

NBT BANCORP INC
Form 10-Q
May 12, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10 Q

(Mark One)

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

For the quarterly period ended March 31, 2014.

OR

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

For the transition period from _____ to _____.

COMMISSION FILE NUMBER 0-14703

NBT BANCORP INC.
(Exact Name of Registrant as Specified in its Charter)

DELAWARE 16-1268674
(State of Incorporation) (I.R.S. Employer Identification No.)

52 SOUTH BROAD STREET, NORWICH, NEW YORK 13815
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (607) 337-2265

None

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant has submitted electronically and posted 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 (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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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 Exchange Act).
Yes No

As of April 30, 2014, there were 43,689,389 shares outstanding of the Registrant's common stock, \$0.01 par value per share.

NBT BANCORP INC.
FORM 10-Q--Quarter Ended March 31, 2014

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1 Financial Statements

Consolidated Balance Sheets at March 31, 2014 and December 31, 2013 3

Consolidated Statements of Income for the three month periods ended March 31, 2014 and 2013 4

Consolidated Statements of Comprehensive Income for the three month periods ended March 31, 2014 and 2013 5

Consolidated Statements of Stockholders' Equity for the three month periods ended March 31, 2014 and 2013 6

Consolidated Statements of Cash Flows for the three month periods ended March 31, 2014 and 2013 7

Notes to Unaudited Interim Consolidated Financial Statements 9

Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations 39

Item 3 Quantitative and Qualitative Disclosures about Market Risk 55

Item 4 Controls and Procedures 55

PART II OTHER INFORMATION 56

Item 1 Legal Proceedings 56

Item 1A Risk Factors 56

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds 56

Item 3 Defaults Upon Senior Securities 56

Item 4 Mine Safety Disclosures 56

Item 5 Other Information 56

Item 6 Exhibits 57

SIGNATURES 58

INDEX TO EXHIBITS 59

Table of Contents

Item 1 – FINANCIAL STATEMENTS

NBT Bancorp Inc. and Subsidiaries
Consolidated Balance Sheets (unaudited)

	March 31, 2014	December 31, 2013
(In thousands, except share and per share data)		
Assets		
Cash and due from banks	\$ 182,071	\$ 157,625
Short-term interest bearing accounts	3,493	1,301
Securities available for sale, at fair value	1,377,585	1,364,881
Securities held to maturity (fair value \$114,920 and \$113,276, respectively)	117,896	117,283
Trading securities	6,954	5,779
Federal Reserve and Federal Home Loan Bank stock	41,458	46,864
Loans	5,482,025	5,406,795
Less allowance for loan losses	69,434	69,434
Net loans	5,412,591	5,337,361
Premises and equipment, net	87,647	88,327
Goodwill	263,634	264,997
Intangible assets, net	24,248	25,557
Bank owned life insurance	115,775	114,966
Other assets	119,777	127,234
Total assets	\$7,753,129	\$7,652,175
Liabilities		
Demand (noninterest bearing)	\$ 1,616,612	\$ 1,645,641
Savings, NOW, and money market	3,482,925	3,223,441
Time	969,361	1,021,142
Total deposits	6,068,898	5,890,224
Short-term borrowings	356,878	456,042
Long-term debt	308,679	308,823
Junior subordinated debt	101,196	101,196
Other liabilities	85,276	79,321
Total liabilities	6,920,927	6,835,606
Stockholders' equity		
Preferred stock, \$0.01 par value. Authorized 2,500,000 shares at March 31, 2014 and December 31, 2013	-	-
Common stock, \$0.01 par value. Authorized 100,000,000 shares at March 31, 2014 and December 31, 2013; issued 49,651,494 at March 31, 2014 and December 31, 2013	497	497
Additional paid-in-capital	574,071	574,152
Retained earnings	394,589	385,787
Accumulated other comprehensive loss	(11,550)	(16,765)
Common stock in treasury, at cost, 6,050,806 and 6,138,444 shares at March 31, 2014 and December 31, 2013, respectively	(125,405)	(127,102)
Total stockholders' equity	832,202	816,569
Total liabilities and stockholders' equity	\$7,753,129	\$7,652,175

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

	Three months ended March 31,	
	2014	2013
NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Income (unaudited) (In thousands, except per share data)		
Interest, fee, and dividend income		
Interest and fees on loans	\$60,015	\$53,695
Securities available for sale	6,757	5,746
Securities held to maturity	768	525
Other	537	403
Total interest, fee, and dividend income	68,077	60,369
Interest expense		
Deposits	3,284	4,150
Short-term borrowings	231	42
Long-term debt	2,507	3,609
Junior subordinated debt	538	428
Total interest expense	6,560	8,229
Net interest income	61,517	52,140
Provision for loan losses	3,596	5,658
Net interest income after provision for loan losses	57,921	46,482
Noninterest income		
Insurance and other financial services revenue	6,737	6,893
Service charges on deposit accounts	4,369	4,323
ATM and debit card fees	4,072	3,242
Retirement plan administration fees	2,918	2,682
Trust	4,446	2,913
Bank owned life insurance	1,382	849
Net securities gains	7	1,145
Other	2,346	3,182
Total noninterest income	26,277	25,229
Noninterest expense		
Salaries and employee benefits	29,534	27,047
Occupancy	6,226	4,977
Data processing and communications	4,001	3,455
Professional fees and outside services	3,415	2,901
Equipment	3,116	2,582
Office supplies and postage	1,685	1,590
FDIC expenses	1,278	1,130
Advertising	739	723
Amortization of intangible assets	1,310	851
Loan collection and other real estate owned	1,040	718
Merger expenses	-	10,681
Other	5,173	4,050
Total noninterest expense	57,517	60,705
Income before income tax expense	26,681	11,006
Income tax expense	8,672	3,357
Net income	\$18,009	\$7,649
Earnings per share		
Basic	\$0.41	\$0.21
Diluted	\$0.41	\$0.21

See accompanying notes to unaudited interim consolidated financial statements.

4

Table of Contents

	Three months ended March 31,	
	2014	2013
NBT Bancorp Inc. and Subsidiaries Consolidated Statements of Comprehensive Income (unaudited) (In thousands)		
Net income	\$18,009	\$7,649
Other comprehensive income (loss), net of tax		
Unrealized net holding gains (losses) arising during the period (pre-tax amounts of \$8,623 and (\$1,752))	5,208	(1,058)
Reclassification adjustment for net gains related to securities available for sale included in net income (pre-tax amounts of \$7 and \$1,145)	(4)	(691)
Pension and other benefits:		
Amortization of prior service cost and actuarial gains (pre-tax amounts of \$19 and \$826)	11	503
Total other comprehensive income (loss)	5,215	(1,246)
Comprehensive income	\$23,224	\$6,403

See accompanying notes to unaudited interim consolidated financial statements

5

Table of Contents

NBT Bancorp Inc. and Subsidiaries

Consolidated Statements of Stockholders' Equity (unaudited)

	Common Stock	Additional Paid-in- Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Common Stock in Treasury	Total
(in thousands, except share and per share data)						
Balance at December 31, 2012	\$ 393	\$ 346,692	\$ 357,558	\$ (5,880)	\$ (116,490)	\$ 582,273
Net income	-	-	7,649	-	-	7,649
Cash dividends - \$0.20 per share	-	-	(6,758)	-	-	(6,758)
Issuance of 10,346,363 shares, net of 408,957 treasury shares, for Alliance acquisition	104	225,447	-	-	(5,779)	219,772
Net issuance of 28,339 shares to employee benefit plans and other stock plans, including tax benefit	-	(965)	-	-	606	(359)
Stock-based compensation	-	1,964	-	-	-	1,964
Other comprehensive loss	-	-	-	(1,246)	-	(1,246)
Balance at March 31, 2013	\$ 497	\$ 573,138	\$ 358,449	\$ (7,126)	\$ (121,663)	\$ 803,295
Balance at December 31, 2013	\$ 497	\$ 574,152	\$ 385,787	\$ (16,765)	\$ (127,102)	\$ 816,569
Net income	-	-	18,009	-	-	18,009
Cash dividends - \$0.21 per share	-	-	(9,207)	-	-	(9,207)
Net issuance of 87,638 shares to employee benefit plans and other stock plans, including tax benefit	-	(1,335)	-	-	1,697	362
Stock-based compensation	-	1,254	-	-	-	1,254
Other comprehensive income	-	-	-	5,215	-	5,215
Balance at March 31, 2014	\$ 497	\$ 574,071	\$ 394,589	\$ (11,550)	\$ (125,405)	\$ 832,202

See accompanying notes to unaudited interim consolidated financial statements.

6

Table of Contents

	Three Months Ended	
	March 31,	
	2014	2013
NBT Bancorp Inc. and Subsidiaries		
Consolidated Statements of Cash Flows (unaudited)		
(In thousands, except per share data)		
Operating activities		
Net income	\$18,009	\$7,649
Adjustments to reconcile net income to net cash provided by operating activities		
Provision for loan losses	3,596	5,658
Depreciation and amortization of premises and equipment	2,046	1,791
Net accretion on securities	921	1,091
Amortization of intangible assets	1,310	851
Stock based compensation	1,254	1,964
Increase in surrender value of bank owned life insurance	(968)	(849)
Purchases of trading securities	(1,043)	(744)
Unrealized gains in trading securities	(132)	(100)
Deferred income tax benefit	(18)	(309)
Proceeds from sales of loans held for sale	439	15,417
Originations and purchases of loans held for sale	(1,418)	(17,307)
Net gains on sales of loans held for sale	(3)	(480)
Net security gains	(7)	(1,145)
Net gain on sales of other real estate owned	(102)	(151)
Proceeds from settlement of bank owned life insurance	573	-
Gains on bank owned life insurance settlement	(414)	-
Net decrease in other assets	7,136	915
Net increase (decrease) in other liabilities	1,156	(9,336)
Net cash provided by operating activities	32,335	4,915
Investing activities		
Net cash provided by acquisitions	-	81,049
Securities available for sale:		
Proceeds from maturities, calls, and principal paydowns	67,341	109,986
Proceeds from sales	-	2,607
Purchases	(70,339)	(119,749)
Securities held to maturity:		
Proceeds from maturities, calls, and principal paydowns	5,107	6,940
Purchases	(5,217)	(3,131)
Proceeds from FHLB stock redemption	15,306	1,989
Net increase in loans	(78,304)	(17,791)
Net increase in Federal Reserve and FHLB stock	(9,900)	-
Purchases of premises and equipment	(1,114)	(1,006)
Proceeds from sales of other real estate owned	902	1,023
Net cash (used in) provided by investing activities	(76,218)	61,917
Financing activities		
Net increase in deposits	178,674	118,194
Net (decrease) increase in short-term borrowings	(99,164)	1,326
Repayments of long-term debt	(144)	(43,757)
Proceeds from the issuance of shares to employee benefit plans and other stock plans	362	(359)
Cash dividends and payment for fractional shares	(9,207)	(6,758)
Net cash provided by financing activities	70,521	68,646
Net increase in cash and cash equivalents	26,638	135,478
Cash and cash equivalents at beginning of period	158,926	163,668

Cash and cash equivalents at end of period

\$185,564 \$299,146

7

Table of Contents

	Three Months	
Supplemental disclosure of cash flow information	Ended March 31,	
Cash paid during the period for:	2014	2013
Interest	\$6,829	\$8,000
Income taxes paid	2,745	344
Noncash investing activities:		
Loans transferred to other real estate owned	\$460	\$959
Acquisitions:		
Fair value of assets acquired	\$-	\$1,503,448
Fair value of liabilities assumed	-	1,283,676

See accompanying notes to unaudited interim consolidated financial statements.

