeds from maturities, calls, and principal paydowns	44,756	34,413	31,506
Purchases	(49,479)	(84,621)	(20,193)
Other:			
Net increase in loans	(212,238)	(255,318)	(277,530)
Proceeds from FHLB stock redemption	78,441	27,409	-
Purchases of Federal Reserve and FHLB stock	(64,203)	(36,366)	(1,886)
Proceeds from settlement of bank owned life insurance	6,064	-	-
Purchases of premises and equipment, net	(9,003)	(5,766)	(6,994)
Proceeds from sale of equity investment	19,639	-	-
Proceeds from sales of other real estate owned	3,612	5,224	3,616
Net cash used in investing activities	(143,741)	(183,754)	(126,850)
Financing activities			
Net increase (decrease) in deposits	409,381	(7,545)	135,095
Net (decrease) increase in short-term borrowings	(139,240)	271,497	(18,651)
Proceeds from issuance of long-term debt	120,051	-	-
Repayments of long-term debt	(315,831)	(163,595)	(3,354)
	6,256	5,334	1,395

Proceeds from the issuance of shares to employee benefit plans and other stock plans			
Purchase of treasury stock	(72)	(12,459)	(15,490)
Cash dividends and payments for fractional shares	(36,905)	(33,518)	(26,712)
Net cash provided by financing activities	43,640	59,714	72,283
Net (decrease) increase in cash and cash equivalents	(12,290)	(4,742)	34,287
Cash and cash equivalents at beginning of year	158,926	163,668	129,381
Cash and cash equivalents at end of year	$146,636	$158,926	$163,668

Table of Contents

Supplemental disclosure of cash flow information	Years ended December 31,		
Cash paid during the year for:	2014	2013	2012
Interest	$23,387	$31,307	$35,344
Income taxes, net of refund	38,912	20,848	25,512
Noncash investing activities:			
Loans transferred to other real estate owned	$4,330	$4,746	$2,734
Preferred stock acquired from sale of equity investment	2,762	-	-
Transfer of available for sale securities to held to maturity portfolio	332,115	-	-
Acquisitions:			
Fair value of assets acquired	$-	$1,505,490	$258,467
Fair value of liabilities assumed	-	1,285,718	285,012
Fair value of debt issued in purchase combination	-	-	502

See accompanying notes to consolidated financial statements.

NBT BANCORP INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements
December 31, 2014 and 2013

(1) Summary of Significant Accounting Policies

The accounting and reporting policies of NBT Bancorp Inc. ("NBT Bancorp") and its subsidiaries, NBT Bank, National Association ("NBT Bank"), NBT Holdings, Inc., and NBT Financial Services, Inc., conform, in all material respects, to U.S. generally accepted accounting principles ("GAAP") and to general practices within the banking industry. Collectively, NBT Bancorp and its subsidiaries are referred to herein as "the Company."

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Estimates associated with the allowance for loan losses, income taxes, pension expense, fair values of financial instruments, status of contingencies and other-than-temporary impairment on investments are particularly susceptible to material change in the near term.

The following is a description of significant policies and practices:

Consolidation

The accompanying consolidated financial statements include the accounts of NBT Bancorp and its wholly owned subsidiaries mentioned above. All material intercompany transactions have been eliminated in consolidation. Amounts previously reported in the consolidated financial statements are reclassified whenever necessary to conform to the current year's presentation. In the "Parent Company Financial Information," the investment in subsidiaries is recorded using the equity method of accounting.

The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under GAAP. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities ("VIEs") are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in a VIE is present when the Company has both the power and ability to direct the activities of the VIE that most significantly impact the VIE's economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. The Company's wholly owned subsidiaries CNBF Capital Trust I, NBT Statutory Trust I, NBT Statutory Trust II, Alliance Financial Capital Trust I and Alliance Financial Capital Trust II are VIEs for which the Company is not the primary beneficiary. Accordingly, the accounts of these entities are not included in the Company's consolidated financial statements.

Segment Report

The Company's operations are primarily in the community banking industry and include the provision of traditional banking services. The Company also provides other services through its subsidiaries such as insurance, retirement plan administration, and trust administration. The Company operates solely in the geographical regions of central and upstate New York, northeastern Pennsylvania, western Massachusetts, southern New Hampshire, Vermont, and the greater Portland, Maine area. The Company has no reportable operating segments.

Cash Equivalents

The Company considers amounts due from correspondent banks, cash items in process of collection, and institutional money market mutual funds to be cash equivalents for purposes of the consolidated statements of cash flows.

Table of Contents

Securities

The Company classifies its securities at date of purchase as either available for sale, held to maturity or trading. Held to maturity debt securities are those that the Company has the ability and intent to hold until maturity. Trading securities are securities purchased with the intent to sell within a short period of time, and unrealized gains and losses are included in earnings. Available for sale securities are securities that are not classified as a held to maturity or trading securities. Available for sale securities are recorded at fair value. Unrealized holding gains and losses, net of the related tax effect, on available for sale securities are excluded from earnings and are reported in stockholders' equity and the statement of comprehensive income as a component of accumulated other comprehensive income or loss. Held to maturity securities are recorded at amortized cost. Trading securities are recorded at fair value, with net unrealized gains and losses recognized in income. Transfers of securities between categories are recorded at fair value at the date of transfer. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses or in other comprehensive income, depending on whether the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss. If the Company intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. If the Company does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into (a) the amount representing the credit loss and (b) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes.

In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the historical and implied volatility of the fair value of the security.

Non-marketable equity securities are carried at cost.

Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the interest method. Dividend and interest income are recognized when earned. Realized gains and losses on securities sold are derived using the specific identification method for determining the cost of securities sold.

Investments in Federal Reserve Bank ("FRB") and Federal Home Loan Bank ("FHLB") stock are required for membership in those organizations and are carried at cost since there is no market value available. The FHLB New York continues to pay dividends and repurchase stock. As such, the Company has not recognized any impairment on its holdings of FHLB stock.

Loans

Loans are recorded at their current unpaid principal balance, net of unearned income and unamortized loan fees and expenses, which are amortized under the effective interest method over the estimated lives of the loans. Interest income on loans is accrued based on the principal amount outstanding.

For all loan classes within the Company's loan portfolio, loans are placed on nonaccrual status when timely collection of principal and interest in accordance with contractual terms is doubtful. Loans are transferred to nonaccrual status generally when principal or interest payments become ninety days delinquent, unless the loan is well secured and in the process of collection, or sooner when management concludes circumstances indicate that borrowers may be unable to meet contractual principal or interest payments. When a loan is transferred to a nonaccrual status, all interest previously accrued in the current period but not collected is reversed against interest income in that period. Interest accrued in a prior period and not collected is charged-off against the allowance for loan losses.

If ultimate repayment of a nonaccrual loan is expected, any payments received are applied in accordance with contractual terms. If ultimate repayment of principal is not expected, any payment received on a nonaccrual loan is applied to principal until ultimate repayment becomes expected. For all loan classes within the Company's loan portfolio, nonaccrual loans are returned to accrual status when they become current as to principal and interest and demonstrate a period of performance under the contractual terms and, in the opinion of management, are fully collectible as to principal and interest. For loans in all portfolios, the principal amount is charged off in full or in part as soon as management determines, based on available facts, that the collection of principal in full is improbable. For commercial loans, management considers specific facts and circumstances relative to individual credits in making such a determination. For consumer and residential loan classes, management uses specific guidance and thresholds from the Federal Financial Institutions Examination Council's Uniform Retail Credit Classification and Account Management Policy.

Commercial type loans are considered impaired when it is probable that the borrower will not repay the loan according to the original contractual terms of the loan agreement, and all loan types are considered impaired if the loan is restructured in a troubled debt restructuring ("TDR"). In determining that we will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreements, we consider factors such as payment history and changes in the financial condition of individual borrowers, local economic conditions, historical loss experience and the conditions of the various markets in which the collateral may be liquidated.