Table of Contents

NBT BANCORP INC. and Subsidiaries

NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

Note 1. Description of 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 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 and the greater Burlington, Vermont 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.

Note 2. Basis of Presentation

The accompanying unaudited interim consolidated financial statements include the accounts of the Registrant and its wholly owned subsidiaries, the Bank, NBT Financial and NBT Holdings. Collectively, the Registrant and its subsidiaries are referred to herein as “the Company.” The interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in accordance with generally accepted accounting principles (“GAAP”). These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our 2013 Annual Report on Form 10-K. The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. All intercompany transactions have been eliminated in consolidation. Amounts in the prior period financial statements are reclassified whenever necessary to conform to current period presentation. The Company has evaluated subsequent events for potential recognition and/or disclosure and there were none identified.

Table of Contents

Note 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
March 31, 2014				
U.S. Treasury	\$33,204	\$ 269	\$ -	\$33,473
Federal Agency	305,245	430	5,517	300,158
State & municipal	111,583	1,967	855	112,695
Mortgage-backed:				
Government-sponsored enterprises	351,748	6,164	1,404	356,508
U.S. government agency securities	20,781	940	71	21,650
Collateralized mortgage obligations:				
Government-sponsored enterprises	501,563	2,080	13,411	490,232
U.S. government agency securities	46,876	656	117	47,415
Other securities	12,839	2,851	236	15,454
Total securities available for sale	\$1,383,839	\$ 15,357	\$ 21,611	\$1,377,585
December 31, 2013				
U.S. Treasury	\$43,279	\$ 337	\$ -	\$43,616
Federal Agency	285,880	343	7,308	278,915
State & municipal	113,435	1,842	1,612	113,665
Mortgage-backed:				
Government-sponsored enterprises	337,666	5,788	2,131	341,323
U.S. government agency securities	21,924	1,002	85	22,841
Collateralized mortgage obligations:				
Government-sponsored enterprises	521,257	1,777	18,141	504,893
U.S. government agency securities	43,943	794	102	44,635
Other securities	12,367	2,854	228	14,993
Total securities available for sale	\$1,379,751	\$ 14,737	\$ 29,607	\$1,364,881

Other securities primarily represent marketable equity securities.

There were no sales of securities available for sale during the three months ended March 31, 2014. Proceeds from the sales of securities available for sale were \$2.6 million during the three months ended March 31, 2013, and gains on the sales were \$1.1 million. There were no losses on the sales during 2013.

Securities with amortized costs totaling \$1.5 billion at March 31, 2014 and \$1.4 billion at December 31, 2013 were pledged to secure public deposits and for other purposes required or permitted by law. Additionally, at March 31, 2014 and December 31, 2013, securities with an amortized cost of \$224.9 million and \$218.4 million, respectively, were pledged as collateral for securities sold under repurchase agreements.

Table of Contents

The amortized cost, estimated fair value, and unrealized gains and losses of securities held to maturity are as follows:

(In thousands)	Amortized cost	Unrealized gains	Unrealized losses	Estimated fair value
March 31, 2014				
Mortgage-backed	\$ 881	\$ 120	\$ -	\$ 1,001
Collateralized mortgage obligations	60,973	-	3,444	57,529
State & municipal	56,042	361	13	56,390
Total securities held to maturity	\$ 117,896	\$ 481	\$ 3,457	\$ 114,920
December 31, 2013				
Mortgage-backed	\$ 953	\$ 128	\$ -	\$ 1,081
Collateralized mortgage obligations	62,025	-	4,569	57,456
State & municipal	54,305	442	8	54,739
Total securities held to maturity	\$ 117,283	\$ 570	\$ 4,577	\$ 113,276

11

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Table of Contents

The following table sets forth information with regard to investment securities with unrealized losses at March 31, 2014 and December 31, 2013:

Security Type:	Less than 12 months			12 months or longer			Total		
	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions	Fair Value	Unrealized losses	Number of Positions
March 31, 2014									
Investment securities available for sale:									
Federal agency	\$245,397	\$(5,221)	21	\$9,704	\$(296)	1	\$255,101	\$(5,517)	22
State & municipal	48,377	(839)	171	934	(16)	3	49,311	(855)	174
Mortgage-backed Collateralized mortgage obligations	1,110,605	(1,465)	58	960	(10)	4	1,111,565	(1,475)	62
Other securities	295,408	(10,516)	31	60,681	(3,012)	4	356,089	(13,528)	35
Total securities with unrealized losses	5,507	(186)	2	198	(50)	1	5,705	(236)	3
	\$1,705,294	\$(18,227)	283	\$72,477	\$(3,384)	13	\$1,777,771	\$(21,611)	296
March 31, 2014									
Investment securities held to maturity:									
Collateralized mortgage obligations									
State & municipal	\$57,528	\$(3,444)	5	\$-	\$-	-	\$57,528	\$(3,444)	5
Total securities with unrealized losses	2,120	(13)	3	-	-	-	2,120	(13)	3
	\$59,648	\$(3,457)	8	\$-	\$-	-	\$59,648	\$(3,457)	8
December 31, 2013									
Investment securities available for sale:									
Federal agency	\$233,935	\$(6,927)	20	\$9,619	\$(381)	1	\$243,554	\$(7,308)	21
State & municipal	50,328	(1,612)	177	-	-	-	50,328	(1,612)	177
Mortgage-backed Collateralized mortgage obligations	143,080	(2,216)	79	-	-	-	143,080	(2,216)	79
Other securities	379,273	(18,243)	36	-	-	-	379,273	(18,243)	36
Total securities with unrealized losses	5,490	(203)	2	223	(25)	1	5,713	(228)	3
	\$812,106	\$(29,201)	314	\$9,842	\$(406)	2	\$821,948	\$(29,607)	316
December 31, 2013									
Investment securities held to maturity:									
Collateralized mortgage obligations									
State & municipal	\$57,456	\$(4,569)	5	\$-	\$-	-	\$57,456	\$(4,569)	5
Total securities with unrealized losses	1,012	(8)	1	-	-	-	1,012	(8)	1
	\$58,468	\$(4,577)	6	\$-	\$-	-	\$58,468	\$(4,577)	6

Table of Contents

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.

Management has the intent to hold the securities classified as held to maturity until they mature, at which time it is believed the Company will receive full value for the securities. Furthermore, as of March 31, 2014, management also had the intent to hold, and will not be required to sell, the securities classified as available for sale for a period of time sufficient for a recovery of cost, which may be until maturity. The unrealized losses are due to increases in market interest rates over the yields available at the time the underlying securities were purchased. When necessary, the Company has performed a discounted cash flow analysis to determine whether or not it will receive the contractual principal and interest on certain securities. The fair value is expected to recover as the bonds approach their maturity date or repricing date or if market yields for such investments decline. As of March 31, 2014, management believes the impairments detailed in the table above are temporary and no other-than-temporary impairment losses have been realized in the Company's consolidated statements of income.

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

(In thousands)	Amortized cost	Estimated fair value
Debt securities classified as available for sale		
Within one year	\$27,461	\$27,627
From one to five years	302,113	301,603
From five to ten years	259,225	259,821
After ten years	782,201	773,080
	\$1,371,000	\$1,362,131
Debt securities classified as held to maturity		
Within one year	\$24,714	\$24,765
From one to five years	21,654	21,957
From five to ten years	8,401	8,395
After ten years	63,127	59,803
	\$117,896	\$114,920

Maturities of mortgage-backed, collateralized mortgage obligations and asset-backed securities are stated based on their estimated average lives. Actual maturities may differ from estimated average lives or contractual maturities because, in certain cases, borrowers have the right to call or prepay obligations with or without call or prepayment

penalties.

Except for U.S. Government securities, there were no holdings, when taken in the aggregate, of any single issuer that exceeded 10% of consolidated stockholders' equity at March 31, 2014.

13

Table of Contents

Note 4. Allowance for Loan Losses and Credit Quality of Loans

Allowance for Loan Losses

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.

To develop and document a systematic methodology for determining the allowance for loan losses, the Company has divided the loan portfolio into three segments, each with different risk characteristics and methodologies for assessing risk. Those segments are further segregated between our loans accounted for under the amortized cost method (referred to as “originated” loans) and loans acquired in a business combination (referred to as “acquired” loans). Each portfolio segment is broken down into class segments where appropriate. Class segments contain unique measurement attributes, risk characteristics and methods for monitoring and assessing risk that are necessary to develop the allowance for loan losses. Unique characteristics such as borrower type, loan type, collateral type, and risk characteristics define each class segment. The following table illustrates the portfolio and class segments for the Company’s loan portfolio:

Portfolio	Class
Commercial Loans	Commercial
	Commercial Real Estate
	Agricultural
	Agricultural Real Estate
	Business Banking
Consumer Loans	Indirect
	Home Equity
	Direct

Residential Real Estate Mortgages

Commercial Loans

The Company offers a variety of commercial loan products including commercial (non-real estate), commercial real estate, agricultural, agricultural real estate, and business banking loans. The Company’s underwriting analysis for commercial loans typically includes credit verification, independent appraisals, a review of the borrower’s financial condition, and a detailed analysis of the borrower’s underlying cash flows.

Commercial – The Company offers a variety of loan options to meet the specific needs of our commercial customers including term loans, time notes and lines of credit. Such loans are made available to businesses for working capital needs such as inventory and receivables, business expansion and equipment purchases. Generally, a collateral lien is placed on equipment or other assets owned by the borrower. These loans carry a higher risk than commercial real estate loans due to the nature of the underlying collateral, which can be business assets such as equipment and accounts receivable. To reduce the risk, management also attempts to secure real estate as collateral and obtain personal guarantees of the borrowers.

Commercial Real Estate – The Company offers commercial real estate loans to finance real estate purchases, refinancings, expansions and improvements to commercial properties. Commercial real estate loans are made to

finance the purchases of real estate, generally with completed structures. These commercial real estate loans are secured by first liens on the real estate, which may include apartments, commercial structures, housing businesses, healthcare facilities, and other non owner-occupied facilities. These loans are typically less risky than commercial loans, since they are secured by real estate and buildings, and are generally originated in amounts of no more than 80% of the appraised value of the property.

Table of Contents

Agricultural – The Company offers a variety of agricultural loans to meet the needs of our agricultural customers including term loans, time notes, and lines of credit. These loans are made to purchase livestock, purchase and modernize equipment, and finance seasonal crop expenses. Generally, a collateral lien is placed on the livestock, equipment, produce inventories, and/or receivables owned by the borrower. These loans may carry a higher risk than commercial and agricultural real estate loans due to the industry price volatility, and in some cases, the perishable nature of the underlying collateral. To reduce these risks, management may attempt to secure these loans with additional real estate collateral, obtain personal guarantees of the borrowers, or obtain government loan guarantees to provide further support.

Agricultural Real Estate – The Company offers real estate loans to our agricultural customers to finance farm related real estate purchases, refinancings, expansions, and improvements to agricultural properties such as barns, production facilities, and land. The agricultural real estate loans are secured by first liens on the farm real estate. Because they are secured by land and buildings, these loans may be less risky than agricultural loans. These loans are typically originated in amounts of no more than 75% of the appraised value of the property. Government loan guarantees may be obtained to provide further support.