A loan is considered to be a TDR when the Company grants a concession to the borrower because of the borrower's financial condition that the Company would not otherwise consider. Such concessions include the reduction of interest rates, forgiveness of all or a portion of principal or interest, or other modifications at interest rates that are less than the current market rate for new obligations with similar risk. TDR loans are nonaccrual loans; however, they can be returned to accrual status after a period of performance, generally evidenced by six months of compliance with their modified terms.

When the Company modifies a loan, management evaluates any possible impairment based on the present value of the expected future cash flows, discounted at the contractual interest rate of the original loan agreement, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases, management uses the current fair value of the collateral, less selling costs, instead of discounted cash flows. If management determines that the value of the modified loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), impairment is recognized by segment or class of loan as applicable, through an allowance estimate or a charge-off to the allowance. Segment and class status is determined by the loan's classification at origination.

Table of Contents

Acquired Loans

Acquired loans are initially measured at fair value as of the acquisition date without carryover of historical allowance for loan losses.

For loans that meet the criteria stipulated in ASC 310-30, the Company shall recognize the accretable yield, which is defined as the excess of all cash flows expected at acquisition over the initial fair value of the loan, as interest income on a level-yield basis over the expected remaining life of the loan. The excess of the loan's contractually required payments over the cash flows expected to be collected is the nonaccretable difference. The nonaccretable difference shall not be recognized as an adjustment of yield, a loss accrual, or a valuation allowance. Decreases in the expected cash flows in subsequent periods require the establishment of an allowance for loan losses. Improvements in expected cash flows in future periods result in a reduction of the nonaccretable discount, with such amount reclassified as part of the accretable yield and subsequently recognized in interest income over the remaining lives of the acquired loans on a level-yield basis if the amount and timing of future cash flows is reasonably estimable.

Acquired loans that met the criteria for nonaccrual of interest prior to the acquisition are considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, the Company may no longer consider the loan to be nonaccrual or nonperforming and may accrue interest on these loans, including the impact of any accretable yield. As such, charge-offs on acquired loans are first applied to the nonaccretable difference and then to any allowance for loan losses recognized subsequent to acquisition.

For loans that meet the criteria stipulated in ASC 310-20, the Company shall amortize/accrete into interest income the premium/discount determined at the date of purchase on a level-yield basis over the life of the loan. Subsequent to the acquisition date, the methods utilized to estimate the required allowance for loan losses are similar to originated loans. Loans accounted for under ASC 310-20 are placed on nonaccrual status when past due in accordance with the Company's nonaccrual policy.

An acquired loan may be resolved either through receipt of payment (in full or in part) from the borrower, the sale of the loan to a third party, or foreclosure of the collateral. In the event of a sale of the loan, a gain or loss on sale is recognized and reported within noninterest income based on the difference between the sales proceeds and the carrying amount of the loan. In other cases, individual loans are removed from the pool based on comparing the amount received from its resolution (fair value of the underlying collateral less costs to sell in the case of a foreclosure) with its outstanding balance. Any difference between these amounts is recorded as a charge-off through the allowance for loan losses. Acquired loans subject to modification are not removed from the pool even if those loans would otherwise be deemed troubled debt restructurings as the pool, and not the individual loan, represents the unit of account.

Allowance for Loan Losses

The allowance for loan losses is the amount which, in the opinion of management, is necessary to absorb probable losses inherent in the loan portfolio. The allowance is determined based upon numerous considerations, including local and regional conditions, the growth and composition of the loan portfolio with respect to the mix between the various types of loans and their related risk characteristics, a review of the value of collateral supporting the loans, comprehensive reviews of the loan portfolio by the independent loan review staff and management, as well as consideration of volume and trends of delinquencies, nonperforming loans, and loan charge-offs. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. As a result of tests of adequacy, required additions to the allowance for loan losses are made periodically by charges to the provision for loan losses.

The allowance for loan losses related to impaired loans specifically allocated for impairment is based on discounted cash flows using the loan's initial effective interest rate or the fair value of the collateral for certain loans where repayment of the loan is expected to be provided solely by the underlying collateral (collateral dependent loans). The Company's impaired loans are generally collateral dependent. The Company considers the estimated cost to sell, on a discounted basis, when determining the fair value of collateral in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loans.

The allowance for loan losses for homogeneous non impaired loans is calculated using a systematic methodology with both a quantitative and a qualitative analysis that is applied on a quarterly basis. For purposes of our allowance methodology, the loan portfolio is segmented as described in Note 5, Allowance for Loan Loss and Credit Quality of Loans. Each segment has a distinct set of risk characteristics monitored by management. We further assess and monitor risk and performance at a more disaggregated level which includes our internal risk grading system for the commercial segments.

We first apply historical loss rates to pools of loans with similar risk characteristics. Loss rates are calculated by historical charge-offs that have occurred within each pool of loans over the loss emergence period, or LEP. The LEP is an estimate of the average amount of time from the point at which a loss is incurred on a loan to the point at which the loss is confirmed. In general, the LEP will be shorter in an economic slowdown or recession and longer during times of economic stability or growth, as customers are better able to delay loss confirmation after a potential loss event has occurred. In conjunction with our annual review of the ALL assumptions, we update our study of LEPs for each portfolio segment using our loan charge-off history. Another key assumption is the look-back period, or LBP, which represents the historical data period utilized to calculate loss rates.

Table of Contents

After consideration of the historic loss analysis, management applies additional qualitative adjustments so that the allowance for loan losses is reflective of the inherent losses that exist in the loan portfolio at the balance sheet date. Qualitative adjustments are made based upon past loss experience; size, trend, composition, and nature of loans; changes in lending policies and procedures, including underwriting standards and collection, charge-offs and recoveries; trends experienced in nonperforming and delinquent loans; current economic conditions in the Company's market; portfolio concentrations that may affect loss experience across one of more components of the portfolio; the effect of external factors such as competition, legal and regulatory requirements; and the experience, ability, and depth of lending management and staff. The evaluation of the various components of the allowance for loan losses requires considerable judgment in order to estimate inherent loss exposures. In addition, various regulatory agencies, as an integral component of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to make loan grade changes as well as recognize additions to the allowance based on their examinations.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize loan losses, future additions to the allowance for loan losses may be necessary based on changes in economic conditions or changes in the values of properties securing loans in the process of foreclosure. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance for loan losses based on their judgments about information available to them at the time of their examination which may not be currently available to management.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation. Depreciation of premises and equipment is determined using the straight-line method over the estimated useful lives of the respective assets. Expenditures for maintenance, repairs, and minor replacements are charged to expense as incurred.

Other Real Estate Owned

OREO consists of properties acquired through foreclosure or by acceptance of a deed in lieu of foreclosure. These assets are recorded at the lower of fair value of the asset acquired less estimated costs to sell or "cost" (defined as the fair value at initial foreclosure). At the time of foreclosure, or when foreclosure occurs in-substance, the excess, if any, of the loan over the fair market value of the assets received, less estimated selling costs, is charged to the allowance for loan losses and any subsequent valuation write-downs are charged to other expense. In connection with the determination of the allowance for loan losses and the valuation of other real estate owned, management obtains appraisals for properties. Operating costs associated with the properties are charged to expense as incurred. Gains on the sale of OREO are included in income when title has passed and the sale has met the minimum down payment requirements prescribed by GAAP. The balance of OREO at December 31, 2014 and 2013 was approximately $4.0 million and $2.9 million, respectively, and is recorded in Other Assets on the Consolidated Balance Sheet.

Goodwill and Other Intangible Assets

Goodwill and intangible assets that have indefinite useful lives are not amortized, but are tested at least annually for impairment. Intangible assets that have finite useful lives are amortized over their useful lives. Core deposit intangibles and trust intangibles at the Company are amortized using the sum-of-the-years'-digits method. Covenants not to compete are amortized on a straight-line basis. Customer lists are amortized using an accelerated method.