Business Banking - The Company offers a variety of loan options to meet the specific needs of our business banking customers including term loans, business banking mortgages and lines of credit. Such loans are generally less than \$0.5 million and are made available to businesses for working capital such as inventory and receivables, business expansion, equipment purchases, and agricultural needs. Generally, a collateral lien is placed on equipment or other assets owned by the borrower such as inventory and/or receivables. These loans carry a higher risk than commercial loans due to the smaller size of the borrower and lower levels of capital. To reduce the risk, the Company obtains personal guarantees of the owners for a majority of the loans.

Consumer Loans

The Company offers a variety of consumer loan products including indirect, home equity, and direct loans.

Indirect – The Company maintains relationships with many dealers primarily in the communities that we serve. Through these relationships, the company primarily finances the purchases of automobiles and recreational vehicles (such as campers, boats, etc.) indirectly through dealer relationships. Approximately 75% of the indirect relationships represent automobile financing. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from three to six years, based upon the nature of the collateral and the size of the loan. The majority of indirect consumer loans are underwritten on a secured basis using the underlying collateral being financed.

Home Equity – The Company offers fixed home equity loans as well as home equity lines of credit to consumers to finance home improvements, debt consolidation, education and other uses. Consumers are able to borrow up to 85% of the equity in their homes. The Company originates home equity lines of credit and second mortgage loans (loans secured by a second junior lien position on one-to-four-family residential real estate). These loans carry a higher risk than first mortgage residential loans as they are in a second position with respect to collateral. Risk is reduced through underwriting criteria, which include credit verification, appraisals, a review of the borrower's financial condition, and personal cash flows. A security interest, with title insurance when necessary, is taken in the underlying real estate.

Direct – The Company offers a variety of consumer installment loans to finance vehicle purchases, mobile home purchases and personal expenditures. Most of these loans carry a fixed rate of interest with principal repayment terms typically ranging from one to ten years, based upon the nature of the collateral and the size of the loan. The majority of consumer loans are underwritten on a secured basis using the underlying collateral being financed or a customer's deposit account. In addition to installment loans, the Company also offers personal lines of credit and overdraft protection. A minimal amount of loans are unsecured, which carry a higher risk of loss.

Table of Contents

Residential Real Estate Mortgages

Residential real estate loans consist primarily of loans secured by first or second deeds of trust on primary residences. We originate adjustable-rate and fixed-rate, one-to-four-family residential real estate loans for the construction, purchase or refinancing of a mortgage. These loans are collateralized by owner-occupied properties located in the Company's market area. Loans on one-to-four-family residential real estate are generally originated in amounts of no more than 85% of the purchase price or appraised value (whichever is lower), or have private mortgage insurance. The Company's underwriting analysis for residential mortgage loans typically includes credit verification, independent appraisals, and a review of the borrower's financial condition. Mortgage title insurance and hazard insurance are normally required. Construction loans have a unique risk, because they are secured by an incomplete dwelling. This risk is reduced through periodic site inspections, including one at each loan draw period.

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 make loan grade changes as well as recognize additions to the allowance based on their examinations.

After a thorough consideration of the factors discussed above, any required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These charges or credits 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 and reductions of 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.

Table of Contents

The following tables illustrate the changes in the allowance for loan losses by our portfolio segments for the three months ended March 31, 2014 and 2013:

Three months ended March 31	Commercial Loans	Consumer Loans	Residential		Total
			Real Estate Mortgages	Unallocated	
Balance as of December 31, 2013	\$ 35,090	\$ 27,694	\$ 6,520	\$ 130	\$69,434
Charge-offs	(479)	(4,032)	(319)	-	(4,830)
Recoveries	399	741	94	-	1,234
Provision	(573)	4,033	(70)	206	3,596
Ending Balance as of March 31, 2014	\$ 34,437	\$ 28,436	\$ 6,225	\$ 336	\$69,434
Balance as of December 31, 2012	\$ 35,624	\$ 27,162	\$ 6,252	\$ 296	\$69,334
Charge-offs	(3,322)	(3,723)	(671)	-	(7,716)
Recoveries	467	977	14	-	1,458
Provision	2,589	1,869	1,113	87	5,658
Ending Balance as of March 31, 2013	\$ 35,358	\$ 26,285	\$ 6,708	\$ 383	\$68,734

For acquired loans, to the extent that we experience deterioration in borrower credit quality resulting in a decrease in our expected cash flows subsequent to acquisition of the loans, an allowance for loan losses would be established based on our estimate of future credit losses over the remaining life of the loans. As of March 31, 2014 and 2013, there was no allowance for loan losses for the acquired loan portfolio. Net charge-offs related to acquired loans totaled approximately \$0.2 million during the three months ended March 31, 2014 and 2013, and are included in the table above.

Table of Contents

The following tables illustrate the allowance for loan losses and the recorded investment by portfolio segments as of March 31, 2014 and December 31, 2013:

Allowance for Loan Losses and Recorded Investment in Loans
(in thousands)

	Commercial Loans	Consumer Loans	Residential Real Estate Mortgages	Unallocated	Total
As of March 31, 2014					
Allowance for loan losses	\$ 34,437	\$ 28,436	\$ 6,225	\$ 336	\$ 69,434
Allowance for loans individually evaluated for impairment	925	-	-		925
Allowance for loans collectively evaluated for impairment	\$ 33,512	\$ 28,436	\$ 6,225	\$ 336	\$ 68,509
Ending balance of loans	\$ 2,436,202	\$ 1,989,030	\$ 1,056,793		\$ 5,482,025
Ending balance of originated loans individually evaluated for impairment	15,025	4,248	2,722		21,995
Ending balance of acquired loans individually evaluated for impairment	9,873	-	-		9,873
Ending balance of acquired loans collectively evaluated for impairment	385,669	199,196	300,360		885,225
Ending balance of originated loans collectively evaluated for impairment	\$ 2,025,635	\$ 1,785,586	\$ 753,711		\$ 4,564,932
As of December 31, 2013					
Allowance for loan losses	\$ 35,090	\$ 27,694	\$ 6,520	\$ 130	\$ 69,434
Allowance for loans individually evaluated for impairment	715	-	-		715
Allowance for loans collectively evaluated for impairment	\$ 34,375	\$ 27,694	\$ 6,520	\$ 130	\$ 68,719
Ending balance of loans	\$ 2,392,621	\$ 1,972,537	\$ 1,041,637		\$ 5,406,795
Ending balance of originated loans individually evaluated for impairment	16,120	3,248	2,012		21,380
Ending balance of acquired loans individually evaluated for impairment	10,060	-	-		10,060
Ending balance of acquired loans collectively evaluated for impairment	392,329	219,587	308,416		920,332
	\$ 1,974,112	\$ 1,749,702	\$ 731,209		\$ 4,455,023

Ending balance of originated loans collectively
evaluated for impairment

18

Table of Contents

Credit Quality of Loans

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 or 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. The Company's nonaccrual policies are the same for all classes of financing receivable.

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. 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. When in the opinion of management the collection of principal appears unlikely, the loan balance is charged-off in total or in part. 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.

Table of Contents

The following table illustrates the Company's nonaccrual loans by loan class:

Loans on Nonaccrual Status as of:

(In thousands)	March 31, 2014	December 31, 2013
ORIGINATED		
Commercial Loans		
Commercial	\$3,644	\$ 3,669
Commercial Real Estate	7,282	7,834
Agricultural	1,366	1,135
Agricultural Real Estate	1,758	961
Business Banking	5,708	5,701
	19,758	19,300
Consumer Loans		
Indirect	1,549	1,461
Home Equity	7,074	5,931
Direct	76	86
	8,699	7,478
Residential Real Estate Mortgages	6,905	7,105
	\$35,362	\$ 33,883
ACQUIRED		
Commercial Loans		
Commercial	\$6,477	\$ 6,599
Commercial Real Estate	3,493	3,559
Business Banking	1,037	1,340
	11,007	11,498
Consumer Loans		
Indirect	129	93
Home Equity	808	570
Direct	38	49
	975	712
Residential Real Estate Mortgages	4,120	3,872
	\$16,102	\$ 16,082
TOTAL NONACCRUAL LOANS	\$51,464	\$ 49,965

Table of Contents

The following tables set forth information with regard to past due and nonperforming loans by loan class as of March 31, 2014 and December 31, 2013:

Age Analysis of Past Due Financing Receivables

As of March 31, 2014

(in thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Non-Accrual	Current	Recorded Total Loans
<u>ORIGINATED</u>							
Commercial Loans							
Commercial	\$ -	\$ 409	\$ -	\$ 409	\$ 3,644	\$ 631,041	\$ 635,094
Commercial Real Estate	367	69	-	436	7,282	959,156	966,874
Agricultural	-	-	-	-	1,366	60,979	62,345
Agricultural Real Estate	136	-	-	136	1,758	36,719	38,613
Business Banking	1,151	159	158	1,468	5,708	330,558	337,734
	1,654	637	158	2,449	19,758	2,018,453	2,040,660
Consumer Loans							
Indirect	9,189	2,061	1,286	12,536	1,549	1,203,341	1,217,426
Home Equity	5,403	2,032	583	8,018	7,074	502,372	517,464
Direct	413	90	52	555	76	54,313	54,944
	15,005	4,183	1,921	21,109	8,699	1,760,026	1,789,834
Residential Real Estate							
Mortgages	3,307	1,076	444	4,827	6,905	744,701	756,433
	\$ 19,966	\$ 5,896	\$ 2,523	\$ 28,385	\$ 35,362	\$ 4,523,180	\$ 4,586,927
<u>ACQUIRED</u>							
Commercial Loans							
Commercial	\$ 150	\$ -	\$ -	\$ 150	\$ 6,477	\$ 97,406	\$ 104,033
Commercial Real Estate	-	-	-	-	3,493	219,524	223,017
Business Banking	45	-	-	45	1,037	67,410	68,492
	195	-	-	195	11,007	384,340	395,542
Consumer Loans							
Indirect	575	84	50	709	129	107,501	108,339
Home Equity	288	93	112	493	808	83,044	84,345
Direct	99	8	15	122	38	6,352	6,512
	962	185	177	1,324	975	196,897	199,196
Residential Real Estate							
Mortgages	1,329	39	-	1,368	4,120	294,872	300,360
	\$ 2,486	\$ 224	\$ 177	\$ 2,887	\$ 16,102	\$ 876,109	\$ 895,098
Total Loans	\$ 22,452	\$ 6,120	\$ 2,700	\$ 31,272	\$ 51,464	\$ 5,399,289	\$ 5,482,025

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Table of Contents

Age Analysis of Past Due Financing Receivables

As of December 31, 2013

(in thousands)

	31-60 Days Past Due Accruing	61-90 Days Past Due Accruing	Greater Than 90 Days Past Due Accruing	Total Past Due Accruing	Non-Accrual	Current	Recorded Total Loans
ORIGINATED							
Commercial Loans							
Commercial	\$ 105	\$ 247	\$ -	\$ 352	\$ 3,669	\$ 612,402	\$ 616,423
Commercial Real Estate	1,366	-	-	1,366	7,834	925,116	934,316
Agricultural	150	21	-	171	1,135	63,856	65,162
Agricultural Real Estate	519	-	-	519	961	35,172	36,652
Business Banking	1,228	122	105	1,455	5,701	330,523	337,679
	3,368	390	105	3,863	19,300	1,967,069	1,990,232
Consumer Loans							
Indirect	14,093	2,878	1,583	18,554	1,461	1,141,829	1,161,844
Home Equity	6,033	1,888	1,115	9,036	5,931	517,856	532,823
Direct	679	125	46	850	86	57,347	58,283
	20,805	4,891	2,744	28,440	7,478	1,717,032	1,752,950
Residential Real Estate Mortgages							
	3,951	379	808	5,138	7,105	720,978	733,221
	\$ 28,124	\$ 5,660	\$ 3,657	\$ 37,441	\$ 33,883	\$ 4,405,079	\$ 4,476,403
ACQUIRED							
Commercial Loans							
Commercial	\$ 24	\$ -	\$ -	\$ 24	\$ 6,599	\$ 96,603	\$ 103,226
Commercial Real Estate	-	-	-	-	3,559	225,455	229,014
Business Banking	320	2	-	322	1,340	68,487	70,149
	344	2	-	346	11,498	390,545	402,389
Consumer Loans							
Indirect	939	113	71	1,123	93	123,870	125,086
Home Equity	753	63	-	816	570	85,690	87,076
Direct	76	56	9	141	49	7,235	7,425
	1,768	232	80	2,080	712	216,795	219,587
Residential Real Estate Mortgages							
	1,725	-	-	1,725	3,872	302,819	308,416
	\$ 3,837	\$ 234	\$ 80	\$ 4,151	\$ 16,082	\$ 910,159	\$ 930,392
Total Loans	\$ 31,961	\$ 5,894	\$ 3,737	\$ 41,592	\$ 49,965	\$ 5,315,238	\$ 5,406,795

There were no material commitments to extend further credit to borrowers with nonperforming loans.

Impaired Loans

The methodology used to establish the allowance for loan losses on impaired loans incorporates specific allocations on loans analyzed individually. Classified and nonperforming loans and troubled debt restructured loans (“TDR”) with outstanding balances of \$0.5 million or more are evaluated for impairment through the Company’s quarterly status review process. 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. For loans that are impaired as defined by accounting standards, impairment is measured by one of three methods: 1) the fair value of collateral less cost to sell, 2) present value of expected future cash flows or 3) the loan’s observable market price. All impaired loans are reviewed on a quarterly basis for changes in the measurement of impairment. Any change to the previously recognized impairment loss is recognized as a change to the allowance account and recorded in the consolidated statement of income as a component of the provision for credit losses.

Table of Contents

The following table provides information on loans specifically evaluated for impairment as of March 31, 2014 and December 31, 2013:

(in thousands)	March 31, 2014			December 31, 2013		
	Recorded Unpaid Investment Principal Balance (Book)	Recorded Unpaid Investment Principal Balance (Legal)	Related Allowance	Recorded Unpaid Investment Principal Balance (Book)	Recorded Unpaid Investment Principal Balance (Legal)	Related Allowance
<u>ORIGINATED</u>						
With no related allowance recorded:						
Commercial Loans						
Commercial	\$2,026	\$2,096		\$4,721	\$4,777	
Commercial Real Estate	7,252	7,823		4,613	5,164	
Agricultural	124	195		125	195	
Agricultural Real Estate	1,418	1,697		1,431	1,708	
Business Banking	172	564		210	602	
Total Commercial Loans	10,992	12,375		11,100	12,446	
Consumer Loans						
Home Equity	4,248	4,534		3,248	3,472	
Residential Real Estate Mortgages	2,722	3,036		2,012	2,255	
Total	17,962	19,945		16,360	18,173	
With an allowance recorded:						
Commercial Loans						
Commercial Real Estate	4,033	5,890	925	5,020	6,877	715
<u>ACQUIRED</u>						
With no related allowance recorded:						
Commercial Loans						
Commercial	6,380	6,538		6,501	6,538	
Commercial Real Estate	3,493	3,842		3,559	3,842	
Total Commercial Loans	9,873	10,380		10,060	10,380	
Total:	\$31,868	\$36,215	\$ 925	\$31,440	\$35,430	\$ 715

Table of Contents

The following tables summarize the average recorded investments on impaired loans specifically evaluated for impairment and the interest income recognized for the three ended March 31, 2014 and 2013:

(in thousands)	For the three months ended			
	March 31, 2014		March 31, 2013	
	Average		Average	
	Recorded Investment	Interest Recognized	Recorded Investment	Interest Recognized
ORIGINATED				
Commercial Loans				
Commercial	\$2,038	\$ -	\$5,069	\$ 29
Commercial Real Estate	11,553	42	12,339	72
Agricultural	125	-	378	3
Agricultural Real Estate	1,424	12	900	12
Business Banking	185	12	80	-
Consumer Loans				
Home Equity	4,282	43	2,901	29
Residential Real Estate Mortgage	2,727	23	2,065	11
Total Originated	\$22,334	\$ 132	\$23,732	\$ 156
ACQUIRED				
Commercial Loans				
Commercial	6,436	-	-	-
Commercial Real Estate	3,524	-	-	-
Total Acquired	\$9,960	\$ -	\$-	\$ -
Total Loans	\$32,294	\$ 132	\$23,732	\$ 156

Table of Contents

Credit Quality Indicators

The Company has developed an internal loan grading system to evaluate and quantify the Company's loan portfolio with respect to quality and risk. The system focuses on, among other things, financial strength of borrowers, experience and depth of borrower's management, primary and secondary sources of repayment, payment history, nature of the business, and outlook on particular industries. The internal grading system enables the Company to monitor the quality of the entire loan portfolio on a consistent basis and provide management with an early warning system, enabling recognition and response to problem loans and potential problem loans.

Commercial Grading System

For commercial and agricultural loans, the Company uses a grading system that relies on quantifiable and measurable characteristics when available. This would include comparison of financial strength to available industry averages, comparison of transaction factors (loan terms and conditions) to loan policy, and comparison of credit history to stated repayment terms and industry averages. Some grading factors are necessarily more subjective such as economic and industry factors, regulatory environment, and management. Classified commercial loans consist of loans graded substandard and below. The grading system for commercial and agricultural loans is as follows:

·Doubtful

A doubtful loan has a high probability of total or substantial loss, but because of specific pending events that may strengthen the asset, its classification as a loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Pending events can include mergers, acquisitions, liquidations, capital injections, the perfection of liens on additional collateral, the valuation of collateral, and refinancing. Generally, pending events should be resolved within a relatively short period and the ratings will be adjusted based on the new information. Nonaccrual treatment is required for doubtful assets because of the high probability of loss.

·Substandard

Substandard loans have a high probability of payment default, or they have other well-defined weaknesses. They require more intensive supervision by bank management. Substandard loans are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. For some Substandard loans, the likelihood of full collection of interest and principal may be in doubt and those loans should be placed on nonaccrual. Although Substandard assets in the aggregate will have a distinct potential for loss, an individual asset's loss potential does not have to be distinct for the asset to be rated Substandard.

·Special Mention

Special Mention loans have potential weaknesses that may, if not checked or corrected, weaken the asset or inadequately protect the Company's position at some future date. These loans pose elevated risk, but their weakness does not yet justify a Substandard classification. Borrowers may be experiencing adverse operating trends (declining revenues or margins) or may be struggling with an ill-proportioned balance sheet (e.g., increasing inventory without an increase in sales, high leverage, tight liquidity). Adverse economic or market conditions, such as interest rate increases or the entry of a new competitor, may also support a Special Mention rating. Although a Special Mention loan has a higher probability of default than a pass asset, its default is not imminent.

·Pass

Loans graded as Pass encompass all loans not graded as Doubtful, Substandard, or Special Mention. Pass loans are in compliance with loan covenants, and payments are generally made as agreed. Pass loans range from superior quality to fair quality.

Table of Contents

Business Banking Grading System

Business banking loans are graded as either Classified or Non-classified:

·Classified

Classified loans are inadequately protected by the current worth and paying capacity of the obligor or, if applicable, the collateral pledged. These loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt, or in some cases make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Classified loans have a high probability of payment default, or a high probability of total or substantial loss. These loans require more intensive supervision by management and are generally characterized by current or expected unprofitable operations, inadequate debt service coverage, inadequate liquidity, or marginal capitalization. Repayment may depend on collateral or other credit risk mitigants. When the likelihood of full collection of interest and principal may be in doubt; classified loans are considered to have a nonaccrual status. In some cases, Classified loans are considered uncollectible and of such little value that their continuance as assets is not warranted.

·Non-classified

Loans graded as Non-classified encompass all loans not graded as Classified. Non-classified loans are in compliance with loan covenants, and payments are generally made as agreed.

Consumer and Residential Mortgage Grading System

Consumer and Residential Mortgage loans are graded as either Performing or Nonperforming. Nonperforming loans are loans that are 1) over 90 days past due and interest is still accruing, 2) on nonaccrual status or 3) restructured. All loans not meeting any of these three criteria are considered Performing.

Table of Contents

The following tables illustrate the Company's credit quality by loan class as of March 31, 2014 and December 31, 2013:

Credit Quality Indicators

As of March 31, 2014

ORIGINATED

Commercial Credit Exposure	Commercial			Agricultural	
By Internally Assigned Grade:	Commercial	Real Estate	Agricultural	Real Estate	Total
Pass	\$ 585,553	\$ 910,431	\$ 57,573	\$ 34,754	\$ 1,588,311
Special Mention	12,755	20,924	366	7	34,052
Substandard	36,786	35,519	4,394	3,852	80,551
Doubtful	-	-	12	-	12
Total	\$ 635,094	\$ 966,874	\$ 62,345	\$ 38,613	\$ 1,702,926

Business Banking Credit Exposure

	Business	Total
By Internally Assigned Grade:	Banking	
Non-classified	\$ 319,727	\$ 319,727
Classified	18,007	18,007
Total	\$ 337,734	\$ 337,734

Consumer Credit Exposure

By Payment Activity:	Indirect	Home Equity	Direct	Total
Performing	\$ 1,214,591	\$ 509,807	\$ 54,816	\$ 1,779,214
Nonperforming	2,835	7,657	128	10,620
Total	\$ 1,217,426	\$ 517,464	\$ 54,944	\$ 1,789,834

Residential Mortgage Credit Exposure	Residential	Total
By Payment Activity:	Mortgage	
Performing	\$ 749,084	\$ 749,084
Nonperforming	7,349	7,349
Total	\$ 756,433	\$ 756,433

Table of Contents

Credit Quality Indicators

As of March 31, 2014

ACQUIRED

Commercial Credit Exposure	Commercial			
By Internally Assigned Grade:	Commercial	Real Estate	Agricultural	Total
Pass	\$ 88,439	\$ 204,582	\$ -	\$293,021
Special Mention	2,010	2,699	-	4,709
Substandard	13,584	15,736	-	29,320
Doubtful	-	-	-	-
Total	\$ 104,033	\$ 223,017	\$ -	\$327,050

Business Banking Credit Exposure

	Business	
By Internally Assigned Grade:	Banking	Total
Non-classified	\$ 63,332	\$63,332
Classified	5,160	5,160
Total	\$ 68,492	\$68,492

Consumer Credit Exposure

	Indirect	Home	Direct	Total
By Payment Activity:		Equity		
Performing	\$ 108,160	\$ 83,425	\$ 6,459	\$198,044
Nonperforming	179	920	53	1,152
Total	\$ 108,339	\$ 84,345	\$ 6,512	\$199,196

Residential Mortgage Credit Exposure	Residential	
By Payment Activity:	Mortgage	Total
Performing	\$ 296,240	\$296,240
Nonperforming	4,120	4,120
Total	\$ 300,360	\$300,360