When facts and circumstances indicate potential impairment of amortizable intangible assets, the Company evaluates the recoverability of the asset carrying value, using estimates of undiscounted future cash flows over the remaining asset life. Any impairment loss is measured by the excess of carrying value over fair value. Goodwill impairment tests are performed on an annual basis or when events or circumstances dictate. In these tests, the fair values of each reporting unit, or segment, is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated. If so, the implied fair value of the reporting unit's goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value.

Bank-Owned Life Insurance

The Bank has purchased life insurance policies on certain employees, key executives and directors. Bank-owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Treasury Stock

Treasury stock acquisitions are recorded at cost. Subsequent sales of treasury stock are recorded on an average cost basis. Gains on the sale of treasury stock are credited to additional paid-in-capital. Losses on the sale of treasury stock are charged to additional paid-in-capital to the extent of previous gains, otherwise charged to retained earnings.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. The Company recognizes interest accrued and penalties related to unrecognized tax benefits in income tax expense.

Tax positions are recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50 percent likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

Stock-Based Compensation

We maintain various long-term incentive stock benefit plans under which we grant stock options, restricted stock awards, and restricted stock units to certain directors and key employees. We recognize compensation expense in our income statement over the requisite service period, based on the grant-date fair value of the award. For restricted stock awards and units, we recognize compensation expense ratably over the vesting period for the fair value of the award, measured at the grant date. The fair values of options are estimated using the Black-Scholes option pricing model.

The Company's stock-based employee compensation plan is described in Note 14 "Stock-Based Compensation," of this Report.

Table of Contents

Interest Rate Swaps

The Bank offers interest rate swap agreements to its customers. These agreements allow the Bank's customers to effectively fix the interest rate on a variable rate loan by entering into a separate agreement. Simultaneous with the execution of such an agreement with a customer, the Bank enters into a matching interest rate swap agreement with an unrelated third party provider, which allows the Bank to continue to receive the historical variable rate under the loan agreement with the customer. The agreement with the third party is not a hedge contract therefore changes in fair value are recorded through earnings. Assets and liabilities associated with the agreements are recorded in other assets and other liabilities on the balance sheet. Gains and losses are recorded as other noninterest income. The Bank is not subject to any fee or penalty should the customer elect to terminate the interest rate swap agreement prior to maturity. The Bank is exposed to credit loss equal to the fair value of the derivatives (not the notional amount of the derivatives) in the event of nonperformance by the counterparty to the interest rate swap agreements. Additionally, the Bank receives a fee from the customer that is recognized when the Bank has fulfilled its obligations under each agreement, which is generally upon execution of the agreement with the Bank's customer. Since the terms of the thirty three interest rate swap agreements with the customers are identical to the related swaps with the third party, the income statement impact to the Bank is generally limited to the fees it receives from the customer.

Other Financial Instruments

The Company is a party to certain other financial instruments with off-balance-sheet risk such as commitments to extend credit, unused lines of credit, as well as certain mortgage loans sold to investors with recourse. The Company's policy is to record such instruments when funded.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Under the standby letters of credit, the Company is required to make payments to the beneficiary of the letters of credit upon request by the beneficiary contingent upon the customer's failure to perform under the terms of the underlying contract with the beneficiary. Standby letters of credit typically have one year expirations with an option to renew upon annual review. The Company typically receives a fee for these transactions. The fair value of stand-by letters of credit is recorded upon inception.

Loan Sales and Loan Servicing

The Company originates and services residential mortgage loans for consumers and sells 15-year, 20-year and 30-year residential real estate mortgages in the secondary market when the interest rate environment is determined to be favorable by management, while retaining servicing rights on the sold loans. Loan sales are recorded when the sales are funded. Mortgage servicing rights are recorded at fair value upon sale of the loan. Loans held for sale are recorded at the lower of cost or market.