Table of Contents

Credit Quality Indicators
As of December 31, 2013

ORIGINATED

Commercial Credit Exposure	Commercial			Agricultural	
By Internally Assigned Grade:	Commercial	Real Estate	Agricultural	Real Estate	Total
Pass	\$ 576,079	\$ 878,411	\$ 60,043	\$ 33,136	\$ 1,547,669
Special Mention	16,836	22,777	381	43	40,037
Substandard	23,508	33,128	4,726	3,473	64,835
Doubtful	-	-	12	-	12
Total	\$ 616,423	\$ 934,316	\$ 65,162	\$ 36,652	\$ 1,652,553

Business Banking Credit Exposure

	Business	Total
By Internally Assigned Grade:	Banking	
Non-classified	\$ 319,578	\$ 319,578
Classified	18,101	18,101
Total	\$ 337,679	\$ 337,679

Consumer Credit Exposure

By Payment Activity:	Indirect	Home	Direct	Total
Performing	\$ 1,158,800	\$ 525,777	\$ 58,151	\$ 1,742,728
Nonperforming	3,044	7,046	132	10,222
Total	\$ 1,161,844	\$ 532,823	\$ 58,283	\$ 1,752,950

Residential Mortgage Credit Exposure

By Payment Activity:	Residential	Total
Performing	\$ 725,308	\$ 725,308
Nonperforming	7,913	7,913
Total	\$ 733,221	\$ 733,221

Table of Contents

Credit Quality Indicators
As of December 31, 2013

ACQUIRED

Commercial Credit Exposure	Commercial			Total
By Internally Assigned Grade:	Commercial	Real Estate	Agricultural	
Pass	\$ 85,692	\$ 205,010	\$ -	\$290,702
Special Mention	2,230	6,183	-	8,413
Substandard	15,304	17,821	-	33,125
Doubtful	-	-	-	-
Total	\$ 103,226	\$ 229,014	\$ -	\$332,240

Business Banking Credit Exposure

	Business Banking	Total
By Internally Assigned Grade:		
Non-classified	\$ 65,437	\$65,437
Classified	4,712	4,712
Total	\$ 70,149	\$70,149

Consumer Credit Exposure

	Indirect	Home Equity	Direct	Total
By Payment Activity:				
Performing	\$ 124,922	\$ 86,506	\$ 7,367	\$218,795
Nonperforming	164	570	58	792
Total	\$ 125,086	\$ 87,076	\$ 7,425	\$219,587

Residential Mortgage Credit Exposure	Residential Mortgage	Total
By Payment Activity:		
Performing	\$ 304,544	\$304,544
Nonperforming	3,872	3,872
Total	\$ 308,416	\$308,416

Table of Contents

Troubled Debt Restructured Loans

The Company's loan portfolio includes certain loans that have been modified where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Company's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. Substantially all of these modifications included one or a combination of the following: an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; temporary reduction in the interest rate; or change in scheduled payment amount.

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.

TDRs that occurred during the three month period ending March 31, 2014 consisted of 22 home equity loans and 12 residential real estate mortgages totaling \$1.1 million and \$1.0 million, respectively. For all such modifications, the pre and post outstanding recorded investment amount remained unchanged. During the three month period ending March 31, 2014 there was one default on a home equity loan totaling \$11,000 and one default on a residential real estate mortgage totaling \$0.1 million.

TDRs that occurred during the three month period ending March 31, 2013 consisted of 10 home equity loans and one residential real estate mortgage totaling \$0.6 million and \$0.1 million, respectively. For all such modifications, the pre and post outstanding recorded investment amount remained unchanged. During the three month period ending March 31, 2013 there were no defaults on previously modified loans.

Table of Contents

Note 5. Defined Benefit Postretirement Plans

The Company has a qualified, noncontributory, defined benefit pension plan (“the Plan”) covering substantially all of its employees at March 31, 2014. Benefits paid from the plan are based on age, years of service, compensation and social security benefits, and are determined in accordance with defined formulas. The Company’s policy is to fund the pension plan in accordance with Employee Retirement Income Security Act of 1974 (“ERISA”) standards. Assets of the plan are invested in publicly traded stocks and bonds. The Company is not required to make contributions to the Plan in 2014, and did not do so during the three months ended March 31, 2014.

The Company assumed a noncontributory, defined benefit pension plan in the Alliance acquisition. This plan covers certain Alliance full-time employees who met eligibility requirements on October 6, 2006, at which time all benefits were frozen. Under the plan, retirement benefits are primarily a function of both the years of service and the level of compensation. Effective May 1, 2013, this plan was merged into the Plan.

Market conditions can result in an unusually high degree of volatility and increase the risks and short term liquidity associated with certain investments held by the Plan which could impact the value of these investments.

In addition to the Plan, the Company also provides supplemental employee retirement plans to certain current and former executives. These supplemental employee retirement plans and the Plan are collectively referred to herein as “Pension Benefits.”

Also, the Company provides certain health care benefits for retired employees. Benefits are accrued over the employees’ active service period. Only employees that were employed by the Company on or before January 1, 2000 are eligible to receive postretirement health care benefits. This health care benefits plan is contributory for participating retirees, requiring participants to absorb certain deductibles and coinsurance amounts with contributions adjusted annually to reflect cost sharing provisions and benefit limitations called for in the plan. Eligibility is contingent upon the direct transition from active employment status to retirement without any break in employment from the Company. Employees also must be participants in the Company’s medical plan prior to their retirement. The Company funds the cost of postretirement health care as benefits are paid. The Company elected to recognize the transition obligation on a delayed basis over twenty years. In addition, the Company assumed post-retirement medical life insurance benefits for certain Alliance employees, retirees and their spouses, if applicable, in the Alliance acquisition. These postretirement benefits are referred to herein as “Other Benefits.” The components of expense for Pension Benefits and Other Benefits are set forth below (in thousands):

	Pension Benefits		Other Benefits	
	Three months ended March 31,		Three months ended March 31,	
Components of net periodic (benefit) cost:	2014	2013	2014	2013
Service cost	\$587	\$604	\$4	\$6
Interest cost	1,040	722	90	34
Expected return on plan assets	(2,175)	(1,825)	-	-
Net amortization	25	603	(6)	223
Total (benefit) cost	\$(523)	\$104	\$88	\$263

Table of Contents

Note 6. Earnings Per Share

Basic earnings per share 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 earnings per share 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 units).

The following is a reconciliation of basic and diluted earnings per share for the periods presented in the consolidated statements of income.

Three months ended March 31, (in thousands, except per share data)	2014	2013
Basic EPS:		
Weighted average common shares outstanding	43,762	36,410
Net income available to common shareholders	18,009	7,649
Basic EPS	\$0.41	\$0.21
Diluted EPS:		
Weighted average common shares outstanding	43,762	36,410
Dilutive effect of common stock options and restricted stock	505	384
Weighted average common shares and common share equivalents	44,267	36,794
Net income available to common shareholders	18,009	7,649
Diluted EPS	\$0.41	\$0.21

There were 479,543 stock options for the quarter ended March 31, 2014 and 1,171,825 stock options for the quarter ended March 31, 2013 that were not considered in the calculation of diluted earnings per share since the stock options' exercise price was greater than the average market price during these periods.

Note 7. Reclassification Adjustments Out of Other Comprehensive (Loss) Income

The following table summarizes the reclassification adjustments out of accumulated other comprehensive loss (in thousands):

Detail About Accumulated Other Comprehensive (Loss) Income Components	Amount reclassified from accumulated other comprehensive income (loss) Three months ended March 31, 2014	Affected line item in the consolidated statement of comprehensive income March 31, 2013
Available for sale securities:		
Gains on available for sale securities	\$(7)	\$(1,145) Net securities gains
Tax benefit	3	454 Income tax expense
Net of tax	\$(4)	\$(691)

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Pension and other benefits:

Amortization of net gains	\$74	\$882	Salaries and employee benefits
Amortization of prior service costs	(55)	(56))Salaries and employee benefits
Tax benefit	8	323	Income tax expense
Net of tax	\$11	\$503	

Total reclassifications during the period, net of tax \$7 \$(188)

33

Table of Contents

Note 8. Fair Value Measurements and Fair Value of Financial Instruments

U.S. GAAP states that 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 exists within U.S. GAAP that 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.

For the three month period ending March 31, 2014, the Company has made no transfers of assets between Level 1 and Level 2, and has had no Level 3 activity.

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Table of Contents

The following tables set forth the Company's financial assets and liabilities measured on a recurring basis that were accounted for at fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement (in thousands):

March 31, 2014:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of March 31, 2014
Assets:				
Securities Available for Sale:				
U.S. Treasury	\$33,473	\$-	\$ -	\$33,473
Federal Agency	-	300,158	-	300,158
State & municipal	-	112,695	-	112,695
Mortgage-backed	-	378,158	-	378,158
Collateralized mortgage obligations	-	537,647	-	537,647
Other securities	7,238	8,216	-	15,454
Total Securities Available for Sale	\$40,711	\$1,336,874	\$ -	\$1,377,585
Trading Securities	6,954	-	-	6,954
Interest Rate Swaps	-	1,283	-	1,283
Total	\$47,665	\$1,338,157	\$ -	\$1,385,822
Liabilities:				
Interest Rate Swaps	\$-	\$1,283	\$ -	\$1,283
Total	\$-	\$1,283	\$ -	\$1,283

December 31, 2013:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2013
Assets:				
Securities Available for Sale:				
U.S. Treasury	\$43,616	\$-	\$ -	\$43,616
Federal Agency	-	278,915	-	278,915
State & municipal	-	113,665	-	113,665
Mortgage-backed	-	364,164	-	364,164
Collateralized mortgage obligations	-	549,528	-	549,528

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Other securities	6,796	8,197	-	14,993
Total Securities Available for Sale	\$50,412	\$1,314,469	\$ -	\$1,364,881
Trading Securities	5,779	-	-	5,779
Interest Rate Swaps	-	281	-	281
Total	\$56,191	\$1,314,750	\$ -	\$1,370,941

Liabilities:

Interest Rate Swaps	\$-	\$281	\$ -	\$281
Total	\$-	\$281	\$ -	\$281

35

Table of Contents

Certain common equity securities are reported at fair value utilizing Level 1 inputs (exchange quoted prices). The majority of the other investment securities are reported at fair value utilizing Level 2 inputs. The prices for these instruments are obtained through an independent pricing service or dealer market participants with whom the Company has historically transacted both purchases and sales of investment securities. Prices obtained from these sources include prices derived from market quotations and matrix pricing. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things. Management reviews the methodologies used in pricing the securities by its third party providers.

U.S. GAAP requires disclosure of assets and liabilities measured and recorded at fair value on a nonrecurring basis such as goodwill, loans held for sale, other real estate owned, collateral-dependent impaired loans, mortgage servicing rights, and held-to-maturity securities. The only nonrecurring fair value measurement recorded during the three month period ended March 31, 2014 and December 31, 2013 was related to impaired loans. The Company had collateral dependent impaired loans with a carrying value of approximately \$4.0 million which had specific reserves included in the allowance for loan losses of \$0.9 million at March 31, 2014. The Company had collateral dependent impaired loans with a carrying value of approximately \$5.0 million which had specific reserves included in the allowance for loan losses of \$0.7 million at December 31, 2013. The Company uses the fair value of underlying collateral, less costs to sell, to estimate the specific reserves for collateral dependent impaired loans. The appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses ranging from 10% to 35%. Based on the valuation techniques used, the fair value measurements for collateral dependent impaired loans are classified as Level 3.

The following table sets forth information with regard to estimated fair values of financial instruments at March 31, 2014 and December 31, 2013. This table excludes financial instruments for which the carrying amount approximates fair value. Financial instruments for which the fair value approximates carrying value include cash and cash equivalents, securities available for sale, trading securities, accrued interest receivable, non-maturity deposits, short-term borrowings, accrued interest payable, and interest rate swaps.

	Fair Value Hierarchy	March 31, 2014		December 31, 2013	
		Carrying amount	Estimated fair value	Carrying amount	Estimated fair value
(In thousands)					
Financial assets					
Securities held to maturity	2	\$ 117,896	\$ 114,920	\$ 117,283	\$ 113,276
Net loans	3	5,412,591	5,460,326	5,337,361	5,386,520
Financial liabilities					
Time deposits	2	\$969,361	\$969,980	\$1,021,142	\$1,023,982
Long-term debt	2	308,679	323,712	308,823	325,195
Junior subordinated debt	2	101,196	105,864	101,196	105,121

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Table of Contents

Fair value estimates are based on existing on and off balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. For example, the Company has a substantial trust and investment management operation that contributes net fee income annually. The trust and investment management operation is not considered a financial instrument, and its value has not been incorporated into the fair value estimates. Other significant assets and liabilities include the benefits resulting from the low-cost funding of deposit liabilities as compared to the cost of borrowing funds in the market, and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimate of fair value.

Securities Held to Maturity

The fair value of the Company's investment securities held to maturity is primarily measured using information from a third party pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the bond's terms and conditions, among other things.

Net Loans

The fair value of the Company's loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made for the same remaining maturities. Loans were first segregated by type, and then further segmented into fixed and variable rate and loan quality categories. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

Time Deposits

The fair value of time deposits was estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments. The fair values of the Company's time deposit liabilities do not take into consideration the value of the Company's long-term relationships with depositors, which may have significant value.

Long-Term Debt

The fair value of long-term debt was estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

Trust Preferred Debentures

The fair value of trust preferred debentures has been estimated using a discounted cash flow analysis.

Note 9. Commitments and Contingencies

The Company is a party to financial instruments in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuating interest rates. These financial instruments include commitments to extend credit, unused lines of credit, and standby letters of credit. Exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to make loans and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit origination guidelines, portfolio maintenance and management procedures as other credit and off-balance sheet products. Commitments to extend credit and unused lines of credit totaled \$1.1 billion at March 31, 2014 and December 31, 2013. Since commitments to extend credit and unused lines of credit may expire without being fully drawn upon, this amount does not necessarily represent future cash commitments. Collateral obtained upon exercise of the commitment is determined using management's credit evaluation of the borrower and may include accounts receivable, inventory, property, land and other items.

Table of Contents

The Company guarantees the obligations or performance of customers by issuing standby 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 credit 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 guidelines, portfolio maintenance and management procedures as 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 commitments. Standby letters of credit totaled \$38.3 million at March 31, 2014 and \$36.8 million at December 31, 2013. As of March 31, 2014, the fair value of standby letters of credit was not significant to the Company's consolidated financial statements.

The Company has also entered into commercial letter of credit agreements on behalf of its customers. Under these agreements, the Company, on the request of its customer, opens the letter of credit and makes a commitment to honor draws made under the agreement, whereby the beneficiary is normally the provider of goods and/or services and the Company essentially replaces the customer as the payee. The credit risk involved in issuing commercial 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 guidelines, portfolio maintenance and management procedures as other credit and off-balance sheet products. Typically, these agreements vary in terms and the total amounts do not necessarily represent future cash commitments. Commercial letters of credit totaled \$41.0 million at March 31, 2014 and \$41.3 million at December 31, 2013. As of March 31, 2014, the fair value of commercial letters of credit was not significant to the Company's consolidated financial statements.

Note 10. Subsequent Event

On April 17, 2014, NBT Capital Corp., a wholly-owned subsidiary of NBT, sold to LendingClub Corporation, its 20% ownership interest in Springstone Financial, LLC, which NBT originally acquired in exchange for a \$3 million investment, as part of LendingClub's acquisition of all of the outstanding equity in Springstone. In total, LendingClub paid the group of selling equityholders a purchase price equal to \$140 million in cash and preferred stock. Springstone provides affordable financing options for consumers seeking to finance private education and elective medical procedures through a network of over 14,000 schools and healthcare providers. In connection with the acquisition, NBT Bank and Springstone entered into an amended and restated program agreement pursuant to which NBT Bank will continue to participate in lending activities with respect to Springstone's financing operations. NBT is exploring balance sheet strategies for optimal use of the proceeds from this transaction.

Table of Contents

NBT BANCORP INC. AND SUBSIDIARIES

Item 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The purpose of this discussion and analysis is to provide a concise description of the financial condition and results of operations of NBT Bancorp Inc. and its wholly owned consolidated subsidiaries, NBT Bank, N.A. (the "Bank"), NBT Financial Services, Inc. ("NBT Financial"), and NBT Holdings, Inc. ("NBT Holdings") (collectively referred to herein as the "Company"). This discussion will focus on results of operations, financial condition, capital resources and asset/liability management. Reference should be made to the Company's consolidated financial statements and footnotes thereto included in this Form 10 Q as well as to the Company's Annual Report on Form 10 K for the year ended December 31, 2013 for an understanding of the following discussion and analysis. Operating results for the three-month period ending March 31, 2014 are not necessarily indicative of the results of the full year ending December 31, 2014 or any future period.

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," "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 those described above and other factors discussed in the Company's annual and quarterly reports previously filed with the Securities and Exchange Commission, 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.

Table of Contents

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

Non-GAAP Measures

This Quarterly Report on Form 10-Q 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 measures to exclude the effects of sales of securities and certain non-recurring and merger-related expenses. Where non-GAAP disclosures are used in this Quarterly Report on Form 10-Q, the comparable GAAP measure, as well as a reconciliation to the comparable GAAP measure, is provided in the accompanying tables. 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 non-recurring nature of the excluded items. Non-GAAP measures should not be considered substitutes 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.

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 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.

Management is required to make various assumptions in valuing the Company's 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.

Table of Contents

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 adverse effect on the Company's results of operations.

Another critical accounting policy is the policy for acquired loans. Acquired loans are initially recorded at their acquisition date fair values. The carryover of allowance for loan losses is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. Fair values for acquired loans are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, prepayment risk, liquidity risk, default rates, loss severity, payment speeds, collateral values and discount rate. Subsequent to the acquisition of acquired impaired loans, applicable accounting guidance requires the continued estimation of expected cash flows to be received. This estimation involves the use of key assumptions and estimates, similar to those used in the initial estimate of fair value. Changes in expected cash flows could result in the recognition of impairment through provision for credit losses. Subsequent to the purchase date, the methods utilized to estimate the required allowance for loan losses for the non-impaired acquired loans is similar to originated loans.

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, acquired loans, provision for income taxes and intangible assets are disclosed in Note 1 to the consolidated financial statements presented in our 2013 Annual Report on Form 10-K. 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.

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 average assets, equity and tangible common equity, net interest margin, noninterest income, operating expenses, certain core results, 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 first three months of 2014:

Table of Contents

Reported net income for the three months ended March 31, 2014 was \$18.0 million, up from \$7.6 million for the same period in 2013. Reported results for the three months ending March 31, 2014 include the full impact of the acquisition of Alliance Financial Corporation (“Alliance”) on March 8, 2013. Reported results for the three months ending March 31, 2013 include a partial impact of Alliance, including \$10.7 million in merger related expenses. Core net income was \$18.4 million for the three months ended March 31, 2014, up 29.1% from \$14.3 million for the same period in 2013. Core diluted earnings per share for the three months ended March 31, 2014 was \$0.42, up from \$0.39 for the same period in 2013. Core annualized return on average assets and return on average equity were 0.98% and 9.02%, respectively, for the three months ended March 31, 2014, compared with 0.90% and 9.01%, respectively, for the three months ended March 31, 2013. A reconciliation of “core” results with their GAAP equivalents is presented in the table below.

Net interest margin (on a fully taxable equivalent basis (“FTE”)) was 3.63% for the three months ended March 31, 2014 as compared to 3.68% for the same period in 2013.

Annualized loan growth for the first three months of 2014 was 5.6%.

Past due loans as a percentage of total loans were 0.57% at March 31, 2014 as compared to 0.77% at December 31, 2013.

Net charge-offs, annualized, were 0.27% of average loans for the first three months of 2014, compared to 0.44% for the year ended December 31, 2013.

Table of Contents

The following table depicts several annualized measurements of performance using core and GAAP net income that management reviews in analyzing the Company's performance. Returns on average assets and average equity measure how effectively an entity utilizes its total resources and capital, respectively.

(Dollars in thousands)	For the three months ended March 31,			
	2014		2013	
Reconciliation of Non-GAAP Financial Measures:				
Reported net income (GAAP)	\$18,009		\$7,649	
Adj: Gain on securities transactions, net (net of tax)	(5)	(795)
Adj: Other adjustments (net of tax) (1)	430		-	
Plus: Merger related expenses (net of tax)	-		7,423	
Total Adjustments	425		6,628	
Core net income	\$18,434		\$14,277	
Weighted Average Diluted Shares	44,296,445		36,794,356	
Core Diluted Earnings Per Share	\$0.42		\$0.39	
Performance measures:				
Reported Return on Average Assets (2)	0.95	%	0.48	%
Core Return on Average Assets (2)	0.98	%	0.90	%
Reported Return on Average Equity (2)	8.81	%	4.83	%
Core Return on Average Equity (2)	9.02	%	9.01	%
Reported Return on Average Tangible Common Equity (2)(3)	14.16	%	7.49	%
Core Return on Average Tangible Common Equity (2)(3)	14.48	%	13.58	%

(1) Primarily reorganization expenses for 2014 related to rebranding initiative

(2) Annualized

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

	For the three months ended March 31,	
	2014	2013
Average stockholders equity	\$828,588	\$642,693
Less: average goodwill and other intangibles	290,019	200,779
Average tangible common equity	\$538,569	\$441,914

Table of Contents

Net Interest Income

Net interest income is the difference between interest income on earning assets, primarily loans and securities, and interest expense on interest bearing liabilities, primarily deposits and borrowings. Net interest income is affected by the interest rate spread, the difference between the yield on earning assets and cost of interest bearing liabilities, as well as the volumes of such assets and liabilities. Net interest income is one of the key determining factors in a financial institution's performance as it is the principal source of earnings.

Net interest income was \$61.5 million for the first quarter of 2014, down slightly from the prior quarter, and up \$9.4 million from the first quarter of 2013 primarily due to the acquisition of Alliance. FTE net interest margin was 3.63% for the three months ended March 31, 2014, up from 3.61% from the prior quarter, and down from 3.68% for the first quarter of 2013. Average interest earning assets were up \$54.4 million, or 0.8%, for the first quarter of 2014 as compared to the prior quarter, driven primarily by organic loan production during the first quarter highlighted by growth in the consumer and commercial loan portfolios. Slight rate compression on earning assets continued to negatively impact net interest margin in the first quarter of 2014 as evidenced by decreasing loan yields from 4.54% for the fourth quarter of 2013 to 4.50% for the first quarter of 2014. The increase in average earning assets during the first quarter of 2014 offset the rate compression resulting in the relatively flat margin in the first quarter of 2014 as compared to the prior quarter. Average interest bearing liabilities increased \$42.5 million, or 0.8%, from the fourth quarter of 2013 to the first quarter of 2014. The rate compression on earning assets was offset by a decrease of 3 basis points in the rates paid on interest bearing liabilities in the first quarter of 2014 versus the prior quarter. This decrease was primarily driven by a decrease of 4 basis points in rates paid on deposits and lower time deposit balances.