Repurchase Agreements

Repurchase agreements are accounted for as secured financing transactions since the Company maintains effective control over the transferred securities and the transfer meets the other criteria for such accounting. Obligations to repurchase securities sold are reflected as a liability in the Consolidated Balance Sheets. The securities underlying the agreements are delivered to a custodial account for the benefit of the dealer or bank with whom each transaction is executed. The dealers or banks, who may sell, loan or otherwise dispose of such securities to other parties in the normal course of their operations, agree to resell to the Company the same securities at the maturities of the agreements.

Earnings Per Share

Basic earnings per share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity (such as the Company’s dilutive stock options and restricted stock).

Subsequent Events

The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

Comprehensive Income

At the Company, comprehensive income represents net income plus other comprehensive income (loss), which consists primarily of the net change in unrealized gains or losses on securities available for sale for the period and changes in the funded status of employee benefit plans. Accumulated other comprehensive (loss) income represents the net unrealized gains or losses on securities available for sale and the previously unrecognized portion of the funded status of employee benefit plans, net of income taxes, as of the consolidated balance sheet dates.

Pension Costs

The Company maintains a noncontributory, defined benefit pension plan covering substantially all employees, as well as supplemental employee retirement plans covering certain executives and a defined benefit postretirement healthcare plan that covers certain employees. Costs associated with these plans, based on actuarial computations of current and future benefits for employees, are charged to current operating expenses.

Table of Contents

Trust Operations

Assets held by the Company in a fiduciary or agency capacity for its customers are not included in the accompanying consolidated balance sheets, since such assets are not assets of the Company. Trust income is recognized on the accrual method based on contractual rates applied to the balances of trust accounts.

Fair Value Measurements

Fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value measurements are not adjusted for transaction costs. A fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 - Quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3 - Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

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

The types of instruments valued based on quoted market prices in active markets include most U.S. government and agency securities, many other sovereign government obligations, liquid mortgage products, active listed equities and most money market securities. Such instruments are generally classified within level 1 or level 2 of the fair value hierarchy. The Company does not adjust the quoted price for such instruments.

The types of instruments valued based on quoted prices in markets that are not active, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include most investment-grade and high-yield corporate bonds, less liquid mortgage products, less liquid agency securities, less liquid listed equities, state, municipal and provincial obligations, and certain physical commodities. Such instruments are generally classified within level 2 of the fair value hierarchy.

Level 3 is for positions that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management’s best estimate will be used. Management’s best estimate consists of both internal and external support on certain Level 3 investments. Subsequent to inception, management only changes level 3 inputs and assumptions when corroborated by evidence such as transactions in similar instruments, completed or pending third-party transactions in the underlying investment or comparable entities, subsequent rounds of financing, recapitalizations and other transactions across the capital structure, offerings in the equity or debt markets, and changes in financial ratios or cash flows.

(2) Acquisitions

Acquisition of Alliance Financial Corporation

On March 8, 2013, the Company acquired Alliance Financial Corporation ("Alliance"), the parent company of Alliance Bank, N.A., for total consideration of $226 million. As part of the acquisition, Alliance was merged with and into the Company and Alliance Bank, with 26 branch locations in the central New York counties of Onondaga, Cortland, Madison, Oneida and Oswego, was merged with and into the Bank. The merger with Alliance enabled the Company to expand its footprint into demographically attractive and contiguous markets located in the aforementioned New York counties. Alliance operations were integrated into the Company and were included in the Consolidated Statements of Income from the date of acquisition.

Other Goodwill Adjustments

During the twelve months ended December 31, 2014, the Company recorded deferred tax adjustments totaling approximately ($1.0) million and valuation adjustments totaling ($0.4) related to the 2013 acquisition of Alliance resulting in a decrease in goodwill of approximately ($1.4) million in 2014. During the twelve months ended December 31, 2013, the Company recorded a deferred tax adjustment related to the 2012 acquisition of Hampshire First Bank resulting in a decrease in goodwill of approximately $(1.0) million. In addition, the Company recorded a goodwill adjustment of approximately $0.1 million related to the 2012 acquisition of a financial services company.

Table of Contents

(3) Securities

The amortized cost, estimated fair value, and unrealized gains and losses of securities available for sale are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
December 31, 2014				