Table of Contents

Average Balances and Net Interest Income

The following tables include 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%.

Three Months ended March 31,

(dollars in thousands)	2014			2013		
	Average Balance	Interest	Yield/ Rates	Average Balance	Interest	Yield/ Rates
ASSETS						
Short-term interest bearing accounts	\$2,733	\$7	1.02 %	\$75,110	\$39	0.21 %
Securities available for sale (1)(2)	1,381,744	7,185	2.11 %	1,197,238	6,179	2.09 %
Securities held to maturity (1)	116,613	1,012	3.52 %	52,905	790	6.06 %
Investment in FRB and FHLB Banks	43,596	531	4.94 %	31,312	367	4.75 %
Loans and leases (3)	5,425,938	60,232	4.50 %	4,492,106	53,904	4.87 %
Total interest earning assets	\$6,970,624	\$68,967	4.01 %	\$5,848,671	\$61,279	4.25 %
Other assets	679,246			554,355		
Total assets	\$7,649,870			\$6,403,026		
LIABILITIES AND STOCKHOLDERS' EQUITY						
Money market deposit accounts	\$1,411,444	527	0.15 %	\$1,190,555	\$410	0.14 %
NOW deposit accounts	932,528	124	0.05 %	799,219	447	0.23 %
Savings deposits	1,000,029	183	0.07 %	770,559	145	0.08 %
Time deposits	999,579	2,450	0.99 %	1,015,711	3,148	1.26 %
Total interest bearing deposits	\$4,343,580	\$3,284	0.31 %	\$3,776,044	\$4,150	0.45 %
Short-term borrowings	398,951	231	0.24 %	168,783	42	0.10 %
Junior subordinated debt	101,196	538	2.16 %	82,295	428	2.11 %
Long-term debt	308,760	2,507	3.29 %	382,177	3,609	3.83 %
Total interest bearing liabilities	\$5,152,487	\$6,560	0.52 %	\$4,409,299	\$8,229	0.76 %
Demand deposits	1,589,865			1,283,737		
Other liabilities	78,930			67,297		
Stockholders' equity	828,588			642,693		
Total liabilities and stockholders' equity	\$7,649,870			\$6,403,026		
Net interest income (FTE)		62,407			53,050	
Interest rate spread			3.49 %			3.49 %
Net interest margin			3.63 %			3.68 %
Taxable equivalent adjustment		890			910	
Net interest income		\$61,517			\$52,140	

(1) Securities are shown at average amortized cost

(2) Excluding unrealized gains or losses

(3) For purposes of these computations, nonaccrual loans are included in the average loan balances outstanding

Table of Contents

The following table presents changes in interest income and interest expense attributable to changes in volume (change in average balance multiplied by prior year rate), changes in rate (change in rate multiplied by prior year volume), and the net change in net interest income. The net change attributable to the combined impact of volume and rate has been allocated to each in proportion to the absolute dollar amounts of change.

Three months ended March 31,

(in thousands)	Increase (Decrease)		
	2014 over 2013		Total
	Volume	Rate	
Short-term interest bearing accounts	\$(251)	\$219	\$(32)
Securities available for sale	959	47	1,006
Securities held to maturity	2,156	(1,934)	222
Investment in FRB and FHLB Banks	149	15	164
Loans	28,729	(22,401)	6,328
Total interest income	31,742	(24,054)	7,688
Money market deposit accounts	80	37	117
NOW deposit accounts	438	(761)	(323)
Savings deposits	64	(26)	38
Time deposits	(49)	(649)	(698)
Short-term borrowings	94	95	189
Junior subordinated debt	100	10	110
Long-term debt	(637)	(465)	(1,102)
Total interest expense	90	(1,759)	(1,669)
Change in FTE net interest income	\$31,652	\$(22,295)	\$9,357

Table of Contents

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 periods indicated:

	Three months ended March 31,	
	2014	2013
(in thousands)		
Insurance and other financial services revenue	\$6,737	\$6,893
Service charges on deposit accounts	4,369	4,323
ATM and debit card fees	4,072	3,242
Retirement plan administration fees	2,918	2,682
Trust	4,446	2,913
Bank owned life insurance	1,382	849
Net securities gains	7	1,145
Other	2,346	3,182
Total noninterest income	\$26,277	\$25,229

Noninterest income for the three months ended March 31, 2014 was \$26.3 million, up 3.9% from the prior quarter, and up 4.2% from the first quarter of 2013. The increase from the prior quarter was \$1.0 million and was driven primarily by insurance and other financial services revenue, mostly due to an increase in contingent insurance revenue in the first quarter of 2014. The increase from the three months ended March 31, 2013 was due primarily to increases in trust and ATM and debit card fees, due in large part to the full quarter impact from Alliance in 2014. In addition, the increase in bank owned life insurance was due primarily to the receipt of a policy benefit during the first quarter of 2014.

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 periods indicated:

	Three months ended March 31,	
	2014	2013
(in thousands)		
Salaries and employee benefits	\$29,534	\$27,047
Occupancy	6,226	4,977
Data processing and communications	4,001	3,455
Professional fees and outside services	3,415	2,901
Equipment	3,116	2,582
Office supplies and postage	1,685	1,590
FDIC expenses	1,278	1,130
Advertising	739	723
Amortization of intangible assets	1,310	851
Loan collection and other real estate owned	1,040	718
Merger	-	10,681
Other	5,173	4,050
Total noninterest expense	\$57,517	\$60,705

Table of Contents

Noninterest expense for the three months ended March 31, 2014 was \$57.5 million, up 3.7% from the prior quarter. This increase from the prior quarter was due primarily to a 5.1% increase in salaries and employee benefits and an 18.3% increase in occupancy expenses mostly due to the harsh winter. Noninterest expense for the three months ended March 31, 2014 was down 5.3% from the first quarter of 2013 primarily due to merger expenses associated with the acquisition of Alliance. Excluding merger expenses totaling \$10.7 million during the first quarter of 2013, noninterest expense was up 15.0% for the first quarter of 2014 as compared to the same period last year. This increase from the prior year was due primarily to the acquisition of Alliance expenses including occupancy, salaries and employee benefits, data processing, and equipment. The increase in salaries and benefits from the Alliance acquisition was partially offset by lower retirement plan expenses due mainly to plan asset performance and a previous plan amendment.

Income Taxes

Income tax expense for the three month period ended March 31, 2014 was \$8.7 million, up from \$3.4 million from the three months ended March 31, 2013. The increase was due primarily to the increase in pre-tax income. The effective tax rate was 32.5% for the first quarter of 2014 and 30.5% for the first quarter of 2013. The increase in our effective tax rate from 2013 was due to a lower level of tax-exempt income as a percentage to total taxable income during the first quarter of 2014.

ANALYSIS OF FINANCIAL CONDITIONSecurities

Average total earning securities increased \$248.2 million, or 19.9%, for the three months ended March 31, 2014 when compared to the same period in 2013. This increase resulted primarily from the Alliance acquisition. The average total securities portfolio represents 21.5% of total average earning assets for the three months ended March 31, 2014, up slightly from 21.4% for the same period in 2013.

The following table details the composition of securities available for sale, securities held to maturity and regulatory investments for the periods indicated:

	March 31, 2014		December 31, 2013	
Mortgage-backed securities:				
With maturities 15 years or less	23	%	23	%
With maturities greater than 15 years	1	%	1	%
Collateral mortgage obligations	39	%	40	%
Municipal securities	11	%	11	%
US agency notes	22	%	21	%
Other	4	%	4	%
Total	100	%	100	%

The Company's mortgage backed securities, U.S. agency notes, and collateralized mortgage obligations are all "prime/conforming" and are guaranteed by Fannie Mae, Freddie Mac, Federal Home Loan Bank, 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 subprime mortgages in our investment portfolio.

Table of ContentsLoans

A summary of loans, net of deferred fees and origination costs, by category for the periods indicated follows:

	March 31,	December
(In thousands)	2014	2013
Residential real estate mortgages	\$1,056,793	\$1,041,637
Commercial	878,152	859,026
Commercial real estate mortgages	1,347,940	1,328,313
Real estate construction and development	99,295	93,247
Agricultural and agricultural real estate mortgages	110,815	112,035
Consumer	1,387,221	1,352,638
Home equity	601,809	619,899
Total loans	\$5,482,025	\$5,406,795

Total loans increased by \$75.2 million, or 1.4%, at March 31, 2014 from December 31, 2013, due to annualized organic loan growth of 5.6% during the quarter and represent approximately 70.7% of assets, equivalent to December 31, 2013.

Allowance for Loan Losses, Provision for Loan Losses, and Nonperforming Assets

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 using a methodology designed to ensure that 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 degree of judgment exercised in evaluating the level 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 factors 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 thorough current assessment of a number of factors, which could affect collectability. These factors include: past loss experience; the size, trend, composition, and nature of the loans; changes in lending policies and procedures, including underwriting standards and collection, charge-off and recovery practices; 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 judgment about information available to them at the time of their examination, which may not be currently available to management.

Table of Contents

After a thorough consideration and validation of the factors discussed above, required additions or reductions to the allowance for loan losses are made periodically by charges or credits to the provision for loan losses. These charges are necessary to maintain the allowance at a level which management believes is reasonably reflective of the overall inherent risk of probable loss in the portfolio. While management uses available information to recognize losses on loans, additions or reductions 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. Management considers the allowance for loan losses to be adequate based on evaluation and analysis of the loan portfolio.

The following table reflects changes to the allowance for loan losses for the periods presented. The allowance is increased by provisions for losses charged to operations and is reduced by net charge-offs. Charge-offs are made when the ability to collect loan principal within a reasonable time becomes unlikely. Any recoveries of previously charged-off loans are credited directly to the allowance for loan losses.

Allowance For Loan Losses

	Three months ended	
	March 31, 2014	March 31, 2013
(dollars in thousands)		
Balance, beginning of period	\$ 69,434	\$ 69,334
Recoveries	1,234	1,458
Chargeoffs	(4,830)	(7,716)
Net chargeoffs	(3,596)	(6,258)
Provision for loan losses	3,596	5,658
Balance, end of period	\$ 69,434	\$ 68,734
Composition of Net Chargeoffs		
Commercial and agricultural	\$ (81) 2 %	\$ (2,855) 46 %
Real estate mortgage	(225) 6 %	(657) 10 %
Consumer	(3,290) 92 %	(2,746) 44 %
Net chargeoffs	\$ (3,596) 100 %	\$ (6,258) 100 %
Annualized net chargeoffs to average loans	0.27 %	0.56 %

Net charge-offs were \$3.6 million for the three months ended March 31, 2014, down from \$6.3 million for the three months ended March 31, 2013. Charge-offs during the first quarter of 2013 included a \$2.2 million charge-off on a large commercial loan which was previously provided for in 2012. The Company recorded a provision for loan losses of \$3.6 million for the three months ended March 31, 2014, compared with \$5.7 million for the first quarter of 2013.

Table of Contents

The allowance for loan losses totaled \$69.4 million at March 31, 2014, equal to the December 31, 2013 balance. The allowance for loan losses as a percentage of loans was 1.27% (1.51% excluding acquired loans with no related allowance recorded) at March 31, 2014, compared to 1.28% (1.55% excluding acquired loans with no related allowance recorded) at December 31, 2013.

Nonperforming assets consist of nonaccrual loans, loans 90 days or more past due and still accruing, restructured loans, OREO, and nonperforming securities. Loans are generally placed on nonaccrual when principal or interest payments become ninety days past due, unless the loan is well secured and in the process of collection. Loans may also be placed on nonaccrual when circumstances indicate that the borrower may be unable to meet the contractual principal or interest payments. OREO represents property acquired through foreclosure and is valued at the lower of the carrying amount or fair value, less any estimated disposal costs. Nonperforming securities, which include securities which management believes are other-than-temporarily impaired, are carried at their estimated fair value and are not accruing interest.

Nonperforming Assets

(Dollars in thousands)	March 31, 2014		December 31, 2013	
	Amount	%	Amount	%
Nonaccrual loans				
Commercial and agricultural loans and real estate	\$27,035	52 %	\$27,033	54 %
Real estate mortgages	10,205	20 %	10,296	21 %
Consumer	8,210	16 %	7,213	14 %
Troubled debt restructured loans	6,014	12 %	5,423	11 %
Total nonaccrual loans	51,464	100 %	49,965	100 %
Loans 90 days or more past due and still accruing				
Commercial and agricultural loans and real estate	158	6 %	105	3 %
Real estate mortgages	444	16 %	808	22 %
Consumer	2,098	78 %	2,824	75 %
Total loans 90 days or more past due and still accruing	2,700	100 %	3,737	100 %
Total nonperforming loans	54,164		53,702	
Other real estate owned (OREO)	2,564		2,904	
Total nonperforming assets	56,728		56,606	
Total nonperforming loans to total loans	0.99 %		0.99 %	
Total nonperforming assets to total assets	0.73 %		0.74 %	
Allowance for loan losses to total nonperforming loans	128.19 %		129.29 %	

Past due loans as a percentage of total loans was 0.57% at March 31, 2014, down from 0.77% at December 31, 2013. In addition to nonperforming loans, the Company has also identified approximately \$101.1 million in potential problem loans at March 31, 2014 as compared to \$89.9 million at December 31, 2013. The increase was due to a downgrade of one large commercial loan during the first quarter of 2014. At March 31, 2014, potential problem loans primarily consisted of commercial real estate and commercial and agricultural loans. Potential problem loans are loans that are currently performing, but known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms and which may result in classification of such loans as nonperforming at some time in the future. Potential problem loans are typically defined as loans that are performing but are classified by the Company's loan rating system as "substandard." 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.

Table of ContentsDeposits

Total deposits were \$6.1 billion at March 31, 2014, up \$178.7 million, or 3.0%, from December 31, 2013, due primarily to growth in NOW and money market accounts. Total average deposits for the three months ended March 31, 2014 increased \$873.7 million, or 17.3%, from the same period in 2013, due primarily to the acquisition of Alliance.

Borrowed Funds

The Company's borrowed funds consist of short-term borrowings and long-term debt. Short-term borrowings totaled \$356.9 million at March 31, 2014 compared to \$456.0 million at December 31, 2013. This decrease was due primarily to the aforementioned increase in deposits from December 31, 2013 to March 31, 2014. Long-term debt was \$308.7 million at March 31, 2014, as compared to \$308.8 million at December 31, 2013. For more information about the Company's borrowing capacity and liquidity position, see "Liquidity Risk" below.

Capital Resources

Stockholders' equity of \$832.2 million represented 10.73% of total assets at March 31, 2014, compared with \$816.6 million, or 10.67% as of December 31, 2013. Net income of \$18.0 million and a \$5.2 million increase in other comprehensive income due to a decrease in unrealized losses on securities were partially offset by dividends paid of \$9.2 million.

The Company did not purchase shares of its common stock during the three month period ended March 31, 2014. As of March 31, 2014, there were 1,000,000 shares available for repurchase under a previously announced plan, which expires on December 31, 2014.

The Board of Directors considers the Company's earnings position and earnings potential when making dividend decisions. The Board of Directors declared a 2014 second-quarter cash dividend of \$0.21 per share at a meeting held May 6, 2014. The dividend will be paid on June 13, 2014 to shareholders of record as of May 30, 2014. The Company does not have a target dividend pay-out ratio.

As the capital ratios in the following table indicate, the Company remained "well capitalized" at March 31, 2014 under applicable bank regulatory requirements. Capital measurements are well in excess of regulatory minimum guidelines and meet the requirements to be considered well capitalized for all periods presented. Tier 1 leverage, Tier 1 capital and Total risk-based capital ratios have regulatory minimum guidelines of 3%, 4% and 8% respectively, with requirements to be considered well capitalized of 5%, 6% and 10%, respectively.

	March		December	
	31,		31,	
Capital Measurements	2014		2013	
Tier 1 leverage ratio	9.05	%	8.93	%
Tier 1 capital ratio	11.81	%	11.74	%
Total risk-based capital ratio	13.06	%	12.99	%
Cash dividends as a percentage of net income	51.12	%	54.28	%
Per common share:				
Book value	\$19.09		\$18.77	
Tangible book value (1)	\$12.48		\$12.09	

(1) Stockholders' equity less goodwill and intangible assets divided by common shares outstanding

Table of Contents

Liquidity and Interest Rate Sensitivity Management

Market Risk

Interest rate risk is the primary 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. 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 effect of 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 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. Assuming interest rates remain at or near current historical lows, net interest margin will continue to experience compression. Additional rate reductions on deposits are becoming more difficult as deposit rates are at or near their floors, and with asset yields continuing to reprice at lower rates, this could result in additional margin pressure as well as a decrease in net interest income.

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.

Table of Contents

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 with static balance sheets: (1) a gradual increase of 200 bp, and (2) a gradual decrease of 100 bp taking place over a 12-month period. 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 resulting 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 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 at a faster rate than interest bearing liabilities. The inability to effectively lower deposit rates will likely reduce or eliminate the benefit of lower interest rates. In the rising rate scenarios, net interest income is projected to experience a decline from the flat rate scenario. Net interest income is projected to remain at lower levels than in a flat rate scenario through the simulation period primarily due to a lag in assets repricing while funding costs increase. The potential impact on earnings is dependent on the ability to lag deposit repricing. If short-term rates continue to increase, the Company expects competitive pressures will likely lead to core deposit pricing increases, which will likely continue compression of the net interest margin.

Net interest income for the next 12 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 March 31, 2014 balance sheet position:

Interest Rate Sensitivity Analysis

Change in interest rates (in bp points)	Percent change in net interest income
+200	(4.01%)
-100	(1.70%)

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 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 and tactical actions. 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 the 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. Basic Surplus is calculated by subtracting short-term liabilities from liquid assets. 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 March 31, 2014, the Company's Basic Surplus measurement was 7.9% of total assets or approximately \$612 million as compared to the December 31, 2013 Basic Surplus of 9.7% or \$734 million, and was above the Company's minimum of 5% or \$388 million 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.

Table of Contents

The Company's primary source of funds is the Bank. Certain restrictions exist regarding the ability of the Bank to transfer funds to the Company in the form of cash dividends. The approval of the Office of Comptroller of the Currency (OCC) is required to pay dividends when a bank fails to meet certain minimum regulatory capital standards or when such dividends are in excess of a subsidiary bank's earnings retained in the current year plus retained net profits for the preceding two years (as defined in the regulations). At March 31, 2014, approximately \$57.7 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 is also subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements. Under the General Corporation Law of the State of Delaware, the Company may declare and pay dividends either out of its surplus or, in case there is no surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

At March 31, 2014 and December 31, 2013, FHLB advances outstanding totaled approximately \$395 million and \$515 million, respectively. The Bank is a member of the FHLB system and had additional borrowing capacity from the FHLB of approximately \$585 million at March 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 \$288 million at March 31, 2014, or used to collateralize other borrowings, such as repurchase agreements. At March 31, 2014 the Bank also had additional borrowing capacity from unused collateral at the Federal Reserve of \$752 million.

Recent Accounting Pronouncements

In January 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-01 —Investments (Topic 323), Accounting for Investments in Qualified Affordable Housing Projects. The amendments in this ASU provide guidance on accounting for investments by a reporting entity in flow-through limited liability entities that manage or invest in affordable housing projects that qualify for the low-income housing tax credit. The amendments permit reporting entities to make an accounting policy election to account for their investments in qualified affordable housing projects using the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). The amendments in this ASU are effective for the Company for annual periods beginning January 1, 2015 and should be applied retrospectively to all periods presented. A reporting entity that uses the effective yield method to account for its investments in qualified affordable housing projects before the date of adoption may continue to apply the effective yield method for those preexisting investments. The Company does not expect the adoption to have a material impact on the financial statements.

In January 2014, the FASB issued ASU No. 2014-04 —Receivables —Troubled Debt Restructurings by Creditors (Subtopic 310-40), Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. The amendments in this Update clarifying when an in substance repossession or foreclosure occurs, that is, when a creditor should be considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan such that the loan receivable should be derecognized and the real estate property recognized. The amendments in this ASU were effective for the Company beginning January 1, 2014 and did not have a significant impact on the financial statements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information called for by Item 3 is contained in the Liquidity and Interest Rate Sensitivity Management section of the Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and

procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2014, the Company's disclosure controls and procedures were effective.

There were no changes made in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1 – 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, except as described in the Company's 2013 Annual Report on Form 10-K.

Item 1A – RISK FACTORS

There are no material changes to the risk factors as previously discussed in Item 1A, to Part 1 of our 2013 Annual Report on Form 10-K.

Item 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) Not applicable
- (b) Not applicable
- (c) None

Item 3 – DEFAULTS UPON SENIOR SECURITIES

None

Item 4 – MINE SAFETY DISCLOSURES

None

Item 5 – OTHER INFORMATION

None

56

Table of Contents

Item 6 – EXHIBITS

3.1 Certificate of Incorporation of NBT Bancorp Inc. as amended through May 2, 2012 (filed as Exhibit 3.1 to the Registrant's Form 10-Q for the quarter ended September 30, 2012, filed on November 9, 2012 and incorporated herein by reference).

3.2 Amended and Restated By-laws of NBT Bancorp Inc., effective May 7, 2013 (filed as Exhibit 3.1 to the Registrant's Form 8-K, filed on May 7, 2013 and incorporated herein by reference).

3.3 Certificate of Designation of the Series A Junior Participating Preferred Stock (filed as Exhibit A to Exhibit 4.1 of the Registrant's Form 8-K, filed on November 18, 2004, and incorporated herein by reference).

4.1 Specimen common stock certificate for NBT's common stock (filed as exhibit 4.3 to the Registrant's Amendment No. 1 to Registration Statement on Form S-4 filed on December 27, 2005 and incorporated herein by reference).

4.2 Rights Agreement, dated as of November 15, 2004, between NBT Bancorp Inc. and Registrar and Transfer Company, as Rights Agent (filed as Exhibit 4.1 to the Registrant's Form 8-K, file number 0-14703, filed on November 18, 2004, and incorporated by reference herein).

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Written Statement of the Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Written Statement of the Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document.

101.SCH XBRL Taxonomy Extension Schema Document.

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.

101.DEF XBRL Taxonomy Extension Definition Linkbase Document.

101.LAB XBRL Taxonomy Extension Label Linkbase Document.

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, this 12th day of May 2014.

NBT BANCORP INC.

By: /s/ Michael J. Chewens
Michael J. Chewens, CPA
Senior Executive Vice President
Chief Financial Officer

58

Table of Contents
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